The everyone economy: how to make capitalism work for all

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Martin Sandbu, *The Financial Times*, July 3, 2020

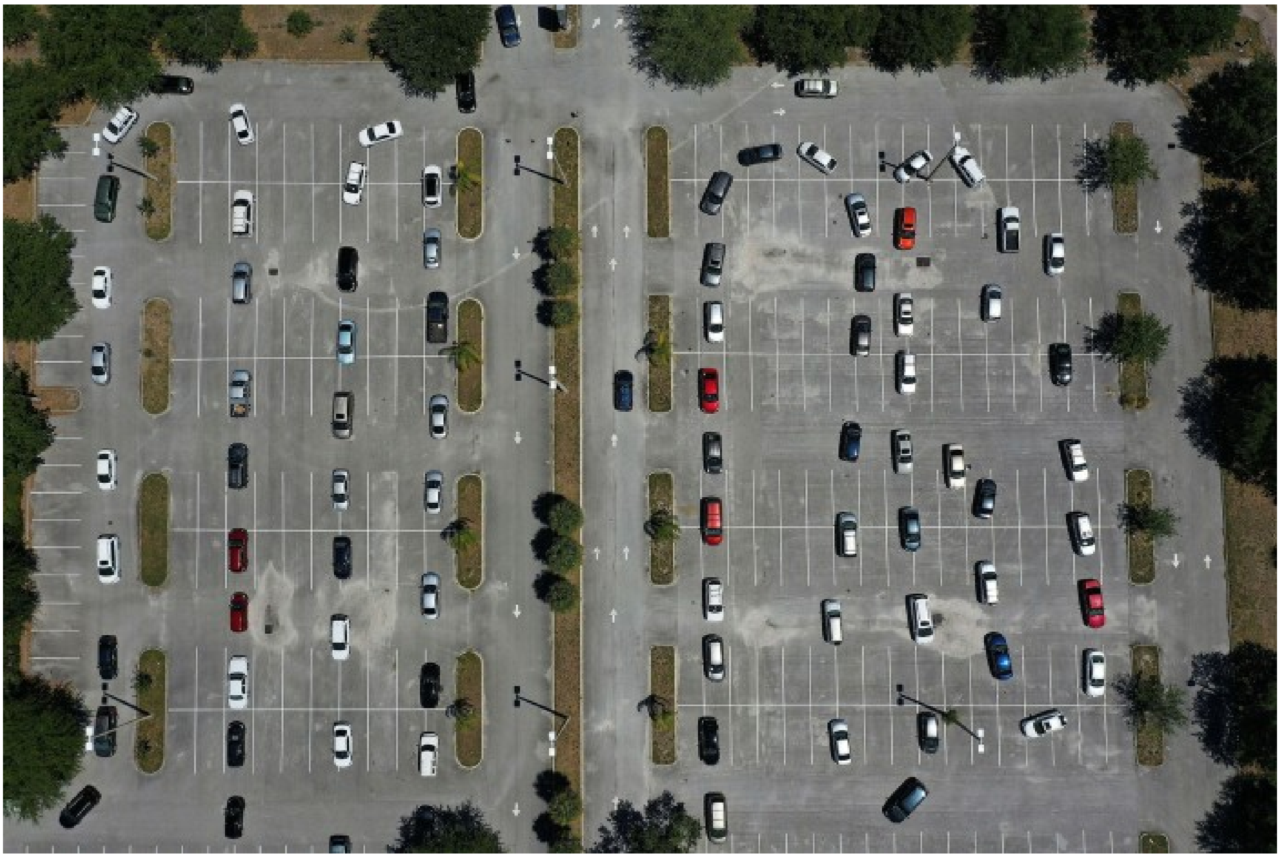
After four decades of rising inequality, the Covid crisis is a chance to change the rules

A few weeks into the lockdown, when UK Covid-19 deaths were hitting a thousand a day, I crossed my London street to check on a neighbour. Around 50, she does not fall into a vulnerable category, but she works at a supermarket checkout and has been more exposed to contagion than most. And we had not seen her for a while, which was unusual.

As it turned out, our neighbour was fine. With a pavement between us, we chatted about how she was not allowed to wear a face mask and gloves at the till. Then she said: "But I have to go to work, otherwise people won't be able to buy their food, will they?" It was not a complaint, but an expression of pride in her new-found status of essential worker.

That pride reflected the public appreciation suddenly afforded a group that had previously been treated with neglect. The pandemic and the lockdown brought home how we literally depend for our lives not just on doctors and nurses but also on the humbler jobs of cleaners and care workers, shelf-stackers and bus drivers, delivery couriers and cashiers. The weekly clap for carers, which in March became a national ritual in many European countries, embodied this new recognition.

Pondering this fleeting moment of moral reordering, I could not help noticing how starkly it clashed with the underlying economic reality. In many rich countries, decades of economic polarisation have left people like my neighbour not just underpaid, but having to accept short-term contracts, erratic shift patterns and unpredictable earnings. This "precariat" faces debilitating insecurity, which lockdown has made worse. As the *gilets jaunes* protests in France illustrated, many people see the economy as a system to which they do not belong, rigged to benefit others.



Cars queue outside a food bank in Orlando in May © Zuma Press / eyevine

How did it come to this? How did much of the work we count as essential become ill-rewarded and precarious? And what has economic polarisation done to the way our societies and politics function? These are questions that Covid-19 forces us to confront.

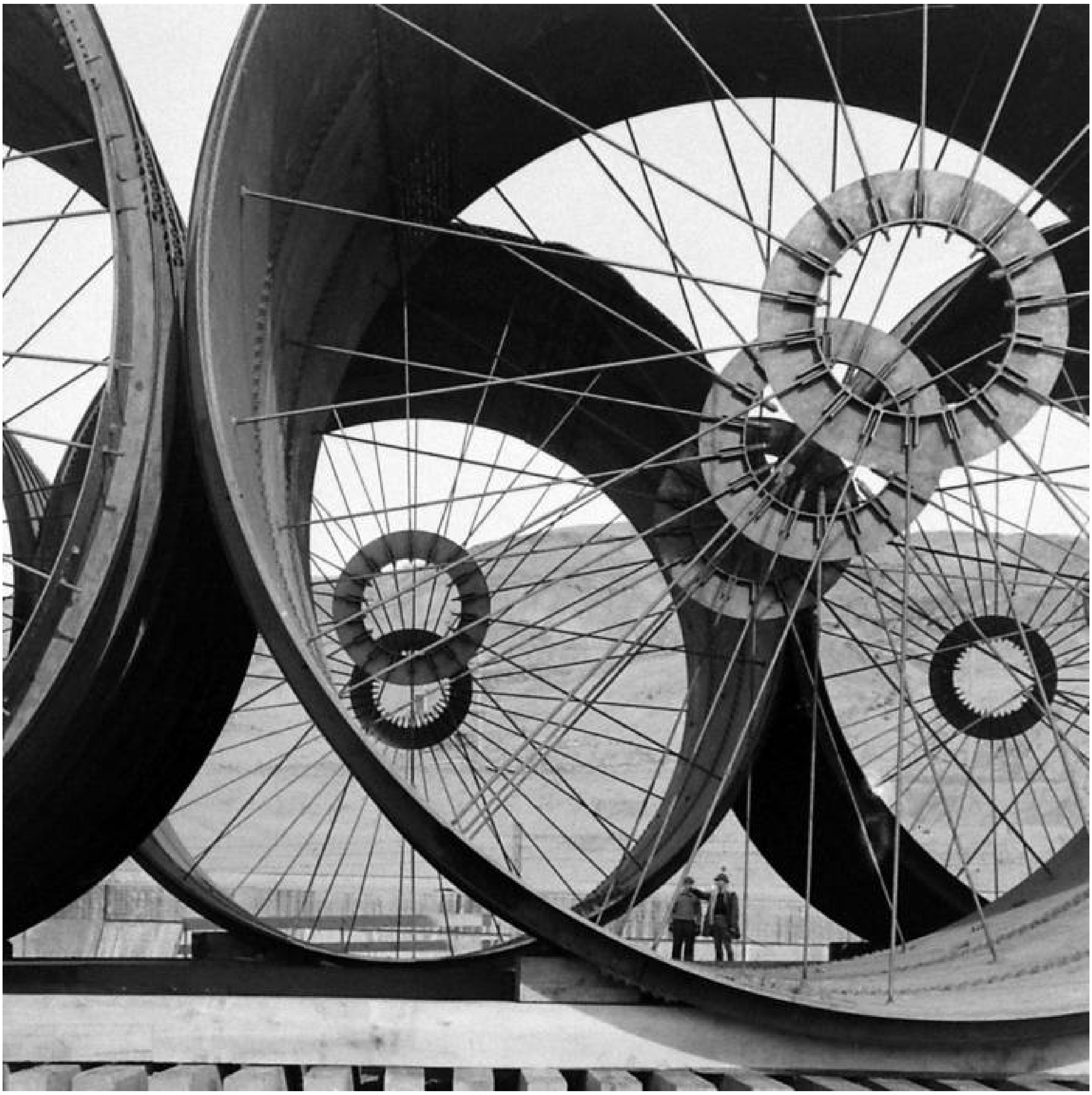
They were becoming hard to ignore long before this crisis. As an economic commentator for the FT, I have spent years trying to understand the causes of economic polarisation in the western world, its effects and what policies might reverse it. Like many others, I have worried that when our societies divide economically, they also fall apart culturally and politically.

But the pandemic makes these questions more urgent, and adds a new one: will Covid-19 remake society? Is this tragedy also a once-in-a-lifetime opportunity to rebuild better economies?

It is tempting to think we could be at a 1945-style moment, a year remembered as ushering in a new era. As Branko Milanovic, the economist known for his work on global inequality, writes, it is “utterly wrong to believe that history does not matter and that the social and political changes wrought by the pandemic can be ignored”. The political forces it has set in motion, he suggests, “will fundamentally affect how economies behave in the future”.

The pandemic also highlights forces that were already at work. Donald Trump, the architects of Brexit and populist movements across Europe all advanced by appealing to groups that felt forgotten by elites and saw the economic system as rigged against them.

They have, in effect, been promising to restore the post-1945 era and bring about the sort of moral reordering we glimpsed in the lockdown.



Two workers stand next to giant pipe sections used to divert the Missouri River during construction of the Fort Peck Dam in Montana, 1936 ... © The LIFE Picture Collection via

… and Civil Works Administration workers in California as part of the New Deal in 1934 © Getty Images

There is a "rhetoric of how the golden days were better", says political scientist Catherine De Vries. It is obvious why such nostalgia resonates. By happy accident as well as by policy design, the postwar industrial economy of the west was particularly well-suited for most people to share in economic growth. The three decades the French call *les trente glorieuses* produced a remarkable convergence in income and wealth levels between rich and poor, between workers of different educational levels, between countryside and city.

I have a lot of sympathy with this nostalgia, having grown up in Norway in the 1970s and 1980s — a time and place that arguably came as close as any modern society to the ideal of an economy with a place for everyone. Few have ever had lower economic inequality or a shorter social distance between top and bottom, and managed to combine it with high productivity and strong growth.

When I was living in New York in the 2000s, one mundane activity struck me as embodying the economic difference between the US and Norway: having your car cleaned. On entering a New York car wash, you would be set upon by a group of workers — often immigrants — who proceeded to clean your car by hand. In my childhood in Norway, your choice was between an automated car wash or doing the job yourself.

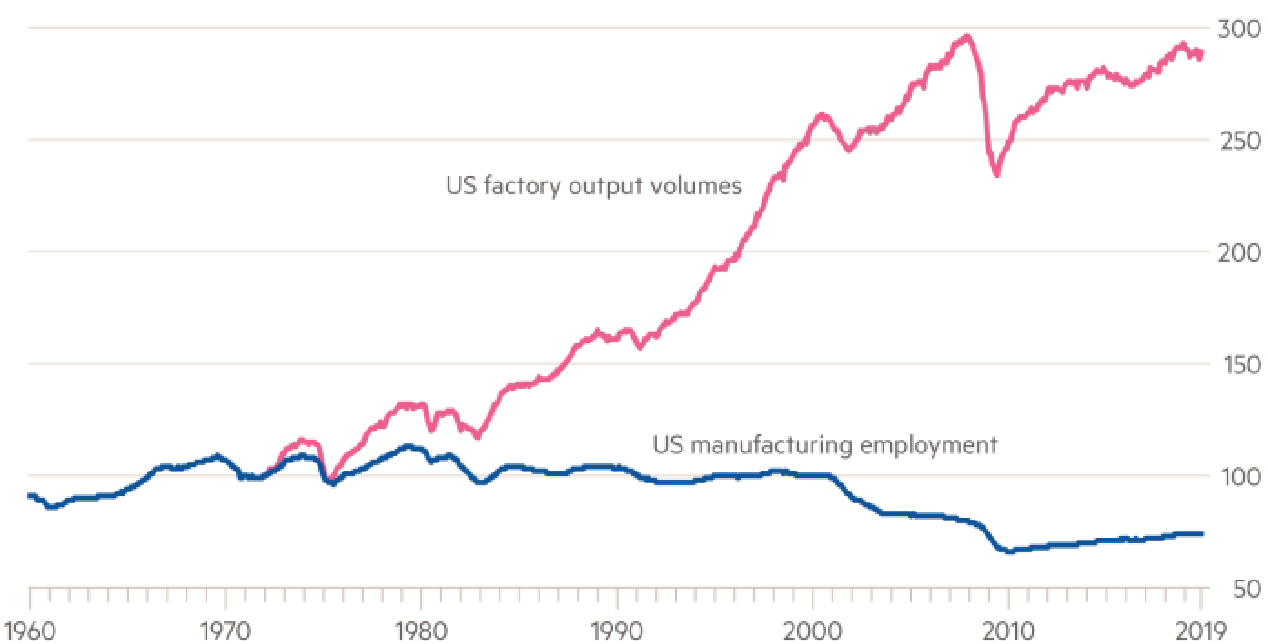
It was the difference between an economic model employing low-productivity, low-wage labour and one where wage equality made it commercially necessary to automate to make labour more productive. It was, too, the difference between the precariat and what I think of as an economy of belonging.

Since the late 1970s, every western economy, albeit some much more than others, has experienced widening economic fractures that have also polarised societies politically and culturally. We moved from an economy of belonging to an economy divided between the successful and the left behind. (*Et in Arcadia Ego*: the manual car wash has had a renaissance in Norway too, courtesy of underpaid immigrants.)

This end of economic belonging coincided with the peak in industrial employment across what used to be known as the industrialised world. It is a widespread misunderstanding that the shift from industrial to knowledge-intensive economy involved manufacturing vanishing, or being whisked off to China and other low-cost countries. In fact, most rich economies produce about as much stuff today as they ever have.

Factory jobs have disappeared but industrial production has kept growing

Rebased (100=Jan 1972)



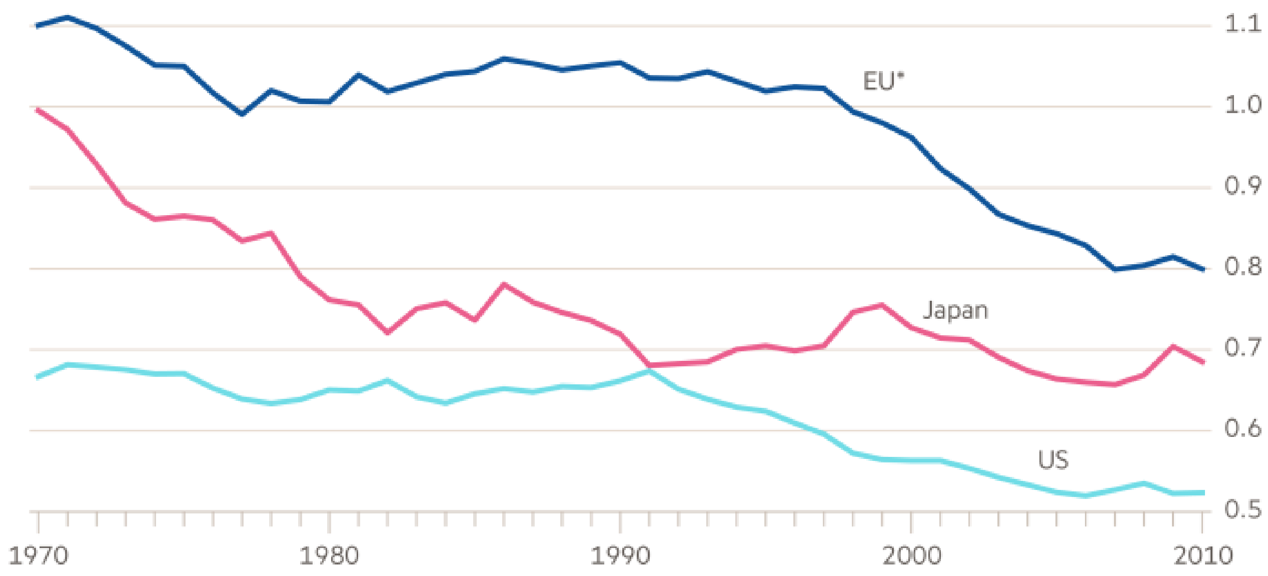
Source: US Bureau of Labor Statistics via Federal Reserve of St Louis

What changed was that factories no longer absorbed the same workforce. Growing productivity through automation and better know-how meant ever fewer hands were needed on assembly lines. New jobs were created in services but many of these were less productive, less well paid and less secure than the ones they replaced, as well as geographically distant from them. (This also meant growth rates slowed down, since manufacturing made up a shrinking share of employment even as its own productivity kept growing.)

Job-altering technological transformation did not stop with factory work. Roughnecks and dockhands gave way to automated rigs and container cranes. Computing put an end to many clerical jobs. The internet has upended in-person retail. Too often, those who rely on such jobs have had to accept worsening conditions to remain employed.

The increase in trade with poorer countries came too late to have caused the post-1980 polarisation in the rich world

Weighted average per capita income of each bloc's trading partners, as a ratio of each bloc's own per capita income



*EU=27 EU member states as of 2013
Source: Arvind Subramanian and Martin Kessler, 'The Hyperglobalization of Trade and Its Future', Peterson Institute Working Paper 13-6, July 2013, with updated data provided by the authors

These changes are not, on the whole, the fault of globalisation, that scapegoat of the populist insurgency, but of technology-driven changes combined with policies that have reinforced the underlying forces of divergence. For example, western countries shifted tax burdens away from capital and high-wage incomes even as income and wealth inequality rose. Unions, which played a part in reducing income inequality, have declined almost everywhere.

All this undermined the promise that the postwar economy had largely delivered on: that everyone could expect a secure place in the national economy. In many countries, median wages fell behind labour productivity after tracking it closely for decades. Income inequality and wealth inequality both started rising from around 1980. New jobs were not all created equal: manual and routine work lost out to knowledge work, as pay and job security increasingly depended on workers' educational background and on where they lived.

The last effect — regional inequality — is perhaps the most corrosive for our politics. The economic geographer Andrés Rodríguez-Pose calls the support for anti-system populists in peripheral areas "the revenge of the places that don't matter". Highly paid jobs and capital (but also low-paid service jobs to serve high earners) have been concentrating in the big metropolitan areas, capital cities above all, while peripheral regions have been drained of capital investment and good job prospects.

The blow from the pandemic, in other words, landed on economies already made brittle by deep fractures. And not only that; it is making those fractures worse.

Despite rising inequality, taxes on capital and high earners have kept falling

Taxation of capital and high earners (%)

Source: OECD

Lockdown causes more pain for those already suffering from low pay and job insecurity, because it preponderantly affects manual jobs that require physical presence. In the UK, one-third of the lowest-paid quintile have lost work, against 15 per cent of the top quintile, according to the Resolution Foundation. In the US, African-Americans have suffered income losses at higher rates than other groups.

Covid-19's most important political legacy could be that these pre-existing fractures can no longer be ignored. The moment of moral clarity triggered by the pandemic opens a political opportunity to "rebuild better" so as to make the economy work for everyone, including my neighbour and others like her.

Acute crises have helped reorient societies in the past. But David Edgerton, the British historian, cautions that 1945 may be the wrong reference. The postwar consensus on the welfare state was less radical than sometimes believed, he says — it was the continuation of a wartime consensus in which "Labour buys into a conservative agenda". There is also no equivalent to the postwar confrontation with the Soviet Union today, Trump's talk of a "Chinese virus" notwithstanding. According to Edgerton, "1933 is a better analogue." Like then, the question today is: "How do you get economies going again?"

The Great Depression was indeed an economic disaster so great that returning to the status quo ante was politically impossible. It produced radicalism unlike any seen today (yet): in the US, Franklin Roosevelt's hyperactive New Deal reforms; in Scandinavia, groundbreaking compromises between capital and labour; and in continental Europe, fascism. Could the economic consequences of Covid-19 spur similarly radical change, and if so, how to turn it into a force for good?

Volunteers at a church in Minneapolis take donations in the wake of protests following the killing of George Floyd by a police officer in late May © Redux / eyevine

Even before the pandemic, I frequently argued that a Roosevelt-style "centrist radicalism" was necessary to stave off a much greater — and potentially much nastier — disruption, of which signs could already be seen in the rise of authoritarian populism. What would this look like today? It would not give up on globalisation. Instead, to close the economic fractures we have allowed to open in the past 40 years, I think such a programme would need to achieve five goals.

First, it would jettison business models based on using low-productivity (and therefore low-paid) labour, and harness automation rather than resisting it. That means allowing low-productivity jobs to be competed out of existence by higher-productivity ones. Scandinavia has long shown how this can be done: high wages at the bottom of the distribution encourage employers to automate and boost productivity, while high skill levels and active labour-market policies help workers change jobs frequently and adapt to technological developments.

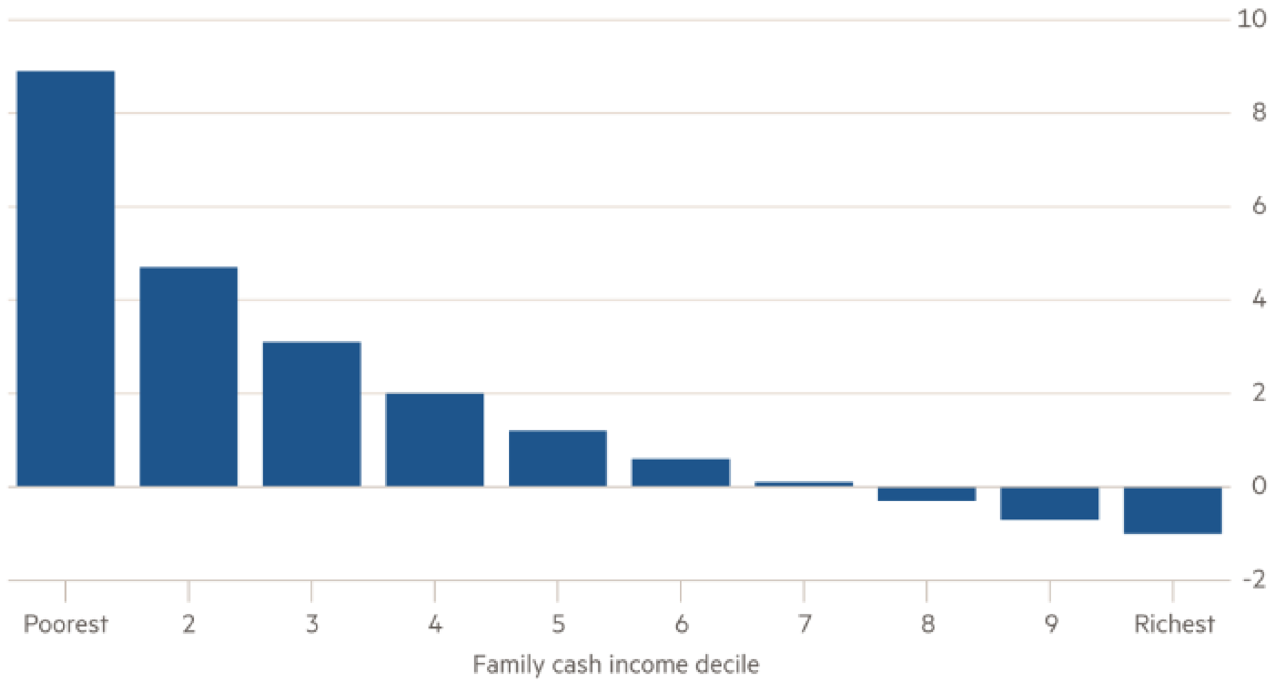
Second, the programme would aim to shift more labour-market risk from employees to employers and the welfare system. That means lower tolerance for erratic earnings that make it harder for people to plan, retrain and seek new and better work. And it means avoiding aggressive means-testing of benefits, which, when combined with tax, leaves many lower-middle earners facing effective marginal income-tax rates of around 80 per cent or more.

Together, these two principles point in the direction of higher minimum wages, a universal basic income (or its less budget-heavy equivalent, a negative income tax), generous government funding for education and labour-market mobility, and strict enforcement of labour standards.

Third, we can reform taxes to counteract economic divergence instead of intensifying it. That means lowering taxes that penalise hiring. To pay for this, as well as for a negative income tax and policies supporting a well-working labour market, other taxes have to go up. The best candidates are a net wealth tax — which, unlike other capital taxes, favours those who put their capital to the most productive use — and removing the gaping loopholes in multinational taxation, as well as increasing tax revenue from carbon emissions, in line with the climate challenge. A particularly promising proposal is the “carbon tax and dividend”, where revenue from higher emissions taxes would be paid out as a universal basic income. Calculations show that such a policy can leave poorer households significantly better off, even after fuel-price increases are taken into account.

A 'carbon tax and dividend' can make the poorest better off

Change in after-tax income (%)



Source: 'Methodology for Analyzing a Carbon Tax', US Department of the Treasury Office of Tax Analysis Working Paper 115, January 2017

Fourth, macroeconomic and financial sector policy can be reformed in favour of the left behind. That means sustaining a "high-pressure economy" to keep job creation high, in the knowledge that those on the margins of the job market are fired first in a recession and hired last in a recovery. Governments and central banks must stimulate demand strongly for a long time after the lockdowns end, with debts restructured so they do not hold back investment.

Fifth, and most challenging, we can work to reverse the divergence between the centre and the periphery. The previous four elements would help with this. But greater policy efforts are needed to give regions, where possible, a critical mass of knowledge jobs so they can connect with the leading economic activity in national centres.

These are big changes. But, as Milanovic argues, one consequence of the pandemic we can predict with some confidence is a "tendency toward [a] greater state role in many countries". Some politicians are embracing this with gusto, at least rhetorically: this week, Boris Johnson and his colleagues cast themselves as latter-day Roosevelts, and explicitly compared their levelling-up agenda to FDR's New Deal.

Governments everywhere have already gone to extraordinary lengths both to halt the pandemic and to offset the economic consequences of the lockdown. After this experience, as French president Emmanuel Macron has asked in the context of climate change, will publics accept claims that large-scale policy shifts are too hard to achieve?

Having become accidental radicals, centrist parties may well be tempted to keep making more ambitious offers to voters. “When people are unhappy they go for more extreme choices,” says De Vries. Behind populists’ success, she adds, was “the story of how mainstream parties had become Tweedledee and Tweedledum”, lacking any ideology. Centrist parties “could reinvent themselves by taking clearer positions”.

With the pandemic causing widespread economic damage to already polarised societies, continued radical policy action cannot be in doubt. What we are going to find out is for what — and for whom — that radicalism will be used.

Martin Sandbu is an FT economics commentator. His new book ‘The Economics of Belonging: A Radical Plan to Win Back the Left Behind and Achieve Prosperity for All’ is published by Princeton

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