

I ncreasing Income Inequality — Today Is Different from Past Debates

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Introduction

The main topic of this issue, inequality, has been discussed many times since the birth of economics. However, this time is different. While efficiency of resource allocation and equality of income distribution may appear contradictory, both have been key goals of economists for a long time, and today the issue has become a political one. It is not too much to say that the basis of our democracy is being shaken by the increase in the income gap. It is worth looking, therefore, at how this classical question of economics has come to be at the center of political arguments among wealthy democratic states.

Entering a Zero Growth Economy

The last century could be depicted as the age of the growth of prosperity. Many nations enjoyed economic growth that benefitted their people, and many economists believed that efficiency of resource allocation would be achieved by market competition, spurring economic growth. This is what we call neoclassical economics, and it was particularly dominant then among capitalist countries.

Most importantly, in growing economies where people are becoming much wealthier year after year, there would be few concerns about income distribution. In the last century, neoclassical economists believed there would be no contradiction between efficiency of resource allocation and equality of income distribution. Both goals could be simultaneously achieved if market mechanisms worked well and animated competition in international as well as domestic markets was observable.

This is a positive sum game where all the players will gain. In this game, politics in a democratic society has very little to do. All the wealthy states happened to be democratic states as well as capitalist ones. In such societies, it was believed that democracy worked very well and that social discontent could be mitigated by achieving economic growth.

But the assumption that economic growth would continue indefinitely cannot be applied to our world anymore. Zero growth is a common phenomenon in the developed nations' economies today. Without increasing prosperity every year, wealthy people cannot fully achieve their own material desires, and much worse, poor people cannot expect any trickle down of the fruits of growth. This will

provoke enormous social discontent among poor people that could destabilize a society. No growth means that we have to be players of a zero sum game rather than a positive sum game. This makes our contemporary world significantly different from the past. Politics is expected to play a more pivotal role in this situation to deal with the social discontent caused by a zero sum game.

According to McKinsey Global Institute's report issued in July 2016 titled "Poorer than Their Parents? A New Perspective on Income Inequality", between 2005 and 2014 some 65-70% of all households among the 25 highest-income countries saw either stagnancy or a decline in their income, whereas only 2% of those households suffered from such between 1993 and 2005. Even when looking at their disposable income after tax and provision of social welfare, between 2005 and 2014 some 20-25% of the households in these countries suffered from stagnant or declining income.

MGI's research on the personal nature of the standard of living also discovered that people would be happier to feel that they were wealthier than their parents had been rather than having a standard of living closer to that of their contemporary wealthy friends. This again indicates how a lack of growth could provoke serious social discontent.

There are a number of arguments about the reasons for this economic stagnancy among wealthy states. The financial crisis of 2008 destabilized global financial systems and the recession triggered by this crisis continues to weigh upon the developed nations' economies. The existence of cumulating fiscal debt among these nations' governments has prevented them from stimulating their economies through more active fiscal expenditures. Their monetary policies have also been much less effective in stimulating their economies, since their public interest rates have reached almost zero since the recession started.

Over the long term, the aging of society will continue among all developed nations and we cannot expect a high increase in labor productivity in such aging societies. Innovation is expected to raise our economic growth potential, but new technologies such as Artificial Intelligence (AI), renewable energy sources, biotechnology, and stem cell technology will all take time to reach full bloom. We cannot expect high economic growth to return in the near future. Thus, the question of growing income inequality at this moment is a serious political question that cannot be solved only by economists but must also be tackled by politicians.

What Is Happening in Developed Nations?

Continuing poor economic performance and the growing social discontent, especially among the working class, has resulted in a declining confidence in the political elites responsible for economic policy management. Political movements against the governing intellectual elites can be seen to have spread in developed nations. Donald Trump won the Republican nomination for US president by advocating a simple and narrow-minded nationalism and an “America First” policy, and more nationalistic political movements are gaining strength in some other developed nations. We may call it populism.

Political elites have been leading nations in accordance with the trend toward globalization, believing that it encourages international competition through free trade and investment, and that international competition would achieve the best resource allocation and high economic growth. But in a situation where there is no longer high economic growth, the belief is spreading that free trade and investment, and in particular immigration and the free movement of labor, could end up in taking job opportunities from a nation’s working class. Working class people in particular having started to lose confidence in the political elites due to continuing poor economic performance and expanding income inequality, and find themselves attracted to a more populist nationalism. But in an effective democracy, politicians need to combat such populism.

Politicians’ Duties in a Democracy

All politicians or political elites in a democracy facing an upsurge in populism will need to convince people of the utility of logic rather than emotionalism in achieving authentic prosperity over the long term. Under globalization, people would have to understand that all nations and economies are mutually dependent on each other. No country in the world today can achieve prosperity on its own without trade and investment and other economic relations with other nations. This is the first priority that should be understood. They should use all possible communication channels such as public debates in the mass media or think-tank fora to convince people of this reality.

Second, they will need to engage in the reform of capitalism to ensure equal job opportunities and working conditions among people. Any discrimination by sex, nationality or race will need to be eliminated, and any discriminatory treatment between permanent employees and non-permanent ones erased.

Third, they will need to do their best to raise their economy’s growth potential. Raising long-term economic growth will be the minimum requirement to get rid of social discontent caused by

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Republican presidential nominee Donald Trump shakes hands with Democratic presidential nominee Hillary Clinton after their debate at Washington University in St. Louis on Oct. 9, 2016.

increasing income inequality. They should encourage technological innovation, especially through the use of Big Data. They can achieve innovations through the computer software used for Big Data and it would be relatively easy to achieve as this could be consolidated on the basis of today’s existing ICT.

Fourth, they will need to strengthen the functions of the think tanks in their countries. The views of experts and professionals should be clearly communicated to the voters in a democracy, as a way of discouraging a purely emotional response to complicated economic or political issues, especially by those who suffer from a deep sense of inequality. Without understanding the reality of interdependency among nations under globalization, protectionist and anti-free trade attitudes could result in the decline of a country’s economic welfare. Political elites should make more use of think tanks as the venues of public debate and should occasionally organize international fora among such think tanks to discuss policy issues related not only to trade and investment but also to social welfare reform, immigration, and the aging of societies, all of which are related to income inequality.

Finally, and most importantly, political elites must not look down on working class people, who like other voters determine a nation’s destiny. They should not complain about working class people’s supposed stupidity in being unable to understand the reasons behind any event or policy, but should lament their own incompetence in being unable to convince them of the need to follow logic rather than emotion. They should take note that arrogance can lead to disaster.

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