<u>Sir Simon Robertson Essay Prize</u>

A BLUEPRINT FOR SOLVING THE INEQUALITY CONUNDRUM:

Background Statement "Many parts of the world since the turn of the century have seen a big rise in inequality between the "haves" and the "have nots". The safety net which was the bedrock of the social compact of the democratic countries in Europe after World War II has broken down. Something has to be done if we are to avoid unpleasant surprises as those left behind become more resentful and nationalism raises its ugly head" (Sir Simon Robertson)

How can the current political economy be reorganised without undue disruption in order to reduce inequality within our society in the UK?

<u>Building a True Jerusalem: Restoring the Social Compact and Reducing Inequality in UK Society</u>

By Lucy Bayliss

In this essay, I will argue that in order to bring about a reduction in inequality without causing undue disruption, we must take a multi-faceted approach to reorganising the UK's political economy, trying to reverse trends that have manifested themselves in various sectors. Specifically, the premise of the question breaks down into two parts: the first being the big rise in inequality since the turn of the century and the second being the breakdown of the social safety net created post-war. I believe that in analysing the causes of these trends we can then find solutions to reverse them, with particular attention given to intergenerational, regional and healthcare inequality. This original and diverse approach is far stronger than offering a single, radical solution to one dimension of inequality as the danger of that is not only the creation of undue disruption but also the high risk of failure and being left with nothing to show. By addressing both the aforementioned themes from their root causes, we get the most comprehensive blueprint to remedy this pressing conundrum.

Inequality damages our society as, according to the law of diminishing marginal utility, an income's marginal utility decreases as the income itself increases, therefore inequality reduces the total utility attained from national income. Small increases in the incomes of those at the poorest end of society cause large improvements to their welfare by substantially raising their standards of food and accommodation, whereas for those better off, such increases benefit their utility far less. As such, a skewed income distribution negatively affects society by ensuring much lower living standards for a large proportion of the population and can also, as evidenced in Pickett and Wilkinson's potent text 'The Spirit Level', have a direct harmful impact on levels of health, social mobility, mental illness and crime, which all in turn damage productivity levels.

The philosophical grounding from which this stems is the concept of utilitarianism; at any moment we wish to maximise the total utility achieved as a society and, as explained above, a reduction in inequality would achieve this if it doesn't cause disruption, specifically causing GDP to contract or severely stunting growth. It is often argued that inequality is necessary to provide the incentives for innovation and thus growth to exist, but the solutions I present deliberately maintain these. Furthermore, Rawls' concept of the 'Veil of Ignorance' is intrinsic to this, the idea that we should mould our society without knowledge of where we place in it. Mathematically speaking, we maximise our expected utility from a random distribution of income by maximising the sum of the utilities derived from it, and this gives us our utilitarian basis.

<u>How did we end up here?</u>

The first point of analysis is how the significant rise in inequality since the turn of the century has come to pass. An OECD report from 2014 placed the average global Gini coefficient for household disposable income at 0.318, the highest on record since the mid-1980s (in 2015 the UK had a coefficient of 0.36) whilst the average income of the richest 10% across the OECD has risen in the last 25 years from seven to nine times that of the poorest 10%. In the past decade, these trends have been primarily driven by the financial crisis of 2007-8 and the resulting economic crisis. The massive economic bubble in the lead up to this saw wealth accumulate generally, but particularly to those involved in the financial sector, while government spending rose even faster than the growing tax receipts. As financial deregulation had allowed a reduction in banks' reserves and the government hadn't made provisions for the potential consequences of this, the whole of the country had to contribute to the bail-out once the bubble burst, and the exaggerated spending levels resulted in a huge deficit, making the subsequent austerity unavoidable. Those reliant on the government for income (i.e. those in the public sector or on state benefits who are generally the lower earners in society anyway) were therefore hit the hardest. The resulting decline in living standards fell far more broadly than the increase in living standards prior to the crash had, resulting in not just material but also social inequalities; this is a key reason for the rise in nationalism as people look for a scapegoat. Though we could consign this one-off event to history, its effects are perpetual. The rate of return on capital has for some time been higher than that of national income growth in our economy, and thus wealth that has been accumulated self-perpetuates, further widening the gap. Meanwhile, those at the other end of the wealth spectrum face further cuts and pay freezes so that their incomes, as they are struggling to keep up with the current rates of inflation, are falling in real terms, and the inequality in our standards of living is even further exacerbated.

Another concept to be addressed within this theme is intergenerational inequality. New Labour 1997-2010 saw a rise in private finance initiatives that removed the cost of public projects from the working generation of the time but also removed the investment returns from these that would've benefitted later generations. Combined with the massive pension deficit that we are currently seeing due to the growing demand not matching people's contributions, the government's promises of pensions to public sector workers that they haven't set enough money aside for and the fiscal irresponsibility of Labour under Blair and Brown (defined by an increase in government spending, borrowing and debt as a proportion of GDP) we see this inequality widen. As the state pensions, social care and related costs of the older generation outstrip the amount they contributed in income tax and 'National Insurance' (now just another payroll tax), the current generation must not only make up this shortfall and pay off the debts of the past, but pay and save for their own futures as well.

Yet the younger generations must also bear the weight of government cuts, particularly in terms of youth services and education, in addition to the burden of the older generations which reduces the wealth available to them even further. This uneven pattern of wealth gain and loss among the generations, and that between the rich and the poor mentioned earlier, therefore contributes to an inequality in the availability of enhancing opportunities for those from lower social backgrounds, such as work experience schemes and internships, and a reduced rate of human capital accumulation because people lack the time and money to invest in training and skills development. This intensifies the inequality as such human capital is now more essential than ever due to the increase in the automation of unskilled labour processes.

The second factor in this equation is the breakdown of the post-war social safety net which this essay defines as the services and protections offered by the state and other friendly institutions (such as the NHS and benefits system) and measures by the minimum standards of living that a household on the lowest wages or unemployment benefit in the UK can afford.

To begin with, the suppression of wages due to an imbalance in the labour market's supply and demand, as there are more applicants than jobs, has kept not only the minimum wage at a relatively low level, but by default unemployment benefit too as this can't noticeably exceed the minimum wage for incentive purposes. The baby boom post-war, the raised retirement age, the increase in life expectancy and in commonwealth immigration in the 60s, the reduction of the military and the social shift on women to work, are all factors which have increased the labour supply. However, this has not been met with a proportional rise in demand as manufacturing moves to Asia and processes become automated to save money – this wasn't helped by the lack of competitive modernisation in the UK for much of the 20th century. All of this contributes to a more skewed wage profile with the mean wage becoming more disparate from the median as higher earner wages continue to grow but wages for less skilled jobs and benefits are suppressed, so those losing skilled jobs in the economy or lacking the required skills suffer and inequality grows. As the lowest wages (and subsequently the highest benefits) are suppressed, households can't keep up with the rising costs of living so, despite an overall growth in living standards, standards for the poorer members of society are comparatively lower than those of the remaining population, causing greater disparity and damaging the social safety net.

A further inequality in this damaged safety net exists in the health service. The pace of medical research is far outstripping that of our economy's growth, meaning people's expectations for the service are enlarging faster than its budget. Rather than research on the most advanced treatments slowing down in accordance, the damage has instead fallen more broadly with the fixed budget ensuring that each service comes at another's expense. Therefore routine services come under pressure, causing inequality, as for many of those who are better off such services are often accessed privately, while also worsening the tendency for scandals and crises (as seen in the past winter) as parts of the NHS become severely underfunded.

Regional inequality is the last part of this extensive analysis. London and South East England dominate our economy to the detriment of other parts of the country, creating the 'North-South divide'. This also partly exists because of the damage rendered to Northern manufacturing over the last century and the failure to entice new business to move north. The supply of labour in these areas is therefore excessively high, further suppressing wages. The safety net there is at its worst due to a comparative lack of funding and investment given the social issues it faces. Cheap land prices in the North make it ideal for settlement for those looking for somewhere inexpensive to buy a house so it has seen a larger than proportionate increase in immigration. With people struggling to meet even the basic living standards, there is also a greater increase in women entering the workforce. These demographic changes further damage the safety net by increasing labour supply which suppresses wages and subsequently benefits, as explained earlier.

The damage to the social safety net inflicted by each of these issues, whether that be through their effects on standards of living or on vital services, has happened over many years. The break down in the social compact and a rise in nationalism are not mutually exclusive, nor are they solely down to a notion of 'blame the immigrants', the discontentment among the poorer members of society about the continually widening gap between them and those at the top is a key factor- especially when (as discussed) they are bearing the impacts of the aggressive wealth creation of these upper echelons. Having now adequately diagnosed these detrimental developments, this essay can now begin to suggest how we might remedy them.

<u>Multiple solutions to a diverse problem</u>

First, we will look at ways to tackle the big rise in inequality. The first issue raised was the lack of proportionality between the losses from the bursting of the economic bubble and the gains from the creation of it. Here the value of existing capital is rising in a self-perpetuating cycle without sufficient dues being paid. Therefore a rise in Capital Gains Tax for when capital is sold on as well as the introduction of a Capital Income Tax on the returns made annually from capital (including interest, dividends and rental income) above a certain threshold, would be a good way of redistributing some of these gains. Equally an increase in Inheritance Tax from the current 40% in combination with an Asset Transfer Tax for the transferal of any assets to another party (excluding spouses) would prevent those who have accumulated wealth disproportionately to their generation from being able to pass it along to their associates at the expense of the next one. Now any movement of, and profits made from, existing capital would be subject to higher levels of taxation, thus preventing wealth from self-perpetuating and decreasing intergenerational inequality by spreading the wealth accumulated in previous generations much more evenly among those in future, allowing the entire generation to benefit.

To enhance this, the current tax breaks for charitable donations would be extended to any donation or investment of capital to a worthy cause for social mobility. These standards would be extended to Corporation Tax too. There would be a slight increase in the level of tax demanded from corporations but they would be exempt from paying this additional amount if they used it to invest in social mobility schemes involving human capital accumulation like apprenticeships. Designed to incentivise the improvement of prospects for those for whom such opportunities are scarce, companies would also benefit long-term from the improvement in skills and when additionally combined with the incentive of altruism, there would be no reason for this to cause undue disruption.

Moving to look at how best to reverse the breakdown of the social safety net, it must be noted that several contributing factors to this problem will eventually stop or reverse themselves anyway as there is only a relatively finite amount of UK manufacturing that can move to the Far East, of women that can enter the workforce, and of immigrants than can come and settle in the UK, so the disproportionately high supply of labour will inevitably decrease. Moreover, the baby boom generation moving into retirement will further decrease the size of the workforce and create demand for non-automated, low-skilled jobs in social care, providing more employment opportunities and, in all, reducing income inequality. This will also cause a rise in tax contributions towards the social safety net as well as lower demand for it, meaning that it can start to repair itself and offer benefits at a level that will close the relative inequality in living standards. However, this does not prevent measures being implemented to achieve this sooner.

Initially, to raise the living standards of the poorer members of society, it’s necessary to increase the lowest wages and therefore the highest benefits as employment levels are currently at a record high (according to the Office of National Statistics, the unemployment rate for those aged 16+ is at 4.3%, its lowest since 1975) so creating an immediate rise in labour demand is difficult. The problem is wage suppression not unavailability. However, raising the living wage increases the overall cost to the employer which could cause companies to lay off staff, decrease their hours, or implement further automation. So in the short term employers need an incentive to support the progression of those wages at the lowest levels, that doesn’t increase employment costs. Therefore, this essay proposes a pro-rata tax break for employers for money used for wage expenses to pay salaries that are below a set threshold. This encourages the company to spend more on wages, either increasing the number of people they employ (reducing demand on the safety net) or increasing the wages of their lowest paid employees (helping them achieve a better standard of living), leading to a rise in unemployment benefit but not their costs.

Corporation Tax should also be split into two parts as way of solving our society’s regional inequality. The government would set a national minimum level of corporation tax, whilst local authorities would set an additional, regional level of corporation tax (similar to the Scottish income powers) so that a lower tax rate could be implemented in poorer regions, making them more attractive to companies and giving them the incentive to base themselves around the country. Additionally, this would see enterprises more closely linked to the community as the local authority’s budget would partly be directly funded by their tax contributions. Post-Brexit, it’s also vital that the UK government matches EU regional funding. But more importantly, large investment in transport is needed to reduce geographical monopolies. Improving links between the North West and North East and nearby cities such as Edinburgh and Glasgow are imperative, as better infrastructure will allow these areas to take on the metropolitan character of London and the

South. Although these schemes take time, there are still the benefits of multiple job opportunities to be enjoyed during the construction period.

All of the measures suggested in this essay should combine to bring about a definite reduction in material inequality in the UK, which would benefit the population's health as described earlier. However, a further measure to tackle health inequality would be the introduction of a nominal fee for all NHS appointments along with a Specialist Treatment Insurance Scheme, which would cover the more complex procedures that are currently draining the budgets for routine services. Naturally, these charges would be waived for those unable to pay but the former would hopefully prevent the current, significant amount of missed or wasted GP appointments and both would reduce the underfunding of vital services. Whilst altering the NHS' 'free' characteristic could be viewed as potentially disrupting, after the crisis of last winter the UK population recognise the proximity of the service to breaking point and so it's doubtful they would object to these clearly necessary measures and on the whole, the introduction of prescription charges in the 1950s caused no more than a split in the Labour party- it didn't impact the quality or accessibility of care.

To conclude, what this essay lays out is a clear and compelling plan to reduce inequality in the UK, having already established that no single solution can be offered to such a complex conundrum. It's carefully considered approach employs the concept of utilitarianism to ensure that greater equality (whose benefits for society, social cohesion and the economy are proven) is at the focus of every policy suggestion. The multi-faceted structure laid out can in no way be seen as causing undue disruption and indeed successfully provides a solution for each of the key areas of inequality in the UK.

(3000 words)