On Wealth and Income Inequalities

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In the late nineteen sixties and the early nineteenth seventies, an argument used to be put forward by theorists of Social Democracy that went as follows. In any society wealth inequality is always greater than income inequality; but if this income inequality is curtailed, then that ipso facto has the effect of curtailing wealth inequality as well, and that too quite substantially. Hence it is not necessary to actually nationalize private property and institute social ownership of the means of production; all that is required is the use of taxes and subsidies to reduce income inequality, and over time wealth inequality will automatically come down and even get completely eliminated, as would income inequality itself (assuming that labour is homogeneous and all workers are equally thrifty).

The proposition that wealth inequality is always greater than income inequality is indisputable for all societies characterized by class antagonism. This is because the workers, who own no assets, nonetheless have to be paid a subsistence wage (which is also true of corresponding social categories in all pre-capitalist societies based on class exploitation). If, for instance, there is a total capital stock of 100 (consisting, for simplicity, entirely of fixed capital), which yields an output of 40 (assuming, again for simplicity, that there is full capacity utilization) by employing 20 labourers, each of whom has to be paid a subsistence wage of 1 unit, then the income ratio between the workers and the capitalists is 20:20, while the asset or wealth ratio is 0: 100. Hence greater inequality in wealth than in income is a feature of all societies based on class exploitation.

But the social democratic argument stated that if income inequalities are large and the workers barely eke out a subsistence, then they would be consuming their entire wage bill and saving nothing, while if these inequalities are kept low then they get a bit more than bare subsistence and start "saving". "Saving" by definition, however, constitutes addition to wealth, so that once they start saving they begin to own assets and hence get an income from wealth in addition to their income from work. If their saving ratio out of this composite income, consisting of both income from wealth and income from work, is high enough, and not too much lower than that of the capitalists, then their wealth ownership grows at a faster rate than that of the capitalists proper (who do no work), in which case the workers in effect become capitalists over time, and the social divide between the two classes disappears, together with all wealth and income inequality (assuming homogeneous labour and equal thriftiness among all workers).

Let us clarify the argument using the numerical example already given above. Let us assume that the share of wages in total output remains unchanged at 50 percent as in the above example. But the workers save 40 percent of their income while the capitalists proper save 60 percent. Then if 100 was the capital stock to start with, it becomes 120 in the next period, with capitalists' saving being 12 (60 percent of their income of 20) and workers' saving being 8 (40 percent of their income of 20). The output from this capital stock of 120 in the second period will be 48, of which the wages will be half, i.e. 24, and profits will be 24.

The workers' income however will now include some profit income as well: since they own 8 capital stock out of 120 (i.e. 1/15), their profit income will be 24/15 or 1.6; and their total income will be 24 (their income from work) plus 1.6 (their income from property), which is 25.6. The capitalists' income will be 24 (total profits) minus 1.6 (profits going to the workers), which is 22.4. If they save the same ratios of their respective incomes as before,

then the workers' savings in this second period will be 40 percent of 25.6, which is 10.24 while the capitalists' savings will be 60 percent of 22.4, which is 13.44.

Let us see what this implies. The workers' savings increase from 8 in the first period to 10.24 in the second, i.e. by 28 percent. The capitalists' savings increase from 12 in the first period to 13.44 in the second, i.e. by 12 percent. Since savings constitute additions to wealth, it means that the workers are adding to their wealth at a faster rate than the capitalists; and if this keeps happening, then over time the workers will keep increasing their share of capital stock and the capitalists will progressively dwindle into insignificance, which will constitute a "bloodless" silent revolution in the capitalist system. (The recognition of this basic logic was first expressed in a joint paper by two American economists, Paul Samuelson and Franco Modigliani, each of whom went on to win the Nobel Prize in economics, though not for this paper).

All that is required for this "bloodless" silent revolution therefore is that income redistribution through fiscal means should occur to the extent required to enable the workers to have a high enough savings-ratio compared to the capitalists. Social democracy which in the immediate post-war period had successfully undertaken measures to reduce income inequality was sanguine that it was effecting this silent revolution. And to be fair, it was not just the Social Democrats who were taken in by this argument. Since its logic was impeccable within the context in which it was propounded, and since the context itself was not too far-fetched in the post-war setting, it had a surreptitious appeal even to socialists who otherwise argued publicly for social ownership of the means of production.

In that post-war setting the obvious lacunae in the argument got overlooked. The first such lacuna is the absence of any recognition of deficiency of aggregate demand. In the above example for instance we assumed full capacity utilization all along, which presumes that the production of full capacity output never gets thwarted by any shortage of aggregate demand. If it did get thwarted, then there would be an increase in unemployment and unutilized capacity, which would mean that the workers' income would shrink, forcing them to live at bare subsistence where their entire income got consumed, negating the very assumption underlying the social democratic argument. But this lacuna was ignored because in the post-war setting, the policy of "demand management" by the State in capitalist economies more or less ensured that the problem of deficiency of aggregate demand was kept at bay.

The second obvious objection to the argument is the belief in the persistence of a bourgeois State that pursues social democratic policies, not only of "demand management" but of reducing income inequalities through fiscal means. And again in the post-war setting where the correlation of class forces was such that even a formal change of government from Labour or social democratic parties to conservative parties, appeared incapable of overturning such policies, the assumption of "social-democratic-policies-in-perpetuity" did not seem far-fetched.

The third objection was in fact linked to the first two. Capitalism being a "spontaneous system" which has its own immanent tendencies, no particular correlation of class forces remains frozen for ever. One basic immanent tendency under capitalism is centralization of capital, or the coming together of capital in larger and larger blocs, which in turn produces a tendency for capital to become "globalized". The pressure for "globalization" gathered momentum in the sixties and European governments, including social democratic governments, willy-nilly had to lift controls over cross border flows of capital, especially in the form of finance. Though such lifting was cautious to start with, it further strengthened

"globalization of capital" and hence further demands that the State, which continued to remain a nation-State, should abandon the role imposed upon it in the heyday of social democracy, and should concern itself above all with promoting the interests of globalized finance capital.

Even though the actual shift away from the social democratic paradigm to the "neo-liberal" paradigm (where the State is pre-eminently concerned with appeasing globalized finance capital) occurred during the rule of Margaret Thatcher in Britain and Ronald Reagan in the U.S.A., social democracy had no answer to the basic conundrum of how a nation-State could remain committed to Keynesian "demand management" and redistributive fiscal policies, when the capital confronting it was globalized and could simply move to other locations if its "confidence" got dented by such intransigence on the part of the State.

As a result of the shift in policies, Keynesian "demand management" was abandoned, resulting in higher average levels of unemployment in the capitalist economies in the period after the mid-seventies than in the preceding post-war years; it also meant that booms in capitalist economies got associated with the formation of "bubbles" whose collapse inevitably brought in slumps of the sort we are witnessing now. In addition the shift entailed a weakening of trade unions and hence of the bargaining power of the workers; a rolling back, in varying degrees, of the Welfare State; and substantial tax concessions to the rich; all of which, far from reducing or even stabilizing the level of income inequality, actually widened income inequality quite significantly.

In fact Joseph Stiglitz argues that an average American worker earns less in real terms today than 45 years ago, and that American men without a university degree earn 40 percent less than four decades ago. On the other side, the top 1 percent of the American population take home 22 percent of the nation's income; and the top 0.1 percent take home a staggering 11 percent of the nation's income. (All figures are taken from Graham Peebles' article in Truthout January 21, 2014). The recent crisis has only worsened this inequality. And it is not surprising that wealth inequalities too have widened quite dramatically. At present the richest 2 percent of the world's population own 51 percent of the world's assets!

Faced with these figures, many progressive economists and agencies like the UNICEF have been demanding a redistribution of resources from the world's privileged to the world's deprived. While the sentiments behind these demands are laudable, to believe that it can be done without overthrowing the system that reproduces this inequality in an accentuated manner, is naïve. The end of the social democratic dream, that the State can be used even within the capitalist system to bring in redistributive measures that would ultimately alter the system itself through a silent revolution, only underscores the fact that even the preservation of whatever limited "gains" are made by the people within the system requires an intensification and a widening of class struggle against the system. The maintenance of such "gains" cannot simply be taken for granted and mathematically extrapolated to a limit point entailing a withering away of capitalism.

Capitalism does not wither away as a result of social democratic redistributivism; on the contrary it has forced a withering away of social democracy itself. It needs to be consciously overthrown.

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