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## CAPITALISM AND DEMOCRACY AT CROSS-PURPOSES

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Mainstream politicians and mainstream economists in Anglophone countries have been very relaxed about people becoming “filthy rich”, as though a structure of income distribution with high concentration at the top has no society-wide costs. In the words of University of Chicago professor of economics and Nobel Prize winner Robert Lucas, “[O]f the tendencies that are harmful to sound economics, the most seductive and ... poisonous is to focus on questions of distribution”.<sup>1</sup> In the words of Willem Buiter, former professor of economics at the London School of Economics and currently chief economist of Citigroup, “Poverty bothers me. Inequality does not. I just don’t care”.<sup>2</sup>

This essay begins by describing the neoliberal thinking that sanctions a relaxed attitude to income inequality; next it describes why the discipline of economics has failed to provide a critical focus on income inequality; and then it summarizes evidence on the society-wide costs of inequality, especially the underemphasised political costs. The essay ends with some basic points for a center-left strategy of reform.

The central argument is that neoliberal thinking has helped to produce a rising degree of income concentration at the top both directly and indirectly through its contribution to the transformation of the Anglophone state into a “plutocratic” state. The plutocratic state has a structure of laws and policy settings which, net, channels income upwards, even as some parts of the residual welfare state counter these tendencies by channelling income and services downwards. The combination of high-inequality capitalism and a plutocratic state undermines the democratic political system.

### *Neoliberalism*

People born in western countries before the 1960s came to maturity during the post-war consensus around ideas of social planning and welfarism (University of Chicago economics department and a few others excepted). Governments followed full employment strategies, unions were strong, and governments believed that rising wages

<sup>1</sup> Robert Lucas, 2004, “The industrial revolution: past and future”, Annual report Essay 2003, Federal Reserve Bank of Minneapolis, May 1.

<sup>2</sup> Willem Buiter, 2007, “Economists forum”, Financial Times, February 14.

and job security were good for capitalism. Since the 1980s that consensus has been thoroughly displaced by another known as “neoliberalism”, especially in the Anglo countries and in international organizations those states control, including the World Bank, the IMF, and the Organization for Economic Cooperation and Development (OECD).<sup>3</sup>

There are many strands of neoliberalism, but they share the core idea that “the (private) market” is the best mechanism for meeting human aspirations, and better, in particular, than “the state”, which is inefficient and a constraint on freedom, though necessary for certain limited purposes like national defence and law and order.

This is how neoliberalism is generally presented. But the presentation actually conceals what neoliberalism is about. “The market” is the polite way of referring to “the owners and managers of capital, especially financial capital”. To say that “the market” is the best mechanism for meeting human aspirations is to say that the state and public policy should reflect what the owners and managers of capital want – “should reflect” because their preferences for state institutions and policies will benefit the whole society more than the preferences of other categories (workers organized in trade unions, for example). This is the sentiment behind slogans such as “a rising tide lifts all boats”, and “what is good for General Motors, and Goldman Sachs, is good for you and me”.

Alan Budd, Special Advisor at the UK Treasury in 1979-81, explained how the Thatcher government sought to create such a neoliberal structure in Britain by first creating mass unemployment, disguising the strategy as an anti-inflation strategy. Interviewed in 1991 he said, “The nightmare I sometimes have ... is that there may have been people making the actual policy decisions, or people behind them, or people behind them, who never believed for a moment that this was the correct way to bring down inflation. *They did, however, see that it would be a very, very good way to raise unemployment, and raising unemployment was an extremely desirable way of reducing the strength of the working classes....* What was engineered there in Marxist terms was a crisis of capitalism which re-created a reserve army of labour and has allowed the capitalists to make high profits ever since”.<sup>4</sup> He said this a month after Tory Chancellor Norman Lamont stated in parliament (6 May 1991), “Rising unemployment and the recession have been the price that we have had to pay to get inflation down. That price is well worth paying”. In fact, the rate of retail price inflation when Mrs Thatcher left

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<sup>3</sup> Robert Wade, “From global imbalances to global reorganizations”, *Cambridge J. Economics*, 33, 4, July 2009: 539-62; “Reflections: Robert Wade on the global financial crisis”, *Development and Change*, 40, 6, 2009, 1153-90; Wade, “The state of the World Bank”, *Challenge*, 53, 4, July/August 2010; J. Vestergaard, and R. Wade, (2012). The new Global Economic Council: governance reform at the G20, the IMF and the World Bank. *Global Policy*, 3 (3): 57-69; J. Vestergaard and R. Wade (2013). Protecting Power: how Western states retain their dominant voice in the World Bank’s governance reforms. *World Development*, 46: 153-164.

<sup>4</sup> Alan Budd, interviewed by Adam Curtis, June 1991, <http://cheltenham-gloucesteragainstcuts.org/2013/04/09/former-thatcher-adviser-alan-budd-spills-the-beans-on-the-use-of-unemployment-to-weaken-the-working-class-sound-familiar/>. Emphasis added.

office in November 1990 was identical to the rate when she took office in May 1979, at 9.2%, while the share of income accruing to the top few percentiles of the population had greatly increased.

The neoliberal microeconomic formula prescribes:

- low tax rates on high incomes and capital gains, so as to incentivize value creation – and hence generate economic growth and employment;
- low state benefits to people on low incomes, so as to incentivize job search, training and hard work;
- profit-seeking private firms or charities (not publicly-owned agencies) for supplying goods and services, which translates into the imperative to privatize and outsource government services to the maximum extent possible;
- employment on short-term contracts, linked to performance targets and regular monitoring – because a highly “flexible” labor market is a mark of an economy’s strength (and not at all to be described as Marx’s “reserve army of labor”);
- employment on short-term task-related contracts is especially important in the public sector, where the efficiency-inducing discipline of private profit-seeking competition is lacking;
- freedom for savings and loans, or building societies, to become consumed by national or multinational banks with no regional roots.

The paradox is that this agenda is particularly favored by political parties which describe themselves as “conservative”, yet have little interest in conserving institutions which block opportunities for private profit-making. The reconciliation is effected by claiming that when applied comprehensively, neoliberalism produces more prosperous and more moral societies, composed of adults who are self-reliant, hard-working, and law-abiding citizens, and children who follow rules set by their strict fathers – or more so than societies with more state and less market.<sup>5</sup>

Contrary to the pattern in earlier bouts of hard times, elites in western countries have even strengthened their commitment to neoliberalism since the global financial crisis of 2008 and subsequent long slump. Neoliberalism supports the macroeconomic agenda known as “expansionary austerity” or “fiscal consolidation” applied through much of the western world and now increasingly in developing countries too (amplifying recessionary and unequalizing tendencies on a world scale). It rests on the claim that fiscal contraction at a time of recession (mainly through public spending cuts) will *boost* economic growth; or conversely, that above a certain threshold (generally believed to be around 90%) further increase in the amount of public debt to GDP will stunt growth. E.U. policy makers and central bankers have been particularly zealous in insisting that there is

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<sup>5</sup> George Lakoff, *Moral Politics: How Liberals and Conservatives Think*, 2<sup>nd</sup> edition, 2002, University of Chicago Press.

no alternative to public spending cuts and shrinking the state, however unpalatable that may be. “Growth is the key to getting out of the crisis, we all agree on that”, said Jens Weidmann, head of the German central bank recently. “But renouncing budget consolidation will not bring us closer to that objective”.<sup>6</sup>

A simple – and no doubt simplistic – way to see the fallacies of a lot of neoliberal economic thinking is to consider the situation where 100 dogs are ushered into a room in which 95 bones have been hidden. The macro (or Keynesian) problem is that there are not enough bones for the dogs; five must go without. But neoliberals reduce it to microeconomics and morality. Neoliberals of the compassionate conservative kind say: the problem is that the five dogs lack hunting skills, they must be sent to bone-hunting school, the state may even subsidize their education. Neoliberals of the normal conservative kind say: the five dogs are lazy, they must be incentivized by withdrawing their income support (as in Norman Tebbit’s “get on your bike and look for work”).<sup>7</sup>

Meanwhile, the western finance industry has effectively blocked government efforts to strengthen financial regulation (which could moderate neoliberalism). Banking is the most heavily subsidized industry in the world, by far, especially through the invisible subsidy of an implicit guarantee that if one of them collapses the relevant taxpayers will save it – which allows the banks to take bigger financial risks than otherwise, grow bigger than otherwise, and become too big to fail – or jail, or manage effectively. The balance sheet of one British-based bank, Barclays, is bigger than Britain’s entire GDP. Andy Haldane of the Bank of England calculated the taxpayer subsidy to the world’s largest banks at \$70 bn every year between 2002 and 2007, the subsidy accounting for roughly half the average post-tax profits enjoyed by these banks over that period.

On top of the subsidies, governments authorize big tax advantages to the use of debt financing, as compared with equity financing, even as they complain that the economy is handicapped by too much debt and too little equity. The tax advantages of debt boost the demand for debt, and hence bank profits. And the tax advantages of debt mean that multinational companies like Google keep their profits in low-tax jurisdictions and *borrow* to pay out dividends rather than repatriate profits (on which they would pay tax); so squeezing western tax bases.

Understandably the industry is doing everything it can to protect these built-in advantages, including all possible lobbying of governments against efforts to make the banks safer. Robert Rubin, the Democratic kingmaker on Wall Street and Treasury Secretary under Bill Clinton, recently gave a remarkable defence of having some banks which are too big to fail. Asked by an interviewer whether he thought that “too big to fail” was a problem, Rubin replied “No, don’t you see? Too big to fail isn’t a problem

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<sup>6</sup> Quoted in Paul Taylor, “The policy that can’t be named”, *International Herald Tribune*, May 28, 2013, 22.

<sup>7</sup> Tebbit became famous or notorious for this remark, but it is a statement of what he implied rather than what he said (while a minister in Mrs. Thatcher’s government, 1981).

with the system. It *is* the system. You can't be a competitive financial institution serving global corporations of scale without having a certain scale yourself. The bigger the multinationals get, the bigger financial institutions will have to get".<sup>8</sup> In other words, the system requires that the biggest private banks are propped up regardless of their performance.

Separately from finance industry lobbying, governments have recently taken the initiative to scale down their financial regulatory efforts in the hope that this will encourage the banks to lend more to households, that households will increase consumption, and that consumption will again boost economic growth -- and improve governments' re-election prospects.

The upshot is that the effort at a Great-Re-regulation in the wake of the Crash has become, instead, the Great Escape. The sprawling Dodd-Frank Act in the US has generated endless rule rewriting by regulators, leaving holes big enough to drive a coach and horses through. Almost three years into the euro crisis the European Union is still in the early stages of figuring out how it might regulate banks across borders.

More favouritism to the banks comes via the monetary policy known as Quantitative Easing. It is presented to the public as a means of keeping interest rates low to stimulate business investment and the housing market. But it is at least as much about making banks *appear* more solvent or less insolvent. Low interest rates raise the price of debt instruments, and higher prices of debt instruments raise the value of banks' balance sheets. In this way their collapse or radical restructuring is postponed in the hope that they can trade their way out of trouble, at least up to the next election. And while the policy has substantially failed in stimulating investment it has worked to boost the stock market and the housing market – and thereby channel income up towards the top.

Neoliberal ideas have penetrated every nook and cranny of western societies. In British universities they shape operations all the way from undergraduate recruitment to fees to the content of courses to research agendas and to promotions. Not that this is all bad. For example, the periodic programs to evaluate the research output of every British academic and every academic department ( known as the Research Assessment Exercise, RAE, though the current one, whose census date is December 31 2013, is known as the Research Excellence Framework, REF) have helped to break the Oxbridge-dominated old-boys networks and the leisurely academic life style that could earlier be enjoyed. On the other hand, the exercise produces a homogenization of thinking discipline by discipline, because the assessment panels tend to be readily captured by people representing the current orthodoxy, who judge others' research by the standards of that orthodoxy.

Moreover, the intense performance-management justified by neoliberal ideas (and impelled by liability under employment law) produces, in universities, gross

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<sup>8</sup> Quoted in Mike Sharpe, "The corporation and the state against the public", *Challenge*, 55, 3, May/June 2012, 137-141, at 141.

inefficiencies, such as a proliferation of managers and very time-consuming managerial demands on academics; an erosion of intellectual collegiality; and a “bottom line” criterion for measuring the value of courses.

Far from wanting to conserve the BBC as a landmark of Britishness, ministers in the Conservative Party-led government, and the radical 2010 intake of Tory MPs, want to reduce the BBC to the insignificance of US public broadcasting, seeing it as an affront to the profit-seeking private sector media companies. The government has also been very helpful to private health firms wanting to divert tax-financed revenue flows away from that other landmark of Britishness, the British National Health Service (NHS). The government boosts a narrative of NHS failure (nurses too busy to care for their patients, is one of the perennials) in order to justify privatization, including care for older people. And it downplays recurrent evidence of private firms making over-ambitious bids and under-fulfilling contracts. The biggest company is Serco, whose *modus operandi* includes steep job cuts when it takes over from a local NHS trust, providing false data on its response to emergency calls, and even (according to a current investigation) charging the Ministry of Justice for tagging dead people.

The privatization or “opening up” of public services has fuelled the process of casualization of employment. Local authorities respond to cuts in funding by driving through tighter tenders on outsourced contracts, whose contractors respond by offering employment on “zero hours”, such that employees are tied to the company with no guarantee of work. Agency working, temporary work and enforced part-time working have mushroomed since 2008; nearly half of the jobs created have been temporary, as half a million permanent jobs have been lost. In early August 2013 the Conservative-Liberal Democratic coalition introduced a prohibitive £1,200 fee for anyone going to an employment tribunal to protect their legal rights.<sup>9</sup> The obvious next step in “flexibility” is child labor.

Mainstream media content reinforces the neoliberal bias. Media ownership by profit-maximizing firms (as distinct from firms in the legal category of low-profit, or in cross-subsidizing trusts, as in the case of *The Guardian*) means that content is driven towards crime, sex, celebrity and scandal and towards political and economic commentary in line with the preferences of the owners and managers of capital. The result, in Britain, is that the readership of national newspapers is about 75% for “right-wing” papers and 25% for “not right-wing” (including *Financial Times*). Scarcely an edition in the 75% leaves the presses without a hit against the BBC or the NHS. The British public is surrounded by a fog-horn of right-wing opinion.

New Zealand has been an epicentre of neoliberal ideology since the reforms pushed through by the Labour government’s Finance Minister Roger Douglas after 1984. A story told by a former champion of neoliberal thinking in NZ, now senior policy advisor, illustrates how deeply neoliberalism took hold. He and colleagues were planning the privatisation of air traffic control. One of his colleagues suggested that firms should tender or auction for *each individual landing*. At this point the penny dropped. “We

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<sup>9</sup> Seumus Milne, “In Cameron’s Britain, the dockers’ line-up is back”, *Guardian*, August 7, 2013.

suddenly realised it wasn't very practical”, he said, without joking. Such was the zeitgeist when New Zealand was “a neoliberal model for the world”, and woe betide a New Zealand economist who argued against it.

New Zealand’s current labor law is among the weaker labor laws in OECD countries in terms of protecting and assisting workers, in line with neoliberal precepts. Most workers’ pay is now set unilaterally by the employer; only 9% of private sector workers are covered by a collective bargaining agreement, and about 25% of public sector workers. In the face of weak collective bargaining, labor productivity rose by almost 50% between 1989 and 2011 while the real average hourly wage rose just 14% -- a gap which directly sluiced income up towards the top.

Yet the National Party-led government is now proposing to pass a law weakening labor protection and assistance still more. The draft law gives employers close to carte blanche to apply to the Employment Relations Authority for an order declaring an existing collective bargaining agreement at an end. And it creates a “no rights” period of 60 days thereafter when employers are free to pressure workers to sign individual agreements or to threaten to contract out the work to no-union firms.

This is just what neoliberal economics prescribes, for it sees unions as (a) groups which concentrate on getting a bigger share of the pie for themselves at the expense of making it grow over time, and (b) groups which cause inefficiency of resource allocation. So the right policy is to limit or remove the unions’ ability to exercise their harmful monopoly power; just what the new New Zealand labor law aims to do. This ignores – in line with the tendency of neoliberal economics to justify the preferences of the owners and managers of capital, and ignore structures of power – the effect of weakening unions on income distribution and the balance of power in the political system. Weaker unions allow business lobbying to face less counterweight, which indirectly tips income distribution even more towards the top.<sup>10</sup>

### *Economics*

The discipline of economics might have provided an evidence-based check on the application of neoliberal precepts. However, throughout the West the great majority of university economists teach fairly conventional neoliberal economics.<sup>11</sup> Indeed, they may not even teach much about real-world economies, as distinct from mathematical models. David Colander investigated the views of 231 graduate students at the seven

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<sup>10</sup> Daron Acemoglu and James Robinson, “Economics versus politics: pitfalls of policy advice”, National Bureau of Economic Research working paper 18921, March 2013.

<sup>11</sup> For a case study of what happened when orthodox economists, backed by the university administration, tried – over three decades -- to marginalize or close down the teaching of (left) political economy, despite strong student demand, see Gavan Butler, Evan Jones, Frank Stillwell, *Political Economy Now! The Struggle for Alternative Economics at the University of Sydney*, Sydney University Press, 2009. For neoliberal trends in the sub-discipline of international political economy see Nicola Phillips and Catherine Weaver (eds.), *International Political Economy*, London: Routledge, 2011, including Robert Wade, “Beware what you wish for: lessons for international political economy from the transformation of economics”, 92-104.

top-rated US economics departments, and found that (in the early 2000s) only 9% thought that “a thorough knowledge of the economy” was “very important” for success. Broken down by year of study he found that 15% of first and second year graduate students thought it “very important”, while less than 1% of fourth and fifth year students thought it very important – suggesting that the already low level of interest in real-world economies among the first and second year students had been thoroughly beaten out of them by the fourth and fifth years.<sup>12</sup>

Deep socialization into the mathematically-elegant world view of economics leads economists to see themselves as members of an elite group, superior to other social scientists. As Durkheim’s and Pierre Bordieu’s researches would lead us to expect,<sup>13</sup> neoclassical economists are aware of their dominant position among economists and of the status of economics as queen of the social sciences, and fearful of abandoning the “normal” conceptual and normative ideas of the paradigm even in response to easily observable events – like frequent financial crises and collapses of output around the world -- lest they be alienated from the group. Robert Shiller, one of the few economists who spelled out the likelihood of a major crisis well in advance, admitted that, during his tenure on the advisory panel of the Federal Reserve Bank of New York from 1990 to 2004, he warned about the housing bubble “very gently and felt vulnerable expressing such quirky views. Deviating too far from consensus leaves one feeling potentially ostracized from the group, with the risk that one may be terminated”.<sup>14</sup> Durkheim could not have put it better.

Young academics are often advised not to publish at all than to publish in low-ranked journals like the *Cambridge Journal of Economics* or the *Journal of Economic Issues* or the *Review of Keynesian Economics* – low ranked because they publish papers which are “heterodox” and may not use formal theory.<sup>15</sup>

The discipline’s epistemic certainty in the neoliberal core was expressed recently by one of the most highly respected academic-cum-policy-making economists in Britain, who has been central both to macroeconomic policy and control of entry to top economics journals. He exclaimed, “Keynes was a disaster. Skidelsky [a latter-day Keynesian] should be locked up. Krugman has lost all respect in the economics profession.”<sup>16</sup>

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<sup>12</sup> David Colander, “The making of an economist redux”, *J. Economic Perspectives* 19, 1, 2005.

<sup>13</sup> Pierre Bordieu, “Social space and symbolic power”, *Sociological Theory* 7, 1, 1989, 14-25.

<sup>14</sup> Robert Shiller, 2008, “Challenging the crowd in whispers, not shouts”, *New York Times*, B5, February 11, at p.5.

<sup>15</sup> Frederic Lee, X. Pham and G. Gu, “The UK research assessment exercise and the narrowing of UK economics”, *Cambridge J. Economics*, 37, 4, 2013. The journal now called *Review of Keynesian Economics* was founded when the new chief editor of the leading journal, *American Economic Review*, informed some leading Keynesians in the early 1970s that under his editorship the journal would be unlikely to publish papers written from the approach of Keynesian economics.

<sup>16</sup> Personal communication, November 2011.

The discipline accepted largely at face value the study by Carmen Reinhart and Kenneth Rogoff which discovered the 90% threshold for public debt relative to GDP, above which subsequent growth falls sharply. Policy makers and politicians wanting to slash social programs even in the face of mass unemployment seized on the finding as support for “expansionary austerity”. Soon after the paper was released some critics pointed out that a negative correlation between debt and subsequent growth does not mean that high debt causes lower growth; low growth could cause high debt, as in Japan following its growth collapse in the early 1990s. But only when a graduate student at one of the few US centers of “heterodox” economics tried to replicate the results and discovered coding errors did the study receive wider critique. It is now clear that the 90% threshold is not robust; and that the study fudges the important distinction between “failure to impose austerity amounting to a few percentage points of GDP might reduce GDP a decade from now by a fraction of a percent” and “failure to impose austerity is very likely to reduce future GDP by 10 percent”, which is how the austerity champions have interpreted it.<sup>17</sup>

A new IMF research paper finds that *fiscal consolidation typically raises income inequality, raises long-term unemployment, and lowers the share of wage income; and that cuts in spending have bigger effects of these kinds than tax increases* – yet most of the burden in western countries has been placed on public spending cuts.<sup>18</sup> Two things are striking about this paper, beyond its conclusions. First, it comes from the IMF – though it is a working paper from the IMF research department, which is quite separate from IMF operations (in its operations the IMF continues to push fiscal consolidation in most cases). Second, it is one of very few – in the economics literature as a whole -- to examine the *distributional* effects of the standard western policy prescription over the past several years. Few economists have been interested in distributional effects, reflecting the general lack of interest in income and wealth distribution across the mainstream economics profession.

The conviction of epistemic certainty reflected in the above quote from the distinguished British economist helps to explain why the discipline has resisted – until a small concession by the American Economic Association very recently – all efforts at an organized discussion about professional ethics. Economics has far more influence over people’s life chances than any other social science, up there with medicine and engineering. But while medicine and engineering give a great deal of attention to professional ethics, economics gives virtually none.<sup>19</sup>

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<sup>17</sup> Paul Krugman, 2013, “The Excel depression”, *International Herald Tribune*, April 20-21; Krugman, 2013, “Reinhart and Rogoff are not happy”, *The Conscience of a Liberal*, May 26.

<sup>18</sup> L. Ball, D. Furceri, D. Leigh and P. Loungani, “The distributional effects of fiscal consolidation”, IMF Working Paper, 21 June 2013. See also G. Fontana and M. Sawyer, “Fiscal austerity: lessons from recent events in the British Isles”, *Challenge*, 54, 2, March-April 2011, 42-60.

<sup>19</sup> George DeMartino, *The Economist’s Oath: On the Need for and Content of Professional Economic Ethics*, Oxford University Press, 2011; Robert Wade, “Economists’ ethics in the build-up to the second Great Depression”, chapter in George DeMartino and Deidre McCloskey (eds.), forthcoming, *Oxford Handbook of Professional Economic Ethics*.

Anyone who thinks economists' allergy to ethics is not a serious problem should see the films *Inside Job* and *The Flaw*. The former includes the memorable exchange:

Charles Ferguson (director): "A medical researcher writes an article saying 'To treat this disease, you should prescribe this drug'. Turns out doctor makes 80% of personal income from the manufacturer of said drug. Doesn't that bother you?"

John Campbell (chair of Harvard University's economics department): "I think ... It's certainly important to disclose the, um...The, um... Um... Well, I think that's also a little different from the cases we're talking about here, because, um....Um...."

### *Income inequality*

Where neoliberal ideas reign one finds that substantial increases in inequality do not provoke much political attention or citizen concern (beyond talk-back radio). The standard reflex is to point to Steve Jobs, J.K. Rowling, Steven Spielberg, David Beckham and other contributors to the mass enhancement of life and say, "They obviously deserve their riches" – implying that the larger structure of income concentration carries no society-wide costs and that the government has no right to try to reduce income concentration at the top (except perhaps when an individual's riches are "undeserved").<sup>20</sup>

Like other Anglo countries, New Zealand has experienced a substantial rise in income inequality over the past three decades. In the early 1980s the top 10 percent of population received about a fifth of disposable income. Ever since the mid 1990s it has been more like a quarter. In the three decades to 2012 the average income of the top 10 percent grew (inflation-adjusted) by 63 percent or 1.6% per year, while the average income of the bottom 90 percent grew at less than half of that.<sup>21</sup> Most households in the bottom 90 percent experienced stagnant and falling real incomes for the first two decades, until economic policy began to abandon the most extreme forms of neoliberalism. Top 10% real incomes increased in just about every year.<sup>22</sup>

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<sup>20</sup> See Gregory Mankiw's defence of present US levels of income concentration, at <http://www.pbs.org/newshour/rundown/2013/07/former-bush-economist-defends-the-1-percent.html>. My earlier relevant essays include "Globalization, growth, poverty, inequality, resentment and imperialism" in John Ravenhill (ed.), *Global Political Economy*, Oxford University Press, 2011; "Why has income inequality remained on the sidelines of public policy for so long?", *Challenge*, 55, 3, May-June 2012; "Income inequality: should we worry about global trends?", *European Journal of Development Research*, 23, 4, September 2011, 513-520.

<sup>21</sup> One should be wary of "inflation-adjusted". Statistician John Williams (shadowstats.com) reports that recent US real GDP growth has been artificially boosted by an understated measure of inflation. If nominal GDP is deflated with the previous official methodology US GDP growth has actually been negative between 2007 and today. See also Paul Craig Roberts, *The Failure of Laissez Faire Capitalism*, Atlanta, GA: Clarity Press, 2013.

<sup>22</sup> B. Perry (2013) *Household Incomes in New Zealand: Trends in Indicators of Inequality and Hardship 1982-2012* (Wellington, MSD) p.236.

The top 1 percent did even better. Precise figures are not available, but estimates suggest that their share of total disposable income has risen from a low of slightly under 6 percent in 1980 to a bit under 9 percent today. But this includes only reported incomes, not realized capital gains or the large amount of income shifted into trusts (which pays lower taxes). Nor does it include the incomes of those living outside the country for part of the year who avoid having to pay any income tax at all (which does not prevent many of them being actively involved in New Zealand politics).<sup>23</sup> With these several kinds of income included the share of the top 1 percent would be appreciably higher.

This degree of income concentration puts New Zealand well into the more unequal half of the OECD countries. By comparison, the share of the top 1% in Scandinavia is around 5-6% of national income, and has remained flat since the 1980s (Norway was an upper exception for a few years in the 2000s). Other northwest European countries are similar. These countries demonstrate that it is possible to have a prosperous capitalism without income concentration as high as in NZ and other Anglo countries.

But New Zealand income concentration remains well below the US level, the United States having the most concentrated distribution among the OECD countries (apart from new developing country members like Chile and Mexico). The share of the top 1% in US national income (including capital gains) fell from a peak of around 23% in 1929 to reach a low of around 9% by the late 1970s, and then, with globalization, technical change and Reagan, rose fast to re-gain the 1929 level by 2006, paving the way for the great Crash of 2008. Another measure is the share of the *increase* in national income accruing to the top 1%. During the expansion of the Clinton years (1990s) the share was about 45%, during the expansion of the Bush years (2000s) about 65%, and in 2009-12 (Obama) it was 95%.<sup>24</sup> Still another measure is the ratio of the remuneration of chief executives to that of the salary at the 50<sup>th</sup> percentile of total cash compensation for full-time employees in the same company or a subsidiary. Chief executives at Fortune 500 companies now earn on average 324 times the median. This is not a misprint.

British trends are similar to the US's, though not as extreme. Chief executives of the top 100 British companies now earn 185 times the median – making £4.8 mn or US\$7.4 mn a year with a mix of salary, bonuses and long-term share plans. So British chief executives are impoverished compared to American counterparts. On the other hand, they have gained very handsomely compared to 1979, when the executive pay ratio was only 15 times the average wage.<sup>25</sup> And today they do very well compared to German counterparts; executive pay at the DAX 30 companies is “only” 90 times the average. Note that German CEOs are not relocating to New York or Dubai or retiring to play golf all day in protest at their relatively low pay.

### *Costs of income inequality: economic*

<sup>23</sup> See Max Rashbrooke, 2013, “Inequality and New Zealand”, in *Inequality*, figure 2.4.

<sup>24</sup> See <http://elsa.berkeley.edu/~saez/TabFig2012prel.xls>.

<sup>25</sup> The top pay/average pay figures come from the UK High Pay Center. The 1979 ratio is based on five major companies.

If higher inequality countries (among the developed countries) were more prosperous, and if one could plausibly argue that their inequality was a necessary condition for their higher prosperity, then one could shrug off worries about inequality as merely “the politics of envy”.

At first glance the US seems to suggest that inequality does go with prosperity: it is the most unequal of the developed countries, and also about the most prosperous by GDP per person (though below about seven European countries in terms of the more relevant measure of prosperity, GDP per hour worked). But by many non-income measures of performance the US looks backward. It has the highest rates of infant and maternal mortality in the developed world; and life expectancy at birth and at 60 is among the lowest. The inequalities cascade down the generations, as rich families invest more in their children’s education and the state provides minimal pre-school education; so the prosperity of American children is more dependent on the prosperity of their parents than that of children in most other developed countries.<sup>26</sup> The US and Britain have the lowest rates of intergenerational social mobility of the core OECD member states; which is ironic, given that they present themselves as free market economies with open opportunities, unlike the nanny states of old Europe.

Overall there is no evidence that more unequal countries are more prosperous, even by the standard income measures. NZ, one of the more unequal of the developed countries, ranked number 21 in the OECD in terms of GDP per person (2005), and number 22 in terms of GDP per hour worked. This is hardly testimony to the economy-wide success of Roger Douglas’ neoliberalism (“Rogernomics”).

Most political attention to issues of inequality in the Anglo countries is actually about poverty and exclusion, such as the issue of the “living wage”. What many advocates miss is the intimate connection between problems at the bottom and income concentration at the top. They are opposite ends of the same thought. Increasing income concentration squeezes the share of income and tax payments of those lower down the income hierarchy. While the share of the top 1% was soaring in the US over the 2000s the disposable income of families in the *middle* of the distribution *shrank* 4 percent between 2000 and 2010, according to OECD figures. So to focus only on problems of the bottom (as in, “stop cutting resources for people with disabilities”) misses main causes of the problems at the bottom.<sup>27</sup>

### *Costs of income inequality: social and health*

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<sup>26</sup> Eduardo Porter, “U.S. needs to be bolder on inequality”, *International Herald Tribune*, August 1, 2013, p.15.

<sup>27</sup> A fuller exposition of the economic costs of income concentration would include the effects on financial bubbles and trubbles. See Robert Wade, “The economy has not solved its problems”, *Challenge*, 54, 2, Mar-Apr 2011, 5-41; Robert Wade, “The Great Slump: what next?”, in *Crisis: Causes, Prospects and Alternatives*, *International J. Labour Research*, 3, 1, 2011, 21-50; Yan Liang, “Global imbalances and financial crisis: financial globalization as a common cause”, *J. Economic Issues*, XLVI, 2, June 2012, 353-62.

The best summary of the social and health costs of inequality is the book by Richard Wilkinson and Kate Pickett, *The Spirit Level: Why More Equal Countries Almost Always Do Better*.<sup>28</sup> Testifying to public concern about rising inequality, the book has sold about 250,000 copies in 23 languages since publication in 2009.

The book pulls together a mass of evidence about the relationship between inequality, on the one hand, and, on the other, nine variables relating to social costs and health costs:

- level of trust;
- mental illness (including drug and alcohol addiction);
- life expectancy and infant mortality;
- obesity;
- children's educational performance;
- teenage births;
- homicides;
- imprisonment rates;
- social mobility.

It draws on data from two samples: one, 23 developed countries; two, all 50 US states. It measures income inequality by the average income of the top 20% over that of the bottom 20% when comparing countries, and the Gini coefficient when comparing US states.

The bottom line is that the higher inequality entities (countries and US states) have higher frequencies of social and health problems of the kind measured by the above nine variables. The correlation between inequality and frequency of social and health problems is much stronger than between average income (of countries, US states) and the frequency of those problems; in particular, it is not the case that the frequency of the problems is higher in poorer entities and lower in richer entities. The US and Norway have similar average incomes, but are at almost opposite ends of the scale in terms of the index of social and health problems. The US has the worst performance in the sample by a long way.

Wilkinson and Pickett's argument has been criticised for relying largely on comparisons between countries and US states at one point in time, providing little evidence on trends across time. True, but not much longitudinal evidence exists. Also, if the cross-sectional correlations are found to hold at different times and places, that is evidence that the relationship between inequality and social and health problems also holds over time in any one society: as the society becomes more unequal performance on the above indicators deteriorates relative to what it would be if the society had not become more unequal. If you have photos of a man and a woman eating together in Wellington, London and Rio it is safe to assume that they are in a relationship.<sup>29</sup>

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<sup>28</sup> Richard Wilkinson and Kate Pickett, 2009, *The Spirit Level: Why More Equal Countries Almost Always Do Better*, Allen Lane, London.

<sup>29</sup> Thanks to Richard Wilkinson for this metaphor, 2 August 2013.

The best known correlations are those between inequality and health outcomes, though these are actually weaker than those between inequality and the social indicators. One major study concludes, “Our meta-analysis of cohort studies including around 60 million participants [and including studies across time] found that people living in regions with high income inequality have an excess risk for premature mortality independent of their socioeconomic status, age and sex.... Although the size of the excess risk seems relatively ‘modest’, it has potentially important policy implications for population health as income inequality is an exposure that applies to society as a whole”.<sup>30</sup> Another major study concludes, “The death rate for U.S. adults 18 years and older continues declining... thanks to substantial socioeconomic development, medical advances and the public health movement. But increasing income inequality in the past three decades suppressed the overall improving health trend. We might have seen an even higher extent of improvement of health if income inequality had remained at a relatively low level”.<sup>31</sup>

Then there is another debate about the likely causal pathways from levels of inequality to social and health outcomes. One is that higher income concentration is associated with a higher proportion of the population in relative poverty, and relative poverty is associated with poorer health and social outcomes. Wilkinson and Pickett go further, and argue that income inequality worsens health and social outcomes of not only the relatively poor but also the better off, through the mechanism of harmful effects of psychosocial stress. Some experts contest this latter argument.

Wilkinson and Pickett show a strong positive correlation between the level of income inequality and the density of the prison population: more unequal countries and US states have more people in prison per 100,000 population. New Zealand’s figures are a lot worse than the average for countries with its level of inequality. The prison population rose from 91 per 100,000 in 1987 to 199 per 100,000 by 2011; and for the Maori it is now around 700 per 100,000. On a world scale the extremes are the US, with around 740 per 100,000, and Iceland, with around 50. Scandinavia has around 60-70, Germany 90, the UK around 135, the highest in western Europe. So the New Zealand figure is far higher than the highest in western Europe. Yet crime rates have fallen significantly in the last twenty years.<sup>32</sup> Just how the rise in income concentration has helped to drive the New Zealand prison trends is not clear.

### *Costs of income inequality: political*

It is hardly surprising that elites in relatively unequal countries institute harsh penal regimes as a core defence of their superior position. Nor is it surprising that once the technology permits they institute mass surveillance of their own populations’ contacts

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<sup>30</sup> N. Kondo et al., 2009, “Income inequality, mortality and self-rated health: meta-analysis of multilevel studies”, *BMJ*, 339:b4471, pp. 1-9.

<sup>31</sup> Hui Zheng, 2012, “Do people die from income inequality of a decade ago?”, *Social Science and Medicine*, 75, 36-45, at p.44.

<sup>32</sup> See Kim Workman and Tracey McIntosh, “Crime, imprisonment and poverty”, in *Inequality*.

with each other and with foreigners; and classify information about the mass surveillance as top secret, and brand whistleblowers such as Edward Snowden “traitors”. In fact, the intelligence services of western governments have long known full well about the US and others’ programs; Snowden’s “crime” is that he revealed the programs to the public being surveilled, to whom governments are meant to be accountable. What is worrying is that large majorities of western populations have passively accepted the steady rise in income concentration, the proliferating number of super-rich, the harsh penal regimes, the cuts to social services in the name of spurious economics like “you can’t cure a debt problem with more debt”; and now the passive acceptance of mass surveillance.<sup>33</sup> Passive and fearful acceptance would not be surprising in a military dictatorship; but we in the west live in democracies.

The political costs of income concentration at the top include the erosion of the old understandings of the social compact binding states to citizens, as the resource flows based on these understandings are squeezed by the concentration of income at the top and by the ability of the rich to get their preferences translated into government policy when their preferences diverge from those of middle- and low-income voters (see below).

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<sup>33</sup> I asked several prominent New Zealanders whether the Snowden revelations about the US Justice Department scooping up data on telephone calls and internet communications had raised alarm bells in New Zealand, given that NZ and its Government Communications Security Bureau (GCSB) is a member of the five-country sharing entity at the core of western intelligence (with US, UK, Canada, Australia). They seemed to know virtually nothing about it, and evidenced no concern. My question stems from my and many others’ concern that the US Patriot Act section 215 allows the FBI and the NSA to obtain court orders for surveillance – from the highly secret Foreign Intelligence Surveillance Court – on grounds that it might produce evidence “relevant” to an investigation, and not just a present investigation but a possible future one; and they need not demonstrate probable connection to a crime or terrorism. The court can approve surveillance of whole categories of people or organizations, not just specific people. It has so far refused only about 10 out of 21,000 requests for approval. One of the architects of the Patriot Act, Representative James Sensenbrenner, has said, “Congress intended [with the Patriot Act] to allow the intelligence communities to access targeted information for specific investigations. How can every call that every American makes or receives be relevant to a specific investigation?” (quoted in Jennifer Stisa Granick and Christopher Jon Sprigman, “The criminal N.S.A.”, *International Herald Tribune*, 29-30 June 2013). But the Obama government is at full steam ahead in its mass surveillance activities, seemingly marginalizing the Fourth Amendment to the Constitution, which declares that “The Right of the people to be secure in their prisons, homes, papers, and effects, against unreasonable searches and seizure shall not be violated...”. Presumably New Zealand’s GCSB is cooperating.

The public passivity in response to the Snowden revelations can be compared with US public anger at “Obamacare”, the effort to introduce a social insurance component into the private and very profitable US health care system. The anger helped propel von Hayek’s *The Road to Serfdom* – about the consequences of Beveridge’s proposed National Health Service in Britain, published in 1944 – to number 241 on the Amazon Best Seller’s list in mid 2010. Conservative thinkers promoted the book as a guide to the “leftish” machinations of the Obama government. See Andrew Farrant and Edward McPhail, “Does F.A. Hayke’s *Road to Serfdom* deserve to make a comeback?”, *Challenge*, 53, 4, July/August 2010, 96-120. Hayek expounded his overall argument as, “The trouble ... with partial planning is precisely that every step forces us to further steps ... and that it constantly reduces our freedom of action and makes us more and more the servants of the machinery we have created”. Hayek, unpublished “Postscript” to *The Raod to Serfdom*, quoted in A. Farrant and E. McPhail, “Hayek, Samuelson, and the logic of the miexed economy?”, *J. Economic Behavior and Organization*, 69, 1, 2009, 5-16.

The upshot is a tendency for “establishment” elites to become “plutocratic” elites, the latter concerned mainly to use the levers of state power to create a structure of laws and markets which channels income and wealth upwards; and rely on a combination of penal institutions, Murdoch-like media, and neoliberal economists to obtain social compliance. As the income ladder stretches up, those high on the ladder tend to demonstrate a widening “money-empathy” gap, in the sense that their having far more money than everyone else itself tends to make them less empathetic, more prejudiced about categories of “other”, more selfish, more inclined to see others as either aids or obstacles to their own ambitions. This is one of the main conclusions from a body of recent research on the effects of social class by social psychologists such as Paul Piff at Berkeley.<sup>34</sup>

The spirit of the money-empathy gap is caught in the recent statement by Paul Ryan, chair of the Congressional Budget committee, one of the most powerful politicians in the US: social programs “turn the safety net into a *hammock* that lulls able-bodied people to lives of dependency and complacency”.<sup>35</sup>

New Zealand Prime Minister John Key gave his own gloss. The National Business Review reported, “Prime Minister John Key today stood by his comment that some people needed to use foodbanks because they had made poor choices....’Anyone on a benefit actually has a *lifestyle choice*. If one budgets properly, one can pay one’s bills’, Mr Key said”.<sup>36</sup>

The money-empathy gap of the rich is all the more worrying in the light of recent research by Martin Gilens, among others, which shows that US national politicians respond mainly to the wealthiest voters (not to the “median voter”). As Gilens summarizes,

“When Americans with different income levels differ in their policy preferences, actual policy outcomes strongly reflect the preferences of the most affluent but bear virtually no relationship to the preferences of poor or middle-class Americans. The vast discrepancy ... in government responsiveness to citizens with different income levels stands in sharp contrast to the ideal of political equality that Americans hold dear....*representational biases of this magnitude call into question the very democratic character of our society*”.<sup>37</sup>

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<sup>34</sup> See Lisa Miller, 2012, “The money-empathy gap”, *New York Magazine*, 1 July.

<sup>35</sup> Paul Krugman, 2013, “War on the unemployed”, *New York Times*, June 30, emphasis added. For more on the money-empathy gap of billionaires, see Thomas Frank, *Pity The Billionaire: The Hard Times Swindle and the Unlikely Comeback of the Right*, London: Harvill Secker, 2012.

<sup>36</sup> “Key stands by ‘some poor make poor choices’ foodbank comment”, *National Business Review*, 21 February 2011, emphasis added.

<sup>37</sup> Martin Gilens, “Inequality and democratic responsiveness”, *Public Opinion Quarterly*, 69, 5, 2005, 778-96, at 778, emphasis added.

Research by Benjamin Page and colleagues comes to much the same conclusion about the preferences of ordinary Americans and those of the very wealthy.<sup>38</sup> The average American is somewhat worried about large budget deficits, unsurprisingly given the barrage of media focus on the deficit as the big problem. But the wealthy by a large margin regard the deficit as the most important problem, not unemployment or part-employment; and say that it must be cut by cutting welfare spending, not by raising taxes. The wealthy also say that the minimum wage should not be linked to the cost of living, contrary to the preferences of the majority. Actual policy reflects upper-class preferences. As Paul Krugman summarizes, “What the top 1 percent wants becomes what economic science says we must do”.<sup>39</sup>

Another study starts from the staple of democratic theory, the argument that active participation in associations and civic organizations is crucial to a vibrant democracy.<sup>40</sup> It examines the relationship between household income and civic participation (such as voting, visiting public officials, participating in school groups, civic and religious organizations) as the current recession developed from 2008 onwards. It finds that the already low level of civic participation by low-income households (under \$30,000 a year) fell; the higher level of participation by middle-income households also fell; and the level of participation of high-income households (over \$100,000 a year), which was initially lower than that of middle-income households, was sustained. These findings help to illuminate the mechanisms behind the representational biases discovered by Gilens and Page et al.

The large representational biases found in the US go with much evidence that the US middle-class, long the world’s embodiment of optimism and upward mobility, has become fearful of falling out of the middle class over the next few years. This pervasive middle-class fear feeds into the polarization of US politics, including foreign policy.

In New Zealand, Finance Minister Bill English recently asserted, “Economic policy in NZ is *not* made by the top 1% for the top 1%”.<sup>41</sup> Nicky Hager’s *The Hollow*

<sup>38</sup> Benjamin Page, Larry Bartels, and Jason Seawright, “Democracy and the policy preferences of wealthy Americans”, *Perspectives on Politics*, 11, 1, 2013.

<sup>39</sup> Paul Krugman, “The 1 percent’s solution”, *International Herald Tribune*, April 27-28, 2013.

<sup>40</sup> Oren Levin-Waldman, “Rising income inequality and declining civic participation”, *Challenge*, 55, 3, May-June, 2012, 51-70.

<sup>41</sup> English made the assertion in an interview on TVNZ’s Q&A, Sunday 14 July 2013, in response to my summary statement that economic policy in high-inequality countries like the US, UK and NZ is being made by the top 1% for the top 1%. (I should have made more of a distinction between NZ and the others, for reasons given earlier.) The irony is that, according to Nicky Hager, *The Hollow Men: A Study in the Politics of Deception*, Nelson, NZ: Craig Potton, 2006, especially p. 213, English was replaced as National Party leader in 2003 by Don Brash because he advocated too *centrist* policies for the dozen or so Big Donors on whom the National Party depended; while Brash promised the party caucus that the donations would flow with him as leader and future prime minister – without spelling out the hard-right policies wanted by the money men. Hager’s book describes in detail the deception of the electorate that went on in the run-up to the 2005 election, to keep the hard-right policies out of sight. So English himself had directly suffered from the influence of Big Donors on National party policy. Hager observes, “What is significant about National’s main donors is not so much their wealth (and they are very wealthy) but their political beliefs. These are not well-heeled businesspeople who happen to lean a bit to the right. This small and distinct group comes mostly from the radical right of New Zealand politics and business” (223).

*Men: A Study in the Politics of Deception*, provides graphic details about the role of a dozen or so super-rich donors to the National Party in the first half of the 2000s, which contradict the English hypothesis; but they are hardly conclusive. More comprehensive studies of the role of rich donors in New Zealand politics are lacking.

### *Conclusions*

All through the period since 2008 the center-left in the western world has remained on the defensive, unable to cohere around alternatives beyond more or less diluted neoliberalism. This is good news for the top 1% and especially the top 0.1%.

The center-left should take a leaf out of the strategy of the neoliberals. Milton Friedman summarized the right strategy at the time when they were on the political and economic margins and the consensus was for social planning and welfarism: “Only a crisis – actual or perceived – produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. That, I believe, is our basic function: to develop alternatives to existing policies, to keep them alive and available until the politically impossible becomes the politically inevitable.”<sup>42</sup>

Hence the neoliberal movement through the 1940s to the 1970s concentrated on quietly building think-tanks and networks to develop the ideas and train cadres while awaiting the crisis. When it came in the later 1970s the movement had the blue-prints to put on the table and the cadres to implement them on behalf of the governments of Reagan, Thatcher, Lange/Douglas and others. The subsequent great achievement of the movement has been to make the core neoliberal ideas seem as natural as gravity, to which there is no alternative, whether the troublesome public likes them or not. The wealthy like them very much, for they have directly helped to raise their share of national income and political power. And as the research by Gilens, Page et al. cited earlier suggests, the wealthy are able to shape public policy in line with their preferences and marginalize the preferences of middle- and low-income people when their preferences differ from those at the top, thanks to the financial imperatives of modern democracy and the ease with which the wealthy can exit or threaten to exit from a political domain they do not like.

Since the 1980s the non-neoliberal left, which has been at least as marginal as the neoliberals through the 1940s to the 1970s, has done little to build corresponding organizations and networks – one obvious reason being that non-neoliberal financing is always more difficult. New Zealand has nothing close to a center-left think-tank, and the few “heterodox” economists are scattered and disparate. The organizational weakness of the center-left, combined with media ownership by profit-maximizing firms (the national radio station being the valuable exception), produces the parlous state of New Zealand newspapers and television, which allows much neoliberal policy to go unchallenged except at the edges.

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<sup>42</sup> Milton Friedman, *Capitalism as Freedom*, University of Chicago Press, 1962, xiv.

The center-left should be able to capitalize on the fact that high income concentration probably means that a majority of the population experience stagnant or falling incomes, and a squeeze on tax-financed social spending.

Here are several points that should go into a center-left strategy.

*All taxation and public spending should be scrutinized for distribution effects.* One of the most important steps is to “normalize” the evaluation of all tax and public spending in terms of effects on the distribution of income and wealth. Too often many of these measures escape distributional scrutiny by being presented as good for “the economy”. The implicit government guarantee that banks above a certain size will not be allowed to fail, and the tax advantages given to debt financing, are examples. And the most spectacular recent case of hidden income concentration effects is the combination of the fiscal policy of “expansionary austerity” or “fiscal consolidation” across the western world since 2008, and (in some countries, notably the US and the UK) the monetary policy of “quantitative easing”, both of which are discussed above.

*“Predistribution” is even more important than redistribution.* Those concerned to rein in income concentration must pay attention to matters well beyond tax and spending—the latter having been the familiar battle ground for left-right fights. The key distinction is between *predistribution* of market incomes, and *redistribution* of market incomes by the state through taxation and public spending. The main determinant of inequality of “take home” income (after tax and spend) is not the magnitude of redistribution but the inequality of market incomes (before tax and spend); so to focus on lowering the concentration of income by tax and spending measures is to miss more than half the picture. One has to examine the whole array of state laws, regulations and policies for their effects on the distribution of market income, before taxes, particularly to show how, in high-inequality developed countries, many parts of the array (including corporate governance law, trade union law, patent law, monetary policy, exchange rate policy, and more) have the effect of sluicing market incomes upwards. If corporate governance law says, for example, that CEOs appoint the boards of directors, and that the directors decide the remuneration of CEOs, no prize for guessing what happens to CEO remuneration. Of course, we are told that top pay rises because firms compete globally for the best talent – and therefore whatever is paid is justified. In fact, only 1 percent of the chief executives of Fortune Global 500 companies were poached from another company in a foreign country.

It is largely through predistribution measures that the plutocratic elites of the US, the UK and some other western states have quietly built up a “conservative nanny state”, with income concentration as one of its expressions.<sup>43</sup> The center-left should press hard to reveal the mechanisms by which the conservative nanny state works.

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<sup>43</sup> Dean Baker, 2006, *The Conservative Nanny State: How the Wealthy Use the State to Stay Rich and Get Richer*, Center for Economic and Policy Research, Washington DC; Baker, 2012, *The End of Loser Liberalism: Making Markets Progressive*, Center for Economic and Policy Research, Washington DC..

*Stop talking down the state.* A further major change to be promoted by the center-left begins by challenging the standard neoliberal opposition between “state and market”, based on the idea that “the market” is natural and the state is “artificial”; which goes with a constant talking down of the state and talking up of the private sector, as though the latter is a caged lion just waiting to spring free from state regulations. For all its faults, the democratic state has an advantage over the private sector in that state actions do have to be justified in terms of societal values, as the actions of private firms do not; and the leaders of the state can be replaced (and their remuneration set) as a result of citizen preferences expressed in public forums – which is not the case for leaders of firms. The state can also exercise comprehensive foresight about the economy’s future growth, in a way that private firms typically do not. These and other points are the basis for formulating a vision of more *complementary* roles of state and markets in capitalist society.

Stop talking down the state means that the question of privatization or outsourcing is to be answered pragmatically, not by an assumption that the private sector is always more productive than the public sector (or vice versa). The pragmatic answer is that a private company will probably out-perform a public agency when the goals are clear, when achieving them does not undermine other socially desirable outcomes, and when rewards to managers and employees can be aligned with the goals. When the goals are complex and diffuse the profit motive may make them more difficult to achieve, and privatization is probably not the solution.<sup>44</sup>

*Industry policy can help achieve a “high productivity-high wage” growth path.* The idea of a complementary relationship between state and market – and not just a “framework-providing” state -- is especially important in the case of industry policy, or economic development policy more broadly. In neoliberal economics the very phrase “industrial policy” is toxic, and automatically equated with “picking winners”, to be rejected with “the government cannot pick winners but can pick losers”.<sup>45</sup> The center-left has been far too willing to conduct the debate on the terrain favoured by the right -- the public sector - - and ignore how to reform the private sector.

That the US remains by far the most innovative economy in the world is due in no small part to an active industrial policy – but one kept below the radar to escape political censure.<sup>46</sup> The Defence Advanced Research Projects Agency (DARPA), the National Institutes of Health, and several other federal agencies have been key to a swathe of US breakthroughs in “general purpose technologies”. To take only the information and communications revolution: The US National Science Foundation funded the algorithm

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<sup>44</sup> Eduardo Porter, 2013, “When profit conflicts with policy goals”, *International Herald Tribune*, January 17.

<sup>45</sup> Robert Wade, *Governing the Market*, Princeton University Press, 2004; Wade, “Return of industrial policy?”, *International Review of Applied Economics*, 26, 2, March 2012, 223-240.

<sup>46</sup> Robert Wade, “The mystery of U.S. industrial policy: the developmental state in disguise”, in UNCTAD-ILO volume edited by Richard Kozul-Wright and Jose Manuel Salazar-Xirinachs, forthcoming; Fred Block and M. Keller, eds. *State of Innovation: The U.S. Government’s Role in Technology Development*. 2011. Boulder: Paradigm; Michael Lind, 2012, “Who’s afraid of industrial policy?”, *Salon*, January 31.

that drove Google's search engine. Early funding for Apple came from the US government's Small Business Innovation Research Program. Moreover, in the words of Mariana Mazzucato, "All the technologies which make the iPhone 'smart' are also state-funded... the internet, wireless networks, the global positioning system, microelectronics, touchscreen displays and the latest voice-activated SIRI personal assistant."<sup>47</sup>

The reason why the state role has been seminal is beyond the ken of neoliberal economics: it is that private companies will not bear the uncertainties, time spans and costs associated with fundamental innovation; and the more competitive, finance-driven the economy the less its firms will bear these risks.<sup>48</sup> (In another blow to neoliberal economics, the great breakthrough discoveries from the private sector – from Bell Laboratories, for one – came from monopolists, with money to spare.) The US state has not only born the costs of many breakthrough innovations; it has acted as an entrepreneur, providing directional thrust to entrepreneurship in the private sector. The problem is that the neoliberal conviction about the sanctity of private profit then kicks in, with the result that the public sector hands over innovations to the private sector for almost no return, while the private sector appropriates the credit and the profit -- so the neoliberal dictum "The government cannot pick winners but can pick losers" prevails, and state budgets (including for research) continue to be squeezed. The solution is to implement "taxpayer warrants", such that the public sector earns royalties on innovations (in IT, pharmaceuticals, etc.) from which the private sector profits. This is all the more imperative if societal challenges like climate change, renewable energy, healthy ageing and food security are to be met.

Germany too has long practiced active and successful industrial policy, also kept unadvertised; though in the past decade and more its government has limited the role of the state and the economy has failed to remain at the forefront of today's new technologies.<sup>49</sup> Taiwan has long practiced both a "big scale" and centrally coordinated industrial policy and also a small-scale nudging kind of "industrial extension" policy carried out by the Industrial Development Bureau.<sup>50</sup>

Active industrial policy is all the more important to promote economic diversification in countries like New Zealand reliant on commodity exports to China, as China slows down; and all the more important for everyone as climate change and population aging speed up. Diversification and innovation left to "the free market" will

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<sup>47</sup> Mariana Mazzucato, *The Entrepreneurial State*, London: Anthem, 2013; Martin Wolf, "the state is the real engine of innovation", *Financial Times*, August 5, 2013, 10. To describe the component technologies of the iPhone as entirely state-funded is an exaggeration.

<sup>48</sup> This statement now needs qualification, as billionaire entrepreneurs like Jeff Bezos of Amazon and Sergey Brin, cofounder of Google, are pushing for the next big technological breakthroughs in space exploration, robotics, advanced materials and new forms of ground transportation.

<sup>49</sup> Trade Union Council (TUC), "German lessons: developing industrial policy in the UK", London, January 2012. For a New Zealand prospectus, see New Zealand Council of Trade Unions, "Alternative economic strategy", October 2010.

<sup>50</sup> See Robert Wade, *Governing the Market*, especially chapters 7 and 9.

be far too slow.<sup>51</sup> That the economics profession in developed countries operates within the ideological precepts of neoliberal economics and largely ignores the non-neoliberal programs of industrial policy is testimony to the epistemic certainty of the neoliberal core.

Of course, in a small open economy like New Zealand the constraints on an entrepreneurial role of the state are tighter than in a much larger and less open economy like the US. The owners and managers of large businesses can always threaten to exit, and exporters can put all their lobbying efforts into keeping labor costs as low as possible, ignoring the Keynesian mechanism of higher wages translating into higher demand. But it would be possible to counter these tendencies by a government talking up its entrepreneurial role in assisting firms to shift to a “high productivity-high wage” path; which entails more tripartite collaboration around the vision of a national project in forums like the old Planning Council, and more public effort at building up New Zealand-based supply chains, along the lines of what Taiwan’s Industrial Development Bureau has done ever since the 1950s.<sup>52</sup>

*Rebalance power in the labor market.* Then there are a whole set of issues around the representational biases in democratic politics reported earlier, and the effects of the hollowing out of middle classes on civic participation. One issue is to do with the “minimum wage”. Increases in the minimum wage tend to raise median wages, and increases in both can be expected to raise participation in democratic society. A plutocratic elite is likely to fear such an increase in participation and to resist wage increases not only for profit reasons but also for political reasons. But everyone who values a vibrant democracy should support efforts to rebalance power in the labor market, including through higher minimum and living wages and an expansion in the legitimate role of trade unions (drawing inspiration from their role in Germany and Scandinavia).

*Political financing.* A second issue under the heading of correcting representational biases is political party financing.<sup>53</sup> As long as political parties and candidates depend heavily on a relatively small number of donors and lenders – which goes up as income concentration rises -- their policies and commitments will incline towards the wealthy when the preferences of the wealthy differ from those of the rest. It is as simple as that. But political party financing is the “third rail” of politics, which none of the big players wish to touch. The UK Committee on Standards in Public Life published “Political party financing: ending the Big Donor culture” in November 2011.<sup>54</sup> It identified three main routes for reform: (1) Restrict the amount any individual or organization (companies, trade unions) can give or loan; (2) limit party and candidate (campaign) spending; (3)

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<sup>51</sup> David Pilling, “The benefits and perils of riding China’s coat-tails”, *Financial Times*, August 1, 2013, p.11. The need for industrial policy also stems from the need to accelerate the switch to sustainable energy sources.

<sup>52</sup> Nigel Haworth, “The rewards of work”, in *Inequality*.

<sup>53</sup> For background on party financing see Jonathan Hopkin, 2004, “The problem with party finance”, *Party Politics*, 10, 6, 627-51.

<sup>54</sup> Committee on Standards in Public Life, 2011, “Political party finance: ending the Big Donor culture”, presented to Parliament by the Prime Minister, November.

provide public funding. Although long and careful, and launched with fanfare, the report died on the day of publication. Nothing more has been heard of it, to audible relief in the corridors of Westminster.

*Insist on banks maintaining a high minimum capital-adequacy ratio.* For all the complexities of stabilizing the financial system one measure stands out for being potentially very powerful and also for commanding a lot of agreement across the political spectrum. Given that banks typically borrow too much and the present regulations are too confusing, regulators should require the use of a simple number indicating the extent to which a bank's owners could bear most losses without requiring a bailout. If a high ratio (15 percent or more) means that banks are smaller and lend less, that is the price of a more stable system.

This short discussion has suggested several agenda items for a center-left strategy. The starting point has to be the evidence that capitalism in much of the West has been working at cross-purposes to democracy. Yet the confluence of forces making for a conservative nanny state and rising income concentration at the top – and squeeze lower down – seems to be locked in, through mechanisms as varied as political party and candidate funding, tax advantages attached to debt finance, dependence of banks on proprietary trading for a major share of profits (almost a guarantee of imprudent banking), and the hegemony of neoliberal economics, with its nonchalance about income concentration and its antipathy to unions. The center-left has its work cut out, but it can draw courage from Milton Friedman's summary of the strategy for the neoliberal movement at a time when it was on the fringes; and from the obvious electoral opportunities presented by the fact that large majorities find their standard of living stagnant or declining as income concentration rises. It must shift the debate away from "you (conservatives) want free markets and we want more redistribution through the state to help the disadvantaged", partly because this makes it easy for conservatives to play on middle-class anxieties with the slogan, "we stand for freedom, hard work and innovation, you stand for taxing the successful and giving handouts to losers". Rather, it should say, "you stand to rig markets in favour of the rich, we stand to make markets work more progressively". Hopefully the center-left will draw in some far-sighted wealthy people and organizations equivalent to John Maynard Keynes, who while making fistfuls of money for himself and Kings College, Cambridge also worked seriously on solving the problems of mankind. END