The Relationship Between Income and Wealth Disparities and Negative Real Interest Rates

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***"The powers of financial capitalism** had another far reaching aim, nothing less than to create a world system of financial control in private hands able to dominate the political system of each country and the economy of the world as a whole." **Carroll Quigley** (1910-1977), American historian, 1966.*

***"There are no nations. There are no peoples…** There is no America. There is no democracy. There is only IBM, and ITT, and AT&T, and DuPont, Dow Union Carbide, and Exxon. Those are the nations of the world today… We no longer live in a world of nations and ideologies… The world is a college of corporations, inexorably determined by the immutable bylaws of business. The world is a business." **Network, 1976**, (a corporation executive talking in the American satirical drama film 'Network'.)*

***"By a continuing process of inflation**, government can confiscate, secretly and unobserved, an important part of the wealth of their citizens… By this method they not only conficscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some." **John Maynard Keynes** (1883-1946), British economist, 1936.*

Has a forty-year trend reached an apex? Indeed, official measures of economic disparities are at an all-time high.

For example, in 2017, the three richest Americans (Bill Gates, Jeff Bezos, and Warren Buffett) owned more wealth than all the people in the bottom 50 percent of the U.S. population. And although income disparity has increased in most advanced economies, the United States is leading the way with levels of income disparities not seen since 1928, just before the Great Depression (1929-1939). All this is happening while the U.S. federal minimum wage has remained fixed at $7.25 an hour since 2009!

A question that begs to be answered is: to what extent can such a record inequality be traced back, at least partly, to the public policies that have been followed over the last forty years?

Since the early 1980s, indeed, governments and central banks in Europe, the United States and in other industrialized economies have adopted an unusual mix of fiscal policy and monetary policy. Governments became the de *facto* bankers of the corporate world through large tax subsidies. For their part, central banks have been busy creating bubbles in the stock and bond markets. Sooner or later, that house of cards is bound to crash.

For one, governments have relied less and less on progressive income and wealth taxes and more on regressive taxes to finance public spending programs.

Secondly, central banks have initiated round after round of money creation through a wholesale purchase of government bonds and other securities, such as mortgage-backed securities (MBS). This was labeled a process of 'quantitative easing' (QE), through which central bankers pushed nominal interest rates to the floor and real interest rates (adjusted for inflation) into negative territory.

In some European countries (Switzerland, Germany, the Netherlands and France) even nominal interest rates have turned negative for ten-year safe investments. Paradoxically, this means that some savers pay borrowers to accept their money. It's the world upside down.

Such a super-aggressive monetary policy has created unintended consequences for some classes of consumers—for retirees, students, etc.—whose incomes and spending fell. In many cases, they were forced to go deeply into debt, in order to sustain a livable level of consumption.

Consequences of economic and financial globalization

Under the guise of financial and corporate globalization, governments became more and more responsive to the demands of international corporations, mega banks and rich individuals, to lower their taxes and to reduce regulations. Their argument was that this was a requirement to remain competitive and retain industrial investment at home. Moreover most governments abandoned domestic industrial policies and let corporate and banking world decisions structure their economies.

The process of de-industrialization in advanced economies and the shift of the tax burden

Many large corporations found it profitable to abandon their domestic production base and began searching the world for the lowest wages they could find, while collecting the most advantageous financial inducements from local governments to locate new industrial investments. International free trade of goods and services, which is in general beneficial to all counties, was extended to encompass the more controversial concept of a free international movement of financial capital and of industrial capital.

In such an international context, national governments were forced to enter into a zero-sum game competition to lower taxes and regulation for industrial investors and to extend subsidies to encourage new investment and employment at home.

Over time, this resulted in two important structural changes.

First, some advanced industrial economies began a gradual process of de-industrialization, when large companies began moving their high-productivity manufacturing activities abroad. This was accompanied by a relative structural shift in domestic employment from the high-productivity manufacturing sector to the generally less productive service sector. Among the latter, some high-knowledge service industries have been paying above average wages, but some labor-intensive service industries are paying relatively low wages. As a consequence, over the last forty years, real wages in advanced economies have remained relatively stagnant.

All the while, some high-income earners and the super rich strata of the population benefited from huge tax deductions. The most recent example is the ten-year $1.5 trillion tax cuts passed into law, in December 2017, by the Trump administration. That measure slashed the corporate tax rate in the U.S. from 35 percent to 21 percent, but with few new benefits for the economy. Contrary to what was expected, many corporations used the tax returns to buy back their own stock shares, rather than to invest in new plants or machinery.

Moreover, since labor is generally immobile internationally, the overall domestic tax burden on income, consumption and profits began to shift more heavily onto workers, consumers and middle class taxpayers, and away from large corporations and mega banks, and from rich investors. To alleviate such a taxation shift, governments were saddled with larger operating deficits and their national debtrose, even during prosperous times.

This has raised a tax fairness issue with the growing gap of income and wealth inequalities among different categories of taxpayers.

A worldwide glut of savings, a decline in real investment spending and a shifting of profits and incomes to low-tax jurisdictions

The impact of economic and financial globalization and the constant rise in income and wealth inequalities since the 1980s—the latter having been exacerbated by the Great recession of 2008, and by the current pandemic crisis—has produced a glut of global savings (supply of funds) as compared to investment spending (demand for funds).

When too much saving is withdrawn from the operating economy and is not properly recycled into productive uses, this can lead to a drop in the circulation of money, even when the supply of money increases. If the velocity of money declines during a period of expansionary monetary policy, this can offset the increase in money supply and could paradoxically lead to deflationary pressures, at least for a while, and sluggish economic growth rather than to inflation and faster economic growth.

The glut of global savings is related to the growing concentration of income and wealth in favor of owners of financial capital and of super rich individuals. The fact that many trillions of dollars of such extra savings have ended up in offshore tax havens, sometimes under the veil of secrecy of cryptocurrencies, has undoubtedly played a role. It has also been a source of demand for bonds and other securities, resulting in higher bond prices and lower interest rates.

The building up of a glut of global savings among mega corporations and super rich individuals, who own most of the stock wealth, was occurring just as another phenomenon took place. Indeed, the 'baby boomers'—the generation born between 1946 and 1964 in the United States, and between 1947 and 1966 in Canada—felt obliged to increase their savings rate, in order to better prepare for their imminent retirement, and also, in part, because of the economic impact of the current pandemic on their spending and the low rates of return on their financial investments.

Consequences of the half-century long rise in income and wealth inequalities

As income and wealth became more and more concentrated, the financial sector tended to grow faster than the real economy. Such a structural change, past a certain threshold, can slow down economic growth and be a factor in creating financial crises. This was demonstrated when new esoteric financial productscatering to the very rich led to the Great recession of 2008.

Some economists fear that the advanced economies of the Western world have entered into a prolonged period of "Secular Stagnation". Indeed, in many advanced economies, the expansion of the financial sector has been such that it has become oversized relative to the real sector. A too-high rate of financial sector growth relative to GDP may be a harbinger of future financial contractions.

Conclusion

There is a link between the great disparities in income and wealth that we see today, in several industrialized countries, and the extraordinarily low interest rates that have become the curse of savers. And, as we have seen, the causal relationship goes both ways, one reinforcing the other. They both enriched an aristocracy of the super rich. How should governments go about breaking this economically and socially damaging relationship?

First, it would seem that there is a need to reorient fiscal policy toward equilibrating the tax burden and income inequality between high and low-income taxpayers, as well as re-evaluating consumption taxes. Maybe an international conference could be held to assist governments in coordinating their efforts in that direction, especially considering the growing reliance on tax havens.

Secondly, central bankers could find it appropriate to review the current policies of monetizing the public debt and the debts of other financial entities on a high scale. Besides evaluating their sustainability, they may also wish to take into consideration the high risk of creating dangerous bubbles and speculative maniasin the stock and bond markets. indeed, history shows that when such financial bubbles burst, as they inevitably do, the real economy suffers badly in production and employment losses.

As for citizens, they should be careful not to vote for clueless and corrupt politicians who are bought and sold by special interests. They should demand that big money and dark money stop dominating politics and government policies. Theirs and their children's economic welfare depend upon it.

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