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A rising tide of wealth inequalities

‘A rising tide lifts all boats’ – the quote from the speech by J.F. Kennedy in September 1960 has been widely used to describe the idea that when an economy is performing well, all people will benefit from it. The theory assuming that economic growth will finally bring about greater justice and prosperity for all still attracts supporters from different backgrounds. There is little doubt, however, that it doesn’t work that way. Economic data show increasing income and wealth disparities in the majority of countries, leaving no doubt that wealth creation mechanisms do not work equally for all. This paper examines key contemporary wealth drivers in an attempt to evaluate their influence on creating wealth inequalities. The analysis is based on vast literature studies, including the latest discussion on Thomas Piketty’s *Capital in the Twenty-First Century*. Looking at the issue from a historical perspective, we come to the conclusion that private ownership rights and capital resources play a decisive role as wealth creation factors. Policy changes, such as deregulation, privatization, and financial secrecy, make the distribution of wealth skewed towards the wealthy, contributing to growing wealth inequalities. The aim of this paper is to highlight the fact that the underlying cause of income and wealth inequalities lies in the uneven access to private ownership of different assets. Further, it aims at provoking a discussion on the right remedies to be undertaken to tackle this problem.

Keywords: wealth drivers, income and wealth inequalities, inequality measures, tax havens

JEL classification: D31, D63, H26

Rosnąca fala nierówności majątkowych

„Fala przyływu podnosi wszystkie łodzie” – te słowa, wypowiedziane przez J.F. Kennedy’ego w roku 1960, stały się synonimem tezy, że ogólny rozwój gospodarczy kraju podnosi standard życia wszystkich obywateli, nawet tych najuboższych. Tzw. *trickle-down effect* ma powodować, że bogacenie się jednostek w końcowym rezultacie podwyższa poziom życia całego społeczeństwa. Historia społeczna i gospodarcza pokazuje jednak, że tak się nie dzieje. Dostępne dane liczbowe wskazują na rosnące w ogromnym tempie nierówności dochodowe i majątkowe oraz na pogłębiającą się przepaść między bogatymi jednostkami a biednymi masami. Niniejszy artykuł analizuje główne mechanizmy kreacji bogactwa celem oceny ich wpływu na powstawanie i pogłębianie nierówności. Przegląd literatury uwzględnia dyskusję nad szeroko komentowanym dziełem Thomasa Piketty’ego *Kapitał w XXI wieku*. Patrząc na poruszany problem z perspektywy historycznej, dochodzimy do wniosku, że kluczową rolę w tworzeniu i pogłębianiu nierówności dochodowych i majątkowych odgrywają przywileje wynikające z prawa prywatnej własności, obejmujące zasoby materialne, kapitałowe i intelektualne. Celem tego artykułu jest zwrócenie uwagi na fakt, że przyczyną nierówności dochodowych i majątkowych jest nierówny dostęp

do własności różnego rodzaju aktywów. Może on również stanowić przyczynek do dyskusji nad właściwymi sposobami walki z tym problemem.

Słowa kluczowe: mechanizmy kreacji bogactwa, nierówności dochodowe i majątkowe, wskaźniki nierówności, raje podatkowe

Klasyfikacja JEL: D31, D63, H26

Introduction

Inequality may have many different dimensions, starting from skills, education, opportunities, and health, and ending with more measurable parameters related to wealth, income, and consumption. This paper will concentrate on economic parameters referring to the latter sphere and is meant to discuss the backgrounds of wealth, income, and consumption disparities. To begin with, the nature of these concepts should be clearly defined. Income is the most commonly used category whenever the issue of inequalities arise. It should not, however, be confused with wealth. Income represents the flow of money coming into a household every year, whereas wealth is the total stock of assets that a household owns, either through accumulation or inheritance. The difference between wealth and income has been highlighted by Kennickell in his symbolic metaphor of 'ponds and streams' [2008]. Whereas income streams take mostly the form of cash, the wealth components are much more numerous and include both financial and non-financial assets. Wealth is also an important metric since, unlike income, it can be inherited. Most researchers agree that wealth is more unevenly distributed than income, while consumption is less concentrated at the upper end than either wealth or income. In effect, consumption inequality is lower than income inequality, though still significant. Since consumption is often leveraged by different credit facilities, it does not reflect the real scale of the economic gap between the rich and the poor. Our attention will therefore be focused on wealth and income as the main drivers of growing economic inequalities.

1. Measures of economic inequality

There are many ways of measuring the economic gap between the rich and the poor, the most common being:

- the Gini coefficient (a measure of inequality in which 1 represents maximum inequality in distribution of income or wealth and 0 means a perfectly egalitarian society with equal distribution),
- decile dispersion ratio (which presents the ratio of the average income of the richest 10% of the population divided by the average income of the bottom

- 10%; this ratio is readily interpretable, by expressing the income of the rich as multiples of that of the poor),
- concentration ratios (the proportion of the total wealth held by various social groups),
 - share of income of the richest/poorest \times % (a direct measure showing the amount of income going to different social groups).

According to the most commonly acknowledged sources of information (OECD Wealth Distribution Database, Credit Suisse Global Wealth Report, IMF publications, Oxfam Reports, to mention only a few), the gap between the richest and the rest has widened dramatically in the last decade and also during the past 12 months. This is happening despite the continuous talks and resolutions emphasizing the need to fight and reduce inequality. The warnings, however, are not followed by serious measures and each year the gap between the rich and the poor is reaching new extremes. Credit Suisse has recently revealed that the richest 1% have now accumulated half of the world's wealth [Credit Suisse, 2015]. If current trends continue, the richest 1% would own more than 50% of the world's wealth by 2016 (Figure 1).

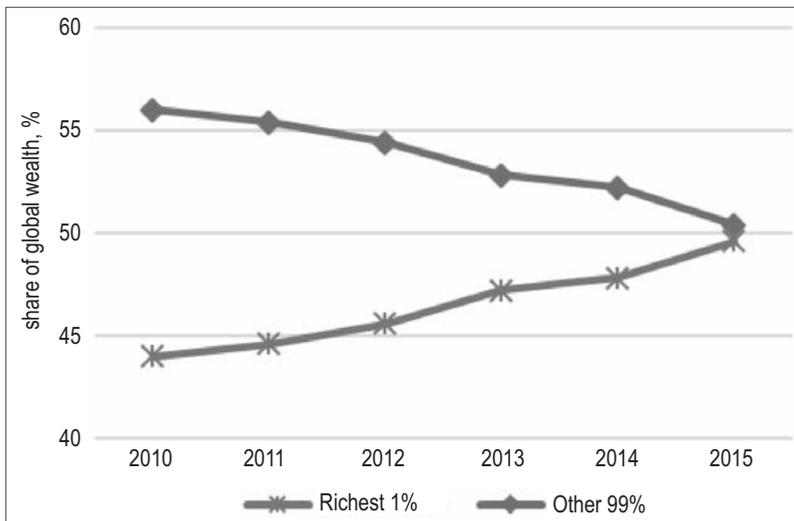


Figure 1. Share of global wealth in the years 2010–2015

Source: Own elaboration based on: [Credit Suisse, 2015].

Another striking information comes from the Oxfam report *An Economy for the 1%* [Hardoon, Fuentes-Nieva, Ayele, 2016]. In 2015, just 62 individuals had the same wealth as 3.6 billion people – the bottom half of humanity. What's more, the wealth of the richest 62 people has risen by 45% in the five years since 2010. Mean-

while, the average annual income of the poorest 10% of people in the world has risen by less than US\$ 3 each year in almost a quarter of a century. Their daily income has risen by less than a single cent every year. The Oxfam report is just the latest evidence of an extreme inequality and its tendency to grow at a very quick pace. Economic prosperity doesn't change the picture; in advanced economies, the gap between the rich and the poor is at its highest level in decades. As the authors of the Oxfam report put it: 'There is no getting away from the fact that the big winners in our global economy are those at the top. Our economic system is heavily skewed in their favour, and arguably increasingly so. Far from trickling down, income and wealth are instead being sucked upwards at an alarming rate'.

Widening income inequality is the defining challenge of our time. While we can agree that income inequality in itself is inevitable and, to some extent, even necessary in order to encourage hard work, investment, and entrepreneurship, yet too much inequality is harmful, unfair, and dangerous. It hampers economic growth, fuels financial and political instability, and makes room for lobbyists to push for more financial deregulation and favourable political decisions.

2. Drivers of economic inequality

The scale and pace of a growing wealth gap have brought about a major shift in the direction of economic research; the research previously focused on economic growth has shifted towards an increasing interest in measuring and understanding the level, causes, and development of wealth and income inequality [Heshmati, 2004]. Disparities in wealth and income are typically jointly determined and interact with each other. Income streams intensify the ability to accumulate assets, inheritance increases the total stock of assets, and economic and policy changes – including deregulation, privatization, financial secrecy, and globalization – have contributed to a further concentration of private wealth. What is the basic cause, the starting point of this unequal pattern? The study of historical trends lead to the conclusion that the very essence of the matter is the issue of private ownership. Uneven access to the ownership of different assets is the key driver of wealth inequalities, whether we consider feudal privileges resulting from land ownership, means of production ownership in the industrial era, or capital ownership and intellectual property rights in our time. This line of reasoning is strongly promoted by Andro Linklater in his book *Owning the Earth: The Transforming History of Land Ownership* [2013]. The author emphasizes the fact that the ideas of private property merged seamlessly from an agrarian to an industrial society. The structure of landowner–tenant–labourer was translated into the structure of shareholder–manager–worker. Moreover, the pattern also works in

post-industrial society, since the ideas behind the common law of property could easily encompass intellectual property – a type of intangible property which gives the owner the right to exclude others from exploiting assets restricted by patents, copyrights, and other intellectual property rights. There are many cases proving that companies use monopoly and intellectual property to skew the market in their favour, forcing out competitors and driving up prices for ordinary people, with pharmaceutical corporations being the most prominent example.

Another concept aimed at finding the reasons underlying the huge concentration of wealth and income in the hands of privileged groups is the increasing return to capital versus labour. In almost all rich countries and in most developing ones, the share of national income going to workers has been falling down. This means that workers are capturing less and less of the gains from growth. In contrast, the owners of capital have seen their capital consistently grow through interest payments, dividends, or retained profits. Indeed, it may be observed that the direction of technological change favours capital over labour and, within labour, skilled labour over unskilled one. Globalization of trade and investment is transmitting these forces to all countries, contributing to growing global inequality.

This way of thinking lies at the heart of Thomas Piketty's [2014] grand theory of capital and inequality. As a general rule, wealth grows faster than economic output, a concept Piketty captures in the expression rg (where r is the rate of return to wealth and g is the economic growth rate). The idea is that when the returns on capital outpace the returns on labour, over time the wealth gap will widen between the people who have a lot of capital and those who rely on their labour. Should that be true, it means that the rich get richer, and wealth inequality never stops increasing. Piketty puts it this way: 'When the rate of return on capital exceeds the rate of growth of output and income, as it did in the nineteenth century and seems quite likely to do again in the twenty-first, capitalism automatically generates arbitrary and unsustainable inequalities that radically undermine the meritocratic values on which democratic societies are based'. By highlighting this point, the author wants to make it clear that growing wealth of the richest 1% has no meritocratic background and is not based on outstanding skills or groundbreaking inventions. Many a time the increase in wealth of a few at the top is a massive claim over the labour, property, and public service availability of others.

As with any widely discussed books, *Capital in the Twenty-First Century* didn't escape criticism. One remark concerns the fact that while evaluating capitalist wealth, Piketty doesn't take depreciation into account. Modern forms of capital, such as technological equipment and software, depreciate faster in value than traditional means of production did in the past, which means that a large share of the gains that flow to owners of capital must be reinvested. Other critical comments point to the fact that Piketty draws too much attention to growing returns on capi-

tal in itself and underestimates the meaning of land ownership and surging house prices as wealth creation factors. According to this view, it's the landowners and homeowners in particular – rather than rentiers in general – who are grabbing the largest share of wealth growth [Smith, 2015]. Regardless of these arguments, Piketty's book makes it clear that income and wealth inequalities should stay in the centre of public interest and that wealth concentration will continue to increase unless some policy measures are undertaken.

3. Income inequality in Poland

Poland is a country which has undergone economic transformation from centrally planned to market economy. Before the transformation in 1989, Polish society could be presumed very egalitarian, although at a very low level of personal and disposable income. In our post-transformation history, there were two main thresholds which influenced the level of social disparity: first was the transformation itself and the switch to market-oriented capitalist rules of social relationships, and the second was Poland's accession to the EU in 2004. According to the data gathered by the World Bank in 1989, at the beginning of transformation the Gini coefficient for Poland was 28.0. After the EU accession, when Eurostat calculated the Gini coefficient for Poland for the first time, it amounted to 35.6. Since that time, the value of the Gini coefficient in our country has been steadily going down, being not that far from the European average (Table 1).

Table 1. The Gini coefficient in Poland and the EU in the years 2006–2013

	2006	2007	2008	2009	2010	2011	2012	2013
Poland	33.3	32.2	32.0	31.4	31.1	31.1	30.9	30.7
EU	30.3	30.6	30.9	30.5	30.5	30.8	30.4	30.5

Source: [Eurostat, 2014].

The diminishing value of the Gini coefficient in Poland may lead to the conclusion that there is no reason for social tension resulting from income inequalities. This may, however, not necessarily be true. The Gini coefficient is an aggregate measure, not overly sensitive to the specifics of the income distribution, concentrating only on how incomes vary relative to the other members of a population. The same value may result from many different distribution curves. To describe probability distributions of money, income, and wealth in a society, a more thorough analysis is needed, implementing methods used in other fields of science, namely mathematics and statistical physics. New research areas have emerged,

with *econophysics* as the most prominent example. The implementation of the rules of physics to the economy paved the way to a conclusion that there are different patterns of income distribution for the not-so-numerous rich and the very numerous poor. Using an analogy with statistical physics, Dragulescu and Yakovenko [2003] found out that the great majority of population is described by an exponential distribution – a process in which events occur continuously and independently at a constant average rate – whereas the high-end tail follows a power law (Pareto law) – a functional relationship between two quantities, where a relative change in one quantity results in a proportional relative change in the other. Accordingly, wealth and income accumulation take either additive or multiplicative pattern.

How does it refer to social disparities in Poland? According to the research on income distribution in Poland done by Julia Włodarczyk [2013], Pareto law applies to 3% of population with the highest income, whereas exponential law refers to the remaining 97% of population with low and middle-class income. Such a distribution pattern gives new insight to the picture composed by the simple value of the Gini coefficient. It leads to a presumption that income inequalities in Poland have not significantly decreased since 2005 – a conclusion somehow contradictory to the Eurostat data.

4. Can inequality be prevented?

This question seems to be the most difficult of all. In so far as the scale of wealth and income inequalities is widely recognized, the remedy seems to be impossible to agree upon and to implement. This is because the wealthy elite have anchored their interests in most important sectors of the economy, including finance, insurance, pharmaceuticals, and extractive industry, which gives them powerful position for lobbying activities. Wealthy individuals and companies spend millions of dollars every year lobbying to create policy environment that protects their interests. Financial and insurance sector – the most powerful one – spent US\$ 550 million on lobbying policy-makers in Washington and Brussels during 2013. Pharmaceutical companies spent more than US\$ 228 million in 2014 on lobbying in Washington [Oxfam, 2015]. The interests of the wealthy elite have been carefully intertwined with economic system. A typical example is the global web of tax havens and the industry of tax avoidance, which has blossomed over recent decades. The system is maintained by a highly paid and highly qualified professionals in the private banking, legal, accounting, and investment industries. The banking sector remains at the heart of the tax haven system; the majority of offshore wealth is managed by just 50 big banks [Cohen, 2016].

What are the solutions proposed by economists and organizations to tackle inequality? Piketty proposes a global wealth tax as a way of addressing the problem. Atkinson (British professor, an academic mentor to Piketty) presents a series of proposals that aim to transform the operation of the markets for labour and capital, introducing new rights for those who now have the fewest of them. His proposals include guaranteed minimum-wage public jobs for the unemployed, new rights for organized labour, public regulation of technological change, and democratization of access to capital [Atkinson, 2014]. Oxfam (international organization devoted to reducing poverty) has presented the most radical proposal. Their 7-point plan to tackle inequality calls for the following actions:

- clamp down on tax dodging by corporations and rich individuals,
- invest in universal, free public services such as health and education,
- shift taxation from labour and consumption towards capital and wealth,
- introduce minimum wages and move towards a living wage for all workers,
- introduce equal pay legislation to give women a fair deal,
- ensure adequate safety-nets for the poorest,
- agree a global goal to tackle inequality.

All of these remedies seem to be reasonable and badly needed. It's worth noticing that most proposals concentrate on the issue of taxation, with off-shore tax havens being the most obvious target. This way of reasoning has, however, been postulated for years, with no effect so far. The offshore business is a world of its own, with special procedures and facilities available for the wealthiest individuals and multinational companies to make it possible for them to avoid paying taxes. What is confusing is the fact that owning an offshore company is not illegal in itself and this kind of tax optimization is widely used by the biggest multinationals and wealthy individuals. In order to make up for the lost revenues from businesses that have evaded taxation, governments tax the rest of the population, which means that a higher proportion of public expenditure has to be funded by tax payers in lower income groups. Thus, the burden is put on the shoulders of ordinary people, while the wealthy are protected. As long as such system exists, we cannot expect to reduce wealth inequalities.

Conclusions

Reducing inequality is an important macro-economic objective. The widening income gap between the rich and the poor has highlighted the need to understand the causes of relative inequality and poverty, and to construct suitable policies to reduce poverty and narrow the income gap. Income differences can be reduced via redistribution through taxes and benefits, or by reducing differences

in pre-tax incomes. Most remedies concentrate on the relatively late stage of income and wealth inequalities, namely on the stage of redistribution. However, if we agree that the key driver of wealth inequalities is the uneven access to the ownership of different assets, other forms of economic democracy would also be needed. Special attention should be put to such forms as employee share ownership, employee representation on boards, access to good education for the low-income groups, and other long-lasting economic and cultural changes which will help equality to become more embedded in a society.

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