Inequality

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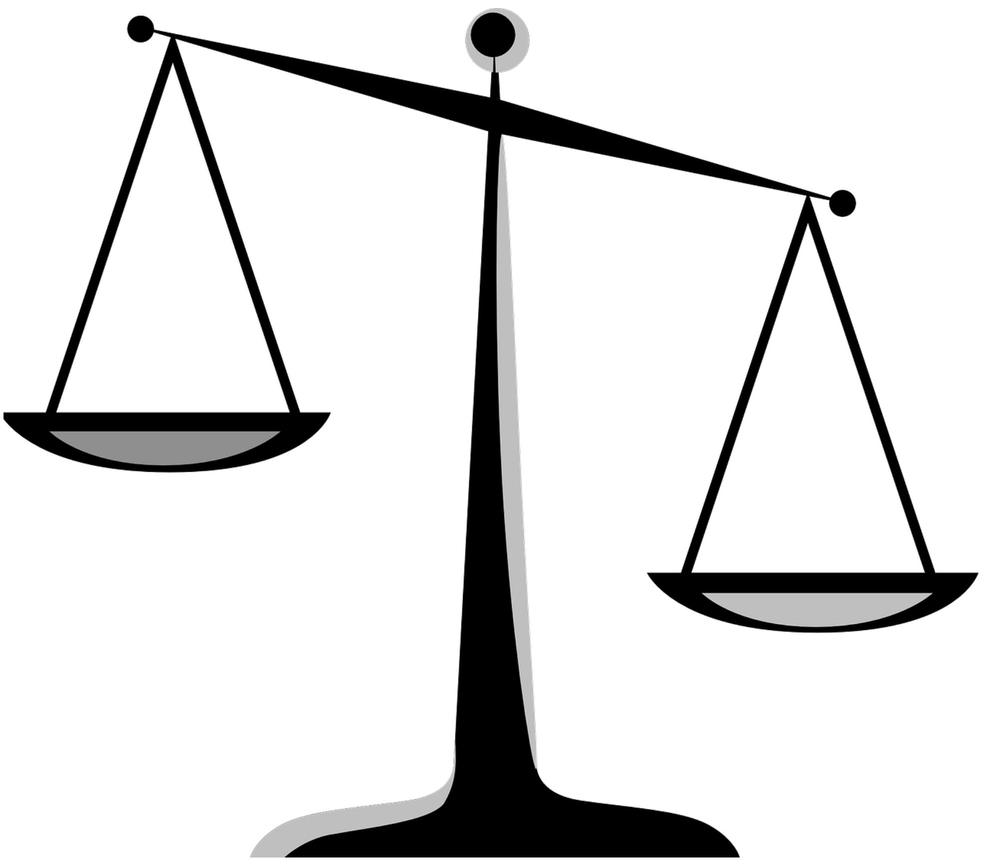

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Inequality

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Inequality is hardly a new issue. The Gospels helped to put the dignity of the poor and the unworthy greed of the rich at the centre of our country's still-dominant religion. Generations of British children have been brought up to admire the heroism of Robin Hood who stole money from predatory Norman barons and fat, greedy abbots and distributed the proceeds to the poor.

The politics of inequality

Socialism, including its Social Democratic variant, has always owed much of its moral and political drive to a reaction against poverty and inequality as in the writings of R. H. Tawney, Leonard Trelawny Hobhouse and Anthony Crosland.[1] Yet, until recently, the issue had receded into the background, except in as much as it concerned the gap between 'first world' affluence and 'third world' poverty.

A comfort blanket, of kinds, was provided by the empirically-based 'Kuznets wave', which saw inequality as following a predicable trend.[2] Pre-industrial societies were fairly equal: the equality of poverty. Industrialisation caused inequality to rise as capital accumulation required expanding profits and a surplus of labour from the countryside kept wages low. But, then, as societies reached maturity, greater equality emerged as a result of the exhaustion of surplus labour (the so-called Lewis turning point),[3] the spread of education (increasing returns to scarce skills) and a preference in democratic societies for shared public services and a welfare state. Though clearly there have been big differences in these social preferences, from egalitarian Scandinavia to the US where equality of opportunity rather than outcomes was valued.

The politics of 'left' and 'right' ensured a rigorous political dynamic between those who emphasised 'fairness' and social solidarity and those who emphasised differential rewards – for entrepreneurs, savers and individual workers – as a spur to improve economic performance. The underlying assumption has been that there is a trade-off between economic efficiency, or growth, and equity. Early economics in the tradition of Adam Smith, David Ricardo and Thomas Robert Malthus largely ignored the ethical and economic consequences of inequality though there was a contrary strand of thinking associated with Jean Charles Léonard de Sismondi, Pierre-Joseph Proudhon and Karl Marx. Mainstream economics, including the Keynesian tradition, was focused on the developed world and was not greatly exercised by issues related to equality. In any event, inequality was becoming less extreme, and the focus of egalitarians was on the north/south divide.[4]

The Thatcher and Reagan years produced a sharp discontinuance, stemming from a belief that western (at least Anglo Saxon) societies were stagnating because of blunted incentives to invest, take entrepreneurial risks and work. The policy reforms that followed led to sharp increases in income inequality.

1. R H Tawney ;The Acquisitive Society Fontana 1961(reprint); L T Hobhouse Liberalism 1911 OUP 1979; A Crosland The Future of Socialism

2. S Kuznets :The Economic Growth of Nations 1971

3. A Lewis : Theory of Economic Growth

4. E Roll : A History of Economic Thought 1953 Faber

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A renewed debate

There was also something more powerful at work. A study of long-term trends by Thomas Piketty – and, separately, by Branko Milanovic [5] – suggests that in the last 30 years incomes have soared for those in the middle of the global income distribution (say, Chinese workers) and for the top one per cent. But the incomes of the working class in developed countries stagnated before the financial crisis and have since fallen.

Arising from the research there has been a more critical approach to global economic integration ('globalisation'). It was hitherto assumed (and not unreasonably) that both history and economics pointed unequivocally to the economic benefits of closer integration through trade, flows of capital and labour, and the diffusion of technology.[6]

There is one element in standard trade theory however that gives support to the western critics of globalisation. The Hecksher-Ohlin theorem suggests that free trade will reward (relatively) labour in the labour-abundant developing country but disadvantage labour in the developed capital-rich economy.[7] The position is changed once the model is enriched to include human capital (skills and education) and technological progress.

There is also vigorously disputed research concerning the relative importance of trade, labour and capital flows, technological change and national policies and traditions. But both theory and practical experience suggests that trade, labour-saving technology and immigration squeeze the living standards of less-skilled workers in rich countries even though the world as a whole, and workers in poor countries in particular, may benefit.[8] Globalisation may well have the effect of raising human welfare, overall, and contributing to less inequality between countries while increasing inequality within developed countries.

What is the evidence?

Income distribution

The classic measure, deriving originally from the preferred analytical tool of Marxist economics, is the labour (wage) share of GDP (as against profits and rents). In advanced economies this measure is a somewhat questionable measure of equity since earnings reflect a wide variety of occupations – potentially including bankers' bonuses but excluding the earnings of the poor who are self-employed. Piketty's major study of inequality draws heavily on it. In the last four decades before the financial crisis, the wage share across the OECD shrunk substantially albeit with a few exceptions, namely Japan, Denmark and Finland.[9]

The UK had one of the biggest falls. The wage share averaged just under 60 per cent in the three decades after 1948 – peaking at 65 per cent in 1975, a year in which profits were squeezed as a matter of policy. In the 1980s and early 1990s the wage share fell to 51 per cent reflecting the economic policies of the Thatcher era. But subsequently the labour share stabilised at around 54 per cent. When wages are disaggregated to isolate the top earners the story is even more striking. The gross weekly real earnings of the top decile of full-time earners doubled in the three decades from 1978 to 2008 but the median grew only 60 per cent and the bottom decile increased by around 25 per cent.[10] The share of the top one per cent rose from six per cent to 15 per cent. So, in essence, median low-earners were getting a shrinking share of a shrinking share. Nonetheless there was some absolute

5. T Piketty :Capital in the 21st Century Belknap Press 2014 and B Milanovic : Global inequality:A new Approach for the Age of Globalisation Belknap Press 2016

6. V Cable : Globalisation and Global Governance 1999 Chatham House/Pinter. M Wolf : Why Globalisation Works Yale University Press 2004

7. B Ohlin :International and Interregional trade Harvard UP 1933

8. One view is that technology is the dominant factor : OECD: Divided We Stand Paris 2011 and J van Reenen: Wage inequality ,technology and trade; 21st century evidence. Labour Economics 2011. The arguments are contested in D Rosnick and D Baker: Missing the Storm, the OECD's Analysis CEPR, 2012 which attributes the problem to the growth of the finance sector.

9. S Lansley and H Reed: How to Boost the Wage Share. Touchstone Pamphlet 13, TUC 2013.

10 Institute of Fiscal Studies: Racing Away, Income Inequality and the Evolutiom of High Incomes. 2008 and Living Standards, Poverty and Inequality in the UK 2013 and 2014.

growth in real wages at least until the financial crisis. After 2008, median real earnings after housing costs fell eight per cent in the UK from 2007/8 to 2012/13 – and some estimates are even higher.

There has been a similar pattern across the rich OECD world. The gains to the top one per cent of earners combined with the squeeze on the wage share have been especially powerful in the US.[11] Over and above the long-term trend, Emmanuel Saez estimates that 95 per cent of the income gains of growth in the first three years of post-crisis recovery went to the top one per cent of earners.[12] Overall, median earnings in the US are no higher now than three decades ago. Those looking for an explanation of Donald Trump's popularity among middle-income, especially blue collar, men are inclined to look no further. But we need to be careful when looking at long-term trends in earnings.

To get a real measure we need to use a price deflator. But these are subject to the usual caveats that conventional price (and output) measures do not capture the qualitative improvement in goods and services enjoyed by most people. Smart phones provide ready access to internet, email, social media, recorded music and film as well as mobile telephony. There is much greater choice of foodstuffs in supermarkets or clothing styles, safer and more reliable vehicles, and over-the-counter painkillers. These innovations have improved enormously the quality of life for all but the poorest and most reclusive parts of the population. However, these improvements are not fully captured in measures of real incomes over time. No doubt this explains why, at least until the post crisis recession, the 'squeezed middle' was not as angry as the numbers suggested it ought to be.

A different approach to measuring inequality comes from looking at household disposable income. This measure is net of taxes and welfare transfer payments, having allowed for differences between households, such as family size. Having made these adjustments, we can compare the top 10 per cent to the lowest 10 per cent.[13] In the UK, the ratio grew from around 5:1 in the late 1970s to 10:1 in the late 1980s. It has fluctuated around that level since, albeit the ratio fell in the wake of the financial crisis as incomes before housing costs rose about one per cent for the bottom decile and fell six per cent for the top decile. After housing costs, the bottom decile saw their incomes fall by six per cent compared to an 11 per cent drop for the top decile.

Another measure is the Gini coefficient, which measures income concentration across the whole distribution ranging from zero (perfect equality) to 100 (one individual gets the country's entire income). Over the period from the late 1980s to the late 2000s, income inequality increased in 17 OECD countries, was unchanged in three and fell in two.[14] When measured both pre- and post-tax, the UK distribution has followed a similar trend to other indicators of inequality. The post-tax Gini coefficient rose from 28 per cent in 1978 to a peak of 41 per cent in 1990 but has stabilised since and fell post-crisis to around 37 per cent in 2012.

In terms of international comparisons, the UK has higher Gini coefficients (after distribution of tax and benefits) than Germany or France. The UK overtook them in the 1980s before which the UK was significantly more equal than them. Inequality is now much higher than in countries in Scandinavia and most of the developing world but lower than in the US, Russia, Mexico or Brazil. Ironically, Sweden and Finland have the highest pre-distribution inequality of any developed economy but the lowest post-distribution, showing the power of progressive taxation.[15]

The UK has moved from being one of the most egalitarian developed countries, postwar, to one of the least, mainly as a result of policy changes in the 1980s. Looked at over time, there are three contrasting periods. In the period from the second world war to the latter part of the 1970s, real incomes and living standards rose broadly in line with productivity and, if anything, low- and

11. Rosnick and Baker

12. E. Saez : Striking it Rich; the Evolution of Top Incomes in the USA Univ of California 2012

13. Department for Business innovation and Skills: Inequality and Unsustainable Growth 2014 (Economic Growth Analysis)

14. B Hodges : The Wild West; Nottingham Economic Review 2014

15. F Solt Standardising the World Income Inequality Database; Social Science Quaterly 2009

middle-income households benefited relatively. Then, from the early 1980s to the financial crisis, and especially in the 1990s, living standards for most of the workforce grew but inequality also grew and living standards for those in the middle lagged behind economic growth. Low earners lagged even further behind – albeit with some uplift from the minimum wage, which was introduced in the UK in 1999. The post-crisis period has seen an absolute fall in living standards for most workers and households, notwithstanding that some – albeit contested – data suggesting that the top decile took a bigger hit than other income groups, and the bottom decile less.

But the most striking trend in the UK and more widely is masked by Gini coefficients and the other standard ratios. It is the rise of the top one per cent and within that group the top 0.1 per cent. Tony Atkinson estimates that the share of the top one per cent fell from 22 per cent in 1900 to a mere six per cent after the egalitarian postwar era in the late 1970s but has risen back to around 15 per cent. For the US the comparable figures are 18 per cent in 1900, eight per cent in the late 1970s and most recently 18 per cent.[16]

The top one per cent consists in the UK of roughly half a million individuals with an average pre-tax income of just over £150,000 at the onset of the crisis. These are almost all middle-aged men in financial services or senior managerial and professional occupations like law and medicine. The top 0.1 per cent, the super-rich, are roughly 50,000 people earning just under £1m on average. The latter group are of two main categories: top company executives and so-called 'superstar' employees. The former have seen an explosion in executive pay, with FTSE 100 executives enjoying a 440 per cent increase in pay between 1998 and 2013 despite the FTSE index growing by only 11 per cent. The latter are an overlapping group who benefit from perceived unique talents, as also with entertainers and footballers. The phenomenon is much less evident in Japan, France and Germany than in Anglo Saxon economies.

Wealth

The flow of income and the stock of wealth – assets – are not the same though we could expect that high post-tax income, unless systematically frittered away, will provide for high savings and further asset accumulation. We would also expect owners of assets to generate extra income from deploying them productively. For these reasons we would expect inequality of wealth and income to be correlated and connected. There are periods in history, major discontinuities, when wealth holding is dramatically affected – by revolution, confiscatory taxation or hyperinflation – but under normal conditions we would expect to see (pre-tax) wealth inequalities to widen with the compounding of returns to the asset rich relative to the asset poor.

Unfortunately, wealth is more difficult to measure than income. Many valuable assets, like jewellery, are virtually impossible to assess without levels of intrusion which few democratic societies will allow. Few countries have a system for valuing land and, though property tax is more common, the database – as in the UK – is hopelessly out of date. There is a tax base in the form of inheritance tax but, by definition, it is available once in a lifetime and is widely circumvented. Capital gains tax gives a partial snapshot of large financial assets and second homes but captures only changes, not levels, of some wealth. France has a wealth tax but few other countries do. So cross-country campaigns and changes over time are much more difficult to measure than income, for which most developed countries have reasonably reliable tax data.

Part of the reason for the excitement over Thomas Piketty's Capital in the 21st century is that it pulls

16. A Atkinson; Inequality, What Can Be Done Harvard UP 2013?

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together the data – his own and others from Tony Atkinson and Emmanuel Saez – that exist on wealth assets net of debt over a long period of time and in three countries (US, UK, France) and sometimes others (Japan, Germany, Sweden).[17] Various trends and forces are identified in the analysis of the data. In the US the top decile own about 70 per cent of the capital, half of which is owned by the top one per cent. By comparison the top one per cent have around 17 per cent of income. European economies, especially Germany, are significantly more egalitarian in terms of wealth. That is also true of the UK, though the position in the UK is heavily influenced by the growth in housing wealth of the middle class while the financial assets of the very wealthy have declined. In all major western economies, wealth inequality calculated through Gini coefficients is greater than for income.

Piketty devotes much of his book to explaining the long-term trends in wealth relative to income. He shows that in France and the UK, capital – the stock of private wealth – was around seven times the level of income over the period from 1700 to 1910. It was three to five in the US where land values were lower). The ratio fell sharply in wartime and the inter-war period, reaching 2.5 in Britain and three in France – although it was fairly stable in the US. Since the second world war however the ratio has risen solidly and Piketty believes it will continue to rise. He argues that the underlying real, after tax, rate of return on capital is fairly steady at around four to five per cent. This rate of return on capital exceeds the economic growth rate – Piketty's r≥g equation. So the growing ratio of capital to income can only be achieved by squeezing the share of wages in the economy relative to rewards to capital.

A variety of other factors reinforce the tendency to growing wealth inequality: inheritance (and the political defence of inheritance by the wealthy); the greater ability of wealthy people to access a wide range of investment opportunities; and the ability of the wealthy to capture political power, as we have seen most obviously in the US. The fatalistic conclusions are strongly disputed by some. They argue, for example, that the rate of return on capital has been forced down since the financial crisis by historically low interest rates. And they claim there is nothing inevitable, let alone axiomatic, about Piketty's relationship between the rate of return on capital and economic growth.

Arguments about wealth inequality merge into arguments about intergenerational inequality. Seen over a lifetime, individuals progress from being net spenders as children, to become net savers, and then to revert to being net spenders in retirement. But in a period of abnormally rising asset prices, the accumulation of wealth by the middle-aged can seriously destabilise the sense of an orderly lifetime progression. It was recently estimated that 25 to 44 year olds in the UK had households with median wealth (net of debt) of £75,000; 16 to 24 year olds had no net assets; and the 55 to 64 year olds had £430,000.[18] The differential is widening because of inflation in the housing market. This boosts the net wealth of older owner occupiers who are unencumbered by mortgages; pushes up the debt and assets of house purchasers; and excludes growing numbers of young people from owner occupation altogether. For low- to middle-income households aged under 35, the proportion of home owners was just under 60 per cent in 1996/7 but by 2013/4 the share had fallen to 25 per cent. At the same time, private renters had increased as a proportion from 22 to 53 per cent. In areas of relatively high house prices, as in London and the south east, the shift is even more dramatic. The Resolution Foundation estimates that by 2025, nine out of 10 of under 35s in the same income bands will not be able to afford to become owner occupiers. The figure is even higher for London, at 19 out of 20 of those aged under 35.

David Willetts argues that while the housing market is the main source of 'intergenerational inequality' there are other factors pushing in the same direction: the virtual disappearance of final salary pension schemes in the private sector; the shift from employment in jobs with long-term stability and career

17. R Solow: Thomas Piketty is Right; The New Republic April 2014

18. Resolution Foundation based on Family Resources Survey (DWP) Feb 2016

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progression to short-term, insecure employment contracts; and the disappearance of 'free' higher education for those pursuing academic qualifications.[19]

There is a link between the intergenerational equity problem and another indicator of growing inequality: low or declining social mobility. For many, what matters is not inequality but the opportunity to 'get on in life'. In the US, in particular, the promise of upward mobility – 'from log cabin to White House' or 'rags to riches' – is what sustains a tolerance of poverty and inequality.

Social mobility can be measured in different ways and with difficulty: over a career lifetime, between generations, by status, as well as by income and/or wealth. But there does seem to be a decline in social mobility in the UK (and more generally). The divisive trends in the UK housing market can be ducked by those who can inherit parental property or more liquid wealth. Recent moves to lift inheritance tax thresholds aggravate the problem. There is also a high correlation between education attainment (and associated earning potential) especially in elite institutions and the education attainment of the next generation because of the opportunities for buying quality education and because of exposure to books, conversation and networks of contacts. Recent work by the OECD suggests that the UK is one of the worst performers in terms of social mobility and there is an exceptionally large wage premium for children growing up in a well-educated family and, conversely, a large wage penalty for those originating in less-educated families.[20] Inequality has other dimensions too. Life expectancy is the most fundamental with a gap of 10 years or more between high and low designation neighbourhoods.

Does inequality matter?

There is a widely held view that inequality of income and wealth is a necessary evil. This holds that it may be ethically troubling or a source of political friction but it is an unavoidable concomitant of a dynamic capitalist economy in which there are adequate incentives to innovate, invest, work and save. Orthodox economic thinking has reinforced this view that there is a trade-off between growth and equality.[21]

A related idea is that what matters is equality of opportunity for the hardworking strivers or the risk-taking entrepreneurs. For those on the political right and many on the centre left, equality of opportunity matters more than equality or inequality. Peter Mandelson expressing his feeling of being relaxed about people becoming 'filthy rich' captures that spirit. And many of those who advocate more steeply progressive taxation, or call for restrictions on bonuses, executive pay or business activities in general, do so with an acknowledgement that it could be at the expense of wealth creation.

Yet the obvious question arises as to why the top one per cent have accelerated away in the US and the UK but to nothing like the same extent in Germany, Japan and France. These countries have experienced the same exposure to technological trends and have not conspicuously underperformed economically relative to the others.

Moreover there is evidence that too much inequality can be economically harmful and that redistributive policies might, at worst, do no harm and, at best, quite a lot of good. We can see that countries which attach higher value to a sense of fairness and social justice, like Finland, Sweden or Denmark, are also successful, innovative economies with high standards of living. And it is one of the

19. D Willetts: The Pinch:How the Baby-boomers Took Their Childrens' Future 2011

20. OECD: Intergenerational Social Mobility In OECD Countries Economic Studies, OECD journal 2010

21. A Okun Introductory Macro-economics 1955

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recognised phenomena of development economics that the more egalitarian Asian countries like Korea and Taiwan consistently outperform more unequal Latin American countries at the same stage of development. Advocates of more egalitarian policies from an economic standpoint argue that too much inequality encourages unproductive 'rent-seeking' activities, damages social mobility and fosters unrest which affects investor confidence. Indeed the trade-off between growth and equality might well go into reverse beyond a certain point such that inequality is damaging economically.[22] Empirical support for this broad approach has come from the IMF. Ostry and associates show, for a wide range of developed and developing economies, that there is a strong negative linear relationship between inequality and growth rates.[23] A rise in inequality (in terms of Gini coefficient) is found to reduce average annual growth and to be associated with the risk of short-term fall in growth. Redistribution is (weakly) correlated, positively, with growth but at high levels of redistribution the growth impact is negative. The authors acknowledge that there are genuine problems translating correlation into causality and there are issues around the quality and meaning of the statistics (readers may be surprised to discover that the UK, with France, Germany and Holland is one of the top 25 per cent of countries when it comes to redistribution).

There are other studies, too, which point to the same conclusions. An OECD study suggested that the rise in inequality across the OECD between 1985 and 2005 knocked 4.7 per cent points off cumulative growth between 1990 and 2010.[24] Kenworthy shows that both 'Anglo Saxon' deregulated labour markets and Nordic welfare models perform roughly equally in terms of employment creation.[25] The ILO has shown that "wage led rather than profit led economies" tend to do relatively well since consumption falls more sharply than investment rises in periods of slowdown. Stewart Lansley and Howard Reed have suggested that there is a strong positive relationship between the wage share of GDP and growth in the postwar period in the UK.[26]

There is also analysis which suggests that inequality is a key factor increasing the risk of financial crises and in particular the 2008 crash. Raghuram Rajan believes that a key role in precipitating the 2008 crisis was the destabilising influence of the bonus culture of banks with extreme reward coming from reckless, short-term financial activity without any responsibility for the risks and long-term outcomes.[27] A further strand in the argument is that extreme rewards have originated in and have fuelled the creation of asset bubbles, rather than productive investment. This amplified the crisis. Furthermore, the continued inflation of asset markets under the influence of quantitative easing widens wealth inequality further.[28]

A direct link between inequality and instability is provided by the argument that the relatively low propensity to save out of – expanding – high incomes has caused demand to weaken. Demand has then been sustained by high levels of personal debt – which in the case of subprime lending in the US was a deliberate policy choice. This personal debt provided, in turn, the fuel for the 2008 crash. One version of this argument is that there is 'trickle up' consumption as the poor seek to emulate the spending of those better off and land themselves in debt distress.[29] An IMF study by Kumhof has given a twist to this narrative. It argues that, as workers' share of income fell, demand was sustained in the UK and US by utilising foreign savings as a source of domestic lending and debt, resulting in a current account deficit.[30]

To these factors might be added the effect of inequality on the ability of less well-off families to stay healthy, acquire skills and educate their families. Conversely, if redistributive tax policies lead to the use of tax revenues to invest in health or education this may promote both growth and equality. All of this suggests that the supposed trade-off between redistribution and growth may not exist or not be a serious worry, except with countries pushing redistribution to extremes.

22. J Benhabib The Trade-off Between Inequality And Growth: Annals of Economics and Finance 2003

23. J Ostry, A Berg and C Tangarides: Redistribution, Inequality and Growth. IMF Staff Papers 2014

24. OECD, In It Together: Why Less Inequality Benefits All, 2015

25. L Kenworthy Jobs With Equality Oxford UP 2008

26. Appendix to How to Boost the Wage Share TUC

27. R.Rajan; Fault-lines Princeton UP 2011 A Atkinson and S Morelli: Inequality and Banking Crises:A First Look Oxford UP 2011

28. P Marshall: Central Banks Have Made The Rich Richer; Financial Times 23 Sept 2015

29. M Bordo and C Meissner: University of California and M Bertrand and A Morse University of Chicago both reviewed in Economist March 17 2012

30. M Kumhof and R Ranciere: Income Inequality and Current Account Imbalances IMF Working Paper 2012

What is to be done?

It will be clear from the above that the issues around inequality are complex with different measures and trends having different policy implications. But the important conclusion of the previous section is that some redistribution of income, wealth and opportunity, provided it is not extreme, is fully compatible with good economic performance.

The most effective measures are unlikely to be grand gestures but numerous small changes instead. Many of these will be derived from initiatives at the local level. This could include ensuring that the poorer areas of town are properly lit, are safe at night and have good access to affordable public transport. Making sure that poorly performing schools in deprived areas have access to the best teachers. Or ensuring that early year's childcare and education is stimulating and safe for the children who need it most.

And in areas of policy that are centrally driven, like taxation, the important changes are often not in the headline-grabbing top rates of income and corporate tax but the proliferating, loophole-ridden, systems of allowances. This includes allowances for pension contributions, age and business costs as well as the withdrawal of child and other benefits. Complexity is often the result of well-intentioned egalitarian initiatives but is almost certainly the ally of those with access to expensive advice.

Taxation

One of the most striking results of comparisons across countries is that two of the countries with the greatest pre-tax income inequality – Finland and Sweden – have the greatest post-tax equality: a tribute to the redistributive power of the tax system. But we also need to note that both countries have been in retreat, somewhat, from high marginal tax on incomes. Also, the experience of both these and other countries is that redistributive taxation rests to a significant degree on consensus and consent, reinforced by the high level of transparency about individual returns. That consensus is maintained politically by coalition government (now somewhat precariously) and socially by ensuring that the middle classes and rich identify with efficient, reformed, public services and an increasingly tough welfare regime with strong sanctions.

The UK diverged from the Scandinavian model in the 1980s, politically and socially, and there appears no great appetite for it at present. There are, nonetheless, changes that could sensibly be introduced, remembering that radical change will have lots of losers as well as winners. The first would be to integrate – gradually – national insurance (NI) and income tax, since the contributory principle of the former has long since lost its meaning and both are taxes on income and there are extraordinary anomalies. It is impossible now, for example, to justify the exemption of pensioners from NI when many pensioners work and pensioners enjoy other fiscal privileges, such as the Winter Fuel Allowance.

It also makes no sense to continue to lift the tax threshold on income tax while leaving NI at much lower thresholds. My party's policy of lifting the income tax threshold had attractions while wages were being squeezed in the aftermath of the 2008 financial crisis and is more progressive than cuts in the rate. But it is now in danger of seriously damaging the tax base while workers on very low pay are still liable for NI. A second set of reforms would be to remove the tax privileges of high earners through their ability to enjoy pension contribution tax relief at the top rate. There is a separate but overlapping proposal, which George Osborne has stepped back from, to shift pension tax relief from contributions to pension payment. This would shift the tax cost to the Treasury forward in time but is neither necessarily progressive nor regressive in effect. However, it has had the effect of undermining political support for reform in general.

Neither of these reforms, however, touch the major issue of the top one per cent. The fashionable preference on the left of politics has been to push up the marginal rate to 50 per cent or above. This will be counterproductive if it accelerates the search for avoidance measures. A pragmatic approach would involve acceptance that 40 to 45 per cent is probably the highest it is feasible to go in an open, free-market economy, combined with a tougher avoidance regime. This regime would prevent arbitrage between income and capital taxation, penalise the use of off-shore accounts by residents, and expose avoidance by publishing individual tax returns, as occurs under the Scandinavian model.

Property taxation is less easy to avoid and also addresses the issue of inequality of wealth. Perhaps for that reason, proposals to make property levies such as council tax more progressive, or even proportional, in relation to value, strike a raw nerve with wealthy individuals. This accounts for the vitriolic response to the proposed 'mansion tax'. But the approach is right and must be a key element in the armoury of progressive politics.

Land value taxation is a less easily-operated approach which has a strong economic policy rationale.[31] Inheritance is a major factor perpetuating inequality of wealth and inhibiting social mobility. That is why genuine meritocrats – like Bill Gates for example – argue for aggressive taxation of inheritance. In fact, policy has moved in the opposite direction with a lifting of inheritance tax thresholds to permit tax-free inheritance of up to £1m for a couple. In practice, inheritance tax has been widely avoided in any event by inter vivos gifts. A more effective mechanism would be the taxation of gifts between generations on the same basis as other taxation of income.

The taxation of property apart, all forms of taxation of income or financial transactions can be avoided by international arbitrage. Any progressive tax policy should try to close loopholes in tax havens and harmonise tax rules to minimise leakage.

Remuneration policy

If taxation is likely to be only partly effective in dealing with extremes of income and wealth, why not deal with the problem at source: escalating and extreme remuneration at the top and very low wages at the bottom.

In the UK, average basic pay has risen by about 100 per cent in the last ten years, excluding bonuses. The pay ratio between the average FTSE 100 CEOs and the average UK worker has risen from 45:1 in 1998 to 185:1 at the latest estimate (2013). By contrast, Plato once suggested a maximum of four between the income of the highest in society and the lowest. Even a country like Switzerland, well attuned to the incentives required in a capitalist economy, conducted a national referendum in 2013 on an obligatory 12:1 ratio for the top and bottom. The UK, and the US, accept far more extreme differentials.

There is an economically liberal view that these differentials merely reflect the international market for talent in which informed firms hire top executives based on an estimate of the value they can bring (the marginal productivity in economic terms) and salary competition from other firms. There are however some fallacies in this approach.[32] It assumes that the firm – that is, the shareholder

31. J Mirrlees :Tax By Design: Review of UK Taxation; Institute of Fiscal Studies 2012

32. S Bevan: Compensation Culture, Is Executive Pay Excessive; The Work Foundation 2013 B Bell and J van Reenen: Extreme Wage Inequality CEP Occasional Paper 2013

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owners – are both informed and free to make choices. In practice, senior executives may have great power within a firm such that they are, in effect, setting their own salaries with captive board remuneration committees reflecting their wishes. And far from measuring marginal productivity, the dominant metric used is that company CEOs all aspire to be in the 'top quartile' which is logically impossible.

It is not surprising that, in practice, the growth of executive pay bears little relation to corporate performance overall. Shareholder value in aggregate for FTSE companies has scarcely increased in the last decade. Some studies however suggest that lagged pay-outs from 'long-term incentive plans' are better aligned with corporate performance.[33] But overall there are far too many cases where there is disconnect between rewards and performance, and the use of large exit payments for failed executives increases that disconnect.[34]

Furthermore, the bonus and other incentives paid in the finance sector particularly contributed to the financial crisis by encouraging a focus on short-term results. As mentioned earlier, the IMF's Raghuram Rajan demonstrated the force of perverse incentives. Lord Turner, then of the Financial Services Authority, also attributed at least part of the severity of the crisis to inappropriate remuneration, though it is fair to say that others have argued that these factors were swamped by other causes of the crisis.[35] Separately, the system of rewards paid to financial intermediaries in equity markets has been linked by John Kay and others to the endemic short termism of those markets and the difficulties firms have in raising long-term patient capital.[36]

When in office I sought to build on the work of Richard Greenbury, David Walker and my Labour predecessors in improving transparency and tightening shareholder responsibility.[37] I brought in legislation requiring the publication of a single number for executive remuneration and a binding vote on forward-looking pay policy, in addition to the existing advisory vote on current pay packages. Anticipation of those reforms contributed to the 'shareholder spring' of 2013, with shareholder challenges to excessive awards. And the implementation of those measures provided a boost to a new wave of challenges from shareholders in 2016, most conspicuously for BP, WPP and Reckitt. The measures were criticised at the time for being insufficiently radical but I notice that the Socialist government in France is now copying them.

Could more be done? One step would be to make it obligatory for companies to consult their workforce on executive pay. At present, they only have to report whether they have done so. This change would keep a focus on internal as well as external relativities. Another reform would be to place an obligation on shareholders to record (on the internet) their votes at AGMs where they are significant investors. At present, there is a rising trend of voter participation but no pressure to do so. And the disclosure requirements could be strengthened, as with pay ratios.

Issues of inequality apply at the bottom as well as the top of the pay scale. A major departure in the UK has been, since 1998, the adoption of the minimum wage. Contrary to earlier fears the predicted negative impact on employment never materialised. A key factor was the consensus and evidence-phased approach of the Low Pay Commission and the willingness of the Treasury to finance tax credits for those on low earnings.

Recently, there has been a shift to a higher – politically mandated – National Living Wage (NLW) and less generous tax credits. It remains to be seen how these changes will affect the workforce but the analysis of the Low Pay Commission suggests that it could have significant negative effects

33. M Farmer et al :New Evidence of Relative Performance Evaluation in UK CEO Compensation; Corporate Law 2010

34. P Gregg et al; Executive Pay and Performance; International review of Finance 2012

35. A Turner: A Regulatory Response to the Global Banking Crisis ; Financial Services Authority 2009

36. BIS :The Kay Review of UK Equity Markets and Long Term Decision Making 2012

37. D Walker: A Review of Corporate Governance in UK Banks and Other Financial Industry Entities; Financial Services Authority 2009

on employment while not ameliorating poverty and inequality – since the minimum wage (now the NLW) is frequently paid to second or even third earners in a family. Some may believe that compressed differentials among lower earners will lead to greater wage inflation in general, which may be welcome now but not in more normal conditions.

Social mobility and equality of opportunity

As discussed earlier, equality and equality of opportunity are by no means the same. The 'American dream' promised equality of opportunity while accommodating high levels of inequality. But the former has now ossified while the latter has widened. The UK offers a less extreme version of a similar model and the trend is the same. Young people from wealthy families have access to resources and a level of stimulus that less-wealthy families do not have, making them more likely to succeed. The evidence suggests that a disproportionate amount of leading UK figures – in business, politics, law, journalism and broadcasting – come from independent schools or selective state schools.

How can we restore greater equality of opportunity? Higher levels of education and skill are clearly key. But there is a fierce debate between those who believe that the key issue is access to early year's education and support – high-quality nursery and infant schools and childcare together with secure accommodation – and those who believe the key differentiator is post-16 education. In particular, the latter involves an opportunity to study at degree level, especially at a prestigious university. In fact, both routes are almost certainly important. The first is now broadly accepted, subject to resource constraints, together with early intervention to resolve the interconnected issues affecting so-called 'problem families'.

The post-16 agenda is a more controversial area given the recent radical reforms in student finance. But some of the key factors affecting social mobility for those who have reached teenage years include: well-funded university outreach programmes to raise aspirations (of the kind now promoted by the access regulator for higher education); 'need-blind' admission procedures; generous scholarships; quality apprenticeships with progression to degree-level qualifications; paid internships; good-quality careers advice and guidance in all schools and colleges. There is much to do in all those areas.

Unintended consequences

There are some areas where widening inequality might be the consequence of other policies undertaken for otherwise valid reasons. Some mitigation measures may be needed without abandoning the original rationale for the policy.

Quantitative easing is a good example and an important one should the need for a strong, but unorthodox, monetary stimulus arise again – as it already has in the eurozone and in Japan. Even if the overall policy is good and necessary, negative impacts can be mitigated through some change in the range of assets chosen or via offsetting tax policies. Joseph Stiglitz argues that there is also a bias to labour-saving technology, and as a consequence low wages, so there have to be offsetting fiscal measures incentivising labour-intensive investment.[38]

Housing policy in the UK is something of a disaster area. Escalating house prices – a product of demand inflation and restricted supply – is creating a growing divide between young and old, and

38. J Stiglitz: The Price of Inequality

between the asset rich and asset poor. I have already pointed to the need for more equitable taxation of property values but there is no escaping the need to address the issues of supply and demand directly as well as the housing mix.

My last example is trade which is currently relatively uncontroversial in Europe but incendiary in the US where it is accused of widening inequalities and undermining the jobs and pay of blue-collar workers. The case for liberal trade remains a powerful one but the regressive side effects have to be addressed through programmes that support retraining or otherwise manage the impact of trade adjustment. Globalisation has negative side effects but the alternative of aggressive nationalism is almost certainly worse.

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