

November 2001

Inequality and Freedom in 2001

*By Andrew Oswald, Professor of Economics, Warwick University.
www.oswald.co.uk*

Nations with similar standards of living often have very different amounts of inequality.

In the United States, for example, there is a large spread of pay. In that country, 17% of people live on less than half of the average American's income. Yet in Sweden, only 5% of people live on less than half the average Swede's income. For Britain the figure is 13%, for Switzerland 9%, for Luxembourg 3%.

Across the world, however, there is statistical evidence that inequality is generally going up through time. Is this trend good or bad? How should we react?

Three concerns about inequality often get raised. First, it is immoral, according to one line of argument, that some human beings have riches while others live in squalor. Most of us can identify with that in our hearts. But it cuts less ice in countries where squalor means having only one car and two televisions. Second, inequality can be undesirable, it is suggested, because the rich get little pleasure out of each additional pound of income. Hence, transferring money from them to the poor, who value each pound highly, would increase total social happiness. Theoretically, this utilitarian argument makes sense, although it currently lacks real empirical support. Happiness surveys do show some slight signs of higher wellbeing in places with smaller inequality, but nobody has yet published really convincing empirical proof (though some of us are looking hard at data to see if it is possible). Third, income inequality threatens society, according to some observers, because the poor may rise up. Revolutions of that type have certainly happened in history, but, unless one counts the anti-globalisation protestors who burn MacDonaldis restaurants, it does not seem likely today.

In the mid-1970s, someone with a university degree in the United States or Britain earned about 25% more than a person with only a competent high school record. By the 1990s, this differential had gone up to around 40%. At the top end of the pay distribution, the change has been even more striking. Today the best sports players and chief executives earn millions a year. Their remuneration is a much greater multiple of a junior worker's salary than was once the case.

Will Hutton, in his interesting book *The State We Are In*, argues that inequality hurts us all. He thinks it is immoral. Lots of good people do.

A different view, however, comes from the Right. Inequality sharpens the effectiveness of capitalism – so that side of the argument goes – and therefore it benefits us all. Plus, this corner of the ring argues, it is actually not anyone's business what another person earns.

All very tricky. So what is the best way to think about this topic?

It pays to begin with the economist's staple approach -- supply and demand. Imagine a hypothetical world where everyone were paid the same amount. Such a society would obviously be inefficient. Libraries and golf courses would work pretty well, but many other activities would not. An endless supply of people would line up to be librarians and golf professionals, but no-one would be willing to be a bodyguard, the chief executive of a huge company, or an oil-rig driller. Human beings do their best to avoid danger and stress. Unfortunately, society needs someone to put up with those jobs -- and money is a convenient way to persuade employees to take them on.

Therein lies the first and best reason for inequality; it helps get things done. Then the question to ask anyone who argues for lower wage inequality is this: are you sure people will be willing to do the tough jobs we need done?

Yes, is the reply from critics. Everyone would love to play football for Manchester United, so how can it be reasonable that David Beckham

makes more on a Saturday afternoon than the average fireman does in a year?

The reason why a top footballer gets a huge salary in 2001, compared to his equivalent in 1951, is that the marketplace has grown. This is 'globalisation' at its sharpest. When Beckham curves a ball into the top corner of the Bayern Munich goalkeeper's net, he can be seen doing so by perhaps 500 million people. Such is the power of global television. Fifty years ago, by contrast, only 50,000 people would have seen him do it, from the stands of the football ground in which the match was being played. The change can be thought of as an enormous growth in the productivity of excellence. Hence the return to talent has risen. With a market that is now 10,000 times larger, indeed, an economist might expect Beckham's pay to be even higher than the millions he currently earns.

Football as an example is not as extreme as it sounds. The latest research evidence is that new technology, like television and fast computers, has contributed quite generally to the growth of pay inequality. Computerization has gone hand in hand with greater dispersion in people's remuneration.

Unless clinching evidence is one day uncovered that inequality makes nations on average less happy, the most sensible view seems to be this. Inequality has a useful side to it, because having a spread of pay levels allows society to motivate people to do the bad jobs that have to be done. Morally it is not desirable to have inequality, but differences in pay have risen for unstoppable world-market and technological reasons, and we must move with that global tide or drown. If Britain's voters really cannot tolerate the natural degree of inequality that is emerging, they can reduce the amount of it, somewhat, by forcing their politicians to adopt a more progressive income tax system (though the voters have so far shown remarkably little interest in doing so).

Whatever the details, one fact of life is not going to go away. Wages would only be equal in a world where a dictator set them by decree. Inequality is the price we pay for freedom.