SUPER RICH

The Rise of Inequality in Britain and the United States

GEORGE IRVIN

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Introduction

> Equality is part of the quality of our life, like income, the environment and public services . . . Equality makes diversity possible, and makes it possible for everyone to count as a person.
>
> Massimo Cacciari, quoted in Bobbio (1996: xiv)

The theme of this book is that it is not just poverty but growing inequality that should concern us; a less equal society is a less civilized society. I have chosen to write on inequality in the rich countries, particularly in the UK and the USA, where, following the neo-liberal revolution of the Reagan-Thatcher period, economic growth has made top income earners vastly richer while much of the population has struggled to maintain its standard of living. In both countries, too, there are signs that the issue of inequality may return to the political agenda, particularly if a prolonged recession occurs. The broad goal I suggest in the concluding chapter will seem revolutionary to some, but in reality it is both modest and feasible: namely, a return within a generation to the lower degree of income inequality which prevailed in the 1970s, taking the Nordic countries as exemplary of desirable levels of social provision.

Three qualifications should be added immediately. First, this book is written for a general audience, not just academics and researchers; I have tried to minimize economic jargon, though I cannot pretend to have eliminated it completely. Second, I hardly touch on inequality and poverty in the developing countries of Africa, Asia and Latin America; nor do I examine the complex interaction between economic growth, distribution and global climate change. I don't wish to minimize the critical importance of these issues. Indeed, I hope that my focus on the growth of inequality in the world's richest countries will help illuminate the wider picture. Third, some readers may feel that I have stressed the similarities of the UK and US experiences at the expense of highlighting the differences. There is a difficult balance to be struck here between the different historical trajectories, particularly as concerns the growth of left-of-centre political parties and

institutions in the past century, and the convergence of the two countries both during and after the Reagan-Thatcher period. Suffice it to say that one cannot write about growing inequality without stressing this convergence.

After Tony Blair became leader in 1994, if the 'new' Labour Party in Britain could be said to have any policy towards inequality, it was one of emphasis on reducing poverty amongst society's most vulnerable groups, children and the aged. Such an aim is admirable, and it is undeniable that under Blair and Brown, many of the very poor in Britain are today less poor. Equally, had a Labour government not come to power in 1997, interpolating the trend of the previous decade suggests that many more would be in poverty today. Nevertheless, whatever Blair and Brown's intentions, it is also true that Britain's rich have grown very much richer under Labour. Poverty may have fallen, but inequality clearly has not. If we focus on the top end of the distribution of household income (say, within the top decile), inequality has actually increased.

The US picture is bleaker and, in contrast to the UK, there has been no ideological ambiguity about poverty on George Bush's watch; he has simply ignored it. Since the Reagan era, the divide between rich and poor has continuously deepened; in the world's richest country, some 36 million people live below the poverty line. (The figure would be over 70 million were the EU definition of 'relative poverty' used.) A further 57 million are estimated to be 'near poor', bringing the total either in poverty or at risk of it to nearly one-third of the total population. Not only is climbing out of poverty more difficult in the USA, but swathes of 'middle-class' families are struggling to make ends meet. Moreover, there is a growing body of evidence drawn from Britain, America and elsewhere that suggests it is *relative* deprivation, not simply absolute deprivation, which matters in the rich countries of the West. There are fundamental implications here, I shall argue, for the way in which we think about designing social policy to achieve a 'fairer' society.

I started researching this book in 2006, a year in which the *Guardian* reported that London's investment bankers had made record-breaking profits.[1] Investment banks, hedge funds and private equity firms paid out nearly £9 billion in bonuses at the end of 2006 – just over 4,000 employees in the City (London's Wall Street) received an extra £1 million each! As I finished the book, total City bonuses had nearly doubled; indeed, when added to 'performance pay rewards', the total for 2007 is likely to be £26 billion, enough to raise the income of the poorest-paid 20 per cent of British workers by £5,000 a year or to lift nearly everyone out of poverty.[2]

Headlines about extravagant bonuses no longer count as 'news'; such pieces appear on a daily basis. Since the 'Big Bang' reform of London's

Stock Exchange in late 1986, the growth of the financial services sector has been precipitous. The evidence of Britain's newfound fortune is everywhere: from the towers of Canary Wharf to the Victorian warehouses of dockland now transformed into luxury apartment blocks, to the astronomical property prices in London and the south-east of England. In the past two decades, the City has 'generated wealth' in the sense of attracting banks, brokerage houses and a host of talented young people from all over the world. This inflow of foreign capital has made it possible for Britain to leave behind its notoriously frail economy, plagued by fiscal and financial stop–go cycles, greatly easing Gordon Brown's job when he was Chancellor and making him appear something of a magician. Doubtless the success of the City is one reason why New Labour has been deeply reluctant to do anything about the rise of the super rich. Witness the Chancellor, Alistair Darling, plugging a few tax loopholes in Britain's laws affecting the non-domiciled rich while raising the inheritance tax threshold to assuage 'middle England', an act of such blatant opportunism that Polly Toynbee declared it to be 'the death of social democracy'.[3] New Labour has to date not countenanced raising the top rate of income tax or creating a new higher tax band, nor does it ever seem likely to do so.

There are a variety of reasons why inequality has grown so much since the 1980s in the United States and Britain – one should add that inequality has not grown to any comparable extent in continental Europe. An obvious starting point is the conservative political and economic revolution (or restoration if you prefer) under Thatcher and Reagan. The roots of the conservative revolution lie in the crisis of the 1970s. As corporate profits were squeezed and inflation rose, the foundations of the post-war social-democratic settlement began to crumble. Internationally, the fixed exchange-rate regime collapsed and the US trade-deficit pumped dollars abroad, setting the stage for a huge expansion in financial services. By the 1980s, deindustrialization and inflation undermined the bargaining power of organized labour and accelerated the casualization of the workforce. The crisis was particularly severe in the UK and the US. The conservative answer was to shrink the state and to 'roll back' the post-war institutions of social democracy and welfare. Capitalism appeared to find new dynamism in the 1980s and 1990s with the explosive growth of corporate mergers, private equity buyouts, the rise of the 'high tech' sector and of finance, particularly in the UK where finance overtook the manufacturing industry in generating GDP and employment. In the USA, the share of financial sector profits in total corporate profits rose from 14 per cent in 1981 to nearly 40 per cent at the turn of the new century.[4]

Financial sector growth brought an explosion in executive rewards. The earnings of Britain's chief executive officers (CEOs), although they have grown less dramatically than in America, are far ahead of CEO earnings in the rest of Europe. In 2005, directors' pay in Britain's top companies rose by 28 per cent, more than seven times the average rate of pay and eleven times the rate of inflation. In the prior three years, directors' pay rose by 16 per cent, 13 per cent and 23 per cent, while average earnings rose at around 3.5 per cent per annum. The average pay for a CEO in Britain's top 100 companies was £2.4 million in 2005. Across the Atlantic, the average CEO of a Standard & Poor's 500 company received $15 million in total compensation in 2006.[5]

Peter Mandelson famously remarked to an American audience that New Labour was 'intensely relaxed about people getting filthy rich' as long as they paid their taxes. His comment has never been contradicted by anybody in the Labour Party leadership. Indeed, starting with the Commission on Social Justice set up under John Smith in the early 1990s, New Labour has moved away from seeking a more egalitarian distribution of income and wealth (i.e., 'outcomes') towards one of equalizing 'opportunities'. Meritocracy, not equality, has been the rhetorical – and indefensibly shallow – flavour of the decade. Any suggestion that Labour should attack unjustifiably high levels of remuneration has been derided as old-fashioned and dismissed as the 'politics of envy'; wealth creation and enterprise are sacrosanct and must be rewarded. Ideological support for the rise of inequality, once the preserve of the extreme right, seems to have colonized the full political spectrum. Nevertheless, there is some evidence that the tide may turn; e.g., a 2007 report for the Rowntree Foundation says: 'There is considerable public concern regarding economic inequality, and certainly no evidence that people see the income gap in the UK positively.'[6]

The chapter sequence runs from the current situation and its historical roots to a section on the costs of inequality, an examination of what various authors proposed to do about it, the sustainability of financing US and UK consumption by means of foreign savings and, finally, to a defence of greater equality which is both theoretically rooted and practically feasible. The first two chapters summarize the empirical evidence on the distribution of income and wealth in the UK and the USA. There is a plethora of specialist material on this matter; I have tried to make the evidence accessible while providing relief to the reader by sprinkling the text with illustrative anecdotes. Chapters 3 and 4 are intended to provide a historical framework to the argument by looking at the following questions. What is neo-liberalism? Why was the conservative reaction greater in the USA and

the UK than in continental Europe? What is the future of the European welfare state? Broadly speaking, I view neo-liberalism as a response to the vulnerability of American and British capitalism in the 1970s, and argue that the welfare state, far from being an unaffordable luxury, is vital to the success of a modern economy.

Do we need more growth? Chapter 5 looks at the 'science of happiness', the subject of much recent attention amongst social scientists. A number of these have reflected on the apparent paradox that, as America and Britain grow wealthier, their citizens seem not to grow happier; instead, they suffer in ever great numbers from anxiety and depression, as reflected for example in the alarming growth of binge drinking, road-rage and other symptoms of social malaise. For reasons which will become apparent, I consider the happiness literature to be something of a curate's egg; the micro-analysis of happiness is in places useful, even if the overarching social theory implied is less than satisfactory.

I devote chapter 6 to the declining socio-economic fortunes of the middle class; more precisely, to that part of the middle class which finds itself slipping into the lower half of the 'hourglass society'. Here I draw heavily on US evidence, partly because the American middle class is so (subjectively) large and because the mythology of upward mobility and meritocratic advance is so pervasive. In Britain, New Labour has sought to appropriate and implant this ideology. In fact, the evidence runs almost entirely in the other direction; in the USA, at least, the middle class swims against far more treacherous currents in the job market than it did two generations ago, and the prospect of disappearing beneath the waves into proletarian obscurity is correspondingly higher. Marx's view that a communality of interests exists between 'workers by hand and by brain' seems apposite, even if the political alliance he supposed would result seems as distant as ever.

Chapter 7 considers the cost to society of growing inequality. There is a burgeoning literature on the subject, ranging from the traditional social sciences including social psychology, to social epidemiology and evolutionary biology. Here again, I mix academic evidence with anecdotal material, hoping this will help more than hinder. In discussing inequality, it is the importance of *relative* socio-economic status which stands out. In chapter 8, I move back to my own domain of economics where I try to tie together the themes of income and consumption growth, financial deregulation, diminishing household savings, global economic imbalance and looming recession. America's propensity to spend more than its income is mirrored by a huge and growing current account deficit. This is not intended as a moral tale about profligacy. Rather, to the extent that global financial

markets perceive the US deficit (and that of its UK cousin) to be unsustainable, there is a real danger that we are drifting into a financial and economic crisis of global proportions. Just as in the 1930s, to respond to the crisis by stringent economic belt-tightening would only make matters worse. Economists recognize the dangers, but policy-makers appear to believe that the problem is best resolved by trusting in the beneficent working of the free market. I argue that such a response is incoherent and irresponsible.

The final chapter puts the case for socio-economic equality. It is argued that the claim for meritocracy is empty unless young adults face a reasonably level playing field; in truth, the growth of inequality has tilted the playing field so violently that the veneer of legitimacy sustaining neoliberal ideology is being stripped away. To stabilize the tilt, much less to redress it, requires a major extension of social provision, particularly to preschool children, as well as the redistribution of income and wealth. I am hardly alone is proposing redistribution; Robert H. Frank, Juliet Schor and others have argued for a progressive tax on consumption. I argue that a far more radical redistribution is needed than what has been proposed by any of them.

It is worth recalling that the notion of 'greater equality' was once central to political discourse in Britain and shared across much of the political spectrum, from Butler to Gaitskell, in the post-war years. In the USA, although the notion of meritocracy has always held greater sway than in Britain, reducing inequality was one of the aims of FDR's inter-war 'New Deal', and that goal was shared by the main parties until the 1980s. Indeed, income and wealth inequality fell steadily in both countries during the post-war period. Doubtless, political support for equality has been weakened by the neoliberal restoration, and some would argue that globalization has made the welfare state an anachronism. In my view, the challenge of globalization and the 'knowledge economy' can only be met by moving towards much greater socio-economic equality; to do so will require the sort of social transfers and investment which the Nordic countries have undertaken for several generations. The reader who has travelled the full length of the book will hardly be surprised to learn that I am unapologetically 'old' Labour and deeply sceptical about the 'new egalitarianism' favoured by some of New Labour's academic advisers.

In writing this book. I wish to express my thanks to the International Centre for European Research (ICER) in Turin where I spent several months in early 2007 enjoying the support necessary to write the bulk of my first draft, as well as to my academic colleagues at the University of London, SOAS, who have helped me hone some of the main ideas.

Particular thanks goes to those who read and commented on the manuscript at different stages: Norman Dombey, Barbara Ehrenreich, Laurence Harris, Alejandro Izurieta, Stuart Lansley, Michael Rustin, John Schmitt, Elaine Sharland, Jenny Shaw, John Grieve Smith, Bob Sutcliffe, Robert Wade and Richard Wilkinson. My editors at Polity Press have been hugely helpful, particularly Sarah Lambert and the copy-editor, Helen Gray. There are others I should add; inevitably, though, a list of names is marred by omissions, particularly of those who helped shape my views on inequality. My own father, the journalist Warren Irvin, was passionate about social justice; he died many years ago, but his influence is embedded in this work. I want to thank my own family, too: my adult children, Marc and Leonora, and my wife, Lindsay Knight. In particular, it is Lindsay – herself a journalist – who has provided not just loving support and encouragement, but long hours of proofing copy and invaluable suggestions about how the text might be improved. The usual caveat about errors applies. As in the past, it is to Lindsay, Marc and Leonora that this book is dedicated.

George Irvin
Brighton, December 2007

1

Neo-liberalism and the Return of Inequality

> Not since the Roaring Twenties have the rich been so much richer than everyone else . . . [the] nation needs an administration that will offer solutions for the scourge of income inequality.
>
> Editorial, 'It didn't end well last time', *New York Times*, 4 April 2007

Is Criminality Redundant?

Max Hastings, a former editor of London's respectably conservative *Daily Telegraph*, is not known for holding strongly socialist views, but the extent of inequality in Britain has led him to write:

> Today's filthy rich are wealthier, healthier and more secure than ever . . . It seems remarkable that any high roller these days resorts to fraud to enrich himself. It is possible to bank such huge sums legally that criminality seems redundant.[1]

There is now a voluminous literature on growing inequality in Britain and the USA, not to mention an avalanche of newspaper articles on City bonuses and 'fat-cat' salaries. For many years the conventional wisdom was that as countries grow richer, inequality at first rises but ultimately tends to fall when countries become fully industrialized.[2] Over the past thirty years, however, inequality appears to have worsened for the OECD countries taken together. This result is most strongly influenced by what has happened in Britain and the United States where income inequality today has returned to levels last seen in the 1930s. Squaring this trend with conventional economic theory has required telling a story about the growing premium placed on highly educated labour (including top entrepreneurial talent) in the 'new economy' while bemoaning the lack of dynamism of 'old Europe'. An alternative story is traced in this book which looks more closely at the changing political and economic landscape of the period.

The rollback of the 'welfare state' – particularly in the UK, but also of its weaker US version set up under Roosevelt's New Deal – is the main legacy of the Reagan-Thatcher years, underwritten by subsequent governments in

both countries and whose international expression is the Washington Consensus.[3] The neo-liberal revolution of the 1980s had two critical implications for the way we think about economics. Not only did it coincide with the decline and demise of the 'socialist' (USSR-style) centrally planned economy, but in Europe neo-liberalism signalled the re-emergence of unfettered free-market capitalism as an alternative to the dominant post-war social democratic consensus. Social democracy was no longer seen as a 'middle path' between unfettered capitalism and state socialism; instead, it became a hindrance to capitalist hegemony.

Underlying the Reagan-Thatcher political project were structural changes in both the USA and the UK; notably, the decline of industrial capital and the trade unions, the rise of the international financial sector and the growing importance of the two-tier service economy; i.e, low-wage and low-skill (e.g, McDonald's and Wal-Mart) and high-tech (e.g, Microsoft and Goldman Sachs). The much-hyped 'new economy' has helped to fragment labour markets, change the structure of remuneration, weaken job security, undermine the bargaining power of trade unions and spread neo-liberal ideology. Growing inequality fed back into the political consolidation of neo-liberalism in a variety of ways, ranging from the shift towards individual and corporate donations in the funding of political parties, the concentration of media power in the hands of fewer owners and the commoditization and repackaging of politics into sound-bites and spin. In short, the modern Anglo-American model has challenged the European 'welfare state' version of the market economy under which a relatively strong, democratically financed state mediates conflicts between capital and labour and guarantees political and social cohesion and high levels of public provision.

It is crucial to emphasize that the Reagan-Thatcher project was itself a response to the decline of US and British industrial hegemony in the post-war period. Having been dominant globally for half a century, by the 1970s Britain was the 'sick man of Europe' and the USA was rapidly losing its manufacturing dominance, in part because of an inflation-financed war (Vietnam), but crucially because it faced stiff competition from reconstructed Europe and emerging Asia – what today we would call a 'globalization' effect. As the rate of profit fell[4] and share prices stagnated, Wall Street complained increasingly that the fault lay with stodgy corporate executives whose salaries were paid regardless of performance; the mantra of 'maximizing shareholder value' began to be heard. Spurred on in the early 1980s by the appearance of corporate raiders and junk-bond finance, America's corporations began to restructure by selling off entire

divisions, becoming 'lean and mean' and looking for new 'synergies' through mergers. Above all, 'maximizing shareholder value' meant tying CEO remuneration to market performance, crucially through the use of share options, thus laying the basis for a quantum leap in executive rewards and the rise of a new class of super rich whose influence soon spread to Britain.

The Reagan-Thatcher period also saw the introduction of important legal milestones which would change the distribution of wealth and power. In the UK, the explosive growth of financial services accelerated after the large-scale deregulation and streamlining of City transactions under the 'Big Bang'[5] legislation of late 1986; this boost in comparative advantage gave London a decisive edge over Frankfurt and New York. The end of national wage bargaining and a variety of anti-union measures – symbolically capped by the defeat of the miners – constrained union activity; Britain's strong exchange-rate policy favoured the financial sector and helped underpin long-term deindustrialization. Moreover, Britain's relatively lax tax residency law, coupled with the absence of the direct taxation of land or financial assets and low rates of tax on income, helped make the country a leading tax haven.

The assault on welfare in the UK was not just a matter of bashing organized workers. Government statistics for the period 1980–2000 show the number of children in poverty having risen from 1.4 million to 4.4 million, and the number of pensioners with less than half the average income doubled.[6] By the end of the century, not only was Britain less equal than other EU states at a comparable average income level, but its social and economic infrastructure was in tatters. Although, since 2000, a Labour government in the UK has made modest progress in alleviating poverty amongst pensioners and children, a 2005 Report from the Office of National Statistics (ONS) suggests that the growth in inequality that Britain experienced under Thatcher has not been reversed. The same Report notes that, when both direct and indirect taxes are counted, the poor in Britain pay a larger share of their income in taxes than do the rich. In the words of Francis Jones, the Director of the Office of National Statistics (ONS):

> Inequality of disposable income increased rapidly in the second half of the 1980s, reaching a peak in 1990 . . . After 1995/96 inequality began to rise again reaching a peak in 2001/02 – actually at a level very similar to that seen in 1990. From 2001/02, there was a small reduction in income inequality, although the latest figures for 2005/06 show an increase over the previous year, and *the latest evidence suggests that inequality may be increasing again* [my emphasis]. [7]

What also seems to be true is that there is greater geographical clustering of poverty and wealth in Britain. A recent study by Dorling et al. (2007) shows the poor and wealthy becoming increasingly physically segregated from each other; moreover, the study suggests that in recent years, while the proportion of very poor households has fallen in Britain, the proportion of 'breadline poor' has increased.[8]

In the United States during the 1980s, airlines, trucking, banking and some utilities were deregulated while industrial concentration – as reflected in growing corporate mergers – would grow explosively in the 1990s. As top corporations became more concentrated, CEO pay grew disproportionately, aided by favourable tax legislation. Reagan's Economic Recovery Act of 1981 greatly reduced the top rate of personal tax while extending corporate tax write-offs and easing depreciation rules; further tax reductions followed in 1986. Corporate tax before Reagan accounted for nearly one-third of total US tax revenue; today's figure is less than 8 per cent. Income inequality grew strongly under Reagan and G. H. W. Bush, a trend that Bill Clinton in the 1990s did little to reverse. Indeed, the 1997 'Taxpayer Relief Act' produced another bonanza for the wealthy: it is estimated for every $1 in tax savings going to the bottom 80 per cent, the top 1 per cent of income earners saved over $1,000 in tax. While swathes of unionized skilled workers lost their jobs as traditional industries disappeared, the remuneration of top CEOs grew. As the president of the New York Federal Reserve Bank, William J. McDonough, noted in a speech to mark the first anniversary of 9/11, in 1980 America's top executives on average earned about forty times as much as the average worker; by 2000 the ratio was 400:1. Such a jump, he said, was impossible to explain by corporate performance.[9] The situation has been summarized more recently by the *Guardian* journalist, Jonathan Freedman:

> You can pick your stat[istic], ranging from the claim that just two men – Bill Gates and Warren Buffett – have as much money between them as 30% of the entire American people, to the findings by a federal reserve study that the top 10% of Americans now own 70% of the country's wealth, while the top 5% own more than everyone else put together. There was a time when a company boss earned perhaps 10 or 20 times the salary of his lowliest employee. By 2004, that ratio between average chief executive and average worker had leapt to 431 to one, and the gap has got wider. It means that the average worker takes more than a year to earn what his boss brings home in less than a day. The result is grand houses on New York's swankiest avenues that were, until recently, multiple apartments but which are now restored to the private homes they were a century ago. Makers of 200ft yachts report record sales.

> Economists say the last time such a yawning chasm separated rich and poor was in the Great Gatsby years, on the eve of the crash of 1929.[10]

London's 'Wealth-creating' Square Mile

London today is booming, and the square mile of the City (London's financial centre) is at the heart of the boom. Hardly a day goes by without a new story about how workers in the City's major banks and financial houses are receiving huge bonuses. The average salary for somebody working in the financial sector in 2006 was reckoned to be £100,000, up by a fifth from the previous year. Nor has the current credit crunch stopped the rich (with a few exceptions) getting richer.

The impact on London's economy is highly visible as these new entrepreneurs queue up at exclusive restaurants, and buy diamonds and luxury cars for their partners. It is a world of 'you deserve it' and 'gorgeous gets what gorgeous wants', apparently without limit, and nowhere is it more visible than in the property market where burgeoning demand and constrained supply have combined to raise the average house price in London to £300,000, nearly three times as high as in the north-east of Britain.

Those who wonder why New Labour is so relaxed about this state of affairs need look no further than the Treasury. With nearly one-third of the capital's workforce in the financial or business services sector, London accounts for more than 20 per cent of the UK's total income tax receipts, while receiving only 15 per cent of government spending. A study by Oxford Economic Forecasting suggests that London's net contribution to public receipts is running at around £13 billion a year, enough to finance, say, the entire bill for replacing Trident missiles in two years. It is hardly surprising that Ed Balls, formerly Gordon Brown's right-hand man at the Treasury, has been called 'Minister for the City'.[11]

And it is not just financial traders and deal-makers who earn big money. London is home to many who have come to the UK to avoid higher tax regimes in other EU countries. A recent study by the accountancy firm Grant Thornton concluded that Britain's fifty-four billionaires, with assets of £126 billion between them, paid only £14 million a year in income tax.[12] The City is also perceived to be less tightly regulated than in other leading centres – including New York and Frankfurt – which is one reason why, since the Big Bang, London has prospered. Of course, London is not just about new wealth. Aristocratic fortunes made centuries ago continue to thrive. Take the 6th Duke of Westminster, who in 2005 was reported to be the third richest man in the UK and whose family fortune derives from the 17th-century

inheritance of a large chunk of what is today Mayfair, Belgravia and Pimlico. Or take the Cadogans, Portmans and Howard de Waldens (or for that matter the Windsors), all of whom own prime chunks of urban real estate and who have made a vast amount out of rising property values in the past decade.[13]

Does London really 'generate wealth'? The answer depends on whether one thinks 'wealth generation' is simply about making money – or, more precisely, making money out of other people's money. It is certainly difficult to claim that those who make fortunes from rising property values are 'generating wealth'. For classical economists like David Ricardo, the landowning classes, far from generating wealth, were an impediment to economic development. Ricardo famously argued that they benefited from the Corn Laws, a form of agricultural protection, which served to keep food prices high and squeezed industrial profits. Indeed, Adam Smith – writing half a century before Ricardo – argued decisively against the Mercantilist notion that the accumulation of gold (through trade or otherwise) could be counted as 'wealth creation'.

The boom in London's financial sector since deregulation in 1986 has been remarkable, it is true. But the financial boom is a *worldwide* phenomenon. Half a century ago, much of the money flowing around London served to lubricate the wheels of trade, whether providing insurance for ships, fees for merchants or finance for cargoes. Today, the flow of money around the world in general – and through London in particular – greatly exceeds what is needed to make or transport goods. On an average day, financial transactions in London are estimated to be in excess of $1 trillion. The power of 'finance capital' has grown out of all proportions to that of industrial capital. In essence, London's financiers are not in the business of producing real wealth in the sense of adding to the world's productive capacity; rather, they make money out of money. This is a crucial distinction which classical economists like Smith and Ricardo wrote about, but which Britain's political elite today has chosen to ignore.

At the other end of the scale sits London's underclass; has the wealth trickled down to them? If one excludes jobs in the City, London's unemployment rate stands at 8 per cent, well above the national average; in boroughs like Hackney and Tower Hamlets, unemployment is typically twice that rate. Five of the ten most deprived boroughs in the UK are reported to be in London. Moreover, because the cost of living is so high in London relative to the rest of the UK, the poor are poorer than elsewhere. The capital's Living Wage Campaign – backed by London's mayor, Ken Livingston – has helped to spotlight the plight of cleaners, catering staff and other low-paid workers. The Transport and General Workers' Union has championed a

'Justice for Cleaners' campaign and argues that the minimum wage in London needs to be at least 30 per cent above that in the rest of Britain if the low paid are merely to survive. 'We are working hard for companies earning millions of pounds but we can't afford to feed our children. Cleaners, come out of your cleaning cupboards and fight for justice!', said cleaner Abiola Arowolo, getting the campaign for justice under way outside KPMG's offices in the City of London in March 2006.[14]

A piece in the *Observer* illustrates the contrast between rich and poor with particular poignancy.[15] On one side of the page is the picture of the City banker, Bob Diamond, who is head of Barclay's Capital, the bank's investment banking arm. He lives in the ultra-chic area of Kensington, where the average family home is said to cost several million pounds. In 2005, his basic salary was a mere £146,000, but he received a $4.4 million cash bonus and £1.9 million in share awards. He is reported to have been promised a bonus of £15 million if Barclay's Capital met its end-of-year targets in 2006.

On the other side of the page is a picture of Charlie Sawyer, a fifty-eight-year-old cleaner who works for the London Underground. Charlie says:

> I start at 11pm, finish at 6:30am and earn £6.05 an hour. I live in southeast London, in Peckham – I'm a council tenant. What they pay me is not sufficient: I do another job as a porter. . . . I came from Sierra Leone nine years ago. Most of the cleaners are migrants. People don't respect us, but without cleaners the Queen couldn't live in Buckingham Palace. . . . We only get 12 days' holiday pay. We don't get a tube pass, and we're cleaning the tube.

And it is not just the low paid who struggle. Teachers, nurses, civil service clerks and other public service workers who once thought of themselves as 'middle class' now struggle to survive, with rent and travel costs eating up their take-home pay. As house prices continue to rise (albeit more slowly in 2007), it is clear that most of these same people – never mind the unskilled and semi-skilled – will never manage to get on to the property ladder within 10 miles of central London, and that many will never be able to afford property anywhere in London. The middle class is being hollowed out. London's entrepreneurial spirit and 'wealth creation' may be good for some and admired by the political classes, but for the growing number who are being left far behind, there is real pain.

What of the American Dream?

What is true of Britain is even more so of the USA. Numerous authors have noted that in the United States it is not just the poor who are growing

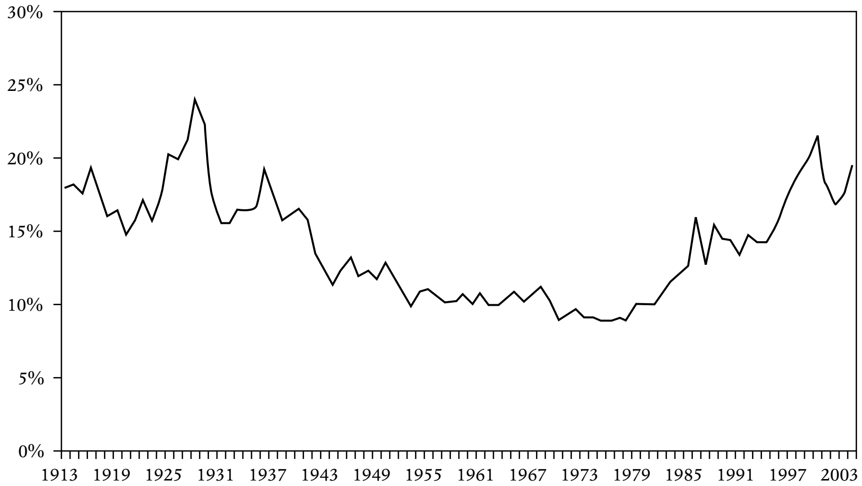

Figure 1.1: The share of income going to the top 1 per cent, including capital gains, 1913–2004
Source: Figure 1M from: L. Mishel, J. Bernstein and S. Allegretto (2007)

poorer, but the middle class too. The American Dream – the notion that anyone willing to work hard enough can go from rags to riches – was always a convenient ideological myth serving the interests of the few. Even at the height of post-war prosperity in the 1960s, when America was growing richer and somewhat more equal, some social scientists disputed the extent of upward mobility in the USA.[16]

Today, as US inequality grows, the dream is receding – even if a majority of Americans still cling to its promise. For many Europeans, the television images of Hurricane Katrina were revelatory, stripping away the gloss to reveal the underside of the 'American way of life': an underclass of poor whites, blacks and Hispanic migrants living in dire poverty and largely neglected by their political representatives in Washington. Several recent studies suggest that before Katrina struck, poverty amongst the families it displaced was far greater than previously imagined.[17] The official poverty rate in the USA is about 14 per cent (2005) for all families, but 18 per cent for children and 30 per cent for blacks; these are the worst figures for any OECD country.

Figure 1.2 provides a graphic illustration of income inequality in the United States and is based on Congressional Budget Office research data released in December 2005. In 2003, the top fifth of earners in the USA received over half of the national income while the bottom fifth received only 5 per cent. In fact, the top 1 per cent took in more of the pie than the

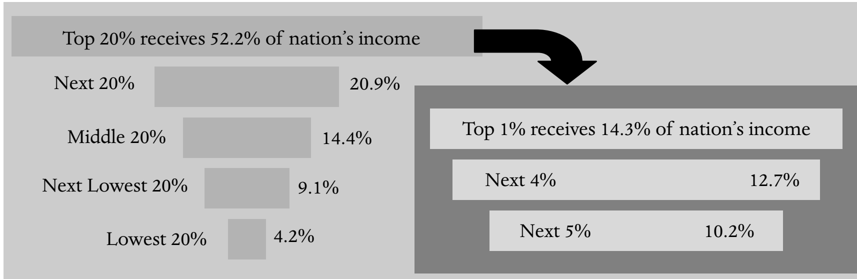

Figure 1.2: 2005 Distribution of income in the USA
Source: <http://www.cipa-apex.org/toomuch/inequality.html>

bottom 40 per cent. According to an editorial in *The New York Times*, 'In 2005, the latest year for which figures are available, the top 1 percent of Americans — whose average income was $1.1 million a year — received 21.8 percent of the nation's income, their largest share since 1929. Over all, the top 10 per cent of Americans . . . collected 48.5 per cent, a share last seen before the Great Depression.'[18] Moreover, it is not just under the presidency of George W. Bush that average wages in the United States have fallen; official figures show that the share of labour remuneration (compensation of employees) in GDP is lower than at any time since 1947. Since CEO salaries are part of the share of labour remuneration in GDP, this means that ordinary workers have been squeezed very hard indeed.

Just like in Britain, growing inequality in the USA is producing what is called an 'hourglass economy'; i.e., one in which there are lots of lower-paying (though not necessarily low-skill) jobs and higher-paying jobs, but fewer of the middle-class, middle-income jobs that used to span the gap between skilled blue-collar and high-level, white-collar professional jobs. During the heyday of the American middle class, the USA had a diamond-shaped economy: growing middle-income jobs with fewer low- and high-end ones. In the words of one observer:

> The most significant aspect of our emerging hourglass economy is that, even as the economic top is pulling farther away from the bottom . . . Stockbrokers, money-managers and CEOs become superrich while college professors, doctors and other professionals struggle to stay in the upper middle class. This ultimately ends in the classic pyramid economy of the pre-democracy era: a small group of the superrich organizes politics and economics to continue to feed wealth to them at the expense of everyone else.[19]

Runaway CEO Rewards in the USA

Every spring, media and business research organizations in the United States release CEO compensation surveys of pre-tax executive pay levels over the preceding year. The numbers must be treated with care because sample sizes and the exact groups of corporations surveyed differ. Equally, discrepancies arise because of the different ways in which bonuses and perks are treated. The accompanying figure 1.3 shows results for 2005 as published by different US research organizations. With the exception of Forbes, which puts average remuneration at $10.9 million, the five data sources show results in the $5–7 million range. Given that US median income in 2005 was about $46,000, the average of top pay shown ($7.42 million) here exceeds median income by a multiple of 161. Moreover, top CEO salaries in the USA have been growing much faster than has median income.

Similar survey figures exist for Britain or other OECD countries, but precise international comparisons are difficult to make, in part because of the differing nature of remuneration, the different exchange rate that can be used and so on. Nevertheless, the broad picture is that the gap between median and top earnings in Britain, though less wide than that in the USA, is considerably wider than the earnings gap in continental European countries (see chapter 4).

The Reagan Revolution

A quarter of a century ago in August 1982, Ronald Reagan signed the Economic Recovery Tax Act of 1981. This Act slashed top rates of tax in the United States, reversed the egalitarian consensus in place since Roosevelt's New Deal and set into motion a conservative fiscal revolution which would affect much of the rest of the world. Reaganomics incorporated the 'supply side' principle that high taxes act as a disincentive to wealth creation and, therefore, that cutting rates would raise both GDP and tax revenue, a view formalised by the economist, Arthur Laffer. The Reagan 1981 Tax Act did more to benefit America's 'successful' than any single piece of legislation in modern history. The Act indexed tax brackets for inflation and reduced the corporate income tax rate. Crucially, it sliced the top tax rate on most income over $200,000 from 70 to 50 per cent and, in the process, set the United States on a course that would see the top rate fall to the current level of 35 per cent for incremental income above $336,000.

These principles, not surprisingly, were warmly applauded by the US financial sector in general and by the *Wall Street Journal* in particular.