Why we need action to tackle wealth inequality

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Brave New Europe is a blog that regularly reposts material that first appears here, as it also reposts work from those writing on the sites that its editors think of value.

I noted that in their latest mail that they said that one of their best read articles in the last month was by me, but that rather unusually it was one first published in 2017. If it is attracting attention there it seems worth noting again here as well. This is the post:

As the Guardian has reported that:

The richest 0.1% of the world's population have increased their combined wealth by as much as the poorest 50% — or 3.8 billion people — since 1980, according to a report detailing the widening gap between the very rich and poor.

Piketty's report on which this is based is here. It suggests that ten per cent of the world's wealth - and a much larger part of the 27% held by the top 1% of wealth owners - is in tax havens.

Why does this matter? The Guardian notes:

Thomas Piketty [has] warned that inequality has ballooned to "extreme levels" in some countries and said the problem would only get worse unless governments took coordinated action to increase taxes and prevent tax avoidance.

Which does not answer the question, which answer I have to say also appears to be absent in the report itself. My review of it this morning offers no obvious, let alone headline, explanation as to why the issue should be tackled, which I think is a major deficit. Let me offer three headline reasons why this is the case then, before dealing with the counter arguments and then drawing conclusions.

Relative inequality matters

First, this matters because inequality is both absolute and relative, as is poverty. Those with literal minds say that so long as people have sufficient to live on the distribution of the remaining wealth in society is of no consequence, and at a literal level there is, I admit, a logic to this. But it's also literally wrong precisely because we are not literal beings. We are instead relative ones and we undertsand ourselves not just in isolation, as the literal approach implies, but in relation to others who we witness all around us, as the relative appraoch implies. And since the world is now designed to highlight relative difference, largely because we are daily bombarded by advertising messages that are premised on drawing attention to the inadequacies of our relative position to induce demand, relative difference matters enormously, and we are intensely aware of it. If then that relative difference is growing, as the data implies, social stress will result and be manifested in a great many ways, from political breakdown to increases in mental ill health.

Public wealth matters

Second, as the report highlights, at the same time that private wealth and disparities within its distribution are increasing, the value of public, commonly held, wealth is declining. In other words, the capacity of the state to both correct for wealth disparity and to tackle it is reducing. The capture of public wealth for private gain, which has been the objective of a great deal of economic policy for the last 35 or more years has succeeded in achieving this result: wealth appears entrenched.

Inequality is killing capitalism from within

Third, as I argue in my book **Dirty Secrets****, this is intensely bad news for the future of capitalism. The fact is that risk takers, on whom market capitalism is dependent for real innovation rather than for financial returns, work best when they have little to lose. As a result those on lower income and smaller businesses innovate more with less capital than larger businesses do. And, as importantly, those with wealth to preserve put higher value on that act of preservation than they do on innovation, because their every instinct is to avoid downside risk. The consequence is the rise of the professional wealth manager, as Brooke Harrington has documented, and their deeply risk averse offshore structures that look for rentier returns and not entrepreneurial profit. In addition, the existence of perpetual trusts in offshore jurisdictions means that capital no longer passes between generations: the result is that concentration is bound to increase in the future and the chance that the funds held will be used as risk capital is very low, meaning that capitalism is itself threatened by this increase in wealth concentration.**

In other words, I think that what Piketty and his colleagues note is very serious.

The counter argument

But it should be said that there is a counter-argument. For this I am, perhaps surprisingly, turning to Tim Worstall of the Adam Smith Institute who has recently published an article on **CapX where he suggested:**

Inequality is beneficial to us all.

Or rather, as he adds:

If there's more output from an increasingly efficient use of resources, more consumption is made possible. And when we see the people over in the next field being able to consume more by whipping cows at the yoke, then we start to whip cows and we too get richer.

The economists reason it thus: firstly, greater productivity leads to inequality; secondly, the increased inequality pushes all to become more productive.

Hence his conclusion. But even Worstall has the sense to caveat the conclusion:

Or rather, understanding how and why inequality arises can lead to it being beneficial, just as it can be a disaster. If that inequality arises as a product of skimming the production of those proving to be more efficient, or even just the forced confiscation of production itself, then that's not a good idea. For that means that those producing, those more productive, will slow their output and won't be spurred to improve the techniques. This makes all poorer in general even as some wax fat off what is confiscated. Economists are well aware of this; they have called it "rent seeking."

He then discusses what he thinks rent seeking might be, referring to trade unions, regulation preventing market entry and London cab drivers, which is a highly selective view of rent seeking, because none have driven the gross inequality we are now seeing.

However, I include Worstall's argument for a reason. It is true that some are more productive than others in an economy and it is true that this has always meant, and is likely now to mean, that those who are more productive do earn higher rewards than those who are less productive. In principle I have little argument with this idea: I have no difficulty with there being some differential in earnings within any society and think them inevitable subject to their being a safety net to ensure that all can have access to the resources they need to fully engage in the society in which they live (which means much more than having a basic material standard of living). Importantly though, what Worstall's suggestion implies is that there are very obvious limits to wealth differentials, because the fact is that however clever someone might be the differences in productivity we humans have to offer is not that big.

For example, who can be sure who is the more productive in a business: the person who can use the technology that a company owns or the person in the boardroom who decided to invest in it? There is no obvious answer for a very good reason and that is that their returns are mutually interdependent. Without the skill of the user of technology the person deciding to invest in it can make no return from doing so. So who is the most valuable? Both are, of course, but that suggests that all returns in such situations must tend towards a mean, and not towards diversity, but the latter is what we actually see and that must mean there are faults in the system.

The faults that exacerbate inequality

So why is it, when we look rather more broadly than the absurd list of examples that Worstall uses, that returns are so diverse and inequality is so great as a result? It is precisely because of the impact of the rents Worstall does not name, plus another key factor.

First, let's name the rents. These include limited liability, which enables some to make money at cost to others because debts do not always have to be paid. That's a state provided benefit that should be paid for by higher taxes on income recorded in this way, and on distributions from it.

Then there are the rents facilitated by copyrights and patents, which have more than anything else facilitated the rise of new wealth and the increasing divide in society resulting from the tech economy and the growth in intellectual property rights.

After that there's monopoly power that goes unchallenged by the state even though it is an abuse.

And there are economic externalities such as pollution and the exploitation of natural resources that create rents when not corrected.

This list also ignores rents resulting from the control of land, and its non-taxation in a great many situations.

That also hints at the rent return to lobbying to permit light regulation and low or no tax. This might be at its worst in tax havens but it is commonplace everywhere.

I could go on but the theme should be apparent by now and is that far from the state being the enemy of the rentier they have gone out of their way to capture it to permit perpetuation of their abuse.

Second then let me mention the 'other factor'. This is that productivity is not fairly distributed. Whatever our natural predispositions, the access we have to education, capital and society's resources influence the extent to which we can reap a return on ability. In other words, productivity is heavily biased by the pre-distribution of wealth and so the two are not independent variables. And in this context, the incredibly generous treatment of wealth by the world's tax systems has clearly helped fuel inequality.

Some conclusions

After saying all of which I draw some obvious conclusions. The first is that we will always have an unequal society and to the extent that the inequality is due to genuine differences in personal productivity, it is not just tolerable, but will always be tolerated by society.

The second is that I suspect that society has some tolerance for inequality at above this level. Parents will always have aspirations for their children and will seek to provide for them. Some are going to be better able to do so than others. I suspect that society has reasonable tolerance for this because most understand it.

But that said society is not, I think, now under any illusions that all wealth disparity arises for these reasons. Vast amounts of both income and wealth inequality now arise for the reasons I have noted, and others like it (like the capture of companies by senior management for personal gain). In proportion tiny amounts arise for the reasons Worstall notes. But the difference is telling.

Few resent the London cab driver their return for learning 'the knowledge'. Nor do they resent the professional person the excess return they earn for having passed professional exams that afford them an income premium for life (I admit). Come to that, when union membership is widely available to argue that the rent they extract is a bias is a little absurd. If this is inequality then it is within the bounds society can readily accept.

But what is apparent is that the rents I noted impose costs that society is increasingly unwilling to tolerate. And so Piketty et al are right to highlight that the resulting inequalities are excessive and action needs to be taken against them. The contribution of Worstall to this debate is to a) make clear there is a rational justification for some inequality that very few would argue with and b) to suggest that over and above that some levels of inequality may be tolerated as well, of which he provided examples. But his failure to note the real causes of rent induced inequality indicates to what extent the likes of the Adam Smith Institute and other right wing think tanks are part of the problem on this issue by ignoring and even seeking to exacerbate a problem that they know exists.

Action

In that case action is required. Tax is not the only such action, but it's fundamental to progress. I have suggested short term reforms that could increase the tax on income derived from wealth **here and have discussed why we need a wealth tax here. I have a chapter on wealth tax in a book linked to the World Bank out soon.**

But we also need to crack open wealth in tax havens soon, and that includes refusing to recognise their trusts that are only designed to concentrate

wealth. This is possible in the UK, EU and other widely used legal systems where great equality is a national objective. Only then can the abuse of these places be stopped.

And stopped it must be. Some inequality we can live with. But I agree with Tim Worstall for once; that from rents is intolerable. And the vast majority of wealth inequality derives from the exploitation of economic rents.