Ethics and Inequality: A Strategic and Practical View

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The Great Escape: Health, Wealth, and the Origins of Inequality, Angus Deaton (Princeton: Princeton University Press, 2013), 376 pp., $18.95 paper, $29.95 cloth.

Inequality: What Can Be Done?, Anthony B. Atkinson (Cambridge, Mass.: Harvard University Press, 2015), 400 pp., $29.95 cloth.

Deng Xiaoping once said, "Let some get rich first, the others will follow." This is Angus Deaton's basic view in *The Great Escape*. Deaton, co-winner of the Leontief Prize in 2014 and winner of the Nobel Prize in 2015, chronicles the rise of almost all of humanity out of conditions of widespread hunger, disease, destitution, and premature death, and into a world where infant and child mortality has fallen sharply, and where heart diseases and even cancers are declining. Consequently, with exceptions related to AIDS and in the poorest countries, life overall is longer and health better than ever before.

There is a strong correlation between such measures of wellbeing and economic income. Deaton shows that the link is logarithmic: a proportional change in national income is tied to a step-change in longevity or scales of happiness or life satisfaction. The reasons for this are less clear. The causes of movement in health indicators, for instance, must themselves be teased out from the history of overcoming particular diseases. Vaccinations and antibiotics have contributed to rising health standards, but Deaton shows that they are a secondary part of the story. For example, the use of variolation to control smallpox long predated the vaccine; the practice came from Africa to America on slave ships, and Boston was smallpox-free by 1760. Similarly, in the nineteenth century infectious diseases like cholera

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yielded to improvements in the quality of drinking water, while in the mid-twentieth century vast—amazingly vast—gains were made by public health campaigns against smoking. (Alas, these were less effective with women, whose smoking rates continued to rise, and who will be paying the price for many decades still to come.)

Importantly, however, the starting point for these gains was exceptionally low. Deaton notes that the forensic record on heights and weights tells us that the eighteenth and nineteenth centuries may have been the worst in human history for malnutrition and stunted development; the hunter-gatherers and agriculturists who peopled the earlier millennia were in important ways better off. The Great Escape followed a Great Fall; Karl Marx and Victor Hugo appeared when they were needed.

Deaton's point here, however, is that *all* of the great gains since the disasters of the Conquest and the Industrial Revolution have *generated* inequality. Whatever the field (medicine, hygiene, transport, housing) someone—or some country, city, or township—has to go first, and thus a gap opens up. If some are successful, the good practices spread and inequality narrows again later on, when the laggards catch up. But without rising inequality in the first place, there would be no gap to close and no Great Escape. Whether the rate of infant mortality is two per thousand or forty per thousand makes a vast difference. But, following Deaton, the existence of that differential (or even the fact that it may be rising as mortality falls in the rich countries), harsh though it is, is not necessarily a bad thing at any given moment of time. *It may be a sign of progress, and not of injustice.* The important goal is to ensure that the gap, once opened, closes again in the right way.

To complete the Great Escape, lagging countries (which are usually poor) and poor peoples must have the opportunity and the means to catch up—and when they do, inequalities fall. What, asks Deaton, should be done to help them along? Here again his answer is provocative. For the most part, he writes, the rich countries should do nothing. The most important thing is to s*top interfering*. Deaton especially opposes foreign aid—not on principle, but on the ground that it does not work.

While Deaton concedes the benefits of some specific forms of health aid, such as retrovirals against AIDS, he argues that the weight of evidence shows that aid hurts the poor. He claims that it distorts priorities, corrupts officials, and advances the agendas of donors and project evaluators—an enthusiastic brood, especially in recent years. All of this saps the indigenous state capacity required for effective

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health, education, and development policies. Deaton sees no accident in the fact that foreign aid volumes are uncorrelated with development success. Nor would he be shocked by the fact that almost 100 percent of the reduction in extreme poverty worldwide up to 2000 occurred in China—a country that experienced rapid development without foreign aid. Post–2000 poverty reduction in Latin America and parts of Africa also rested on independent state policy and rising commodity prices, not on external assistance.

Deaton suggests that, instead of providing foreign aid, rich countries should focus on what they can do on their own soil. They could, for example, invest *at home* in cures and treatments and technologies relevant to the global poor. The pursuit of knowledge is best conducted by people and institutions with the relevant capabilities and resources; these already exist in rich states. Deaton also points to the need to end *inflicted* evils, such as trade policies that ensure high prices for critical pharmaceutical treatments—an evil embodied by the infamous agreement on Trade-Related Intellectual Property Rights. To this list he might have added the use of poor countries as outlets for the arms trade. However, once the problems of human development and mass poverty are solved (if they ever are), it remains part of the irony of capitalism that inequalities are continuously re-created: if not in health and living conditions, then in wealth, status, celebrity, and—above all—power. These are the features of inequality with which ordinary nondevelopment economists tend to be most concerned. Today in the United States they are the dominant features of political debate. Should something be done about these inequalities? And if so, what exactly?

These questions are central to Anthony Atkinson's *Inequality*. Atkinson is the dean of inequality researchers, a legend in the field, and this new book shows us why. It is a painstaking study, a summary of what he calls "plodding statistical investigations" undertaken since a time, decades ago, when most other leading economists paid little attention to distribution. Atkinson gives careful attention to data sources, to conceptual distinctions, and to the details of measurement and reporting. As a fellow plodder, I found these passages a pleasure to read. Others may possibly find them a trifle slow.

Atkinson is, however, highly Anglocentric. His book builds on data for the United Kingdom and the United States. While it extends a bit to Western Europe, Atkinson makes only passing remarks, at most, about countries outside

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the Organisation for Economic Co-operation and Development. He is therefore unable to address the forms of international inequality in life, health, income, and poverty that are Deaton's stock-in-trade. Sometimes having your nose too deep in the data restricts your field of vision, especially where the data are limited. Indeed, as Atkinson himself writes, "comparability is key to this research" (p. 47).

Still, Atkinson has thought a great deal about policies to address inequality, again mostly (not entirely) in the context of the United Kingdom. He offers proposals for increasing tax progressivity, expanding Social Security and Child Benefit, a basic income scheme, national pay and minimum/living wage standards, a minimum capital transfer or inheritance tax, and more. He would also raise the target for foreign aid to 1 percent of GDP, which places him on the opposite side of that issue from Angus Deaton. Still, in the present British political climate, he is riding a bit of a wave. His platform is, one might say, tailor-made for the Age of Jeremy Corbyn.

As an aging McGovernite—I was the deputy national student coordinator for that campaign back in 1971—I get a thrill from the imagined return of Old Labour or the New Deal. But years spent as a congressional staffer and later life cooled my ardor for policy ideas designed mainly to attract the applause of friends. This is why, for instance, I have criticized Thomas Piketty's self-described "utopian" scheme for an annual global tax on financial valuations. It is preposterous even as a thought experiment; writing or speaking about such ideas is a distraction and a waste of time.

Atkinson is more sophisticated about policy details than Piketty. Yet he shares a predilection for the utopian. He favors, for instance, some form of the Basic Income Grant—the policy descendant of McGovern's embarrassing 1972 thousand-dollar-a-year plan. He would raise marginal income tax rates in the United Kingdom back to 65 percent, without a word on how this would be received (with joy, no doubt!) by neighboring governments, including, among other places, the one in Dublin. He produces a figure showing how the income share of the top 0.1 percent rose as top tax rates fell. The figure is for the United Kingdom, but the argument it makes—that the rich got richer as their tax rate fell—is, one imagines, intended to be equally applicable to the United States. But in the U.S. case a key feature of the 1986 Tax Reform Act, which reduced those top rates, was to reduce exemptions and deductions used by the top group, thus requiring them to report more taxable income and leaving the share of taxes paid by that group as a whole unchanged. The gain in reported

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top income share was a feature, not a bug, of that particular reform. Not incidentally, the reform originated around 1983 with Democrats in Congress—specifically Senator Bill Bradley and Representative Richard Gephardt—and not with the Reagan administration, as is so often claimed; it became a Reagan bill in 1984 as a peculiar consequence of the electoral politics of that year.

I do not know whether something similar happened in the United Kingdom, but the point is germane anyway, given that Atkinson's book is aimed in part at American readers, and a full discussion of top marginal rates should clarify the politics and distributive effects when rate changes are combined with base-broadening. Of course, sometimes marginal income tax rates should be raised. But there are reasonable arguments against returning to the tax regime that was introduced in World War II. That was a world with no capital movements and little foreign trade or investment, and a vital interest in curbing war profiteers. These conditions cannot be re-created, nor should they be.

Let us stipulate that there is such a thing as excessive inequality, sometimes; this is a broad enough proposition so that Deaton would likely agree with Atkinson on the point. But a key lesson from *The Great Escape* is that when egalitarian measures are considered, they should be smartly targeted at the more reprehensible aspects of inequality, and they should take account of the fact that capitalism perpetually reproduces it. It is a dynamic, not a static, process. Therefore, the choice of when and where to intervene is one that requires a touch of strategic thinking. For all his virtues, Atkinson is not a strategic thinker. On policy questions he is more of a maker of lists; he writes down and discusses those measures that are on the public agenda in our time.

To explore the practical economic effects of greater or lesser inequality requires one to ask practical questions, and thus to engage in "plodding statistical investigations." These are Atkinson's forte, in general, but they do not come to his assistance here. When the book turns to the question of *why* inequality should be reduced, Atkinson falls back on the quasi-utilitarian political ethics of John Rawls. Inequalities, he writes, should be reduced mainly to advance a concept of social justice. Atkinson refers to these reasons as "*intrinsic*." As for the "*instrumental*" reasons to reduce it, Atkinson simply defers to others, notably Richard Wilkinson and Kate Pickett who have argued (in *The Spirit Level*) that more equal societies have better health and welfare outcomes. Atkinson also mentions Joseph Stiglitz and the research department of the IMF, but gives no details as to their proposals.

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Yet there are good theoretical, historical, and empirical reasons for believing that, up to a point, more equal societies actually do function better in economic terms. That is, equality tends to correlate with wealth, fuller employment, and higher productivity growth. Indeed, the relationship of greater equality to greater national income is almost tautological. If one does a proper job of measuring inequalities across countries and through time on a conceptually consistent basis—something my students and I have been doing for nearly two decades—it becomes clear that wealthier countries are more egalitarian than poor ones. To surmise the reason does not require deep reflection: a country cannot be wealthy on the whole unless it has a substantial, well-established middle class. Yet the presence of such a class—a group in the middle—is precisely what brings inequality measurements down.

Second, there is good evidence that economies with more equal *wage* structures enjoy *less* joblessness than their less-equal neighbors. That is, there is habitually less unemployment in Sweden than in Spain. This is the opposite of the standard intuition, beloved of economics textbooks and derived from the venerable supply-and-demand diagram. That intuition has held that flexibility in wage rates is the key to high employment; that employers, substituting labor for capital, will hire more workers if the wage rate is low than if it is high. In fact, such substitution is very minor. Much more important is the fact that big pay differentials prompt workers to leave bad jobs (down on the farm, say) and seek out the small number of better jobs (in factories, traditionally). But not everyone can get such work. A basic fact of unequal societies is that good jobs are scarce. Inequality, unemployment, and migration are thus tied closely together. Anyone observing the mass migration of the Chinese labor force from the countryside to the cities knows this.

The usual trope behind the conventional view holds that Europe, with egalitarian values and high wages, suffers more unemployment than the United States, with unequal wage structures and flexibility in its labor markets. But the evidence underlying this case rests on a bad statistical habit of comparing the whole United States to individual European countries, such as Belgium or Denmark. The latter are small countries, comparable to middling American states, and are embedded in what has been for many years a large, highly integrated continental economy. To make a fair comparison, one must add up inequality across countries, from Portugal to Finland to Greece, or even to Bulgaria, taking account of the differences between them in order to obtain a continental measure of European inequality. There are no surveys that do this. But there are good ways to approximate the

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answer, and when used, these reverse the results of the initial comparison. So far as ordinary wages are concerned, especially in manufacturing, the United States is *not* less equal than Europe. Instead, it may be that the United States enjoys less unemployment (on recent historical averages) in part because, so far as wages alone are concerned, it is *more* egalitarian. And if the United States were more egalitarian than it is, unemployment would be lower still.

A third practical argument for more equality applies mainly to small countries in open trading relationships. In the 1950s the leading economists of the Swedish trade union, Rudolf Meidner and Gösta Rehn, argued that a more egalitarian wage structure would accelerate productivity growth, since companies with advanced technologies would find the setting attractive, while those dependent on low-wage labor would be forced to adapt or to close. The policy bore fruit over decades, as Sweden and its like-minded Scandinavian neighbors rose from the middle of the European income/productivity distribution to the top. This enabled them to fund a comprehensive welfare state, reinforcing the capacity to remain at the top, despite a complete abstinence from protectionism.

Inside the protected spheres of certain countries—such as Japan, Korea, or Taiwan during their phases of rapid industrialization, or for that matter in Latin America from the 1930s to the 1970s—similar effects were achieved. However, the developing countries pursuing import substitution paid the price of a lower ceiling on living standards, since a protected industrial sector is unlikely to reach the same levels of quality and productivity as one that competes (and survives) when faced with the entire world. This accounts, in part, for the rise of the East Asian economies toward living standards comparable to those in Europe.

The leading argument in favor of *unequal* economic outcomes in advanced societies draws mainly from the thought of Joseph Schumpeter and the experience of the United States. Here, the technology sector, alongside finance, stands as the world's leading example of progress linked to vast inequalities of income. Inequalities in these sectors do not arise mainly in wages. They do not even come mainly from enterprise cash flow. Rather, the vast inequalities mostly derive from the flows of capital resources that enter the sector through the asset markets—as investments, loans, and the proceeds of initial public offerings. On the whole, tech tycoons get rich from the valuations of their stock. Nevertheless, the inequalities are there. And so again we ask, should something be done?

Since unrealized capital gains are not taxed, *these* inequalities cannot be fixed by raising income tax rates or taxes on realized capital gains. Nor is it obvious that

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they should be fixed. Why should a company that attracts capital—because it has the prospect of making something that consumers want—not enjoy the capital valuation that reflects its prospects? Apart from such issues as monopoly and financial fraud, there is no apparent reason why the shares of Apple or Google or Intel should be priced lower than they actually are, and therefore no reason why the owners of such shares should have less wealth and income from dividends and capital gains than they do.

Yet there is an obvious objection to complacency in this area. The problem is not with accumulations, but with the creation and perpetuation of dynasties based on them. Oligarchies are anti-republican. They are the classic enemy of democracy, from the time of Pericles and Socrates to the present. The remedy is to do—effectively—what the United States has actually been doing for a century now: to tax estates and gifts, while exempting from tax all donations to qualified charity. The effect is what we observe even under present imperfect tax law: a vast flow of private wealth into foundations and nonprofits, including hospitals, universities, and churches, which together provide over 8 percent of American jobs.

Atkinson's discussion of inheritances concentrates on the desirability of spreading bequests over many individuals, so as to disperse great fortunes. He would tax gifts not as given but as received, thus encouraging smaller distributions and discouraging large ones. This is an interesting detail, but it misses the larger point. The larger point is that large fortunes should not remain long under the control of those who create them, even while they are living. The tax regime should encourage—even coerce—those who become very rich to off-load most of their wealth to an appropriate institution at a relatively early moment. It does not matter whether they do this in small or large pieces. There are disadvantages to vesting power over cultural and educational life in the grant officers of foundations, to be sure, and the system the United States has can be improved. But even as it stands, it is far better than allowing the whole of great fortunes to pass along family lines.

An effective anti-dynastic estate and gift tax is a good example of what one may call a strategic approach to inequality. It recognizes Deaton's point that inequalities derive (often, though not always) from progress; and it focuses attention and action on providing a suitable remedy—not all at once, but in due time. With this model in mind, let me offer a few other recommendations.

Taxing land and other resources, such as deposits of minerals and fossil fuels, is the sort of thing that should help reduce inequality. Land cannot be moved. Land values capitalize economic rents without effect on the allocation of resources.

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Taxing them effects a pure transfer from a largely passive land-owning-and-speculating class—the group that gives rise to people like Donald Trump. Prohibitions against taxing land at the higher levels of government (state and federal) exist—there is one in the state constitution of Texas, for instance—but it is obvious in whose interest they were written. They should be removed.

The case for taxing mineral rights is even stronger. In most instances these rights arise from the pure accident of landholding (or judicious acquisition), and once acquired they give rise to the political authority of people like Charles and David Koch. Taxing is in fact a lenient solution to a noxious problem. Around 1789 the consequences of not taxing land were felt by the aristocrats of France; after 1949 they were felt in China. That process was extremely ugly, but the result today (in China) is that land rents are largely collected by units of government. Any visitor to Shanghai can see how the city has enough funding to keep its airports, railroads, roads, public transport, and so forth up to scratch. It has been justly said that the leading practical economic influence in the construction of modern China was not Karl Marx, but Henry George.

A particular source of great inequalities is to be found in the role of finance. Finance is the commanding height of any capitalist economy: it is behind the rise and fall of enterprise and employment in the credit cycle; it gets to choose where money flows and where it does not. Finance is also a pure money-game: real assets, technologies, output, and consumption are not involved; the banker puts money in to get money out, and may never see or touch a factory, farm, or mine. That is why bankers can all live together, as they tend to do, in a place like New York or London.

The problem with money games is that they are, like nothing else in the world, open to cheating, fraud, and tax evasion. There are few independent technical experts, such as engineers or doctors, who have ethical standards of their own against which to judge the organization in which they work. Too big to fail is too big to manage. Finance works better when individual banks are kept midsized or small, with relatively simple, specialized functions; when executives are paid like ordinary mortals; and when these institutions fall within the competence of specialized regulators. That is not the case today, but the remedy—to break up the large banks and to establish firewalls between them—is under active political discussion.

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In the real world wages and pensions are set by social decisions, including collective bargaining and legislation. Raising the minimum wage and increasing the payout of Social Security benefits in the United States is the province of Congress; the "labor market" has nothing to do with either. Reducing wage and pension inequalities will affect neither the international inequalities that most concern Deaton nor the gross income inequalities driven by transformations in the structure and valuation of capital asset holdings. But such action makes a difference in the lives of people affected, and it has (as noted above) favorable long-term effects on employment and productivity.

While inequalities in a large, rich, continental economy such as the United States can be dealt with by national policy, it is a mistake to think that other countries enjoy the same freedom. Smaller countries depend on trade and financial relationships with rich states, and their fate is largely determined by such external factors as interest rates, speculations in foreign exchange, stock and commodities prices, and the demand policies of wealthy countries. Exchange rates can be especially decisive. When the Mexican peso falls, the peso income of Mexicans who export to the United States rises, while that of Mexicans who sell goods or services into the Mexican market does not. Since exporters are generally better paid (and this is true in most economies), this has an immediate effect on Mexican inequality, easily visible in the data. At the time of this writing, the global movement toward currency wars and collapsing commodity prices seems certain to ignite a wave of rising inequality throughout the developing world. If one cares about inequality, a fight against commodity and exchange rate speculation on the Chicago, New York, and London markets would be a good place to begin.

At the international level, there is one measure of policy that would achieve a great deal toward the goal of reducing inequalities in the global distribution of well-being, and that is to secure peace and suppress the arms trade. The geography of war in our time has become highly concentrated in poor countries, from Africa to Afghanistan, with limited exceptions for the formerly middle-income parts of the Middle East, notably Iraq and Syria, both of which are now reduced in many places to a state of pauperism. War blocks development. Conversely, in countries free of major conflict, most notably China and India (and in South America since the disappearance of the military regimes of the 1960s and 1970s, and especially since the demise of the reactionary "Washington Consensus" around 2000), developmental progress and inequality reduction have been most rapid.

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In sum, statistical explorations can inform a practical, strategic approach to inequality reduction, with the goal of achieving higher employment and better productivity performance. Even within their limits they permit one to seek out trends, to identify patterns, to make comparisons and correlations to other variables, and so to rule out certain hypotheses (and rule in others). There is thus a great deal to be said for the plodding statistical investigations to which Anthony Atkinson has devoted his career, and they can be extended to promote effective tools of economic development and inequality reduction.

Yet statistical work is limited by the short range and fuzzy focus of the instruments at hand. Improving the instruments has been an ongoing task, to which I have tried, also, to make a contribution. But to be realistic, one has to recognize the limits of even the most diligent statistical approach. To achieve a fully coherent understanding of—and a realistic policy approach to—the conundrum and challenge of economic inequality requires something more. It requires a grip on the relevant dimensions of economic theory; insight as to how they apply to the modern world; acceptance of the way historical forces play out for good and evil under capitalism; strategic thinking; and an open-minded, critical approach to both national and international policy choices. These traits are rare.

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