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## **Working For the Few: Political Capture and Economic Inequality**

Ricardo Fuentes-Nieva and V. Nicholas Galasso

Oxfam

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Housing for the wealthier middle classes rises above the insecure housing of a slum community in Lucknow, India. Photo: Tom Pietrasik/Oxfam

# WORKING FOR THE FEW

## Political capture and economic inequality

**Economic inequality is rapidly increasing in the majority of countries. The wealth of the world is divided in two: almost half going to the richest one percent; the other half to the remaining 99 percent. The World Economic Forum has identified this as a major risk to human progress. Extreme economic inequality and political capture are too often interdependent. Left unchecked, political institutions become undermined and governments overwhelmingly serve the interests of economic elites to the detriment of ordinary people. Extreme inequality is not inevitable, and it can and must be reversed quickly.**

# SUMMARY

In November 2013, the World Economic Forum released its 'Outlook on the Global Agenda 2014', in which it ranked widening income disparities as the second greatest worldwide risk in the coming 12 to 18 months. Based on those surveyed, inequality is 'impacting social stability within countries and threatening security on a global scale.' Oxfam shares its analysis, and wants to see the 2014 World Economic Forum make the commitments needed to counter the growing tide of inequality.

Some economic inequality is essential to drive growth and progress, rewarding those with talent, hard earned skills, and the ambition to innovate and take entrepreneurial risks. However, the extreme levels of wealth concentration occurring today threaten to exclude hundreds of millions of people from realizing the benefits of their talents and hard work.

Extreme economic inequality is damaging and worrying for many reasons: it is morally questionable; it can have negative impacts on economic growth and poverty reduction; and it can multiply social problems. It compounds other inequalities, such as those between women and men. In many countries, extreme economic inequality is worrying because of the pernicious impact that wealth concentrations can have on equal political representation. When wealth captures government policymaking, the rules bend to favor the rich, often to the detriment of everyone else. The consequences include the erosion of democratic governance, the pulling apart of social cohesion, and the vanishing of equal opportunities for all. Unless bold political solutions are instituted to curb the influence of wealth on politics, governments will work for the interests of the rich, while economic and political inequalities continue to rise. As US Supreme Court Justice Louis Brandeis famously said, 'We may have democracy, or we may have wealth concentrated in the hands of the few, but we cannot have both.'

Oxfam is concerned that, left unchecked, the effects are potentially immutable, and will lead to 'opportunity capture' – in which the lowest tax rates, the best education, and the best healthcare are claimed by the children of the rich. This creates dynamic and mutually reinforcing cycles of advantage that are transmitted across generations.

Given the scale of rising wealth concentrations, opportunity capture and unequal political representation are a serious and worrying trend. For instance:

- Almost half of the world's wealth is now owned by just one percent of the population.
- The wealth of the one percent richest people in the world amounts to \$110 trillion. That's 65 times the total wealth of the bottom half of the world's population.
- The bottom half of the world's population owns the same as the richest 85 people in the world.

- Seven out of ten people live in countries where economic inequality has increased in the last 30 years.
- The richest one percent increased their share of income in 24 out of 26 countries for which we have data between 1980 and 2012.
- In the US, the wealthiest one percent captured 95 percent of post-financial crisis growth since 2009, while the bottom 90 percent became poorer.

This massive concentration of economic resources in the hands of fewer people presents a significant threat to inclusive political and economic systems. Instead of moving forward together, people are increasingly separated by economic and political power, inevitably heightening social tensions and increasing the risk of societal breakdown.

Oxfam's polling from across the world captures the belief of many that laws and regulations are now designed to benefit the rich. A survey in six countries (Spain, Brazil, India, South Africa, the UK and the US) showed that a majority of people believe that laws are skewed in favor of the rich – in Spain eight out of 10 people agreed with this statement. Another recent Oxfam poll of low-wage earners in the US reveals that 65 percent believe that Congress passes laws that predominantly benefit the wealthy.

The impact of political capture is striking. Rich and poor countries alike are affected. Financial deregulation, skewed tax systems and rules facilitating evasion, austerity economics, policies that disproportionately harm women, and captured oil and mineral revenues are all examples given in this paper. The short cases included are each intended to offer a sense of how political capture produces ill-gotten wealth, which perpetuates economic inequality.

This dangerous trend can be reversed. The good news is that there are clear examples of success, both historical and current. The US and Europe in the three decades after World War II reduced inequality while growing prosperous. Latin America has significantly reduced inequality in the last decade – through more progressive taxation, public services, social protection and decent work. Central to this progress has been popular politics that represent the majority, instead of being captured by a tiny minority. This has benefited all, both rich and poor.

## RECOMMENDATIONS

Those gathered at Davos for the World Economic Forum have the power to turn around the rapid increase in inequality. Oxfam is calling on them to pledge that they will:

- Not dodge taxes in their own countries or in countries where they invest and operate, by using tax havens;
- Not use their economic wealth to seek political favors that undermine the democratic will of their fellow citizens;
- Make public all the investments in companies and trusts for which

they are the ultimate beneficial owners;

- Support progressive taxation on wealth and income;
- Challenge governments to use their tax revenue to provide universal healthcare, education and social protection for citizens;
- Demand a living wage in all the companies they own or control;
- Challenge other economic elites to join them in these pledges.

Oxfam has recommended policies in multiple contexts to strengthen the political representation of the poor and middle classes to achieve greater equity. These policies include:

- A global goal to end extreme economic inequality in every country. This should be a major element of the post-2015 framework, including consistent monitoring in every country of the share of wealth going to the richest one percent.
- Stronger regulation of markets to promote sustainable and equitable growth; and
- Curbing the power of the rich to influence political processes and policies that best suit their interests.

The particular combination of policies required to reverse rising economic inequalities should be tailored to each national context. But developing and developed countries that have successfully reduced economic inequality provide some suggested starting points, notably:

- Cracking down on financial secrecy and tax dodging;
- Redistributive transfers; and strengthening of social protection schemes;
- Investment in universal access to healthcare and education;
- Progressive taxation;
- Strengthening wage floors and worker rights;
- Removing the barriers to equal rights and opportunities for women.

# 1 THE GROWING CONCENTRATION OF INCOME AND WEALTH IN A FEW HANDS

The past quarter of a century has seen wealth become ever more concentrated in the hands of fewer people. This global phenomenon has led to a situation where one percent of the world's families own almost half (46 percent) of the world's wealth. The bottom half of the world's population owns less than the richest 85 people in the world.<sup>1</sup>

In the past year, 210 people have become billionaires, joining a select group of 1,426 individuals with a combined net worth of \$5.4 trillion.<sup>2</sup> Corporate profits, chief executive officer (CEO) salaries, and stock exchanges are breaking new records daily, with no signs of slowing down. At the time of writing, the Dow Jones industrial average reached the highest mark in its 117-year history.<sup>3</sup> The wealth of the one percent richest people in the world amounts to \$110 trillion. That's 65 times the total wealth of the bottom half.<sup>4</sup>

This trend may seem surprising in light of the recent global financial crisis. Yet, while the crisis caused a momentary dip in the share of global wealth held by the rich, they have already gained it back, and more. In the US, the wealthiest one percent captured 95 percent of post-financial crisis growth between 2009 and 2012, while the bottom 90 percent became poorer.<sup>5</sup> The Great Recession did not change the trend in concentration of income: the share of US national income going to the top decile stands at 50.4 percent – its highest since World War I.<sup>6</sup> Had the share of income going to the richest one percent stayed the same as in 1980, the rest of America would have an additional \$6,000 dollars at their disposal in 2012.<sup>7</sup>

Global elites are increasingly becoming richer. Yet the vast majority of people around the world have been excluded from this prosperity. For instance, while stocks and corporate profits soar to new heights, wages as a percentage of gross domestic product (GDP) have stagnated. To give an indication of the scale of wealth concentration, the combined wealth of Europe's 10 richest people exceeds the total cost of stimulus measures implemented across the European Union (EU) between 2008 and 2010 (€217bn compared with €200bn).<sup>8</sup> Furthermore, post-recovery austerity policies are hitting poor people hard, while making the rich even richer. Austerity is also having an unprecedented impact on the middle classes.

Rich people are pulling further away from everyone else in terms of wealth in many countries. The World Top Incomes Database covers 26 countries, with information on the share of pre-tax income going to the richest one percent since the 1980s (see Figure 1).<sup>9</sup> In all but two countries (Colombia and the Netherlands), the share of income of the richest percentile increased – and in Colombia, it stayed at around 20 percent.<sup>10</sup> The richest one percent of people in China, Portugal, and the

*'The freest government, if it could exist, would not be long acceptable if the tendency of the laws were to create a rapid accumulation of property in few hands and to render the great mass of the population dependent and penniless.'*

Franklin Delano Roosevelt

*'No society can be flourishing and happy of which the far greater part of members are poor and miserable.'*

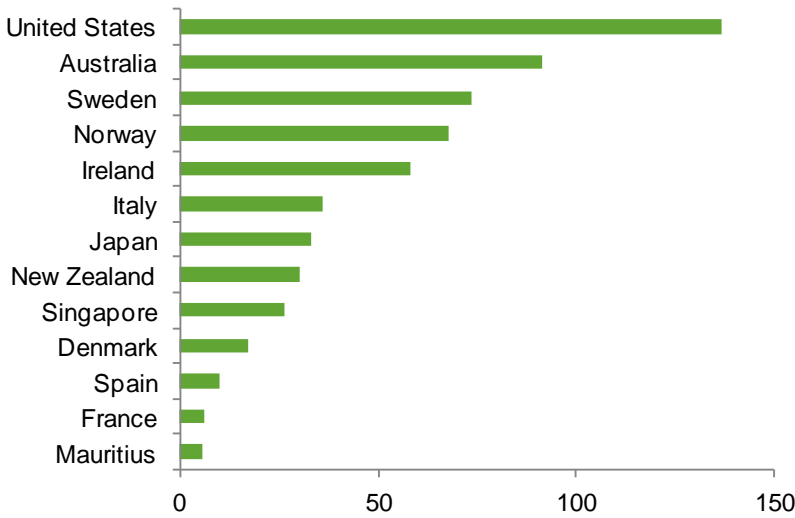
Adam Smith

US have more than doubled their share of national income since 1980, and the situation is getting worse.<sup>11</sup> Even in more egalitarian countries such as Sweden and Norway, the share of income going to the richest one percent has increased by more than 50 percent (see Figure 1).

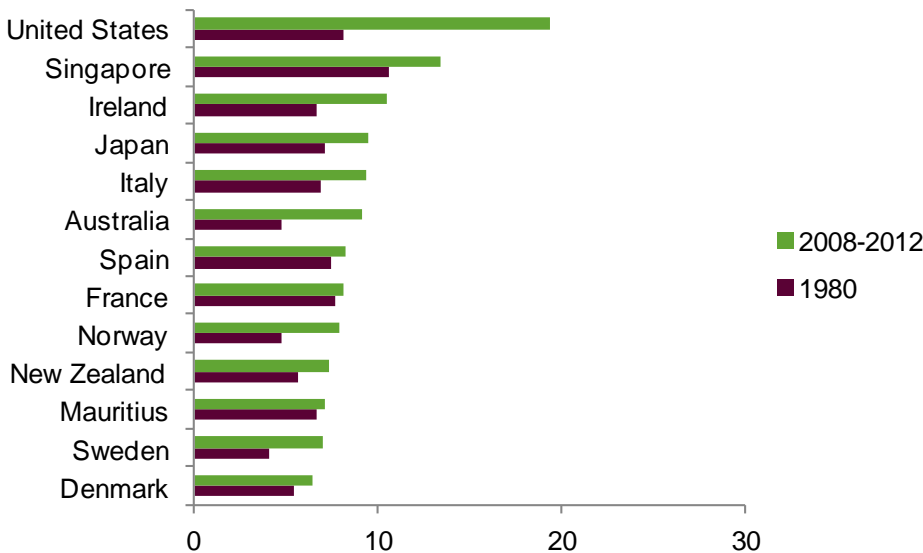
It is likely that the full concentration of wealth is in fact even worse, as a significant amount of wealth among those at the top of the scale is hidden away in tax havens. It is estimated that \$18.5 trillion is held unrecorded and offshore.<sup>12</sup>

**Figure 1: The rich get richer**

**The percentage increase in share of income of the richest one percent, 1980–2012**



**The share of national income going to the richest one percent**



Source: F. Alvaredo, A. B. Atkinson, T. Piketty and E. Saez, (2013) 'The World Top Incomes Database', <http://topincomes.g-mond.parisschoolofeconomics.eu/> Only includes countries with data in 1980 and later than 2008.



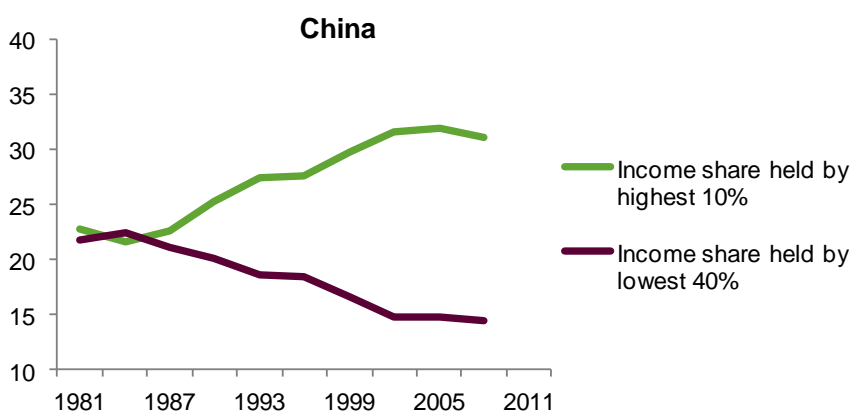
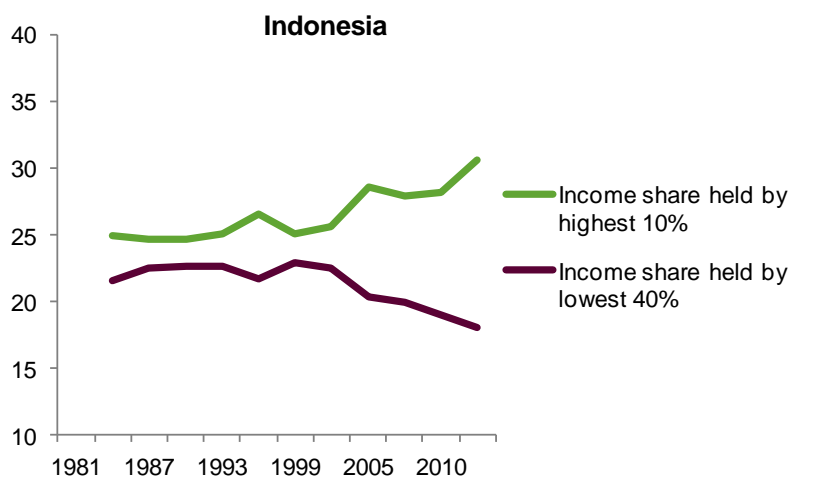
Data on the share of national income going to the richest people are scarcely available for developing countries. However, other measures support the argument that countries are becoming more unequal. For instance, between 1988 and 2008, the Gini coefficient increased in 58 countries for which data are available.<sup>13</sup> Seven out of every 10 people in the world live in countries where inequality has increased.<sup>14</sup>

Rising levels of inequality are also an important feature of populous middle-income countries. These countries matter because they are where most of the world's poor now live. Prior to globalization, these were low-income countries with significantly lower levels of inequality. Economic growth, however, has graduated them into middle-income status and has driven a wedge between the haves and have-nots.

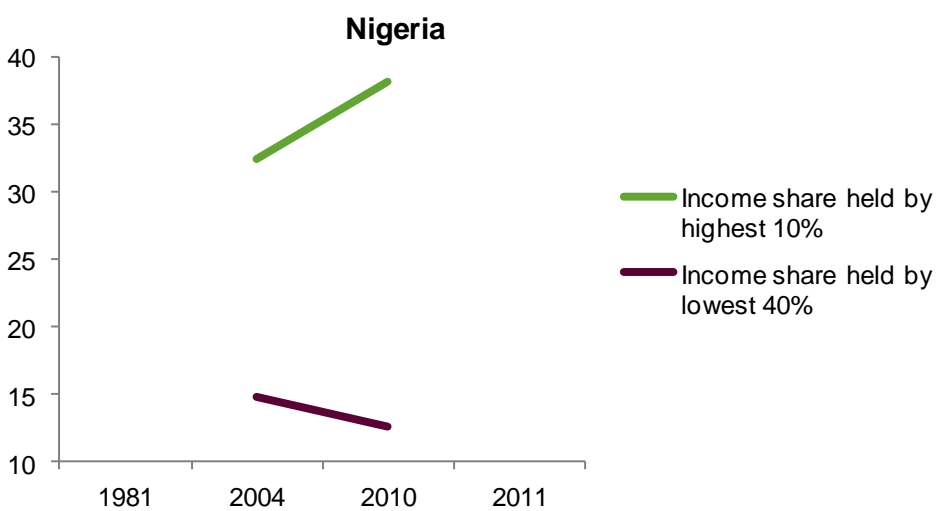
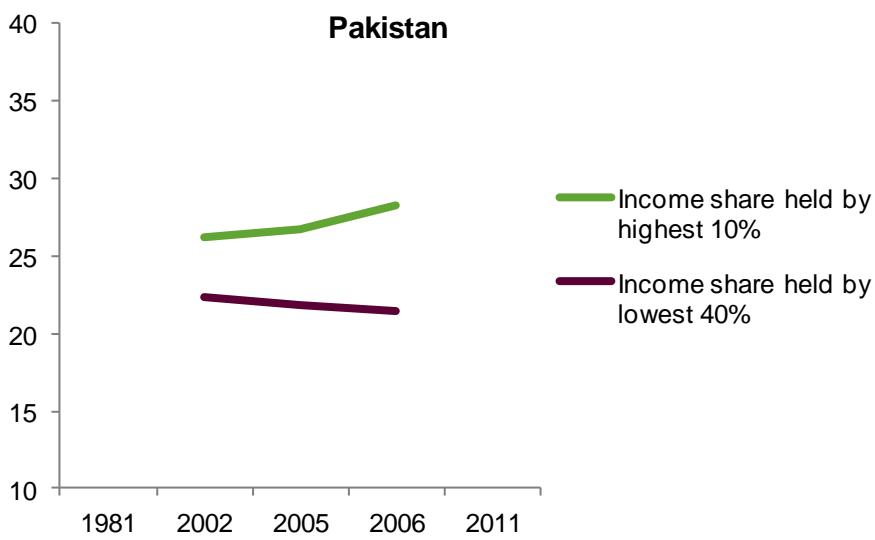
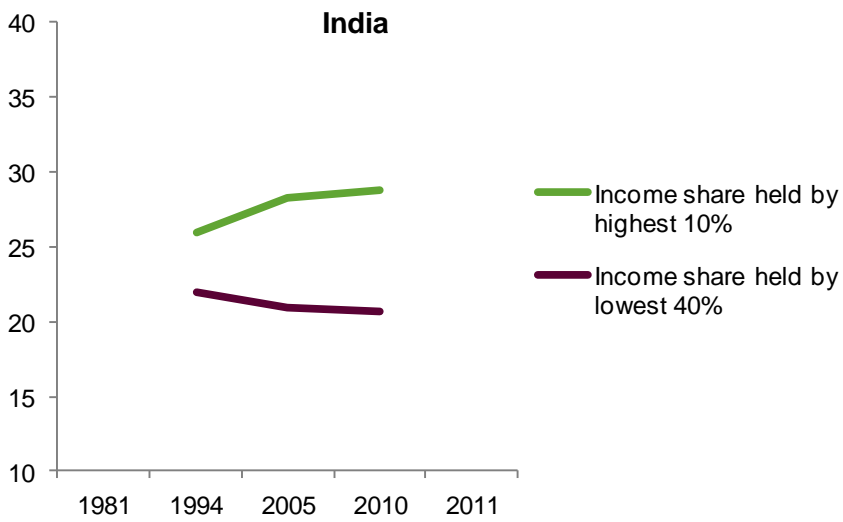
## RISING LEVELS OF INEQUALITY IN FIVE MIDDLE-INCOME COUNTRIES

Figure 2 shows the extent to which inequalities are increasing. They show that in Indonesia, China, India, Pakistan and Nigeria – all lower middle-income countries except for China, which is now classed as upper middle-income – the richest 10 percent of the population have acquired a much greater share of national income than the poorest 40 percent over the past 30 years, with the trend set to continue.

**Figure 2: Increasing inequality in selected middle-income countries**







Source: World Bank (2013) Poverty and Inequality Database

We also now have credible estimates of the distribution of wealth (as opposed to income) within countries. According to Credit Suisse, 10 percent of the global population holds 86 percent of all the assets in the world,<sup>15</sup> while the poorest 70 percent (more than 3 billion adults) hold just 3 percent. By some measure, the riches of billionaires are now unparalleled in history. The Mexican Carlos Slim, owner of large monopolies in Mexico and elsewhere, could pay the yearly wages of 440,000 Mexicans with income derived from his wealth.<sup>16</sup>

**Table 1: The concentration of global wealth**

Wealth (USD)	Percentage of the world's population	Number of adults (millions)	Percentage of world's wealth	Total wealth (trillions of dollars)
<10,000	68.7	3,207	3.0	7
10,000–100,000	22.9	1,066	13.7	33
100,000–1 million	7.7	361	42.3	102
> 1 million	0.7	32	41.0	99

Source: 'Global Wealth Report 2013'. Zurich: Credit Suisse

Some countries are managing to buck this global trend though. In Latin America, countries have achieved declining inequality during the past decade. However, these improvements must be tempered, as they are taking place in some of the most unequal countries in the world. The rate and depth at which inequality is declining also varies, and it is too soon to suggest a real trend.

Among the G20 countries, emerging economies were usually those with higher levels of inequality (including South Africa, Brazil, Mexico, Russia, Argentina, China, and Turkey) whereas developed countries tended to have lower levels of inequality (France, Germany, Canada, Italy, and Australia). Yet even this is changing, and now *all* high-income G20 countries (except South Korea) are experiencing rising inequality, while Brazil, Mexico, and Argentina are seeing levels of inequality decline.

## PEOPLE ARE CONCERNED ABOUT INEQUALITY

Discussions around inequality and the concentration of income and wealth are now at the center of global policy debates. But this was not always the case. Only a few years ago, Anne Krueger, then First Deputy Managing Director of the International Monetary Fund (IMF), said,<sup>17</sup> *'Poor people are desperate to improve their material conditions in absolute terms rather than to march up the income distribution. Hence it seems far better to focus on impoverishment than on inequality.'*

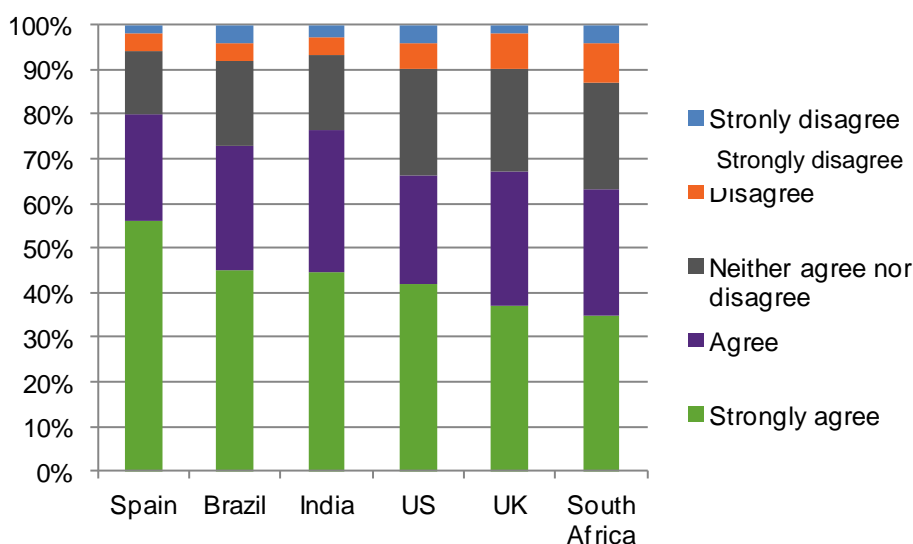
That view is no longer in fashion, so what changed the debate? The facts described in the previous section are partly responsible. They run counter to the consensus that shared prosperity and inclusive growth should be a high order goal. Instead, economic growth looks more like a winner-takes-all system. Recent findings also suggest that chronic

inequality stunts long-term economic growth,<sup>18</sup> and makes it more difficult to reduce poverty.<sup>19</sup>

New research substantiating the rise of inequality is affecting global public opinion. Global polling by the Pew Research Center Global Attitudes Project suggests that people in all regions of the world are concerned about rising inequality.<sup>20</sup> In November, the World Economic Forum released its 'Outlook on the Global Agenda 2014' report, in which 1,592 global elites ranked widening income disparities as the second greatest worldwide risk in the coming 12 to 18 months.<sup>21</sup>

Oxfam's own polling not only supports these findings but goes further; revealing an overwhelming sentiment that laws and regulations are designed to benefit the rich. A survey in six countries (Spain, Brazil, India, South Africa, the UK and the US) showed that a majority of people (8 out of 10 in Spain, for example) believe that laws are skewed in favor of the rich. Similarly, a majority of people agreed with the statement 'The rich have too much influence over where this country is headed' (see Figure 3).

**Figure 3: Oxfam survey on attitudes to wealth and power in six countries**



Source: Oxfam own polling. Respondents were asked whether they agreed with the statement 'The rich have too much influence over where this country is headed'.

In later sections of this paper, we explore how growing inequality at the national level biases the political process and distorts institutions in favor of the rich. This poses a challenge for attempts to strengthen political participation and build inclusive political systems. As US Supreme Court Justice Louis Brandeis famously said,<sup>22</sup> 'We may have democracy, or we may have wealth concentrated in the hands of the few, but we cannot have both.' If, as nations and as a global community, we choose the latter, we accept weakened democratic institutions, which will inevitably lead to greater economic inequality and its wide-ranging consequences. The rest of the paper explains how this might happen, and what historical lessons we can use to reverse this damaging trend.

## 2 RIGGING THE SYSTEM IN FAVOR OF THE FEW

Markets are not autonomous, spontaneous phenomena operating according to their own natural laws. In reality, markets are social constructions whose rules are set by institutions and regulated by governments that should be accountable to the participants and citizens. When there is growth and diminishing inequality, the rules governing markets are working *in favor* of the middle classes and the poorest sections of society. However, when only the rich are gaining, the rules start bending towards their interests exclusively.

Oxfam has spent 70 years working to fight poverty and injustice in more than 90 countries. Oxfam has fought against unsustainable debt and against tax havens. Through these experiences, Oxfam has witnessed first-hand how the wealthiest individuals and groups capture political institutions for their aggrandizement at the expense of the rest of society. Today's unprecedented levels of economic inequality tell us that left unchecked, representative institutions will decay further, and the power disparity between the haves and have-nots may become entrenched and immutable.

Strong quantitative data support Oxfam's concerns regarding rising wealth concentration and unequal political representation. A recent study presents compelling statistical evidence that the preferences of wealthy Americans are *overwhelmingly* represented in their government, compared with those of the middle classes. By contrast, the preferences of the poorest people demonstrate *no* statistical impact on the voting patterns of their elected officials. If this trend continues, public policies will most likely reproduce the conditions that are worsening economic inequality and political marginalization.<sup>23</sup>

How do the rules governing national economies become subservient to elite interests? This is a problem inherent to the nature of politics. As we have seen, the influence of wealthy groups leads to imbalanced political rights and representation. The outcomes include the capture of legislative and regulatory decision-making functions by those powerful groups.<sup>24</sup>

The short examples that follow demonstrate how our argument applies in different contexts.

### HOW ECONOMIC INEQUALITY AND RIGGED POLITICAL RULES INTERACT

Concentration of wealth in the hands of the few leads to undue political influence, which ultimately robs citizens of natural resource revenues, produces unfair tax policies and encourages corrupt practices, and challenges the regulatory powers of governments. Taken together, all of

these consequences serve to worsen accountability and social inclusion. The following case studies are from very different country contexts across the world.

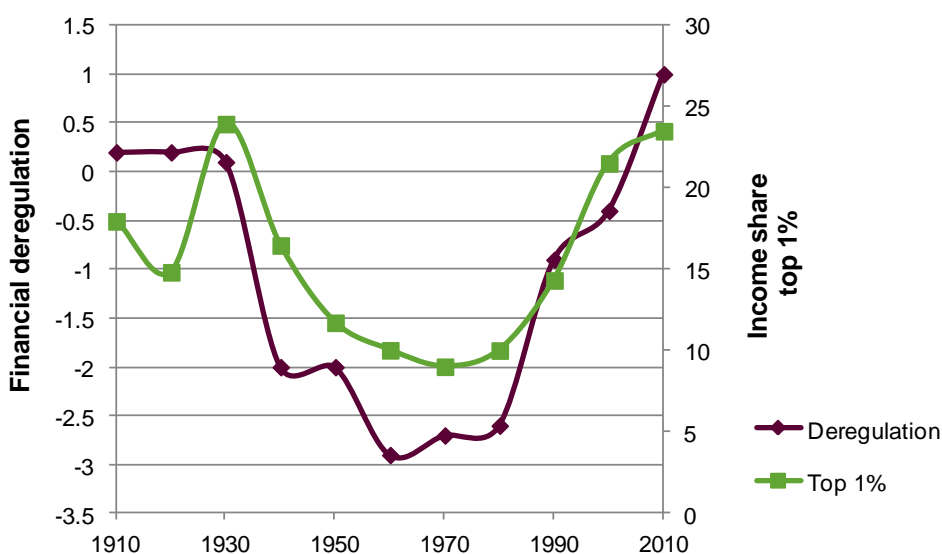
## Buying policy: how money skews political representation and drives inequality in the US

Since the late 1970s, weak regulation of the role of money in politics has permitted wealthy individuals and corporations to exert undue influence over government policy making. A pernicious result is the skewing of public policy to favor elite interests, which has coincided with the greatest concentration of wealth among the richest one percent since the eve of the Great Depression.

As policies favoring corporations gained ascendancy, the bargaining power of labor unions plummeted and the real value of the minimum wage and other protections eroded. It is now harder for unions to organize, and easier for big businesses to suppress wages and erode workers' benefits. Wealthy interest groups have also used their financial might to influence legislators and the general public to keep downward pressure on top income tax rates and capital gains, and to create corporate tax loopholes. Because capital is taxed at lower rates than income, millions of average working Americans pay higher tax rates than the rich.

From the 1980s onwards, the financial and banking sectors pumped millions of dollars into undoing regulations put in place after the stock market crash and Great Depression of the 1930s. Deregulation has had two major ramifications: corporate executives associated with the banking and financial sectors have become exceptionally wealthy, and global markets have become much more risky, culminating in the global economic crisis that began in 2008. As Figure 4 demonstrates, there is a direct correlation between financial deregulation and economic inequality in the US.

**Figure 4: The relationship between financial deregulation and inequality in the US**



Source data: Financial Deregulation, <http://www.nber.org/papers/w14644.pdf>; Income share: Piketty and Saez (2003, 2012).

In 2010, President Obama signed into law the Wall Street Reform and Consumer Protection Act (known as the Dodd-Frank Bill). The objective of this legislation is to regulate financial markets to protect the economy from a second major crash. However, the financial industry has spent more than \$1bn on hundreds of lobbyists to weaken and delay the Act's full implementation. In fact, in 2012 the top five consumer protection groups sent 20 lobbyists to defend Dodd-Frank, while the top five finance industry groups sent 406 to defeat it. Even though Dodd-Frank was signed into law more than three years ago, only 148 of its 398 rules have been finalized, and the financial system remains just as vulnerable to crash as it was in 2008.<sup>25</sup>

## **The impact of austerity in Europe: boosting the inequality gap**

Even before the financial crisis, a number of European countries were seeing increased levels of income inequality despite high levels of growth.<sup>26</sup> Portugal and the UK already ranked among the most unequal countries in the Organisation for Economic Co-operation and Development (OECD).<sup>27</sup> This raises serious questions as to how equitable any growth will be when those countries fully emerge from recession.

Under huge pressure from financial markets, austerity programs have been implemented across Europe in the face of large-scale public protests. Based on regressive taxes and deep spending cuts – particularly to public services such as education, healthcare and social security – these moves have started to dismantle the mechanisms that reduce inequality and enable equitable growth. They have also sought to erode labor rights. The poorest sections of society have been hit hardest, as the burden of responsibility for the excesses of past decades is passed to those who are most vulnerable and least to blame. Although it has come too late, leading proponents of austerity such as the IMF are beginning to recognize that harsh austerity measures have not delivered the expected results in terms of growth and recovery, and have in fact harmed the prospects for growth and equality.<sup>28</sup>

All the while, the richest 10 percent have seen their share of total income grow. The combined wealth of Europe's 10 richest people exceeds the total cost of stimulus measures implemented across the EU between 2008 and 2010 (€217bn compared with €200bn).<sup>29</sup>

## **The building of India's billionaires**

India has seen its number of billionaires increase from less than 6 to 61 in the past decade, concentrating approximately \$250bn among a few dozen people in a country of 1.2 billion. What is striking is the share of the country's wealth held by this elite minority, which has skyrocketed from 1.8 percent in 2003 to 26 percent in 2008, though it declined in the aftermath of the global financial crisis.<sup>30</sup>

By some estimates, *half* of India's billionaires acquired their wealth in 'rent thick' sectors.<sup>31</sup> This means sectors where profits are dependent on

access to scarce resources, made available exclusively through government permissions and therefore susceptible to corruption by powerful actors – as opposed to creation of wealth. Such sectors include real estate, construction, mining, and telecommunications. In fact, it is common knowledge that property development is India's most opaque business, where enormous sums of illegal money exchange hands and little tax is collected.<sup>32</sup> Wealth accrued from rents is made possible by the coaction of government and powerful groups, whereby the economic rules of the game are rigged in favor of elites.

Despite incredible economic gains by a few dozen people in India, poverty and inequality remain rampant. While the number of billionaires has multiplied by ten, government spending on the needs of the poorest and most vulnerable groups in society remains remarkably low. For example, India's public spending on healthcare is just one percent of GDP.<sup>33</sup> The Asian Development Bank's recently released *Social Protection Index* (assessing country expenditure on poor and economically vulnerable groups) ranked India 23 out of 35 countries in the region. Even among the 19 low- to middle-income countries, India ranked in the bottom half, in twelfth place.<sup>34</sup>

Corruption and loopholes mean that tax revenues necessary to address inequality are either too low or misappropriated. The fortunes amassed by India's new billionaires are often hidden through shell companies established in foreign countries, making it easy to evade taxes.<sup>35</sup> A recent working paper by Oxfam India demonstrates that ending the inheritance tax (in 1985) and limiting the wealth tax (in 1993) to non-productive assets (thereby excluding financial assets) has driven a low tax-to-GDP ratio and is permitting the much greater concentration of wealth. The tax structure in India is also highly regressive, with only 37.7 percent of total taxes coming from direct taxation such as income, profits, and capital gains.<sup>36</sup>

## **Tax avoidance & regressive tax systems: rigged rules in Pakistan**

The nexus of wealth concentration, capture of resources and government power by elites, and worsening inequality is especially apparent in Pakistan. The Parliament is comprised of the nation's wealthiest elites, who create economic rules specifically aimed toward advancing their narrow interests, while doing little to build the capacity of the state or enhance the economic power of the millions of citizens it is supposed to represent.

This is nowhere clearer than Pakistan's problem with income and asset tax avoidance. Of the 10 million people who qualify, only 2.5 million are actually registered to pay tax, making Pakistan's revenues from taxation among the lowest in the world, even beating Sierra Leone in having the lowest ratio of tax to GDP in the world.<sup>37</sup>

Despite an average worth of \$900,000 (with the richest member worth \$37m), only a few Parliamentarians pay tax. In 2010, a review of Parliament and provincial assemblies revealed that 61 percent of



lawmakers paid no income tax during the year they contested elections. This includes Yousaf Raza Gillani, then Prime Minister, his 25 members of cabinet, and Finance Minister Abdul Hafeez Sheikh.<sup>38</sup>

Parliamentarians create the rules that allow for these loopholes, making their tax exemptions legal. For instance, a 1990s law makes it impossible for authorities to ask questions on money transferred from abroad. Unable to ascertain even the legality of how money is earned, this law enables billions of rupees to move from Dubai back to Pakistan without scrutiny. The rich landowners who dominate Parliament also avoid tax by exempting agriculture – which is particularly galling for middle-class Pakistanis, as nearly half the population work in agriculture and its profits drive the divide between the haves and have-nots.

Many of the poorest people and even middle class Pakistanis do not earn enough to qualify to pay income tax. Yet they are required to pay sales tax – a much more burdensome levy for them than for the rich, and one that feeds an unjust system. Reflecting on Pakistan's unfair tax system, Riyaz Hussain Naqvi, a retired tax administrator said, *'This is a system of the elite, by the elite and for the elite... It is a skewed system in which the poor man subsidizes the rich man.'*<sup>39</sup>

The absence of any real tax base means the state must be propped up by international aid and loans. More importantly, the lack of domestic tax revenues limits government investment in basic services such as education, healthcare, and infrastructure, preventing the growth of a vibrant and strong middle class, and perpetuating Pakistan's widening economic and political inequality.

## **Anti-competition and regulatory failure: the richest man in the world**

Weak regulatory environments are ideal settings for anti-competitive business practices. Without competition, firms are free to charge exorbitant prices, which cause consumers to lose out and ultimately increase economic inequality. When elites exploit weak or incompetent anti-trust authorities, price gauging follows as a form of government *rent* to big business. By not acting when dominant firms crowd out competition, government tacitly permits big business to capture unearned profits, thereby transferring income from the less well-off sections of society to the rich. Consumer goods become more expensive, and if incomes do not rise, inequality worsens.<sup>40</sup>

Mexico's privatization of its telecommunications sector 20 years ago provides a clear example of the nexus between monopolistic behavior, weak and insufficient regulatory and legal institutions, and resulting economic inequality.

Mexico's Carlos Slim moves in and out of the world's richest person spot, possessing a net worth estimated at \$73bn. The enormity of his wealth derives from establishing an almost complete monopoly over fixed line, mobile, and broadband communications services in Mexico. Slim is the CEO and Chairman of América Móvil, which controls nearly 80 percent of

fixed line services and 70 percent of mobile services in the country. A recent OECD review on telecommunications policy and regulation in Mexico concluded that the monopoly over the sector has had a significant negative effect on the economy, and a sustained welfare cost to citizens who have had to pay inflated prices for telecommunications.<sup>41</sup>

As the OECD report argues, América Móvil's 'incessant' monopolistic behavior is facilitated by a 'dysfunctional legal system', which has *de facto* replaced the elected government's right and responsibility to develop economic policy and execute regulation of markets. This system has stunted the emergence of a dynamic and competitive telecommunications market. In fact, many of the regulatory instruments present in most OECD countries are absent in Mexico.<sup>42</sup>

The costs of government failure to curb such monopolistic behavior are large. Mexico has a high level of inequality and has the lowest GDP of all OECD countries. As other OECD countries demonstrate, a more efficient telecommunications (especially broadband) sector can play an important role in driving economic growth and reducing poverty, especially among a large rural population, as in Mexico's case. The OECD calculates that the market dysfunctions stemming from the telecommunications sector have generated a welfare loss of \$129.2bn between 2005 and 2009, or 1.8 percent of GDP per year.

## **Illicit outflows and corruption: inequality in resource-rich Africa**

New natural resource discoveries are driving an explosion of economic growth in sub-Saharan Africa. GDP in oil-rich countries like Equatorial Guinea and Angola has grown at average annual rates of more than 10 percent since 2000. Exports of oil, natural gas, metals, and minerals are also behind strong growth in Tanzania, Zambia, the Democratic Republic of Congo, Mali, and Namibia.<sup>43</sup> However, though several African countries are among the faster growing economies in the world, inequality remains rampant, hindering the rate of poverty reduction.<sup>44</sup> In fact, there is a positive correlation between the level of resources African countries export and their levels of inequality (as measured by the Gini coefficient).<sup>45</sup>

In countries with weak regulatory institutions, some companies undervalue the assets on which they pay royalties and taxes. As the individuals and companies involved in these extractive corporations and their political allies become rich, less and less attention is paid to efforts to reduce poverty and inequality.

## **Tax avoidance and inequality**

Global extractives corporations use their influence to secure generous subsidies and tax avoidance schemes from resource-rich countries. A recent investigation by Oxfam France showed that uranium extraction in Niger contributes only four to six percent to the public budget, despite being the most important export product. A large energy multinational,

*'Resource wealth should promote prosperity on the continent, not undermine inclusive economic growth, fuel corruption, or damage the environment... **Too often extractive industries in collusion with corrupt government officials cheat Africa of its wealth and potential for social spending.** African citizens must get their true share of extractive industry revenues and royalties paid to their governments.'*

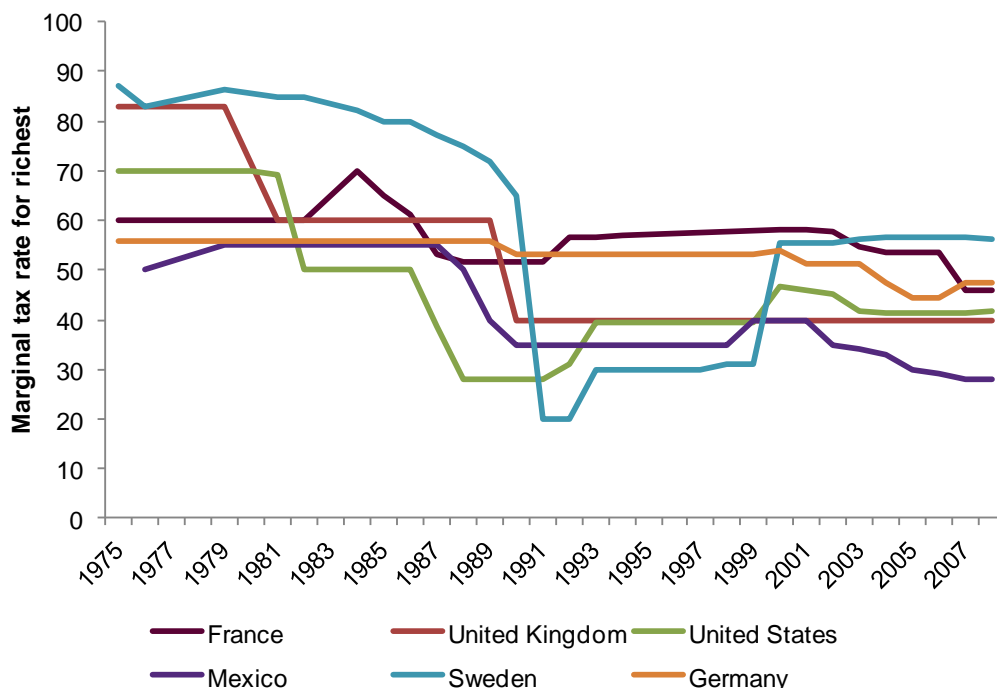
Winnie Byanyima  
Executive Director of Oxfam  
International

AREVA, has been engaged in mining in Niger. Oxfam found that AREVA's two subsidiaries, Somaïr and Cominak, benefit from exemptions from duties, VAT and even fuel taxes; and a 'provision for the reconstruction of mines' allows them to minimize their corporate taxes by setting aside 20 percent of their profits.<sup>46</sup>

## Tax and public expenditure

Another mechanism through which privilege cascades down is changes in fiscal policies that benefit elites. Since the late 1970s, 29 out of 30 countries for which data are available report a lower marginal tax rate for the richest sections of society.

**Figure 5: Top marginal tax rates (selected countries)**



Source: 'Top Marginal Personal Income Tax Rates, 1975–2008', Tax Policy Center, [http://www.taxpolicycenter.org/taxfacts/Content/PDF/oced\\_historical\\_toprate.pdf](http://www.taxpolicycenter.org/taxfacts/Content/PDF/oced_historical_toprate.pdf). Shows data for France, United Kingdom, United States, Mexico, Sweden and Germany.

In several countries, this drop in top tax rates comes with a sharp increase in the pre-tax share of income to the top one percent. As top tax rates began declining, certain sectors began to benefit from changes in laws that grew incomes in those sectors. '*[t]he political factors that led to top tax rate cuts – such as those by Reagan and Thatcher in the 1980s in the United States and the United Kingdom – were accompanied by other legislative changes, such as deregulation, which may have caused top incomes to rise, not least on account of the impetus they gave to the growth of the financial services... and legal services sectors.*'<sup>47</sup> Therefore, the richest members of society not only received a larger share of the economic pie but they also paid less tax on it.

Public expenditure decisions are also affected by the concentration of income. Probably the most notorious, and nefarious, case is the bailout to the financial industry in the wake of the 2008 global financial crisis. The financial sector in several countries has held whole economies to

ransom as the threat of 'too big to fail' has diverted millions of dollars to the sector in subsidies and has unduly influenced the US government – a process that Simon Johnson, former Chief Economist at the IMF, has dubbed a 'Quiet Coup'.<sup>48</sup>

Moreover, wealthy interest groups often challenge efforts to create good quality public services or universal health coverage. Such policies are considered threats to maintaining high concentrations of wealth and income levels. Recent evidence from Latin America (discussed in the following section) shows that the provision of public services decreases income inequality quite substantially; but this is unlikely to happen if those with massive wealth have undue influence over the political decision-making process.

## **Hidden from view – a global network of financial secrecy**

In the last 30 years, a global network of tax havens has evolved that has far-reaching implications for increased economic inequality. Large amounts of wealth are hidden from view, and are largely untaxed, denying national treasuries vital resources that could be used to benefit society. Oxfam has conservatively estimated the amount held offshore at \$18.5 trillion.<sup>49</sup> By comparison, the GDP of the US, the richest country on earth, is \$15.8 trillion.<sup>50</sup> At the same time, the 'race to the bottom' effect of these very low tax jurisdictions has further contributed to lower and lower corporate and personal tax rates for the richest individuals and corporations.<sup>51</sup> In 2011, Zambia's copper exports generated \$10bn, while government revenues from copper were only \$240m<sup>52</sup> – in a country where 69 percent of people live on less than \$1.25 a day.<sup>53</sup> This network of secrecy and low tax rates facilitates the illicit flows of large amounts of capital from the poorest countries. It is estimated that between 2008 and 2010, sub-Saharan Africa lost on average \$63.4bn dollars this way each year, or more than twice what it received in aid.<sup>54</sup>

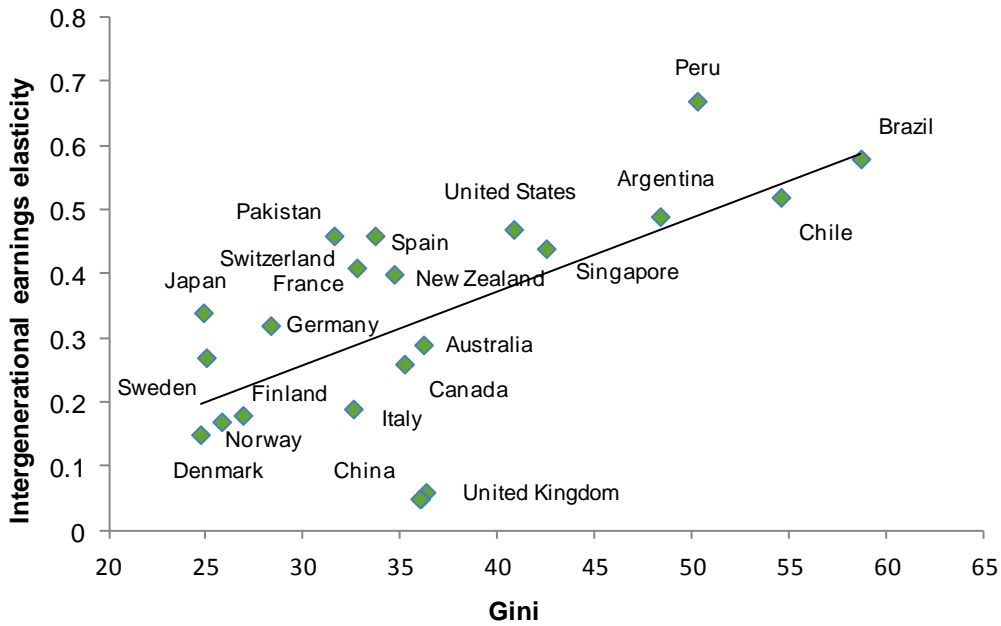
### 3 CASCADING PRIVILEGE: MAKING THE GAPS BETWEEN THE HAVES AND THE HAVE- NOTS PERMANENT

Wealth begets wealth, and once the political and institutional system is rigged in favor of an elite, the consolidation of their privileges cascades down through different mechanisms. This 'privilege cascade' affects elements that otherwise should be conducive to fair opportunities and protection for all members of society. What, by some measure, looks and sounds meritocratic is a result of rules that are biased in favor of the elite. Good quality education and other public services overwhelmingly benefit the few, providing them with more opportunities for development.

Equality of opportunity is a central tenet of inclusive modern societies. It implies that a person's achievements or outcomes should not be determined by their race, gender, family, or any other immutable characteristic. There are strong arguments to defend a certain level of income inequality in any society as it may result from entrepreneurship, effort and merit, as explained earlier; but very few people would oppose equality of opportunity for everyone. Recent evidence shows that income inequality and inequality of opportunity are highly correlated: children's life chances are strongly determined by their parents' socio-economic status.<sup>55</sup>

In a truly fair society, social mobility would be high, but this is not the case where there are high levels of economic inequality. Academic Miles Corak plotted the Gini coefficient against the extent to which a person's income is determined by their parents' income (see Figure 6). In Denmark, for instance, a country with a low Gini score, only 15 percent of a young adult's income today is determined by their parents' income; in Peru, which has a Gini score that is among the highest in the world, two-thirds of what a person earns today is related to what their parents earned in the past. This relationship is known as 'the Great Gatsby curve'. As F. Scott Fitzgerald said, the rich '...are different from you and me'. And so their offspring are too.

**Figure 6: The extent to which parents' earnings determine the income of their offspring**



Source: M Corak (2012) 'Inequality from Generation to Generation: The United States in Comparison'.

This evidence highlights an aspect of 'opportunity hoarding' – or the process through which disparities become permanent.<sup>56</sup> This occurs when certain defined groups take control of valuable resources and assets for their benefit and to 'seek to secure rewards from sequestered resources'.<sup>57</sup> And this might be different types of resources such as public expenditure, access to quality education, or profitable jobs. Even in countries with strong social mobility such as Canada and Denmark, sons and daughters of rich parents are more likely to work for the same employer, which suggests that strong family connections rather than merit help young people get well-paid jobs.<sup>58</sup>

### Access to education and well-paid jobs

Education is one of the most effective ways to increase a person's prospects in life. The premium for college education is a powerful force in wage inequality – which is not bad in itself, assuming that all children have the same access to begin with. It becomes problematic when access to good quality college education is determined by socio-economic preconditions that limit the life chances of poor people and benefit the rich – either through access to financial aid, poor quality secondary education, discrimination, or stunted aspirations.

The college premium is represented in differences in wages between those with college degrees and the rest of the population. This wage gap might be a result of technological change that primarily benefits skilled workers. But at the same time, there is a change in power relations between labor and capital. A report from the International Labour Organization (ILO) shows that between 1989 and 2005, union density (a measure of the membership of trade unions which represents union membership in relation to the total labor force) mostly declined in 51

countries for which data are available,<sup>59</sup> and that union density is negatively correlated with income inequality. Power relations between owners of capital and workers have changed dramatically in the past three decades in many countries, mostly as economies have moved from manufacturing to services, and as globalization has allowed for outsourcing of jobs. This is reflected in the decreasing share of income going to labor: over the past three decades, wages, salaries and benefits represent a smaller share of national income in nearly all ILO member countries.<sup>60</sup>

## **Women and income inequality**

The impacts of rapidly rising income inequality in any society are not felt in isolation, but instead interact with other existing inequalities based on gender, area of residence (e.g., rural and urban households), ethnicity and other factors. These inequalities are themselves not exclusively caused by economic inequality. Gender inequality also has strong cultural causes, for example. But these inequalities are often made much worse in very economically unequal societies.

Very often, in rich and poor countries alike, gender inequality results in women being paid less than men for similar work. In Pakistan, for example, only two-thirds of children attend primary school when they are supposed to. However, the national average hides other inequalities: disaggregated data reveal that 87 percent of boys in the richest 20 percent of the population attend primary school, whereas just 32 percent of girls in the poorest group do. Income inequality also reinforces negative outcomes for women in other areas of life. For example, the maternal mortality ratio for rural women in Pakistan is almost double that for women in urban areas.<sup>61</sup>

Inequality within a family is closely associated with the employment status of its members. A recent paper shows that increasing female employment (and closing the employment gap between women and men) would reduce household income inequality.<sup>62</sup>

Although combating income inequality will not on its own solve gender inequalities, there is a strong link between more economically equal societies and more balanced power relations among citizens. In such societies, a positive feedback loop can be created, with more women in positions of power who can then ensure that institutions and rules act to further progress gender equality.



# 4 ACCOUNTABILITY AND CITIZEN PARTICIPATION: THE ANTIDOTE TO ELITES CAPTURING GOVERNMENT

The good news is that political capture and economic inequality are not inevitable. In fact, there are abundant examples of good governance policies tempering the influence of wealthy elites and allowing society's resources to be shared more equitably. Here, we explore three such cases, focusing on post-war America, Ghana, and Latin America.

## POST-WAR AMERICA

Writing in *Harper's* in 1952, Frederick Lewis Allen appraised the US's experience of the first half of the 20th century with the following words:

*'At the turn of the century America seemed in danger of becoming a land in which the millionaires had more and more and the rest had less and less, and where a few financiers had a stranglehold, not only on the country's economic apparatus, but on its political apparatus, too.'*

*'...Through a combination of... revisions of the systems – tax laws, minimum wage laws, subsidies and guarantees and regulations of various sorts... we repealed the Iron Law of Wages. We had brought about virtual automatic redistribution of income from the well-to-do to the less well-to-do... that, it seems to me, is the essence of the Great American Discovery.'*

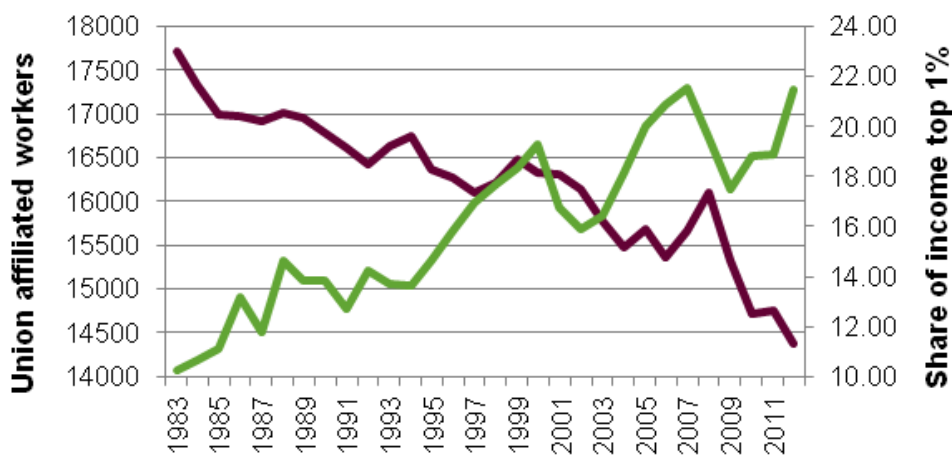
In a film released in 2013, called 'Inequality For All', former US Labor Secretary Robert Reich responds to a question about which country the US economy should emulate, given its high level of inequality (400 of the richest Americans have more wealth than the 150 million citizens who comprise the poorest half of the population). His surprising answer is: the US of some decades ago. Reich then points to the three decades of strong growth and diminishing inequality after World War II.

During this time, the US created the largest middle class the world has ever seen. Reich calls this era 'the Great Prosperity'. It was made possible through a tacit agreement reflecting the interdependence between labor, big business, and the federal government, known as the Treaty of Detroit.<sup>63</sup> Owing to the economic power of middle-class consumers, big business recognized the utility of paying good wages, with cost-of-living increases (as well as health insurance and pensions, which had been primarily management perks until the 1950s). Importantly, big business agreed to productivity-based wage increases too, aligning the interests of labor and management together to ensure rising productivity and growing profits.

The government's role was to maintain the balance between labor and big business. For instance, fearing that a tax cut on investment and income would spur inflation, President John F. Kennedy's Council of Economic Advisers printed 'guideposts' to link wages and prices, which unions and big corporations largely adhered to. Walter Heller, the Chairman of Kennedy's Council of Economic Advisers, reflected with satisfaction years later that industry came to realize that linking wages to productivity increases still brought significant rewards for capital, as corporate after-tax profits doubled between 1961 and 1966.<sup>64</sup>

The era of 'Great Prosperity' fostered by the Treaty of Detroit came to an end as big business increasingly concentrated its economic power to lobby policy makers in Washington DC throughout the 1970s and 1980s, eventually edging out labor, and fighting otherwise popular policies impacting working families, like increasing the minimum wage. As laws making it more difficult for unions to organize increased, average wages stagnated, auguring in the trend of rising inequality that has been evident for the past 30 years.<sup>65</sup>

**Figure 7: Declining union rates and the rising 1% income shares in the US**



Sources: Bureau of Labor Statistics (2013) 'Union affiliation data from the Current Population'; Saez & Piketty (2003) 'Income Inequality in the United States, 1913–1998', *Quarterly Journal of Economics*, 118(1), 1–39 (Tables and Figures Updated to 2012, September 2013).

## REVENUE MANAGEMENT IN GHANA

Ghana's recent Petroleum Revenue Management Bill provides a good example of how targeted regulation can promote shared prosperity and mitigate elite capture. Despite Africa's vast mineral and oil resources, extractive industries have served to make very few people extremely wealthy while the majority have become much poorer. Ghana's experience of more than 100 years of gold mining exemplifies how revenue mismanagement makes it easy for elites to become wealthier, while the majority are robbed of their rightful resources for development and improved wellbeing.

After becoming Africa's newest oil producer in 2009, civil society advocates worked to ensure that revenues would be accounted for and properly invested back into Ghanaian society. The new law establishes

mechanisms for collecting and distributing revenues, with mandates regarding how much will fund the annual budget, how much is invested for future generations, and how much is invested for a rainy day. It also requires the government to publish information on receipts from oil companies, and the Minister of Finance to reconcile receipts and expenditures for public review every quarter. In 2011, petroleum revenues contributed to four percent of national government spending, most of which went to road infrastructure, building capacity for the oil and gas sectors, repaying loans, and supporting fertilizer subsidies.

The law also mandated the creation of a Public Interest and Accountability Committee, which serves as a vehicle for public debate concerning how revenues are spent. The Committee is also charged with monitoring and evaluating compliance by government and related institutions, and providing an independent assessment of revenue receipts. Of course, there are challenges in terms of developing civil society capacity to effectively monitor oil production in order to determine how much the government is rightly owed.<sup>66</sup> But if spent equitably, these revenues could help pay for universal healthcare in Ghana, and fund further investment in agriculture and food production.<sup>67</sup>

## FISCAL POLICY AND SOCIAL SPENDING IN LATIN AMERICA

The case of Latin America gives us hope that the global trend of rising inequality can be reversed. Despite historically being the most unequal region in the world, it is the only region that has managed to reduce inequality during the past decade. In countries where inequality has declined, governments are increasing tax revenues and spending more on social protection and poverty reduction policies. This trend is associated with a transition from military coups and dictatorships during the Cold War era to stronger democratic practices around the region. However, despite these improvements, tax regimes in Latin America remain regressive and fail to collect enough tax as a share of GDP. They also continue to permit unacceptable levels of tax evasion. Combatting these inadequacies is necessary to continue addressing the region's long history of inequality.

The region has a long way to go to achieve its revenue potential. Yet, recent growth of tax revenues in Latin America has been the fastest in the world, and this growth has translated to higher spending to reduce inequality.<sup>68</sup> For instance, between 2002 and 2011, income inequality dropped in 14 of the 17 countries where there is comparable data.<sup>69</sup> During this period, approximately 50 million people moved into the middle class, meaning that for the first time ever, more people in the region belong to the middle class than are living in poverty.<sup>70</sup>

The reduction of inequality is the result of the right mix of government policies that focus on poor people by increasing social public expenditures. This mix of policies includes:

- in some cases, such as Brazil, the use of progressive taxation such as

direct or income taxes, although progressive taxation has not yet been used enough by countries in the region as a redistribution tool as well as a revenue raiser;

- increased spending on health and education (particularly primary and secondary): as a result of which many of the poorest in society have been able to access free social services without having to become indebted in order to pay for them;
- large-scale conditional cash transfer programs: providing direct income, under certain conditions, to millions of families facing poverty and deprivation;
- increases in the minimum wage and employment opportunities: which have created secure livelihoods for millions of people.

By some estimates, social spending as a percentage of GDP across Latin American countries increased by 66 percent over the past twenty years.<sup>71</sup> The impact is noticeable, given that not long ago the region had among the lowest public spending levels in the world. Increased spending on health and education has had the greatest impact on inequality reduction.<sup>72</sup>

Brazil has had significant success in reducing inequality since the new century started: the Gini declined approximately 10 percent between 2001 and 2011<sup>73</sup> – partly because of an increase in public social spending, an emphasis on spending on public health and education, a wide-scale conditional cash transfer program (*Bolsa Familia*), and a surge in the minimum wage that has risen by more than 50 percent in real terms since 2003.

The increase in public expenditure and the reduction in inequality are closely associated with more accountable and representative governments. Many countries in the region have increased democratic practices. Political parties more regularly compete for the electorate,<sup>74</sup> through efforts to reduce the wage gap, for instance. Democracy is fragile and inequality is still very high in the region, but the trend shows that the once intractable problem of enormous income disparities can actually be tackled with policy interventions.

# 5 CONCLUSION AND RECOMMENDATIONS

The large and rising concentrations of income and wealth in many countries represent a global threat to stable, inclusive societies for one simple reason: the unbalanced distribution of wealth skews institutions and erodes the social contract between citizens and the state. The checks and balances in place to ensure that the majority of the population are heard tend to weaken. Concentration of income and wealth actually hampers the realization of equal rights and opportunities because it makes political representation harder for disadvantaged groups, to the benefit of affluent groups. It has happened in the past and unless we pay close attention to the worrying trends outlined here, it can happen again.

Some of those who are among the richest one percent recognize the need to reduce these inequalities, including Bill Gross, founder of PIMCO (a global investment management firm), who said recently that those in the one percent *'should be willing to support higher taxes on carried interest, and certainly capital gains readjusted to existing marginal income tax rates.'*<sup>75</sup> and Warren Buffett (a US business magnate), who has said he should never pay a lower tax rate than the office cleaner.<sup>76</sup> The time to act on inequality is now. Rising inequality, a trend that has grown apace over the past 30 years, must be reversed.

## RECOMMENDATIONS

Those gathered at Davos for the World Economic Forum have the power to turn around the rapid increase in inequality. Oxfam is calling on them to pledge that they will

- Not dodge taxes in their own countries or in countries where they invest and operate, by using tax havens;
- Not use their economic wealth to seek political favors that undermine the democratic will of their fellow citizens;
- Make public all the investments for which they are the beneficial owners;
- Support progressive taxation on wealth and income;
- Challenge governments to use their tax revenue to provide universal healthcare, education and social protection for citizens;
- Demand a living wage in all the companies they own or control;
- Challenge other economic elites to join them in these pledges.

As a major element of the post-2015 development goals, Oxfam is calling for

- A global goal to end extreme economic inequality in every country. This must include consistent monitoring in every country of the share of wealth going to the richest one percent.

Oxfam has also recommended policies to strengthen the political representation of the poor and middle classes to reduce economic inequality. These policies include

- Stronger regulation of markets;
- Curbing the power of the rich to influence political processes and policies that best suit their interests.

The particular combination of policies required to reverse rising economic inequalities should be tailored to each national context. But developing and developed countries that have successfully reduced economic inequality provide some suggested starting points, notably:

- Cracking down on financial secrecy and tax dodging;
- Redistributive transfers; and strengthening of social protection schemes;
- Investment in universal access to free healthcare and education;
- Progressive taxation;
- Strengthening wage floors and worker rights;
- Removing the barriers to equal rights and opportunities for women.

# NOTES

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