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Inequality: the real political poison of our time

While immigration and globalisation polarise politics across the developed world, rising inequality may be the main reason for public discontent

In 2013, US President Barack Obama described inequality as 'the defining challenge of our time'. It is easy to see why. Over the past 35 years, most countries in the developed world have experienced a dramatic rise in economic inequality. Even as other barriers were knocked down and challenges were met, a growing divide between the haves and have nots has characterised many of the richer nations of the world.

Today, inequality appears to be a key driver behind the fractious and feverish nature of much of our politics. Old certainties about the role of the state and the drivers of prosperity are being questioned, as many countries find themselves trapped in a protracted period of stagnating wages and sluggish economic growth.

The danger is that we'll learn the wrong lessons, and that the institutions that have helped to make us safer, and lifted living standards, will lose their legitimacy. In the UK, over 80 per cent of the population believes the gap between the rich and poor has grown too large, and over 70 per cent believe government has a role to play in reducing this inequality. Polls conducted across developed nations return similar results, revealing wide dissatisfaction with a perceived lack of fairness in political and economic systems.

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Countries that continue to ignore the growing public unease caused by inequality are likely to struggle to rebuild confidence in government, or to heal the divisions that have opened up in several developed nations. More importantly, they will also fail to deliver what so many people across the world are clamouring for: more equal societies, with power, wealth and income more evenly shared, where everyone has agency over

their own lives, and a genuine chance to fulfil their potential.

Rising inequality is not inevitable, it is largely a result of the political and economic decisions taken by governments. This is clear from the varying levels of inequality in EU countries, and the processes by which these have come about.

The benefits of good old-fashioned taxation

Perhaps the most obvious area in which countries have been more or less effective in keeping inequality in check is taxation and fiscal redistribution. While many European countries have seen top income tax rates fall in recent years, with expected subsequent increases in inequality, more equal countries such as Denmark, Sweden and Finland have retained top income tax rates of well over 50 per cent. Fiscal redistribution drastically reduces inequality in all developed countries, including the UK and US, but there are significant differences between them. Predictably, the Nordic countries have higher rates of redistribution than the UK, but so do other more equal countries such as Belgium, France, Germany and Ireland.

Taxation and redistribution of income are not the only effective methods by which to tackle inequality. Japan's redistribution rate is low compared to many other developed economies, but starting from a much lower level of market inequality, it results in a lower overall level of economic inequality. This points towards important measures to reduce inequality beyond 'tax and spend' approaches.

For example, corporate governance provides a clue as to the varying degrees of inequality in Europe, and to the likely effective ways of reducing this. In the UK, a corporate culture that appears to lionise executives and downplay the importance of workers has been a clear driver of inequality, and a possible drag on productivity and growth. This is reflected in, and reinforced by, pay setting procedures. Remuneration committees benchmark executives' pay against their peers, often opting to pay within the upper quartile. As each company attempts to be within the upper quartile of its peer group, this has the effect of ratcheting up overall levels of executives' pay each year, irrespective of their performance. At the same time, many of these same executives are overseeing the freezing of workers' wages – cost cutting exercises that work to increase profits, a measure which in turn often increases executive remuneration further.

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In more unequal countries such as the UK, the result is that while executives' pay has continued to accelerate since the financial crash, pay for many others has stagnated. Financial Times Stock Exchange (FTSE) 100 CEOs saw their pay increase by 10 per cent between 2014 and 2015 alone.

A corporate culture of executive excess may not be easy to change in the short term, but there are encouraging signs that measures can be taken to address this. The compulsory publication of a single figure for CEO pay, required in the UK since 2013, appears to finally have an effect in Britain following a barrage of negative press, shareholder revolts and public criticism. In fact, the average pay of FTSE 100 CEOs actually fell by 17 per cent in 2016. With new measures announced to publish pay ratios between bosses and workers, there is reason to be optimistic.

However, this points to another key area of policy and culture that helps explain varying levels of inequality in developed nations: the broad area of business models and industrial relations.

More equal countries listen to their workers

Anyone who has experienced the unreliability of Southern Rail's service in the UK will know that industrial relations in more unequal countries such as the UK leave a lot to be desired. While some other more equal countries, such as France, also suffer from disruptions due to industrial action, many others, such as Germany, enjoy far more cordial relations between management and workers.

A key reason for this is that in more equal countries, businesses are often required to listen to, and consider, the opinions of workers. Most countries with a richer population than the UK have employee representation on boards, for example. It is unlikely to be a coincidence that the majority of these countries are also more equal. Not only does this provide businesses with a wealth of experience and knowledge to draw upon, it also allows for more productive relations between management and workers. Sweden, Luxembourg and the Netherlands, amongst others, all have companies which use unitary boards, as in the UK, and have employee representatives on them. There are several different models of employee representation on company boards, and

how these representatives are chosen, but some form of representation is common across more equal - and successful - economies.

In countries such as Germany, employee ownership models are also more commonplace, and are almost certainly a key dampener on runaway inequality. Unfortunately, in more unequal countries such as the UK, there is less history of such organisations, and even less political enthusiasm for their promotion.

In much of Europe and the rest of the developed world, we are at a crossroads. For many, the dividing line is between protectionist nationalism and a globalised, liberalised approach to politics and economics. However, this misses a more important, older divide – between those who wish power and wealth to remain concentrated in the hands of a few, and those who wish to see control and prosperity enjoyed by the many. The lesson from Europe is that there are measures that can reduce inequality that do not involve retreats into nationalist agendas or reduced worker's rights. If governments are to survive ongoing turmoil and build legitimacy, they will need to look at these and new ideas to build more equal, fairer societies.



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