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Commentary: Contesting inequality

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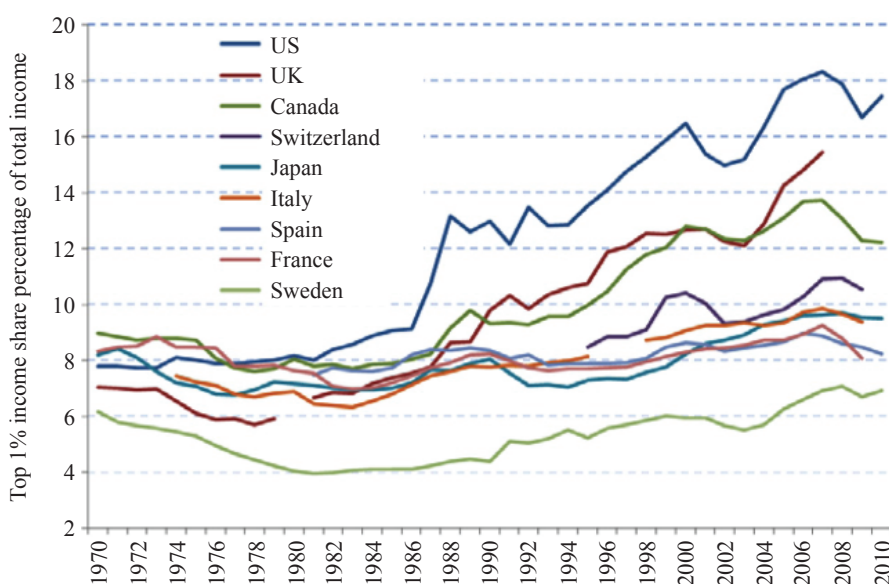
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## Commentary

### Contesting inequality

While the 1950s and 1960s were a period of increased social inclusion and convergence in standards of living for countries of the Global North, inequality has increased and social mobility declined dramatically since the early 1980s (Atkinson and Piketty, 2007; OECD, 2008). And while this trend is particularly pronounced in the US and the UK, it is now observable in several other countries where the shift in incomes from the bottom and middle of the distribution toward the top has been sustained since the 1980s (see figure 1). As Piketty and Saez (2003) demonstrate in their research on US trends, the pretax income share of the top 1% has returned to levels not observed since predepression times. A more recent analysis by Mishel and Bivens (2011) shows that, between 1979 and 2007, inflation-adjusted average annual incomes (which in addition to wages and salaries includes interest, dividend, and capital incomes) increased by 390% and 224%, respectively, for the top 0.1% and 1% of households in the US compared with a meagre 5% increase for the bottom 90% of households. In fact, all of the growth for the bottom 90% occurred between 1997 and 2000, followed by a period of declining incomes from 2000 and 2007.

To counter this relative decline in incomes, consumers in the lower and middle income groups reacted by reducing their savings and significantly increasing their debt load. This led to the build-up of a massive credit bubble that eventually burst in 2007, precipitating the world into the Great Recession (Galbraith, 2012; Rajan, 2010; Stiglitz, 2012). And while this recession officially ended in 2009, the economic recovery has been slow: unemployment remains high (in the US alone, the economy is still nearly five million jobs below its prerecession level), apparent wealth stored in home values was wiped out, and retirement incomes reduced substantially. Again, those in the lower and middle income groups, as well as certain ethnic groups (see, for instance, Kochlar et al, 2011; McKernan et al, 2013), have suffered disproportionately from this protracted slump and the gap between the rich and the poor continues to widen. In the US, while the top 1% received 65% of the gain in total



**Figure 1.** [In color online.] Top 1% income shares for selected countries, 1970–2010 (source: World top income database, <http://topincomes.g-mond.parisschoolofeconomics.eu/>).

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national income between 2002 and 2007, that share jumped to 121% of the additional income generated during the recovery from 2009 to 2011. In contrast, the bottom 99% saw their real incomes decline by 0.4 percentage points (Piketty and Saez, 2003<sup>(1)</sup>). Such a trend stands in stark contrast to the great compression of incomes that followed the depression of the 1930s (Goldin and Margo, 1992; Grusky et al, 2011).

With inequality at historically high levels, the year 2011 saw a number of large-scale protests organized across more than 900 cities the world over where hundreds of thousands poured into the streets to denounce the continually growing concentration of incomes in the hands of a few (Breau, forthcoming; Pickerill and Krinsky, 2012; Sparke, 2013; van Gelder, 2011). The Occupy Movement, it seemed, was finally giving a voice to inequality. But after all the efforts to advocate for a fairer and more equitable distribution of income, little has been done about it. By and large, politicians and policy makers have ignored the issue of rising inequality.

In light of the public outcry and overwhelming evidence on the negative social consequences of unequal income distributions (more on this below), we find the apparent acceptance for the need of austerity measures and reluctance to tackle inequality by political leaders puzzling. This commentary is written to summarize some of the recent work on inequality that helps us understand the puzzle, reflect on steps required to change the current condition, and highlight a number of areas where geographers have contributed to the debate (eg, Essletzbichler, 2011) and can make further contributions to contest the existing system of unequal income and wealth distribution which we see as a major drag on future economic growth and the cause of a large number of social ills. More specifically, we briefly address three central issues: What are the causes of rising inequality? Why should we be concerned with inequality? And how can we contest it?

From the outset, we recognize that in writing this commentary we inherently focus our discussion on the US and UK developments and debates. This is where the increase in inequality has been the most remarkable over the last few decades and where the amount of academic research on the topic has been greatest. Yet, such a focus by no means implies that the causes and consequences of income inequality, nor the steps required to change the current situation, are universal in their applicability. Our closer examination of trends in these two countries does, however, have implications for a number of other countries with similarly rising inequality (eg, Canada, New Zealand, Italy, Spain, Argentina).

### **What are the causes of inequality?**

Among economists the dominant explanations of rising inequality have focused on technological change and globalization. Known as the skill-biased technological change (SBTC) hypothesis, this argument ultimately blames the exogenous process of technical change for rising wage inequality in the Global North as the growing use of machinery and computers is seen to have shifted labour demand towards a more highly skilled workforce. As a result, wages for the highly educated workers increased relative to those of less-educated workers (Autor et al, 2003). More recent versions of the argument see globalization as accelerating this shift as the relocation of routinized and low-skill production to low-wage countries puts further pressure on low-skilled workers in the Global North, depressing their salaries and thus widening wage inequality between the educated and uneducated (see, for instance, Breau and Rigby, 2010). While technological change and globalization can account for part of the increase in inequality, those factors alone do not explain the sustained concentration of income at the very top of the distribution. There are empirical inconsistencies in cross-sectional and time-series analyses that are difficult to reconcile with

<sup>(1)</sup>The supplementary tables have been updated to 2011 and are available at Emanuele Saez's website (<http://elsa.berkeley.edu/~saez/>). Data reported here are from table 1 of TabFig2011prel.xls.

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the SBTC hypothesis. Particularly difficult to reconcile with standard economic theory is the observation that since the 1980s productivity increases have been decoupled from wage increases leading to a declining share of wages on total costs (Fleck et al, 2011). Alternative frameworks are thus emerging and these tend to locate institutional changes at the center of an explanation. Here, emphasis has been placed on changes in tax regimes, the organization of labour, as well as monopolistic economic practices that yield rents seized by corporate managers (rather than distributed to labor) and where the legislature is increasingly influenced by powerful interest groups such as finance, insurance, resource, and pharmaceutical lobbies.

While some economists argue that government policy cannot influence the pretax wage distribution and hence has little impact on inequality, this perception can be refuted. Government has enormous power to affect pretax wages through minimum wage legislation, anti-union laws, regulations of corporate governance, rules for financial markets and the provision of subsidies to the financial sector, privatization of military operation and health care insurance, and the list goes on. In the US, for instance, two key institutional changes have clearly impacted the trajectory of inequality over the last few decades.

The first is union membership, which typically acts as an important counterweight to inequality given that wages and benefits are more equal in sectors where unions are present. Union membership has steadily declined in the US since the 1950s. Yet neither economic necessity nor the desire of workers to obtain union representation can explain the slide in union membership. Rather, it appears the slide is the result of a deliberate political strategy pushed by well-organized business representative groups and state level legislators who were unopposed at the federal level. At a time business groups became increasingly organized, workers had little representation in shaping workplace and national politics as the National Labor Relations Act placed few limits on increasingly vigorous anti-union activities (Hacker and Pierson, 2010, page 59).

A second important set of regulatory shift concerns deregulation in the financial sector where we have witnessed an easing of bank branching rules to facilitate mergers and acquisitions, the relaxation of the traditional separation of commercial and investment banking, the removal of ceilings on interest rates, and repeal of the separation between finance and insurance companies. With deregulation, returns in the financial sectors have soared and executive pay has gone through the roof (Philippon and Reshef, 2012). These changes were coupled with changes in corporate governance where CEOs and boards received power to write their own checks with little supervision by shareholders or 'investor collectives' (like public pension systems and mutual fund operators). As a result, large swaths of the increase in income for the top 1% go to people working in the finance industry (Mishel and Sabadish, 2012).

While those two changes affect changes in pretax income distribution, the government also redistributes income through tax policy. As the very rich do not receive most of their income from wages, they are affected less by payroll but more by corporate, capital gains, and estate taxes. Tax rates for nonwage incomes have declined rapidly since the late 1970s, such that the average federal tax rate for the 'super-rich' (those in the top 0.01 percentile) dropped from 75% to less than 30% (Piketty and Saez, 2007). Many CEOs are able to declare their extra incomes as capital gains which allows them to lower their income taxes as capital gains taxes declined to 15% under the Bush administration. Viewed differently, the reduction of capital gains tax equated to a US\$30 million gift to each of the top 400 tax payers in 2008 and lowered overall tax revenue by about US\$12 billion (Stiglitz, 2012, page 72). While the rich were able to shrug off claims for higher taxation of the top income groups because they received a relatively small share of overall income in the past, the numbers above clearly show that this is no longer the case. As federal deficits rise it is simply no longer affordable to

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subsidize the rich. As we will see later, adopting a more progressive tax structure by closing various regulatory loopholes in the tax code would go a long way to restarting the economy and moving money back to those that earn their living through productive work rather than rent seeking.

The fact that various economic and political processes result in inequality does not explain why the large majority negatively affected by rules that harm them do not exert more political pressure to criticize and push back against those policies. While part of the explanation is rooted in declining representation, we also require a better understanding of human psychology, behavior, and discursive strategies employed to justify rules maintaining or exacerbating inequality. The first important fact is that people have a poor understanding of the level of inequality, believing that the top 20% of the US population holds just about 60% of total wealth when in fact they hold 85%. They thus (i) underestimate the ability of government to do anything about it and (ii) overestimate the costs of doing something about it (Gelman, 2010), both while being (iii) unaware that they are actually using government-funded programs such as Medicare or social security (Mettler, 2010). Cross-country analysis suggests that there is an inverse relationship between trends in inequality and perceptions of inequality and fairness (Stiglitz, 2012, pages 147–148). While the powerful always attempted to shape beliefs, perceptions, and reality, the top 1% now have better knowledge of how to shape preferences and beliefs that allow them to implement rules that advance their own interests and they have better tools and more resources to achieve their goals.

Cognitive psychology and behavioral economics help us understand how individuals process information about inequality. Information that is consistent with their beliefs is seen as relevant, is remembered, and reinforces those beliefs, while information inconsistent with prior beliefs is more likely to be forgotten, discounted, and ignored. This is called confirmation bias (Oswald and Grosjean, 2004). Another important concept is that of framing: that is, the context in which a question is posed. The battle over framing with respect to inequality centers on how we see it, how large it is, what the causes are, and how it is justified. CEOs convinced themselves and society to believe that their high pay is justified because of their larger contribution to society and that it is necessary to reward them for continuing to make those contributions with incentive pay. When performance was low, ‘incentive pay’ was relabelled ‘retention pay’ to justify high salaries.<sup>(2)</sup> On the other end, if the problems of the poor are portrayed as the result of their laziness or stupidity, then voters are likely to agree with reductions in social security expenditures. Media and education are the main weapons of control. Media are increasingly controlled by wealthy individuals framing issues in a way that suits them, while access to education is increasingly closed to the poor because of high access costs. Social distance between the rich and poor impedes the exchange of different world views that are shaped by social context. Social distance can result in social isolation of one group from another resulting in between-group competition for access to resources (Massey, 2007). If social segregation occurs spatially, then those between-group differences will become even stronger. Increasing spatial segregation of the rich from the poor is indeed occurring in the US and UK, where changes to housing benefits may result in the social cleansing of high-cost neighborhoods (Reardon and Bishoff, 2011).

#### **Why should we be concerned with inequality?**

Economics is less concerned with inequality than economic growth. Inequality is considered a short-term and transitory evil on the path to higher growth (Kuznets, 1955), a necessary trade-off with efficiency gains as inequality provides incentives for the poor to work harder (Okun, 1975). Redistribution policies are thus seen as necessarily attenuating incentives. Yet the argument that inequality incentivizes people to work harder in order to move up the

<sup>(2)</sup>For a critical discussion of the logic for incentive pay see Cohen (1991).



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social ladder is difficult to sustain given that it is the top 1% who write the rules (Dorling, 2011). Those rules have benefited mainly the wealthy few rather than society as a whole by allowing them to extract substantial rents. At the same time, those in power underestimate the need for public action to correct market failures and overestimate the importance of financial incentives. As a result, they also overestimate the costs and underestimate the benefits of progressive taxation (Stiglitz, 2012, page 107).

How so? First, fairness (and the perception of fairness) increases productivity. An unequal society is thus perceived as less fair, which reduces the motivation for workers at the bottom of the income distribution. Second, the perception of an unfair system undermines trust (Stiglitz, 2012; Wilkinson and Pickett, 2009), which in turn increases transaction costs and weakens the economy as well as the democratic process. Third, loopholes in the tax system allow companies and individuals to park money in tax havens which distort the economy by lowering productivity (Palan et al, 2009; Shaxson, 2011; Stiglitz, 2012). As many of the top incomes emerge from rents it is possible to establish a more progressive tax system without adverse effects on incentives and productivity. This would allow to increase government revenues and public investments in health, infrastructure, education, and research, all of which are currently under threat following recent tax cuts for the rich that have inflated the deficit and national debt.

Inequality not only reduces motivation and results in lower efficiency, it also reduces economic growth and increases economic instability (Galbraith, 2012). If the current economic crisis is not one of inadequate financial resources of corporations, but of a lack of demand that keeps them from investing available capital, then a redistribution of income can stimulate demand (Stiglitz, 2012). In the US it is estimated that the top 1% saves 20% of their income. Shifting just 5% of that income towards the poor and middle class would increase aggregate demand by 1 percentage point directly and with multipliers, up to 1½ to 2 percentage points. During a recession a reduction of the unemployment rate by the same amount can be expected. A broader redistribution would reduce the unemployment rate to 5% or 6%. Furthermore, the massive decline in the wage share during the recession amounted to more than US\$ half a trillion loss in aggregate demand a year, which is much greater than the stimulus package passed by Congress (Stiglitz, 2012).

High inequality also has a detrimental impact on health and crime rates, increasing government debt as costs for policing, prisons, mental health services, and hospitals increase (Dorling, 2011; Wilkinson and Pickett, 2009). Recent evidence suggests that our understanding of fairness, the need to be treated equally and valued by others, and compassion towards others have evolved because they increased within-group social cohesion which was beneficial for the well-being of groups and, in turn, individuals making up the group (Hodgson, 2013). As a result, we react emotionally to being treated unfairly or undervalued increasing mental illness among populations with higher levels of inequality (Mendes et al, 2008; Wilkinson and Pickett, 2009). In the UK, one in six is diagnosed with having depression or chronic anxiety disorder and 25% of women and 10% of men require treatment for depression at some points in their lives. The wider economic costs of mental illness in England has been estimated at £105.2 billion a year including direct cost of services, lost productivity at work, and reduced quality of life. It is estimated that the cost to businesses is £26 billion a year, which equates to £1000 per employee (<http://www.nhs.uk/NHSEngland/NSF/Pages/Mentalhealth.apx>). Figures for the US are, if anything, worse. These costs are not considered in discussions about the costs and benefits of redistribution.

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### Contesting inequality

We tried to show that the causes of inequality are complex but that the increasingly uneven distribution of income to the top 1% is primarily the result of political choices designed by and benefitting the super-rich. We also submit that inequality reduces efficiency, social welfare, and the standard of living for the vast majority, although we believe that redistribution would also benefit the very top. If those two assumptions are correct, then it is possible and necessary to contest the unequal distribution of income and wealth. The question is how to do that. We think there are a number of steps involved to which geographers can contribute.

*Step 1.* In order to implement changes, it is necessary to reframe the debate and this requires access to alternative media and education as well as a rewriting of the storyline. It is not the 'welfare queens' and 'skivers' bleeding the system at the expense of the productive and 'deserving' rich and poor members of society, but the parasitic existence of those at the top working in the tax evasion and avoidance services industries that extort government funds from bailouts, low interest rates, exploitation of tax loopholes and low corporate and capital gains taxes.<sup>(3)</sup> The recent work of geographers tracking the global fortunes of the super-rich is important here (eg, Hay and Muller 2012). Geographers also have a long tradition of working on the importance of discourse influencing changes in economic and political practices. This work could be extended to highlight more specifically the discursive practices that enable the top 1% to pull the wool over the eyes of the majority. It will also be necessary to examine the relationship between the framing of a discourse and emotional responses, and evaluate the possibility to change engrained habitual responses to existing problems impeding the 'rational' evaluation of alternative evidence. Geographers' work on affect and habit may help here.

*Step 2.* Social context influences beliefs, opinions, and behavior and will inform perceptions of economic and social reality as well as policies to change them (Page et al, 2013). If the social distance between different groups becomes too large there will be little understanding and common ground to develop alternative realities. Spatial segregation exacerbates and cements differences. Work by sociologists and geographers on the role of segregation has focused primarily on the impact of ethnic segregation, but recent work shows the increasing spatial separation by different income classes within and between ethnic groups (Reardon and Bischoff, 2011). Examining whether the extent of political fragmentation in metropolitan areas shapes perceptions and influences social inequality and social mobility in those places would make for an interesting research avenue for geographers.

*Step 3.* Although confirmatory bias means that empirical evidence is selectively absorbed and rejected, we still require more information about the levels and changes in inequality at various spatial scales to highlight the growing divides between patterns of inequality in urban versus rural regions, within urban hierarchies themselves, and to better understand the relationship between spatial and social inequality, the impact of technological change, globalization, immigration, as well as economic policies and legal frameworks on inequality in different places as they often require locally tailored responses. Recent changes in housing benefit distributions in the UK will make it difficult for the poor to remain in rich areas. It is assumed that where people live has little impact on the functioning of their families and quality of life. But this assumption ignores the importance of locally accessible social networks that allow those individuals to arrange childcare, schools, look for and go to work, and other daily routines, complex, interwoven individual time geographies that can only work in but not out of a particular place. Linking microgeographies to broader social processes has a long tradition in geography and could be revived and complemented with recent research

<sup>(3)</sup> *The Guardian* section on welfare offers a number of commentaries on changes in the use of language to discredit social security recipients as welfare dependent at <http://www.guardian.co.uk/politics/welfare>

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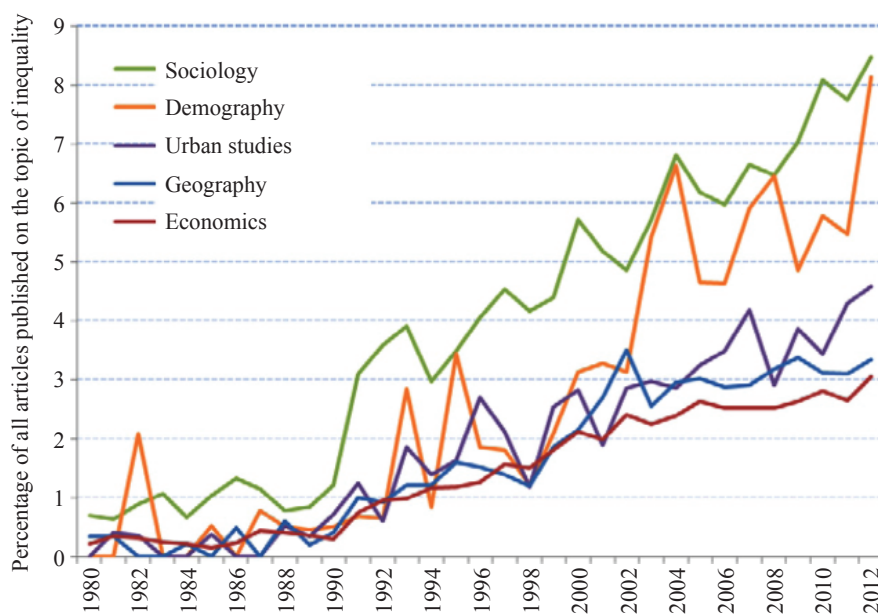
on the geographies of care, education, and health. We may also want to revisit older debates over spatial structure and uneven development (eg, Harvey, 1973; Peet, 1975; Smith, 1979) in our pursuit of a better understanding of the origins of inequality.

*Step 4.* The role of neighborhood effects on social mobility is a long-standing research area in sociology and, to some extent, geography. The impact of neighborhoods on individual opportunity is linked to spatial differences in the access of resources (including social networks) and provision of public services, particularly education, constraining upward social mobility for those in poor areas and preventing downward social mobility for those in rich areas. Perceived school quality influences house prices resulting in social sorting and segregation. While it is useful for schools to exchange best practices there is no need to publish results on the supposed differences in the quality of schools if private schools were abolished and children had to attend their local schools. Abolishing private sector alternatives to publicly provided services more generally would entice the rich to pay higher taxes in order to improve services if unable to opt out from them.

*Step 5.* An obvious immediate and relatively easy-to-design task to reduce inequality and stimulate economic growth is a change in tax code. Recent work by Piketty et al (2013) in the US suggests that optimal tax rates for the rich (after closure of tax loopholes) will be over 80%. Redistributing those revenues to the poor would stimulate demand and result in economic growth. There is plenty for geographers to do here. The ability to evade and avoid taxes and how to challenge it requires research in different areas where geographers have expertise. First, the fragmentation into different jurisdictional units enables tax arbitrage, transfer pricing, the existence of 'off-shore' tax havens, and bank secrecy jurisdictions. These questions have been addressed by geographers (see, for instance, van Hulten, 2012) but could be taken up in the context of fighting inequality. Second, studying the existence and role of global tax avoidance centers (previously known as global city research), where the super-rich are advised how to leech money from the poor (as it is mainly the rich, not the bottom 90% who benefit from those services) has a long tradition in geography (eg, Beaverstock et al, 2013). We need more work on those industries to examine how those places would be affected by changes in the tax codes. Third, the interregional flow of money and wealth would change with changes in the tax code. Places without substantial tax evasion industries may benefit (and hence become political advocates of those changes) while others lose. Fourth, modelling effects of changes in tax code on the bottom 90% in different regions/cities would constitute another interesting line of inquiry.

*Step 6.* The state is immensely powerful and requires more attention by geographers. While the literature on spatial scale has argued that the state is still an important player, the emphasis on the rescaling of state spaces reifies the notion that states are no longer dominant or potent players in a global economy driven by regional/urban production systems. This is problematic. Rules that benefit the rich and harm the poor are very much written at the state level and this is where they need to change. The state needs to be reclaimed, not hollowed out or circumvented by the bottom 90%. Government-funded research, jobs, services, infrastructure, health care, and pensions are necessary and, in many cases, more efficient than those provided by the private sector. Analyses of the US defense and medical industries reveal higher costs of privately delivered programs relative to those delivered by the state (see references listed in Stiglitz, 2012, page 364). While markets have a function to coordinate the economy, they do not guarantee that private firms provide better services than public sector firms, especially when cost and benefit calculations extend beyond the boundary of the firm. Subcontracting usually results in fewer jobs, lower wages, and worse benefits lowering aggregate demand and increasing the burden on social security.





**Figure 2.** [In color online.] Academic publications on inequality, 1980–2012 (source: ISI citation index).

Figure 2 provides a snapshot of recent publication trends on the topic of inequality across major disciplines within the social sciences. Though there is an impressive amount of geographic research on inequality carried out already (in 2012 roughly 108 articles on the subject appeared in geography journals), in relative terms we tend to lag behind other disciplines dedicating a much larger share of their research efforts to questions of inequality. There is thus plenty of work to be done here by pulling together different strengths in geographical research and applying them systematically to the study of inequality. In this commentary we have tried to sketch some of the research areas that map to broader issues on the causes and consequences of inequality identified in other fields (such as economics, political science, sociology, and psychology) in the hope for geographic research to reach and affect a wider audience necessary to change rather than simply explain the current condition.

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