

Inequality and Recession in Britain and the USA

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ABSTRACT

For two of the richest English-speaking countries, Britain and the United States, growing income inequality has been a persistent feature of the past thirty years, leading some economists to question the cosy assumption that as economic development proceeds, intra-country inequality must ultimately fall. Various hypotheses have been advanced to explain this phenomenon, the best known being that the technological revolution has driven a wedge between skilled and unskilled labour, but none is remotely convincing. Fundamentally, it is a question of political economy whether under conditions of stagnant real wages and a falling wage share, growth in deregulated, finance-driven economies can last. The argument advanced here is that probably it cannot. The profit squeeze of the 1970s having given way to a neoliberal wage squeeze, growth came to depend on asset bubble driven consumption and investment. The Great Recession of 2008 raises questions not merely about neoliberal beliefs, but about whether future capitalist growth can occur unless investment is socialized.

INTRODUCTION

‘This is the second generation of people who can’t imagine change except in their own lives, who have no sense of social collective public goods or services, who are just isolated individuals desperately striving to better themselves above everybody else’.¹

There are at least two reasons why growing income inequality² and the Great Recession of 2007–09 in rich countries such as the USA and the UK should be of concern to development specialists. First, until relatively recently, major financial and economic crises had been confined to the developing world; e.g., Argentina 2001, Russia 1998, East Asia 1997 and Mexico 1995. The Great Recession has shattered the widespread presumption that the smooth operation of a sophisticated market system made such crises

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1. Tony Judt, quoted in Pilkington (2010).
2. This paper principally addresses inequalities of income and wealth rather than equally important questions of gender and ethnicity inequality.

unlikely in Washington DC or London. Secondly, it is a corollary of much developmental thought that as capitalist countries grow very rich, they tend to become more equal; i.e., that some form of the ‘Kuznets hypothesis’ holds true (Kuznets, 1955). This comfortable view has been rudely challenged by the precipitous rise of inequality in Britain and the USA since 1980. Globalization is eroding the customary distinction between ‘developed’ and ‘developing’, between rich and poor nations — the crisis appears to be widening the gap between the haves and have-nots everywhere. That is why this contribution focuses on the exemplars of free-market capitalism, Britain and the United States.³

In late 2010, Britain’s low-wage, high-debt economy remained in worse shape than any other major EU economy. Peak-to-trough output in the period 2007 to 2009 fell by 6.2 per cent (more than during the Great Depression of the 1930s) and for six quarters in succession (longer than in any other OECD country). Although growth in the second quarter of 2010 was a higher-than-expected 1.1 per cent, the advent of a new coalition government wedded to immediate swingeing budget cuts has led many economists to fear that the recovery would be short-lived and followed either by a ‘double dip’ recession or by a ‘stagnating’ recovery at a trend growth rate of 1–1.5 per cent, well below the pre-recession level of 3 per cent. In the USA, the comparable peak-to-trough figure was only about 4 per cent and the economy has emerged from recession sooner, but unemployment remains at nearly 10 per cent and property repossessions have not yet bottomed out (Elliot, 2010).

Ostensibly, this bleak picture results from the breadth of the economic recession, and the financial collapse and contagion which preceded it. But there are deeper historical reasons for the crisis. In both Britain and the USA, the Reagan–Thatcher era aimed to reverse the gains secured by the labour movement in the post-war years. By means of de-industrialization, financial deregulation, the growth of a ‘parallel’ banking sector and the establishment of a ‘flexible’ labour market — which entailed greatly weakening the trade unions — the 1970s ‘profit squeeze’ was transformed into a wage squeeze and the profit share in GDP rose accordingly. The 1990s dot.com boom, followed by the housing boom, saw the wages of the poorest 40 per cent stagnate in the USA and lag behind GDP growth in the UK. In turn, low wages and cheap credit meant that household debt exploded.

The high-debt economy was fuelled by the growth of the financial service sector; the enormous bonuses earned on Wall Street and in the City were not about ‘wealth creation’ but about income redistribution. The gains from higher labour productivity, which should have accrued in the form of increased wages to workers, were increasingly siphoned off by the super-rich. Nevertheless, debt-fuelled consumption continued to rise, driving investment and economic growth.

3. The reader should note that 2007–08 is used as a cut-off point for much of the data, coinciding with the beginning of the recession.

Until the end of the property boom in 2007–08, growth in Britain had been pretty steady for nearly a generation, and inflation and unemployment had remained relatively low. What was true for Britain was also true for the USA and some (though by no means all) of the OECD countries. After the initial dot.com bubble burst in 2001, recession was forestalled by looser monetary policy in the USA, the country which had served as the engine of the OECD economy throughout the post-war period. Indeed, one had to look back to the early 1990s for mild recession and the early 1980s for the last serious recession in the USA and Britain. As one insightful commentator has noted, what drove the British economy was ‘private Keynesianism’ — the apparently unlimited buoyancy of consumer demand animating the spirits of investors (Crouch, 2008). But is the story solely about a credit boom (and crunch) and too much private borrowing and leveraging?

In fact, the current crisis can only be understood as part of a much wider picture, a trajectory which started with the profit squeeze of the 1970s. The striking growth of income inequality and the fall in labour’s share of national income, I argue, are merely different sides of the same coin. A key question, examined in the latter part of this article, is how consumer demand is to be maintained in a low-wage, low-welfare economy? The answer lies in the credit and asset price bubble which neoliberal economic policies helped spur. In short, the period of recession and slow growth which advanced economies now seem condemned to live through should be seen neither as a historical accident nor as the result of some anonymous process of globalization. Rather, the crisis is rooted in the political economy of the past thirty years.⁴ Without the language of political economy, we are powerless to analyse it (Irvin, 2007, 2008, 2009).

THE PROFIT SQUEEZE OF THE 1970S

In the three decades following 1945, Western Europe and the USA experienced solid economic growth, buoyant private and public investment and steady productivity and wage growth against a background of low unemployment, low inflation and stable exchange rates governed by the Bretton Woods arrangements. But post-war prosperity, driven by the twin motors of European reconstruction and an apparently unlimited US capital outflow with which to finance the growth in international trade, contained within it the seeds of its own downfall.

In retrospect, three factors stand out in explaining the end of the post-war boom — *la fin des trente glorieuses*. First, as the share of wages in National Income of the OECD countries rose, the share of profits fell and

4. An outstanding analysis of the political economy of this period is provided by Jamie Galbraith (2009). Also see an excellent recent paper on the underlying causes of the current crisis in the USA by Thomas Palley (2009).

investment — particularly in manufacturing — slowed, in turn slowing productivity growth.⁵ A sharp decline in labour productivity took place after 1973 throughout the OECD. As productivity slowed, the struggle over distributional shares intensified between the economic elite and ordinary working people. Rising inflation, ostensibly triggered by the oil price rises in the 1970s, was in good part a reflection of this struggle.⁶

A second factor was the growing cost of the cold war. The USA, the self-appointed guardian of the ‘free world’, was particularly affected by the difficulties of financing high defence expenditure at home and war overseas. As inflation began to bite in the early 1970s, the external current deficit swelled and US gold reserves dwindled. In 1971, dollar parity with gold was abandoned, precipitating the collapse of the Bretton Woods system and the emergence in 1973 of a regime of flexible exchange rates.⁷ The shaky nature of world financial institutions was amply demonstrated by the secondary banking crisis of 1973–75 (Reid, 2003).

The third factor was the internationalization of competition. The late Andrew Glyn⁸ summarized admirably the combined effects of wage pressure, slowing productivity, trade uncertainty and globalization on the rate of profit:

the net rate of profit on capital employed in manufacturing [in the OECD] had fallen by nearly one half by the end of the 1970s [relative to 1970]. It was apparent that the profit squeeze was reflecting a combination of militant wage pressure pushing up . . . [costs] and international competition restraining price increases. The rise in imported material costs and the weakening of productivity growth . . . further exacerbated the distributional struggle. (Glyn, 2006: 7)

Many economists have come to accept this interpretation of the root causes of the 1970s crisis. For example, Roberto Torrini (of the Bank of Italy and the London School of Economics) has written: ‘A widely accepted explanation for the fall in the profit share during the 1970s is the unprecedented wage-push episode which occurred in many European economies in the first half of the decade, together with the first oil shock and the slowdown in total factor productivity growth’ (Torrini, 2005: 1).

If one accepts that the post-war growth in working-class power played a central role in precipitating the crisis, one must accept that curbing this power was the main aim of capitalists as they sought to emerge from crisis.⁹

5. This trend was first identified by Glyn and Sutcliffe (1973).

6. An historical account of the wage-profit squeeze not dissimilar to my own is found in Holtham (2008).

7. The ‘Bretton Woods system’ refers to the post-war system of trade arrangements and regulatory institutions agreed at a conference in Bretton Woods, New Hampshire in 1944; in particular, a fixed exchange rate regime was agreed and countries could only devalue with the approval of the International Monetary Fund.

8. For an overview of Glyn’s work see White (2008).

9. To a degree, of course, declining working class power accompanied the decline in traditional industries, a trend first identified in a prescient article by Hobsbawm (1978).

Table 1. Unemployment Rate Averages in Selected Industrial Countries, 1971–90

Year	USA	France	Germany	Italy	UK
1971–75	6.1	3.1	1.4	3.5	3.8
1976–80	6.8	5.5	3.2	4.2	6.2
1981–85	8.3	9.0	6.2	5.6	10.5
1986–90	5.9	10.0	6.0	7.6	8.9

Source: Irvin (2008: Fig 3.3).

Table 2. Inflation Averages in Selected Industrial Countries, 1971–90

Year	USA	France	Germany	Italy	UK
1971–75	6.8	8.9	6.1	11.5	13.2
1976–80	8.9	8.5	4.0	17.1	14.4
1981–85	5.5	9.6	3.9	13.9	7.2
1986–90	4.0	3.1	1.3	5.7	6.0

Source: Irvin (2008: Fig 3.2).

At the same time, it must be borne in mind that creating a ‘reserve army’ of unemployed was not a universal response in rich countries of the OECD. Once again in the words of Glyn:

At one extreme is the ‘market’ solution of low real-wage increases and expanded job opportunities in the market sector. At the other, more interventionist end, subsidies to preserve jobs in the market sector are combined with heavy taxation accepted by workers to finance expansion of public-sector jobs. The former, to which the USA approximates, represents a rough and ready egalitarianism, or spreading of the misery, which is the rougher the more pronounced are earnings differentials. The latter is the conscious, social-democratic egalitarianism exemplified by Sweden in the 1970s and early 1980s, but generally somewhat reined in during the later 1980s as limits to the compression of take-home pay were reached. (Glyn, 1992: 82)

There can be little doubt about the inflation and unemployment figures for the largest OECD countries over the period 1970 to 1990. Inflation rose in the 1970s while in the 1980s, unemployment in several countries rose to heights not experienced since the 1930s (see Tables 1 and 2). At the same time, union membership declined and the influence of the trade union movement ebbed away — nowhere more so than in the UK where Mrs Thatcher’s defeat of the miners in 1984–85 was emblematic.

Inflation coupled with mass unemployment not only neutralized workers’ power, it destroyed whole industries and impoverished substantial numbers of workers. In the UK, while inflation had been high in the mid-1970s, it had fallen by 1979. In the early 1980s when Thatcher came to power it rose again. As for unemployment, by 1984 the headline figure rose above 10 per

cent (or three million workers) where it remained until the end of 1986. Unemployment led to massive poverty and inequality.

THE REAGAN–THATCHER REVOLUTION IN THE USA AND BRITAIN

Underlying the Reagan–Thatcher political project of the 1980s were structural changes in both the United States and Britain; namely, the decline of industrial capital and the trade unions, the rise of the international financial sector and the growing importance of the two-tier service economy — low-wage and low-skill (e.g., MacDonald’s, Wal-Mart etc.) and high-tech (e.g., Microsoft, Goldman Sachs etc.). In the decade that followed, the much-hyped ‘new economy’ helped to fragment labour markets, change the structure of remuneration, weaken job security and the relative bargaining power of capital and labour and spread neoliberal ideology. Growing inequality fed back into the political consolidation of neoliberalism in a variety of ways ranging from the shift towards individual and corporate donations in the funding of political parties, to the concentration of media power in the hands of fewer owners and the reduction and commoditization of politics into sound-bites and spin. In short, the modern Anglo-Saxon model explicitly challenged the European ‘welfare state’ version of the market economy under which a relatively strong, democratically financed state mediates conflicts between capital and labour and guarantees political and social cohesion and high levels of public provision.

It is crucial to emphasize that the Reagan–Thatcher project itself was a response to the decline of US and British industrial hegemony in the post-war period. Having been dominant globally for half a century, by the 1970s Britain was the ‘sick man of Europe’ and the USA was rapidly losing its manufacturing dominance, in part because of an inflation-financed war, but crucially because it faced stiff competition from reconstructed Europe and emerging Asia — what today we would call the result of ‘globalization’. As profits fell and share prices stagnated, Wall Street complained increasingly that the fault lay with stodgy corporate executives whose salaries were paid regardless of performance; the mantra of ‘maximizing shareholder value’ began to be heard. Spurred on in the early 1980s by the appearance of corporate raiders and junk-bond finance, US corporations began to restructure by selling off entire divisions, becoming ‘lean and mean’ and looking for new ‘synergies’ through mergers. Above all, ‘maximizing shareholder value’ meant tying CEO remuneration to market performance, crucially through the use of share options, thus laying the basis for a quantum leap in executive rewards and the rise of a new class of super-rich whose influence soon spread to Britain.

The Reagan–Thatcher period also saw the introduction of important legal milestones which would affect the distribution of wealth and power. In the UK, the explosive growth of financial services accelerated after the

large-scale deregulation and streamlining of City transactions under the ‘big bang’ legislation of late 1986. This boost in comparative advantage gave London the decisive edge over Frankfurt and New York. The end of national wage bargaining and a variety of anti-union measures following the defeat of the miners in 1986 constrained union activity; Britain’s strong exchange rate policy favoured the financial sector and helped underpin long-term deindustrialization. Moreover, Britain’s relatively lax tax residency law, coupled with the absence of the direct taxation of land or financial assets, lax inheritance laws and low rates of tax on income, helped make the country a leading tax haven.

In the United States during the 1980s, airlines, trucking, banking and some utilities would be deregulated while industrial concentration — as reflected in growing corporate mergers — would grow explosively in the 1990s. As top corporations became more concentrated, CEO pay grew disproportionately, aided by favourable tax legislation. Reagan’s Economic Recovery Act of 1981 greatly reduced top rates of personal tax while extending corporate tax write-offs and easing depreciation rules; further tax reductions followed in 1986. Income inequality grew strongly under Reagan and Bush the Elder, a trend the Clinton years did little to reverse.

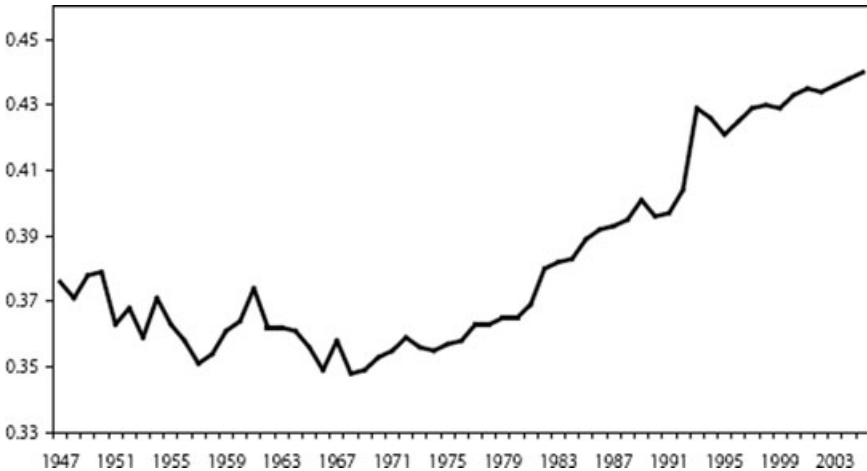
Indeed, the 1997 ‘Taxpayer Relief Act’ under the Clinton administration produced another bonanza for the wealthy: it is estimated for every US\$ 1 in tax savings going to the bottom 80 per cent, the top 1 per cent of income earners saved over US\$ 1,000 in tax. While swathes of unionized skilled workers lost their jobs as traditional industries disappeared, the remuneration of top CEOs kept on growing. As the president of the New York Federal Reserve Bank, William J. McDonough, noted in a speech to mark the first anniversary of 9/11, in 1980 America’s top executives on average earned about 40 times as much as the average worker; by 2000 the ratio was 400:1, a jump impossible to explain by corporate performance.¹⁰

INCOME INEQUALITY, TECHNOLOGY AND TAXATION

The conventional economic explanation of why income distribution in the USA (and to a lesser extent in the UK) has worsened is that the new economy puts a greater premium on high levels of education and entrepreneurship. Doubtless there is some truth in the ‘skill-biased technological change’ view, but recent studies confirm that the change in labour productivity patterns alone does not explain the very high degree of inequality now observed in

10. See Pizzigati (2004: 451, 479). A study by Crystal concluded that differences in corporate performance explained only a tiny fraction of differences in corporate rewards; the main explanatory variable was corporate size; see Day (2000); for the UK also see Dorling (2010).

Figure 1. US Family Income Inequality, Gini Coefficient, 1947–2005



Source: Mishel et al. (2007: Figure 1L).

the Anglo-Saxon countries (see Figure 1 for the USA).¹¹ Paul Krugman has summarized this debate aptly:

[W]hile most economists used to think that technological change . . . was the principal cause of America's rising inequality, that orthodoxy has gradually been wilting as researchers look more closely at the data. . . . [M]any have come to believe that an erosion of the social norms and institutions that used to promote equality, ultimately driven by the rightward shift of American politics, has played a crucial role. (Krugman, 2008: 8–9)

After all, the Nordic countries too enjoy high levels of productivity growth and have produced some of the world's most technologically advanced and dynamic industries; yet there is no sign that inequality has greatly increased in these countries over the past three decades.

Historically speaking, economists have seen economic growth and average productivity growth as two sides of the same coin. If labour productivity growth is high, one would expect the average real wage to be growing. In effect, labour productivity growth and wage growth in the Anglo-Saxon countries have become 'decoupled' from one another. An influential paper by Ian Dew-Becker and Robert Gordon (2005) showed that in the USA over the period 1966 to 2001, only the top 10 per cent of the income distribution enjoyed a growth rate of real wage and salary income equal to or above the average rate of economy-wide productivity growth. Median real wage and salary income barely grew at all. Half of the income gains in the USA went

11. See for example Mishel et al. (2007). An excellent early critique of the 'skills-based' change explanation is Jamie Galbraith (1998).

to the top 10 per cent of the income distribution, with little left over for the bottom 90 per cent. Moreover, only half of the increase in inequality is attributable to gains of the 90th percentile group relative to the rest. Crucially, the other half is due to the increase in inequality within the top 10 per cent.

Dew-Becker and Gordon (2005) argue that too little attention has been paid to the latter phenomenon, i.e., to the growth of inequality within the top decile. They attribute this growth in large measure to two complementary factors. One is the growth of ‘winner-take-all’ markets — markets in which enormous rents go to a few superstars.¹² The other is the escalating earnings of corporate CEOs. Between 1966 and 2001, the median wage in the USA hardly increased in real terms. By contrast, average earnings of the top decile (the top 10 per cent) increased by 58 per cent. More striking still is the fact that over the same period real earnings of the top 1 per cent increased by 121 per cent; the corresponding figure for the top 0.1 per cent was 256 per cent and for the richest .01 per cent the increase was 617 per cent. In their view:

Growing inequality is not just a matter of the rich having more capital income; the increasing skewness in wage and salary income is what drives our results This source of divergence at the top, combined with the role of de-unionization, immigration, and free trade in pushing down incomes at the bottom, have led to the wide divergence between the growth rates of productivity, average compensation, and median compensation. (Dew-Becker and Gordon, 2005: abstract)

Three factors are of particular importance in explaining the explosive growth of CEO compensation in the three decades since the early 1980s: share options, leveraged buyouts and the growth of financial corporations. Granting a low-priced option to buy shares (which can be exercised at some future date as the market rises) became a favoured way of rewarding top executives in the 1980s, initially because of their tax advantage.¹³ During the long boom of the 1980s–90s, as the use of share options became ubiquitous, CEO rewards grew hugely. In the words of *The Economist*: ‘the story behind the growth of pay in the 1990s is really the story of the option. In 1992, S&P 500 companies issued options worth \$ 11 billion . . . in 2000 the number reached \$ 119 billion’.¹⁴

The growth of super-rewards has often been a defensive response to the buyout and merger phenomenon.¹⁵ A leveraged management buyout is merely a debt-funded takeover in which a specialist company — aka, ‘corporate raider’ — gains control of the assets of a limited liability corporation,

12. The phrase ‘winner-take-all markets’ is from Frank and Cook (1995); also see Frank (1999).

13. In the USA, options cashed in by executives become tax-deductible expenses for companies. By the 1990s, the use of options is thought to have cut billions off corporate tax bills (Pizzigati, 2004: 11).

14. See ‘A Special Report on Executive Pay’, *The Economist*, 20 January 2007.

15. In 1999 alone, mergers in the USA totalled US\$ 1.75 trillion, ten times the value of mergers in 1990 (Pizzigati, 2004: 171).

changes its status from public to private, uses its cash flow to service debt, sells off assets (typically greatly profiting the new owners) and ultimately sells the shell back to shareholders. Major swashbucklers in this business include Morgan-Stanley and Kohlberg-Kravis-Roberts, the firms behind the infamous RJR Nabisco buyout in the USA, and financiers such as James Goldsmith and Philip Green in the UK.¹⁶ Most important, in the USA, it is estimated that executives of non-financial companies represent only some 20 per cent of the highest-paid CEOs (and even fewer in Britain). Riding on the back of the 1990s boom, financial consultants, senior investment bankers, fund managers and other top people in the financial services sector became prominent in the US rich-list. ‘To qualify for Institutional Investor’s Alpha magazine rankings of top hedge-fund managers in 2005, you had to earn \$ 130 m [annually]’.¹⁷

Equally, over the same period the incidence of total taxation in the USA became less progressive. A seminal paper by Piketty and Saenz (2006) investigated this issue; the authors summarized their conclusions as follows:

The progressivity [sic] of the U.S. federal tax system at the top of the income distribution has declined dramatically since the 1960s. This dramatic drop in progressivity is due primarily to a drop in corporate taxes and in estate and gift taxes combined with a sharp change in the composition of top incomes away from capital income and toward labour income. The sharp drop in statutory top marginal individual income tax rates has contributed only moderately to the decline in tax progressivity. (Piketty and Saenz, 2006: 1)

During and immediately after World War II, the top marginal rate of income tax in the USA ranged from 84 to 94 per cent. From the early 1950s to the mid-1960s, the top rate was 91 per cent — levied on income in excess of US\$ 400,000 (the equivalent of about US\$ 2.64 million at 2006 prices). In 1971 under Nixon, the top marginal rate was reduced from 71 per cent to 60 per cent on taxable income in excess of US\$ 996,000 (at today’s prices), shortly thereafter it dropped to 50 per cent and remained there until 1987. Under Reagan in 1988, it was reduced to 30 per cent. ‘These large reductions of the top marginal rate during the 1970s and 1980s were an open invitation to astonishing increases in executive compensation, and the invitation was widely accepted’ (Trotter, 2007).

A Harvard study by Frydman and Saks (2005), later republished by the US Federal Reserve, noted the remarkable stability of executive compensation from 1936 to 1969. During this thirty-three year period, the average 1.3 per cent annual increase in executive pay was less than the wage gains made by the average American worker. By 1969, the inflation-adjusted value of executive pay had just barely returned to its pre-World War II level. The Frydman and Saks study also noted that between 1969 and 1992, average

16. For concerns in the UK, see Hutton (2007); also see ‘Special Report: Private Equity’, *The Guardian* 24 February 2007.

17. Ibid.

total executive compensation increased by 75 per cent, and that during the period 1993 to 2002 executive pay rose at an astounding rate of more than 14 per cent per year so that at the end of the twentieth century, ‘the real value of executive compensation was more than seven times its level prior to World War II’ (quoted in Trotter, 2007).

While a similar trend can be observed in the UK, the same is not true for most other EU countries. In France, for example, whereas effective tax incidence thirty years ago was less progressive than in the United States, it is now more progressive — indeed, income inequality in France has actually decreased over the past three decades (see Hills et al., 2010: Fig 2.8). By contrast, the UK currently ranks 14th in the EU-15 income distribution tables. Although a nominally progressive Labour government was in power during the period 1997 to 2010, separate studies by the Institute for Fiscal Studies (Brewer et al., 2004) and the Report of the Equality Panel (Hills et al., 2010) show that inequality has not significantly decreased since 1997.

The above picture also holds true for the distribution of assets, which strongly influences the distribution of earnings, and is in general even more unequal — and more difficult to measure because of inadequate data. The richest 10 per cent of Americans own 70 per cent of the country’s wealth; the remaining 90 per cent own what remains. More instructively, the asset share of the bottom 50 per cent of Americans is 2.5 per cent. Much the same is true of Britain, although here a higher proportion of asset concentration is explained by land ownership.¹⁸ For example, Hills et al. (2010: 58) estimate that in the UK, household wealth of the top 10 per cent of the population is over 100 times higher than the wealth of the poorest 10 per cent while that of the top 1 per cent is 300 times greater.

MEASURING INEQUALITY

That European countries are in general far more egalitarian than the United States is apparent from Table 3 showing 2008 Gini coefficients for the USA and the EU-15.¹⁹ The most egalitarian countries (those with the lowest Gini values) are, unsurprisingly, those of the Nordic group. At the other

18. See for example Cahill (2001); Lansley (2006); Pearce (2004).

19. When discussing inequality, one must distinguish between income distribution before taxes and transfers (sometimes called the ‘market’ distribution) and income distribution after taxes and transfers. It is conventional when comparing countries to use the latter. Until recently, pre- and post-net transfer data were not available for the EU. This has been remedied with the development of the EUROMOD dataset, developed at Cambridge to estimate and compare the effects of taxes and transfers on personal and household income across the EU-15. It should be further noted, however, that if today the EU were treated as a single country, because of large income disparities between member states, its Gini coefficient would probably be higher than that of the USA, a point made by Galbraith (2009).

Table 3. Gini Coefficient by Country

Country	Coefficient
Denmark	0.247
Sweden	0.250
Finland	0.269
Germany	0.283
Austria	0.291
Luxembourg	0.308
Netherlands	0.309
France	0.327
Belgium	0.330
Spain	0.343
Greece	0.343
Ireland	0.344
Italy	0.360
UK	0.360
Portugal	0.375
<i>Average EU-15</i>	<i>0.316</i>
USA	0.408

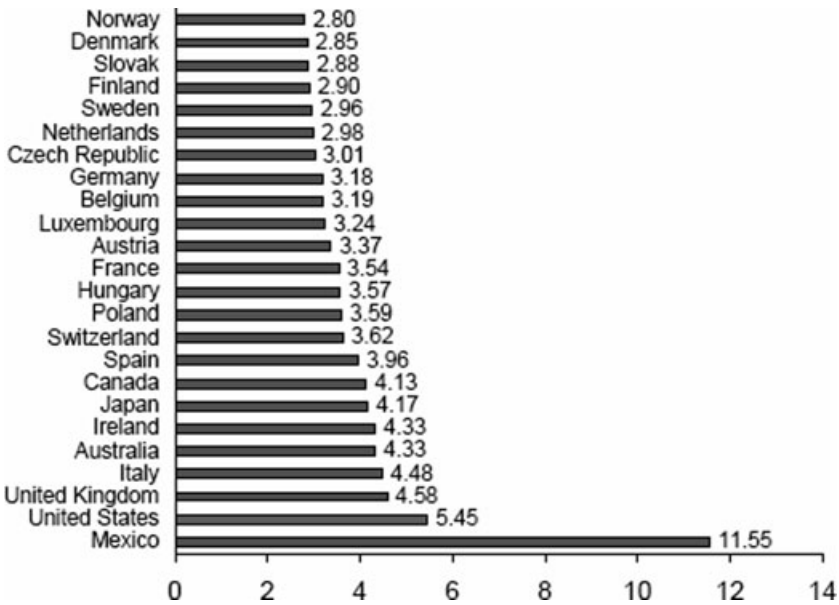
Source: Human Development Report 2008/9.

end of the table one finds the USA and the UK where inequality has grown significantly since 1980. The highest EU values are for Portugal, Italy and the UK.

A slightly different way of measuring inequality is to compare the household income of different percentile groups — 1 per cent slices — of the population. The greater the ratio of the 10th percentile (poor) — those who occupy the 10th slice from the bottom — to that of the 90th percentile (rich), the greater the degree of income inequality. Figure 2 shows these ratios for selected countries, and their ranking corresponds roughly to that found in Table 3, where Gini coefficients are compared. The most egalitarian countries are the Nordic group where the ratio in all cases is below 3.0. In the list of countries covered, Britain and the United States come close to last: the UK's ratio is 4.58 while that of the USA is 5.45. Mexico's score of 11.45 makes it highly unequal even amongst developing countries and is included for comparative purposes only.

What is equally important — but not illustrated properly by these measures of income inequality — is the dispersion of household income at the top of the distribution. Suppose we confine ourselves to the top 10 per cent of the distribution — the top decile group or 'the rich' — and slice this decile group into 10 single percentile levels from (relatively) less affluent to the very, very rich. Surprisingly, we would find that the degree of inequality within the top decile group (the rich) is no less than for the population as a whole. As we have already seen, it is at the top end of the distribution that inequality has been growing most quickly in the past twenty-five years. As one writer has put it, you are rich if you can live comfortably on the interest from your capital, but you are super-rich

Figure 2. Household Income Inequality for Selected Countries (ratio of 90th to 10th percentile)



Source: Smeeding (2004) in Schmitt and Zipperer (2006).

only if you can live comfortably on the interest from the interest on your capital.²⁰

Growing inequality is in large part a political phenomenon, attributable to the policies followed by specific right-wing governments rather than simply a deterministic attribute of globalization (Krugman, 2002). This point emerges clearly when looking at the UK under Thatcher in the 1980s. In the period 1984 to 1990, the Gini coefficient for the UK rose by 10 points. This change was larger than that in any other OECD country, and it happened more quickly. Not only did inequality increase more rapidly in the UK than in the USA in this period, but there were differences in its root causes. In both countries the rich grew richer; in the UK, however, a combination of de-industrialization, a steep rise in unemployment and the political assault on trade unions and welfare meant that the poor grew poorer faster in Britain than in the USA.

The assault on welfare in the UK was not just a matter of bashing organized workers. Government statistics for the period 1980–2000 show a rise in the number of children in poverty, from 1.4 million to 4.4 million, and a

20. For a fascinating account of ‘super rich’ lifestyles in the USA, see R.L. Frank (2007), not to be confused with the economic study by R.H. Frank (2007).

doubling in the number of pensioners with less than half the average income (see for example Gordon and Townsend, 2000). By the end of the twentieth century, not only was Britain less equal than other EU states at a comparable average income level, its social and economic infrastructure was in tatters. It is important to add that since 2000, although progress has been made in improving infrastructure and reducing poverty at the bottom of the income pyramid, inequality has not been reversed (see Hills et al., 2010; Toynbee and Walker, 2005).

PAYING THE BILL: THE EXTERNAL COSTS OF INEQUALITY

If the ‘new consumerism’ is driven by the growing inequality in income distribution, at the same time consumerism drives inequality as top earners aspire to ever more luxurious lifestyles. Growing inequality entails many other costs too. These ‘other costs’ include working more hours, retiring later, saving less and becoming more indebted.²¹ More generally, the renewed rise in sumptuous private affluence is associated with greater neglect of economic and social infrastructure, declining social cohesion and a variety of social ills now being catalogued under the label of ‘social epidemiology’.

To earn the money needed to meet their aspirations, American and British families are putting in longer working hours, and the single earner family is being replaced by one in which both partners have a job. This trend is borne out by a comparison of annual hours worked and female labour force participation rates. Americans, followed by Britons, work longer annual hours, and women work more, than in other industrialized countries. In the USA, moreover, the proportion of workers remaining in the workforce after sixty and indeed well beyond retirement age is far greater than in most European countries.

US workers put in the longest hours on the job in industrialized nations: 1,834 hours per capita in 2000. Based on OECD and ILO data, the US pattern of increasing annual hours worked per person (which totalled 1,824 in 1983) contrasts most sharply with those of European workers, who are spending progressively fewer hours on the job, particularly in countries such as Norway and The Netherlands where hours worked in 2002 were, respectively 1,371 and 1,380 per year. In France, full-time workers put in 1,500 hours in 2002 versus nearly 1,700 in the 1980s. In Germany, average working hours for 2002 were 1,463 versus 1,674 in 1983. Workers in the United Kingdom, who put in 1,707 hours annually in 2002, appear to have neither gained nor lost much free time since 1982 when they worked 1,713 hours.

21. Important work on the USA is Schor (1992); note that this work has been questioned by various authors, including Bluestone and Rose (1997). A recent critique is summarized in ‘The Land of Leisure’, *The Economist* 2 February 2006.

Table 4. Annual Hours Worked per Full-time Person in Active Labour Force: 1983, 2000

Total Employment	1983	2000
Netherlands	–	1371
Norway	1485	1380
Germany	1674*	1463
France	1672	1500
Denmark	–	1504
Belgium	1684	1530
Switzerland	–	1568
Italy	1694	1619
Sweden	1520	1625
Ireland	1910	1690
UK	1713	1707
Portugal	–	1708
Finland	1787	1727
Spain	1912	1814
USA	1824	1834

*1983 figure for West Germany.

Source: OECD (2003: Annex Table F.); ILO (1999).

Not only do twenty-first century Americans work more per year, they appear to remain in employment longer. Table 4 contrasts the trend over 1990–2002 in average employment rates for workers aged 55–64 in the USA, the UK and the EU-15. In 1990, 54 per cent of American workers in this group were in full-time employment compared to 49 per cent in the UK and 39 per cent for the EU as a whole. While the trend is upward in all cases, in 2002 nearly 60 per cent of older American workers were in full-time employment, considerably more than the proportions in the UK and the EU-15 as a whole. While this state of affairs might have worrying implications for pension provision in some EU countries, it does support the argument that Americans not only work longer hours but also enjoy fewer years of retirement.

Unregulated capitalism has meant not just a longer working life and poorer pensions; there is now ample evidence that the growth in inequality — the rise of the super-rich and the celebration of new lifestyles — is associated with poor health, high rates of violence and low levels of social capital. Wilkinson (2005) and Wilkinson and Pickett (2009) cite various studies showing that the difference in life expectancy (measured from age sixteen) between rich whites and poor blacks in USA is about sixteen years for both sexes. The studies quoted cover twenty-three different areas; in all cases, differences in area incomes are closely associated with differences in death rates. Wilkinson (2005) suggests that health inequalities related to different socioeconomic status may deprive the average poor person of 20–25% of the length of life enjoyed by the rich. Wilkinson (*ibid.*: 18) adds: ‘What would we think of a ruthless government that arbitrarily imprisoned all less

well-off people for a number of years equal to the average shortening of life suffered by the less equal of our own societies?'.

Nor is this phenomenon associated purely with poverty: the finding holds across all classes, while slope of gradient varies from one country to another and across time. It is greater in the USA and Britain than in the Nordic countries. For the UK, in a well-known study of the civil service, Rose and Marmot (1981) took a large sample of male office employees and found that the death rate from heart disease among low-status workers was four times as high as among the highest ranks. Donkin et al. (2002) report that whereas in the early 1970s the difference in life expectancy between social class V (unskilled manual) and social class I (professional) was about 5 years, by the early–mid 1990s the difference was 9.5 years for men and 6.5 for women. As Wilkinson (2005: 23–4) writes:

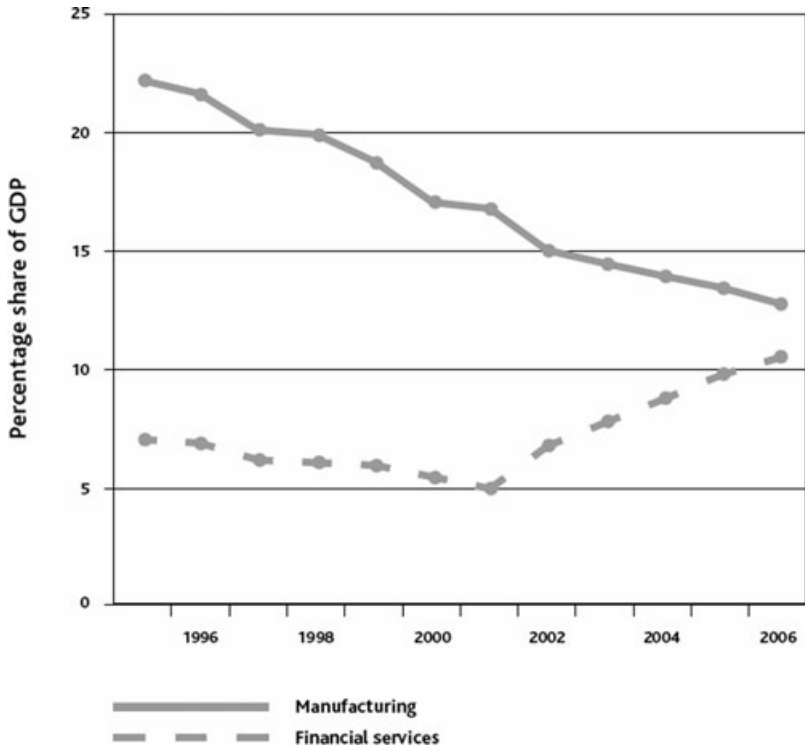
Inequality promotes [survival] strategies that are more self-interested, less affiliative, often highly anti-social, more stressful and likely to give rise to higher levels of violence, poorer community relations, and worse health. In contrast, the less unequal societies tend to be much more affiliative, less violent, more supportive and inclusive, and marked by better health more unequal societies tend to have higher rates of violent crime and homicide, and . . . people living in them feel more hostility, are less likely to be involved in community life, and are much less likely to trust each other; in short, they have lower levels of social capital.

WAGE SQUEEZE IN THE UK AND THE OECD

As might be expected, growing household inequality is reflected in a fall in the share of wages in National Income. After New Labour came to power in the UK in 1997, as we have seen, neoliberal economic policies remained entrenched for the next decade and income inequality actually grew, as shown most recently by Hills et al. (2010). The growth in inequality and the squeeze on the share of real wages was not just the result of the new configuration of domestic politics. Globalization added to the downward pressure on real wages in the form of cheap Asian manufactures. As manufacturing declined in Britain, the financial services sector grew rapidly on a world scale, and as more overseas banks and trading houses settled in London, the sector's share in the UK economy grew precipitously (see Figure 3).

A strong pound and low interest rates, while favouring the City of London, penalized British manufacturing exporters. Similarly, the outsourcing of public sector jobs reinforced the casualization of the UK workforce, while many domestic jobs migrated overseas as a result of globalization. The 'flexible' labour market, whose virtue was extolled by successive governments, was in truth a low-wage market in which employment protection legislation had been pared to the bone. And it was not just earned income that suffered; Britain's services went into decline, unemployment benefit was low by EU standards and the average UK state pension remained risibly low.

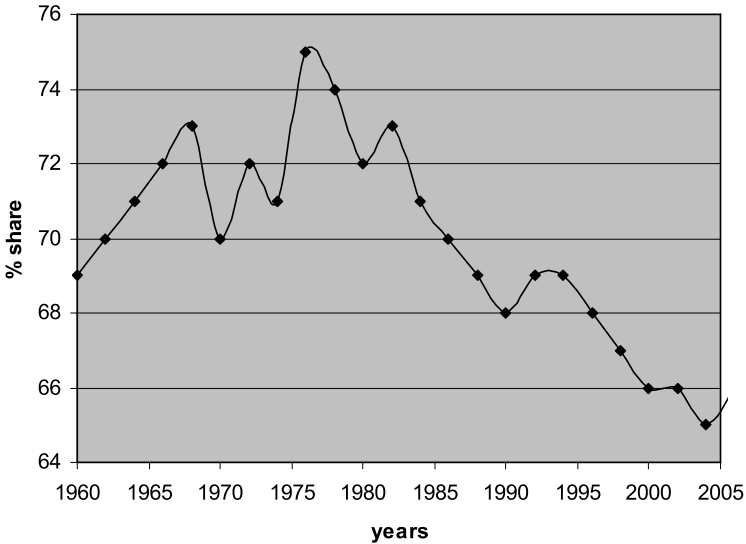
Figure 3. Changing Shares of Manufacturing and Finance in UK GDP, 1996–2006



Source: Lansley (2008: 15).

Although the weakening of labour was more evident in Britain, this same process could be observed in the OECD as a whole, as seen in Figure 4. The IMF’s April 2007 World Economic Outlook chapter on ‘The Globalization of Labor’ suggests that since 1980, the number of workers competing in the global market has risen by a factor of four: the addition of the workforces of China, India, Brazil and the former Soviet Union to the global market place gives some idea of the scale on which this process has evolved, as does the fact that average wages in these countries are between one-half and one-tenth of the OECD average (IMF, 2007). Moreover, as Glyn (2007) argues, the decline in labour’s share was so marked after 1980 that even Ben Bernanke, the Chairman of the US Federal Reserve, expressed the hope that ‘corporations would use some of those profit margins to meet demands from workers for higher wages’ (Glyn, 2007). Figure 4 is based on Glyn (2007) and shows labour’s share — defined as employee compensation adjusted for self-employment as a percentage of National Income — averaged for seventeen OECD countries over the period 1960 to 2005.

Figure 4. Labour's share in National Income (OECD average) 1960–2005



Source: Glyn (2007) and author's own calculations.

Figure 5. Labour's Share in UK National Income, 1955–2008



Source: Lansley (2008: 6).

For Britain, the fall in labour's share of national income was even more marked than for the OECD as a whole, as seen in Figure 5. Growing inequality in the distribution of income between richer and poorer households (or the 'household' distribution) is usually reflected in a squeeze on labour's share in National Income as was indeed the case in the UK after 1979. By

1990, the Gini coefficient for UK household income had risen from 0.24 to 0.34, placing the country only just above the USA at the bottom of the OECD inequality tables. As Stuart Lansley (2008: 6) has written:

Most of this rise in income inequality took place in the 1980s. It steadied off in the first half of the 1990s, rose again from the mid-1990s to 2001 and then levelled off again before rising slightly in 2005/6. Over the period since 1996–7, when Labour came to power, incomes of the top one per cent have risen by an average real rate of 3.1 per cent, well above an average increase of 2.3 per cent.

In the first decade of the new century, before boom turned to bust, almost all the gains from economic growth in the UK went to the top 10 per cent of households. Most income recipients saw very little real growth in their pay; half of all earners saw no growth at all while the bottom third saw their real earnings fall, mainly as a result of holding public sector pay increases below inflation. Indeed, according to a recent study, Britain's national minimum wage (£ 5.80 per hour)²² would need to be raised to £ 7.40 to bring it up to 'living wage' level for a single person working full-time (UNISON, 2010). In 2007 about one-fifth of the population, some thirteen million people, lived at or below this level (Platt, 2007). The 2007–09 recession doubtless has caused this proportion to increase.

WHY THE CREDIT BOOM WAS NECESSARY

How does one get people to spend in a low-wage economy? In essence, this is achieved by increasing the supply of credit, both secured and unsecured, while keeping interest rates low. The supply of secured credit — i.e., secured against an asset such as a house — rose through a combination of rising property values and much greater access to mortgaging and re-mortgaging facilities, the latter made possible by variable-rate and interest-only mortgages and, crucially, by the ease with which lending institutions could 'pass on risk' by bundling mortgages together and selling them on the bond market in the form of collateralized debt obligations (CDOs). By 2008, UK mortgage debt was in excess of £ 1 trillion, of which about a fifth was owed by the over-sixties. Nor was it simply mortgages that were 'passed on' in this way: car loans, credit card debt and almost anything that promised a future income stream was bundled in this way. As house prices fell and credit tightened from 2007 onwards, a significant share of householders were finding it increasingly difficult to meet repayment obligations. Additionally, the deregulation of the financial services industry over a generation had made it relatively easy to increase the supply of unsecured credit. Before financial regulations were loosened, most credit cards charged the same interest and

22. See <http://www.hmrc.gov.uk/nmw/>

penalty rates; since deregulation, interest rates have varied widely as have penalty charges.

In the USA, credit card debt trebled after 1990, totalling nearly US\$ 1 trillion by 2006, with penalty fees alone amounting to over US\$ 17 billion. The same picture holds in Britain where credit card debt in 2007 was thought to be of the order of £ 500 billion — in per capita terms, higher than the USA. In 2007, the average Briton had more than twice as much unsecured borrowing — including overdrafts, personal loans and credit card debt — as the typical continental European, and the Bank of England warned that nearly one million households faced problems with debt repayment (Prosser, 2008). By early 2009, total personal indebtedness (including mortgage debt) was estimated to be about £ 1.5 trillion; slightly more than the value of the UK's GDP.²³ And of course it was the financial services industry which thrived on the growth of personal indebtedness.

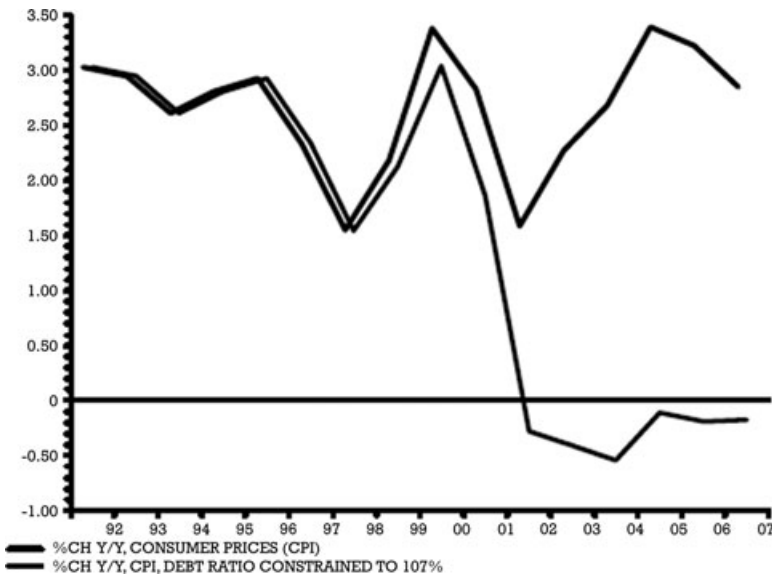
Since the crash of 2007–09, it has become common to bewail the unconstrained growth of private indebtedness, not only amongst the public in general but particularly in the financial sector itself where leverage (borrowing to augment one's equity) became a byword for the sorts of mega-deals from which bankers and traders made vast sums of money. But was the crash the fault of 'greedy bankers', or is it an inherent part of finance capital as Minsky argued?²⁴ What would have happened to the UK economy had credit growth been regulated in the same way as, say, in the pre-Thatcher era?

In his book on the credit crunch, Graham Turner has looked at this question carefully, running some simulations of the growth of aggregate demand and the general price level under conditions of credit supervision not so different from those pertaining before Thatcher (Turner, 2008a; see also Turner, 2008b). Turner's simulations assume that over the past decade the ratio of debt to disposable income was allowed to rise — but only from 102 per cent in 1997 to 120 per cent in 2007, or about one-quarter of the rise which actually took place. Turner's assumed rate of credit creation is based on that which prevailed before deregulation. The model covers not just the private sector but the public sector too. Although interest rates remain the same, it is further assumed that because of slower economic growth, fiscal receipts grow more slowly resulting in a slower rise in public spending and in public borrowing. In brief, under a credit constrained scenario, nominal consumption in the UK over the period would have been 20 per cent lower and real consumption about 9 per cent lower than was actually the case.

23. See Baines and Ernst (2010); UK GDP in 2009 was about £1.4 tr.

24. Minsky argued that as corporations and banks become more profitable, they are increasingly tempted to borrow (gear up) to increase the return on equity; hence 'financialization', leading to speculative bubbles (see Minsky, 2008).

Figure 6. Alternative Inflation Scenarios in the UK 1997–2007



Source: Turner (2008a: Figure 3.9, p. 39) (reproduced with the permission of Pluto Press).

This divergence is shown in Figure 6 which plots the rate of inflation over the time period in question. The upper line shows the UK Consumer Price Index which pertained in reality while the lower line shows inflation which would have pertained under a constrained credit regime. As a result of constrained credit, the UK inflation rate, instead of averaging 1.5 per cent per annum, would have averaged just 0.2 per cent — and would actually have been negative for the four years from 2000 to 2003. The obvious question is whether four years of deflation (negative inflation) might not have produced deflationary expectations and resulted in the sort of deflationary stagnation experienced by Japan for more than a decade. Could the Bank of England have fine-tuned credit growth in a manner which steered successfully between the hazards of a credit bubble on the one hand and a deflationary trap on the other?

Such a question is of course counter-factual, but the exercise illustrates the implicit dilemma of maintaining growth in a relatively low-wage, low-productivity and fiscally weak economy such as Britain’s. Perhaps paradoxically, it would appear to be true that in the absence of a more active public sector, the cost of maintaining Britain’s much-vaunted ‘flexible’ labour market was to boost private sector aggregate demand by allowing the credit boom to go unchecked.

Figure 7. *Effective Household Total Tax Incidence by Decile, 2008*

Decile Group	Effective tax rate	Post-tax income (£/annum)
Poorest	46.1%	£4,891
2 nd	33.7%	£9,033
3 rd	32.9%	£11,294
4 th	33.0%	£13,635
5 th	34.6%	£16,858
6 th	35.1%	£19,435
7 th	36.6%	£23,538
8 th	36.7%	£28,313
9 th	36.0%	£34,961
Richest	34.2%	£62,243

Source: Byrne and Ruane (2008: Table 2).

REGRESSIVE TAXATION IN THE UK

We have already examined taxation as a factor in explaining US income inequality. Unlike the USA, the overall incidence of direct and indirect tax on gross income in the UK is regressive — i.e., the poorest 10 per cent pay a higher proportion of their income in tax than the richest 10 per cent — a state of affairs which even Adam Smith would have abhorred.

Figure 7 is based on the work of Byrne and Ruane (2008) showing the effective incidence of both direct and indirect personal taxation on (standardized) households. It can be noted that the richest (10th) decile group pays an effective rate of 34.2 per cent, a figure considerably lower than the rate of 46.1 per cent paid by the poorest (1st) decile group. Were the data for the richest decile further disaggregated into percentile groups, the degree of regressiveness would be even more striking since the higher up the income pyramid one goes, the lower the percentage of income paid as tax. Two factors help explain this regressive incidence; first, the proportion of indirect tax in the total paid (VAT, NIC, council tax) has risen; secondly, the rich have got very much richer. Crucially, the Byrne and Ruane study does not look at the degree to which tax avoidance affects tax receipts from the upper end of the distribution.²⁵

The ‘tax gap’ in Britain has been analysed in Irvin et al. (2009). The regressive nature of overall household tax incidence is detrimental to the

25. For work on this see Richard Murphy’s work published in TUC (2008) in which it is estimated that personal and corporate tax avoidance together costs the UK Treasury some £ 25 billion per annum. Also see David Leigh et al. (2009), a series of investigative articles looking at tax avoidance schemes used by individuals and companies, and the resulting losses to the UK Treasury.

economy in a number of ways. For one thing, it promotes and sustains inequality. For example in Britain, although Labour since 1997 has attempted to lift the very poorest out of poverty with some degree of success — notably in reducing its incidence amongst groups most-at-risk such as the pensioners and children — income inequality has not declined largely because the top of the richest decile has seen its income rise, particularly the ‘super-rich’. For another, a regressive tax incidence hampers the operation of fiscal stabilizers since, in good times, ‘tax buoyancy’ will be low; i.e., tax revenue will not increase as quickly as it otherwise would were taxation more progressive, thus making it harder for the government to ‘save for the bad times’. Most importantly, in the upswing real wages and thus aggregate consumer demand grow more slowly, making growth increasingly dependent on an unsustainable expansion in credit.

While it has become standard practice for economists to suggest that the widening gap between the ‘haves and have-nots’ can be explained by the rise of the knowledge economy and the higher premium attached to high levels of skill and education, this is far from being either a satisfactory or a comprehensive explanation. In practice, the rich have grown richer and Britain has become more unequal largely because of the country’s changed occupational structure; a workforce once employed in industry whose wages and benefits were protected by strong trade unions has been increasingly dispersed to low-wage, non-unionized employment in services. In the 1960s, nearly 40 per cent of GDP originated in industry, many times the share of total financial services. Under Thatcher, industry declined — and the trend continued under New Labour to such an extent that, today, their relative shares in output (and employment) are nearly equivalent.

CONCLUSION

The financial crisis was not just (or even mainly) about irresponsible banks pushing mortgages out to people who could never hope to repay them. Understanding the crisis requires understanding the main historical features which produced it. In the 1980s, the Thatcher–Reagan revolution reversed the profit squeeze. In Britain, much as in the USA, this meant hobbling the trade union movement to dampen the rise in real wages, and letting manufacturing stagnate or migrate while deregulating the financial sector — in Andrew Glyn’s phrase ‘unleashing’ capitalism.

The ideology which underpinned this new capitalism was not merely pre-Keynesian, it was libertarian — what today is known as neoliberalism — based on the Austrian school’s doctrine of freeing the market from all forms of government interference. The ideas pioneered by von Mises and Hayek were spread by such US think-tanks as the Hoover Institute and the Heritage Foundation and were, by the late 1970s, widely disseminated in the UK

by Thatcher's Institute for Policy Studies. Indeed, this was far more than an intellectual movement; it was exceedingly well funded by the business community and supported by an army of lobbyists (Harvey, 2005).

As income distribution worsened, industrial jobs were replaced by services, trade union membership declined and real wages fell behind the growth in labour productivity, maintaining a high level of aggregate consumption demand (i.e., keeping up real spending) not only meant that more household members joined the workforce and worked longer hours, but that credit expanded. The stock market bubble of the 1990s saw the value of shares rise to impossible multiples of their future earnings, creating the impression of ever-expanding wealth and setting the consumption bar ever higher. When the dot.com bubble burst, the rapid loosening of monetary policy helped fuel a property bubble while creative new financial institutions turned residential mortgages into cash dispensers and magically vaporized risk.

The bursting of the bubble in 2007–09 exposed the institutional fragility of Wall Street and The City, massively leveraged, overexposed to risk and even to criminality in high places. Despite government efforts to rescue the banks, contagion spread in a worldwide-scale impacting of the real economy. At the time of writing, recovery from the economic downturn in the major industrial countries is faltering, and it seems probable that the USA and the UK (and possibly many of the major OECD countries) will enter into a period of prolonged stagnation.

While a return to the *status quo ante* should not be ruled out, recovery is unlikely to produce long-term growth unless a more active state role finds widespread political acceptance. Not only will recovery need to be carefully managed by government, but so too will any prolonged period of growth in average living standards if the dangerous cycle of profit and wages squeeze is not to be repeated. At the heart of such a recovery will be economic policies which foster high levels of education and innovation and which translate renewed growth into decent wages, not just for a few but for all.

This new welfare settlement — as important as that which followed World War II — will contain not just the promise of jobs and just rewards, but of better education for children, universal crèche provision, secure employment for the workforce, decent pensions for the old and an end to gender wage differentials. It will be based not on 'financial wealth creation' but on sustainable growth. Achieving this state of affairs need not entail reinventing the wheel, but it will entail the wholehearted adoption of a new model in which incomes policy, regulated credit and decentralized finance will play a crucial role.

Palley (2009) has rightly distinguished between 'narrow microeconomic' and 'broad macroeconomic' fixes; the former involve little more than improved financial regulation while the latter entail rethinking the changed nature of the growth model underlying the current crisis. This is not to say that improved financial regulation will not be a component of the new welfare settlement; rather, it is but one of several components. The key

building blocks of the new settlement are: (a) high wages; (b) new sustainable industrial growth; and (c) the provision of public goods.

The most important strategic change in government policy will be reversing the growth of super-rich rewards re-establishing the link between productivity and wages growth. This will involve recognizing two things. First of all, the key to the distribution problem lies not just in shoring up the bottom of the income distribution but capping the top; i.e., not just tackling poverty but reversing inequality. Second, although tax reform is important, tackling inequality is not purely a matter of allowing the free market to generate the wealth while using taxation to improve its distribution. Re-establishing a high wage economy depends crucially on industrial innovation; on developing new processes and product lines underpinned by an industrial strategy (see Irvin, 2010). The neoliberal notion that the state has no role to play in industrial strategy has been shown to be false in economies as diverse as France and Finland.²⁶

An important concomitant of a new industrial model will be a far stronger trade union movement. Indeed, part of the inequality story has been the casualization of labour and the virtual exclusion of unions from any significant role in policy making. Higher minimum wages, better employment protection legislation and an end to gender differentials are doubtless part of the solution, but the crucial ingredient is a return to full employment. Employment cannot return to pre-recession levels without growth, and there cannot be growth unless current neoliberal policies to achieve immediate budget balance are jettisoned.

While it may be possible to reduce public borrowing somewhat through tax reform — particularly by greatly reducing tax avoidance and increasing the effective rates of personal tax on very high incomes — the aim of government fiscal policy must be to use public investment to ‘crowd in’ private investment. Nor are candidates lacking: the renewal of public infrastructure, high-speed public transport, modernized hospitals and schools, new forms of sustainable energy generation, a major insulation programme for residential and commercial property — the list goes on and on. To deal with climate change alone, the Stern Report of 2006 estimated that annual investment equivalent to 1 per cent of GDP would be required; that estimate has since doubled (see Jowett and Wintour, 2008). Such an investment-driven programme may not be ‘shovel-ready’, but a delayed resumption of sustainable growth is preferable to decades of possible stagnation implied by adhering to the strictures of the deficit hawks.

Above all, it is simply not true that the current financial crisis condemns us to lower public spending on better education, on affordable housing, on decent pensions and even on overseas aid. If anything, as a society grows richer, it requires more public goods, not fewer. The success of neoliberal

26. See Chang (2010); also see relevant sections of Irvin (2010).

economics over the past generation is very largely explained by a private consumption boom driven at different times by a financial bubble, a housing boom and negative net private savings. While increments in growth were distributed to the very wealthy, leaving the working and middle classes increasingly hard-pressed, growth was maintained by what one writer has aptly described as ‘private Keynesianism’; i.e., the switch from public to private spending as the motor of pump-priming (Crouch, 2008). If that model has now imploded, it does not mean that we can no longer afford to finance public goods. It simply means that the motor of such provision must once again become the public sphere. Thomas Palley has summarized the current dilemma admirably:

While the economics are clear, the politics are difficult, which partially explains the resistance to change on the part of policymakers and economists aligned with the neoliberal model. The neoliberal growth model has benefited the wealthy, while the model of global economic engagement has benefited large multinational corporations. That gives these powerful political interests, with their money and well-funded captive think tanks, an incentive to block change. (Palley, 2009: 31)

In essence, achieving a new welfare settlement is not a matter of economic policy alone; it demands radical political change.

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