International organisations must take the lead on reducing income inequality

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Is income inequality always bad for society? **Francesc Trillas** *writes on the impact of inequality on democracy. Taking issue with the perspectives of economists such as Gregory Mankiw, he argues that a growing income gap between the wealthy and the rest of society can pose a fundamental challenge for a country's political system. He notes that the effects of globalisation, combined with the flawed incentives contained within national politics, have reduced the ability of nation states to tackle inequality. As a result only the development of new international institutions can solve the problem.*

When the Occupy Movement began using the slogan "We are the 99%", many scholars thought that the debate on rising income inequalities had been settled. They were wrong. The phrase made popular the work of economists such as Thomas Piketty and Emmanuel Saez, who have presented evidence from tax records suggesting that economic growth over the past few decades has disproportionately benefited only the wealthiest segments of society.

Their evidence has also shown that economic mobility across generations has been lower than previously assumed. Taken together, along with the fact that the economic and financial crisis has hit the most vulnerable sectors of society in the periphery of Europe particularly hard, it seemed that conservative thinkers and commentators would no longer be able to advance their arguments on the issue successfully. Recent books, such as *Capital in the Twenty-First Century* by Thomas Piketty, *The Haves and the Have-Nots* by Branko Milanovic, and *The Great Escape* by Angus Deaton, have outlined the dangers of income inequality for democracy. In so doing, they have lent support to a number of articles suggesting that the "occupiers" were justified in mobilising around this issue. The debate seemed largely closed.

Increasing income inequality in OECD countries could be the result of factors such as globalisation, technological advances, deregulation, ideology, capture and institutional factors, such as reduced union membership. While market income inequality has risen, redistribution through tax/transfers has also become less effective in many countries, probably because of international capital mobility.

Credit: Andra Mlahli (CC-BY-SA-3.0)

The spread of inequality, however, has not been universal. In Latin America, income inequality has slightly decreased over the last 30 years, according to Gasparini and Lustig, but levels remain very high. The wealthy continue to hold enormous influence over the economy and the political process. In Chile, for example, a country praised for its democratic institutions, one of the country's richest men has been the president for the last four years, and the wealthiest families control almost all newspapers, which have a strong conservative ideological bias. The increase of democracy in the region has reduced inequality, but only slightly. Many would have expected democracy to have had a much greater impact on inequality.

Is income inequality always bad for society?

Despite growing concerns about income inequality, economist Gregory Mankiw has recently argued that inequalities are an unavoidable or even beneficial aspect of economic progress, and therefore the rich must fight to keep them. Robert Solow has replied to Mankiw, countering that the one per cent defend themselves well enough.

Mankiw's core argument is that inequalities are necessary as incentives to encourage work and innovation, and that inequality is not dangerous for democracy because wealthy people are divided in their support for conservative and progressive causes. We should therefore go back to a "pre-Piketty" world, he suggests, where it is important to focus on eradicating poverty, but inappropriate to concentrate on the issue of inequality.

While it is true that a fully egalitarian society in terms of outcomes would be detrimental for wealth creation, it is hard to argue that the monetary incentives (for example in the financial industry) or returns on capital for the richest are truly necessary for value creation. Even the typical argument that entrepreneurs deserve to be extremely rich must be put into context, as many innovations (such as the Internet or the touch screen) were originally developed by government, as pointed out by Mariana Mazzucato.

In any case, the largest fortunes in the world do not exist for meritocratic reasons. Top incomes mostly come from executives in large companies, hedge funds, or from extremely wealthy heirs, as recently noted by Paul Krugman on his blog and Piketty in his book.

Mankiw's other argument is that high inequality is not a danger to democracy. The political power of the wealthy should be considered neutral, since the wealthy support both conservative and progressive causes. However, the fact that they support non-conservative leaders or political parties does not imply that they support progressive or strongly egalitarian policies.

In fact, there are many instances of rich philanthropists focusing on poverty and child malnutrition, but not on income inequality. They may actually support progressive parties or politicians not because they believe in progressive causes, but in order to have influence over them and to pressure them not to adopt policies that might erode the position of the very wealthy. Such attempts to control the political process may not be successful in their own right. Nevertheless, as capital income continues to grow more than labour income (as explained by Piketty), it may lead to an increased risk of plutocracy. The rich will have even more resources to control public life, while their fortunes may escape national tax authorities (Piketty calculates world tax evasion at 10 per cent of global GDP).

Democracy might not be reducing inequality because it is not working well enough. In the future, elites may have even more influence over the political process. They will promote causes that make them popular, but they will likely never call into question the mechanisms that allowed them to amass enormous fortunes. This may lead to the increasing privatisation of politics.

Measuring inequality

The data on inequality is always controversial. When Oxfam published a report stating that the 85 richest people in the world had the same amount of wealth as the 3.5 billion poorest, the NGO's methodology was called into question, for example by Tim Harford in the *Financial Times*.

That is why it is essential that the best experts are involved in data gathering and reporting exercises. In this respect, Piketty's book constitutes one of the most impressive efforts. According to his figures, shown in the Table below, there is a clear trend for the richest people in the world to see their incomes grow much more than those of most other people.

Table: Average annual growth rate in the wealth/income of groups of the world's population

Group	Average annual growth rate 1987-2013 (%)
Wealth of the richest one hundred millionth per cent	6.8
Wealth of the richest twenty millionth per cent	6.4
World GDP	3.3
World average wealth per adult inhabitant	2.1
World average income per adult inhabitant	1.4

Source: Piketty (2013) *Le Capital au XXIe siècle*, p. 693

In the same period, the non-extreme poor in developing countries also increased their income, but Piketty's figures clearly show that the growth in the income of the very rich, coming from very high remunerations and returns on capital, is in a league of their own.

In the first era of democracy, the institutions that built a more cohesive society – such as taxation, unions, education, and public health – were national. With globalised markets, new institutions which perform the same functions must be developed internationally. Nation states are no longer capable of fighting increasing inequalities. National politics tend toward populism precisely because the state is largely powerless.

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