Liberty, Fraternity and Inequality: the Lucky and the Unlucky and the need for a new ethic of social obligation

1. Growth and Prosperity

The last 70 years have witnessed a monumental improvement in the welfare and living conditions of a large proportion of the human race. Both materially and politically the change has been transformational.

Materially, in the last 25 years 700 million people, some 10% of the planet's present population, have been lifted out of extreme poverty (defined in 1990 as a daily income of US$ 1.00, raised to US$1.25 in 2010). The global poverty rate has been halved. Talk in global official circles (the United Nations, the World Bank, the World Health Organization etc.) of the eradication of extreme poverty in the world by 2030, as the enormous progress achieved in the last 20 years is projected hopefully into the future, is increasing and seems less and less unrealistic.

Politically, too, the last 70 years, and especially the last 25 years, have witnessed an acceleration in the number of countries escaping autocratic and often brutal regimes to adopt, or at least take the first steps towards adopting, democratic political structures.

The main driving force for this transformation has been the steady surge in global growth since the early 1980s. Globalization in all its forms (a doubling of world trade, the free movement of capital encouraging a massive and sustained increase in the flow of direct investment into developing economies, the global spread of information and communications technology) enabled the developing countries to enter the global economy and step onto the escalator of growth. With a few hiccups (the recessions of 1990-91 and 2000-2001, the Russian default and the Far Eastern crisis in the late 1990s etc.) the global economy expanded steadily and vigorously for 35 years. Western democratic capitalism became its dominant economic and social regime.

This persistent strong global growth encouraged economists in positions of influence and authority in the world's finance ministries and central banks to believe that they had finally found the holy grail of economics and solved its fundamental policy problem: how to deliver steady, reliable, non-inflationary growth together with high employment. This success, delivering, as it seemed, besides the great alleviation of poverty in the developing countries, high employment and sustained wealth creation in the developed countries as their stock markets boomed, encouraged an explosive increase in the authority and prestige of the economics profession.

Economists and central bank chairmen found their musings and prognostications on their countries' and the world's economies treated with oracular respect. The numbers employed in the economics profession, both in academia and in finance and industry, soared. No bank or industrial company could be without a well-staffed qualified economics team. The parallel development and expansion of virtually 24-hour-a-day television coverage of global and national markets by channels like CNBC and Bloomberg provided a shop-window for economic punditry and fed this demand.

2. The 2008 Crisis: the end of Growth

The 2008 crisis came as a body-blow to this professional complacency. It became apparent that, at least in the developed economies, much of the growth had depended on a succession of credit and asset bubbles and a massive over-leveraging, first by consumers and then by governments as they assumed the burden of the excessive levels of private debt built up during the so-called 'great moderation'.

Little attention was paid to the fact that, while globalization and the adoption of open markets was undoubtedly a key factor in the sustained growth in the global economy, an additional reason was that the economic dominance of the present developed economies, which had prevailed essentially since the Industrial Revolution of the first half of the 19th century, was in the process of being surrendered to the cost-competitive economies of the developing countries. Before the Industrial Revolution China and India constituted a much larger proportion of global GDP than the present developed economies of the Group of 7. During the recent decades of expansion the strongest growth was recorded by these major developing economies. The changes of the last 25 years are thus more accurately viewed as simply the first steps in a reversal of the 150-year economic supremacy of the developed economies triggered by the Industrial Revolution and the resumption by the developing economies of their historic dominant size in the global economy.

The 2008 crisis and the extreme and so far unsuccessful measures taken to solve it have had severe consequences. Chief among these is a significant fall in growth in the developed economies, to barely positive levels. In the USA growth is settling at below 2% p.a., about half the recent historical norm, in spite of monetary stimulus measured in US$ trillions. In Europe, Government debt in several countries in the Eurozone (including France and Italy) now approaches or exceeds 100% of GDP. Eurozone unemployment is at record levels and continues to climb. Since a rapid return to significant positive growth looks less and less likely, even in Germany with its heavy reliance on exports, the Eurozone faces prolonged stagnation. For the peripheral Eurozone countries the austerity regimes, imposed in a deluded and irresponsible attempt to restore financial health, are creating negative growth, unprecedented unemployment and immense and widespread misery. Japan is still recovering from a recession which is now more than two decades old and, thanks to very unfavourable demographics, also faces a steady drop in living standards. Thus the developed economies face persistent low growth for the foreseeable future.

Yet, over the next few decades the global economy will be subjected to intense and growing pressure from two new external social factors: population growth and resource exhaustion. Maintaining even the present reduced levels of growth will be extremely difficult. Even if the gloomiest Malthusian forebodings prove unfounded the severe effects of continued population growth and the environmental impact of resource overuse and exhaustion are already clearly visible throughout the developing world.

3. Inequality

However, these bald, high-level statistics overlook a much more pernicious and problematic human consequence of economic developments over the last 35 years and the low-growth world which is expected to prevail for the foreseeable future. This is the wide-spread jump in income inequality.

The analytical yardstick commonly used to measure an economy’s income inequality is the Gini co-efficient. A higher Gini number for a country reflects higher income inequality. In the developed countries income inequality has increased steadily over the last 25 years, with a jump since 2008 as the global slowdown has spread. In the USA the median family income (i.e. the level at which there are equal numbers of families above and below the line) is now 9% below its level in 1999. The rewards to labour have fallen sharply, while corporate profits and especially the rewards to management, have soared. According to a recent study by Bloomberg, the average Fortune 500 CEO in the USA now makes more than 200 times the pay of the average worker; the American Federation of Labor has calculated the multiple as 354 times. Either way this figure has more than doubled since 2000 and increased 10 times since 1950. More than 40% of the US population now lives on food stamps and a similar figure have no health insurance. In France and Italy continuously rising unemployment and pressure on the public finances has not led to any revision of the remuneration and benefits of the vast numbers of public sector employees which have for long been significantly above those prevailing in the private sector.

In the developing economies income and wealth inequality shows itself differently. The creation of substantial and growing middle classes in China and India and the great success of redistributive social programmes like the Bolsa Familia in Brazil have greatly and admirably reduced poverty in these countries but have gone hand-in-hand with the accumulation of extraordinary wealth by the political and financial elites. In China a recent study showed that the 70 richest members of the National People’s Congress, the national legislature, had a combined wealth of US$ 90 billion and, as a recent report by the Financial Times disclosed, the wealth of China’s ruling political families, the members of the Politburo, is measured in US$ hundreds of millions during a period when the vast numbers of the very poor in China have faced the disappearance of the welfare support of Mao’s iron rice bowl.

4. Welfare Systems: the big squeeze

The developed economies still, just, represent 50% of the global economy and are the home of most examples of redistributive social and welfare systems but these systems are now under huge pressure as the financial crisis of 2008, and the global slowdown which is its aftermath, squeeze economies and public finances. If the global economy has now entered an extended period of low growth, the developed economies will face enormous social and political pressure in the years to come. Until the 2008 crisis it was, just about, possible to argue that a rising tide of growth was raising all boats and that the enormous benefits being awarded to executives were matched by better working conditions for the average employee. Since the crisis this view has been shown to be manifest nonsense.

Developed economies therefore face an immense and stark problem: how to maintain social peace in a low-growth world where the financial surplus available from taxable profits and income for redistribution in welfare benefits to the worse-off is under continuous downward pressure. Generally lower living standards are the almost certain outcome for the populations of the developed countries.

Unless there is a fundamental shift in the structure of human economic and social relationships in the developed economies and in the present psychological perception of entitlements and obligations, these societies can look forward to a prolonged period of severe social unrest. The prevailing ethical concepts underlying human economic and social behaviour will need to adapt fundamentally to the new regime of prolonged austerity.

5. Inequality and the social sciences: Economics and Political Theory

Recent thinking in the social sciences, particularly Economics and Political Theory or Ethics, which has undergone its own evolution over the last decades will not be of much help in the search for a solution to the problem of inequality.

Economics

The crisis of 2008 destroyed at a stroke the complacent confidence of economists and economics advisors that they had solved the fundamental problem of sustained growth. In a Congressional hearing in October, 2008, Alan Greenspan, then chairman of the US Federal Reserve, admitted that when the Lehman Brothers crisis struck, none of the Fed's economic models worked, 'not one... across the board'. During this period, as noted earlier, the profession of Economics, both academic and applied, has experienced explosive growth in numbers, prestige and influence. According to its website, the Fed now employs 250 academically-qualified economists, a large proportion of whom are PhDs. This disastrous failure has exposed the shortcomings, both theoretical and practical, of the prevailing official economic theories and models. With very few notable exceptions, the leading figures in the economics profession, many of them directly responsible for economic policy, failed entirely to foresee the crisis. Furthermore, nothing the macro-economists have done since then suggests they are about to redeem this failure.

(There is of course a continuing question whether economics should be considered a science at all. It is very difficult to apply the title of 'science' to a process which can arrive at diametrically conflicting conclusions from the same set of data. In this respect it is instructive to read the speech given by Friedrich von Hayek, accepting the Nobel Prize for Economic Science in

December, 1974, firmly repudiating the notion that economics is a science.)

In micro-economics - the analysis and explanation of the behaviour of individuals and companies as economic agents in limited and specific situations – an empirical analytical approach has seen some explanatory success. Nonetheless these successes are of minor and subsidiary importance, tinkering at the margins of economics. The problem is that economics, and most economists, prefer to deal with human beings in the aggregate and to propound abstract theories which have little or no demonstrable and reliable basis on how human beings actually behave in the real world. The methods of economics and econometrics lend themselves easily to theoretical abstraction. The common practice is for projections of economic behaviour at both the macro and micro levels to be generated from selective and reductive aggregate historical statistical data and given a specious semblance of precision and accuracy by being presented in elaborate mathematical form, typically opaque even to the educated layman. Human beings, whether individual agents as consumers, debtors, or investors, or collective groups such as firms, are treated as economic abstractions.

Political and Social Theory

Recent thinking in the fields of political and social theory has been no more helpful in pointing the way towards possible solutions to the problem of inequality.

The most notable recent contributions have centred round two more or less opposing theories. One, springing from the concept of fairness developed by John Rawls (in ‘A Theory of Justice’), is a structure of ethical obligation which has usually been interpreted as favouring redistributive and egalitarian social policies. The other is based on the concept of the primacy of individual liberty and is associated with the work of Robert Nozick (in 'Anarchy, State and Utopia'). Yet both these theories focus on human relationships and rights in the abstract. This is certainly the language in which philosophical and political ideas are normally expressed but the corollary is that they ignore entirely the actual way in which human beings experience and act on moral obligations in real life, whether in the family, the tribe, the company they work for, or their country. (In the case of their employment of course, their relationships are mainly bound by obligations which are based on formal contracts; these relationships are therefore essentially different from the relationships arising within families and other non-contractual relationships.)

Present concepts in both Economics and Political Theory, therefore, are dominated by theories which are unremittingly abstract and have little basis in the way human beings actually behave. Consequently they give little help in finding a solution to the looming problem of the consequences of low growth and rising inequality. In Economics the structures within which individuals are assumed to operate are fundamentally unrealistic but above all impersonal, ignoring entirely the varied range of natural human responses of mutual value, respect and esteem besides those of duty, obligation and rights.

6. The Lucky and the Unlucky

Before the Industrial Revolution, the economic structure of the major countries was dominated by agriculture and the social structure by a rigid, formalized system based on social class. While exceptionally talented individuals could rise, as they have in any period, the structure was essentially static: an individual's chance of a comfortable material existence depended chiefly on the accident of his birth. It depended, in other words, on the luck of his social endowment.

The Industrial Revolution opened the door to the development of a much looser, dynamic economic and social structure and over time this became the modern free-market capitalist model, the efficient growth-engine which has been responsible for the sustained acceleration in global economic growth and the enormous improvement in human well-being of the last 60 years. For the average individual in a major economy the new structure proved a great liberation. The economic growth generated by the Industrial Revolution created an expanding, varied and adaptable market-place where a talented individual could for the first time have a realistic chance of improving his material standard of living by his own efforts. Social mobility was enormously enhanced.

Nevertheless, there were from the start winners and losers. The creation of a growing middle class in Victorian England was offset by the parallel growth of a substantial under-class of urban poor, well described by Charles Dickens in 'Hard Times ', and an exactly similar economic and social process is now under way in China and India.

If, before the Industrial Revolution, material improvement depended mainly on the accident of an individual's inherited social position, it now depends mainly, even in the developed economies, on talents and abilities which are essentially accidents of genetic inheritance. Even in the developed economies, therefore, a person's chance of achieving a comfortable standard of living is still fundamentally a matter of luck.

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If this is so, the relationships of social obligation need to change. The successful have a responsibility to contribute more equitably towards alleviating the hardship of the unsuccessful unlucky, those who have had worse luck, genetically or socially, in life's lottery. The principle should be, as is almost universally the case in the real world of obligations among families, tribes and other social groups, that the lucky look after the unlucky. Since social security systems will now be under enormous pressure it is therefore appropriate and desirable that the better-off should accept, as individuals, an obligation to play a much greater, more organized and more personal role in looking after the worse-off.

In modern developed economies this responsibility is largely discharged impersonally through comprehensive welfare systems redistributing tax received from the better-off to the worse-off. The increasing size and extent of these systems, covering health care, unemployment benefits, education etc., though regretted by some, has constituted a massive, civilizing reduction in human want and misery. The system is, however, impersonal and has the unfortunate psychological consequence of casting the tax payers and the benefits receivers in the roles of adversaries competing for the favours granted by the central government.

It is perhaps fanciful to admire, and regret the passing of, the human structure of mutual respect and concern between family members and their servants portrayed in the television series 'Downton Abbey' but it is easy to believe that part of the great popularity of this programme (and of the earlier Upstairs, Downstairs) springs precisely from this essentially equitable sense of mutual human dependency and esteem: the better-off looking after the worse-off and vice versa, the lucky looking after the unlucky. Unless the societies of the developed economies are able in some way to recover this sense of mutual personal obligation they face a turbulent future.