Poverty, inequality and extractive capitalism

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Are poverty and inequality separate issues determined by different factors? Can low levels of poverty co-exist with high levels of inequality? The answers to these questions are critical to the anti-poverty agenda. For most of the last 200 years, these key measures of social fragility have been viewed as separate conditions, with anti-poverty policy focussed on raising the income floor, largely ignoring what has been happening at the top.

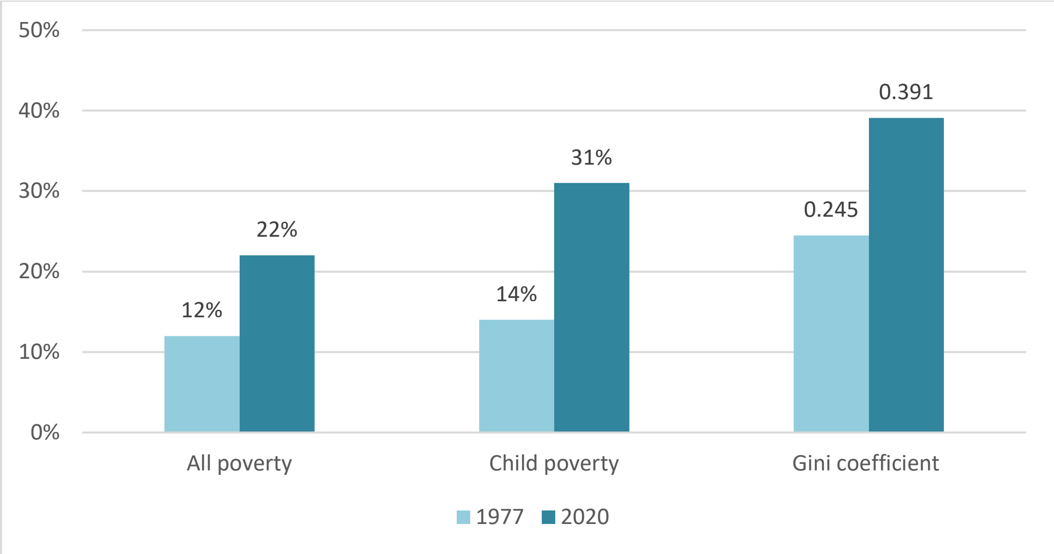
Britain's high inequality, high poverty cycle

Since the birth of industrial capitalism, rates of (relative) poverty and inequality have moved in line, creating a 200-year long inequality, poverty cycle. Just as your chance of being in poverty depends on where you are born - by country and region - the risk of being poor in the UK has been an accident of timing.

There have been three waves to this cycle. The first – an extreme inequality, high poverty wave - lasted close to a century and a half, only finally drawing to an end with the outbreak of war in 1939. There then followed a more forgiving wave, one that saw a narrowing of Britain's yawning divide and a fall in poverty down to an historic low. The breaking of this cycle was in part the product of the impact of war, but also the result of egalitarian thinkers finally winning the long battle of ideas. The multiple reforms from 1945 contributed to the historic achievement, in the late 1970s, of both peak equality and a low point for poverty.

While this egalitarian high water mark was a seminal moment in social history it was short-lived. Over the next 45 years, the gap in income, wealth and opportunities widened sharply while poverty levels surged (chart 1).When it comes to equality, the 1970s is the best Britain has been able to achieve. This period – the 'great narrowing' - then gave way to a second prolonged wave of high inequality and poverty that has so far lasted around four decades, and shows no sign of abating[1].

Chart 1: Trends in poverty and inequality, 1977-2020



Poverty is relative poverty (measured as the proportion of individuals in households falling below 60% of median net household income) after housing costs.

The Gini coefficient is a summary measure of inequality where 0 is complete equality and 1 complete inequality.

The two high inequality, high poverty waves have a number of features in common, if at different levels of intensity. In both periods, poverty has effectively been normalised – something we have to live with, while inequality has been seen as natural and necessary for economic dynamism. In both periods, the political response to high levels of deprivation and social scarcity has been more anti-poor than anti-poverty.

Over the last 40 years, governments have largely ignored the way new economic and social shocks have impoverished large sections of society. During the 1980s, Mrs Thatcher banned ministers and officials from using the 'poverty' word, while the 'blame-the-poor` philosophy of the nineteenth century has gradually returned. Since 2010, ministers have claimed, poverty has had little to do with a lack of decently paid, secure jobs, deteriorating housing opportunities, rising insecurity and a mean and patchy benefit system, but has been largely self-inflicted, thus conveniently absolving the state from responsibility to tackle it. For claimants, the emphasis has been on shaming and coercion. In the middle years of that decade, more than 5 million state sanctions, or fines, were imposed on benefit claimants[2]. Parts of the media have led a sustained campaign against the benefit system and those who depend on it. The food poverty debate, claimed *The Daily Mail,* is 'fuelled by questionable and inflammatory statistics`[3]. In many ways anti-poverty policy today is shaped more by the principles of the nineteenth century Poor Law than those of universalism and entitlement at the heart of the post-war reforms.

While the business cycle, a pattern of economic expansion and contraction has tended to last for periods of around a decade, the high inequality-poverty cycle has proved much more enduring. Unlike the 'boom and bust' cycle which is common to most economic systems, the inequality-poverty cycle is neither natural, nor universal. It is an artifact determined by the pattern and distribution of the structures of power.

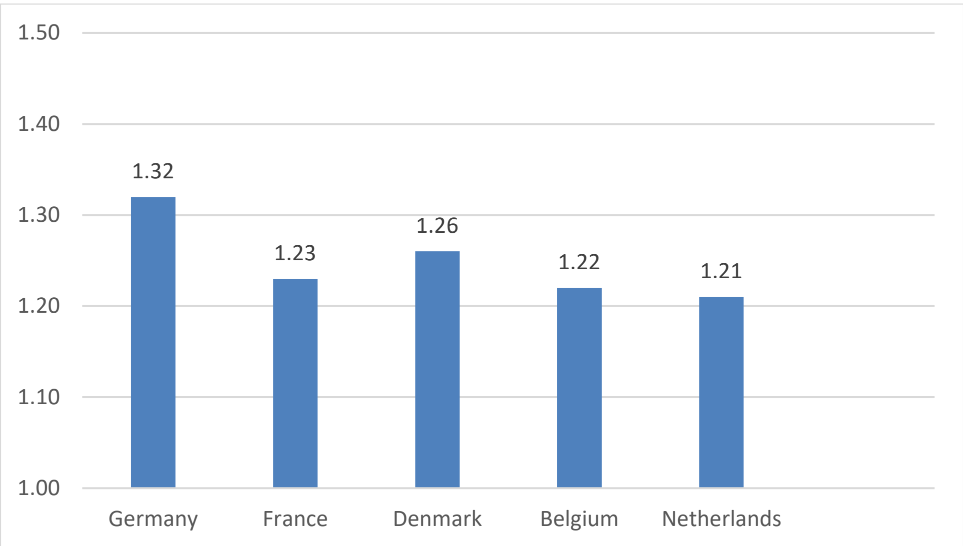
Levels of poverty and inequality are ultimately rooted in the way the 'distribution question` - of how the 'cake is cut` - is resolved. As the Swedish economist Per Molander has put it, 'Without an active distribution policy, society moves relentlessly toward the inequality limit [where a small group control the entire economic surplus].' [4] How the cake is shared has been the outcome of the political and economic power games that play out in company boardrooms, plush City offices and the corridors of Whitehall, and in the extent of popular resistance. In recent decades, as in the period up to 1939, these factors have worked in favour of an over-empowered financial and corporate elite, often with the compliance of the state, a plutocracy that has been unwilling to acquiesce to anything other than a token erosion of its muscle, privileges and wealth. Apart from the post-1945 decades, a significant section of society has had to make do with the proportion of the proceeds of economic activity consistent with the needs of capital and wider political expediency and the self-interest of the wealthiest classes.

Britain has allowed an in- built political and economic bias to inequality. Governments have presided over an increasingly limited degree of social protection, with many of the costs of social and economic change steadily transferred from the state and corporate sector to individuals. The costs of upheaval, often severe, and however necessary for economic progress, have been born most heavily by the weakest members of society, a group which also ends up with a limited share of the subsequent gains. The winners from the industrial revolution were a small group of plutocrats who used their political and economic power to seize an excessive share of the undoubted gains from industrialisation. The same story has been repeated time and again. The Great Crash of 1929 and the state's response wrought years of havoc and intractable poverty across industrial Britain. The fall-out from the rolling shocks of the past four decades – rapid deindustrialisation, globalisation, the 2008 financial crisis, austerity and now Brexit – have, as in the pre-1939 era, been unevenly born in a way that has deepened existing divisions.

This process has been fuelled by the way those who have had the biggest influence on the course of economic and social history – the political classes, business elites, and mainstream thinkers - have mostly taken the view that poverty is a standalone issue, quite separate from the way the gains from economic and social progress are shared. They have simply dismissed or ignored the link between inequality and poverty.

The impact of inequality can be seen by comparing the incomes of the poorest across countries in roughly similar economic positions. The poorest fifth of Britons are today much poorer than their counterparts in other, more equal nations (chart 2). Germany's poorest, for example, are a third better off than those in Britain.

Chart 2: Ratio of average incomes of poorest fifth compared with Britain, 2018, Britain=1



Calculated from OECD, *Better Life Index*, 2018. Incomes across countries have been adjusted to allow for differences in purchasing power.

Extractive capitalism

At the heart of the high inequality/poverty cycle has been a process of 'economic extraction`. Such extraction occurs when a small elite of capital owners has been able to use its power to secure an excessive slice of the economic cake using business practices that have reverberated across society, affecting wages, working conditions, livelihoods, and community resilience.

These leveraged gains have been the primary source of the immense personal fortunes accumulated during the last 200 years. During the Victorian age, a 'collective monopoly power' ensured that the gains from rapid industrialisation were colonised by landowners and the new financial and merchant classes. This 'power` was used to keep wages low, rents high and to prevent state intervention to provide a more even sharing of the expanding cake. The dangers of extraction were recognised by the leading classical economists of the time. The patron saint of economics, Adam Smith, in his immensely influential 1776 work *The Wealth of Nations,* warned that scarcity and the private ownership of land enabled landlords 'to reap where they never sowed, and demand a rent even for its natural produce.' Another leading economist, David Ricardo, - a landlord himself - was highly critical of the surplus 'rent' over and above productive effort – 'money for nothing' - demanded by landlords.[5]

Extractive activity was widespread during the industrial revolution, notably through the treatment of the workforce, became less prevalent post-1945, but then returned in multiple forms from the closing decades of the twentieth century. Such extraction, a kind of private tax on the industry of others, reduces the resources available for wages, investment and innovation. In the nineteenth century, critics drew a clear distinction between productive and unproductive activity. The critic of orthodox economics, J.A. Hobson, distinguished between 'property' and 'improperty', while the historian and social reformer RH Tawney called assets used simply to extract payments from others, and not to perform a positive role, 'property without function'.[6]

Gradually, ever more sophisticated, obscure and unproductive methods were invented by business leaders to build excessive returns, not through innovation and competitive edge but by market manipulation, without the risks of traditional entrepreneurialism. The American economist Thorstein Veblen described these new extractive devices as market 'sabotage'.

Such extractive devises have become an enduring feature of some models of capitalism, with significant consequences for both wider life chances and economic strength. Although other factors have been at work, from the greater global mobility of capital and labour to the impact of new technology in industry, extraction has been a primary source of today's deep-seated inequality bias and spreading impoverishment.

Contemporary examples of extraction - which reduce the resources available for wages, investment and innovation - include the rigging of financial markets, the manipulation of corporate balance sheets and the skimming of returns from financial transactions, a process City traders like to call 'the croupier's take'. Under extraction, the boost to profitability and rising corporate surpluses of recent times have been used to reward executives and investors rather than boost corporate durability and productivity. FTSE 100 companies generated net profits of £551 billion and returned £442 billion of this to shareholders in the four years from 2014, leaving much less for wages and private investment.

Far from delivering the promised market revolution, the consolidation of power amongst City financiers and corporate bosses has driven a rise in market concentration through monopolistic and anti-competitive behaviour. Large parts of the economy are both narrowly owned and controlled by a handful of companies through variations on Veblen's 'market sabotage`. It has been the often ruthless destruction of rivals that has given the mostly young, geek tech founders membership of the global multi-billionaire 'three commas' club. Google has bought 234 companies, while Facebook built what founder Mark Zuckerberg called a 'moat around itself' through the acquisition of competitors. While the big supermarkets have huge power over small suppliers and farmers, Amazon exerts immense muscle over authors, publishers and independent bookshops.

The post-millennium boom in private equity takeovers of public companies (registered on the stock market), from the AA to Morrisons, has brought outsized returns at the expense of the long term viability of companies. Many retail names - from Top Shop to Debenhams – used as cash cows for their takeover owners, have failed to survive the asset extraction involved. Today many key public services, including adult and child care and fostering, once carried out mostly by public agencies, are run by private equity companies whose owners demand excessive returns that squeeze the quality of service provided.

A problem of riches

In a return to a version, if weaker, of the broad social and economic philosophy of the Victorian era with its extreme gaps between top and bottom, the post-1980s saw the launch of a largely state-initiated experiment in high inequality capitalism. This move was driven by an ideology promoted by a small group of small-state, pro-market New Right thinkers who claimed that Britain's egalitarianism had gone too far. For them, poverty was an essentially absolute condition and an individualist rather than a structural problem, while a rise in rewards at the top along with wider differentials and higher profits were seen as necessary conditions for faster economic progress. As Sir Keith Joseph, a key adviser to Mrs Thatcher, put it, bluntly, in 1976. 'The pursuit of income equality will turn this country into a totalitarian slum.'[7]

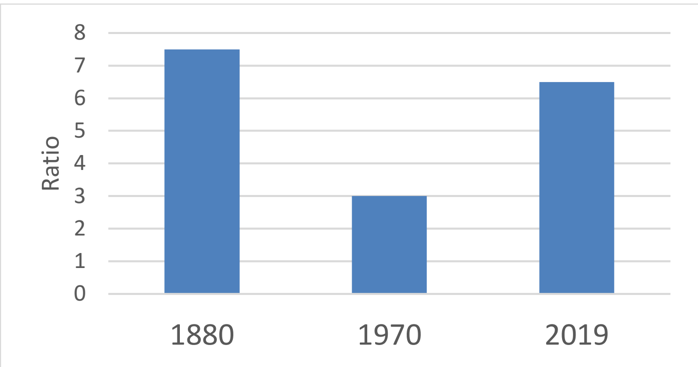
This claim got a considerable boost from the mainstream American economist Arthur Okun who argued that, whatever the morality of a widening gap, you could have more equality or a bigger cake but not both.[8] This 'equity-efficiency trade-off' theory became a key tenet of mainstream economic thinking. It has been taught in universities and business schools, promoted in boardrooms and parts of Whitehall and enacted by political leaders, with the distribution question marginalised in state policy making. 'Of the tendencies that are harmful to sound economics', wrote Robert E. Lucas, the Chicago-based economist and one of the high priests of the post-1980s pro-market revolution in 2003, 'the most poisonous is to focus on questions of distribution.'[9]

All societies need to justify their inequalities, and a long line of social reformers have challenged the trade-off theory. For them tackling poverty requires tackling inequality, with the process of fortune accumulation at the top too often coming at the expense of wider living standards and opportunities. As the prominent social thinker, art critic and philanthropist John Ruskin argued in 1860, 'The art of making yourself rich is equally and necessarily the art of keeping your neighbour poor'.[10] The student of poverty needs to start 'much higher up the stream than the point he wishes to reach' declared the eminent historian and egalitarian R.H. Tawney in 1913: 'What thoughtful people call the problem of poverty, thoughtful poor people call with equal justice, a problem of riches'.[11]

We now have the evidence of the real-life experiment in inequality. This shows that the pro-inequality doctrine has turned out to be a classic case of what the seventeenth-century philosopher Francis Bacon called 'wishful science'. Instead of the promised economic renaissance, Britain – along with a number of other, mostly Anglophone nations wedded to the 1980s' political counter-revolution – the widening gap has delivered a second 'gilded age` for the few, but via a destructive trail of greater economic turbulence and social fragility while contributing to Britain's low-growth, low-productivity, low-wage economy, and a further upward twist in the long high poverty, high inequality cycle.[11] Ruskin and Tawney have been proved right and Joseph and Lucas wrong.

UK private wealth holdings are worth around £15 trillion, nearly seven times the size of the economy, up from three times half a century ago, and close to the ratio of the late Victorian years (chart 3) . These holdings are much more heavily concentrated at the top than in the case of incomes and are a primary driver of today's institutionalised inequality.[12] This is because the considerable returns from ownership (through profits, rents and dividends) accrue disproportionately to the already rich. One of the best summary measures of inequality - the Palma ratio - stands at around 10 for wealth, with the top tenth holding a remarkable ten times more wealth in aggregate than the bottom 40 per cent.[13] As with incomes, it is difficult to see how this level of concentration can be justified, economically, ethically or socially.

Chart 3: Private wealth as share of the economy



Source: F. Alvarado, L. Chancel, T. Piketty, E. Saez and G. Zucman, *The World Inequality Report, 2018*, World Inequality Lab, 2018, fig E6.

Many indicators of progress have gone into reverse, creating a society where extreme affluence sits alongside severe social scarcity. Modern Britain hosts more food banks than branches of Greggs. The long rise in life expectancy has stalled over the last decade and has been falling in some deprived communities.[14] Political alienation has soared, with a rising gap between the electoral turnout of the richest and poorest groups.[15] The 1970s' dictum from the influential economist Fred

Hirsch that 'So long as material privation is widespread, conquest of material scarcity is the dominant concern' has been discarded.[17]

An important implication of the growing concentration of wealth and income at the top has been the return of a form of luxury capitalism - similar to that of the late nineteenth century – with the pattern of economic activity skewed in favour of the demands of an increasingly sybaritic super- rich class.[18] Scarce resources have been used for grand fortress developments, super-yachts, more private airports and even mini-submarines. The withdrawal of the state from meeting housing need and the narrow market interests of a highly profitable housebuilding industry have squeezed housing opportunities, especially for the young. In London and other conurbations, scarce land, that could have been used to tackle a growing housing crisis, has been used to build a mass of expensive and exclusive houses and flats, many, including those in super-prime areas of London and other urban areas, bought for speculative purposes by the global super-rich and left empty for most of the year.

While Britain has badly under-invested in children's services, in young adult training and in social care, one in three new cars bought in inner London in 2020 were SUVs, one of the largest contributors to the rise in global carbon emissions. Luxury capitalism is a principal driver of global warming. **The richest tenth of the global population emitted 48% - and the top 1% 17% - of all global emissions in 2019, while the poorest half of the global population emitted 12%.[19]** A tenth of all flights from France in 2019 were on private jets. The superyacht is one of highest polluting assets, while Jeff Bezos's 11-minute space flight was 'responsible for more carbon per passenger than the lifetime emissions of any one of the world's poorest billion people'.[20]

There have been a long stream of warnings of the dangers of the special privileges and entitlements demanded by elite classes. Adam Smith warned of the consequences of the love of quick money by 'the prodigals'.[21] In 1900, the *New York Post* issued a stark warning of the impact of the heavy concentration of wealth, and the immense power that came with it. 'Discontented multimillionaires', the newspaper editorial argued, form the 'greatest risk' to 'every republic'. They are, it continued, 'very rarely, if ever, content with a position of equality`.

The pioneers of economics also drew an important distinction between wealth *creation* that can contribute to the common good, and wealth *extraction* that merely serves the interests of a powerful few at the expense of weaker members of society. 'The efforts of men are utilized in two different ways', declared the influential Italian economist Wilfredo Pareto in 1896. 'They are directed to the production or transformation of economic goods, or else to the appropriation of goods produced by others.'[22] Such 'appropriation' or 'extraction` benefits those who 'have' rather than 'do', and can also 'crowd out` more productive activity that offers greater social value.

The key lesson from the post-war years was the construction of a set of new pro-equality measures. These included a free health system, a firmer income floor, universal family allowances (later child benefit), a progressive tax system that bore most heavily on those with the broadest shoulders, and a new, if shallow, pact with business to accept greater social responsibility and more moderate personal rewards. That Britain stands at the summit of global inequality tables is the product of the gradual weakening of these measures, the erosion of consensus and the tearing up of the business pact.

To reverse the trends of the last four decades, the egalitarian goals of post-1945 need to be re-embraced with a set of pro-equality measures for modern times that raise the income and wealth floor but also lower the ceiling. A more generous and secure basic income [i]financed by a more progressive tax system along with the steady rebuilding of the social state would help raise the floor, while reforms to tackle widespread corporate appropriation and financial extraction would help strengthen the economy for all while lowering the ceiling. To narrow the wealth gap, part of Britain's towering private wealth mountain –much of it unearned - should be harnessed for the common good, with all given a stake in economic progress through a citizen's owned wealth fund. In this, the 80th anniversary of William Beveridge's 1942 blueprint for social reform, breaking the intertwined poverty and inequality cycle should be a central test of the growing calls for a better society.

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