

THE WORLD OF INEQUALITY

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Given the huge increase in inequality in most countries, higher taxes for those who have done well—to help those who have lost ground from globalisation and technological change—are in order, and could also ameliorate the strains imposed by soaring food and energy prices.

Around the world, protests against soaring food and fuel prices are mounting. The poor—and even the middle classes—are seeing their incomes squeezed as the global economy enters a slowdown. Politicians want to respond to their constituents' legitimate concerns, but do not know what to do.

In the United States, both Hillary Clinton and John McCain took the easy way out, and supported a suspension of the gasoline tax, at least for the summer. Only Barack Obama stood his ground and rejected the proposal, which would have merely increased demand for gasoline—and thereby offset the effect of the tax cut.

But if Clinton and McCain were wrong, what should be done? One cannot simply ignore the pleas of those who are suffering. In the US, real middle-class incomes have not yet recovered to the levels attained before the last recession in 1991.

When George Bush was elected, he claimed that tax cuts for the rich would cure all the economy's ailments. The benefits of tax-cut-fuelled growth would trickle down to all—policies that have become fashionable in Europe and elsewhere, but that have failed. Tax cuts were supposed to stimulate savings, but household savings in the US have plummeted to zero. They were supposed to stimulate employment, but labour force participation is lower than in the 1990s. What growth did occur benefited only the few at the top.

Productivity grew, for a while, but it wasn't because of Wall Street financial innovations. The financial products being created didn't manage risk; they enhanced risk. They were so non-transparent and complex that neither Wall Street nor the ratings agencies could properly assess them. Meanwhile, the financial sector failed to create products that would help ordinary people manage the risks they faced, including the risks of home ownership. Millions of Americans will likely lose their homes and, with them, their life savings.

At the core of America's success is technology, symbolised by Silicon Valley. The irony is that the scientists making the advances that enable technology-based growth, and the venture capital firms that finance it were not the ones reaping the biggest rewards in the heyday of the real estate bubble.

These real investments are overshadowed by the games that have been absorbing most participants in financial markets.

The world needs to rethink the sources of growth. If the foundations of economic growth lie in advances in science and technology, not in speculation in real estate or financial markets, then tax systems must be realigned. Why should those who make their income by gambling in Wall Street's casinos be taxed at a lower rate than those who earn their money in other ways. Capital gains should be taxed at least at as high a rate as ordinary income. (Such returns will, in any case, get a substantial benefit because the tax is not imposed until the gain is realised.) In addition, there should be a windfall profits tax on oil and gas companies, like the US, with food stamp programmes

clearly need to increase the value of these subsidies in order to ensure that nutrition standards do not deteriorate.

Those countries without such programmes might think about instituting them.

Two factors set off today's crisis: the Iraq war contributed to the run-up in oil prices, including through increased instability in the Middle East, the low cost provider of oil, while bio-fuels have meant that food and energy markets are increasingly integrated. Although the focus on renewable energy sources is welcome, policies that distort food supply are not.

America's subsidies for corn-based ethanol contribute more to the coffers of ethanol producers than they do to curtailing global warming. Huge agriculture subsidies in the US and the European Union have weakened agriculture in the developing world, where too little international assistance was directed at improving agriculture productivity. Development aid for agriculture has fallen from a high of 17 percent of total aid to just 3 percent today, with some international donors demanding that fertiliser subsidies be eliminated, making it even more difficult for cash-strapped farmers to compete.

Rich countries must reduce, if not eliminate, distortional agriculture and energy policies, and help those in the poorest countries improve their capacity to produce food. But this is just a start : people have treated most precious resources—clean water and air—as if they were free. Only new patterns of consumption and production—a new economic model—can address that most fundamental resource problem. □□□