nef briefing

Ten Reasons to Care About Economic Inequality

Inequality matters. We often hear politicians talk about 'tackling poverty' and the need to improve 'social mobility' but economic inequality lies at the heart of both these phenomena and much more.

Here are ten reasons to care about economic inequality (in no particular order):

1. **Your pocket.** As social beings we constantly compare ourselves to others, especially those who are better off. In an effort to keep up with what the rich have we exhaust and exceed our household resources and get into debt.
2. **Your talent (and your pocket again).** The wealthy have more collateral to invest in their education and ideas. As there are only so many places at top universities, this locks in their success, and leaves less room at the top for everyone else.
3. **The economy (and your pocket for the third time).** Inequality is bad for the economy. It impacts on tax-take, entrepreneurialism, and it was one of the main reasons for the financial crash.
4. **Your children.** Inequality impedes social mobility because those with advantage can buy their children advantage.
5. **Your streets.** Inequality erodes the connections within and between communities. Rich and poor live in different neighbourhoods and go to different schools. This creates distance between them that generates distrust, social conflict and crime.
6. **Your health.** Inequality drives status anxiety, which contributes to ill-health.
7. **Your happiness.** Inequality sharpens the focus on individual materialism, eroding other aspects of a good life crucial for well-being, such as relationships and community cohesion.
8. **Your planet.** Inequality drives consumption at a rate the planet cannot sustain.
9. **Your government.** Money equals power. Political lobbying instigated by the rich helps prevent redistribution and contributes to the democratic deficit.
10. **Your sense of justice.** High levels of inequality, especially when they are transferred to future generations, are inherently unjust. This injustice damages the reputation of the UK and erodes civic pride and identity.

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Useful statistics on economic inequality

- Economic inequality in the UK is the highest in recorded history – we went from having inequality levels similar to the Netherlands in 1979 to being one of the most unequal developed countries in the world. Our Gini coefficient (a common measure of inequality) increased from 0.26 to 0.36 over this period. Studies have shown that beyond a Gini coefficient of around 0.3, inequality becomes corrosive for society.[1,2]

- The top 10 per cent of the population now earn, on average, more than four times that of the bottom 10 per cent, compared to three times in 1979.[3] This disparity grows exponentially when you look at the difference between the lowest and highest earners in organisations where Chief Executives earn, on average, 250 times what a cleaner earns.

- Looking at every pound that is created in the British economy, 10p goes to the bottom half of the population, 40p to the top half, 39p to profits and 11p to national insurance and pension contributions. Over the past 30 years the top 1 per cent have seen a 50 per cent increase in their share of every pound.[4]

- Wealth disparities are even starker. Fifty per cent of the UK population owns just 1 per cent of the wealth. The richest 10 per cent of the UK has more than 100 times the wealth of the bottom 10 per cent.[5]

- Land concentration is also high in the UK. A comprehensive study in 2009 found that 40 million acres of countryside is shared by 189,000 families – giving each one of these families an average of more than 200 acres each.[6] Many of these families have had this land in their possession for generations. This concentration of land ownership ensures that wealth is knitted into the fabric of this country.

There is a growing chorus of academics, economic commentators and members of the public calling for greater equality. The Occupy Movement that began in Wall Street has now spread across the world. Protests are being assembled from San Francisco to Sydney as people call for fundamental change to a system dominated by the rich and their interests. The slogan 'we are the 99 per cent' captures the sense of injustice that income, wealth and power have been hoarded by the richest 1 per cent. This injustice is made worse because of the belief that within this 1 per cent are the very people who brought the financial system to its knees, causing millions to lose their jobs and homes.

Despite this growing demand for change, there is little general awareness of just how much inequality has grown and why inequality is bad for all of us. This **nef** briefing gives answers to these fundamental questions. We will be adding to the analysis in further reports and briefings in the coming weeks and months, with the aim of providing resources for the debate and pushing the issue of inequality up the public and political agenda. **nef** will follow this briefing by publishing an in-depth report, *Why the Rich are Getting Richer: The determinants of economic inequality*, which details why inequality has grown so rapidly in the past 30 years.

So what?

Inequality in the UK has reached in a new peak for this post-war era, but why should we do anything about it? Surely some inequality is good at providing incentives for those wanting to push themselves and be entrepreneurial? The operative word here is 'some.' Recent evidence has demonstrated that cash incentives do not necessarily stimulate innovative thought.[7] At the other end of the employment ladder, a winner-takes-all economy can act as a disincentive for low-paid workers who feel that there is just no point in trying.[8] Other researchers have studied the US major-league baseball to find that the more successful teams are those where players' salaries are more equitably distributed.[9]

Even if some inequality is good, when it reaches the levels witnessed in the UK (see the useful

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stats box above), it can encourage a number of economic, social and environmental problems. These problems are often inter-connected, for example, living or working in a highly hierarchical society or work place can lead to stress. This in turn can make you unhappy and affect your health. Of course there are methodological problems with establishing some of the causal connections, but we have chosen the outcomes most well-known and researched.

So, the ten reasons to care about economic inequality are:

1. Your pocket

Inequality directly affects the amount of cash in your pocket because it makes you want things. As social beings we are constantly rating ourselves against others. When the rich get richer and spend more on luxury items it also ratchets up everybody else's perception of what they need to have in order to gain respect in society, and have self-respect. As one Nobel prize-winning economist put it recently "trickle-down economics may be a chimera, but trickle-down behaviourism is very real."[10]

Professor Robert Frank, an economist from Cornell University in the US, has written extensively about how income and wealth at the top have set off "expenditure cascades." In his book, *Falling Behind: How rising inequality harms the middle class*, he explains that when individuals are asked whether they would rather have a 4,000-square-foot house in a neighbourhood of 6,000-square-foot mansions, or a 3,000-square-foot home in a zone of 2,000-square-foot bungalows, most people would rather have a smaller house but be relatively better off than their neighbours.[11]

Not only does growth in consumerism mean there is less cash in your pocket, it means you save less and get into more debt. The UK has a particularly high debt mountain, which currently stands at £1.45 billion in unsecure and secure loans.[12] It has been found that the debt/income ratio rose from 45 in 1980 to 91.1 in 1997 and to 156.4 in 2007.[13] The poorest are particularly vulnerable to debt, with one fifth of the poorest in arrears with one or two bills.[14]

2. Your talent (and your pocket again)

Inequality affects the extent to which you can use, express and benefit from your talents by:

- *Limiting the likelihood of moving up the income scale in your own lifetime.* Recent research showed that in the UK, if you start off in the bottom of the income spectrum you are unlikely to make it even to the top half, let alone the top decile.[15] This is to do with the structure of the labour market, where initial advantage pays off – there is a growing divide between those who went to top universities and have highly paid jobs, and those that did not. Once you're poor you're staying poor.

- *Limiting access to credit.* To start an enterprise you are likely to need a bank loan. To get a bank loan you often need some collateral, especially in the current environment where banks are cautious about whom they lend to. For the wealthy availability of collateral is less of a problem, allowing them to be more entrepreneurial. For others, this hurdle can hinder their opportunities to fund new ideas or get loans to educate themselves.[16]

3. The economy (and your pocket for the third time)

The economy is damaged by inequality in two ways:

a. The failure to exploit talent means there is less capacity in the economy which impacts on innovation, tax-take and aggregate economic prosperity and growth.

b. Inequality has also been shown to be a key contributor to the sub-prime crisis, financial meltdown, recession and continued financial instability. As discussed above, the falling wage share for lower income deciles, the desire for a house and more things coupled with easily available consumer credit, led these groups to increase personal debt. Several academic papers and books, including from

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the International Monetary Fund (IMF)[17] and the Financial Times book of the year in 2010,[18] have concluded that this unsustainable increase in personal debt ultimately led to the financial crash of 2008.[19]

The theory is that credit was one way to give the working and lower middle classes an opportunity to own a house, a flat screen TV and a designer handbag. Economist, Raghuram Rajan, has provided a detailed account of the types of policies that governments chose to encourage lending in a chapter titled "let them eat credit."[20] Before the financial crash, governments paraded the increase in home-ownership as a good thing. However, the truth is people were borrowing much more than they could afford. Eventually the bottom fell out of the market.

The financial crash has been linked to inequality in another way too – research has shown that spare cash at the top encouraged speculative financial transactions. This high-risk activity has been associated with the financial crash.[21]

4. Your children

Compared to other high-income countries the UK has one of the lowest levels of social mobility. What you earn is a powerful predictor of what your child will earn.[22] This is perhaps not surprising given the way that economic inequality can act as a barrier to developing talents, as discussed earlier.

The Coalition Government argues that tackling social mobility does not require addressing economic inequality.[23] But it is difficult to sustain this argument given most countries with high levels of social mobility are more equal.[24,25] Intuition also suggests that those with 100 times more wealth will use their economic clout to ensure their children maintain their economic advantages. Finally, if resources continue to disproportionately accrue at the top, there is a smaller share of the resource pot available for everyone else to make investments in their futures.

5. Your streets

Large disparities between the rich and poor, especially when these groups are spatially segregated, are not conducive for social harmony. This is because there is an erosion of social capital – defined as the connections within and between networks or the 'glue' that holds communities together.[26] As the rich and poor live in different neighbourhoods, go to different schools, shop in different places and generally avoid each other, a social distance is created. This manifests itself in distrust,[27] unwillingness to help others and less civic participation. The growth of gated communities is argued to be one outcome of this distrust.[28]

Academic literature makes the link between inequality and crime, in particular violent crime,[29] and this especially seems to be the case when economic disparities are coupled with a society that values competitive achievement.[30]

Some have pointed to inequality as one of the underlying drivers of the recent riots across English cities. Of course it is difficult to prove this, but it is important to note that inequality is widely accepted as a driver of social unrest.[31] Even the former, hard-line conservative, Head of the International Monetary Fund (IMF), Michel Camdessus, had this to say about growing economic inequality: "the widening gaps between rich and poor within nations" is "morally outrageous, economically wasteful and potentially socially explosive."[32]

6. Your health

The link between inequality and health is complicated. The key mechanism that defines the relationships between the two is 'status anxiety.' This is where your social position, specifically how low down you are in a hierarchy, increases the likelihood that you will suffer from stress and insecurity.[33] Studies have found that the stress-hormone, cortisol, can increase as people feel that others are making negative assessments of them.[34] High cortisol levels are associated with heart disease which currently costs the NHS some £3.2 billion every year.[35]

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Perhaps the most famous study looking at the impact of relative status on health was conducted by Michael Marmot. His study of British civil servants in the 1960s and 70s found that the lower-ranking bureaucrats had elevated levels of stress hormones compared to their high-status co-workers, even though the low-ranking workers still had job security, decent pay, hours, and benefits.[36]

Others have pointed out the link between inequality and health by highlighting how the weakening of social bonds provides fertile ground for increased incidence of depression.[37] There are links between income inequality and child health outcomes (infant mortality, low birth weight, and so on), but less support for a link with broader health outcomes such as life expectancy.[38]

We should remember that greater health problems in the population have direct impacts on workers' efficiency and increases national spending on health.

7. Your happiness

All the above makes us unhappy. Studies have found that as income inequality increases well-being falls, and this relationship holds across countries,[39,40] across states in the US[41] and within countries over time.[42] Some academics put this correlation down to the way that we end up not "getting what we want" but "wanting what they get."[43] As we focus increasingly on material, rather than emotional, well-being we neglect the things that actually make us happy, like our relationships.[44,45] Inequality also gives us less time, as we work more to spend more, to nourish and be nourished by our relationships with our family and friends.

Happiness is also affected by perceived fairness and the belief that you can make it,[46] see point 10.

8. Your planet

The rich literally have too much money to burn. They are spending at a rate the planet cannot afford. Worse still, because the rest of us are trying to keep up with the Jones' we are funding our over-consumption through debt.

We already consume 50 per cent more than what the planet can sustain.[47] Worse still, the consumption habits of the West have spread to China and India, placing further demands on the planet's resources.

Recent work carried out by **nef** and the Centre for Analysis of Social Exclusion[48] found that greenhouse gas emissions rise as income rises, with a particular jump in emissions for the richest households. This suggests that very high incomes, not only expand problems of inequality, but are particularly environmentally unsustainable.

9. Your government and policy

As wealth accumulates so does power. This affects the political system because wealth can be used to lobby government to act in the interests of the rich, such as through tax policy. Robert Barro points out that "If more economic resources translate into correspondingly greater political influence, then the positive link between inequality and redistribution need not apply." Higher inequality then pushes more financial capital into lobbying activities to prevent redistribution through the political process. This can result in corruption and hamper political and economic decision-making.[49]

10. Your sense of justice

Given our dismal record on social mobility and the multiple ways the system is rigged for the rich we cannot claim this is a meritocratic country. This unfairness gives us a bad reputation and erodes national identity and civic pride.

This sense of justice is perhaps why a study found that 92 per cent of Americans preferred the look of a society with a much more equal income distribution – such as in Sweden, rather than that of the US. Most interestingly, even the rich chose the Swedish distribution.[50] This provides hope that, if done well, a shift to a more equal society could have support from the majority of the population.

In the coming months nef will be releasing a number of publications looking at the determinants of inequality, and inequality within the labour market. For more information please contact Dr Faiza Shaheen: faiza.shaheen@neweconomics.org

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