The loaded dice: pro-rich state policy is bad news for the poor and the economy

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Eight years after the 2008 Crash, the UK economy is still struggling. Real GDP per head is only slightly higher than in 2007.[1] Median net real household income in 2013/14 (the latest data) was 2.4% lower than the peak in 2009–10. The trend in living standards is especially poor compared with earlier recoveries from earlier 'crashes'.[2]

In the UK, tepid growth reflects the underlying fragility of the economy, one that is endemic to Britain's economic model of liberal capitalism or stock-holders capitalism?. The UK has a very poor record on most of the key determinants of economic success.

Its productivity rate (output per worker) has long lagged behind that of key competitors. Static since 2008, that productivity disadvantage has deepened.[3] It has a poor record on investment, in both the private and public sectors. The UK ranks 24th for 'quality of overall infrastructure' in the World Economic Forum index of global competitiveness.[4] Public sector investment as a share of GDP is set to fall to 1.5 per cent, well below its historic average, and the minimum of 3.5% recommended by the OECD for spending on infrastructure.[5]

Finally, and significantly, the UK has one of the highest levels of inequality amongst wealthy cash-rich nations. As a result, Britain's poorest citizens are poorer than their equivalent group in countries of comparable wealth.[6]

These weaknesses are inter-related. Low productivity reflects low levels of investment. High levels of inequality act as a drag on growth and are associated with a poor record on the key drivers of growth, including spending on research and development (R&D).[7] Indeed, the pro-inequality bias of the UK's model of corporate capitalism is integral to understanding its economic record

Inequality since the Crash

Over the last forty years, the UK has climbed the global inequality league table, with the biggest jump occurring in the 1980s. On some measures, inequality has levelled off over the last two decades. While income polarisation remains much higher than in the mid-1970s, official summary measures show that the gap between high and low incomes has remained broadly static since 2008; and the Gini coefficient fell slightly from 0.40 in 2007/8 to 0.39 in 2013/14 (although this is not statistically significant).[8]

However, these summary figures only show a partial picture of actual trends. First, they are two years out of date, and inequality is predicted to have risen slightly since 2013/14 and to continue to do so until 2020.[9] Secondly, they mask significant differences between demographic groups. One of the key distributional stories is the way inequality has been falling amongst pensioners, mainly the result of improvements in pensioner incomes, while continuing to rise since 1990 amongst those of working age, a trend driven by changes in job opportunities and pay trends.[10]

Thirdly, and most significantly, these summary statistics measure the gap between the broad range of incomes, but are inadequate at measuring the distance between the extremes. Yet it is at the tails of the distribution where the starkest changes have been occurring. The central problem of inequality is not about the gap across the broad range of incomes, but the way in which a small financial and commercial elite has been colonising a growing share of the economic cake since the late 1970s using mechanisms that weaken the productive base of the economy. At the top, the share of total household income taken by the top 1% fell in the post-war decades, reaching its lowest level in the mid-1970s and, with the exception of a slight dip in the early years of the 2009-12 recession, has been rising ever since.

In contrast, the income floor has become a good deal more fragile, especially since 2008. Britain is a society, increasingly divided between a top tier of the super-rich, and a rising group on low incomes, between super-affluence and mass impoverishment.

Although this is not picked up in most official statistics – which are poor at measuring the ends of the distribution[11] - the best evidence is that this gap between top and bottom has continued to widen since the mid-2000s.

In Figure 1, we compare changes in median total earnings for FTSE 100 company chief executives with median earnings for all full-time employees. Since 2000, despite a temporary dip in the aftermath of the meltdown, top pay has risen much more quickly than that of the average employee. In 2000, the ratio of FTSE 100 top executive to typical employee pay stood at 47:1. By 2014 it had risen to around 140.[12] Against this, there have been some counter-trends, including some trimming back of banker bonuses, though these may prove temporary.

Figure 1: 'Racing Away': changes in top executive and employee pay, 2000-2012
Index: 2000 = 100

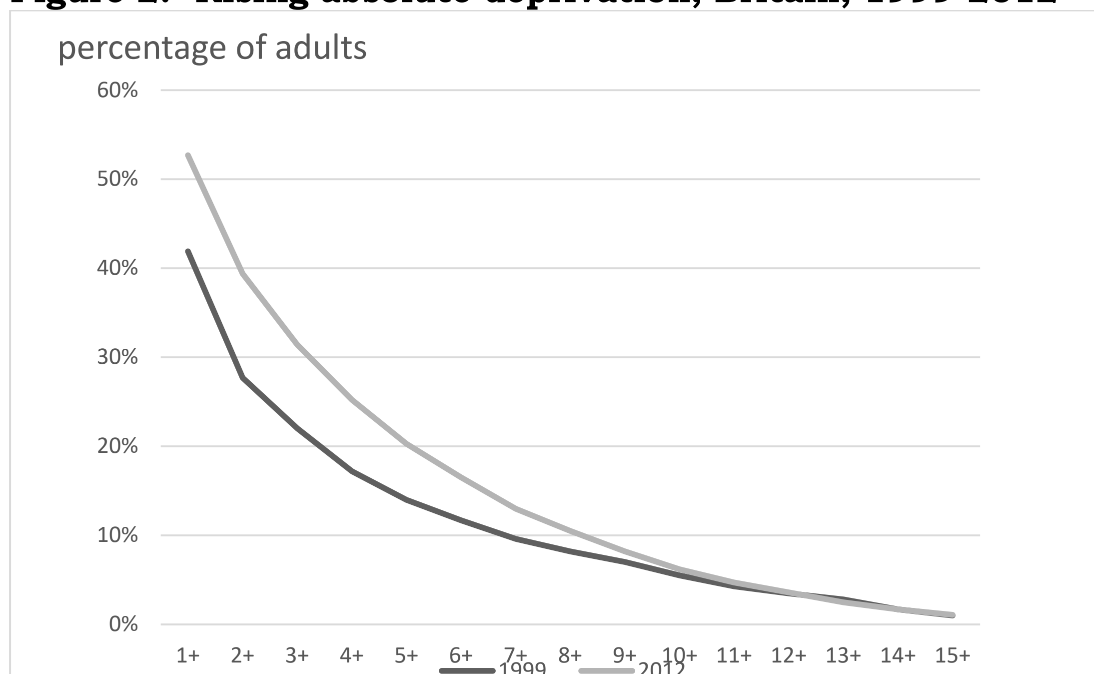
Source: Income Data Services; the figures are nominal, unadjusted for inflation.

While the top has been 'racing away'.[13], the living standards of the poorest have been falling in absolute terms.[13] Again the official figures understate the actual trends. According to the annual series, Households Below Average Incomes (HBAI), published by the DWP – the proportion of the population in relative poverty, measured by those falling below 60% of median incomes, fell slightly from 23% in 2007/8 to 21% in 2013/14.[14] This is despite an actual fall in real incomes over this period amongst the poorest. The fall in poverty on this measure reflects the way poverty is defined. When the median income level falls, the poverty threshold – set at a fixed percentage (60%) of the median – also falls.

A different picture emerges on the basis of trends in *actual* living standards. A study of deprivation in 1999 and 2012, based on an inability to afford publicly chosen necessities (from a lack of heating

and an inadequate diet to basic social activities), found that over this period levels of deprivation have risen.

Figure 2: Rising absolute deprivation, Britain, 1999-2012



Source: S Lansley and J Mack, *Breadline Britain: The Rise of Mass Poverty,* Oneworld, 2015, p56

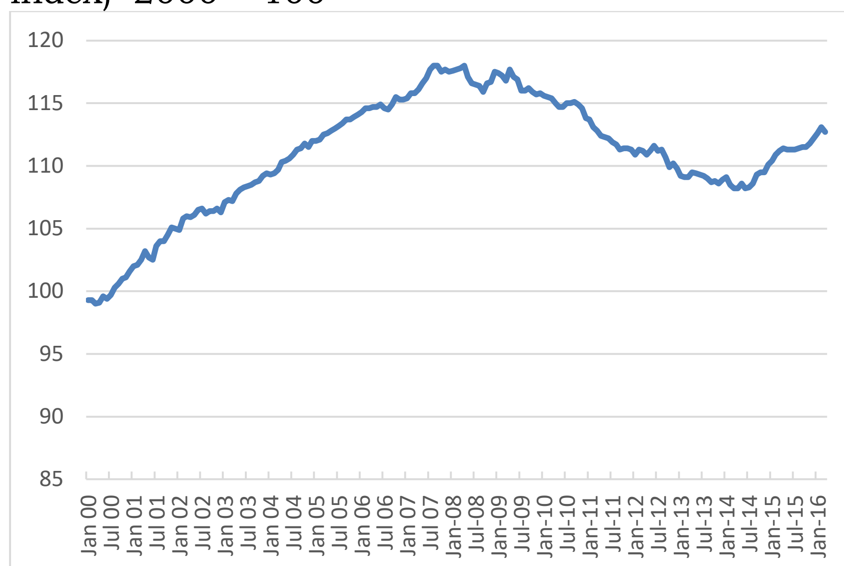
Using a fixed basket of items designated as necessities by the public in 1999, the comparison shows that more households are falling below the 1999 standard in 2012 than in 1999. So, 53% lacked one or more necessities in 2012 compared with 42% in 1999, while 21% lacked five or more items in 2012 compared with 14% in 1999.

Why this rising gap?

There are a number of explanations for the long run rise in inequality. The steadily rising gap amongst the working age population since the mid-2000s, and the fall in living standards at the bottom, has been the product of two main factors. *First,* an ongoing upheaval in the pattern of jobs and pay. Although the news on the number of jobs has been positive, with unemployment falling from a high of over 9% in 2012 to 5.2% at the beginning of 2016, figure 3 shows that average earnings has been falling in real terms; in April 2016 they were still 4% below the peak pay level in 2008. *Second*, the wage fall in the UK is significantly greater than the OECD average.

Figure 3: The wage squeeze

Index of average real weekly earnings (deflated by consumer price index) 2000 = 100



Source: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/articles/supplementaryanalysisofaverageweeklyearnings/may2016

This fall in real wages continues a long term trend in the UK towards a low pay economy. The proportion of the workforce on low pay has risen from around 12% in the 1970s to 21% today, taking Britain to second place for low pay amongst rich nations.[15] The fall in real wages since 2008 is, in part, the price being paid for a relatively modest increase in unemployment during the downturn, a lower rise compared with other recessions. But it also reflects a much longer squeeze on wages.

Of course, real wages have been rising since 2015, and the government is to raise the national minimum wage to £9.00 an hour by 2020. Although this will raise the wage floor a little, and will benefit multiple-earner households, the net incomes of many low income working families will fall as planned benefit reductions will outstrip any pay increase.[16]

Further, while the jobs picture itself has been brightening, there has been a continued deterioration in the quality and type of jobs being created. Of the roughly 1.5 million net new jobs added between 2008 and 2015, just under half (46%) were self-employed (despite self-employment accounting for just 15 per cent of all jobs in the economy) and 30% were part-time employee roles (despite such jobs accounting for 22% of all employment).[17]

Self-employment – which can offer a very mixed experience - accounts for 4.6 million workers, up from 3 million in 2001. Many of the new jobs are temporary or low paid, and come with new flexible contracts. Zero-hour contracts, which offer no guarantee of any work are increasingly widespread. Although such flexibility suits some categories of worker, including students and older workers, there is mostly little choice over the deal on offer.
While unemployment is heading down, the modern labour market is an increasingly hostile place for a growing proportion of the workforce, with more and more employees facing low pay, weaker social protection from sickness pay to pension arrangements, intermittent hours and growing insecurity.[18] High levels of poverty are being locked more firmly into the economic system, and this is before the impact of the robotic revolution on job opportunities and pay differentials begins to bite.

The *second key factor* has been the increasingly pro-rich and anti-poor bias of state policy since the Crash. The regressive nature of much government policy is in part a by-product of the post-2008 wider economic strategy, but much of it is by design. 'Reverse redistribution` is endemic to three significant areas of government policy: economic management, housing, and tax/benefits.

The main thrust of macro-economic policy since 2008 has been loose monetary and austere fiscal policy. To stimulate recovery, governments have resorted to the mass printing of money (through quantitative easing: QE) and historically low interest rates. This twin strategy helped to prevent a worse crisis, but has failed to build sustainable recovery. What it has delivered is a big bonanza for those already at the top end of the distribution.

One of the most significant effects of QE – which has pumped £375bn into the economy - has been to boost the value of assets, from equities to property. As the Bank of England has shown, the policy is 'heavily skewed with the top 5% holding 40% of these assets`.[19] According to one estimate, top wealth holders have reaped an average (unearned and mostly untaxed) £215,000 windfall.[19] Between 2008/10 and 2012/14, the increase in aggregate personal wealth was of disproportionate benefit to the already wealthy: the wealth enjoyed by the top fifth as a ratio of the bottom fifth rose from 92 to 117 over this period.[20]

The housing divide has also grown sharply since 2008. While tenants have faced substantial hikes in rents, mortgage holders have gained some <u>£25 billion a year</u> since 2009 from interest rate cuts.[21] The

inevitable house price boom from wider economic and housing policy has boosted wealth holdings of owners entirely at the expense of tenants who are facing an ever tougher barrier to buy. Britain's ever higher house prices are a mechanism for transferring wealth: from tenants to owners, from the young to the old and from the poor to the rich.

Tax and benefit reforms since 2010 have also been entirely regressive. The cost of tax changes (such as the raising of the higher rate tax threshold and cuts in capital gains and corporation tax rates) has been more or less the same as the savings from successive rounds of benefit cuts, thus offering no contribution to cutting the deficit. As a study by the London School of Economics has shown, the tax cuts – which have been of greatest benefit to the most affluent – have been paid for by the poorest 25%, concentrated amongst those of working age, a direct state-designed upward transfer of income.[22]

What is at work is a significant shift in the protective role of the state, involving a substantial weakening in the safety net for the poorest and a degree of upward redistribution while wider economic and social policies have disproportionately benefited those at the top. The net effect has been to boost top wealth holdings, make the social security system less generous and more punitive, leading to cuts in the incomes of the poorest, and greatly weaken housing opportunities. The dominance of austerity economics (with its highly deflationary bias) has not only contributed to sluggish growth – to what Christine Lagarde, the head of the IMF has called 'the new mediocre` - but has greatly weakened the capacity of the state to tackle social recession.
Government policy has loaded the dice further against the weakest groups in society. Most modern economic trends, from the impact of new technology to globalisation, have a built-in tendency to accentuate inequality. If government abdicates its responsibility to counteract such trends, the income and wealth gap will grow ever wider. As the Institute of Fiscal Studies is predicting, relative child poverty is likely to rise sharply between 2015 and 2020.[23]

Inequality and the economy

Based on the established orthodoxy, that there is a trade-off between inequality and efficiency (you can have more equality or more efficiency, but not both), many of these policies have been justified in the name of boosting the economy. But the evidence is now overwhelming: that above a certain limit, one breached over the last two decades, income polarisation leads to more fragile economies that

are more prone to crisis.[24] There is now a considerable body of work to show that inequality was a significant contributory factor in the 2008 Crash, which helped to deepen the recession and delay recovery, and is now making the national and global economy much more prone to crisis.

The evidence is that the post-1980 experiment in deregulated, unequal capitalism has not only brought much greater inequality, but has failed to deliver the promised pay-off of a bigger cake and a more robust economy. As a highly influential study by the IMF has found: 'Lower net inequality is robustly correlated with faster and more durable growth.'[25]

A cross-national study by the OECD has come to a similar conclusion: in the two decades up to the Great Recession, 'In Italy, the United Kingdom and the United States, the cumulative growth rate would have been six to nine percentage points higher had income disparities not widened... On the other hand, greater equality helped increase GDP per capita in Spain, France and Ireland prior to the crisis.' [26]
The Geneva-based International Labour Organisation (ILO) has shown that nearly all large economies – including the UK and the US – are 'wage-led' not 'profit-led'. That is, they experience slower growth when an excessive share of output is colonised by profits, with less going in wages.[27]

There are several reasons why inequality leads to damaging economic consequences. Firstly, high levels of inequality cut the level of wage-based demand and stifle purchasing power: consumer societies simply lose the capacity to consume. This is because the rise in inequality has been heavily driven by the fall in the share of output accruing to wages, and a rise in the share going to profit.[28] In the UK the fall in the wage share since 1980 is the equivalent of some 5-6% of output.[29] The structural rise in the return to capital at the expense of the workforce has led to what *Guy Ryder, director general* of the ILO, has called a 'dangerous gap between profits and people'[30]

Secondly, despite the predictions of pro-market theorists, the growth in profits (the counterpart of the falling relative wage pool) has not been associated with improvements to productivity and innovation. With the exception of the economically powerful US, innovation rates have been higher in more equal than in less equal, countries.[31] In the UK, higher profits since the 1980s have been associated with a steady decline in investment as a share of GDP.[32] Investment in manufacturing has fallen to barely a trickle. By making labour increasingly cheap, long term wage contraction in the UK has reduced

the incentive for firms to invest to become more productive, helping to steer the UK into today's low value-added, low-skilled economy, highly indebted and low productivity economy.

The lack of investment has also added to the weakness of demand induced by wage compression. Demand deficiency has made the economy increasingly dependent on artificial stimulants, including rising indebtedness. 'Let them eat credit` is how Mark Carney, the Governor of the Bank of England, has described the economy's growing reliance on debt, a level which proved unsustainable in 2008, yet is rising to dangerous levels again.[33] Household unsecured debt (consumer borrowing on credit cards, loans and overdrafts) as a share of disposable income peaked in 2008, fell during the downturn years, but is now rising sharply again.[34]

Thirdly, high levels of inequality create a number of other economic distortions that exacerbate instability. One of the key effects of corporate strategy over the last three decades has been a surge in financial surpluses. Instead of boosting investment, these surpluses – corporate and private, and increasingly held offshore - have created a mountain of footloose global capital that has been used in ways that amplify the risk of financial crisis. The world economy was awash with spare capital in the build-up to 2008, a product of corporate and private accumulation that continued to gather pace through the crisis years.

The record on pay since 2008 contrasts sharply with the underlying financial strength of big business in the UK and across the globe. Corporate cash surpluses amongst non-financial UK large companies, already at record levels before the recession, rose by more than a third between 2007 and 2013, and now stand at $US181bn. This is triple the aggregate surplus held in 2000. Corporate surpluses in the US are even higher, with ten of America's largest corporations, from Microsoft to Google - holding a massive $1.7 trillion at the end of 2015.[35]

These growing corporate cash surpluses have been driven by the long shift in the distribution of national income in favour of profits by wider cost-cutting, a rise in tax engineering and an ability to make higher returns other than through investment. Wage compression and cash expansion are not just bad news for the labour force. Since 2008, they have been a key source of sluggish growth: 'dead money' as Mark Carney has called them.[36] As *The Economist* magazine has noted, the 'fruits of economic growth are being hoarded`.[37]

It is no coincidence that the two nations with the largest corporate cash surpluses, the US and the UK, are also characterised by low pay and insecurity. When they are released, these surpluses tend to be used for financial restructuring— from share buy -backs to grandiose acquisition schemes —that deliver large, short term, windfall gains for those masterminding the deals, but which do little to strengthen the productive base.

A growing proportion of business activity, big business deals and accountancy practices in the UK – from financial and property speculation to private equity led mergers – has been associated less with the creation of new products, companies and jobs than the upward extraction of existing wealth. Today's business and financial elite have used their growing economic muscle to colonise a larger share of the national and global cake for themselves, a process known as 'rent-seeking'. Wealth accumulation has become increasingly decoupled from productive activity which can benefit society more widely, while much of the activity which creates big fortunes has contributed to the crisis-ridden nature of modern capitalism.

Conclusion

The lessons of the last eight years are clear. The fundamental problems of the pre-crash economy are still in place: excessive inequality; over-dependence on debt to maintain demand; persistently weak capital spending; a dismal record on productivity; stagnant real wages and unaffordable housing.

The monetary medicine used to heal economies after the 2008 Crash with quantitative easing and low interest rates have not only helped further economic meltdown, but it has failed to tackle the underlying fault-lines, which widened the inequality gap. With the financial system largely unreformed, the economy remains vulnerable to another financial crisis.

With the UK and much of the global economy running out of steam, policy makers are, as *The Economist* has warned, 'out of ammo`.[38] The pro-rich and anti-poor policies of recent years have added to economic weakness.

That the UK model of pro-inequality, corporate capitalism has been a failure, not least on its greatly flawed record on growth, but is now being ever more widely accepted. In another of several U-turn, even the IMF, once the leading cheerleader for the neo-liberal experiment, now admits that 'neo-liberalism was oversold`.[39]

Creating a sustainable and more resilient economy and more equal society requires fundamental changes and a very different economic model. This requires an alternative, progressive set of instruments aimed at boosting demand and investment, and encouraging real entrepreneurship, which will simultaneously help tackle inequality and build a more robust productive base. This means a range of policy shifts that involves a shift in emphasis towards fiscal policy and a more central role for state investment (via a state investment bank). Even the once pro-austerity OECD is calling for fiscal stimulus and higher public investment that involve new forms of credit control that make the financial system work for the economy rather than financiers; policies that tackle the excessive power enjoyed by big corporations through polices that spread power more evenly between big business, the workforce and small companies, and, crucially, between profits and wages. This policy mix needs to be reinforced by measures that secure the greater socialisation of the economy- through the creation of social wealth funds - to secure higher levels of investment and the greater sharing of the proceeds of economic activity. Tackling the next recession when it comes, as it will, will require a more directed monetary policy, through the careful and targeted use of 'helicopter money` aimed at directing cash directly into the economy via consumers and public investment. [40]

This package of change would ultimately build a more robust and resilient economic base, help restore the progressive role of government and ensure that the dice is less heavily loaded in favour of a small, rich and affluent elite.

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