**Free markets will do more for equality than high tax**

**Growing pay gaps among workers are the result of a widening gulf in companies’ performance rates in this winner-takes-most economy**

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Income tax rates of 50pc or more; a mansion tax and far higher inheritance and wealth taxes; more generous benefits to redistribute wealth to the poor – there are lots of ideas out there about how we can reduce inequality, and just about all of them involve a bigger role for the state. But hold on. Is that really the right direction? Some of the latest research suggests that what we really need is more competition. Why? Because the only reason inequality has been rising in most developed countries is because a small group of “super-star” companies have broken away from the pack and kick-started dramatic rises in productivity and pay for their staff.

If that is true, then the only fix is to encourage more of those stars – and a tough, free-market competition policy is the best way to do that.

Since the 2008 financial crash we have heard a lot about the widening gulf between rich and poor. Wages have stagnated across much of the developed world for the great bulk of workers, while a small group at the top grow wealthy. Even mainstream Tories, like Theresa May, have bought into that analysis as the Prime Minister talks of creating an economy that works for all.

To someone like the economist and writer Thomas Piketty this inequality is an inherent flaw in capitalism and can only be fixed by draconian taxes. Others blame the free market, or immigration, neo-liberalism, globalisation, or the slowing pace of technological change. There is probably someone out there who blames the weather, or the rise of the split infinitive.

But might the real problem actually be something quite different? Not so much people becoming less equal, as companies.

Prof Nicholas Bloom, of Stanford University, argues in the latest Harvard Business Review that inequality has risen because a few megasuccessful companies are breaking away from the rest. He says companies can contribute to inequality in two ways: by paying tons to fat cats on boards while the rest are on zero hours, minimum-wage contracts; or by letting a gap open, not within workplaces but between them.

So, everyone at Google, Apple or Goldman Sachs is really well paid – and everyone at mid-sized, slow-growth businesses is relatively poorly paid.

Prof Bloom’s study took data from US employers and employees from 1978 to 2013, and found that average wages at companies employing those at the top of the income scale rose very rapidly, while income stagnated for those at companies near the bottom of the scale. Yet people at top-level companies produce more. For example, while American productivity overall has stagnated in services since 2000, at the top tier it rose by more than 40pc. In manufacturing, overall productivity is up by only 5pc over the past 15 years but at the top businesses it’s up 30pc. “In other words, the increasing inequality we’ve seen for individuals is mirrored by increasing inequality between firms,” says Bloom.

These figures are American, but much the same will be true in most developed economies. In the City, even the secretaries at investment banks and hedge funds make £50,000 or £60,000 a year. The reason? The study argues that it is the result of outsourcing, which means that only the most highly valued skills are concentrated within the company.

The emergence of a “winner-takes-most” economy suggests we need a radically different policy on inequality. It is sometimes argued that there should be a legally mandated wage range within companies – so that, for example, the chief executive only earns 50 times the average salary. The Swiss even had a referendum on just that issue. Yet, that will not help if everyone at the most successful companies makes a lot of money. Nor will fashionable ideas for more transparency, or shareholders putting more pressure on businesses to control executive pay.

Disclosure won’t make any difference to the “super-star” companies, and they are the last people that fund managers want to argue with.

Punitive taxes will be even more damaging. In the short term, you might level up incomes a bit, but after a while you will simply have fewer tax targets as people move abroad. All you will end up doing is destroying well-paid jobs.

In fact, the best way to tackle inequity would be to have more super-star companies. Easier said than done, of course. If governments could wave a magic wand and have a few more Apples or JP Morgans they would have done so. But that doesn’t mean there isn’t anything they can do.

Governments should be concentrating on anti-trust and competition rules, reducing barriers to entry in key industries, and opening up markets, especially in the public sector.

There is lots of evidence, especially in the US, that the rate at which new businesses replace incumbents has gone down dramatically, leaving sluggish old giants to dominate. Make it easier for entrepreneurs to break into the market and there will be a lot more high-performers.

In the post-Brexit UK, we can offer some of the lowest corporate tax rates and lighter regulation in order to tempt more super-star companies to make their European (even global) bases here.

The debate about inequality is usually seen as a matter of simply capping pay, or taxing people more. But if it has been created by the divergence between the top companies and the rest, all those policies only make matters worse.

In reality, we need more competition and freer markets – and we will end up richer, and more equal as well.

‘The best way to tackle inequity, is to have more of these super-star companies’