Economic Inequality or Social Justice for Everybody?

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Introduction

Social inequality has become the focus of political interest in the wake of the financial crisis. Expert economists like Joseph Stiglitz regard stagnating salaries for the masses on the one hand in conjunction with increasing assets on the other as the cause of the debt-driven, speculative growth, which preceded the collapse of the financial bubble. The costs are primarily borne by medium to low wage earners, especially in those countries in which strict austerity measures have been adopted. The consequences include high levels of unemployment, falling actual earnings, and a long-term recession. Now that the casino has reopened for business and the stock markets are once again booming with the aid of the central banks, inequality is increasing almost everywhere.

And it is not only progressive and left-wing pundits, who are raising concerns about the consequences of increasing inequality. Christine Lagarde, Managing Director (MD) of the International Monetary Fund (IMF), warned that: "*Rising inequality can damage economic growth and social ties, and may also cause political instability*". And the authors of the current Global Risks Report published by the World Economic Forum (WEF) in Davos regard the growing gap between rich and poor as the greatest risk for the global economy.

1. Income and wealth distribution trends

The triumph of Neoliberalism in the 1980s has resulted in a significant change to incomes and in the distribution of wealth around the world over the past 25 to 30 years to the detriment of the less privileged. Although many states, particularly in Asia, are in the process of catching up with the West, there too it is primarily the economic and social elites (i.e. the top 10 per cent), and to a lesser extent, a new middle class, who are profiting. The lowest 40 per cent on the income scale, by contrast, are getting very little benefit from it. According to some estimates the wealthiest 20 per cent of the global population earn some 50 times more than the poorest 20 per cent (Dauderstädt/ Keltek, 2011). By comparison, the corresponding ratio within Germany currently stands at 4.5 (ibid.).

There are three distinct trends involved in growing income inequality. Firstly there has been a global change in terms of income distribution between wages and profits to the detriment of wages. Whilst investment incomes have frequently achieved double-figure growth rates, average actual earnings have stagnated. In this context there is also a further significant factor at work: whilst salaries for workers in jobs regulated by collectively bargained agreements have continued to grow, the rapidly increasing number of workers in precarious or atypical employment situations have been obliged to accept reductions to their actual earnings. Taking all the developed countries as a whole, the labour income share of the gross domestic product sank from 74 to 65 per cent between 1980 and 2010 (Stockhammer, 2013). Wage ratios have also been sinking in developing and emerging economies - for example at an average rate of not less that 20 per cent points in Mexico, Turkey and South Korea. On the other hand it has been actors within the finance sector who have profited most on the capital investment side. However this has been the result of sham profits with no value for the relevant national economies rather than of some 'productivity miracle'. Since the 1980s, investment income has been growing faster than the corresponding economies within the member states of the Organisation for Economic Co-operation and Development (OECD). The result has been wealth concentration in conjunction with a shrinking middle class (Piketty, 2014).

Secondly there have been some dramatic increases in earned income spreads. Back in 1970 top managers in the USA were earning 30 times the average worker salary. Today that has risen to 300 times or more. In the UK in 2013 CEOs in the companies listed in the FTSE 100 Index were bringing home 120 times more than the average salary of their employees.

In many places economic growth has been decoupled from the material prosperity of the majority of the population. Since 2009, 95 per cent of all income growth in the USA has gone into the pockets of the most affluent 1 per cent of the population (Stiglitz, 2013). That is fully in line with the longer term trend: between 1976 and 2007 the top 1 per cent on the income scale had already secured the lion's share of income growth for themselves at 58 per cent (Atkinson / Piketty / Saez, 2011). The same trend can be observed in other OECD member states. The *World Top Income Database* shows the level of income before tax for 26 countries. What it reveals is that the income ratio of the richest percentile of the population has increased in nearly every country since the 1980s. Even in traditionally egalitarian states like Sweden and Norway it increased by over 50 per cent (Oxfam 2013). In China and Portugal it has more than doubled!

Thirdly, tax and social transfer policy has had less of a corrective influence on income distribution than in the past. In many countries progressive taxation has been significantly decreased over the past few decades. In the USA it has even disappeared entirely at the higher end of the earnings scale. The fact that investment income is taxed less than earned income almost everywhere is an extremely undesirable development. In Germany, for example, capital gains tax currently stands at 25 per cent, whilst the top taxation bracket for earned income is 42 per cent.

Latin America is among those regions in which economic inequality has not increased over the last two decades. Despite the fact that it remains one of the regions with the highest levels of income inequality, the level actually decreased in 14 out of 20 South American states between 1990 and 2013.[1] There are three factors that account for this; better secondary school education, active state-led minimum wage policies, and state-led wealth transfer programmes in favour of the poor (UNDESA 2013).

The unequal distribution of wealth is far greater than of income. Almost half of all asset holdings are owned by the richest one per cent. But there is yet another statistic that is more repugnant still. The richest 85 people in the world currently lay claim to more combined wealth than the poorest half of the entire global population (Oxfam 2013). That is primarily due to the logic of financial capitalism, but also to a plethora of existing tax evasion and tax fraud opportunities. A significant proportion of the assets held by the rich is currently hidden away in so-called tax-havens. According to some estimates, some 18.5 billion US dollars are currently languishing in off-shore accounts where they cannot be taxed (Oxfam, 2014). This includes one third of the assets of investors with a personal wealth in excess of one million US dollars (Ötsch 2012).

[1] The Gini coefficient (also known as the Gini index or Gini ratio) is a common measure of the relative concentration of income and/or wealth distribution. It is expressed in values between 0 and 1. A Gini coefficient of 0 represents the maximum possible distribution equality in relation to income and/or wealth (i.e., everybody earns precisely the average income and/or owns a share of the overall wealth precisely equalling the population average). At the other extreme, a Gini coefficient of 1 represents the maximum possible inequality of income and/or wealth distribution (i.e., one single person receives 100% of the income and/or owns the entire wealth considered for the calculation).

2. The causes and effects of economic inequality

2.1. On the analysis of the causes of increasing inequality

Not unexpectedly opinions diverge as to the causes of increasing inequality. Some see it as the result of economic imperatives rooted in the laws of supply and demand. Others regard political decisions to the benefit of market deregulation as the real culprit.

There are those who blame technological change, which impacts those lacking the appropriate qualifications *(skills-biased technological change*) in conjunction with increasing competition from low-wage countries, which are able to undercut local wage levels. And finally some analysts identify the dismantling of state regulation in employment and financial markets, tax reductions for corporations and the rich, and the idolisation of shareholder value as the root causes.

2.2. The economic, social, and political consequences of increasing inequality

Current levels of inequality are far in excess of what the majority of people in the world regard as fair, which raises serious issues in terms of justice, and also has ramifications in the economic, social, and political spheres. The prevailing situation is cementing existing power structures with their inherently biased social opportunity frameworks, hindering social mobility, endangering social harmony, and undermining democracy. The dominance of the financially powerful elite over political decision-making is growing even in supposedly well-established democracies. The rule of the people (democracy) is giving way to the rule of money resulting in the establishment of plutocracies.

- **Inequality and economic development**

Changes are currently taking place within the analytical discourse surrounding inequality. A neo-classical paradigm has prevailed for decades in which a fundamental antagonism between economic growth and wealth distribution has been assumed. For adherents to this view it is axiomatic that income distribution from the wealthy to the poor can only take place at the expense of economic growth. Redistribution, they claim, acts as a disincentive to performance and productivity. Accordingly they go on to assert that, far from being a problem, inequality is a prerequisite for economic growth.

But in actual fact inequality can slow economic growth, for example when it impacts negatively on education and health care provision, or when social conflict destabilises the political status quo. In addition such microeconomic analyses overlook the role of demand in market economies. Low wage earners inevitably spend a larger proportion of their income than high wage earners on the bare essentials. As a rule, at a certain point income-based inequality results in lower demand, and there is a direct correlation between increasing inequality and decreasing demand.

The most recent financial crisis has changed the way many people think about inequality. Rather than simply being regarded as a potential social problem, it is increasingly being thought of as an economic issue. Thus a recent study by the IMF found that there is a global correlation between low levels of inequality and robust economic growth (Berg and Ostry, 2011). A follow-up study also demonstrated that state-led redistribution policies have no negative effects on economic growth. On the contrary, on average it tends to promote economic growth (Ostry / Berg / Tsangarides, 2014).

These studies were preceded by a series of analyses, which demonstrated striking parallels between the Great Depression in the 1930s and 'Great Recession' of 2007-2008. Both crises were rooted in similarly steep increases in inequality in conjunction with increasing debt levels among low and medium wage earners (Kumhof / Rancière, 2010).

- **Inequality and social development**

Not only does severe inequality weaken long-term growth prognoses and increase the crisis susceptibility of the relevant national economies, it also lessens the poverty decreasing impact of economic growth (UNDESA, 2013: 66ff.). Those countries, such as South Korea and Taiwan in the 1960s and '70s, which had an equal income and wealth distribution structure prior to the start of a phase of strong economic growth, tend to have particularly impressive records of poverty reduction. The same is true of countries in which inequality was reduced during the process of economic growth and improved distribution, as has most recently been the case in parts of Latin America.

Research has demonstrated that increasing distribution inequality also has a negative influence on social permeability. Even in countries with traditionally high levels of social mobility, like the USA, the life prospects of members of the up-and-coming generation are becoming increasingly dependent on the status of their parents. Alan Kruege, Chairman of the US *Council of Economic Advisers*, has referred to this as the ***'Great Gatsby Curve'*** (Krueger, 2012). The offspring of people who are raised in poverty also tend to remain (relatively) poor in adulthood. To a significant extent, the rich stick together[2]. This nexus is

[2] The existence of the 'Great Gatsby Curve' also inspired the truism: *"to live the American Dream you'll have to move to Norway".*

also apparent within Germany, where opportunities for social advancement tend to be declining for children from the poorer or less well educated layers of society.

In their 2009 bestseller, *The Spirit Level – Why More Equal Societies Almost Always Do Better*, British epidemiologists Richard Wilkinson and Kate Pickett demonstrated the link between income inequality and social problems. It impacts every kind of social issue ranging from mental health and life expectancy, to drug abuse, obesity, under performance in schools, and childhood pregnancy to murder rates. According to this analysis, countries in which inequality is high, such as the USA and UK, must be struggling with far greater societal problems than countries like Japan or the Scandinavian states. Non equal societies are less considerate, socially colder and more brutal.

3. Policy approaches to combating economic inequality

3.1. An overview of policy approaches

Proponents of the efficient market theory regard distribution results as positive only when they reflect the effects of the free market economy. In this view individuals are remunerated in strict accordance with their contribution to the prosperity of the country. Should social norms require any type of corrective measures, they postulate, then state intervention ought to take place, if at all, through taxes and duties, but must never directly affect market revenues. The primary measures such people deem to be in line with market requirements are those which would contribute to more equal access to the market. One example of this is investment in education and healthcare.

Access to high-quality educational and healthcare facilities, they argue, increases equal opportunities and social mobility for everyone and is therefore economically efficient. But we also require short-term policy approaches that will shape the here and now. On the one hand this does include direct intervention in market revenues, such as state-regulated minimum wages, measures aimed at reducing the gender pay gap and relative earnings ceilings for managers. On the other hand the state can also contribute towards the reduction of inequalities through redistribution measures based on state revenues (taxes) and public spending.

The reduction of inequalities primarily belongs within the remit of the national government. Nevertheless international collaboration is also important in this context. This is particularly true in the case of cross-border capital flight and tax evasion undertaken by transnational corporations and wealthy individuals, both of which are significant factors in the increasing concentration of income and wealth.

3.2. Approaches to influencing market revenues and primary distribution

Minimum wage tariffs, whether set by the state or linked to inflation or average income levels could also reduce the income differential 'from the bottom up'. However the wage and salary structure also depends to a large extent on the role played by the unions. These are tasked with compensating for the lack of market power on the part of individual wage earners through the organisational and negotiating power of representative associations founded on the principles of solidarity and collective action. In sectors in which the organisational level of unions is poorly developed, any tariff agreements negotiated by specific unions and employers can be made binding through government regulations in the form of statutory extension decrees.

It is vital to reduce the prevalence of informal and atypical employment relationships in favour of types of employment that are in line with the ideals of human dignity.

Labour market policy instruments such as state-sponsored employment programmes can also improve income levels. One example of this is a rural employment programme created under the *Mahatma Gandhi National Rural Employment Guarantee Act* (MNREGA) in India in 2005. This programme guarantees 100 days of work at the legal minimum wage for every rural household. Other measures that can contribute to more equality are things like reduced-hour jobs, flexitime wage accounts, and a reasonable level of protection against unfair dismissal, all of which help to stabilise income and jobs in times of crisis.

'Top down' inequality reduction can be achieved by setting upper limits for salaries, bonuses, severance packages, and pensions. Very little of this type of things has actually happened, despite the fact that plans exist within the European Union (EU) to the effect that the shareholders of listed companies will be given the power to vote on directors' salaries in future. This will take place with reference to a so-called pay ratio, i.e., the relationship between board member remuneration and average salaries paid within the company. The suggestion elicited a fierce reaction from corporate lobbyists, even though the plan does not envisage state-enforced guidelines (Financial Times, 07.03.2014). Clearly the objectors are already concerned alone about the potential impact of increased transparency.

3.3. State-led redistribution and secondary redistribution

State-led redistribution through taxes and duties as well as direct fiscal transfers will help correct the income spread. Fiscal transfers, either in the form of conditional cash transfers à la Bolsa Familia or in accordance with the Social Protection Floor model tabled at the International Labour Conference in 2012 are designed to take effect at the lower end of the income scale. The latter involves the guaranteed provision of essential health care as well as a universal basic assured income, and stipulates general principles for a minimum level of socio-political security.

Other state expenditures also affect income distribution, as they do not benefit all people equally. This is true for public spending on streets and roads, state-sponsored schools and kindergartens, hospitals, libraries, theatres, opera houses, local public transport, free school meals or subsidies for electricity and staple foods. In earlier debates surrounding the welfare state such public spending by the government was referred to collectively as the *social wage*. However this does not equate to a top-to-bottom wealth redistribution. Those who profit most from the social wage tend to be those who are able to represent their interests most effectively in the public sphere: rarely these are the members of a given society which are most in need. Wherever corruption is rife, the relevant political decision-makers also profit along with the associated contractors.

Any policy programme aimed at genuine redistribution of wealth to where it is most needed must involve a monitoring element to discern who specifically profits from any particular service or expenditure. This approach would be particularly beneficial in developing countries and emerging economies, for example in relation to energy subsidies. It is a matter of fact that public spending programmes in countries with weak administrations seldom benefit the most needy members of society, as these are least able to stand up for their rights. Programmes such as the *Public Expenditure Tracking System* (PETS) may improve this state of affairs.

Ostensibly, the easiest way to bring about state-led redistribution is through the taxation regime. But by no means is it the case that all fiscal systems tax higher income earners more than low-wage earners. Particularly in developing countries, whose state coffers are primarily replenished from purchase taxes and excises, the poor carry a proportionally higher tax burden than the wealthy.

Progressive tax systems are characterised by the fact that state revenues are primarily drawn from direct taxes, in particular income tax and corporate taxes. They ought to tax those in the higher income bracket more heavily that low wage earners; the exact opposite to the *flat tax* regimes which were introduced across the board in the wake of the collapse of state socialism in Eastern Europe and Central Asia. In addition, from the perspective of fair redistribution, investment income should not be taxed at a lower rate than earned income. However this is exactly what currently happens in the majority of countries. All types of income tax ought to be treated in the same way.

One element of a fair taxation regime of this kind would involve the requirement to capital gains tax on financial transaction profits. As it currently stands, this is one of the few economic transactions not, or only partially, subject to taxation in most countries. Apart from the stabilising effect that this would have in the financial markets, in addition to the potentially substantial tax revenues it would generate, a tax on financial transactions would be one of the few indirect taxes involving a progressive rather than a regressive redistribution effect.

Over the past few decades, tax reduction measures, particularly in the higher income tax bracket, capital gains tax, and corporate taxes have resulted in increased inequality. In many cases, the putative positive effects of such measures have failed to materialise. Reduced corporation taxes in Germany, for example, have not resulted in increased investments on the part of corporate enterprises; on the contrary: the long-term trend for investment quotas in the economy as whole has been falling. Therefore any progressive taxation agenda ought to correct for the errors made during the past two decades.

It is particularly important to correct for negative developments in relation to the distribution of wealth, which has got completely out of hand. Two instruments through which this could be achieved are inheritance tax and capital tax. This is particularly relevant to those states that can expect low national product growth rates over the long term, because of the fact that investment return rates there are permanently such that they encourage the concentration of wealth.

In the majority of cases the only option open to states in which it has proved impossible to reduce high levels of state debt, despite major sacrifices by the population, is debt restructuring or a debt cut. Above all it ought to be the wealthy who make a fair contribution to this in the form of one-off capital or property levies and/or low or zero interest compulsory loans.

It will only prove possible to enforce a heavier tax burden on individuals with high incomes or major asset holdings as well as on corporate enterprises, who are currently evading their fiscal responsibilities, if international regulations are finally put in place to counteract tax competition, harmonise taxation legislation, eliminate tax havens, and ensure automated information exchanges between different fiscal authorities.

3.4. Indirect and additional measures

The reforms undertaken to date are nowhere near sufficient to avoid a new financial crisis, or at least to restrict the impact of any future crisis to those responsible for it. Therefore efforts must be made to restrict or prevent those financial activities, whose potential benefit to national economies is out of all proportion to the risks involved. At the core of the issue is the question of liability. In spite of all the recent reforms, the capital reserves held by banks and other financial players remain completely inadequate. Speculators can still confidently expect the state, and therefore the tax payer, to bale them out in case of loss. Therefore the incentive for irresponsible behaviour remains in place. That applies particularly to those institutions that consider themselves to be *too big to fail*.

4. Summary: The need for joint action and potential alliances

The profound economic, social, and political crisis, which has devastated 'first-world' countries since 2008 and has since spread across the entire globe, has created an enormous challenge for the people and nations in the surrounding and dependent regions. However it is unacceptable that the cost of overcoming this new crisis be borne by ordinary working people and populations.

We are currently experiencing the development of an international crisis of far-reaching dimensions and ramifications, which forces us to question the hegemonic, Neoliberal economic model, which has been imposed on us for over three decades. To date, however, the central countries have only provided economic responses, involving the application of political measures based on precisely the same logic as those that unleashed the crisis in the first place. The result has been to exacerbate the worst effects of the crisis, with undeniable consequences for the majority of people in the affected societies. It is becoming increasingly obvious that policies aimed at rescuing the banks and benefiting corporate enterprises rather than ordinary people have resulted in higher unemployment rates, increased inequality and social exclusion.

In light of this situation we are united in the conviction that the way out of the crisis will require an urgent and structural response involving the inevitable participation of all left-wing and progressive parties, trade unions, worker movements, and all the various forms of collective expression of the popular will. Among others this includes social movements, and other mass movements involving farmers, environmentalists, students, feminists, adolescents and children, and human rights campaigners, as well as societies for the protection of victims of violence, advocates of sexual diversity, opponents of oppression, indigenous peoples rights campaigners, movements involving the producers of the social and solidarity economy, migrant rights organisations, educators and trainers, and sponsors of the arts and culture. In today's global society of the 21st century the only way humanity is going to be able to tackle the existential challenges we are facing will be through a process of joint action. It will also be necessary to restructure the historical asymmetries between North and South, and to equip global institutions with the capacities to regulate any tensions, imbalances and conflicts that may arise during this process.

The World Commission on Environment and Development, founded by the United Nations in 1983, defined sustainable development as a "development that meets the needs of the present without compromising the ability of future generations to meet their own needs".

The term 'sustainable development' appears to be an alternative, which counters the Neoliberal paradigm, and promotes a form of understanding and organisation of essential aspects of social life based on a new logic, as a response developed by and for the majority of humankind. It reconfirms the basic principles of labour in line with the needs of human dignity, the sharing of wealth, participatory democracy and gender equality. It promotes regional integration whilst emphasising articulation at international negotiations and the consolidation of jointly held positions in relation to topics of mutual interest. It requires the successful exchange of experiences between state governments and calls for the social security and inclusion of all people, of all generations. It is based on due consideration of the environment and on the integration of economic, social, ecological and political dimensions.

Given these enormous challenges it is vital that we do not permit ourselves to fall into a state of paralysation. On the contrary, it is time to take action and to develop specific options for bringing about change. There are many critical voices within our society, but there is also a huge latent potential for solidarity and emancipation. It is therefore more important than ever for the progressive and left-wing parties, the trade unions and organisations of civil society to embrace this potential and forge ahead with discussions on, as well as with the development of, alternatives. What we need are concrete solutions for tackling the current problems, but with the scope to go beyond these to create the foundations for societies with more social justice.

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