Time to Rewrite the Rules

Remarks to the OECD Global Parliamentary Network Meeting on Inclusive Growth

House of Lords, Wednesday 4th April 2018

Rt Hon Liam Byrne MP

Introduction

Secretary General, my Lords, my fellow Parliamentarians from 27 countries, Officials and observers from the IMF, the EU and the European Parliament, welcome to London, and welcome to this first OECD Global Parliamentary Conference on Inclusive Growth.

After months of planning, its a great privilege to host you here to the Robing Room of the House of Lords for what I believe is the first gathering of international gathering of Parliamentarians devoted to exploring the question of just what is it we need to do, to build a more equal economy.

Over the next two days we will hear from each other, from key figures in business, in capital markets, in trade unions, in churches, in civil society and in the media, about both the challenge ahead - but crucially the choices ahead if we're to build an economy that is more stable, more sustainable - and yes, more equal. I want to pay a huge thank you to the OECD, to the Inter-Parliamentary Union, the Cabinet Office, our sponsors, and above all to Tom Hunt at SPERI for ensuring that we were able to come together today.

During the financial crisis, it was my task to help coordinate Downing Street for our prime minister, Gordon Brown, before taking on the design of our own fiscal consolidation programme as Chief Secretary to the Treasury. There was a saying we had back then: 'we know what to do; we just don't know how to get re-elected once we've done it'. And in our case, so it proved.

"Ten years on, the world economy is finally returning to 'normal'. But politics is not"

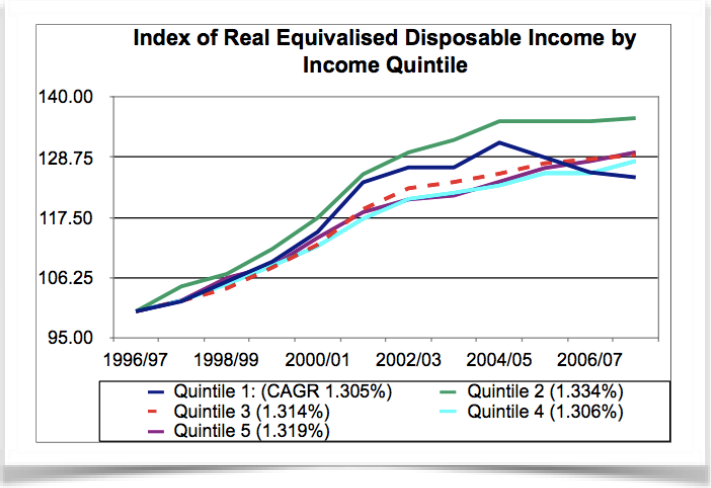
Now, ten years on, the world economy is finally returning to 'normal'.

But politics is not.

Far from it. Populism is wracking democracy, the world over; 150 million votes cast for populist parties and candidates from the United States, to Europe, to Russia in the last two years alone.

The Emergence of the **'Squeezed Middle'**

Now, as a good social democrat, once upon a time I bought into the consensus that a measure of inequality was probably inevitable - and that the task was to build a state strong enough to redistribute wealth and opportunity.



In the UK, incomes began to plateau in around 2004. Source: HM Treasury analysis for Liam Byrne

But a decade ago, in our Treasury, one piece of work[1] changed my view.

It was the work that revealed the challenge of what we called the 'squeezed middle'; that huge group of citizens in the middle - not the rich, not the very poor - who work hard but whose living standards were seriously lagging behind the overall rate of economic growth.

We realised if these trends persisted, we would have to redistribute (to this group) some £20 billion over the course of a decade - at a time of austerity. That's when I saw clearly that if we couldn't intervene to raise the hours people worked, then we would have to intervene in the economy in new ways, to both raise levels of productivity growth - but, more seriously - to strike a fairer split between capital and labour of who walked off with the prizes.

In other words, we would need to step into the marketplace to rewrite the rules for how market institutions worked to change the outcomes, especially wages.

Now, this of course cuts against the economic consensus which took slowly hold in the 20 years between Milton Friedman's *Capitalism and Freedom* and the election of Ronald Reagan and Margaret Thatcher in '79/80.

[1] https://liambyrne.co.uk/research_archive/challenge-equality-britains-squeezed-middle/

The Malmesbury Charter, first issued in 924AD

But what my own study of Britain's economic history underlines is that there is not and never has been, some 'natural', celestial or Platonic ideal of the marketplace.

Markets are social technology. They are designed, with the intention of maximising social good. And what's more these strange inventions only work because we invent institutions to help them work. A visible hand, to help the invisible hand do its thing.

Here in England at least, we've been writing the rules for these markets since the Malmesbury Charter of Edward the Elder in 924. Where you are sitting today is the place where we agreed down the centuries, parliamentary protection of profits through our control of tax; the foundation of the capital markets in the Royal Exchange; the huge expansion of the Royal Navy to police international trade; the Royal Society to advance science; the reorganisation of the Royal Mint and later the Gold Standard; the Bank of England, intellectual property protection through the Patent Act; the advance of the Royal Courts of Justice, the issue and repeal of monopolies like the East India Company, limited liability companies, and in time, the creation of the welfare state.

Down the centuries, Britain has constantly created new institutions to help shape economic growth.
Source: Liam Byrne, Dragons: Ten Entrepreneurs Who Built Britain (2016)

Every time we brought forward a new idea, we justified it with an appeal to what it would do for the common good. Not the benefit of one class or another. But the common good.

Today, our marketplace is not working. It may be a free market. But it is not a fair market. And so it is time we rewrote the rules for how it works - because spiralling inequality now threatens the common good. Let me explain why.

The Future of Inequality

Last year, as Oxfam pointed out[2], we saw the largest ever increase in the number of billionaires. And yet on our streets we have more people sleeping rough than at any time in the last decade. In the tube station many of you arrived through, someone died sleeping rough this winter. Those stories of The Road to Wigan Pier, or Death on Credit have a familiar ring once more.

Yet we now know that rising levels of inequality are a *threat* to economic growth. As Berg & Ostry[3] put it back in 2011, 'We find that longer growth spells are robustly associated with more equality in the income distribution.[4]' What's more, the lower the inequality, the faster and the more durable, the level of growth.

> Second, *lower net inequality is robustly correlated with faster and more durable growth, for a given level of redistribution*. These results are highly supportive of our earlier work.
>
> And third, *redistribution appears generally benign in terms of its impact on growth; only in extreme cases is there some evidence that it may have direct negative effects on growth*. Thus the combined direct and indirect effects of redistribution—including the growth effects of the resulting lower inequality—are on average pro-growth.

Equality is good for growth. The famous summary from 'Redistribution, Inequality, and Growth' by Jonathan D. Ostry, Andrew Berg, and Charalambos G. Tsangarides, IMF 2014

Yet as bad as things are today, things can always get worse.

In the years since the Crash, the wealth of the top 1% has been growing at 6% a year - twice the speed of the bottom 99%. If this continues, as it might until 2030, the richest 1% won't command half of global wealth - but almost ***two-thirds.***

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[2] See Oxfam, Reward Wealth Not Work, 22 January 2018

[3] See https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf

[4] https://www.imf.org/external/pubs/ft/sdn/2011/sdn1108.pdf

What would that mean in numbers?

Well, not adjusting for inflation, it means the aggregate total wealth of the top 1% grows from around $140 trillion in 2017 to $305 trillion in 2030.

The top 1% become richer than the GDP of the most of the G20 - put together.

It is very, very hard to see how we recover a more equal world from such a point.

Estimated distribution of global wealth under different scenarios, 2017-2030

	Wealthiest 1%	Least wealthy 99%
Share of total wealth in 2017	**50%**	**50%**
Total wealth, annual rate of increase 2000-17	*6%*	*5%*
Total wealth, annual rate of increase 2008-17	*6%*	*3%*
Share of total wealth in 2030		
Assuming total wealth grows at 2000-17 annual rate	54%	46%
Assuming total wealth grows at 2008-17 annual rate	64%	36%

Note: the composition of each group will change from year to year. Someone who is in the wealthiest 1% in one year may be in the least wealthy 99% in the next.

Source: Estimates based on wealth data for 2000-2017 published in Credit Suisse, *Global Wealth Report 2017* and *Global Wealth Databook 2017*

Source: House of Commons Library

We are therefore at a tipping point.

Unless we take action today to accelerate the wealth-growth of the many, and not the few, we are destined to wave goodbye to any meaningful measure of equality in this century.

This level of inequality is already a systemic risk to the future of our economy.

Why?

Because levels of inequality like this bring huge new political risks; like voters who reject free trade either by exiting trade blocs like the European Union or voting for Presidents who instigate tariffs and trade wars.

What is to be done? Towards policy choices

So, what is to be done? Well, the core of the strategy must be to raise productivity levels, but re-connect productivity growth to wages. We see three big steps as vital.

First and foremost, there has to be a 'good jobs' revolution, that recognises, on the supply side of the economy, it is no longer merely the supply of capital that is important, but the supply of innovation.

This is crucial in an economy where by and large big firms are no longer net creators of many good new jobs. It is the smaller, high growth firms that do the heavy lifting.

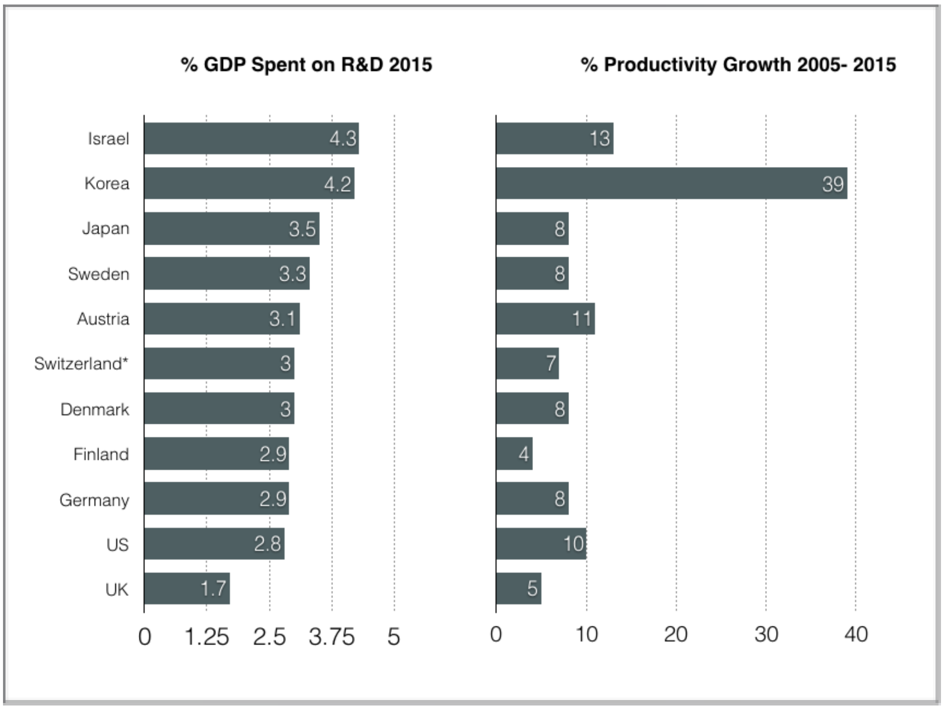
This simple insight takes us to a very different supply side revolution to that proposed at the end of the 70's.

To support high growth firms, it is vital we raise levels of public funding for research and development. It is no coincidence that those nations which spend 3% of GDP on R& D are the countries that boast bigger, wealthier manufacturing sectors. Crucially, countries spending more on R&D have enjoyed the greatest rises in productivity growth.

This is insight is fuelling a return of industrial strategy - or Fourth Industrial Revolution Strategy as the South Koreans call it. It is now shaping a new agenda at a national level, and, crucially at a local level. That's why we zoom in on the role of mayors this week to ask: how do local leaders shape good growth in towns and cities with new partnerships between science and industry, and wise use of public procurement to accelerate the path of good ideas from the lab to the real world.

Part of this new supply side revolution has to be a new agenda for labour markets.

It goes without saying that supply of skills requires attention.



By and large, those countries that spend more on R&D enjoy faster rises in productivity. Source: House of Commons Library

Here in the UK, the premium enjoyed by graduates has been flat now for some time, but like many countries, we face a crisis in technical education, and as automation begins to hit certain jobs, we have new challenges when it comes to designing systems to re-skill workers, especially those in their 50's. We much much to learn from others.

But the labour market will also need new regulation to ensure that the gig economy is not shorthand for a return to mass casualisation of the Victorian age. This should not frighten us. Here in Britain, the home of the industrial revolution, we did not have one Factory Act in the 19th century - we had seventeen of them, to democratise new progress and new protections as technology and economics evolved.

Now if labour markets are to more skilled, then capital markets must become more patient. Investors like Larry Fink, head of Black Rock already bemoan the lack of long term thinking in board rooms[5], arguing, 'To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society'.

Today, the asset management industry has unprecedented power; it will manage more than $111 trillion worldwide by 2020. It is also incredibly concentrated.[6] Back in the 1950s, 90% of equities were in private hands. Today institutions own about 78% of all US

[5] https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

[6] https://www.pensioncorporation.com/media/136149/purpose-of-asset-management-report-final-15-03-18-low-res-1.pdf

equities - and the top 25 own upwards of 50% of a large cap firm. The industry's habits, however, do not encourage the sort of investment in social purpose that Mr Fink is seeking. As Andy Haldane recently pointed out, using OECD research[7]: 'Average holding periods of shares have been in secular decline in a large number of countries for a number of decades. In the UK and US, they have fallen from around 6 years in 1950 to less than 6 months today'[8]

So: the challenge for us, is how to do we rewrite the rules - and the incentives - to encourage today's smaller number of concentrated institutional investors, to be a force for good. And how do we encourage them to think about the managing the systemic risks that fund managers cannot defend themselves against with the diversification preached by modern portfolio theory: systemic risks like climate change, and yes, like inequality.

To give these reforms real force, we argue there's a range of new rules to rewrite; rules that will change investing behaviour. Like a Hippocratic Oath for bankers; new fiduciary duties for pension fund trustees to ensure they think long term, and a change in corporate governance rules to reflect a firm's wider set of responsibilities to groups beyond shareholders, and a push to put people with long term perspectives - like workers - on company boards.

These questions are so important that we include a sharp focus on them in our agenda this week.

<u>Second</u>, on the demand side, we have keep new rates of growth rates on track, and crucially keep trade on track.

Trade wars are the last thing we need. And if TTIP and TPP are now off the table, then perhaps we have to explore more aggressively new possibilities like President Xi's New Silk Road initiative. After all, by 2030 the major economies of the Silk Road, will be three times the size of the Atlantic economies. The challenge will be to build a world, not simply of free trade but fair trade; where we ensure there is no race to the bottom on labour standards; on environmental standards, or indeed tax avoidance.

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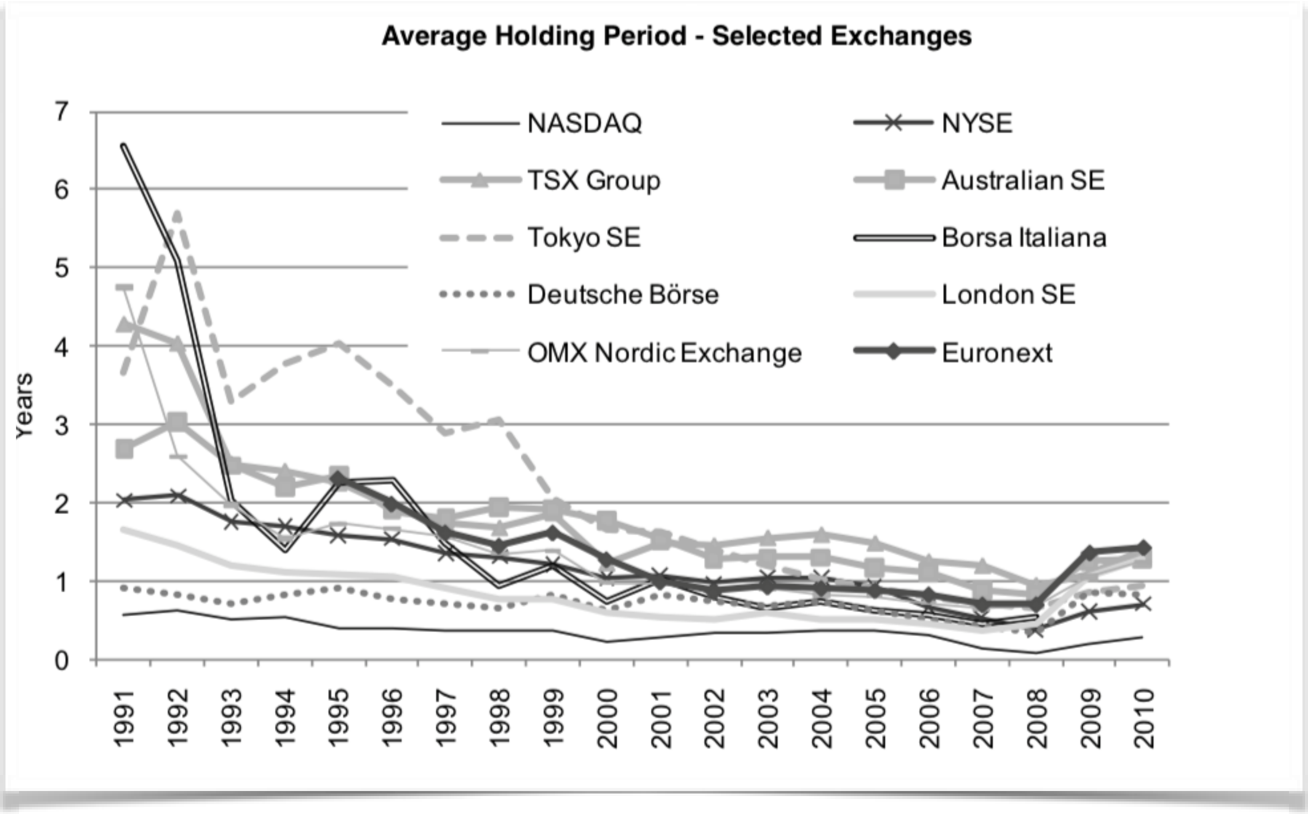
[7] http://www.oecd.org/finance/private-pensions/48616812.pdf

[8] [8] https://www.bankofengland.co.uk/-/media/boe/files/speech/2015/who-owns-a-company.pdf

Underpinning this has to come new investment in the sort of infrastructure that makes trade possible; whether that's high speed rail, ports, or universal braodband. Very few states, outside China, have simply capitalised on low, long term interest rates to transform the state of old infrastructure, some of which in our country dates back to when this Palace was built; which, and I don't wish to alarm you here, is slipping slowly into the Thames!



OECD analysis of average tenure of shareholding, by exchange

<u>Third</u>, we have to renew the power of states to redistribute in order to help, to help both young and old, and address the scandal of gender inequality.

That means rebuilding the fractured tax base with policies that deliver tax justice. Analysis by economist Gabriel Zucman for Oxfam argues that the top 1% may evading an estimated $200 billion in tax[9]. Here the work of the OECD in creating tax transparency is absolutely essential. In the UK, we are seeking to lead, but we need to go further with

[9] https://d1tn3vj7xz9fdh.cloudfront.net/s3fs-public/file_attachments/bp-reward-work-not-wealth-220118-en.pdf

registers of beneficial ownership so that we can see who precisely owns what - and where they are sheltering it, at what cost to the public exchequer.

Tax avoiders may think of themselves as citizens of the world but patriots still pay their taxes - somewhere.

With new resources, states have to take on new roles expanding the asset-building across the new life-cycle of saving. In many countries, that means a revolution in social housing for the young, pensions for the old, and justice for women.

Today, the prospects facing our children are very uncertain. Youth unemployment is already far too high. The risks of automation - as the OECD has argued - may be less than we thought; perhaps its only 13% - not 49% - of jobs that may be taken by robots10. But, what the OECD finds is that 'teenage jobs' are most vulnerable of all. That creates the huge risk that high levels of youth unemployment may simply get worse over the years to come.

Further, when people live longer in a world of low interest rates they have to save perhaps up-to ten times more than in the past. It's hard to see how that can happen without new public-supported second pensions.

Finally, renewed states have to end the scandalous state of gender inequalities in the labour market. When 78% of companies country pay men more than women, as they do in Britain, then #MeToo has to become #PayMeToo. A wise alliance of good public policy and good business leadership has to fix this.

[10] https://www.oecd-ilibrary.org/fr/employment/automation-skills-use-and-training_2e2f4eea-en

Conclusion: Towards the Third Consensus

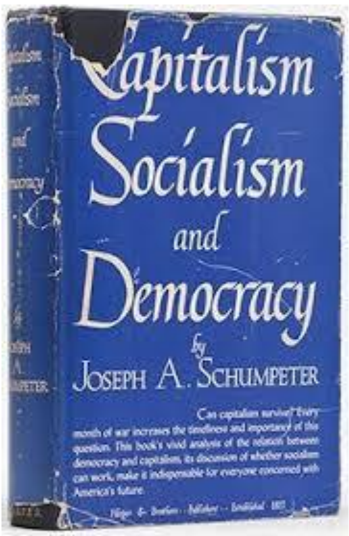
Since World War Two, there have been two great moments of economic consensus; around the Keynesian revolution and the Bretton Woods settlement of 1944, and the monetarist revolution of the late 70's.

Today, as global growth returns to normal, we are in search of a third consensus. Over the last thirty years, in Europe and America, we doubled down on the 19th century 'religion' of free trade and free exchange of ideas, creating NAFTA, the World Trade Organisation, doubling the size of Europe, and pumping billions into skills and science.

We bet that trade and tech together would deliver the tax we needed to rebuild public services and roll-back inequality. And for many years, we were right.

But while we mastered how to globalise, we failed to develop good ways of ensuring that globalisation worked for the many, not the few.

Why?



Because the creation of vast new global markets transformed the commanding heights of capitalism; huge new companies bigger than countries took shape with unprecedented market power[11].

Seventy five years ago this year, Joseph Schumpeter forecast the phenomenon of 'creative destruction'; but people forget he also forecast the flip-side: the destruction of competition[12].

Well, he was right.

A $20 trillion merger wave inside America and around the world has created exactly the sort of oligopolies Schumpeter predicted; giant new firms with unparalleled power to set prices - and wages.[13]

[11] Few have argued this point as early or as effectively as Prof Peter Nolan. See for instance: https://academic.oup.com/cje/article-abstract/32/1/29/1685937/The-global-business-revolution-the-cascade-effect

[12] See Joseph Schumpeter, Capitalism, Socialism and Democracy, (1942)

[13] See for instance, https://www.economist.com/news/briefing/21695385-profits-are-too-high-america-needs-giant-dose-competition-too-much-good-thing or

For just as they formed, one billion people were entering the labor force in a massive movement from "farm to factory"[14] offering these new global firms new power to outsource production to wherever costs were lowest, while the transformation of technology meant that in industries like automotive, robots are already two-thirds cheaper than people[15].

These trends together meant, that as Obama White House put it, mega-corps acquired monopsony power[16], the ability to dictate wages while workers lost all power to 'vote with their feet' and move to different firms paying better, because those alternative opportunities simply did not exist[17].

This fundamental change ruined the political economy of 'trade, tech and tax'.

Now, policymakers around the world have woken up to this.

IN 2015, the world agreed new sustainable development goals, that include SDG8 and SDG10; commitments to "Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all" and to "Reduce inequality within and among countries". In Hangzhou, in 2016, G20 leaders agreed to to "work to ensure that our economic growth serves the needs of *everyone* and benefits all countries and all people including in particular women, youth and disadvantaged groups, generating more quality jobs, addressing inequalities and eradicating poverty so that no one is left behind[18]."

https://obamawhitehouse.archives.gov/sites/default/files/page/files/20151016_firm_level_perspective_on_role_of_rents_in_inequality.pdf

[14] McKinsey & Co, The world at work: Jobs, pay, and skills for 3.5 billion people

[15] In the American, European and Japanese car industries, it costs $8 an hour to employ a robot for spot welding, compared to $25 for a worker

[16] See Council of Economic Advisors Issue Brief, Labour Market Monopsony: Trends, Consequences, and Policy Responses, October 2016

[17] https://stats.oecd.org/glossary/detail.asp?ID=3265

[18] https://www.g20.org/en/g20/timeline

So the targets are set: now I hope we can together, ahead of the G20 summit in Argentina in December, being to build a consensus around the policy choices we must take. The faster that consensus emerges between parties, business, finance, unions, churches and civil society, the faster progress will emerge.

This Palace, where we hold our conference today, was built as a great symbol to the superpower of the steam age. Now as we enter the cyber age, I hope it is the place where we make a progress how we democratise the wealth and opportunity, the power and potential of what could be an extraordinary century ahead.

Thank you and I wish you all a very successful conference.

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