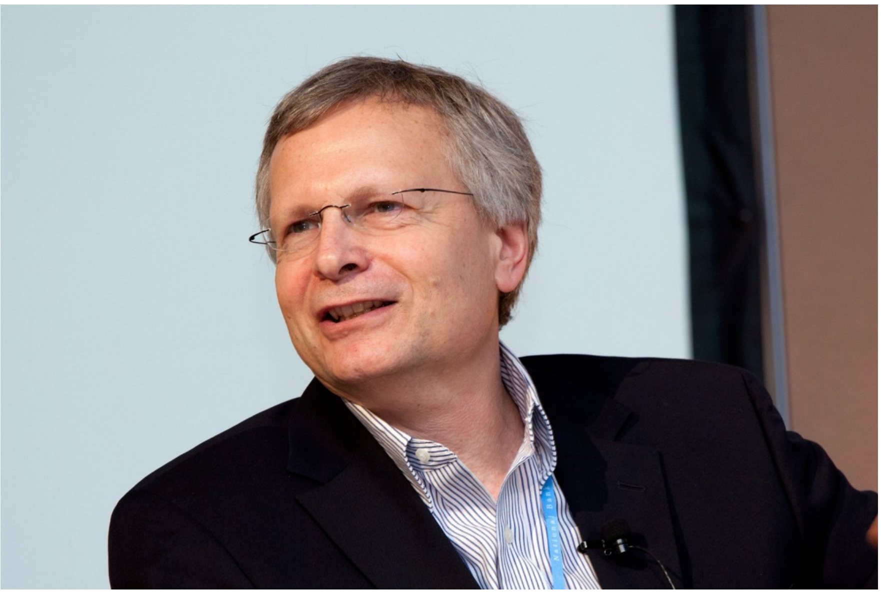
Tackling inequality from the middle

The rise of populist movements and street protests from Chile to France has made inequality a high priority for politicians of all stripes in the world's rich democracies. But a fundamental question has received relatively little attention: What type of inequality should policymakers tackle? **By Dani Rodrik**



Looming large

Inequality looms larger on policymakers' agenda today than it has in a long time. With the political and social backlash against the established economic order fueling the rise of populist movements and street protests from Chile to France, politicians of all stripes have made the issue an urgent priority. And whereas economists used to fret about the adverse effects of egalitarian policies on market incentives or the fiscal balance, now they worry that too much inequality fosters monopolistic behavior and undermines technological progress and economic growth.

No shortage of tools available

The good news is that we have no shortage of policy tools with which to respond to rising inequality. At a recent conference I organized with Olivier Blanchard, a former chief economist of the International Monetary Fund, a group of economists advanced a wide range of proposals, covering all three dimensions of an economy: pre-production, production, and post-production.

Important pre-production interventions are educational, health, and financial policies that shape the endowments with which individuals enter markets. Tax and transfer policies that redistribute market income fall within the post-production category.

Growing consensus that some policy experimentation is desirable and necessary

The remaining category, production-stage interventions, includes perhaps the most pioneering ideas. Policies in this category directly target firms' employment, investment, and innovation decisions by shaping relative prices, the bargaining environment between claimants to output (workers and suppliers, in particular), and the regulatory context. Examples are minimum wages, labor-relations rules, employment-friendly innovation policies, place-based policies and other types of industrial policies, and anti-trust enforcement.

Some policies – such as early childhood interventions, workforce development programs, and public funding of tertiary education – are well tested, and there is evidence that they work. Others, such as a wealth tax, remain controversial, or, as with place-based policies, are accompanied by considerable uncertainty regarding their optimal design. Nonetheless, there is a growing consensus that some policy experimentation is desirable and necessary.

Inequality of a different kind

But a fundamental question has received relatively little attention: What type of inequality should these measures tackle? Policies to address inequality typically focus either on reducing incomes at the top, as with progressive income taxation, or on lifting the incomes of the poor through, say, cash grants to families below a poverty line.

Such policies should be expanded, especially in a country like the United States, where existing efforts are insufficient. But today's inequality also calls for a different approach that focuses on the economic insecurities and anxieties of groups at the middle of the income distribution. Our democracies can minimize the threats of social strife, nativism, and authoritarianism only by boosting the economic wellbeing and social status of middle- and lower-middle-class workers.

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The need for such an approach is reflected in the fact that conventional indicators of inequality are a poor predictor of economic and political discontent in democracies. In France, for example, the far right has made large gains and social protests (by so-called yellow vests) have been pervasive. Yet inequality (as measured by the Gini coefficient or top income shares) has not increased much, unlike in most other rich democracies. Likewise, current street protests in Chile come after two decades of significant reduction in income inequality. US President Donald Trump's election in 2016 was rooted not in the poorest states, but in those where economic opportunity and employment creation lagged behind the rest of the country.

Clearly, the discontent stems from inequality of a different kind, affecting mostly the middle of the income distribution. A key part of the problem is the disappearance (and relative scarcity) of good, stable jobs.

Deindustrialization has laid to waste many manufacturing centers, a process aggravated by economic globalization and competition from countries such as China. Technological changes have had particularly adverse consequences for jobs in the middle of the skill distribution, affecting millions of production, clerical, and sales workers. The decline of labor unions and policies to increase the "flexibility" of labor markets has further contributed to the casualization of employment.

New challenges require new remedies

Another part of the story, not reflected in conventional measures of inequality, is the increasing geographical, social, and cultural separation between large segments of the working class and the elites. This is reflected most immediately in spatial segmentation between prosperous, cosmopolitan urban centers, and lagging rural communities, smaller towns, and outlying urban areas.

> *Increasing geographical, social, and cultural separation between large segments of the working class and the elites*

These spatial gaps drive, and are reinforced by, broader social cleavages. Professional metropolitan elites are plugged in to global networks and are highly mobile. This makes their influence on governments all the stronger, while distancing them from the values and priorities of their less fortunate compatriots, who become estranged and resentful of an economic-political system that apparently neither works nor cares for them. The inequality manifests itself in the form of a perceived loss of dignity and social status on the part of less educated workers and other "outsiders."

Economists are coming to recognize that combating the resulting polarization depends in large part on reinvigorating the economy's capacity to generate good jobs. There is no shortage of ideas here, either. Labor-market institutions and global trade rules need to be reformed to strengthen the bargaining power of labor vis-à-vis globally mobile employers. Firms themselves must take on bigger responsibilities for their local communities, employers, and suppliers. Government support of innovation must be directed toward explicitly employment-friendly technologies. We can envisage an entirely new regime of public-private collaboration in the service of building a good-jobs economy.

Many of these ideas are untested. But new challenges require new remedies. If we are not ready to be bold and imaginative in the service of creating inclusive economies, we will cede the ground to hawkers of old, tested, and disastrous ideas.

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