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The perils awaiting Conservatives who seek to reduce inequality

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Inequalities of wealth and income in the U.K. are bad and the Conservatives should embrace left-wing policies to reduce them. So concludes Tim Pitt, a former adviser to Savid Javid and Philip Hammond, writing for the Social Market Foundation.

As with most Tory egalitarian calls, Thatcherites are his boogeymen. One Nation Conservatives have always cared about inequalities threatening our political and social fabric, he says, but were "drowned out" by economic liberals from the 1980s onwards. Now, Pitt considers the authoritative evidence in: inequality hinders social mobility, impairs long-term economic growth, and undermines political stability. The growth-chasing, equal opportunity-declaring Thatcherites were thus wrong on their own terms. It is time to Make Economic Conservatism One Nation Again.

Much (besides this potted history) perturbed me in Pitt's essay: the constant conflation of income and wealth inequality, the very partial reading of empirical literatures, and the shifting yardsticks to judge whether inequality is "too high". On income, for example, OECD comparisons are used, showing the UK at the high end; for wealth inequality, no cross-country comparisons are forthcoming (hint: the UK has unspectacular levels of wealth inequality internationally, with a Gini coefficient lower than in Germany, Sweden or Denmark).

But Pitt ignores the fundamental disagreement most economic liberals have with him about how to think about an income or wealth distribution. He talks about these as if they are themselves independent variables, that can both be easily manipulated and which then determine other economic outcomes. Like Angus Deaton, the Nobel prize winning economist, I think this gets the story about inequality, and what it means, back-to-front.

When we talk of "inequality," what we are really describing is a snapshot, summary statistic of the distribution of wealth or income across the economy. This is itself shaped by millions of past and present trades, investment, business, and education decisions, inheritances, policies, demographic trends and more. "Inequality," then, "is not so much a cause of economic, political, and social processes, as a consequence," as Deaton explains.

Three implications follow from this pretty uncontroversial observation. First, that inequality cannot be denounced "good" or "bad" per se, without assessing what has caused it. Second, that "solutions" to inequality are not created equal. Some might unpick bad causes, such as ill-gotten gains from cronyism; others might deter activity enriching us all. Third, saying "reducing inequality" is central to your economic platform, causes be damned, shows a willingness to trade-off other economic goals, whether reducing poverty, raising growth, or more.

Take a cross-country example. According to Credit Suisse, Sweden, the U.S. and Russia all have near-identical levels of wealth inequality (Gini coefficients of 86.5, 85.2, and 87.5, respectively). This shows that wealth inequality is a useless metric for any reasonable conception of economic health. But thinking through the causes is illuminating.

In Sweden, high wealth inequality is driven in part by a hugely expansive welfare state. Generous government entitlements mean the middle-classes have much less relative need and means (due to high taxes) to save and build up private assets. That government entitlements are non-heritable (relatively more of the poor's wealth being tied up in them) also tends to widen measured private wealth inequality further. So though a big welfare state might reduce *income* inequality, it tends to increase private wealth inequality.

In the U.S., high levels of wealth inequality are instead driven significantly by income inequality, in turn arising from a globalised economy. Top entrepreneurs, sports stars, and CEOs often lead "winners take all" markets, earning high incomes and building up assets. Yes, this is not the whole story. There's cronyism and lack of competition in some markets too. But it should go without saying that this is a far less significant driver than in Russia, where wealth inequality often reflects corruption (indeed, very high wealth inequality is common in crony-capitalist economies).

By not analysing what drives inequality (in the UK or elsewhere), you therefore risk making big policy mistakes in reducing it. Does Pitt really think wealth inequality in Sweden is as worrisome as Russia, and necessitates similar responses? Surely not. Blanket denouncements (inequality bad, equality good) make one susceptible both to ignoring obvious follow-up questions and to wishful thinking about solutions.

If income and wealth inequality are "too high," as Pitt claims, then what are the right levels? If reducing inequality would, in his utopia, be a central aim of government, then how would he weigh its pursuit against other goals? He calls for more redistribution, for example. But what if this widened wealth inequality while lowering income inequality?

Consider another pertinent example. A government social insurance system for social care would widen wealth inequality, by protecting the assets of wealthier social care users with much higher life expectancies. Would Pitt reject this policy given this consequence? Or would other considerations dominate?

To avoid such tough questions, egalitarians tend to reach for bad cross-country studies suggesting that reducing inequality is "win-win." One OECD paper claiming that lower inequality is "good for growth" is central to Pitt's particular case.

Now, there are big problems with this degree of aggregation and ignoring within-country stories. China has become much more unequal as it has liberalised, but this has clearly been good, on net. In other countries, rising cronyism has seen both growth-sapping while widening inequality. Generalising across countries in terms of implications for policy is therefore very dangerous.

Delve deep into the underlying OECD paper and you see already how confusion can reign. Yes, this paper finds inequality and growth negatively statistically associated. But the results make clear this is about inequality between the poorest and the middle-classes. The paper explicitly says: “no evidence is found that those with high incomes pulling away from the rest of the population harms growth.” Yet Pitt’s policy prescriptions are highly focused on taxing the rich more.

One Nation Tory-types likewise reach for economic explanations for Brexit and Donald Trump, buying into the idea this “rise of populism” is caused by inequality breeding political instability. But is Britain really less stable today than during the 1970s industrial strife, when inequality was lower? That’s subjective. But we are certainly happier today. Again, such sweeping statements about equality’s benefits are pretty dangerous as a guide. Historically, mass mobilisation war, communism, state failure and plague have been necessary to cause big reductions in economic inequality. This hardly seems likely to improve political stability.

In all then, Pitt’s arguments for a new Tory egalitarianism are unconvincing. Evidence that inequality is a key *driver* of slow growth or political dysfunction here is weak. And in failing to analyse inequality as the end result of complex economic forces, his proposed policy agenda seems muddled, at best, and highly risky at worst.

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