NEW FINANCIAL
Rethinking capital markets

THE CRISIS OF CAPITALISM - A SUMMARY

Why are so many people around the world so angry with capitalism, big business, politicians and the elite? And what can we do about it?

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> Few sectors of the economy have been blamed more for fuelling popular anger with capitalism as banking and finance - and few sectors have as much to lose from the backlash against it. This report summarises the main causes of the widespread loss of faith in capitalism over the past few decades in the form of 10 different types of real and perceived inequalities - and outlines the main policy responses that have been proposed.

An introduction to the crisis of capitalism

Jamie Dimon thinks it is 'fraying', hedge fund manager Ray Dalio thinks it is no longer working for the majority of Americans, while Jeremy Corbyn, Bernie Sanders, Elizabeth Warren and millions of their political supporters want to turn it on its head. Capitalism, it seems, is in crisis. Nearly 50 years after Milton Friedman declared that the sole responsibility of a company is to its shareholders, the mantra of shareholder value and the relentless pursuit of profits may have run its course. And you don't have to be a flag-waving socialist to recognise that something has gone wrong.

Few sectors of the economy have been blamed more for fuelling popular anger with capitalism as banking and finance - and few sectors have as much to lose from the backlash against it. Finance can also be one of the most tin-eared sectors when it comes to understanding why so many people are so angry with capitalism and what they perceive as its failure to deliver on its basic promise of increased prosperity for all.

We thought it would be useful to pull together a summary of the main reasons behind the popular backlash against capitalism, and to flag up the wide range of policy responses that have been floated as potential solutions. We have presented the drivers of the crisis of capitalism as a series of different types of inequalities; from the widening gaps in income and wealth, to regional and intergenerational inequality, and the perceived inequality of accountability, behaviour and power between big companies and the rest of us. They make for sobering reading.

The report is **not** a theoretical analysis of the merits or otherwise of capitalism and focuses instead on how the outcomes from capitalism are experienced and perceived by people around the world. And it is **not** a New Financial manifesto for change. New Financial was founded on the basis that markets can and should be a force for economic and social good. But capitalism is in danger of losing the social licence from which it derives its legitimacy. The good news is that capitalism remains the best available system to address the problems that it causes - but only if those who practice and preach it recognise those problems, accept the need for change, and make concrete commitments to reform. Understanding the causes of the loss of faith in capitalism is the first step towards reforming and preserving capitalism for the greater good.

Contents
The paper includes four sections:

- A summary of the 10 main drivers of the crisis of capitalism and of the 10 main areas of potential policy responses
- A more detailed analysis of the drivers of the crisis of capital
- A more detailed analysis of the potential policy responses
- A separate appendix of further reading with summaries of recent books and articles on the subject (click *here* to read)

Acknowledgements
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New Financial is a think tank that believes Europe needs bigger and better capital markets to help drive prosperity and growth.

We believe this presents a huge opportunity for the industry to embrace change and rethink how capital markets work.

We work with market participants and policymakers to help make a more positive and constructive case for capital markets around four main themes: unlocking capital markets; rebuilding trust; driving diversity; and the impact of Brexit.

We are a social enterprise that launched in September 2014. We are funded by institutional membership.

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Part 1 - Summary of the drivers of the 'crisis of capitalism'

The growing sense of disenchantment with free market capitalism in the early 21st century is perhaps best understood as a series of different types of inequality: from the widening gaps in income and wealth, to regional and intergenerational inequality, and the inequality of opportunity and accountability. Here is a short summary of 10 types of inequality that we believe have fuelled the growing crisis of capitalism:

1. **Income inequality:** income inequality has widened over the past few decades as capitalism has failed to deliver on its promise of raising living standards for all. Since 1970, median pay in the US has flatlined in real terms, while the pay of the top 20% has doubled. Average wages in the UK have still not yet recovered in real terms to their 2008 peak - a decade on from the financial crisis.

2. **Wealth inequality:** the growth in wealth inequality has been even more pronounced. The share of total wealth owned by the top 1% has doubled in the UK and US over the past 40 years, and the combined wealth of the top 10% of adults in the UK is five times that of the bottom half of the population.

3. **Regional inequality:** globalisation and the shift to a knowledge-based economy has concentrated wealth, jobs and commercial activity in big cities and widened the income and productivity gap between regions. Economic output per capita in London is three times higher than in parts of northern England, and average incomes in London are twice as high.

4. **Intergenerational inequality:** the divide in wealth and income is particularly acute when viewed from a generational perspective. Capitalism is failing in its basic promise that the next generation will be better off than the current one: less than half of people in the UK believes this is true. In the US, only half of 30-year-olds earn more than their parents, compared with 90% in 1970.

5. **Inequality of opportunity:** people tend to accept unequal outcomes if they believe the system is fair but more than two thirds of people in the UK believe society is rigged towards the rich and powerful. Access to good education sits at the heart of this sense of widening inequality of opportunity. Social class and education remain a huge barrier to the best universities and jobs.

6. **Inequality of representation:** the loss of faith in capitalism is closely linked to the loss of trust in traditional politics, fuelling the recent rise of populism. Around two thirds of people in Western economies believe that 'politicians don't care about people like me' and feel increasingly powerless.

7. **Inequality of employment:** the fault line between high-paid and high-productivity jobs in knowledge-based sectors and everyone else has widened, creating a two-tier employment system. Average pay in finance and technology is more than double that of retail and hospitality. A growing 'precariat' of workers are on insecure contracts with low pay, limited benefits and protections, and limited prospects.

8. **Inequality of behaviour:** the mantra of shareholder value and the relentless pursuit of profit over the past 50 years has stretched the social contract between business and society. This has fundamentally changed companies' relationship with employees, suppliers and customers: workers feel expendable, suppliers are beaten into submission on price, and customers often feel exploited.

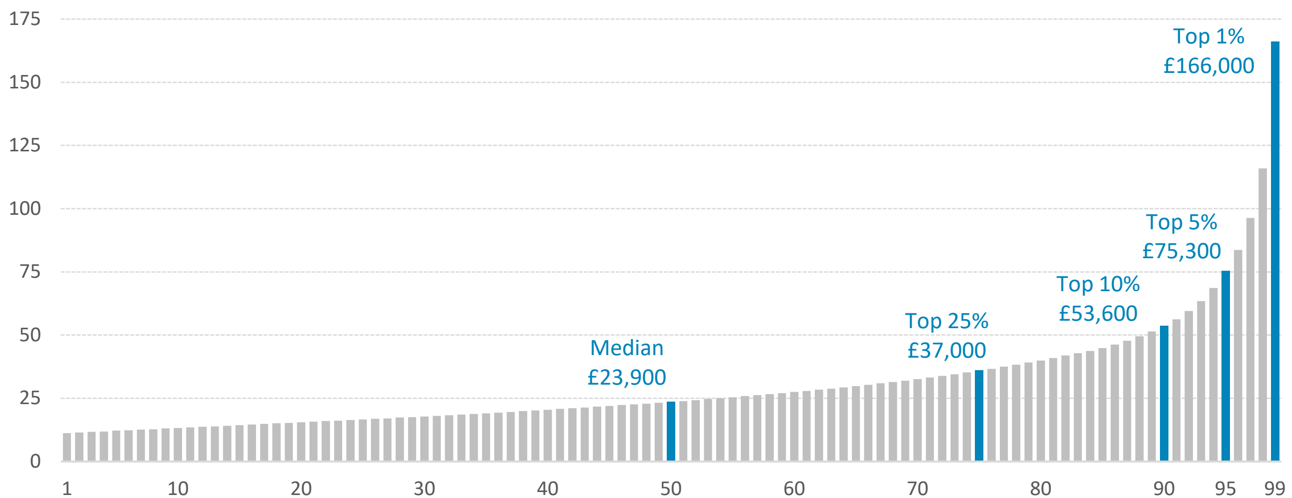
9. **Inequality of power:** 'big business' and 'crony capitalism' have long been problematic. The increase in market power and concentration means that larger firms are increasingly able to influence the rules under which business operates. This can create a vicious circle: large firms become more powerful and monopolistic, stifling competition and undermining the wider benefits of capitalism to consumers.

10. **Inequality of accountability:** 'big business' can give the impression that it doesn't have to play by the same rules, such as paying tax, and being held accountable for failure. Too often governments appear to acquiesce, creating an uneven playing field between large and smaller companies.

Fig.1 Inequality of income in the UK

Pre-tax earnings per taxpayer in the UK £'000 in 2017 - by percentile

These two charts are a sobering reminder of the current levels of income and wealth inequality in the UK. Fig.1 shows the distribution of pre-tax income in 2017 by percentile for the 32 million people who pay income tax (note that more than 40% of adults don't earn enough to pay any income tax). The distribution is heavily skewed to the highest few percent of taxpayers. Median income is £23,900; £53,600 puts someone in the top 10%; the top 5% requires income of £75,600; while earnings of £166,000 qualify for the top 1%.

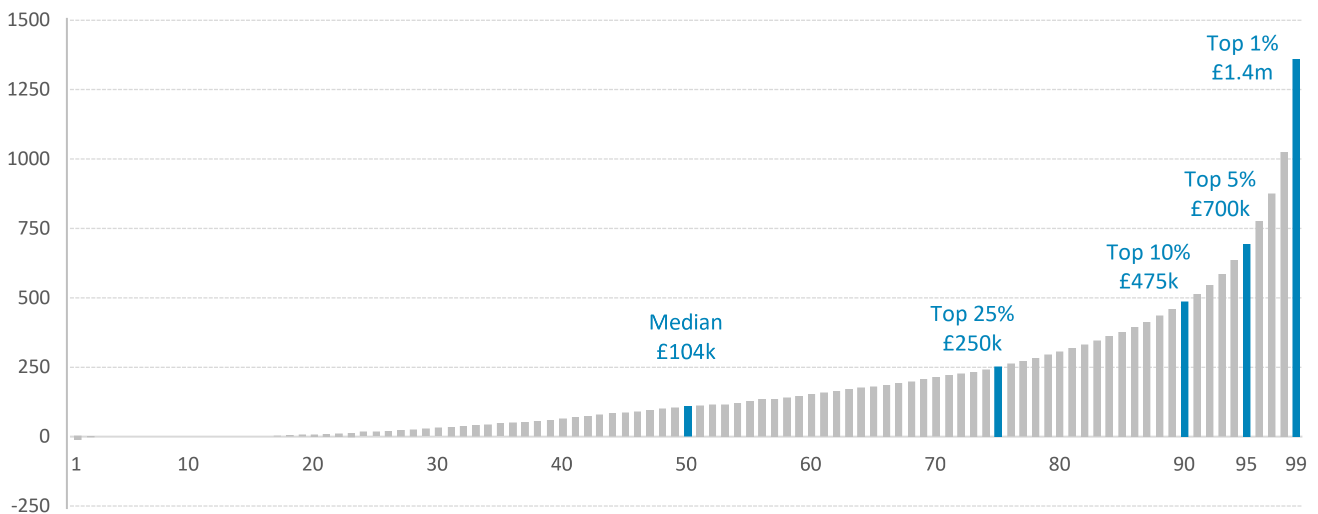


Source: HMRC

Fig.2 Inequality of wealth in the UK

Household wealth per adult in the UK in £'000 in 2012 - by percentile

The quality of data on the distribution of wealth is significantly worse than for income but this is the best analysis we have found. Inequality of wealth is much higher than for income: the Gini co-efficient (a measure of inequality) for wealth is 0.62, nearly double the 0.35 for income. Unlike income, a larger group of the top 10% to 20% of adults have significant wealth relative to the rest of the population. The ratio between the 90th percentile and the median for wealth is 4.5x, compared with 2.2x for income.



Source: IFS / Crawford, Innes & O'Dea 2016: analysis of Wealth & Asset Survey data from the ONS
Note: wealth includes net property, financial assets and pensions wealth but excludes physical wealth (such as art, antiques and jewellery)

Summary of the potential solutions to the 'crisis of capitalism'

Here is a short 10-point summary of some of the potential solutions that have been proposed around the world in response to the crisis of capitalism. Some are more sensible and more palatable than others. This summary aims to capture the views expressed by a range of politicians, economists and commentators and does not represent the views of New Financial.

1. Tax reform: the biggest single area for potential reform is tax. The range of activities that have been subject to tax has changed over the years depending on the political and economic climate, but faced with growing inequalities and structural tensions there is increasing momentum behind reform of tax systems that were designed in the 19th and 20th centuries to make them fit for the 21st century economy.

- **Income tax**: as the biggest single source of tax receipts income tax is the obvious place to start. There are three main themes to tackling income inequality - raising personal tax allowances and tax bands, increasing tax rates on higher earners or lowering the level at which higher rates kick in, and a 'super tax' on the very highest earners.

- **Wealth tax:** given the widening gap in wealth inequality, the idea for some sort of wealth tax (usually a small levy on total wealth) has gained ground. Wealth taxes can be hard to assess and collect, and have been phased out in some of the countries that had applied them. But various models exist in different forms in the likes of Switzerland and the Netherlands that could be copied and improved.

- **Property tax:** in the UK property is undertaxed compared with many other countries. The three main areas of focus on changes to property tax are reforms to local taxation, how gains on property are taxed, and potentially an annual levy on highest value properties (a 'mansion tax').

- **Land tax:** a more radical (yet simple) alternative to the complex systems of taxing commercial and residential property is an annual levy on the value of land. It would be easy to collect, hard to avoid, and would reflect more accurately the contribution of the public and private sector to the value of the land.

- **Robot tax:** increased automation is eliminating jobs and reducing tax revenues. A tax on robots - either on the capital invested in them or on their economic output - could help redress the balance.

- **Capital vs labour:** in most developed economies labour ('earned income') is taxed at a significantly higher rate than capital (which generates 'unearned income'). Reducing or eliminating this differential, by increasing taxes on capital and removing loopholes, would help address inequality.

- **Financial transaction tax:** the idea of an FTT, Robin Hood or Tobin tax has been around for decades but has recently gained momentum in the EU, US and UK. A small charge on trading in equities, bonds or derivatives trades could generate significant revenues, while reducing speculative trading and risk taking.

- **Corporation tax:** in the UK and US the headline rates of corporation tax have fallen sharply over the past few years. Increasing corporation tax levels - combined tax breaks to encourage R&D and investment - could boost tax revenues and allay concerns that companies don't pay their fair share.

- **Tax avoidance:** at the same time, governments around the world have stepped up efforts to reduce perceived and actual tax avoidance by multinationals, including the recent publication by the OECD - working more than 130 countries - of a proposal to end the exploitation of mismatches and loopholes in tax regimes by multinational companies.

- **Activity tax:** more controversially a number of countries including France and the UK have introduced plans to charge multinationals (particularly large technology companies) a low level of tax on revenues generated in specific countries, rather than on their profits.

- **Debt vs equity:** in most developed economies, debt attracts tax relief while equity is taxed three or four times over. Reducing the tax differential between debt and equity would encourage more companies to issue equity, increase corporation tax receipts, incentivise investment and innovation, and widen wealth creation.

2. Government redistribution: there is increasing demand for governments to take action (beyond taxation) to redistribute wealth, centred around four main ideas. A more realistic 'living wage' is one popular idea - the UK's minimum wage offers annual income of just £17,000 for someone aged over 25 working a 40-hour week. Second is increasing welfare benefits for the worst off, and possibly requiring employers to share the cost of tax credits payments to their lowest paid workers. Third is establishing social wealth funds - akin to those in Alaska and Norway - that share income to citizens and / or invest in welfare and pension provision. And fourth, a more radical idea, is some form 'baby bond' that invests a sum of money for every citizen until their 18th or possibly 30th birthday.

3. Universal basic income: a more radical and seemingly simple approach to government-led redistribution is UBI, where every citizen receives a regular cash sum to cover basic needs regardless of their wealth or employment. It has growing support on the left in Europe and the US but is eye-wateringly expensive. A UBI of £5,000 a year for 53 million UK citizens over16 years old would cost £265bn a year (roughly the same as the entire welfare and pensions budget). An alternative to a UBI is UBS (universal basic services), whereby all citizens have free access to a defined range of basic services.

4. Monopolies & anti-trust: there are growing calls for bolder antitrust legislation as a pushback against the excessive power of larger companies, and their ability to reduce competition, entrench their market position and distort markets. In particular, technology giants like Google, Facebook and Amazon have come under greater scrutiny.

5. Skills & education: retraining and education programmes could play a much bigger role in addressing growth and productivity challenges; from early years education programmes to the expansion of technical education, apprenticeships and internships; and more investment in retraining schemes in regions most affected by shifts in the structure of the economy. In Germany, 1.5 million young people work in apprenticeships with local businesses annually.

6. Increasing transparency: more radical transparency and disclosure requirements for companies - particularly on social, environmental and governance factors - would increase public accountability and incentivise companies to change, while simultaneously helping them reconnect with wider society. There is scope to develop a more rigorous framework that accounts for human, social and natural capital as well as financial metrics that could also help redress the balance between labour and capital.

7. Regional infrastructure: infrastructure initiatives focused on regional regeneration - such as the UK's Northern Powerhouse or Midlands Engine initiatives - are becoming an increasingly popular approach to helping address regional inequality but need to be stepped up by several gears. Infrastructure investment, particularly when it is well-targeted to meet local needs, has a high rate of return: a recent study found that every dollar spent on restoring and expanding US infrastructure would produce nearly four dollars in economic benefits.

8. Stronger worker protections: the rise of 'gig economy' giants and the decline of trade union influence has reduced the bargaining power of workers and fuelled the imbalance between labour and capital. A rethink of legal definitions of employees, workers and contractors for the 21st century is needed to ensure they have more appropriate protection, benefits, and prospects, and perhaps also better access to share ownership and a bigger say in management decisions.

9. A focus on purpose: big companies are under growing pressure to focus less on profits and growth and more on their underlying purpose and wider impact on society. New UK reporting rules require directors to consider corporate success in relation to employees, suppliers, customers and impact on the environment, while the Business Roundtable of largest corporations has pledged to focus on all stakeholders and the environment rather than just prioritising shareholders.

10. Corporate structural reform: allied to this shift is the question of alternative potential structures for corporations. A number of alternatives already exist: 'B corporations' in the US or social enterprises in the UK more clearly balance social values with profits. Mutually owned companies such as John Lewis in the UK, family or trust systems that include cornerstone shareholders, or worker-owned cooperatives in Germany demonstrate that alternative structures can work just as well than traditional limited liability corporations designed to maximise profits. Wider employee share ownership can also play a big part.

Part 2 - Analysis of the main drivers of the crisis of capitalism

This section analyses in more detail 10 types of inequality that we believe have fuelled the growing crisis of capitalism. It is important to note that these inequalities are related and feed each other: income and wealth inequality are most likely to be felt by younger people (intergenerational inequality) in more deprived areas (regional inequality) - and they are most likely to encounter inequality of opportunity and employment.

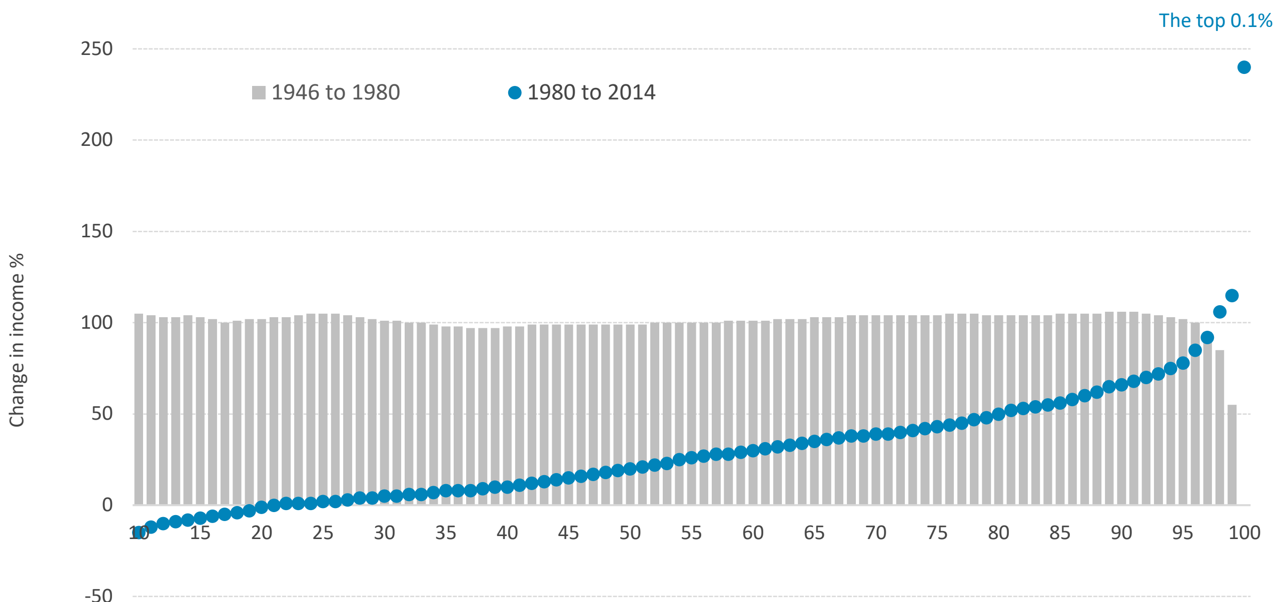
1) Income inequality

The most obvious cause of anger is widening income inequality and the apparent failure of capitalism over the past few decades to deliver on its basic premise of raising living standards for all. The incomes of the wealthiest parts of society have risen sharply in real terms over the past few decades, while for most people they have stagnated. For example, incomes have flatlined in real terms since 1970 for the bottom 60% of earners in the US, while the incomes of the top 20% have doubled over the same period. The share of total income of the top 1% has doubled since 1980 in both the UK (from 7% to 14%) and the US (from 10% to 20%), while the share of income for the bottom half has halved. A decade on from the financial crisis, and average earnings in the UK have still not recovered to their peak of 2008.

The divide has helped fuel a sense of relative deprivation and a feeling of being 'left behind'. It's a far cry from the more collective capitalism of the previous few decades: in the 35 years up to 1980, post-tax incomes roughly doubled in the US in real terms for everyone except the top 1% and 5% whose incomes only increased by half (see the grey columns in Fig.3). However, over the next 35 years, for most people income growth was much more depressed: more than three quarters of people saw their income rise by less than 50% in real terms between 1980 and 2014 (the blue dots); median pre-tax income only rose by around 20%; while the only people who enjoyed the same sort of rise in income that virtually everyone had enjoyed in the post-war period were the top few percent of earners.

Fig.3 The changing shape of income growth

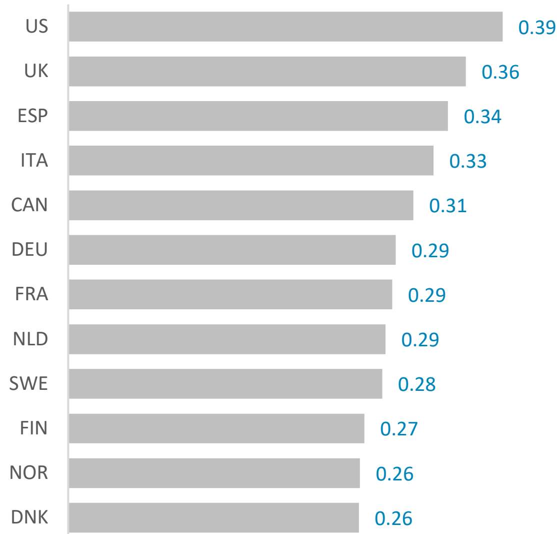
The change in income in real terms in the US by percentile of earners: from 1946 to 1980 and from 1980 to 2014



Source: Deutsche Bank analysis data from Thomas Pickett, Emmanuel Saez & Gabriel Zucman in Quarterly Journal of Economics Sept 2017

Fig.4 The range in income inequality

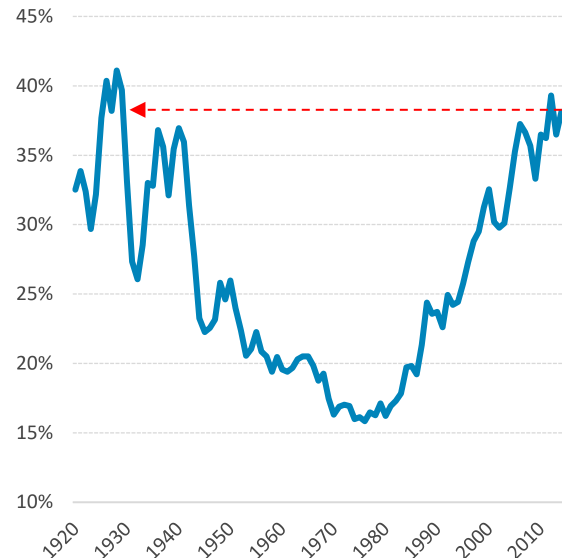
Gini coefficients in a selection of countries 2017 (or latest available)
1= perfect inequality, 0 = perfect equality



Source: OECD

Fig.5 A return to the 1930s

Income share of the top 1% as a % of the bottom 90% in the US
1920 to 2014



Source: World Inequality Database

One problem with addressing income inequality is that the distribution of income is very skewed with a relatively small number of high earners who often do not consider themselves wealthy. It is sobering that the median income for a full-time employee in the UK is just over £29,500 and the overall median income for UK taxpayers is £23,900. Around £55,000 would put a teacher in the top 10% (a group of three million people), and although a journalist or MP earning £75,000 a year may not feel rich, they are in the top 5% of all earners. A relatively junior investment banker on just over £160,000 would find themselves in the top 1% just a few years out of university.

The threshold for the top 0.5% is £240,000, and the top 0.1% requires an income of £650,000 a year, according to research by the Institute for Fiscal Studies. Up in the top 0.01%, the average FTSE 100 chief executive earns around 115 times the median wage, meaning it takes them less than three days to earn what an average employee at their company earns in a year.

The UK is towards the top of the rankings for net income inequality among developed economies (see Fig.4). The US on 0.39 has the highest level of income inequality as measured by the Gini coefficient, in which 0 means a perfectly equal distribution and 1 denotes perfectly unequal distribution, ahead of the UK on 0.35. Income inequality has risen sharply in the UK since the late 1970s, when it had a Gini score of around 0.25. Other developed European economies such as France, Germany and the Netherlands, have significantly less inequality of income, while Nordic countries are much more equal when it comes to income distribution.

One way of looking at the change in income inequality is to compare the share of the top 1% with the bottom 90%: Fig.5 shows that on this measure, income inequality in the US has risen sharply since the mid-1970s and is now at its highest levels since the Wall Street Crash in 1929. The combined income of the top 1% adds up to 38% of the combined income of the bottom 90%, more than double its level from the late 1960s to the early 1980s.

Meanwhile, just under a fifth of American children live in poverty and this figure has not meaningfully improved for decades. A similar proportion of American children lived in 'food-insecure' homes in 2017 (i.e. they don't have enough money to guarantee regular meals) putting the US behind Poland, Greece and Chile.

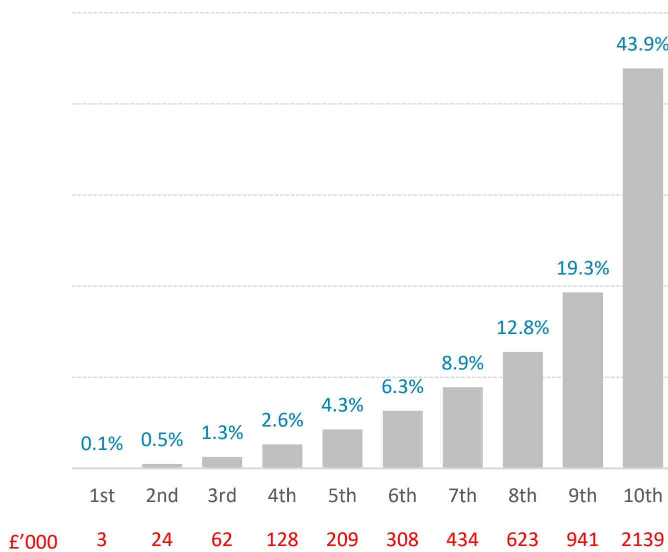
2) Wealth inequality

The growth in wealth inequality has been even more pronounced, fuelled by rising asset prices and the compound effect of returns on capital being consistently higher than growth in earnings. In the US, the share of total wealth owned by the top 1% has doubled to just under 40% over the past 40 years (its highest level since the 1940s) and in the UK the wealthiest 10% of the population own 45% of all assets (or five times the combined wealth of the bottom half of the population - see Fig.6). The combined wealth of the top 1% in the US is more than 40% higher than the bottom 90% (Fig.7).

One problem in addressing wealth inequality and concentration is the tendency of wealth to create wealth. The lower rate of tax on capital gains widens the divide between those who have it and those who don't; the co-ordinated response to the financial crisis of pumping money into the economy has delivered excellent returns for people with financial assets but left behind those without; and wealth is being passed on through inheritance at the highest rate in more than 75 years. It is a sobering reminder that while stock markets have boomed in the past decade, 40% of the UK have less than £1,000 in savings and 40% of people in the US would struggle to pay an unexpected bill of $400.

Fig.6 The distribution of wealth in the UK

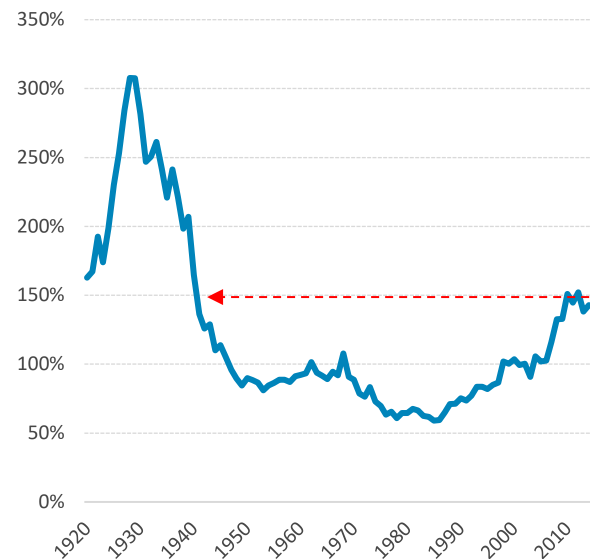
Share of total household wealth by decile in the UK in 2016
(The number in red denotes average wealth in each household)



Source: ONS, New Financial

Fig.7 Back to the 1940s

The share of wealth of the top 1% as a % of the bottom 90% in the US - 1920 to 2014



Source: World Inequality Database

While debate on income inequality tends to be framed in terms of the top 1%, with wealth inequality it would be better framed in terms of the top 10% of 20%. Fig.6 shows the share of total household wealth in the UK by decile, based on our analysis of data from the ONS. The top 10% of households collectively own 44% of all wealth (which includes savings, investments, property and pensions), which is five times the combined wealth of the bottom half of households, and the top 20% of households have just under two thirds (63%) of all wealth. The average wealth of the top 10% of households is around £2.1m.

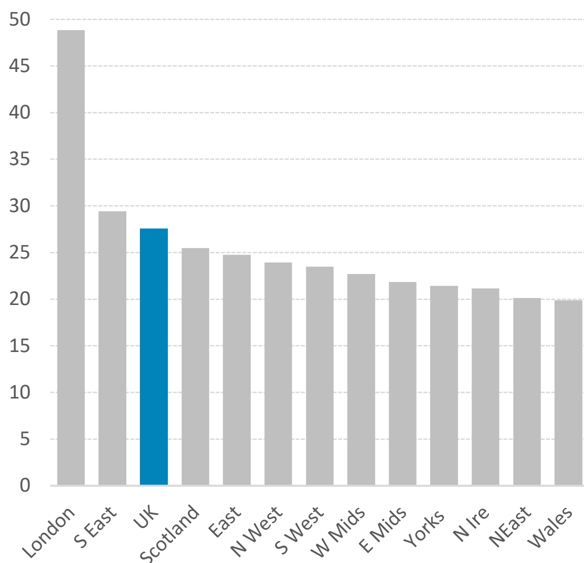
Note: the data on wealth in the UK includes actual and imputed pensions wealth, which represents 42% of all wealth (ahead of property on 35%, financial assets on 13% and physical wealth on 10%). Pensions income is converted to an asset value based on annuity rates, so a pension of £5,000 a year would translate into pensions wealth of about £110,000. This helps explains why some of the numbers on wealth are higher than many people might expect and why many people fall into a wealthier category than they might think without feeling 'wealthy'.

3) Regional inequality

The shift from manufacturing to a services-led economy in many Western countries over recent decades has widened the gap between the cosmopolitan cities and the declining provinces. This has created significant regional inequalities in terms of productivity, income, jobs and wealth. In the UK, London's output per capita is nearly 70% more than any other UK region (see Fig.8) and nearly three times higher than the most deprived areas in the North of England. Over the past 20 years, the London economy has grown at over 3% a year in real terms, (see Fig.9) well ahead of any other region and around double the rate in the North East, West Midlands and Yorkshire and Humberside.

Fig.8 A regional divide - output

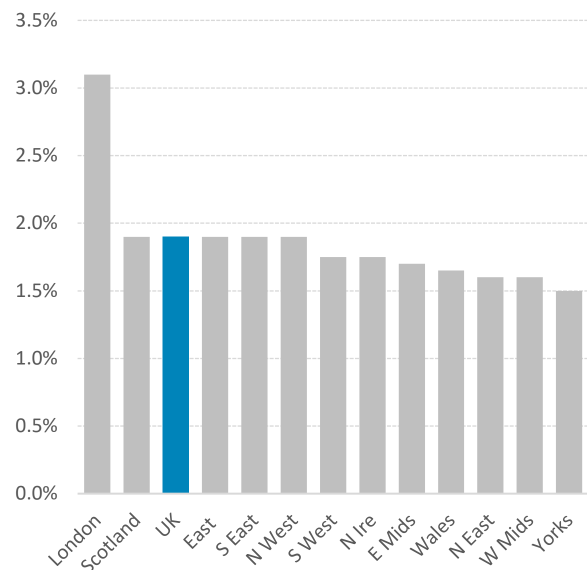
Economic output per capita in the UK by region in 2017
£'000



Source: IFS / Deaton Review / ONS

Fig.9 A regional divide - growth

Average annual growth in economic output (gross value added in real terms) by region in the UK 1998 to 2017 %



Source: IFS / Deaton Review / ONS

Across Europe, the economies in capital cities that rely more on knowledge intensive industries has grown at twice the rate of the rest of the country since 1980. In the US, half of all job growth in the past decade took place in just 20 cities, and the median household income in states like Mississippi is just half that of the wealthiest states like Maryland.

This shift in the nature of economic activity has widened income disparity between regions: average income (mean) in Kensington in central London of £162,000 is nearly eight times higher than in Blackpool (although median income is only twice as high). Despite being one of the wealthiest countries in the EU, the UK is also home to nine of the 10 poorest regions in Northern Europe, according to data from Eurostat. At the bottom of the scale are 'end of the line' towns like Clacton in Essex, which is less than 90 minutes by train from London and the only constituency to have elected a UKIP MP. Median household income in Clacton is less than 60% of the UK average, while the unemployment rate and the number of people receiving benefits are twice the national rate.

This regional inequality is compounded by the centralisation of government and commercial activity in capital cities, and the perceived regional imbalance in spending and infrastructure. While higher economic output means that London generates far more in tax receipts than it receives in government spending (and therefore subsidises spending in the rest of the country), in some areas there is a stark difference in priorities: spending on transport infrastructure per capita in London of over £4,100 is nearly three times the level of per capita spending in the North of England.

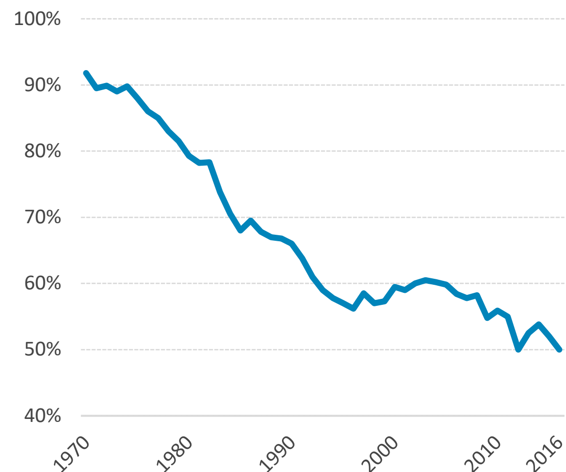
4) Intergenerational inequality

The increase in wealth and income inequality is particularly acute when viewed through the lens of intergenerational inequality and the breakdown in the basic promise of capitalism that the next generation will be better off than the current one. In the UK, just one fifth of people think that this is true today.

In its simplest form, there is a growing sense that older people who benefited from economic growth, rising house prices, and generous pensions in the 50 years before the crisis have pulled up the ladder behind them. Millennials - roughly anyone under the age of 40 - are struggling to get on to that ladder, let alone climb it: they came into the workforce in the past few decades and have been hit hardest by the financial crisis. In the US, the percentage of 30-year-olds who earn more than their parents has fallen from 90% in 1970 to 50% (see Fig.10). And median wealth and income of under 35-year-olds was a quarter lower in 2016 than the decade earlier.

Fig.10 Worse off than your parents

The % of 30-year-olds who earn more than their parents in the US 1970 to 2016



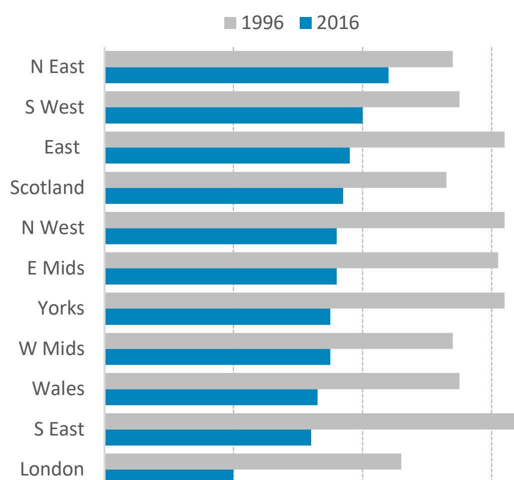
Source: National Bureau of Economic Research

In the UK, two thirds of all wealth (including property, pensions and financial assets) is owned by people over the age of 55, and home ownership rates among people under the age of 35 have halved in the past 30 years (see Fig.11). While you would expect older people who have been working longer to have accumulated more wealth, many millennials cannot see a route to financial security given the rapid rise in house prices, relative stagnation in incomes, high levels of student debt, and the withdrawal of generous pensions. For example, in 1999, it took around three years for someone on an average income to save a deposit for their first house: today it would take more than 15 years. In less than 20 years, the ratio of median house prices to median incomes in the UK has more than doubled from just under four times to nearly eight times (see Fig.12).

And as pensions switch from the more generous defined benefits schemes enjoyed by their parents for defined contribution schemes, many younger people think they will have to pay more and work longer to receive a lower pension in their retirement.

Fig.11 The receding prospect of home ownership

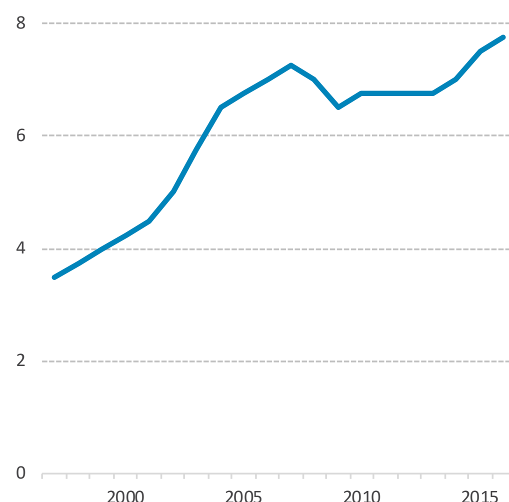
The proportion of 25 to 34 year-olds who own their home by region 2016 vs 1996



Source: IFS

Fig.12 A steep property ladder

The ratio of median house prices to median earnings in England 1997 to 2016



Source: ONS

5) Inequality of opportunity

For people to accept that outcomes will be unequal it helps if they believe that opportunity is fair and equal for all. But over recent decades the sense of inequality of opportunity has widened, particularly when it comes to education. As modern economies have shifted towards knowledge-based industries, the value of a good education has risen and education has become a fault line in people's political, social and cultural views (for example, only 20% of graduates in the UK under the age of 35 voted for Brexit compared with nearly two thirds of non-graduates in the same age group).

Social class and education are still a huge barrier to accessing the best universities and best jobs. In the US, two thirds of students at Harvard come from the top 20% of households by income, while the share of students at Ivy League universities from families in the top 1% by income is slightly higher than the share of students from the bottom 50%. This disparity is perhaps not surprising when the headline cost of attending Harvard is around $75,000 a year (a three-year university course in the UK 'only' costs students an average of £54,000).

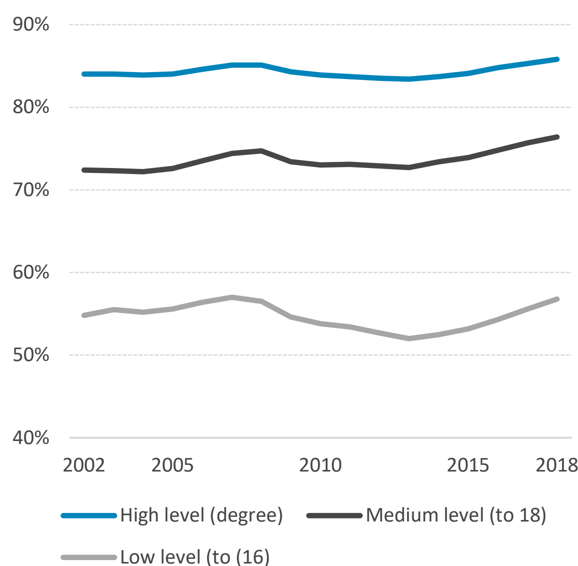
With a degree generating an income premium of around 20% within a few years of graduation (and much higher for elite universities), the income and wealth gaps between graduates and non-graduates over time is huge. On average, earnings for graduates are 60% higher than non-graduates in the UK, and 80% higher in the US.

Across the EU, employment rates for workers with degrees are significantly higher at around 85% than for less educated workers (see Fig. 13), while less educated workers suffered disproportionately from the financial crisis. In the UK, demand for highly skilled workers increased sharply over the 20 years to 2015 but it fell or flatlined for less skilled workers (see Fig.14).

Inequality of opportunity starts at school (if not before) and is closely related to regional inequality. For example, nearly a third of state secondary schools in London are rated as 'outstanding', more than three times the level of secondary schools in places like Hartlepool, Hull and Wigan in the north of England.

Fig.13 The educational divide

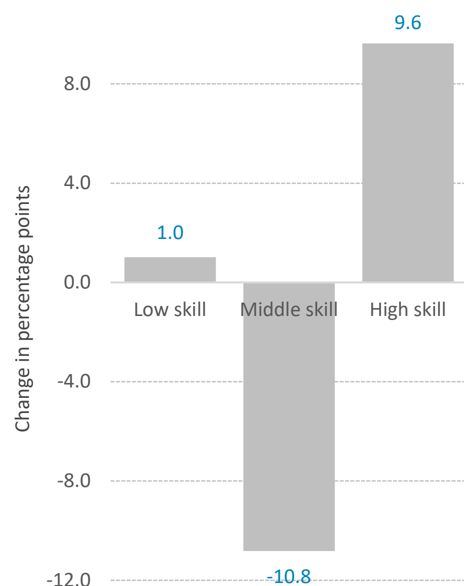
% of people in employment in the EU based on their level of education 2002 to 2018



Source: Eurostat

Fig.14 Mixed job prospects

The change in demand for workers based on their skill level in the UK 1995 to 2015



Source: OECD

6) Inequality of representation

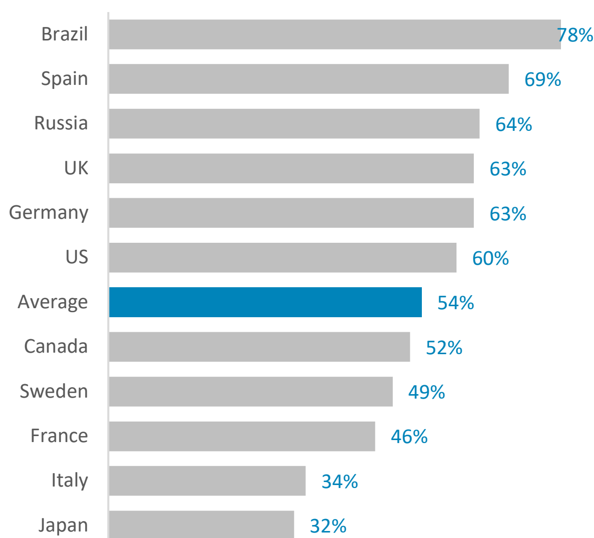
The recent rise of populism in Europe and the US has highlighted a growing sense of inequality in values and representation: namely that a significant and growing number of people feel that they don't have a voice. Nearly 70% of people in the UK feel that mainstream politicians 'don't care about people like me' across the range of economic, social and cultural issues (see Fig.16).

This diffuse sense of impotence is particularly acute among white working-class voters. It can be tempting to think of their concerns purely in economic terms, or to dismiss them as the view of the poor, uneducated and anti-immigrant masses. But it's a lot more complicated than that (see this recent discussion we hosted with Prof Matthew Goodwin on Pitchforks and Populism) and the sense of being 'left behind' involves wider issues of culture and identity.

This shift has coincided with three clear trends. First, the increased distance between individuals and government, with more power shifting in the post-war era to international organisations such as the EU. Second, a collapse of trust in government: just over one fifth of people in the US trusted the government in 2015, down from more than three quarters 50 years earlier. And third, a sense that politicians have become a distant elite: two thirds of the current cabinet attended private school compared with just 7% of the wider population. Half of Clement Attlee's 1945 cabinet came from a blue-collar background compared with only one member of Tony Blair's cabinet 50 years later.

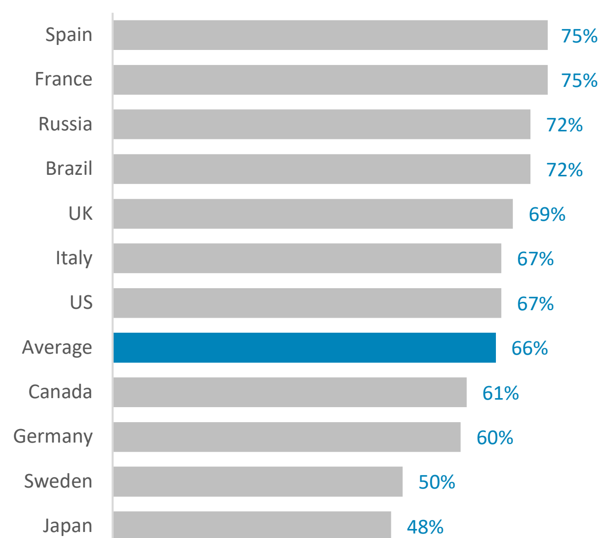
This sense of 'voicelessness' challenges some of the fundamental tenets of modern liberal democracies that are based on free market capitalism. A powerful recent survey of global attitudes by Ipsos Mori found that around two thirds of people in the UK believe society is broken, that the economy is rigged to the advantage of the rich and powerful, and experts don't understand the lives of 'people like me'. While people arguably have a louder voice through social media, they don't believe that they are necessarily being listened too.

Fig.15 Is society broken?
% of people agreeing with the statement 'society is broken'



Source: Ipsos

Fig.16 Do politicians care?
% of people agreeing with the statement 'traditional parties and politicians don't care about people like me'



Source: Ipsos

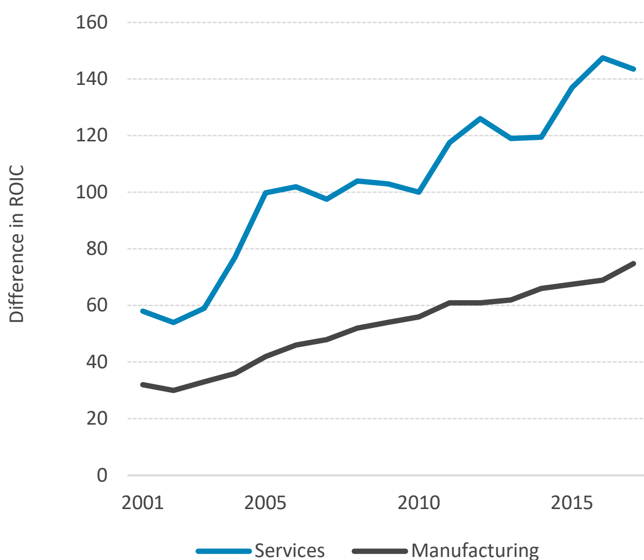
7) Inequality of employment

The fault line in the workforce between high paid and high productivity jobs in knowledge-based sectors and everyone else has widened in the past few years, accentuating the sense of inequality in income and opportunity, and between regions.

At one end, there are dynamic, growing productive sectors like finance, technology and media where the median income in the UK is around £41,000. The profitability of the top performing services companies in Europe has increased rapidly over the past 20 years, and the gap between the services sector and manufacturing has widened (see Fig.17 and Fig.18). These sectors tend to concentrate in big cities (see regional inequality – page 10), offer good career prospects (see income and wealth inequality – pages 8 and 9)), hoover up the best graduates (see inequality of opportunity – page 12), and are dominated by big international companies (see inequality of accountability – page 17). At the other end, sectors like food services, retail and leisure are characterised by lower incomes (with median pay of just £20,000), limited prospects, and increasingly insecure employment.

Fig.17 The rise of the services economy

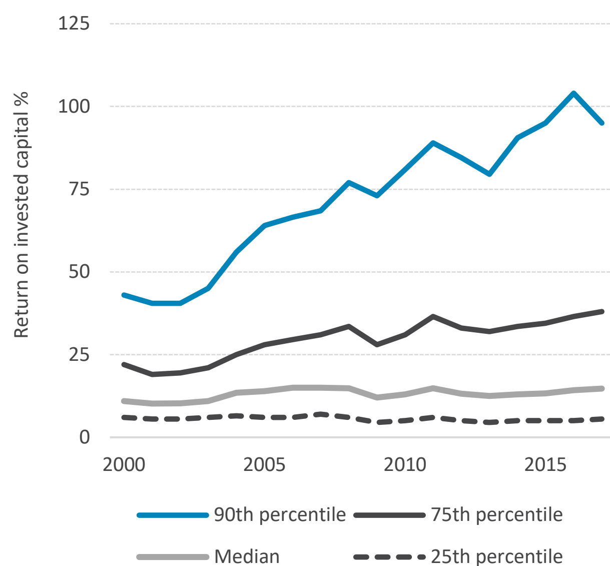
The return on invested capital by sector in Europe 2001 to 2017 (ROIC of 90th percentile minus the median)



Source: Bloomberg Economics

Fig.18 The concentration of performance

Return on invested capital by European companies 2001 to 2017



Source: Bloomberg Economics

In addition, there is a growing number of people working in low paid and less creative jobs to support sectors like finance: the median pay at large UK banks is lower than the national average because of the vast number of staff working in bank branches and back office support centres. Skilled labour - particularly in former industrial centres in the regions - has been especially hard hit, and for millions of people the traditional career path of working their way up from the factory floor to the foreman has disappeared.

The emergence in recent decades of the 'precariat' and the 'gig economy' underlines this trend: a growing cohort of workers on unstable and uncertain work patterns, with no formal employee status, low pay or an 'on demand' paid-per-job basis, and an increasingly distant relationship with the formal structures of society. If only a few sectors offer a route to secure, well-paid and fulfilling work, the disconnect between capitalism and society will grow.

The unequal impact of capitalism and globalisation

The last three inequalities relate to a broader sense of injustice about the unequal impact of capitalism and globalisation on different sectors of the economy and on different communities, which has fuelled a growing sense of separation in the behaviour, power and accountability of 'big business' and everyone else. While most normal people don't spend too much time thinking about the nuances between the work of Milton Friedman or Adam Smith, they see and feel their impact every day. Globalisation and increased migration have had a huge impact on jobs in manufacturing - particularly lower paid jobs. We have broken this theme into three: inequality of behaviour, inequality of power, and inequality of accountability:

8) Inequality of behaviour

Over the past 40 years, capitalism has been dominated by the mantra of shareholder value, in which generating profits has become the primary if not the sole purpose of a company. This has changed the behaviour of many companies - particularly large companies - and fundamentally redrawn their relationships with their employees, their suppliers, their customers and wider society.

Many critics argue that employees have become an expendable resource that can be hired or fired on demand or relocated to cheaper countries like China (while productivity in the US has increased by 70% in real terms since the 1970s, average pay has only increased by 12% over the same period). Suppliers have been beaten into submission with lower prices, lower margins and punitive payment terms. And many customers have come to feel that they are have been taken for a ride (for example, the absurdly complex range of price plans for mobile phones, the loyalty penalty at utilities or insurance firms, the race to the bottom in airlines, or the opacity of fees in banking and finance).

The perception that big business is focused relentlessly on profits at all cost has not been helped by repeated scandals such as Volkswagen deliberately cheating on car emissions tests, BP cutting corners on safety before the oil spill in the Gulf of Mexico in 2010, or the dripfeed of scandals in banking.

One measure of this disconnect is the (perhaps surprising) high level of support in the UK for the radical economic programme of renationalisation and tax rises outlined by the Labour Party in what has been dubbed 'Corbynomics' (see Fig.19). While bankers, economists and politicians may preach the economic virtues of privatisation, the view of many consumers is that privatisation has led to higher prices that pay for 'fat cat' bonuses and bigger dividends for the owners of privatised companies (the UK water industry, which is largely owned by private equity firms, is a prime example).

Fig.19 Support for Corbynomics in the UK

% of UK voters who support the following policies or statements - November 2019

Support nationalisation of:

Agree with:

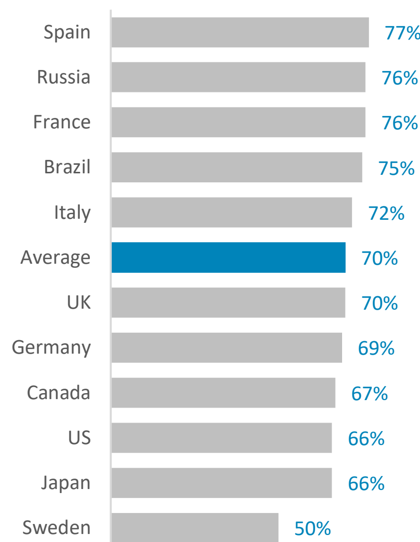
*Source: YouGov polling except * ComRes*

9) Inequality of power

Most of the anger towards capitalism has been directed not so much at 'capitalism' itself but at the perceived abuse of capitalism by big business that is more accurately called corporatism or crony capitalism. The close relationship between big business and government has long been problematic, and the growth in lobbying has helped create a system in which the framework that business operates is shaped by the interests of those big businesses who can afford to influence it. In the UK, 70% of people think capitalism is rigged to the advantage of the rich and powerful (see Fig.20).

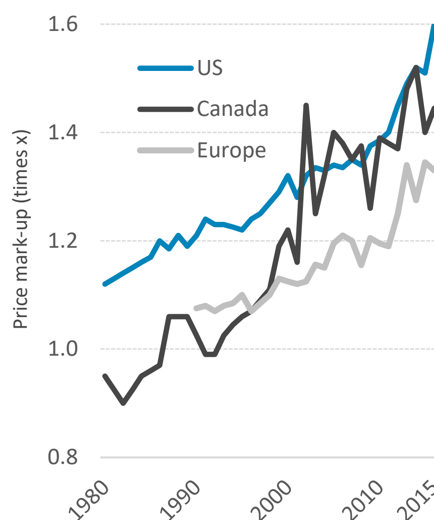
This is reflected in the increasing concentration and market power of big business. In time most industries and business tend towards monopolistic behaviour that stifles competition and often undermines the benefits of capitalism to consumers. Big technology firms such as Amazon, Facebook and Google have abused their market position as quasi-monopolies (and in some case monopsonies), as have many privatised utilities which take advantage of their effective monopoly status to extract rents rather than to innovate (the history of BT Openreach is a good example).

Fig.20 A rigged system?
% of people agreeing that 'the economy is rigged to advantage the rich & powerful'



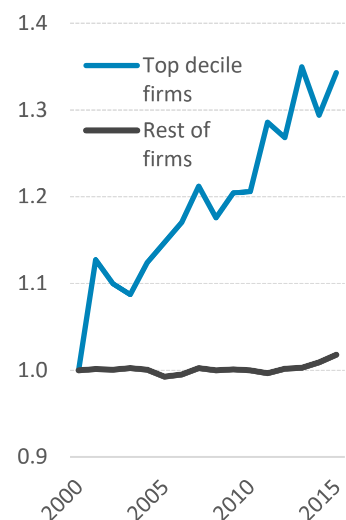
Source: Ipsos

Fig.21 Increased market power…
The evolution of price mark-ups by publicly listed companies 1980 to 2015



Source: IMF

Fig.22 …driven by an elite
The concentration of the growth in price mark-ups (rebased to year 2000=1)



Source: IMF

Over the past few decades, companies have exerted this power in the form of price mark-ups, which have increased by around a third in the US and Canada since 1980 at publicly listed companies, while European companies have followed the same trend over the past 30 years (see Fig.21). This increase in market power has been driven by a small elite of the dominant top 10% of companies (see Fig.22). In other words, while prices for many good and services have fallen sharply, a small proportion of large companies are capturing a disproportionate share of income for themselves.

The revolving door between business and government is a particular issue: while industry experience can lead to better government, in the other direction it can be hard to see how government officials are not influenced by the prospect of lucrative future employment in the industries they oversee. This creates a disconnect between big business preaching the virtues of free market capitalism, while doing everything possible to influence and control the rules of the game to its advantage.

Big companies have also got a lot bigger. Research by the UN showed that in 2015 the 100 largest listed companies in the world had a combined value 7,000 times greater than the bottom 2,000 companies. Twenty years earlier the ratio was just 31 times.

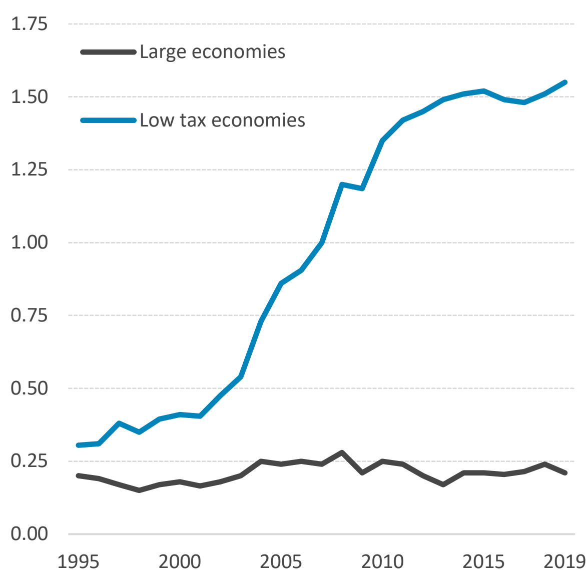
10) Inequality of accountability

To many people, 'big business' doesn't appear to play by the rules - and governments seem to apply a different set of rules to big multinationals than to smaller businesses. Over the past few decades, globalisation (and the shift from tangible assets to intangible assets – or 'stuff you can touch' to 'ideas') has enabled multinationals to create complex cross-border corporate structures to reduce their tax liabilities and channel profits to lower tax jurisdictions. For example, technology companies (or chains of coffee shops) can massively reduce their reported profits in a particular country with the use of internal charges for 'intellectual property' and then direct the profits that are left to somewhere like Bermuda, Ireland or Luxembourg.

This creates a sense of an uneven playing field for big business and smaller companies. One recent study by the Council on Foreign Relations (see Fig.23 and Fig.24) found that the combined profits reported outside the US by a selection of big multinationals were seven times bigger in low tax jurisdictions like Luxembourg or Ireland than the total profits that they reported in big economies like China, France, Germany, India, Italy and Japan. It also found that while pre-tax profit per employee in the US were just over $50,000, employees in the entities located in low tax jurisdictions were much more productive, generating more than $300,000 per head. This sort of tax optimisation is not usually available to small businesses.

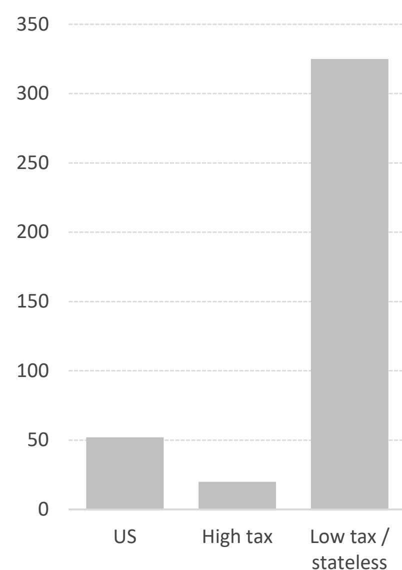
In the UK, the government's response to the financial crisis has prompted a similar sense of unfairness. The banking system was bailed out with nearly £100bn of public money, but when other big companies get into trouble (for example, British Steel, Carillion or Thomas Cook) the government allows them to fail. And while lots of bankers lost their jobs or had their bonuses slashed they are widely seen (rightly or wrongly) as having caused the financial crisis and then being allowed to get away with it. Nearly 20,000 people every year are sent to prison in the UK for theft - but no-one has been imprisoned in the UK as a result of the financial crisis.

Fig.23 Redirecting profits (i)
Offshore profits generated by US multinationals by tax jurisdiction 1995 to 2019 as a % of GDP



Source: Brad Setser / Council on Foreign Relations

Fig.24 Redirecting profits (ii)
Pre-tax profits per employee by type of tax jurisdiction 2016 $'000



Source: Brad Setser / Council on Foreign Relations

Part 3 - Analysis of the potential policy responses to the crisis of capitalism

This section analyses some of the potential policy responses that have been proposed in response to the crisis of capitalism. It aims to capture the views expressed by various politicians, economists and commentators and does not necessarily represent the views of New Financial.

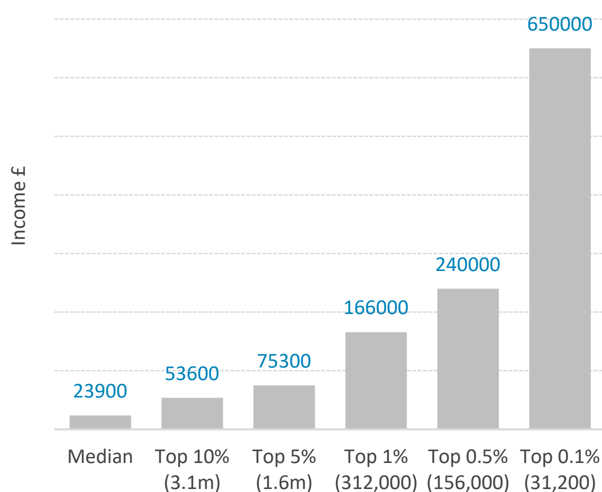
1. Tax reform: government has levied taxes for as long as government has existed. The range of activities that have been subject to tax has changed depending on the political and economic winds of the time: from personal income to corporate profits, property to capital gains. Faced with the growing inequalities and structural tensions discussed in this paper, there is increasing interest in how tax systems largely designed in the 19th and 20th centuries could be reformed to make them fit for the 21st century economy.

- Income tax: as the largest source of government tax receipts, reforming income tax is an obvious place to start (it accounts for a quarter of all tax receipts in the UK). There are three main options that would help address income inequality:

    i. Increase personal tax allowances to raise the amount of money people can earn before they start to pay tax (in the UK, the personal tax allowance has almost doubled in nominal terms in the past decade to £12,500 in the current tax year) or reduce tax rates and / or increase tax bands to ease the burden on middle earners. While this approach reduces the number of taxpayers (more than 40% of adults in the UK don't earn enough to pay income tax) it significantly increases the post-tax income of lower earners.

    ii. Increase the tax rate on higher earners. In the UK, the Labour party has pledged to increase tax to 45% for anyone earning more than £80,000 (roughly the top 4%) and to reintroduce a top rate of 50% on earnings above £125,000 (the top 2%) from its current rate of 40%. Increasing tax on the highest earners would have a limited revenue impact: the top 1% of earners already pay 26% of all income tax and there are not enough of them to generate significant amounts (there are only 312,000 of them in the UK - see Fig.25). However, it would help address the wider anger at income inequality by forcing those who can most easily afford it to pay more.

Fig.25 A steep ladder
Income distribution in the UK in 2018
(numbers in brackets denote number of individuals in each band)



Source: HMRC / IFS

iii. Introduce a 'super tax' on the small number of very high earners. In the US Alexandria Ocasio-Cortez, the Democrat New York congresswoman, has proposed a top marginal tax rate of 70% on any income above $10m, while Abigail Disney, the granddaughter of the Disney empire founder, has called for much higher taxes on income of more than $5m.

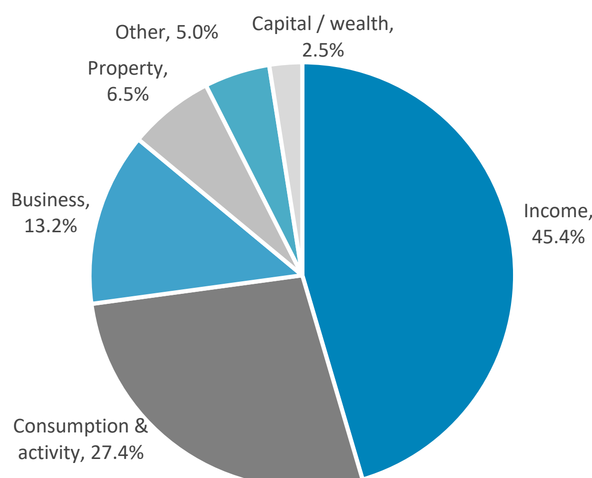
Another option related to income but not strictly income tax is for companies to pay higher tax on high earnings paid to staff. In the UK, the Labour party has outlined a surcharge in employer tax on any incomes above £330,000 (roughly the top 0.25% of workers). While many European countries already have progressive and punishingly high employer contributions on salaries, UK employer contributions are fixed at 13.8% of salary above earnings of £8,600 a year.

- **Wealth tax**: the widening inequality in wealth in recent decades has pushed the idea of wealth taxes higher up the agenda. The principle behind it is the equalisation of taxation on labour ('earned income') and capital ('unearned income'): while the initial creation of wealth may have been earned, the subsequent increase in that wealth from rising asset prices is unearned. It is also a question of an apparent imbalance in the tax systems and identifying a sizeable potential source of tax receipts from a segment of the population that can afford to pay. In the UK, for example, total household wealth (excluding pensions) is around £7.5 trillion. While the combined annual income of UK workers of around £1 trillion a year is heavily taxed (income tax and national insurance contributions generate 45% of UK tax receipt), wealth and property only generate 9% of tax receipts (see Fig.26). A 1% tax on financial and physical wealth would - in theory - generate just under £30bn a year in tax receipts (or around 4% of the total).

  Wealth taxes can be complex to construct and collect, but there are examples that could be used as a model. In Switzerland, most cantons charge a progressive wealth tax on assets above CHF100,000 with rates starting as low as 0.13%. In the Netherlands, a 'wealth yield tax' officially taxes income on wealth but is in effect a wealth tax: it assumes a fixed 4% yield per year on assets that is automatically taxed at 30% (the equivalent of a 1.2% a year tax on wealth). In Germany, the left has proposed a wealth tax on assets above €1m, while US presidential candidate Elizabeth Warren favours an annual wealth tax of 2% on assets over $50m (effectively a 40% tax on an average return of 5%) rising to 3% for assets over $1bn.

Fig.26 Where tax receipts come from

Summary of sources of tax receipts in the UK in 2019



Source: New Financial analysis of data from the Office for Budget Responsibility

Income
Income tax, national insurance contributions (employer & employee)

Consumption / activity
VAT, fuel duties, sin taxes (tobacco, alcohol, betting etc), customs duties

Business
Corporation tax, business rates, various levies

Property
*Stamp duty, council tax**

Capital / wealth
*Capital gains tax, inheritance tax, stamp duty on share trading***

Notes:
** council tax is based on property value but is payable by the occupant not the owner*
*** stamp duty on share trading is not strictly a tax on wealth but is largely paid by people with wealth*

- **Property tax**: higher property taxes can capture some of the disproportionate gains enjoyed by house owners living in prosperous areas. Property tax reform broadly falls into three categories: first, reforming local taxation that is often based on property values to bring it into line with other countries. For example, someone living in Westminster in a £10m house would pay council tax of £1,508 a year in council tax (an annual rate of 0.15%) while the owner of an equivalent house in the US would likely face an annual local property tax of more than 1% a year or £100,000. Second, changing how gains on property are taxed: in the UK, stamp duty currently paid by a property buyer could be replaced with stamp duty or capital gains tax paid by the seller (above a specific percentage and / or inflation, as in the US).

  Or third, an annual levy on the highest value properties: a 'mansion tax' of 1% or 2% on properties worth more than £2m proposed by Labour and the Lib Dems in the UK would apply to roughly 100,000 properties. Property tax is easier to collect and harder to avoid than wealth tax: for example, while France has phased out its wealth tax it has instead introduced a tax on the value of residential property.

- **Land tax:** one of the simplest forms of tax would be a land tax - an annual levy on the value of land to replace the complex systems of taxing commercial and residential property. The core principle is that land prices largely reflect location and enable landowners to enjoy an income based on the surrounding infrastructure, heritage and proximity to commercial activity. Much of this value derives from the state and other taxpayers. Unlike other property taxes, land value taxes don't reduce supply ('they don't make land any more'), are hard to avoid, simple to collect - and land is disproportionately owned by people who are already wealthy. Milton Friedman called it the 'least bad tax' and Adam Smith said 'nothing could be more reasonable'. A UK land tax was first proposed in the 1910 budget, and it operates in various forms in Denmark, Singapore and Taiwan, where it generates 8% of government tax receipts (the equivalent of about £60bn a year in the UK).

- **Robot tax:** the increased automation of manufacturing and other sectors has a double-whammy effect on inequality: it removes jobs and reduces earnings from (mainly) lower skilled and lower earning staff (increasing income inequality) and at the same time reduces the tax base to fund government spending. Andy Haldane, chief economist at the Bank of England, has called the rise of automation a 'regressive income tax on the unskilled'. One option - supported by Bill Gates and the late scientist Stephen Hawking - is a tax applied to the capital value of robots or their economic output. A 'robot tax' could be targeted and reinvested in local schemes for retraining or local development initiatives.

- **Capital v labour:** ending the preferential tax treatment that income from capital receives over income from labour is an increasingly common proposal to redress the imbalance of power between the two. In most economies, capital gains and dividends are taxed at significantly lower rates than labour, which can distort behaviour, concentrate wealth and increase inequality.

  In the UK for example, capital gains are taxed at around half the level of income. A top rate taxpayer currently pays 45% on any income above £150,000 but only 20% on capital gains, 28% on dividends, and 28% of the sale of residential property that is not their main residence. Increasing tax rates on capital towards the rate on income or to the same level - while increasing the allowances for capital gains and equalizing the tax rates on selling second homes - would help reduce this imbalance. The Institute for Public Policy research forecasts that reforming capital gains tax could raise around £90bn over five years.

- **Financial transaction tax:** the principle behind an FTT is that it would levy a small charge on financial trading activity to reduce speculative trading and help curb risk behaviour, while simultaneously generating significant revenues. It has existed in stock markets in the form of a stamp duty for almost as long as stock exchanges have been around.

  A wider FTT became synonymous with the economist James Tobin (the Tobin tax) in the 1970s. The EU launched plans for an FTT in 2011 and while 10 countries are still officially committed it has become a zombie policy - although the Labour party supports a UK FTT. The EU's current proposal is a 0.1% tax on buying shares and bonds, and a 0.01% tax on derivatives trading. With equities trading in the EU at nearly €20 trillion a year, this could add up to around €20bn a year in tax revenues - although in practice it would generate far less and likely reduce trading volumes. Attempts in the past to apply the tax where the trading takes place has simply led to the relocation of trading activity

- **Corporation tax:** it has become something of a mantra in the conservative economic circles that lower rates of corporation tax encourage growth and investment, while simultaneously generating higher tax receipts. Corporate tax revenues have been falling as a proportion of GDP and rates of corporation tax have significantly reduced in the UK (from 26% to 19% - although the Conservatives have shelved plans for a further 2% cut) and in the US (35% to 21% under Trump's tax reforms in 2017). This has raised concerns that corporations are failing to pay their fair share: in the UK, corporation tax generates 8% of tax receipts while corporate profits represent about a quarter of GDP. Higher rates of corporation tax - perhaps returning closer to the weighted OECD average of around 25% - allied with more generous tax breaks to encourage investment, R&D or higher pension contributions to employees, could raise additional revenues, and send a political message that companies are paying their fair share.

- **Tax avoidance:** there is growing international movement to reduce the perceived and actual avoidance of tax by international companies who exploit gaps and mismatches in tax regimes in different countries. For example, more than 130 countries have worked with the OECD on its BEPS project (base erosion and profit shifting) to reduce these mismatches and behaviour. One approach adopted by some countries is an activity tax (see below), which charges multinational companies a low level of tax on revenues generated in specific countries, rather than on profits (this is easier to enforce though not infallible).

  There are also plenty of loopholes closer to home that can be closed. For example, in the UK just over 4% of individual estates pay inheritance tax on death (raising just over £5bn a year). Three to four times that proportion would qualify for paying IHT but use a complex series of tax reliefs and exemptions to reduce or remove their liability. Abolishing many of these reliefs would simplify IHT, encourage more redistribution and raise tax revenues.

- **Activity tax:** corporation tax is traditionally charged on profits but many other aspects of taxation are based on headline activity (activity and consumption taxes represent more than a quarter of tax receipts in the UK). This can encourage companies to reduce their profits and / or move their profits around (sometimes artificially) to minimise their tax liabilities in a particular country. Many private equity-backed firms use high levels of debt funding to reduce their taxable profits, and then create complex corporate structures to shift those profits to lower tax countries. Many international firms - particularly technology companies - steer their profits towards lower tax regimes. The UK is exploring a 2% activity tax on the revenues of large technology companies generated in the UK in an attempt to recoup some of this 'lost' tax, while France recently introduced a 3% activity tax on tech companies.

- **Debt vs equity:** there is a significant differential in the tax treatment between debt and equity. If a company issues a corporate bond, the interest payments that it makes are tax deductible (in other words they can be used to reduce a company's taxable profits). Meanwhile, equity is effectively taxed four times: shares are taxed with stamp duty when they are traded, investors pay taxes on the dividends they receive from companies, and they also pay tax on the capital gains they make from their investors, and companies pay tax on their profits.

  This differential encourages companies to issue bonds rather than equity - particularly in the sustained low interest rate environment of the past 10 years - and can encourage companies to take on excessive levels of debt. This in turn increases the concentration of wealth and reduces the democratisation of wealth creation. For example, a private equity firm can finance the acquisition of a company with a leveraged loan or bond issue, offset the interest on that finance against taxable profits to reduce its tax bill or even to create tax losses. Reducing this tax differential using or limiting the amount of debt that can be used to attract tax relief, would increase corporation tax receipts while widening wealth creation. In the US for example, the recent tax reforms introduced by President Trump limited the amount of deductible interest to 30% of Ebitda and from 2021 this will be tightened to 30% of Ebit.

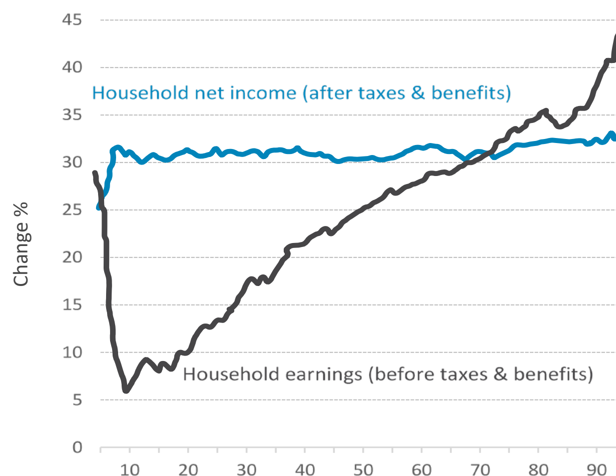
2. Government-led redistribution: there is growing interest in a variety of creative policy proposals beyond taxation for governments to redistribute wealth in order to reduce inequality. There are four main ideas:

- **Increase minimum wages**: many economies' minimum wage provides little more than a low-level floor and there is growing pressure to enforce a more realistic 'living wage'. Since its introduction in 1999, the UK's minimum wage has increased from £3.60 to £8.21 an hour for someone over the age of 25 (an increase of around 50% after inflation). This translates into income of around £17,000 a year based on a 40-hour week, less than 60% of median earnings. The minimum wage in France is €10.03 an hour (£8.92) and in Germany it is €9.63. The UK campaign for a 'real living wage' recommends £9.00 an hour or £10.55 an hour for workers in London: the Labour Party has proposed an increase to £10, while the Conservatives have promised an increase by 2023 to £10.50. In the US, Bernie Sanders has called for a national minimum wage of $15 an hour - more than double the statutory $7.25 an hour (although in some states it is $14 an hour).

- **Increase benefits**: people on the lowest incomes often rely wholly or in part on benefits and social welfare for that income. Many governments have tried to simplify the benefits system but the underlying amounts remain low and many recipients are effectively living in poverty (on around half of median incomes or less). For example, the Gilets Jaunes movement in France has called for a 40% increase in basic benefits. Changes to the benefits system have a big impact on people's real income. At a headline level (before taxes and benefits) lower earners enjoyed significantly lower growth in their income between 1995 and 2018 than higher earners (see the grey line in Fig.27). However, once you adjust for the impact of changes in tax and benefits, the growth in incomes is much more equal (the blue line).

Fig.27 The benefit of benefits

Changes in net income by percentile in the UK before and after the effect of taxes and benefits 1995 to 2018



Source: IFS / Deaton Review

Tax credits for people in work have become more widely used and help supplement incomes of lower paid workers. However, these credits arguably subsidise companies that pay lower wages, which are then topped up by taxpayers. One approach could be for companies to share some of the cost of the tax credits that their employees receive.

- **Social wealth funds**: on this model a country creates an investment fund and shares some or all of the resulting income in the form of a universal basic dividend or deliberately invests the fund to help finance future pensions or welfare provision. For example, the $64bn Alaska Permanent Fund was created in 1976 to invest a proportion of the state's oil revenues and pays a universal dividend to Alaskan citizens each year. The Norwegian government pension fund, launched in 1990, now has assets of more than $1 trillion and is used to top up gaps in government spending and provide for future pensions. The UK could seed a social wealth fund from the sale of its remaining stakes in RBS, invest the proceeds and top it up each year with a small contribution from general government spending (perhaps from one of the tax reforms above).

- **Baby bonds**: a more radical idea is that of 'baby bonds', where a government allocates a sum of money at birth to every citizen and this is invested on their behalf until their 18th birthday. A grant of £5,000 for every birth in the UK would cost around £4bn a year and if topped up by £100 every birthday could grow to around £16,000 when they turn 18 (or a £50,000 pension pot on retirement). An alternative (floated by former minister David Willetts) is to grant every adult £10,000 on their 30th birthday to put towards housing or education costs. These ideas are still very much in their infancy, but their growing profile suggests increased demand for redistributive action.

3. Universal basic income (UBI): a more radical approach to government-led redistribution is the UBI, which has emerged as a seductively simple and eye-catching concept. UBI reinvents the welfare state so that government pays every citizen a regular cash sum to cover basic needs regardless of their wealth or employment status. Its supporters argue that the cash payments would bring reassurance to workers in industries vulnerable to automation and free people up to undertake entrepreneurial pursuits. While a pilot scheme in Finland suggested that UBI does not help with finding a job and others argue that it undermines the dignity of work and inefficiently allocates resources, there is considerable momentum behind the idea.

The Italian government is considering a universal monthly income of €780 to 'preserve dignity' while US Democratic presidential candidate Andrew Yang has pledged a 'Freedom Dividend' of $1,000 a month for every US adult. However, a UBI of any reasonable value (for example, 40% of median earnings) would be prohibitively expensive. Professor John Kay estimates that a UBI for the UK at this level would require all tax rates to increase by around half, making it economically and politically impossible. A UBI of just £5,000 a year for 53 million UK citizens over 16 years old would cost around £265bn a year - roughly equivalent to the entire social welfare and pensions budget.

4. Monopolies & anti-trust: most sectors of the economy have become more concentrated over the past few decades and the appearance of competition is not always matched by reality. Across the political spectrum there are growing calls for bolder antitrust legislation as a pushback against the excessive power of larger companies, and their ability to reduce competition, entrench their market position and distort markets. Technology companies - particularly giants like Google, Facebook and Amazon - have come under greater scrutiny because of their growing portfolios of businesses, their access to data, and their behaviour. New laws in Europe that require companies to disclose their data to consumers are being looked at in the US.

5. Skills & education: retraining and education programmes could play a bigger role in addressing growth and productivity challenges.

- **Early years**: the period from birth until starting school is critical for a child's cognitive development. Childhood education programmes have an extraordinary rate of return in terms of school performance, lifetime earnings and the odds of committing crime. In contrast, there is a growing body of evidence indicating that adversity and disadvantages in this early period can have lasting negative effects. Widening access to free nursery schooling through higher subsidies would significantly reduce childcare costs, increase labour market participation among women, and raise educational standards. In Sweden for example, fees for pre-school are capped at 1% to 3% of the parent income, depending on how many children they have, with the state paying the lion's share.

- **Later years**: the expansion of technical education, apprenticeships and internships is high on the education agenda of many governments. The German system is often looked to as a standard-bearer for a successful skills and education strategy. Germany has one of the lowest youth unemployment rates in the world, technical degrees are viewed on a par with academic university degrees and 1.5 million young Germans work in apprenticeships with local businesses annually. All three of the main parties in the UK are proposing changes to the apprenticeship levy which has not had its desired impact. For example, the LibDems propose to broaden it into a 'skills and training levy' and reinvesting some of the proceeds in a social mobility fund.

- **Localised programmes**: while unemployment rates in the UK and US have been falling and GDP is recovering across most of Europe, at a local level the picture can be very different. A multinational's decision to close a large factory can devastate the local community, often leaving government to pick up the bill in terms of benefits, training programmes and development grants. One option is to require companies that lay-off significant numbers of staff, or close plants, to pay a part of the cost of retraining staff, perhaps related to the annual savings they expect to make.

  There is a big opportunity for businesses and education authorities at a local level to work more closely together to close the gap between education systems and employers' current demands, to boost worker productivity and to better prepare future generations for work.

6. Increasing transparency: the agency problem, information asymmetry and a strong focus on financial metrics have enabled many companies to avoid scrutiny of how they operate. More radical transparency and disclosure requirements, particularly on social, environmental and governance factors, would increase public accountability and could pressurise companies to change. Initiatives such as gender pay gap reporting and more comprehensive ESG reporting are a step forward but there is scope for a more rigorous framework of corporate reporting that accounts for human, social and natural capital as well as financial metrics.

For example, instead of pages of detail on executives' pay, more granular and consistent information on the wider workforce - such as bands and rates of pay, working conditions, benefits, contractual arrangements, level of engagements, staff turnover, and diversity in its broadest sense - would provide a more holistic picture of how a company operates.

7. Regional infrastructure investment: with many Western modern economies suffering from deep regional divisions, infrastructure initiatives focused on regional regeneration are increasingly popular - and typically have a relatively high rate of return. A recent study found that every dollar spent restoring the American infrastructure system of airports, bridges, water, roads and aviation and expanding its capacity would produce nearly four dollars in economic benefits. Earmarking investment for second-tier cities and regions, government initiatives such as the UK's Northern Powerhouse strategy or the Midlands Engine and regional devolution agreements could all help address regional inequality.

The Labour Party in the UK has gone further by arguing for a state investment bank and regional banks that can adapt their interest rates for local circumstances. Local prosperity and civic pride can be a powerful socio-economic force and drive a stronger sense of belonging and purpose for workers.

8. Strengthening worker protections: one of the biggest changes in the workplace in recent decades has been the rise of the 'precariat' - workers who are employed on unpredictable hours or even zero-hours contracts, or on a contract basis without the benefits and protections of being formally employed. At the same time, the power and influence of trade unions has declined significantly, particularly in the UK and US, which reduces the bargaining power of employees. For example, there is a strong inverse correlation between union membership and growth in income inequality: in the US, union membership has halved from just over 30% in the 1960s, while over the same period the share of income earned by the top 10% has increased by around half from just over 30%.

Rethinking the legal definitions of employees, workers and contractors to ensure that 'gig economy' giants like Uber or Deliveroo offer more benefits and protections to people who work for them; giving staff a bigger say in management decisions and encouraging employee share ownership; and rethinking the union movement for the digital age could all help redress the imbalance between labour and capital.

9. A focus on purpose: at a more fundamental level, companies are facing growing pressure to focus less on profits and growth and more on their underlying purpose and wider impact on society. In the UK, companies will have to start reporting on their adherence to a new section of company law (Section 172), which redefines the responsibilities of directors in terms of 'promoting the success of the company' by considering the long-term, its employees, relationship with suppliers and customers, and impact on the environment and society. The Business Roundtable, a group of large companies in the US, recently revised its statement on the purpose of a corporation, moving away from prioritising shareholders to incorporating the interests of all stakeholders - customers, employees, suppliers and communities - and the environment.

Such commitments may seem 'touchy feely' but recent research shows that companies with a clear purpose that permeates from the top down - and goes beyond a new corporate slogan or charitable donations - perform significantly better in terms of share price, higher long-term growth, higher productivity and lower staff turnover. Changes in corporate behaviour could be encouraged by more metrics on measures such as social and environmental factors in the award of government contracts, and potentially offering tax breaks or reduced tax rates to companies that demonstrate a concrete commitment to their public statements on purpose.

10. Corporate structure reform: allied to this shift is growing interest in how corporations could be structured differently to the standard model that focuses on maximising shareholder value. 'B corporations' in the US or social enterprises in the UK, which more clearly balance social values or impacts with profits, or successful mutuals such as John Lewis or Nationwide in the UK, could act as a model. The profit motive still exists, as do competitive market forces, but the pursuit of profit is not an end in itself.

Other models include family or trust systems that include 'cornerstone' shareholders who may be better able to anchor long-term ambitions, enforce board accountability and focus on social purpose; or worker-owned cooperatives and the German principle of 'co-determination', which has given shareholders and employees a more equal say in the running of firms (without crippling German competitiveness). There is no panacea: there are plenty of examples of corporate scandals at German companies (dieselgate at VW) and mutuals (the Co-Operative Bank). But given that most of the scandals and behaviour that have helped undermine faith in capitalism have come in the pursuit of growth and profit, perhaps there is scope to experiment with some alternative models.

One potential route to reform the existing model is taking measures to expand employee share ownership to give workers a more direct stake in the companies where they work. In some cases, owners of companies are already doing this this voluntarily: Julian Richer, the owner of hi-fi retailer Richer Sounds, recently transferred more than half of his shares to employees, who received £1,000 of shares for every year they have worked at the firm.

The Labour Party has taken this a step further by proposing that companies with more than 250 employees will have to transfer up to 10% of their shares to employees over time. Nudges and incentives to encourage companies to boost employee share ownership would probably work better than forcing them to do so.

Part 4 - Appendix of further reading on the crisis of capitalism

This report has tried to pull together the main reasons why so many people around the world are so angry with capitalism, big business, politicians and the elite. A huge amount has been written by prominent academics, thinkers and business leaders on an around the same theme. If you are a highly motivated reader and want to read more, we have summarised the salient points from 10 books on the subject and some key articles, and boiled them down into a 10 page appendix which you can read *here*.

For discussion

This report shows that for many people capitalism is probably the worst economic system except for all the others that have been tried. There is, of course, no silver bullet to address these concerns, and the banking and finance industry cannot single-handedly solve this problem. However, here are 10 suggestions as to how the industry could respond:

1. **Don't ignore:** it can be easy to dismiss many of these concerns and potential policy responses as ignorant, ill-informed, or the 'politics of envy'. But that won't change the minds of many millions of people who are angry - or change the views of politicians who are trying to win their votes. Keeping your head down and hoping that this anger blows over so that capitalism can return to business as usual is probably not a sustainable strategy.
2. **Pause for thought:** understanding the main causes of the loss of faith in capitalism doesn't mean you have to agree with them, but it's a vital first step towards reforming and preserving capitalism for the greater good. Reflecting on the experience of capitalism for many people on different points of the income, wealth, educational or employment spectrum over the past few decades may help.
3. **The politics of finance:** all businesses operate within a framework that is determined by the wider social and political climate. Capitalism relies for its legitimacy on this social licence that has become stretched over the past few decades, and the industry needs to build a reservoir of social and political capital with politicians and the wider public before it can spend it.
4. **A focus on purpose:** a good place to start might be to focus on the underlying purpose of the industry, how that translates into its products and services, the way in which it operates, and how it makes money. Where does it fit within society and what is its impact on people's everyday lives?
5. **Mind your language:** the finance industry has a tendency to blind people with detail and bombard them with jargon and acronyms. Think about how to communicate in simpler language with customers and other stakeholders in language your mother would understand.
6. **Making a better case:** the industry often makes the case for what it does in terms of itself ('we employ a lot of people and pay a lot of tax'). How can the finance industry make a more compelling and more constructive case for the value of what it does in more concrete terms that real people can relate to?
7. **Engage with customers:** talking to real customers and end users around the country to learn more about their concerns may help in identifying what the industry can do to help address them. What role can the industry play in supporting regional investment? How can it help address the housing shortage? What products could it develop to help people on lower incomes save for their retirement?
8. **Decomplexification:** to most people outside the industry, finance seems impossibly complex. Products or pricing structures can sometimes seem deliberately confusing or opaque to customers. Reducing this complexity and aligning the economics of the business more clearly with outcomes for customers would help address the disconnect between finance and the rest of society.
9. **Sustainable finance:** sustainability involves a lot more than launching an ESG fund or underwriting a green bond. How can the industry turn a public commitment to ESG into sustainable business in the broadest sense, including issues like climate change; balancing the interests of shareholders, customers, employees and wider society; improving diversity and addressing social mobility?
10. **Spinning the wheel:** treating this as a PR or rebranding exercise without asking and addressing more fundamental questions is likely to backfire.

New Financial believes that capital markets can and should play a vital role in the wider economy as a force for economic and social good. Working with the capital markets industry to address these questions and help make a better case for the value of what it does - and how it can do it better - will be the main focus of our work in 2020 and beyond.