inequality and the economy

Building a better London for all Londoners

Economic inequality, the size of the gap between the very rich and everyone else, is the defining issue of our time. We know more now about inequality and its negative economic and social consequences than ever before. But now we need action.

This pamphlet describes how our society started down a path towards gross inequality, how corporate elites persuaded right wing politicians to adopt 'neoliberal' policies, and how this has led us back towards levels of inequality not seen since before the First World War.

Inequality in London drives our housing crisis, traumatises our young people, undermines our economy and corupts our politics. We could have taken a different path and we still can. My Fair London wants to help shape a different future for our city. Read on for some of our ideas about the changes that need to happen to make our city a better place for everyone.

My Fair London

THE STARTING POINT OF THE GREAT DIVIDE

In the late 1970s there was a major change in the economic policies persued by UK and US governments. Following the election of Margaret Thatcher and Ronald Reagan both Britain and America moved away from the interventionist economic policies adopted during the Second World War, and which had defined the post war world. Adopting ideas sponsored by US corporations in the late 60's, and backed by big business, politicians on the right successfully claimed that the 'post war economic consensus' was to blame for rising inflation, strikes and economic stagnation.

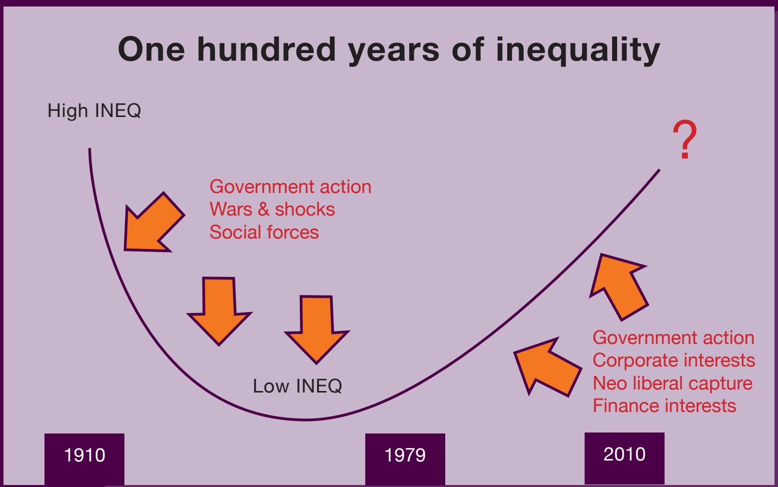
The new policies that emerged in the seventies are commonly described as free market (or neo-liberal). Free market policies were based on a narrow reading of classical economics and developed by a small group of theorists who believed that economic efficiency and growth were maximised when markets were left free from interference.

They said Governments should cut regulations in favour of self-regulation without penalties, legal requirements or powers of enforcement. They opposed institutions that limited the power of business leaders or investors or that championed regulation, such as trade unions. They argued for minimal taxes and a minimal role for the public sector. They said things would be better if the market provided education, health, housing, social care and pensions privately without the involvement of the state. They favoured privatisation. Any remaining public services should be provided by private contractors competing for Government contracts.

THE MYTH OF TRICKLE DOWN ECONOMICS

These extreme free market theories were supported by big business, particularly in the US, and many wealthy people who said that restraints of government held back their ability to innovate and create more wealth. They called for reduced taxes on the rich and on businesses arguing that lower tax levels would encourage entrepreneurs and generate economic growth. Returns to business owners and senior managers increased dramatically, justified by the idea that richly rewarded senior managers would work harder and create more wealth.

Free market advocates claimed that despite the reduction in tax rates, rapid economic growth would mean that more tax would be collected. They said that some of this extra wealth would then 'trickle down' from the wealthy to the whole of society.



Thirty years later, when asked about his faith in 'trickle down economics', Sir Alan Budd, one of Mrs Thatcher's top economic advisors said, ***"I thought they would be more generous."***

The impact of free market policies on equality

In the 1980s Presidents Reagan and Bush reduced tax rates for high earners in the US. The highest marginal rate of income tax was reduced from 70% in 1980 to 28% in 1988. In the UK it fell from 98% in 1978 to 40% in 1988. The increase in wages and the reduction of taxes for the rich contributed directly to a sharp increase in inequality and led to a fall in tax revenues. Governments were forced to borrow to fund social programmes leading to increased government deficits. 'Trickle down' turned into 'cascade up'.

This was a dramatic change. From the Second World War until the mid 1970s as Government's took more responsibility for their populations, economic inequality steadily declined in the UK and US while economies grew rapidly. From then on, as 'free market' policies came to dominate, economic inequality in the USA and UK increased rapidly. By 2008 it had reached levels not seen since before the First World War.

The levels of inequality created in the UK and USA are not inevitable. They are the direct and intended result of political policy choices. Levels of inequality are much lower in many other successful capitalist countries: Germany, Japan, Sweden and many others.

Free market policies and the financial sector

In line with political shift towards 'free market' policies, both the UK and US governments deregulated their banking system in the 1980s and 1990s. Between 1990 and 2000 the financial sector doubled from 4% of the US economy to 8%, a spectacular growth rate. This remarkable growth was in part based on the creation of paper assets that were barely connected to the real economy and did not require ownership of the underlying assets. As Adair Turner points out in "Economics after the Crisis", the volume of oil futures traded in 2008 was ten times the annual consumption of oil.

Speculator's optimism and rashness drives up the price of assets (houses in London for example). In contrast, in the real economy profit growth is limited by the concrete facts of income growth and the pace of innovation or productivity change in industry. Periodically the divergence between asset prices in the finance sector and the real economy forces asset price corrections and speculative bubbles burst. This is what happened in the 2008 crash. Risky 'sub-prime' US mortgage debt had become a speculative bubble, repackaged and resold within an un-regulated finance industry.

photo: My Fair London's giant banker shows the scale of inequality

Financial crashes have a disastrous effect on employment, investment and Government budgets, and can take many years to recover from. It is fair to say that free market policies, particularly deregulation created the conditions for the 2008 economic crash.

Free market policies and the real economy

The most important impact of rising inequality on the economy is to reduce the level of demand for goods and services from the majority of the population. Money in the hands of middle and low income groups is more likely to be spent on general goods and services, this demand is the main engine of economic growth. Money accrued by the top 5 or 1% is more likely to be saved, or spent on assets such as houses, yachts or luxury goods, feeding a much smaller sector of the economy.

If very large numbers of people are on low wages, or if those in middle income groups see their incomes stagnate, as in the last two decades, the level of demand in the economy is less than its potential and economic growth suffers. This is why high levels of inequality are bad for total economic growth.

The direct and indirect ownership of manufacturing companies by the financial sector, and the implementation of free market policies, has also been extremely damaging for innovation. Innovation is the key to the creation of long-term growth in the economy, but financial assessments focused on short-term share price increases, mergers and acquisitions don't encourage the long-term investment needed to develop new ideas or technologies. In fact a focus on the maximization of short term returns creates a pressure to reduce investment for the longer term.

CEO's of FTSE 100 companies

1999: paid 69 times average pay

2009: paid 145 times average pay

2014: paid 175 times average pay

In the past the state has played a key role in directly developing new technology or paying for it. Economist Mariana Muzzacato points out in “The entrepreneurial state” (2013), most of the technology underlying Apple products was created in publicly funded California state university laboratories. It is deeply ironic that aggressive tax avoidance by technology companies and others makes it less likely that governments will be able to fund future research.

The impact on society

From the end of the Second World War through to the late seventies most families experienced steadily increasing incomes and an improvement in the quality of their lives. There was perhaps a general assumption that improvements would continue for their children. The expectation was not only that material standards of living would go on getting better but also that life would offer greater richness of experience, increasing education, travel, and more free time.

Since the 1980s, and especially since the 2008 crash many low and middle income families now expect their children and grandchildren to face insecurity, poorer housing, lower incomes and a falling quality of life. The prospect of lives improvinggeneration after generation is fast disappearing.

At the top end of society, the economic elite are doing very well, seeing both wealth and incomes rise. Some retired people, especially those with company pensions and mortgage-free houses, are better off than any previous generations of pensioners. The lottery of home ownership in the UK and the astonishing increase in London house prices has left some feeling very surprised by their wealth.

“We have an economy in which the rules have been changed to benefit the 1%, at the cost of the 99%.”

Chuck Collins,author,
99 to 1: How wealth inequality is wrecking the world

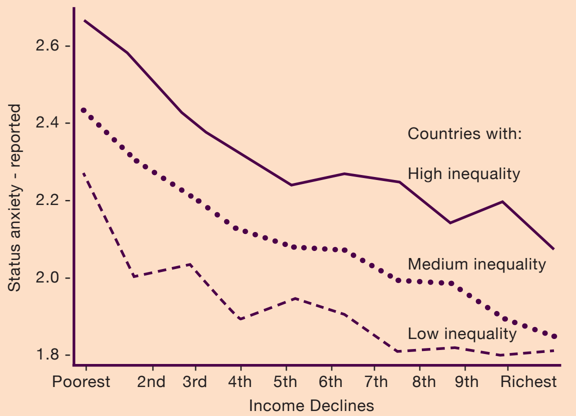
The middle-aged are experiencing mixed fortunes depending on the stability of their employment and the value of their homes. Many are anxious about job security and the level of their future pensions. Will their pensions, which are often significantly inferior to those of current pensioners, leave them short? Will they be made redundant and face unemployment?

Worst affected are the young, entering the jobs market with far fewer chances of establishing a stable economic future. In London most young people face low pay, under and insecure employment, unpaid internships, chronically unaffordable housing. They look forward to a longer working life, and poor pension prospects. A far smaller proportion than in previous generations have the resources to buy a home. And for far too many young people, higher education now creates high personal indebtedness, with uncertain prospects of a reaonable salary level to recompense.

Today there are fewer high-skilled jobs available in the middle of the pay structure than in the past and fewer opportunities to develop a career. Further rapid technology changes is now predicted to undermine mid-grade jobs even more in the future. Well educated young Londoners, despite having good skills, are forced into poorly paid, low-skilled jobs, often in the personal services economy, exemplified by graduate coffee-making baristas.

According to the British Social Attitudes Survey, as our day-to-day economic circumstances have gradually become more challenging we have become harsher and less generous in our attitudes to other people. In the immediate post war era people expected fairness and humanity from public and private sector institutions. They assumed that people in difficulties, through disadvantage, or bad luck would be helped. Rising levels of inequality have undermined that faith in the system and each other, replacing it with a pervasive culture of self-defeating individualism.

The enemy between us: The psychological and social costs of inequality



The negative consequences of inequality have been described in many studies, most notably in “The Spirit Level” (2010), by Kate Pickett and Richard Wilkinson. Among other things they showed that people living in more unequal societies have worse health, lower life expectancy, more mental health problems, face higher levels of violence and have poorer educational achievements. Inequality gets under your skin and hurts everyone, but we can change our society for the better.

Graph from Wilkinson and Pickett, European Journal of Social Psychology Volume 47, Issue 1, pages 11-24, 22 MAY 2017 DOI: 10.1002/ejsp.2275http://onlinelibrary.wiley.com/doi/10.1002/ejsp.2275/full#ejsp2275-fig-0002

Growing criticism from within the system

More and more people, including many financial insiders, are worried by increasing inequality and see it both as manifestly unfair and counterproductive. Those who care for the health of the capitalist system and even social stability in general see them threatened by the loss of legitimacy that flows from extreme inequality:

“I see pitchforks, as in angry mobs with pitchforks ...”, “disaffection, breakdowns of authority, even large scale violence could ensue, jeopardizing the civility on which growing economies depend”.
The first of these quotes is by US venture capitalist and millionaire Nick Hanauer, the second from Alan Greenspan the chief secretary to the US treasury for nineteen years until 2006, well known as an enthusiastic supporter of free trade and promoter of much of the market deregulation that created the great crash of 2008.

Inequality has been recognised by Mark Carney, Governor of the Bank of England as a strategic threat to the system. He puts much of the blame on unwarranted and excessive commitment by politicians and policy makers to a mythical free market ideal: “All ideologies are prone to extremes. Capitalism loses its sense of moderation when the belief in the power of the market enters the realm of faith.”

Mr Carney argues strongly that current ways of thinking erode the social capital on which the economy depends. Inequality undermines the sense of society. The system does not work well if it is discredited. Those on low and middle incomes realize that the economy is not working for them. They lack a stake in society and become increasingly aware of it. In practical terms, this can lead to increases in crime and antisocial behaviour as well aslower levels of trust and community engagement.

The International Monetary Fund says: “We find an inverse relationship between the income share accruing to the rich and economic growth - the benefits do not trickle down”. The Organisation for Economic Co-operation and Development (OECD) notes in its report “In it Together - Why Less Inequality Benefits All” that “income inequalities tend to drag down GDP growth.”

Finally, evidence is mounting that inequality is itself politically destabilizing. It seems clear that the feelings of being ‘left behind’contributed to Donald Trump’s victory, to support for Brexit, and to a general growth in nationalist sentiment. And political instability does not help the economy either. But perhaps we also need to find solutions to the problem of inequality that will win support right across the political spectrum?

IF WE DO NOT CHANGE DIRECTION WE SHALL ARRIVE WHERE WE ARE GOING Chinese proverb

WHAT CAN BE DONE? A NEW SOCIAL CONTRACT

High levels of inequality and the resulting economic and social problems we now face are not inevitable. The future shape of our economy and society will be the result of political choices made by electors and politicians. The free market policies of Government’s since the late 1970’s were deliberate, have led us to the current extreme position, and political action can take us in a new direction.

We believe that a balanced, mixed economy, which combines stronger government action with elements of the market works best for society. We need a new social contract to define a society and economy that works for everybody. Developed, modern economies create enough wealth for us all to be free from gross material needs: for decent accommodation, healthcare, food and security. We can distribute our shared to wealth to create the conditions for us all to lead more fulfilling, flourishing and active lives.

Key areas for action:

- We must further reform the banking and financial sector to prevent recurrent speculative crises. Reforms should put in place structures to protect society from the impact of financial shocks when they do occur.
- Financial elites should be held legally accountable for their actions.
- Parliament should legislate to reduce the influence of economic elites over politics and economic policy, for example by reforming party funding, making all political donations public or capping their size.

- At the heart of any effort to reduce economic inequality will be fair taxation, rooted in ability to pay and sufficient to fund the services that we all depend on.
- Transform Council Tax into a progressive property tax, revaluing properties and creating new bands with higher rates of tax for higher value properties – this is particularly important in London.
- Introduce policies to reduce income gaps between the economic elite and the rest of us (for example tough penalties on tax avoidance, mandatory wage ratio reporting and maximum permitted pay ratios).
- Government should set and report on targets for reductions in inequality and measure success through an internationally recognised measure of inequality like the GINI Coefficient.
- Government should invest for the long-term in science, research and development and develop collaborative, transparent links with progressive businesses.
- Government and state institutions should act to manage demand and particularly focus state investment in research, and technological innovations. This means rejecting unbalanced austerity and managing the effect of new technology on employment.
- The powers of institutions that enhance transparency and balance the power of private sector interests, such as cooperatives, mutuals, trade unions and social wealth funds should be strengthened as a step towards a fairer society.
- Company law should be changed to give private companies a primary responsibility to create social value alongside returns to shareholders. All corporate boards should include worker representatives.

www.myfairlondon.org.uk

HOW CAN YOU HELP?

1. Join My Fair London (www.myfairlondon.org.uk)
2. Join The Equality Trust (www.equalitytrust.org.uk)
3. Convene a discussion of inequality and its consequences in your workplace or community
4. Come along to a My Fair London meeting and help us build our campaign

Find out more & join us at www.myfairlondon.org.uk and follow us on twitter - @fairlondon

INTERESTED IN READING MORE?

Antony B Atkinson, **Inequality,** 2015 · John Hill, **Good Times, Bad Times,** 2015 · Andrew Jackson and Ben Dyson, **Modernising Money,** 2012 · Oliver James, **The Selfish Capitalist,** 2008 · Mariana Mazzucato, **The Entrepreneurial State,** 2015 · Branko Milanovic, **Global Inequality,** 2016 · Kate Pickett and Richard Wilkinson, **The Spirit Level,** 2009 · Thomas Piketty, **Capital in the 21st Century,** 2013 · Joseth Stiglitz, **The Price of Inequality,** 2013 · Wolfgang Streeck, **Buying Time,** 2014 · Adair Turner, **Economics After the Crisis,** 2012 · Yanis Varoufakis, **And the Weak Suffer What They Must?,** 2016 · Robert H Frank, **Success and Luck: good fortune and the myth of meritorcracy,** 2016 · Danny Dorling, **The Equality Effect,** 2017

THE EQUALITY TRUST

My Fair London is an autonomous group of Londoners affiliated to The Equality Trust https://www.equalitytrust.org.uk