Capitalism

Nobel Economist Says Inequality is Destroying Democratic Capitalism

Taking the free out of free markets is making a mockery of democracy.

Angus Deaton

At the launch of the IFS Deaton Review, a 5-year review of rising inequalities in the UK, Sir Angus Deaton decried extreme inequality and the system that allows it. "As it is, capitalism is not delivering to large fractions of the population."

We are about to embark on a large, ambitious, and open-ended review of inequalities. We are bringing together a distinguished group of scholars and writers from different disciplines. Each thinks about inequality differently, and together they encompass a wide range of methodological, political, and philosophical perspectives. At a first stage, currently underway, the guiding panel is asking each member of this larger group to write about one or other aspect of the topic; this collective effort will be one of our main products. At the second stage, the panel will write a synthetic volume. We will think about inequalities broadly—note my use of "inequalities" rather than "inequality"—and will not be confined to the traditional economic concerns with measures of the distribution of income and wealth, important although those are. Our main focus is the United Kingdom, but there is a great deal of recent thinking and evidence from other countries, particularly the United States, Scandinavia, and other European countries, and we shall repeatedly have to assess its relevance, and are often asking authors or combinations of authors to make the links.

As at no other time in my lifetime, people are troubled by inequality. In 2016, Theresa May, in her first speech as Prime Minister, said "we believe in a union not just between the nations of the United Kingdom but between all of our citizens, every one of us, whoever we are and wherever we're from. That means fighting against the burning injustice that, if you're born poor, you will die on average 9 years earlier than others." Jeremy Corbyn has called for a new economics to address what he called "Britain's grotesque inequality." President Obama said that he believed that the defining challenge of our time is to make sure that the US economy works for every American. Across the rich world, not only in America, large groups of people are currently questioning whether their economies are working for them. The same can be said of politics. Two-thirds of Americans without a college degree believe that there is no point in voting, because elections are rigged in favor of big business and the rich. Britain is divided as never before and, once again, many believe that their voice doesn't count either in Brussels or in Westminster. And one of the greatest miracles of the 20th century, the miracle of falling mortality and rising lifespans, is no longer delivering for everyone, and is now faltering or reversing.

Yet when people say that they are worried about inequality, it is frequently unclear what they mean or why they care. Economists think they know what they mean when they talk about inequality, and they produce charts of gini coefficients of income and of wealth, and when other social scientists say that they have wider concerns, economists—among whom I count myself—have often been too ready to tell them that they don't know what they are talking about. What we would like to do in this review, even with its large quota of economists, is to get a better understanding of exactly what it is that bothers people about inequality.

We will also think about how we might address concerns about inequality and which concerns need to be addressed. If the concern with inequality is simply envy—as is often claimed by the right—it is perhaps better to address the concern than the inequality. If the inequality comes from incentives that work for a few but benefit many, then we may want to do a better job of documenting the need for incentives and what they do for the economy as a whole. If working people are losing out because corporate governance is set up to favor shareholders over workers, or because the decline in unions has favored capital over labor and is undermining the wages of workers at the expense of shareholders and corporate executives, then we need to change the rules. Why are the myriad differences between men and women so persistent and so difficult to erase?

Given that we are just starting, it is perhaps presumptuous of me to say anything substantive at this point. But what I am going to say is what I myself think, or at least what I think today, and I look forward to changing my mind as we go; I wouldn't be chairing this review if I didn't expect that to happen. I am also perhaps too much influenced by my own work—particularly my recent work with Anne Case—and this work is primarily about the United States, though we have been doing quite a bit of thinking about how it applies to Britain.

At the risk of grandiosity, I think that today's inequalities are signs that democratic capitalism is under threat, not only in the US, where the storm clouds are darkest, but in much of the rich world, where one or more of politics, economics, and health are changing in worrisome ways. I do not believe that democratic capitalism is beyond repair nor that it should be replaced; I am a great believer in what capitalism has done, not only to the oft-cited billions who have been pulled out of poverty in the last half-century, but to all the rest of us who have also escaped poverty and deprivation over the last two and a half centuries. It also provides our jobs and the cornucopia of goods and services that we take for granted. And Milton Friedman, whose starry-eyed view of capitalism has much to answer for, was not entirely wrong when he extolled the freedom that free markets can bring. Though history has not been kind to his view that equality would be guaranteed by using markets to pursue freedom.

But we need to think about repairs for democratic capitalism, either by fixing what is broken, or by making changes to head off the threats; indeed, I believe that those of us who believe in social democratic capitalism should be leading the charge to make repairs. As it is, capitalism is not delivering to large fractions of the population; in the US, where the inequalities are clearest, real wages for men without a four-year college degree have fallen for half a century, even at a time when per capita GDP has robustly risen. Mortality rates are rising for the less-educated group at ages 25 through 64, and by enough that life expectancy for the entire population has fallen for three years in a row, the first time such a reversal has happened since the end of the first world war and the great influenza epidemic. Less educated Americans are dying by their own hands, from suicide, from alcoholic liver disease, and from overdoses of drugs. Morbidity is rising too, and they are also suffering from an epidemic of chronic pain that, for many, makes a misery of daily life.

In Britain, these inequalities are not so stark, at least not yet. But median real wages in Britain have not risen for more than a decade. One decade is much better than five decades, but we surely do not want to wait to find out whether the American experience will be replicated here. There have also been prolonged periods of real wage stagnation in recent years in Italy and in Germany. In those countries too, increasing overall prosperity is not reaching everyone. And as I noted above, democracy too does not seem to be working for everyone. The sense of being left behind, of not being represented at Westminster, is much the same as the sense of not being represented in Washington.

In Clement Attlee's 1945 cabinet—the cabinet that implemented the Beveridge Report and built the first modern welfare state—there were seven men who had begun their working lives at the coal face. When labor MPs from Glasgow set off to London, local bands and choirs came to the station to see them off as if they were going to war, which indeed they were. Only three percent of MPs elected in 2015 were ever manual workers, compared with sixteen percent as recently as 1979. The union movement, which once produced talents like those in Attlee's cabinet, has been gutted by the success of postwar meritocracy. Attlee's warriors would today have gone to university and become professionals; they would never have been down the pit, nor in a union hall. Meritocracy has many virtues, but, as predicted by Michael Young in 1958, it has deprived those who didn't pass the exams, not only of social status and of the higher incomes that degrees bring, but even of the kind of political representation that comes from having people like themselves in parliament. Young wrote, "The bargaining over the distribution of national expenditure is a battle of wits, and defeat is bound to go to those who lost their clever children to the enemy." He referred to the less educated group as "the populists" who, in turn, refer to the elite as "the hypocrisy."

What does history tell us? Not surprisingly, we have been here before. There have been several episodes where capitalism seemed broken, but was repaired, either on its own, or by deliberate policy, or by a combination of the two.

In Britain at the beginning of the 19th century, inequality was vast compared with today. The hereditary landowners not only were rich, but also controlled parliament through a severely limited franchise. After 1815, the notorious Corn Laws prohibited imports of wheat until the local price was so high that people were at risk of starving; high prices of wheat, even if they hurt ordinary people, were very much in the interests of the land-owning aristocracy, who lived off the rents supported by the restriction on imports. The Industrial Revolution had begun, there was a ferment of innovation and invention, and national income was rising. Yet working people were not benefitting. Mortality rates rose as people moved from the relatively healthy countryside to stinking, unsanitary cities. Each generation of military recruits was shorter than the last as their childhood nutrition worsened, from not getting enough to eat and from the nutritional insults of unsanitary conditions. Churchgoing fell, removing a major source of community and support for working people, if only because churches were in the countryside, not in the new industrial cities. Wages were stagnant and would remain so for half a century. Profits were rising, and the share of profits in national income rose at the expense of labor. It would have been hard to predict a positive outcome of this process.

Yet by century's end, the Corn Laws were gone, the rents and fortunes of the aristocrats had fallen along with the world price of wheat. Reform Acts had extended the franchise, from one in ten males at the beginning of the century to more than a half by its end, though the enfranchisement of women would wait until 1918. Wages had begun to rise in 1850, and the more than century-long decline in mortality had begun. All of this happened without a collapse of the state, without a war, or a pandemic, through a gradual change in institutions that slowly gave way to the demands of those who had been left behind.

America's first Gilded Age is another case. It also shows that the fundamental rules of the game can be changed. In the Progressive Era, four constitutional amendments were passed, all designed to limit inequality of one form or another. One instituted the income tax, one gave women the vote, one prohibited alcohol—strongly supported by women, who believed that alcohol abuse was an instrument of their oppression—and one an electoral reform that instituted the direct election of senators, as opposed to their previous appointment by state legislatures that were often dominated by business.

I have already mentioned the case that is most on my mind, the construction of the modern welfare state by Attlee's government after the Second World War. The Great Depression, like the stagnation of wages in the early 1800s, spawned a large literature on how to modify or abolish capitalism, and according to one version of the story, it was Attlee's government that tamed the beast and that made it possible for the tamed beast to deliver the unprecedented shared growth that many of us grew up on. Joe Stiglitz has recently written that he grew up in the golden age of capitalism though, as he wryly notes, it was only later that he discovered that it was the golden age. And, of course, it wasn't a golden age—at least in terms of material living standards or in terms of health—but perhaps it was such in terms of the rules of the game that allowed growing prosperity to be widely shared. I don't think that anyone would argue that the late 1940s was a golden age in Britain— there was bread rationing, petrol rationing, and to a young Angus Deaton, the terrible deprivation of sweet rationing, but the safety net that was built in those years played a role in fairly sharing, and perhaps even in helping generate, the prosperity that was to come.

That safety net is needed just as much today. Globalization and automation are challenging us today just as they did in the early 19th century. Safety nets are most needed when change is rapid, and it is one of the reasons why America is doing so much worse—most obviously in deaths of despair—than are wealthy European countries. But what is happening today is also a real threat to Britain and to Europe.

The argument that Anne Case and I are making in our new book is that less-educated white men and women in America have had their lives progressively undermined, starting in the 1970s, and showing up, since 1990, in rising numbers of deaths from suicide, alcoholic liver disease, and drug overdoses. African Americans experienced a similar disaster thirty years earlier and the improvements in their lives since then have protected them to an extent. In the face of globalization and innovation, many of us would argue that American policy, instead of cushioning working people, has instead contributed to making their lives worse, by allowing more rent-seeking, reducing the share of labor, undermining pay and working conditions, and changing the legal framework in ways that favor business over workers. Inequality has risen not only due to wealth generation from innovation or creation, but also through upward transfers from workers. It is not inequality itself that is hurting people, but the mechanisms of enrichment.

How much is this a threat in Britain? Some of the mechanisms of enrichment are not operative here. The US wastes about a trillion dollars a year on a healthcare system that is very good at enriching providers, hospitals, device manufacturers, and pharmaceutical companies, but very bad at delivering health. You do not have that problem. The US has licensed pharma companies to sell opioids to the general public, including for chronic pain, which ignited an epidemic of addiction and death with a cumulative death toll larger than all Americans lost in both World Wars. You too use opioids, but usually in hospitals, not in the general population. Yet the opioid manufacturers are following the model of tobacco manufacturers, and working hard, when blocked in the US, to expand elsewhere. Purdue Pharma has a subsidiary, Mundipharma, that agitates on behalf of the greater pain relief that they argue opioids can bring. As I write this, Matt Hancock, the Minister of Health, noted that “things are not as bad here as in America, but we must act now to protect people from the darker side of painkillers.” The BBC news report on this carries a chart showing the extraordinary geographical inequality in opioid prescriptions in England, with prescription rates five times larger in Cumbria and the North East than in London. As the briefing note for this launch shows, deaths of despair are rising in Britain, particularly in less successful parts of Britain, just as they are in other English-speaking countries, though the numbers (and death rates) are small compared with the US.

What about wages? The US has extensive business lobbying, which the UK does not have, or at least not in the same overt form. (The US also had very little prior to 1970, so it could happen here too.) As in the US, unions have become much less powerful in Britain, a decline that many have welcomed, but their countervailing power in boardroom decisions may have protected wages and working conditions. Unions provided social life and political power for many people who have less of both today. The replacement of stakeholder capitalism by shareholder value maximization is widespread in the US and has been remarked on here, too. Paul Collier has noted that Imperial Chemical Industries, once the crown jewel of British industry, used to boast “we aim to be the finest chemical company in the world,” but that, before it was lost to takeovers and mergers in 2006, it had changed its slogan to “we aim to maximize shareholder valuation.”

In Britain, as in America, some cities and towns are doing much better than other cities and towns, and the easy mobility that tended to keep these differences in check seems to have been much reduced. America has no city that is as dominant or as uniquely prosperous as is London.

Political dysfunction in Britain is different, but there is a common thread that many voters believe that they are not well represented. And there are sharp differences across groups, with age, education, ethnicity, gender and geography important in both countries.

I think that people getting rich is a good thing, especially when it brings prosperity to others. But the other kind of getting rich, "taking" rather than "making," rent-seeking rather than creating, enriching the few at the expense of the many, taking the free out of free markets, is making a mockery of democracy. In that world, inequality and misery are intimate companions.

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