Distributing the Future

Why More Equal Prospects Matter

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policy network *ideas*

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Summary

The negative implications of inequality are manifold. While devastating for individuals at the bottom of the ladder, evidence also shows that an unequal society causes the economy as a whole to suffer.

Focusing on experiences in Germany, this essay makes the urgent case for public intervention to alleviate the causes, not just the symptoms, of inequality.

It argues that life chances – as determined by wealth, earning potential and educational opportunity – must be more equal in order for society to be equipped to take advantage of technological and scientific progress. To fail to make them so risks damaging a nation's competiveness in an increasingly globalised world.

About the authors

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The situation is distressing: inequality of wages, income, wealth, education and future life chances is so serious in Germany that even economists are warning that it could jeopardise the future competiveness of our economy.

The president of the German Institute for Economic Research, Marcel Fratzscher, goes so far as to argue that in Germany our previously much-admired social market economy no longer exists. His research shows, for example, that the wages of the bottom 50 per cent have not grown in real terms since 2000 and German real wages are below the average of 1990, whereas GDP per capita has risen by 25 per cent and top incomes have increased significantly.

Wealth inequality is also greater in Germany than in other countries in the eurozone. Almost nowhere else in Europe do the top 10 per cent own more, namely two-thirds of total national wealth, while at the same time 40 per cent of the population own nothing. What may surprise is that the disparity is greater even than in the United States. And those who are poor, all too often, remain poor, because our educational system is not good enough at promoting social mobility: about 60 per cent of 25-64-year-olds have the same level of education as their parents. In the light of these figures it is clear that we have to reframe the question of distribution.

Distribution is not merely a matter of cold statistics. The level of fair distribution is crucial in determining an individual's opportunities, career paths, life destinies and whether people can live in dignity and freedom, and actively participate in society. Poor people are sick more often and die younger. These individuals live in areas with poor social fabric: damaged schools, rundown public spaces, high crime rates and weak social networks. People with lower incomes also pass on the pattern of lower education to the next generation, vote less frequently and are less actively engaged with the political processes.

Question of distribution: double challenge

It is not only the current state of unequal distribution that is problematic. It is also problematic that there exist few ways out of poverty and that disillusion about individual career chances is so widespread. This is why we face a double challenge. On one hand it is a challenge of the material distribution of income and on the other it is about the distribution of life prospects. Currently the future is open for everyone at the top but closed for everyone at the bottom. Society is stuck. It is socially, economically and culturally divided, insecure and sceptical of modernisation. It is susceptible to fear of loss of status, social exclusion and both xenophobia from within and isolation against the outside.

The negative implications of consolidated inequality and blocked opportunities are manifold. On an individual level it affects those who are struggling to cope with low skills and badly paid jobs throughout their working lives and who when they retire receive dramatically low pensions. For the economy it means that businesses suffer from an unproductive workforce, weak domestic demand and low growth prospects which will make them worse off in a competitive global economy. And finally for society as a whole, people find themselves in a country that is socially destabilised, reducing security and the quality of life for all. This may cause the spread of anger and disappointment, not only among the socially deprived part of the population.

To be clear, there is no chance of fighting inequality without overcoming mass unemployment. In this respect Germany has made progress over recent years: unemployment has fallen from over 5 million to less than 3 million. The rate of long-term unemployment has been lowered, creating new chances and preventing joblessness becoming the new normal for those out of work long term. This is essential because if unemployment becomes permanent qualifications lose their value in the marketplace and the risk increases that people are forced into any work, not the work they are trained for and all too often that will be precarious, low-paid work.

Thankfully no longer can anyone drop out of the official unemployment statistics, as was the case under Germany's old social welfare system. Rising levels of employment, more jobs that are subject to social insurance contributions and a higher job participation of people over 50 and women is a very positive development. This has the longer-term impact of reducing the risk of poverty among the elderly and material dependency within marriage.

As noted above there are two major challenges remaining with respect to the desired reduction in income inequality. First, there is the tendency in Germany for the fruits of recent reform efforts to have been partially marred by the misuse of the flexibility mechanisms which were designed to bring people back in work and maximise the available work force. Sadly now these are being misused by some businesses to generate higher marginal returns. Such misuse has led to the hollowing out of standard labour conditions and contracts.

Low pay, fixed-term contracts, forced part-time employment and freelancing have increased in scope and size and spilled over into the core of the mainstream labour market. As a result we see strong disincentives for businesses to pay fair wages; as it is not uncommon for employers to exploit publicly funded and supplementary social benefit schemes to compensate for low pay – businesses are in competition with each other to further reduce wages and have that support from the state fill in the gaps. The honest and fair employer who pays workers well is often left looking foolish in this unfair competition. This must not be allowed to happen.

Collective representation of interests

Politics has to be made to work for workers. The economy has to be understood as a space for public intervention if the causes, not just the symptoms, of inequality are to be alleviated. Collective representation of interests through effective work councils and trade unions is a central precondition of the fair distribution of outcomes. Strong social partnerships are an expression of a market equilibrium that ensures active participation in society. It is also essential to uphold the principle of intervention by social laws. The minimum wage, but more importantly the general applicability of collective bargaining agreements for businesses, can strengthen the power balance between capital and labour.

Proactive distribution policy must define, constitute and shape the market. The American economic historian Robert J Gordon describes in his new book *The Rise and Fall of American Growth* how the decline of productivity growth throughout the 20th century is an example of the poor overall balance of distribution. In the 'golden age' from 1920-70 productivity in the US economy rose by two per cent annually, whereas in the following decades until the 21st century the economy experienced only marginal increases of less than 0.5 per cent per annum. Gordon compares this trend to the distribution of real income. Until 1970 the top earners' income grew by 2.46 per cent annually while the other 90 per cent saw growth rates of 2.65 per cent. Between 1970 and 2013 this trend reversed: whereas top earners received a 1.42 per cent increase, everyone else lost 0.17 per cent of income in real terms. The numbers are evident for the loss of productive jobs and the related income of the middle classes. In comparison, the innovative capacity of expanding financial markets with their complex investment products has proved relatively low. Speculative returns on assets benefited a very small proportion of wealthy people. The shareholder economy was a big loss-maker for the middle class.

Sustainable innovation policy

Gordon is too pessimistic in his prophecy that productivity gains and the scope for distribution in developed economies will remain low for the foreseeable future. It is a fact that technological and scientific challenges will persist in the future. This may include the fight against incurable diseases, such as cancer or dementia, the sustainable use of resources and energy, electronic mobility or the digitalisation of the economy. New innovations that foster more efficient production and consumption can raise overall national welfare. But it takes a sustainable and interventionist innovation policy to initialise and expand markets. In modern societies markets are never static. They are dynamic, constantly in motion. And innovation for the future means unlocking new markets through:

- A fiscal and tax policy that discourages economic short-termism and instead promotes long-term investments in research, development, process and production innovation. Assets and capital gains are to be taxed progressively. Tax on assets that are invested to create new products and jobs in the company are to be lowered. Tax incentives for research funding must be put back on the political agenda.

- An active state which uses political and fiscal capital in order to promote technological and economic progress. Mariana Mazzucato describes in her book The Entrepreneurial State how much public sectors across the globe have boosted significant innovations and nurtured them into breakthrough success stories. This applies not only to the railway or power grid but also to the improvement of semiconductors, the internet and the digitalisation of photos, film and music. In times of historically low interest rates, European states should perform their duties by taking out new loans and investing in projects that promise more economic benefits.

- Higher investment in education, foremost in socially deprived communities with high unemployment and low future prospects. Such investment would help finance flagship initiatives to create modern, world-class schools. Education, knowledge and vocational qualifications are the key indicator of an economy that is both innovative and fairly distributing success. The individual and macroeconomic returns on investment in education have never been needed more.

We need social investment and modernisation projects which can usher in a new era of brighter prospects. The link between income and inequality has to be broken; opportunities have to be allocated more equally. This is a precondition of a society that is open to technological and scientific progress and which understands it, fosters it and actively adapts so that the society as a whole can benefit. It is a matter of competiveness that talent and know-how productively and sustainably integrate. More equality also means better future prospects. This should have priority in economic, labour market and tax policy. More equality, more prospects. More prospects, more future – that is the logic of a modern welfare state.

It is time to push for more solidarity and justice in Germany. We have to make sure that labour is secure in an era of digital advancements; that the balance of tax on capital assets and labour is fair; that tax evasion is restricted and that holding financial assets in off-shore banking centres is forbidden; that a European financial transaction tax and tax harmonisation system is put in place; that income in Europe cannot be as easily shifted from place to place to avoid paying taxes; and that the future of the rule of law and the welfare state are secured by establishing fundamental rights for the digital age and extending the income basis for our social security systems. Further, we have to support municipalities, so they can create more affordable housing and much more.

We have to start a debate. In fighting against inequality and for more equal distribution we must be brave and break with conventions. Social democracy should follow its values but not be afraid to discuss smart suggestions from academics such as the German Institute for Economic Research's ideas on the taxation of assets.

A big share of our society is economically, socially and culturally unsettled. They are waiting for a strong sign of solidarity – credible and long term.