Institute for
New Economic Thinking
AT THE OXFORD MARTIN SCHOOL

Inclusive Growth Seminar

Somerville College

Input by Brian Nolan

Department of Social Policy and Intervention and Nuffield College

16th. October 2019

What Do We Mean by Inclusive Growth?

This first seminar is focusing on the scale and nature of the challenge, nationally and locally, posed by the need to secure inclusive growth. Academics naturally debate what exactly one might mean by inclusive growth and how best to measure it. The OECD, the rich countries collaborative think-tank, has made inclusive growth a centre-piece for their activities, which is itself a marker of just how important it has become. Their definition is that:

> "Inclusive growth is economic growth that is distributed fairly across society and creates opportunities for all".

That serves as a good starting-point for our discussion. Concretely measuring whether inclusive growth is being achieved, where and how far we are falling short, is of course more complex. The OECD itself has developed a dashboard of 24 inclusive growth indicators to monitor progress over time, ranging from income growth in the middle of the distribution – an indicator I have concentrated on in my own research programme – to wage dispersion and productivity growth.

Another useful point of reference is the Sustainable Development Goals, adopted by the countries of the United Nations in 2015 for the year 2030. These cover a wide span, but include for example

- progressively achieving and sustaining income growth of the bottom 40 per cent of the population at a rate higher than the national average
- achieving full and productive employment and decent work for all
- sustaining per capita economic growth and achieving higher levels of economic productivity.

Why the Concern about Inclusive Growth?

The current emphasis on inclusive growth reflects of course the fact that across the rich countries, growth in recent decades is seen to not have delivered sufficiently for 'ordinary households' – not just those lower down the distribution but also the much-discussed 'squeezed middle'. This is reflected most strikingly in stagnant wages and incomes across much of the distribution since the 1980s in the USA, which tends to 'frame the narrative' for research and policy debate in rich countries more generally – not always helpfully. But while experiences vary, the transmission of growth through to the middle and lower parts of the income distribution has often been quite limited, compounded by the severe and long-lasting impact of the Great Recession and accompanying austerity policies.

Why Has Growth Not Been Inclusive (Enough)

In a rich-country context, why would growth be much less inclusive in recent decades than previously? Globalisation and technological change are widely seen as principal culprits. Technological change has certainly created greater reliance on graduates and raised their relative wages, while a recent authoritative review concluded that "globalisation in the form of foreign trade and offshoring has not been a large contributor to rising inequality". The technology versus globalisation debate may be misguided in any case given the extent of the interactions between globalisation and technological change, with the development of ICT making possible the global chains of production and distribution that exploited the opening-up of trade and capital flows. Research also suggests that the effect of immigration on the real earnings of the native population has been small. But it is not simply a matter of exogenous forces beyond our control, as technological change is often regarded, impacting on rich countries – as is clear from the marked differences across them in how much income and wealth inequality have increased and how ordinary families have fared.

Many have also pointed to the rise of rentier capitalism, where "economic rent" means rewards over and above those required to induce the desired supply of goods, services, land or labour. "Rentier capitalism" refers to an economy in which market and political power allows privileged individuals and businesses to extract such rent from everybody else. One aspect of this relates to the financial sector. It has been estimated that "rents" in this sense account for 30-50% of the pay differential between finance professionals and the rest of the private sector, and rewards in finance also contribute substantially to rising top income shares and inequality. Recent research suggests that the level of financial development is good only up to a point, after which it becomes a drag on growth; a fast-growing financial sector is detrimental to aggregate productivity growth, and also often fuels the credit booms that usually end in financial crises. The explosion of financial activity since 1980 has not raised the growth of productivity, if anything it has lowered it, especially since the crisis.

The same is true of the explosion in pay of corporate management, which is another form of rent extraction. In the UK the ratio of average chief executive pay to that of average workers rose from 48 to one in 1998 to 129 to one in 2016, while in the US this ratio rose from 42 to one in 1980 to 347 to one in 2017. The linking of CEO and other management pay to the share price from the 1980s has given management the incentive to concentrate exclusively on

that price, on increasing it by manipulating earnings or borrowing money to buy back the shares, at the expense of corporate investment and so of long-run productivity growth.

Underpinning the increase in rent extraction is the decline of competition. There is evidence of increased market concentration in the US, a lower rate of entry of new firms and a lower share of young firms in the economy compared with three or four decades ago. Widening gaps in productivity and profit mark-ups between the leading businesses and the rest also suggest weakening competition and rising monopoly rent. Moreover, a great deal of the increase in inequality arises from radically different rewards for workers with similar skills in different firms: this, too, is a form of rent extraction

Experiences Vary across Rich Countries

My own research at INET has highlighted how much the USA is an outlier in the extent of its toxic combination, going back to the 1980s, of stagnating wages and incomes and rising inequality and in particular the rising share of growth that has gone to the very top of the distribution. While top incomes shares in terms of gross income have generally risen, the extent of that increase has been much more modest than the US in most other rich countries; the impact of direct taxes on how much that has fed through to shares in income after tax also vary a good deal. Focusing on the extent to which growth in incomes around the middle is achieved and how much this lags behind growth in GDP, most rich countries have done somewhat better than the USA, at least until the global financial crisis.

This illustrates how much national contexts, institutions and policy responses have mattered. Both increasing concentration of economic power in product markets among a few firms and the weakening of organised labour have been particularly pronounced in the US. Other countries have also had more robust redistributive systems so increasing inequality in incomes from the market does not transmit so directly to the incomes after tax and social transfers that households have to spend.

The Growth-Inequality Relationship

So experiences across the rich countries in recent decades have actually varied quite a lot, with respect to how much inequality has grown and whether households around the middle and lower down the income distribution have seen much improvement in their living standards. (I will come to how the UK has fared shortly.) What analysing this range of

experience underpins is a very different way of thinking about the relationship between inequality and economic growth to the conventional one, in economics at least. The long-standing notion was that there is a strict trade-off: attempting to reduce inequality, or push back against rising inequality, would hamper economic growth by distorting and reducing economic incentives to work, save and invest. Instead, high inequality is now increasingly seen as a fundamental barrier to growth, operating through multiple channels. These include the inefficiencies associated with excessive market concentration, the distortion to investment decisions when the focus is on short-term share prices and 'shareholder value', and the loss of productive potential when people cannot afford to invest in their own upskilling and the education of their children.

How Has the UK Fared?

Against this background, how has the UK been faring? Nationally, the picture going back to the 1980s is mixed: there have been periods of very rapidly rising inequality, and others when real incomes rose quite substantially across most of the distribution. More recently, though, the last decade has seen a remarkably poor performance in terms of income growth, whereas employment has been strong. Real wages declined markedly in the crisis and have only shown any significant growth very recently. Experience here and elsewhere shows that rising real wages are at the heart of inclusive growth, but the very poor UK performance in terms of productivity is critical in that respect. Inequality across most of the income distribution has been broadly stable over the last decade or even declined marginally, and the share going to the very top took a hit at the onset of the financial crisis. However, recent estimates are that since then the rising trend in the share going to the top has resumed and it is now back to its pre-crisis levels. These latest estimates show the fraction of pre-tax income going to the top 1 percent in the UK, at 15%, was the 2nd. highest amongst comparable rich nations, after the United States.

Regional and Local Perspectives

Inequality between regions is also of course a striking feature of the UK landscape, and one that has been receiving a great deal of attention since the Brexit referendum given the clear geographic divide in voting. The evidence suggests that in terms of regional differences in productivity, the UK is one of the most unequal countries in the OECD and is the most unequal of the G7 countries (although the variation in productivity across regions has fallen slightly rather than increased over the past decade). Differences between regions in living

standards as measured by household incomes are however much less, and a lot lower than their 1990 peak. While internationally the UK is an outlier in terms of geographic differences in productivity, it is fairly typical of other OECD countries when it comes to differences in household incomes. The UK is more unequal than Germany and Japan, but less unequal than the US, Italy, Canada and Spain. Differences in employment rates have been falling steadily since the early 1990s, as employment have rise fastest in lower-employment regions, while wage variation between regions has been falling since 2012 and is no higher today than in the mid-2000s

I will mostly leave the more local perspective to Mark Fransham to discuss, but note that the picture with respect to trends in differentials across them is somewhat opaque. Differences in earnings and employment across local authorities have declined since the turn of the millennium, perhaps suggesting that differences in household income have also narrowed. However, national accounts data presents a different story, with differences in gross disposable household income across local authorities in Great Britain having risen since 1997.

Thinking about cities specifically, it is worth noting the emphasis in recent research on what are termed the network externalities of agglomerations (emphasised for example by Paul Collier in his recent book *The Future of Capitalism*). Metropolitan areas such as London, New York, the Bay Area in California generate powerful feedback loops, attracting and rewarding talented people and disadvantaging businesses and people trapped in left-behind towns. Agglomerations also create rents, not just in property prices, but also in earnings.

The Range of Responses Required

The complex, interconnected barriers that have emerged to inclusive growth require a correspondingly broad range of responses, in terms of actions and actors. In that context it is worth pointing to the Framework for Action on Inclusive Growth developed as part of the OECD Inclusive Growth Initiative to guide policy action that “brings everyone along” (and thus leave no one behind) and aims to reduce multi-dimensional inequalities and empower people to live happy, healthy and productive lives. The Framework provides countries with broad guidance on how to design and implement integrated policy packages to promote inclusive growth, and the OECD is also drilling down to examine how this can be

implemented at individual country level with appropriate recognition of differing national contexts.

While there is much of interest to discuss in this Framework, and in the related framework that the OECD has developed specifically for cities, it is worth highlighting two things. The first is that we have to jettison the notion, so influential since the 1980s, that we can leave it to the market. This has been comprehensively exploded by bitter experience, not least with respect to the spatial concentration of the benefits of growth: action explicitly aiming to assist lagging regions and areas and spread the benefits of growth via coherent cross-sectoral strategies is the only hope.

The second is that the responsibility for action is not confined to national or indeed national plus local governments. Promoting inclusive growth is not just seen as a matter for government but necessarily involving the corporate sector as well as the voluntary sector if it is to be successful. This includes the core element of promoting productivity, which in the current UK context of sustained poor productivity levels needs little justification.

What this calls for, among other things, is a reconfiguring of the role that firms play. The US Business Roundtable, which represents the chief executives of 181 of the world's largest companies, recently explicitly abandoned their longstanding view that "corporations exist principally to serve their shareholders", stating instead that "While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders." The implications for not just how rewards are distributed but for their activities in the public arena are fundamental, as highlighted in the very illuminating recent book by Colin Mayer, *Prosperity. Better Business Makes the Greater Good.*

Engaging at the local level, companies have the scope to contribute most obviously via their approach to employment and to pay. These are at the heart of inclusive growth, whether it be nationally or locally. Imaginative approaches to hiring practices and on the-job training have been implemented elsewhere that bring those on the margins into the productive workforce. This serves to increase the productive capacity of the economy while at the same time improving lives for the individuals affected and in the local areas in which they live. Firms can also play a key role in building up local development funds and promoting their optimal use. There is much to be learned from experience elsewhere, and much to be discussed about how best to do so in the Oxford context, but the need for an integrated approach is clear.