How to repair economic inequality

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Wealth and income inequality are pressing global issues, affecting the quality of life for countless people, suppressing economic growth, stretching governments' capabilities and destabilising social systems. The good news? Politicians, corporations and investors can all do their part to enact change.

Even though extreme poverty has fallen in recent years, economic inequality has grown more pervasive. In addition to having a human cost, it drags down economic growth and destabilises social systems, and it stresses government spending and revenue streams.

Yet while there's no easy fix, there are ways to narrow the inequality gap.

Policy makers can focus on social safety nets, taxation structures and educational systems; corporations can boost training, compensation and sustainability efforts; and investors can promote responsible corporate governance. And we must make this a high-priority global effort: inequality is one of the most pressing social and economic issues the world faces today.

Inequality is one of the most pressing social and economic issues facing the world today

How pervasive is economic inequality?

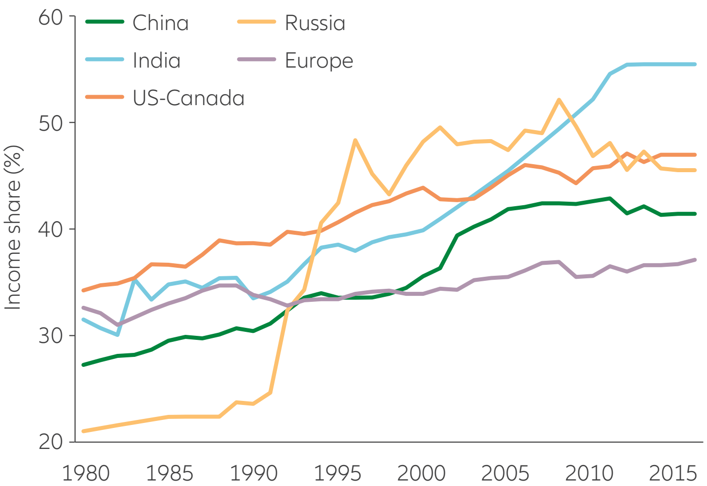
While society has always had its share of haves and have nots, economic inequality – the uneven distribution of income and wealth – is arguably more widespread now than at any point since the Industrial Revolution.

Key takeaways

- Economic inequality may be at its highest level since the Industrial Revolution; in the US alone, the top 1% owned more than 38% of total wealth in 2016
- The social safety net is weakening as more people can't afford basic living expenses, quality health care or retirement savings
- Those who invested in the financial markets in the last 10-40 years have done extremely well, but the many people who don't – or can't – invest in risk assets have fallen further behind
- Governments, corporations and investors all have roles to play in fixing the inequality problem. Allianz Global Investors constantly strives to add value beyond pure economic gain by aligning our interests with those of our clients and our communities.

Income inequality is rising almost everywhere

Income shares of the top 10% of populations (1980-2016)



Source: World Inequality Database, World Inequality Report 2018. Data as at 2016.

According to the United Nations, the top 1% of the US population owned more than 38% of the country's total wealth in 2016. But as the accompanying charts show, this is not just a US problem: economic inequality is rising worldwide, and the top 10% of populations are benefiting disproportionately.

Multiple factors are driving inequality higher

In recent years, globalisation has given rise to global manufacturing, enabling goods to be produced in low-cost centres and increasing the affordability of consumer products, including high-tech goods. But this shift of activities to developing nations has hollowed out industries in developed countries, including traditional big employers such as mining and steel. The rise of robotics, automation and artificial intelligence will also threaten conventional jobs in the future. Together, these and other developments have reduced the traditional work opportunities that once supported large segments of the population. This has made income and wealth inequality worse and created a growing opportunity gap – particularly for the next generation.

Financial globalisation via the deregulation of financial markets has also played a role in making inequality worse by helping those who have wealth to increase it. Those who were able to invest in the financial markets since the 1980s have done extremely well – particularly in the last 10 years, thanks to central banks' extremely accommodative monetary policy pushing up asset prices across the board. By contrast, the large number of people who don't invest in risk assets have found themselves left increasingly farther behind. Enabling more people to participate in the "risk premium" of financial assets is clearly part of the solution.

Helping more people participate in the "risk premium" of financial assets is part of the solution

A clear and present danger

While economic inequality may be rising, extreme poverty has dropped around the world. And it is fair to say that income inequality as a measurement tool doesn't always paint a full picture: a struggling nation can suffer from crippling poverty while being low on the income-inequality scale.

In most countries, however, governments are paying close attention to economic inequality – just for different reasons:

- In the emerging world, where most wages are low, wealth inequality is the bigger issue. Not enough people own their own homes or have sufficient savings or pensions.
- In developed markets, a decreasing number of wealthy individuals shoulder more of the tax burden. Moreover, the social safety net is growing strained as ever-larger portions of the population are unable to afford basic living expenses, quality medical care and retirement savings – exacerbated by the rising, inflationary costs of health care.

Worldwide, economic inequality is a destabilising force: it creates distrust and undermines cohesion, increasing the appeal of factional politics. Moreover, in a world of ultimate openness – aided by social media – people today are more aware of what they are "missing" than were previous generations. This not only boosts populist politics, but it has a social cost: when people perceive they have fallen behind, they can be more stressed, grow less healthy and make riskier decisions as they try to catch up.

Economic inequality is a destabilising force that increases the appeal of factional politics

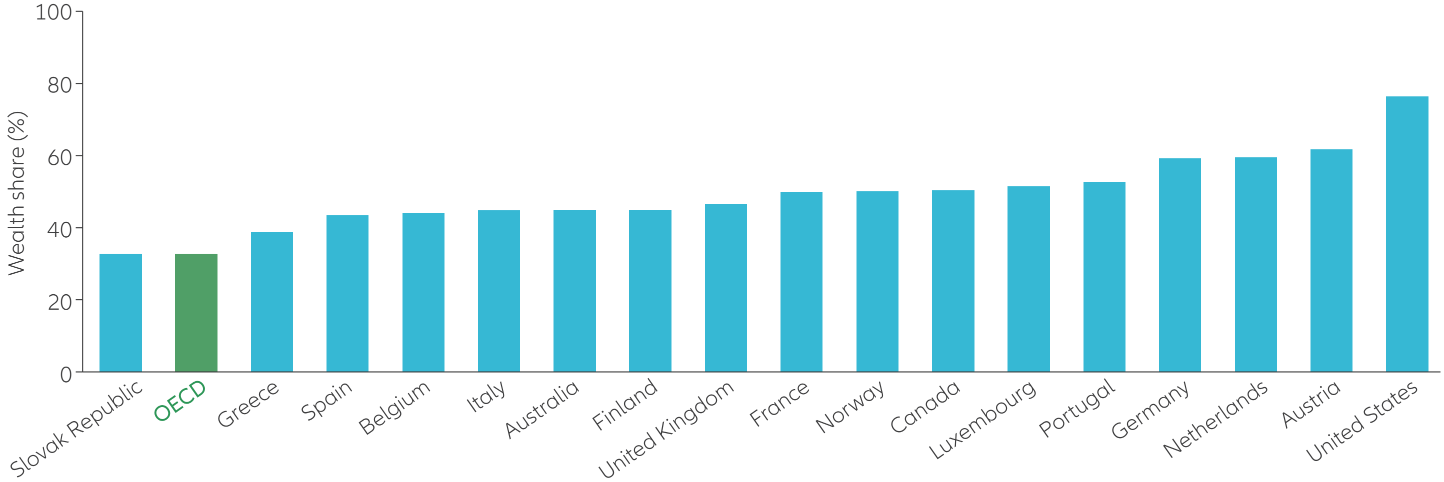
How to repair economic inequality

At Allianz Global Investors, we believe that all societal stakeholders – citizens and governments, investors and corporations – can play a role in addressing rising inequality even as we ensure that poverty levels continue to fall.

1. To raise the level of personal savings and investment, governments should expand policies that educate their citizens about financial markets and encourage investment.
2. The financial industry can improve financial inclusion by promoting wider access to financial services in a sustainable, responsible way.
3. Financial literacy must be enhanced to enable larger portions of the population – particularly younger generations – to raise their economic standing.
4. Regulation and tax reform need to become more fair and less politicized – and central banks must be allowed to focus on the longer-term interests of their economies, free of short-term political considerations.
5. More-progressive tax policies can redistribute wealth in helpful ways, since lower-paid workers spend a greater proportion of their earnings than their higher-paid counterparts.

Wealth inequality is highest in the US

Wealth shares of the top 10% of populations (2010)



Source: OECD Wealth Distribution Database, Allianz Global Capital Markets & Thematic Research. Data as at 2010, except Chile (2011); Australia, Canada, UK (2012); Korea (2013).

6. Governments must improve the social safety net, using ubiquitous new technologies to make it more efficient, less prone to abuse and better at revenue collection.

7. Education systems should be modernised to boost workers' skill sets, and student-loan systems may need to be overhauled, particularly if they reprice education in a way that benefits the supplier, not the student.

8. Workforces need training, investment and support, and management teams should move into a more cooperative approach towards managing and retaining employees. Successful companies tend to pay more than less successful ones; better people and better remuneration deliver better productivity.

9. With lower taxation and smarter regulation, financial services companies and banks should be able to reduce and better align their fees. This may help address accusations of profiteering.

10. Investors can pressure management teams and boards to focus on environmental, social and governance (ESG) factors – particularly executive pay – that can help reduce inequality.

At Allianz Global Investors, we constantly work towards applying the power of active management to real-world issues – from the challenges and opportunities presented by robotics and artificial intelligence, to the perils of low productivity and rising economic inequality, to the ESG factors that help companies and shareholders succeed. As such, we will continue to strive to add value beyond pure economic gain by aligning our interests with those of our clients and our communities – directing capital into initiatives that are likely to promote future growth in a more sustainable and equitable way.

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