An unequal world is an uncharted economic threat

By Gillian Tett

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This week, the American economy won a little burst of applause. The World Economic Forum issued its latest report on which countries are considered to be creating “sustained prosperity” (that is, growth). America jumped to third place in the league table, behind Singapore and smug little Switzerland. This marks a rebound from the period after the crisis, when the US fell to seventh place.

This is pretty gratifying, at least for Washington. What is really interesting about this year’s WEF report, however, is not the public ranking of nations but a furtive debate bubbling about income inequality in America and elsewhere.

Since then, the WEF has been quietly mulling over whether it should emphasise inequality when measuring national competitiveness and the potential for growth. If a country (such as America) is becoming polarised, in other words, does this make it less likely to grow?

“We think it is extremely important to include the issue of income inequality in how we assess countries,” says Jennifer Blanke, a WEF economist, who is now overhauling how the institute examines growth.

In many ways, this is a sensible move. But the problem that dogs the WEF, like anyone else, is that there is limited academic research – let alone consensus – on the issue. What is clear is that since the global economic crisis of 2008, western growth rates have been disappointing; so much so that economists such as Lawrence Summers fear the west faces the onset of a “secular stagnation”.

What is also evident is that inequality has increased in many other rich countries. The issue is not simply that wealth has become concentrated, as Wednesday’s survey from the Federal Reserve illustrates for the US (or Thomas Piketty, the French economist, explains more widely in his bestselling book, *Capital in the Twenty-First Century*). Wage inequality has increased, too: Alan Blinder, an economist, notes that between 1979 and 2012, real wages grew at a compound annual rate of 2.8 per cent for the richest 1 per cent of Americans; they were flat for middle-income workers, and fell for the bottom 20 per cent.

But what is less clear is how – or if – these two trends are linked. Until recently, most business leaders and economists, particularly in the US, presumed inequality was just a byproduct of capitalism. Thus, because it spurs innovation and competition, inequality of outcome was thought to raise growth rates rather than lower them.

Now some economists are disputing this, however. Professor Blinder, for example, argues that since inequality undermines the ability of poor people to invest in education, it hurts overall productivity. Economist Joseph Stiglitz has made similar arguments, as have researchers at Harvard Business School.

Meanwhile, a separate debate is now bubbling in the US Federal Reserve about the impact of inequality on consumer spending. The concern is that, since the rich spend less of their income than the poor, relatively speaking, the economy has been sluggish because the rich are saving their current gains, not spending them.

Then there is the thorny issue of social cohesion and political stability. Economists have not traditionally paid much attention to this in the US. But Standard & Poor’s recently downgraded its forecast for US growth – and specifically cited fears that rising inequality will lead to political gridlock and distrust, and will therefore sap growth.

This is a novel move in the rating agency world. However, it is an argument that would seem to make sense. And other business voices
are echoing these concerns, including on the right; Alan Greenspan, the former US Federal Reserve chairman who calls himself a life-long libertarian Republican, has cited inequality as the “most dangerous” trend afflicting America.

Of course, it is unclear how this tallies with the fact that the US has done better in several respects than many rivals in the post-crisis period. But the other big problem is the paucity of information. Inside the US there is considerable data – such as the Fed survey. But consistent and easily compared statistics on wage inequality or wealth are hard to find. “We just don’t have the data,” admits Ms Blanke.

That does not mean the WEF (or others) should avoid the issue. On the contrary, precisely because there is still so much fog, there needs to be more, not less, research. But perhaps the biggest single contribution that groups such as the WEF can now make is the simplest: talk loudly about data voids and force governments to collect better data around the world. Particularly if the level of inequality keeps growing. Which right now seems a sensible – albeit hard to measure – bet.

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