SUERF
THE EUROPEAN MONEY AND FINANCE FORUM

SUERF Policy Note
Issue No 91, August 2019

How to Make Capitalism Work for All?

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JEL-codes: D3, O11, O15, O43.

Keywords: capitalism, inequality, income gaps, equal opportunities.

The issue of inequality has come at the forefront in the last decade. The occurrence of the global financial crisis triggered the debate, as inequality was perceived as one of the roots of the crisis. Data evidence points to rising uneven income distribution from the 1980s onwards, yet with evident differences among countries. The divergence relates to educational inequalities, differences in tax progressivity, institutional quality. Given the erosion that unequal societies might face, policy makers should address the issue. Some of the available policy options are improvement of the access to markets and levelling the playing field, increasing financial inclusion, investing in human capital, regulatory and institutional reforms that strengthen the rule of law and promote competitive and fair business environments.

In the last decade, the issue of income inequality has come at the forefront. We have been beholding a substantial proliferation of literature, as well as academic and political debates on the different modalities of inequality, the impact of political and economic factors, the adverse consequences of inequality in our societies and the overall wellbeing. Standard metrics on inequality do point to a widespread and rising phenomenon. It obviously underpins the rising populism that reflects the dissatisfaction with the system that fails to create equal opportunities for everyone, a system where reward is not merit based, i.e. system that gradually evolves into a crony capitalism. Therefore, one of the most important economic topics of today is "How to Make Capitalism Work for All?”

It was the burst of the financial crisis and the global recession that turned everyone's eye back to the concept of income inequality, in particular. As economists, we all knew that market based system inherently brings some inequality, but its disruptive power is unthinkable when boundaries are crossed. Let us look through historical lenses – what questioned the sustainability of capitalism and led to Marxism was the stagnation of wages and concentration of wealth in the early phases of industrial revolution. It gave ground for rising inequality, and as Thomas Pikketty, the so-called Modern Marx, reveals in his book *Capital in the Twenty-First Century* - the only exception from this rising trend of global inequality is the period from 1914 to 1970s, as a historical outlier.

Indeed, actual data has indicated rising income inequality from the 1980s onwards almost across the board, although with different intensity. This turning point is very often associated with the end of the so-called "post-war egalitarian regime" around the globe. Data retrieved from the 2018 World Inequality Report reveals that in 1980, the income share of the top 10% in the income distribution in Western Europe, North America, China and India was around 30-35%. By 2016, this percentage rose to around 35-40% in Western Europe, while the increase in the other regions was stronger, reaching 45%-50% of the total income. One might notice the remarkable difference in the income concentration at the top-level earners in Western Europe and the US, meaning the inequality has diverged substantially in these two groups for almost four decades.

This so-called "modern" surge and divergence in inequality leads economists to wonder which forces tend to prevent benefits of capitalism from being widely distributed. Observing the US – Europe nexus, apparently the level of development does not always matter how the income distribution could look like. There are policy tools and fundamental values in the society that could affect the distribution curve markedly. For instance, many authors associate the divergence in Western Europe and the US with the educational inequalities and less progressive tax system in the US. On the other hand, in Western Europe, tax progressivity declined moderately, but even more importantly, the educational system and wage setting policies are thought to be relatively more favorable to low and middle income groups. Hence, equal opportunities to higher quality education, in particular nowadays when technology is rapidly advancing, could be one of the remedies for the "illness" of inequality. It could enable young people at the bottom of the income distribution to get access to better-paid jobs, and hence flatten the income distribution curve.

In the context of the CESEE region, it seems that some of these, though far from exhaustive income inequality indicators do place us comparatively well to the rest of Europe. The top 10% of the income distribution has a share of close to 29% of the total income, lower compared to Europe. Same holds for the bottom 50% of the distribution with a share of around 25%, almost on par with the percentage of Western Europe of around 22%. Nevertheless, if observed in a dynamic context, what is visible is an increase in inequality in the income distribution at the onset of the transition process. The social impact of the transition from the socialist system, a system of guaranteed employment, on markets governed by supply and demand brought many changes, including rising unemployment. "Governments also found themselves unable to maintain the generous universal benefits of the socialist era, especially given the adverse demographic trends (IMF, 2014)". As with unemployment, inequality increased sharply in the initial stages of transition, and oscillated less afterwards.

Apparently, the issue of rising unequal income distribution is neither new, nor the world has been shielded from tectonic changes in the systems, such as the transition in Europe, which was "fertile soil" for rising inequality. However, it is only in the last ten years that we have witnessed such substantial proliferation of literature, and academic and political debates on the roots and consequences of rising income inequality. It was the financial crisis that brought the issue to the fore. Even more, some authors link the severity of the financial crisis and its unexpected spell, exactly to the uneven societies. In his book *Fault Lines*, Raghuram Rajan argued that rising inequality in the past three decades has led to political pressure for redistribution that eventually came in the form of subsidized housing finance, which was at the root of the global crisis.

Whether or not central bank policies affect the income distribution, gained a lot of attention, as well. I would say that the pure fact that we inherently face with heterogeneity across households in terms of their primary sources of income – capital or labor - or with respect to their position of being saver or borrower naturally implies that monetary impact, at least in the short-term, could differ along these groups. Macro-prudential measures, by design are targeted and selectively used to tackle identified points of vulnerability. Purchase of different types of assets also significantly alters the pricing on the financial markets and can have different wealth effects. Still, given the rationale and the features of central banking policies, as Ben Bernanke (2015) states: "By comparison to the influence of (these) long-term factors, the effects of monetary policy on inequality are almost certainly modest and transient". These long-term factors influencing inequality relate to globalization, technological progress, demographic trends, and institutional changes in the labor market.

How should we tackle the chronic problem of uneven income distribution that seems to be a symptom of many fundamental weaknesses of the system? How to return the greatness of the opportunities that modern society should bring? Should the way forward be stronger regulation, more active redistributive role of the state or as Prof. Luigi Zingales claims, through harnessing the power of competition? At the current juncture, when global growth slowdown is on the horizon, pro–growth and pro–equality policies seem inevitable.

We, as policymakers, must reflect on the array of available policies such as improving access to markets and levelling the playing field, increasing financial inclusion, investing in human capital, regulatory and institutional reforms that strengthen the rule of law and promote competitive and fair business environments. We cannot only play the role of "innocent bystanders", scrutinizing and stocktaking, but putting in place reforms that promote strong and inclusive growth that by its nature reduces inequality. Thus instead of re-slicing the pie, more focus is needed on ensuring that the pie gets bigger and more inclusive.

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