BY ANTHONY W. ORLANDO

SAVING CAPITALISM FROM A PAINFUL DEMISE

ECONOMIC INEQUALITY IS THE GREAT BUSINESS CHALLENGE OF OUR TIME.

MIKE AUSTIN

American business leaders rallied around Franklin Delano Roosevelt in 1932 during his candidacy for the presidency, after which he immediately embarked on the most progressive legislative agenda in U.S. history to tackle the Great Depression. From today's vantage point, it may seem surprising that titans of industry, executives from General Electric to Standard Oil to IBM, not only contributed to Roosevelt's campaign but helped author many of his famous New Deal reforms. To the men who ran these companies, it was a simple matter of fiduciary responsibility—to current shareholders and to future ones—that they should ensure a more equitable distribution of prosperity, lest their own wealth be dashed to bits on the jagged rocks of a shrinking economy.

Today, we face a similar predicament. The great challenge of business in our time is reversing the destabilizing threat of inequality. While at first this may seem anathema to our profit-maximizing mission, distribution of income lies at the very heart of sustainable capitalism.

For this reason, today's titans of industry have stepped forward to protest the growing distance between them and the rest of the country. Warren Buffett, Lloyd Blankfein, Stanley Druckenmiller, Bill Gross—legends whose lives and words are studied and idolized at the Wharton School—have all gone public with the wise advice that we steer away from those jagged rocks.

They are not alone in their concern. According to a recent analysis by the Center for American Progress, 68 of the top 100 retailers cite the flat or falling wages of the average American household as a risk to their business—a number that has doubled in the past eight years. A recent poll of small businesses similarly found a strong majority of them in favor of raising the minimum wage.

These business leaders sense an essential truth about our capitalism: Workers are consumers. They spend what they earn—or what they borrow. While the latter may work for awhile, it has limits—and calamitous risks. The only sure way to grow the economy in the long run is to grow consumer spending—and that means growing worker incomes.

In recent decades, workers' incomes have not grown much, on average. Since the beginning of the Great Recession, the average household has lost 8 percent of its income, after adjusting for inflation. All the growth—

and then some—has gone to the richest 10 percent of Americans. And most of that growth—95 percent of total growth, to be precise—has gone to the richest 1 percent. And most of that growth has gone to the richest 0.1 percent. And so on.

Unsurprisingly, economic growth has been slower since the advent of this new trend. From 1950 to 1980, real GDP grew 3.8 percent per year, versus only 2.7 percent from 1980 to 2010. On the rare occasions when it has approached its previous faster rate, it was fueled by unsustainable borrowing. This is no coincidence. Recent work by economists Özlem Onaran and Giorgos Galanis has shown that most developed countries experience lower growth when the share of their income going to wages (as opposed to profits) declines. In the United States, for example, every 10 percent decline in the wage share causes the economy to shrink by 9.2 percent. In fact, that has been the experience of the global economy as well.

High wages are what economists refer to as a "positive externality." They generate "spillover effects" that benefit the people who don't pay for them. When workers receive high wages, they invest more in health and education, increasing their productivity and reducing the costs we all pay for a sicker, less-informed population. They motivate firms to invest in advanced technologies to reduce labor costs, making them more innovative and globally competitive. Workers who receive high wages are less likely to go out on strike, vote against free trade and immigration, protest in the streets, shirk on the job and commit crimes. That's why, in an analysis of 19 developed nations from 1960 to 2004, economists Robert Vergeer and Alfred Kleinknect found that higher wage growth consistently led to higher productivity growth.

In other words, low wages may be good for one firm, but high wages are better for all firms. Yet many businesses would like to raise wages, but they fear losing ground to their competitors.

The only solution is collective action.

Economists have a collective action for precisely this sort of "coordination failure": taxing the negative externality and subsidizing the positive. It is time that we recognize inequality for the negative externality that it is, slowing our productivity growth, roiling our markets with volatility, gridlocking our political system, and starving our economy of willing and able consumers. Inequality is a risk to our businesses, and it ought to be treated as such.

> It is time that we recognize inequality for the negative externality that it is, slowing our productivity growth, roiling our markets.

We should therefore see taxes not as penalties but as investments in a better, more equitable, more sustainable system. We should strive to prevent a "race to the bottom" in workers' incomes; if we don't, the day will come when no one will be left to pay the profits our shareholders demand. Business schools should teach courses about this issue, and business leaders should address it in their boardrooms. It is not merely a political issue. It is very clearly the business of Business.

Joseph Kennedy thought so when he went to work for President Roosevelt. As one of the nation's most notorious stock manipulators, Kennedy might have been the last person we'd expect to join Roosevelt's crew, but when Roosevelt named Kennedy as the first chairman of the Securities and Exchange Commission, he saw it as an opportunity to save the market from itself.

"We of the SEC do not regard ourselves as coroners sitting on the corpse of financial enterprise," said Kennedy in a radio address to the nation. "On the contrary, we think of ourselves as the means of bringing new life into the body of the security business."

As Wharton graduates, let us think of ourselves in the same manner, and act accordingly. ■

Anthony W. Orlando W09 *received his bachelor's degree from Wharton and his master's in economic history from the London School of Economics. He is a lecturer in the College of Business and Economics at California State University, Los Angeles, and a public policy research fellow at the University of Southern California. His latest book* Letter to the One Percent *is available at www.LetterToTheOnePercent.com.*