The case for inclusive growth

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Economic inequality is rising, and fast. The consequences could be catastrophic — politically, economically and socially.

The juxtaposition had its effect. As the rich, famous and powerful gathered on the snowy slopes of the exclusive ski town of Davos in the Swiss Alps for the annual meeting of the World Economic Forum (WEF), British charity Oxfam released its damning take on the state of the global economy — that just 26 of the world's richest people, some of whom have been at Davos in past years, held as much money or assets as the poorest half of the rest of the world, or 3.8 billion people. By Oxfam's estimates, Jeff Bezos, founder of tech giant Amazon.com and the world's richest man, need only donate 1% of his net worth of US$130 billion ($177 billion) to take care of the healthcare budget for the 105 million people of Ethiopia, one of the poorest countries in the world.

Oxfam also noted that last year saw the biggest increase in the number of billionaires in history, one every two days. And, as the rich got richer, the poor became even poorer: The report noted that while the wealth of billionaires around the world grew by US$2.5 billion every day in 2018, the poorest 3.8 billion people saw what they already had decline by 11%.

Yet, even as it grabbed headlines and made the businessmen and politicians gathered at the Davos Congress Centre uncomfortable, the seemingly extreme inequality that Oxfam has laid out is hardly new. Just a month ago, the World Inequality Report 2018 was presented at the Paris School of Economics. The report was co-authored by Thomas Piketty, the French economist who focuses on wealth and income inequality, and based on the World Wealth and Income database, said to be the most extensive repository on the historical evolution of income and wealth distribution.

Over the last four decades, while there has been significant growth in emerging economies, the benefits have not been equitable. Admittedly, economic growth has helped to lift the poorest populations out of abject poverty, notably in countries such as India and China. But that pales in comparison with how the richest 1% in the world captured twice as much global income growth as the bottom 50%.

At the same time, the rise in private ownership of capital versus the decline in public wealth, driven by privatisation, has widened the wealth gap among individuals. But the high levels of inequality do not necessarily correlate with similarly high levels of growth; in the case of China and India for instance, India had higher levels of inequality than China did, but experienced slower economic expansion. Piketty and his fellow researchers assert that, based on their careful analysis, it is possible for higher growth and lower levels of inequality to co-exist.

"The fact that inequality levels are so different among countries, even when countries share similar levels of development, highlights the important roles that national policies and institutions play in shaping inequality," they say.

Interestingly, the report's authors also cast doubt on official statistics, noting that "standard measures of inequality often rely on household surveys, which routinely underestimate the income and wealth of individuals at the top of the social ladder". Still, they asserted that, should "business as usual" continue, "even with optimistic growth assumptions in the emerging world, global inequality will continue to rise."

And the implications of this divide, and inaction to address it, are clear. "Economic inequality is widespread and, to some extent, inevitable," the report's authors acknowledge. "It is our belief, however, that if rising inequality is not properly monitored and addressed, it can lead to various sorts of political, economic and social catastrophes".

Rising discontent

There are already clear signs of a rising backlash against growing inequality. Notably, public discontent in France bubbled over last year as a fuel tax hike triggered the violent "Yellow Vest" protests in Paris and elsewhere.

Much of the income disparity is plainly evident in the corporate world and various interest groups are beginning to highlight it. At the start of the year, it was reported that one of the UK's top CEOs would have earned, by lunchtime on Jan 1, what an average British worker would earn throughout the year. Now, new UK legislation will compel companies to be more transparent about compensation for top executives, effectively asking for justification for the huge pay disparity.

In the US, union advocacy group AFL-CIO's Executive Paywatch Report stated that a CEO at a Standard & Poor's 500 firm made 361 times more than an average worker in a year. According to the group, Barbie maker Mattel was the worst offender among the 500 companies: Mattel's median employee is a factory worker in Malaysia who made US$6,271 a year, which works out to a CEO-to-employee pay ratio of 4,987 to 1.

In July 2018, The Edge Singapore published a special report on CEO remuneration, which detailed the pay packets of CEOs in Singapore-listed companies. Unsurprisingly, the top earners were the captains of Singapore industry — bankers and property tycoons. The report found that the median salary of CEOs was well over $5 million, including performance bonuses. This is in stark contrast to the average median monthly salary of an individual employee of just $4,437, including employer CPF contributions, according to the Ministry of Manpower's statistics. That works out to $53,244 a year, or a mere 1% of what a CEO in a bank could earn.

Along with discontent over such disparity, the new generation of workforce is exhibiting a loss of faith in business and its purpose. In the Deloitte Millennial Survey 2018, fewer than half of those surveyed believe businesses behave ethically (48% versus 65% in 2017) and that business leaders are committed to helping improve society (47% versus 62% in 2017).

Indeed, the call to address mounting public frustrations with big business, and governments, is strengthening. In his 2019 letter to company bosses, Larry Fink, head of the world's largest asset manager, BlackRock, has said stronger corporate leadership was needed to address social and economic issues arising from "wrenching political dysfunction". He called on top executives to rethink the raison d'etre of their companies — and not just to focus on profits.

Still, equitable distribution of wealth is not just the "morally correct" thing to do; unequal wealth distribution has been shown to be detrimental to social stability and strongly linked to an increase in crime. A study from the London School of Economics in 2016 found that in the US, property crime increased in areas where neighbouring residential clusters differed vastly in income. The researchers found that as the income gap with one's poorest neighbouring block widens, the level of property crime in richer blocks increase.

What needs to change?

To its credit, the WEF had, in 2017, proposed rethinking how countries viewed their progress. It released the Inclusive Development Index, which sought to measure growth not just in absolute terms of dollars and cents, but in the broader aspects of socio-economic progress. As an alternative to the use of GDP as a measure of economic performance, the IDI takes into account inclusion, intergenerational equity and sustainability.

The WEF noted that decades of prioritising economic growth over social equity has led to high levels of wealth and income inequality. The problem was exacerbated by an over-reliance by economists and policymakers on GDP as an indicator of growth in a country. In fact, it found that relatively strong GDP growth cannot be relied upon by itself to generate inclusive socio-economic progress.

Of the 29 advanced economies it surveyed in 2018, 26 experienced GDP growth, but only 10 of these registered the same progress in measures of inclusivity (see Table 1). The same pattern can be seen in its measures of intergenerational equity and sustainability. This suggests that GDP growth is a necessary but not sufficient condition for the broad uplift in living standards by which most people judge countries' economic success.

As such, now more than ever, policymakers need a new system that will focus on the purpose of sustainable, equitable progress. "Political and business leaders should not expect higher growth to be a panacea for the social frustrations, including those of younger generations who have shaken the politics of many countries in recent years," it said.

"It could help them to pay greater attention to structural and institutional aspects of economic policy that are important for diffusing prosperity and opportunity, making sure these are preserved for younger and future generations," says Richard Samans, managing director and head of global agenda at the WEF.

Tan Ern Ser, associate professor at the Department of Sociology at the Lee Kuan Yew School of Public Policy, proposes that, in addition to fair wages, corporates must look out for employees' vocational and professional growth, and take care of work-life balance. "Giving fair wages can contribute to enhancing economic security and quality of life, but it is not a sufficient condition. It must be paired with equalising opportunities and enabling people to earn decent wages and participate in meaningful work.

Tan also agrees that GDP is a flawed metric to use to measure a country's progress. "GDP measures whether the economic pie is expanding. Important as this is, it is not people-centric. At the end of the day, economic growth must benefit all citizens, and not just a privileged few."

Indeed, by GDP standards, Singapore has done very well. But, it has fallen short in measures targeted at reducing inequality. Oxfam, for instance, has earlier ranked Singapore in the bottom 10 countries in the world, in terms of its efforts to reduce inequality. In the WEF's IDI measure, Singapore was conspicuously not included despite ranking a high eighth in GDP growth among advanced economies, owing to inadequate information.

The Singapore government has objected to such measures, pointing out that they do not provide a full picture.

Leonard Lim, research associate at the Society and Identity cluster at the Institute of Policy Studies, says rankings such as the IDI can help encourage discourse on tackling the issue of inequality, but cautions taking them at face value. "Such indices and measures are always useful in sparking conversations on tackling inequality. But one must be careful and examine further how such indices are constructed. Different organisations will construct their indices in different ways, depending on preferences and emphasis."

Lim pointed out that the Oxfam measure, for one, contradicted the fact that Singapore topped a World Bank Human Capital Index that measures how well countries develop their people. "One reason cited for Singapore's low score in the Oxfam report was its low public investment in social areas such as education and healthcare. But some of Singapore's outcomes in both areas are among the best in the world, and certainly better than some developed countries who are spending much more as a proportion of GDP."

He believes there are several core policy approaches that are addressing inequality. First, he pinpoints education as the core to any policy decision that strives to narrow the gaps. "Singapore has increased its investment in the pre-school sector substantially in recent years to increase social mobility. This is predicated on the evidence that interventions to level the playing field in a child's formative years are key to addressing inequality in later years," he tells The Edge Singapore.

Recent research has found, however, that even earlier intervention could be crucial. "If you think about it, inequality begins even in the mother's womb, because better-off mothers have the resources to purchase vitamins and other supplements to aid their child's development [in utero]," Lim observes. "So, educational interventions at even earlier ages than pre-school can mitigate inequalities before the gap widens too much. This could also include measures to ensure that lower-off families have adequate access to good-quality and nutritious food for their infants."

Lim argues that social mobility relies a lot on the environment a child grows up in, and lower-income families need help in order to be able to give their children a head start in life.

“Some of these measures are already being piloted and hopefully they will be rolled out nationwide soon so that all low-income families can benefit,” he adds.

Admittedly, such measures would require even greater public spending. Lim proposes that taxation be a way to not only help these families, but also to prevent widening the gap between the rich and the poor.

“Singapore, I believe, has scope to increase wealth taxes on the rich. This could take the form of a capital gains tax (on, for instance, profits from stocks and dividends) or an inheritance tax. Singapore used to have an inheritance tax but this was removed in 2008,” he says.

An inheritance tax would mitigate the intergenerational inequalities perpetuated as families accumulate more wealth and pass it on. Such a tax would undoubtedly be unpopular, hitting at the core of Singapore’s economy — which is driven in large part by its attractiveness as a wealth management hub — and thus be politically problematic. There are also the attendant risks of tax evasion and money laundering.

Yet, the case for progressive tax reform to combat inequality is proven, particularly as the gulf widens at the top, with the richest 1% of the world only getting richer. According to economists, progressive tax rates do not only reduce post-tax inequality, they also diminish the pre-tax inequality by giving top earners less incentive to capture higher shares of growth through pushing for higher pay and wealth accumulation. Piketty and associates says, “It is also worth noting that inheritance taxes are non-existent or near zero in high-inequality emerging countries.” They advocate a global financial register, which records asset ownership, including securities, as a way to combat tax fraud.

Whatever the case, addressing inequality requires leadership from governments and corporates. The tools are there; they just need to be taken up.