
A look at the problem of inequality

● JOSEP FONTANA

Universitat Pompeu Fabra

Inequality is one of the biggest problems of our time. Janet Yellen, Chair of the US Federal Reserve no less, admitted as much in an address given in Boston on October 17:

The extent of and continuing increase in inequality in the United States greatly concern me. The past several decades have seen the most sustained rise in inequality since the 19th century (...). By some estimates, income and wealth inequality are near their highest levels in the past hundred years, much higher than the average during that time span and probably higher than for much of American history before then.

An appraisal that she backed up with the following statistic: “The lower half of households by wealth held just 3 per cent of wealth in 1989 and only 1 per cent in 2013”.¹

Her statements coincided with press reviews of the Global Wealth Report published by Credit Suisse,² which showed that the problem had reached global dimensions: the richest 8.6 per cent of the world’s population control more than 85 per cent of global wealth, while the poorest 70 per cent hold less than three per cent. The most alarming aspect of Credit Suisse’s report, however, is the speed at which inequality has grown in just one year. Danny Dorling

1. Janet Yellen, “Perspectives on Inequality and Opportunity from the Survey of Consumer Finances”, speech delivered on 17 October 2014 to the Federal Reserve Bank of Boston, Boston.

2. Credit Suisse, Global Wealth Report 2014, Zurich, 19 September 2014.

Fecha de recepción: noviembre 2014

Versión definitiva: diciembre 2014

Revista de Historia Industrial

N.º 57. Año XXIV. 2015.1

has claimed that if this pace were to be maintained: “the richest one per cent of the planet would have everything within five years and the poor would have nothing”, which goes to show that the current increase in inequality is totally unsustainable.³

A global look at the historical evolution of inequality since 1820, published by the OECD,⁴ has been prepared by a team of researchers working primarily in Dutch universities and presented as a continuation of the project initiated by Angus Maddison. Using the Gini index as their unit of measurement, they also confirm that since 1970 there has been a gradual increase in income inequality in most countries in Western Europe and in their “Western offshoots” (that is, their former colonies). However, the best history of inequality is undoubtedly the study published by Emmanuel Saez and Gabriel Zucman in October last year, in which they examine the evolution of wealth inequality in the United States since 1913.⁵ The authors conclude that “The rise of wealth inequality is almost entirely due to the rise of the top 0.1% wealth share, from 7% in 1979 to 22% in 2012”, this last figure being very close to the total wealth of the 90 per cent at the bottom.

The mechanisms that produce the accumulation of wealth in the top decile of the table are basically the reduction in wage costs and the reduction in taxes. These same factors account for the worsening situation of the lowest deciles: less income for their work and a reduction in the social services provided by governments, due to the latter’s growing financial problems. To these we can add a phenomenon that needs to be considered separately, namely the growing indebtedness of the lower and middle layers. The way in which the so-called austerity policies have favored this polarization of wealth has been denounced in a study published in November in Britain, where it is concluded that “the reforms had the effect of making an income transfer from the poorer half of households (and some of the very richest) to most of the richer half, with no net effect on the public finances.”⁶

The reduction in wage costs is a phenomenon that has even occurred in the US economy and this at a time when its recovery can be considered complete. Last October unemployment reached 5.8 per cent, but despite this the

3. Danny Dorling, “Why current global inequality is unsustainable”, in *Social Europe Journal*, 28 October 2014.

4. J.L. van Zanden et al., *How was life? Global well-being since 1820*, OECD, 2014.

5. Emmanuel Saez and Gabriel Zucman, *Wealth inequality in the United States since 1913: evidence from capitalized income tax data*, National Bureau of Economic Research, Working Paper 20625, October 2014. Parallel to this, I have also consulted Emmanuel Saez and Gabriel Zucman, “Exploding wealth inequality in the United States”, in *VOX CEPR’s Policy Portal*, 28 October 2014.

6. The study was undertaken by Paola de Agostini and Professor Holly Sutherland, at the University of Essex and Professor John Hills at the LSE. The quotation is taken from an article written by Daniel Boffey in *The Observer*, 15 November 2014.

expected rise in wages has yet to occur with wage levels remaining stagnant. Indeed, it has been noted that “the average weekly wage of full-time workers in the middle of 2014 is slightly below what it was in 2011,”⁷ and the fall has been much greater for part-time workers. Even worse is the situation in the European Union, where unemployment figures remain at 11.5 per cent and part-time jobs are in greater abundance, with workers in some sectors holding contracts of ten, eight or even zero hours.⁸

A few years ago a study of employment in the United States showed that the downsizing in big companies used to be offset by the hiring of new staff in lower wage categories, and that job losses occurred most frequently in companies with greater numbers of unionized workers so as to eliminate the higher cost of expensive union labor.⁹ Thus it comes as something of a surprise that the European Commission should only now discover that wage cuts in Spain have the greatest effect on workers with fixed-term contracts.¹⁰ Do they really need to be told how the world works?

A study undertaken by the OECD, the International Labor Organization (ILO) and the World Bank in the G20 countries not only highlights this downturn in wages between 2006 and 2013, but contrasts these figures with the increase in productivity, up by more than 15 per cent between 1999 and 2013. At the same time the report notes that the labor share of the wealth produced – defined as the ratio between the compensation of employees and gross domestic product – has fallen at different rates in all advanced economies between 1970 and 2013, with Spain recording the maximum loss, in excess of 16 per cent. This in turn leads to a fall in consumption “since wages are the main source of income for most households”.¹¹ Barack Obama pointed out what this means in economic and human terms: “When middle-class families can’t afford to buy the goods or services our businesses sell, it actually makes it

7. Patricia Cohen, “Jobs data show steady gains, but stagnant wages temper optimism” and Justin Wolfers, “The jobs report is even better than it looks”, both in *New York Times*, 7 November 2014; David Leonhardt, “The great wage slowdown of the 21st century”, in *New York Times*, 7 October 2014 (with a follow-up article published on 11 November of the same); David Ruccio reminded him that this slowdown was not “of the 21st century”, but had in fact started back in the 1960s (David Ruccio, “The great wage slowdown in the USA”, in *Real-World Economics Review Blog*, 8 October 2014).

8. On zero-hours contracts, Rowena Mason, “Jobseekers being forced into zero-hours roles”, in *The Guardian*, 5 May 2014.

9. William J. Baumol, Alan Blinder and Edward N. Wolff, *Downsizing in America. Reality, causes, and consequences*, New York, Russell Sage Foundation, 2003. I have yet to examine in detail the recent study, directed by John R. Logan *Diversity and disparities. America enters a new century*, New York, Russell Sage Foundation, 2014.

10. Ignacio Fariza, “Bruselas tacha de ‘lento, ineficaz e injusto’ el recorte salarial en España”, in *El País*, 11 November 2014.

11. *G20 Labour Markets: outlook, key challenges and policy responses*, Report prepared for the G20 Labour and Employment Ministerial Meeting, Melbourne, Australia, 10-11 September 2014; UNICEF, *Children of the recession. The impact of the economic crisis on child well-being in rich countries*, October 2014.

harder for our economy to grow. Our economy cannot truly succeed if we're stuck in a winner-take-all system where a shrinking few do very well while a growing many are struggling to get by".¹²

That inequality is an obstacle for growth has been recognized by researchers at the International Monetary Fund,¹³ in a study which concludes by saying that:

On average, across countries and over time, the things that governments have typically done to redistribute do not seem to have led to bad growth outcomes, unless they were extreme. And the resulting narrowing of inequality helped support faster and more durable growth, apart from ethical, political, or broader social considerations,

which, as we can see, is a highly convoluted way of saying something that runs counter to the policy recommendations that the Fund usually gives to governments when urging them to lower wages. But what is particularly extraordinary is that even the credit rating agency, Standard and Poor's, has reached the same conclusion when recognizing that the increase in inequality has been responsible for the poor recovery following the crisis of 2007-2008.¹⁴

Neil Irwin argues the point as follows:

The wealthy tend to save a large proportion of their income, whereas middle and lower-income people spend almost all of what they earn. Because a rising share of income is going to the wealthy, spending—and hence aggregate demand—is rising more slowly than it would if there were a more even distribution of income.

And he goes on to say, in relation to the good growth figures presented by the US economy in the third quarter of this year, that the most worrying thing is what will happen “unless private sources of demand start growing faster than they did in the summer.”¹⁵

12. The White House, “Remarks by the President on the economy — Northwestern University”, 2 October 2014.

13. Jonathan D. Ostry, Andrew Berg and Charalambos G. Tsangarides, *Redistribution, inequality, and growth*, IMF Research Department, February-April 2014, p. 26.

14. *How increasing inequality is dampening U.S. economic growth, and possible ways to change the tide*, 5 August 2014; see Neil Irwin's response, “A new report argues inequality is causing slower growth. Here's why it matters”, in *New York Times*, 5 August 2014. A subsequent report, published on 15 September, by Standard and Poor's also pointed out that “income inequality means lower tax revenues for the state”.

15. Neil Irwin, “What Janet Yellen said, and didn't say, about inequality”, in *New York Times*, 17 October 2014, and “It was a good summer for the economy, but the future looks less bright”, in *New York Times*, 30 October 2014.

And if these circumstances present themselves in a country like the US, where employment is considered to have fully recovered (although it remains to be seen whether the “quality” of employment is comparable to that before 2008), there can be little doubt that the decline in aggregate demand must be greater in the rest of the world. Indeed, the ILO has estimated that at the end of 2013 a total of 202 million people were unemployed and that this figure could be expected to rise to 215 million by 2018.¹⁶

There is another fundamental aspect in which these factors generating inequality exacerbate the problems faced by the economy, namely the impossibility of eliminating debt – of resorting to “deleveraging”, as recognized in the report published at the international conference of the Center for Economic Policy Research held in Geneva in September.¹⁷ This shows that the size of the global debt, excluding that of the financial sector (i.e. the sum of all government and private borrowing), amounts to 212 per cent of GDP (and in the case of the Eurozone, to 257 per cent). If we recall that analysts of the causes of the 2008 crisis attributed a key role to private debt, we would do well to worry about this.¹⁸

In Saez and Zucman’s studies mentioned above, the authors point out that “the growing indebtedness of most Americans is the main reason behind the erosion of the wealth share of the bottom 90% of families”. They go on to claim that financial deregulation has expanded borrowing opportunities, in some cases leaving consumers insufficiently protected against some forms of predatory lending.

This is not an allusion to the crisis of 2007-2008, but rather to the massive indebtedness of US households, which in the last three months of 2013 alone increased their debts by 241,000 million dollars, due above all to “pay-day loans”, for which they pay an average annual interest rate of 350 per cent. The situation has reached the point at which the boom in dubious loan deals has begun to alarm the authorities, which fear the bursting of a new bubble. Here, mention should first be made of the loans granted to companies with struggling finances, which generates a debt that is then sold on to investment funds, pension funds, etc.¹⁹ Next come housing loans, where lower down payments and more relaxed credit requirements for buyers are leading to a grad-

16. International Labor Organization, *Global Employment Trends 2014. Risk of a jobless recovery?*, Geneva, ILO, 2014.

17. L. Buttiglione, P. Lane, L. Reichlin and V. Reinhart, *Deleveraging. What deleveraging? The 16th Geneva Report on the World Economy*, Geneva, CEPR Press, September 2014.

18. See, for example, Paul Krugman, “Why weren’t alarm bells ringing?”, a review of Martin Wolf’s book *The shifts and the shocks*, in *New York Review of Books*, 61, n° 16, 23 October 2014.

19. Peter Eaves, “A recent surge in leveraged loans rates rattles regulators”, in *New York Times*, 4 November 2014.

ual increase in insecurity.²⁰ And, above all, a proliferation of subprime loans that are being granted by companies such as Citigroup's OneMain Financial, which has 1.3 million customers. Sixty per cent of OneMain's accounts are so-called "renewals", i.e. customers that have been unable to pay on time and who for years have to compensate for this with monthly installments at interest rates that can exceed 30 per cent.

The system is guaranteed by 360,000 debt collectors responsible for finding debtors and making them pay, and who act with remarkable efficiency. For example, a citizen who went bankrupt in 2009, leaving 7,000 dollars unpaid on his credit card, was surprised when he found a new job to see that his first month's paycheck had been docked 25 per cent to pay off his OneMain debt, which in the meantime had ballooned from 7,000 to over 15,000 dollars.

Yet, there are methods that work even faster. For example car sales, which are one of the main sources of this type of indebtedness (27 per cent of buyers here have a poor credit rating), accounting for a volume of 145,000 million dollars in the first three months of 2014. It occurred to me to enter "auto loans" into the Google search engine and in the first link I clicked on a heading popped up saying "We have found seven car loans for you". Lenders have found a safe method, which involves selling the car with a device (apparently already installed in about two million vehicles) that when remotely activated shuts the car down. So a buyer who falls behind on her payments may find that her car grinds to a halt when driving at full throttle along the freeway or that she is unable to get back home with her grocery shopping.²¹

What is the situation of the Spanish economy in this regard? An article published in *Cinco días* on 6 October last says: "Spain has foreign debts of 1.11 billion net euros, more than 100% of its GDP, the highest ratio in the OECD". It goes on to say that the "gross debt", i.e. what the state, the banks and corporations have to refinance, amounts to 2.48 billion, 250 per cent of its GDP, which this year will increase because of the slow deleveraging and the return of the deficit. To this we should add the functioning of the domestic credit system, which must be facing problems, as the Bank of Spain has announced that unpaid loans, the so-called "non-performing loans", had increased in February 2014 by 21.4 per cent with respect to the previous year.²²

20. Peter J. Wallison, "Underwriting the next housing crisis", in *New York Times*, 31 October 2014.

21. Michael Corkery, "States ease interest rate laws that protected poor borrowers", in *New York Times*, 21 October 2014; Paul Kiel and Chris Arnold, "Collectors seize wages of millions of Americans burdened by debt", in *NPR*, 18 September 2014; Michael Corkery and Jessica Silver-Greenberg, "Miss a payment? Good luck moving that car", in *New York Times*, 24 September 2014. On the abuses, Rachel Abrams, "New York City agency subpoenas 2 Santander auto lenders", in *New York Times*, 14 November 2014.

22. José Antonio Vega, "La deuda externa, el flanco débil", in *Cinco días*, 6 October 2014, p. 26; Banco de España, *Financial Stability Report 05/2014*.

Let's return, however, to the consequences of inequality. Regardless of its role as a barrier to growth, inequality within societies in the developed world also raises concerns with regard to the effect it can have on social stability. For some time now Shimshon Bichler and Jonathan Nitzan have been warning of the risk advanced societies face from a combined process of the impoverishment of the majority and an increase in repression, which is leading to an asymptote, an extreme situation, which could lead to social breakdown, as has happened on other occasions in the past. They go on to say that: "Capitalists, though, are largely blind to this asymptote. Their power drive conditions and compels them to sustain and increase their sabotage in their quest for an ever-rising distributive share. Like other ruling classes in history, they are likely to realize they have reached the asymptote only when it is already too late".²³

The conclusion is shared by Nick Hanauer, a wealthy US entrepreneur – one of the founders of Amazon, among many other businesses, who considers himself "one of those .01%ers" of zillionaires – who believes that, while a certain degree of inequality is necessary for a high-functioning capitalist economy, the current degree of accumulation of wealth means US society is rapidly becoming a feudal society. "No society can sustain this kind of rising inequality. In fact, there is no example in human history where wealth accumulated like this and the pitchforks didn't eventually come out. You show me a highly unequal society, and I will show you a police state. Or an uprising. There are no counterexamples. None. It's not if, it's when".²⁴

There is, moreover, another problem that usually goes unnoticed: that is, inequality at the international level. This is no longer a question of comparing countries' GDP indexes, so that we can speak, for example, of the progress of the economies of Africa, but rather it is a matter of the internal reality of these communities.²⁵ It seems self-evident that to conduct these comparisons it is more useful to turn to the "Palma", the ratio of national income shares of the top 10 per cent of households to the bottom 40 per cent; but it is not the measurement problem that interests me here, rather the impact of inequality.²⁶

23. Shimshon Bichler and Jonathan Nitzan, "How capitalists learned to stop worrying and love the crisis", in *Real-World Economics Review*, n° 66 (2014).

24. Nick Hanauer, "The pitchforks are coming... for us plutocrats", in *Politico Magazine*, July-August 2014; see the comment of Steve Keen, "The revolt of (part of) the top 1% of the top 1%", in *Real-World Economics Review Blog*, 19 July 2014.

25. Here, global comparative studies are not useful, what we need are specific studies, such as Mthuli Ncube, John Anyanwu and Kjell Hausken's, *Inequality, Economic Growth, and Poverty in the Middle East and North Africa (MENA)*, Working Paper Series n° 195, African Development Bank, Tunisia.

26. Alex Cobham and Andy Sumner, "Is it all about the tails? The Palma measure of income inequality", Washington, Center for Global Development, Working Paper 343, September 2013.

Jim Yong Kim, President of the World Bank, said in an interview published in April last year that internet access (above all via smartphones) in the developing world is creating the conditions where everyone on the planet knows how the others live (i.e. the average citizen in the developed world), which means “the next huge social movement” could erupt anywhere at anytime.²⁷

Indeed, it is this evidence of the enormous gap that exists between our average standard of living and that in the developing world which provokes this great displacement of population from sub-Saharan Africa to the Mediterranean border. And so we see migrants perched on the fences watching the citizens of Melilla on the other side playing golf, and men, women and children packed aboard their precarious boats risking their lives in order to escape to a non-existent paradise.

If inequality is a problem that threatens continued growth and leads to social divisions, what can be done to stop it increasing? The solutions we are usually offered cannot be taken seriously, starting with the best known, that proposed by Piketty, who for some time now has been hawking his idea that everything can be solved with a tax on capital,²⁸ which seems reasonable, except he unfortunately fails to explain how to introduce such a tax effectively in the present-day world. This simplicity derives from his historical view of inequality as a natural phenomenon: the inevitability of $r > g$ inequality. As José Gabriel Palma has said: “‘r’ is currently so much greater than ‘g’ as a direct result of human agency, and not as a supposed inevitable outcome of the workings of the invisible hand”.²⁹ In the real world, Piketty’s formula requires some additional instructions regarding the policy measures required to implement it. As Stiglitz has said, the inequality debate is, in fact, a “debate about the nature of our society”: slow growth and inequality, he adds, are in reality political choices.³⁰

Remedying this situation requires that governments regain the capacity to impose a tax that would allow them to overhaul the social services, which have been allowed to gradually deteriorate, and that they give the unions back their powers to negotiate wages and working conditions as in the past.³¹ Or, as Saez and Zucman put it, they need to implement “policies switching bargaining

27. Jon Queally, “Climate change and inequality brewing global social upheaval”, in *Common Dreams*, 4 April 2014.

28. In an interview in *La Vanguardia* on 11 November 2014 he claims: “It’s very easy: those with the greatest wealth should pay more taxes”.

29. José Gabriel Palma, “Has the income share of the middle and upper-middle been stable over time, or is its current homogeneity across the world the outcome of a process of convergence? The ‘Palma Ratio’ revisited”, Cambridge Working Papers in Economics 1437.

30. Joseph Stiglitz, “Slow growth and inequality are political choices. We can choose otherwise”, in *Washington Monthly*, November/December 2014.

31. “The bargaining power of most American workers is at a historical low point”, claim Jared Bernstein and Dean Baker in “Full employment: the recovery’s missing ingredient”, in *Washington Post*, 3 November 2014.

power away from shareholders and management toward workers”. The problem is that these are unattainable goals in the present circumstances, regardless of who wins the next elections in Madrid, Berlin or Washington.

This inability to provide solutions to such problems is worrying. I recognize that my sense of panic has grown on reading a few days ago the contradictory estimates of American economists when discussing the role played by the “stimuli” of the US Federal Reserve, which have recently been curtailed. The most sensible thing I’ve read is the claim made by Ben Bernanke that it is clearly a policy that “works in practice, but doesn’t work in theory”.³² And this apparent quip is something that should make us think, because it is clear that economic policy measures are usually adopted in line with theoretical proposals.

This is alarming because interest rates are now likely to be raised – a measure being called for precisely by those who over the last few years have fought to impose their austerity policies. As Binyamin Appelbaum said “the focus (now) turns to interest rates”. This can be especially dangerous in a deflationary state and in an economy like Spain’s, which is supporting its enormous debt burden thanks to the fact that interest rates are currently so low. As is usual, the crisis is likely to find us ill prepared.

Clearly we have made great progress in understanding and evaluating inequality and in specifying its consequences. But we have yet been able to come up with solutions capable of remedying the problem as it now presents itself. This means we need to seek out new approaches to the problem and we need to invent new solutions, since the old ones can no longer be applied. I think as historians we can bring a broader perspective to bear than our colleagues in other disciplines, who tend to be more enclosed within their respective orthodoxies; moreover, we are specially trained to help think about the future. And it would be good that those called upon to do this work, our younger colleagues, set about this task now ... because it is their future that is at stake.

32. Binyamin Appelbaum, “Federal Reserve caps its bond purchases; focus turns to interest rates”, in *New York Times*, 29 October 2014. See, moreover, Michael Roberts’s interpretation, “The story of QE and the recovery”, in *Michael Roberts Blog*, November 2014.



A look at the problem of inequality

ABSTRACT

The continuous increase in inequality is one of the biggest problems of our time. To confront the phenomenon it seems logical to firstly consider the causes, which are looked at here, especially those concerned with labor cost reduction and related consequences, including not only decrease of aggregate demand but also private consumer debt, sometimes ignored but significant as continued growth can lead to precarious situations.

KEYWORDS: Inequality, Global slumps, Employment

JEL CODES: N10, N30, D63, E24, R21



Una ojeada al problema de la desigualdad

RESUMEN

El aumento constante de la desigualdad es uno de los problemas más graves de nuestro tiempo. Para enfrentarse a él parece lógico considerar ante todo sus causas, que se examinan aquí, sobre todo las que se refieren a la reducción de los costes salariales con sus consecuencias, no solo en la reducción de la demanda agregada, sino en un aspecto al que se presta menos atención como es el endeudamiento de los consumidores privados, cuyo continuo crecimiento podría conducir a una situación peligrosa.

PALABRAS CLAVE: desigualdad, depresiones globales, empleo

CÓDIGOS JEL: N10, N30, D63, E24, R21