

David Bromell

# Income Inequality and the Economy of Ideas

## Growing unequal

Among OECD countries, New Zealand has moved from having relatively low income inequality in the early 1980s to having above average inequality by the mid-2000s (OECD, 2008). Research conducted by Bryan Perry (2009) at the Ministry of Social Development shows that in New Zealand in 2008 the percentile ratio of income inequality (equivalised disposable household income before deducting housing costs) for P90 (top decile) to P10 (bottom decile) was 4.0, compared to 3.3 in 1984. The ratio for P80 (top quintile) to P20 (bottom quintile) for before-housing costs in 2008 was 2.6, compared to 2.3 in 1984.

Those ratios are calculated for household incomes and over the population as a whole, in order to assess trends over time and to provide internationally comparable

data. Of course, there are much greater inequalities at the level of individual income. The ratio for P80 to P20 for individual incomes in New Zealand's working-age population (aged 18 to 64) in 2009 was around 5.5.

In the state sector the salary bands of chief executives and the vice-chancellors of universities are a matter of public record (State Services Commission,

2009). The ratio of the mid-point of bottom to top salary bands in public service organisations is not 2.6 or 5.5 but, on average, approximately 11.0. Things are marginally less equal in the university sector, where the ratio is, on average, approximately 13.0. In the private sector, I estimate that the ratio between the mid-point of the average salary of a call centre operator in New Zealand (\$37,500) and the value of the 'compensation' package paid to Paul Reynolds as chief executive of Telecom in the year to 30 June 2009 (an estimated \$7.2 million according to the *National Business Review* (2009)) is 191.0.<sup>1</sup>

Even the least sceptical may wonder whether one employee is capable of providing, on average, value for money for one hour of work that is 11, 13 or 191 times greater than that provided by a fellow employee.<sup>2</sup>

I am personally inclined, moreover, to the idea that inequality damages democracy. For New Zealand to be viable in a global economy, we need effective democracy as well as efficient markets. As John Myles (2007, p.18) puts it: 'Markets need democracy to make

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David Bromell is a principal advisor in the Ministry of Social Development and a senior associate of the Institute of Policy Studies. This article is based on notes prepared for a symposium on economic inequality hosted by the University of Otago on 9 June 2010.

market economies viable for people.' Marked income inequality risks damaging democracy to the extent that it creates two publics: one preoccupied with making ends meet, the other with keeping and growing its wealth; whereas effective democracy depends on a common public in which citizens see themselves as 'all in the same boat' (Cunningham, 2007; Dewey, 1927).

#### 'Equality is better for everyone'?

Richard Wilkinson and Kate Pickett in *The Spirit Level: why equality is better for everyone* (2010) present a significant body of evidence that there is a strong association between social stratification, and specifically economic inequality, and health and social problems in developed nations. The evidence they present suggests that 'we are affected very differently by the income differences *within* our own society from the way we are affected by the differences in average income between one rich society and another' (Wilkinson and Pickett, 2010, p.11, italics theirs). In fact, 'when we make comparisons between different societies, we find that these social problems have little or no relation to levels of *average* incomes in a society' (ibid.). They acknowledge that association does not prove causality, and that even if there is a causal relationship, this does not tell us what is cause and what is effect (pp.190–6). Their book 'simply points out that if you increase the income and status differences related to these [health and social] problems, then – unsurprisingly – the problems all become more common' (p.196).

They assert, moreover, that the ill health and social problems associated with income and status differences affect all members of an unequal society, not just those at the bottom, although it may disproportionately affect those who are relatively least well off.<sup>3</sup> The solution they propose (ibid., pp.238–9) to persistent and interconnected social problems is neither discrete and siloed interventions, nor 'joined-up' services and programmes to address the symptoms of distress within the health, education, justice and welfare sectors. What is required is a concerted programme to address the *cause* of negative social outcomes by reducing economic

inequality and social stratification and improving social mobility at the bottom. As Runciman (2009) puts it, Wilkinson and Pickett invite us to stop trying to join everything up, and to start seeing how it all fits together.

Turning a 'big idea' like that into public policy comes, however, at a price. The cost can be cognitive, economic and political.

#### *Cognitive price*

First, ideas come with a cognitive price because claims as to truth, or value, if they mean anything at all, may at least partially exclude other claims to validity.

For example, the late Brian Barry, a self-styled 'democratic socialist', proposed (1998, pp.22–4) that in order to avoid social exclusion, nobody ought to have less than half the median income, and only a few ought to have more than three times the median income. That is, the ratio of the top income to the bottom income in a society ought not to exceed six to one.

public policy on the 'trickle down' notion that if only the wealthy are able to earn more and keep more of their wealth, they will have an incentive to work harder, invest more, take more risks and drive economic development, which will eventually benefit those at the bottom. These ideas are mutually exclusive, at least in part. (We would also have to let go of some of our operative thinking about merit, risk, reward, 'do it yourself' and 'free loading'.)

Even if ideas and ways of thinking do not logically exclude one another, partially or completely, they can crowd each other out of thinking space and public discourse. For example, since the late 1980s New Zealand's population has become significantly more ethnically diverse, due to higher Māori and Pacific fertility rates, inter-ethnic partnering and parenting, and changing patterns of migration. New Zealand today has a more ethno-culturally diverse population than

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Median weekly income in New Zealand for all people aged 15 years and over from all sources (including for people with no source of income) in the June 2009 quarter was \$538 (Statistics New Zealand, 2009). Barry's proposal implies that no New Zealander should have a gross weekly income of less than \$270 (\$14,000 per annum) or more than \$1,600 (\$84,000 per annum).

If we think that Barry, and Wilkinson and Pickett, are right, then we cannot consistently maintain, at the same time, that in the absence of externalities and other sources of market failure a market free of policy intervention will allocate resources efficiently. Nor can we base

many other developed nations (Bromell, 2008, pp.21–57). This diversity, together with the Māori resurgence and Treaty of Waitangi settlements process since the mid-1970s, has meant that public discourse for over 30 years has been dominated by a politics of identity rather than a politics of social stratification, social mobility and economic equality. This 'crowding out' of a politics of equality is regrettable, because, at least in the short run, immigration and ethnic diversity tend to reduce social solidarity and social capital (Putnam, 2007). When public discourse focuses on social group identities, rather than on the common good and the norms of mutual support that underpin redistribution

within a welfare state, political will to address economic inequality can be seriously compromised (Bromell, 2008, pp.295–9; 2009; cf. Banting, 2005; Banting and Kymlicka, 2006).

The cognitive, or at least rhetorical, price of a politics of equality is that we may have to focus less on our differences than on what we have in common; less on social group identities and special rights than on our common identity, our common needs, our common good.

## The issue is rather that government has not thought through its policy interventions as a coherent package that is explicitly designed to reduce social stratification and economic inequality and to promote social mobility at the bottom.

### *Economic price*

Secondly, ideas come with an economic price. This takes us to the core business of public policy: the definition and analysis of problems; the identification of options; evidence-gathering about correlation, causation and ‘what works’; and the calculation of cost-benefit and trade-offs, who pays, risks and their mitigation, and contingency for unintended consequences.

Wilkinson and Pickett emphasise that what matters is the level of inequality we finish up with, not the particular route that gets us there (Wilkinson and Pickett, 2010, pp.245–7). They nevertheless outline two broad strategies: one using taxes and benefits to redistribute income; the other achieving narrower differences in gross market incomes before any redistribution. Both strategies come at a price.

New Zealand is a small, geographically isolated country with an open economy, a highly mobile population and a limited talent pool, operating within a competitive international labour market. Redistribution through tax and transfers, or a cap on higher salaries, run the risk that a larger number of those with the

drive to get ahead will emigrate and take their capital, skills and entrepreneurial attitudes with them. As it is, around one million New Zealanders (about one in five) are currently living overseas.

On the other hand, unless accompanied by greatly improved labour productivity, raising gross incomes at the lower end by increasing minimum wage rates will drive up the price of goods and services and make New Zealand exports and tourism products less competitive.

Raising benefit levels would have a fiscal impact on the Crown accounts. It could also create a disincentive to employment and independence, when there is strong evidence that the best route out of poverty, at least for the vast majority, is through paid work. Long-term work absence has, in general, a negative impact on health and well-being (Royal Australasian College of Physicians, 2010).

Reducing inequality within a society in order to address the cause of health and social problems could well be a good idea. But talk is cheap unless practicable proposals are developed to implement this ‘big idea’, with robust analysis of who will pay and how, and of the price we, as a society, will put on equality, as on our present levels of inequality.

There is, in fact, a range of conceivable options that, in some combination or other, could reduce social stratification and economic inequality:

- public investment in the early years, and in health and education services generally, to enable upwards social mobility at the bottom;
- investment in state housing and income-related rents;

- economic and regulatory reform, immigration policy, and investment in infrastructure, research and development, capital per worker, and education and training (including significantly raising management skills and performance), to improve labour productivity and create a high-wage economy;
- active labour market policies to move people off welfare and into sustainable employment;
- employment law which discourages both under- and over-employment;
- redistributive policies implemented through tax and transfers;
- policies to promote economic democracy and greater equality in gross incomes before taxes and transfers: for example, the setting or raising of a minimum wage, the introduction of a guaranteed minimum income, and/or a ceiling on remuneration at the top, at least in the state sector;
- encouragement of collective bargaining of wages and terms and conditions of employment;
- tax policies and social marketing to encourage volunteering and philanthropy and otherwise support a strong community and voluntary sector; and
- investment in public broadcasting, and in institutions, urban design, public transport and public space, so that citizens of all sorts can rub shoulders, encounter the reality of one another’s lives, build social capital and social cohesion and constitute a common public.

All these options come at a price and their cost-benefit needs to be calculated within a fiscal context that determines certain limits to and opportunities for what can be undertaken at any particular point in time. And in fact, none of these has been entirely absent from government policy during the period inequality has grown in New Zealand society. The issue is rather that government has not thought through its policy interventions as a coherent package that is explicitly designed to reduce social stratification and economic inequality and to promote social mobility at the bottom. The focus has been rather on ‘baking a bigger cake’

and 'the rising tide that lifts all boats', with a great deal of public expenditure on programmes and services (whether ameliorative or merely palliative) to relieve the symptoms of social distress.<sup>4</sup>

#### Political price

Thirdly, ideas, and especially big ideas, come with a political price.

The job of democratically elected politicians is to develop, promote and vote for policies that express the will of the people they represent in Parliament. The 2005 and 2008 general elections were contested, in significant part, over tax cuts. The National-led government elected in 2008 has delivered these, in a relatively even-handed manner, to general approval.

The prime minister has made much of the 2010 tax changes as being 'fairer' (Key, 2010a). They are fair, if fairness is construed as a roughly proportional impact across all income bands, rather than as a narrowing of the gap between rich and poor. The Treasury has estimated the impact of the tax changes as a percentage of average disposable household income across all income bands as between 0.4 and 0.7% (English, 2010b, p.9). The tax measures announced in the 2010 Budget will probably make no measurable difference to income inequality in New Zealand. Indeed, in a pre-Budget warm-up the prime minister urged Kiwis not to be jealous if the rich get more – 'because the rich are crucial to the economy' (Key, 2010b).

If Wilkinson and Pickett's 'big idea' is to get any political traction in New Zealand, then the electorate will have to want, and demand, a different kind of fairness, a different kind of future New Zealand.

The *New Zealand Listener* recently highlighted some findings of Massey University's Department of Marketing's International Social Survey Programme (*New Zealand Listener*, 2010).<sup>5</sup> When the respondents were asked 'Are income differences in New Zealand too large?', 62% said yes, compared to 75% in 1999 and 72% in 1992. When asked 'Should people on higher incomes pay a larger share of their income in taxes than those on lower incomes?', 53% said yes, compared to 60% in 1999 and 71% in 1992. When asked

'Should the Government reduce income differences between people?', 40% said yes compared to 52% in 1992.

A similar shift in values was evidenced in a 2010 UMR Research survey of 750 people (*ibid.*, p.15).<sup>6</sup> To the statement 'Inequality continues because it benefits the rich and powerful', 44% agreed, compared to 60% in 1992. To the statement 'Large income differences are necessary for New Zealand's economic prosperity', 32% disagreed, compared to 60% in 1992. These findings are consistent with those of the New Zealand Election Study (<http://www.nzec.org/>) and give little hope that the electorate will demand a reduction in income inequalities any time soon.

A democratically-elected government, if it wishes to retain power, will implement policies that reflect its manifesto commitments and electoral mandate. To do otherwise, even from the highest of ethical motives, courts failure in the polls. Wilkinson and Pickett concede that, in fact, 'governments have usually not pursued more egalitarian policies until they thought their survival depended on it' (Wilkinson and Pickett, 2010, p.241).

**A New Deal for the 21st century?**  
Wilkinson and Pickett invite 'a historic shift in the sources of human satisfaction from economic growth to a more sociable society' (*ibid.*, p.231). They suggest that developed nations are 'close to the end of what economic growth can do for us' (p.5). They urge developed nations to trade off an economic growth path and material consumption against improvements in quality of life as measured by health, happiness, friendship and community

#### A New Deal for the 21st century?

life, and to do so in ways that are environmentally sustainable and that will both mitigate against and adapt to climate change.

There seems to be little political will in New Zealand at present for such a New Deal, and that is unlikely to change unless an alternative vision of society captures the hearts and minds of New Zealanders. Short of a national crisis to shake things up (a major earthquake in the capital? a volcanic eruption in the Auckland region?), building the case for a politics of equality will be a long-term

task. Specifically, we need to improve our understanding of:

### ... [Wilkinson and Pickett] urge developed nations to trade off an economic growth path and material consumption against improvements in quality of life as measured by health, happiness, friendship and community life,...

- when and in which respects inequality is bad for almost everyone, and when poor outcomes exhibit strong social gradation and why;
- whether, in which respects and to what extent the relationship between economic inequality and poor social outcomes is one of causation rather than correlation;
- the relationships that prevail over time between income inequality, skills, labour productivity, social capital and the efficient operation of economic markets;
- social mobility in New Zealand, particularly at the bottom and in terms of urbanisation and the geographical clustering of disadvantage;
- life-course and intergenerational accumulation and transmission of advantage and disadvantage; and
- the dynamic relationships between ethno-cultural homogeneity/diversity, social capital and attitudes to income inequality and redistribution.

Above all, a politics of equality will require a great deal of public debate about the kind of society we want to create here and the price we are willing to pay, now and in the future, to achieve it.

- 1 See further Wilkinson and Pickett (2010, p.250) on the ratio of CEO pay to average worker pay.
- 2 New Zealand responses to the International Social Survey Programme on perceived deserved incomes for a company

- 3 Runciman (2009) points out that Wilkinson and Pickett fudge an important distinction between the claim that in more equal societies almost everyone does better, and the claim that everyone does better on average. Compare the sub-titles of various editions of *The Spirit Level*: 'why more equal societies almost always do better'; 'why greater equality makes societies stronger'; 'why equality is better for everyone'.
- 4 New Zealand currently spends close to \$51 billion (72% of core Crown expenditure, or 25% of New Zealand's nominal GDP) on social security and welfare, health, education, and

law and order (English, 2010a).

- 5 The New Zealand survey was conducted in 2009 by a mail survey of around 1,000 responses. Some questions were not asked in 1999. Margin of error of  $\pm 3\%$  or less (at the 95% confidence level).
- 6 Margin of error of  $\pm 3.6\%$  (for a 50% figure at the 95% confidence level).

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