

# A bit rich

---

 [neweconomics.org/2009/12/a-bit-rich](http://neweconomics.org/2009/12/a-bit-rich)

Pay matters. How much you earn can determine your lifestyle, where you can afford to live, and your aspirations and status. But to what extent does what we get paid confer ‘worth’?

Beyond a narrow notion of productivity, what impact does our work have on the rest of society, and do the financial rewards we receive correspond to this? Do those that get more contribute more to society? With controversial bonuses being paid out this Christmas in bailed-out banks, we believe that it is time to ask challenging questions such as these.

We are in the wake of the worst financial crisis for a century. Yet this Christmas, many highly paid employees of City banks that are responsible for creating this crisis are being paid extravagant bonuses. This comes at a time when wage inequality remains stubbornly high, due in large part to the increased concentration of very high and very low earners in the economy.

The controversies over City bankers’ bonuses raise fundamental questions not only about the remuneration of senior executives and public servants but also about the relative value of the work of everyone in our society. How should we assess the wider contribution our work makes?

In this report, the New Economics Foundation (NEF) takes a new approach to looking at the value of work. We go beyond how much different professions are paid to look at what they contribute to society. We use some of the principles and valuation techniques of Social Return on Investment analysis to quantify the social, environmental and economic value that these roles produce – or in some cases undermine.

“How should we assess the wider contribution our work makes?”

Our report tells the story of six different jobs. We have chosen jobs from across the private and public sectors and deliberately chosen ones that illustrate the problem. Three are low paid – a hospital cleaner, a recycling plant worker and a childcare worker. The others are highly paid – a City banker, an advertising executive and a tax accountant. We recognise that our incentives are created by the institutions and systems around us. It is not our intention therefore, to target the individuals that do these jobs but rather to examine the professions themselves.

## Why wage inequality matters

---

In the UK we live in a society of extremes. The incomes of the very rich and the very poor continue to pull away from each other. This is influenced by many factors but wage inequality is at the heart of them. It is a corrosive, destabilising issue that is linked to a range of social problems. It disproportionately affects some groups – particularly women, who predominate in low paid (and unpaid) work. The least well paid jobs are often those that are among the most socially valuable – jobs that keep our communities and families together. The market does not reward this kind of work well, and such jobs are

consequently undervalued or overlooked.

“The least well paid jobs are often those that are among the most socially valuable – jobs that keep our communities and families together.”

## Why a minimum wage is not enough...

---

The idea of a subsistence salary goes back to the early classical economists. We still set wage floors today to ensure there is a minimum below which employers are not allowed to hire. However these minimums are often set very low. The UK minimum wage is not indexed to average wages, which means it slips behind pay levels in the rest of the economy. The impact of globalisation has made matters worse, contributing to an increasing specialisation of the workforce that has seen many previously well-paid, semi-skilled jobs being replaced by low-skilled, service-based jobs with few options for progression.

## ...and why an upper limit is required

---

Low pay is only one part of the issue. There is little political appetite for reining in high pay, and the idea of setting a ceiling on the remuneration of top executives has failed to gain any meaningful momentum. One reason why a minimum wage has become the norm is that it has been accepted that employers have the power to set wages. By the same token, in some sectors, a shortage of skills or the exploitation of monopoly power has allowed a privileged few to capture very high rates of pay. Sectors such as finance are notorious for sky-high salaries and big bonuses, as remuneration committees are self-regulating and accountability to shareholders is often weak.

## From surplus value to social value

---

Early theories of value neglected the extent to which the production and trade of goods and services may have a wider impact on society that is not reflected in the cost of producing them. These ‘externalities’ are often remote or hard to see but that does not mean that they are not real or that they do not affect real people – either now or in the future.

Because social and environmental costs are not properly accounted for, the market tends to oversupply products that may have a significantly negative environmental or social impact – such as cheap consumer goods and complex financial products. In the same way we underpay work that has a high social value, creating high vacancy rates in our most important public services such as nursing and social work. By making social value creation an important societal goal we could set the right incentives to maximise net social benefits, ensure a greater return to labour rather than capital, and a more equal distribution of economic resources between workers.

## A closer look at six professions

---

We have tested our theory by taking a close look at a sample of highly paid and low paid jobs. We found that some of the most highly paid benefit us least, and some of the lowest-paid benefit us most. Although this will not always hold, it does point to a massive flaw in the system and highlights the need for reform.

## **1. Bankers**

High-earning investment bankers in the City of London are among the best remunerated people in the economy. But the earnings they command and the profits they make come at a huge cost because of the damaging social effects of the City of London's financial activities. We found that rather than being 'wealth creators', these City bankers are being handsomely rewarded for bringing the global financial system to the brink of collapse. *While collecting salaries of between £500,000 and £10 million, leading City bankers to destroy £7 of social value for every pound in value they generate.*

## **2. Parents and childcare**

Both for families and for society as a whole, looking after children could not be more important. As well as

providing a valuable service for families, childcare workers release earnings potential by allowing parents to continue working. They also unlock social benefits in the shape of the learning opportunities that children gain outside the home.

*For every £1 they are paid, childcare workers generate between £7 and £9.50 worth of benefits to society.*

## **3. Advertising executive**

Although the role of an advertising executive has high status, the impact of the industry has always been a point of controversy. It encourages high consumer spending and indebtedness. It can create insatiable aspirations, fuelling feelings of dissatisfaction, inadequacy and stress. In our economic model we estimate the share of social and environmental damage caused by overconsumption that is attributable to advertising.

*For a salary of between £50,000 and £12 million, top advertising executives destroy £11 of value for every pound in value they generate.*

## **4. Hospital cleaners**

Hospital cleaners play a vital role in the workings of our healthcare facilities. Not only do they clean

hospitals and help maintain standards of hygiene to protect against infection but they also contribute towards wider health outcomes. The importance of these cleaners is often underestimated and undervalued in the way they are paid and treated.

*We estimated, however, that for every £1 they are paid, over £10 in social value is generated.*

## **5. Tax accountants**

Determining the right amount of tax payable is a specialist skill and often requires professional support. However, some highly paid tax accountants' sole purpose is to help rich individuals and companies to pay less tax. We found that the positive benefits to society of these activities are negligible. However, every pound that is 'avoided' in tax is a pound that would otherwise have gone to HM Revenue. In our model we looked at how this lost revenue could have been better spent.

*For a salary of between £75,000 and £200,000 tax accountants destroy £47 of value for every pound in value they generate.*

## **6. Waste recycling**

Waste recycling workers do a range of different jobs that relate to processing and preventing waste and promoting recycling. Carbon emissions are significantly reduced when goods are recycled instead of sending them to incineration or landfill. There is also a value in reusing goods, and we have included this in our model.

*Our model projects that for every £1 of value spent on wages, £12 of value will be generated.*

## The myths of pay and value

---

This report sets out to shatter some myths about pay and value. Chief among them – and the point of the research – is to show that there is not a straightforward relationship between high financial rewards and good societal outcomes. This isn't just an intellectual exercise – it has big implications for the way in which our society and economy are structured. Financial incentives are very powerful, and we tend to shower them on some of the professions that are the most socially and environmentally costly. This promotes undesirable behaviour, while positive activities are discouraged.

### **Myth 1: The City of London is essential for the UK economy**

Access to finance for everyone is vital for the UK economy to function. Yet the City of London has primarily been concerned with an aggressive quest for profits. This has heaped the worst financial crisis for a century on all parts of the economy. Even those closest to the City are increasingly sceptical about its value to the UK economy. On best estimates it contributes 3 per cent a year in value added compared to 12.5 per cent value added contributed from manufacturing.

### **Myth 2: Low paid jobs create a ladder for people to work their way up – opportunities to advance are open to all**

The level of income inequality in the UK means that high earners can protect their position and that of their children by buying education, assets and advantage. The ladder that might offer a way up for those on low incomes is effectively kicked away. The only way to improve equality of opportunity and outcome is to shorten the ladder in the first place.

### **Myth 3: Pay differentials don't matter, so long as we eradicate poverty**

Of course poverty matters. But increasingly it is not absolute levels of poverty alone but the differences between people that contribute to social problems such as crime, ill health, poor educational attainment and addiction. In focusing so much on improving the lot of those on very low incomes, we have ignored the differentials that underpin what has become a two-tier society.

### **Myth 4: We need to pay high salaries to attract and retain talent in the UK**

Our case studies show that high salaries don't necessarily reflect talent. Even if they did, it is not clear that the best and brightest would be prepared to uproot their families and hike across the world for higher wages. The evidence suggests that more equal countries manage to retain their fair share of innovation and cultural capital.

#### **Myth 5: Workers in highly paid jobs work harder**

People at the bottom of the income distribution scale spend more time on domestic and caring responsibilities than their highly paid counterparts. They are also more likely to have more than one job, and for many that is the only route out of poverty. When we take this into account, it becomes clear that those who are paid less work just as much (or even more) than the better off.

#### **Myth 6: The private sector is more efficient than the public sector**

Work that is cheap is not necessarily work that is effective. This myth that the private sector is more efficient has motivated the increase in competitive tendering of public services to private contractors, and has been used to justify lower unit costs (and lower wages). However, lower prices are sometimes secured at the cost of service quality, suggesting that paying higher wages could in fact be more efficient.

#### **Myth 7: If we tax the rich, they will take their money and run**

Intuitively we understand that decisions on whether to emigrate are far more complex than how much people earn. They depend on a multitude of factors – not only financial circumstances but also cultural familiarity, environment, proximity to friends and family, and quality of public services.

#### **Myth 8: The rich contribute more to society**

The rich pay proportionately less tax than the poor, and many of our tax streams such as council tax and VAT are highly regressive. The rich even give less in relative terms to charity than the poor.

#### **Myth 9: Some jobs are more satisfying, so they require less pay**

Job satisfaction is related to a number of factors. Autonomy, control in the workplace, income and status all contribute towards a sense of satisfaction and fulfilment at work. If high pay is partly intended to compensate for risk, stress and long hours then we would expect dangerous jobs to be well rewarded. Fishing is the most dangerous job in Britain, with roofers and scaffolders also high up on the danger list, and waste recycling collectors are at number 18. Yet in none of these industries are rank-and-file workers highly paid.

#### **Myth 10: Pay always rewards underlying profitability**

It is becoming increasingly apparent that there is only a weak correlation between pay and executive performance. In 2008, for example, the UK's top companies lost almost a third of their value while the bosses of these companies enjoyed a 10 per cent leap in their basic salaries. Empirical studies have demonstrated that pay arrangements are geared towards serving the financial interests of managers, not shareholders.

## Conclusions

---

This report is not about targeting any individuals in the highly paid jobs it scrutinises. Neither is it simply suggesting that people in low paid jobs should be paid more. The point we are making is a more complex one – that there should be a relationship between what we are paid and the value our work generates for society.

We need to overcome deep structural issues to act on the implications of this report. The stakes are high: without proper checks and balances we believe our economic system could squeeze out those aspects of life that people value most. We urgently need to align incentives with the social and environmental value that are generated by the workforce.

## Policy recommendations

---

- **End the policy silence on high pay.** NEF has previously advocated a national maximum pay differential. This has been echoed recently by Compass and others with calls to establish a High Pay Commission. Its task could be to examine what the appropriate differentials should be. The Royal Navy, for example, has had a de facto differential of eight, whilst some Japanese firms voluntarily impose pay ratios limiting the gap between the top and bottom pay. Determining these multiples should be informed by the concept of social value creation.
- **Learn from the successes of anti-discrimination legislation.** Explore the possibility of positively discriminating towards people from low-income backgrounds to level the playing field in access to highly paid professions.
- **Build social and environmental value into prices.** Until goods and services reflect the real costs and benefits of their production, incentives will be misaligned with the kinds of positive behaviours society wishes to promote. Getting the prices right would affect relative profitability and so would align what wages could be paid with the value that is created. Consumption and corporation tax are two vehicles for doing this, but they need to be applied in a progressive way.
- **Introduce more progressive taxation.** The wealthiest do not pay their fair share of tax and the very wealthy may pay none at all. Redistribution, particularly of assets and land, is an effective way both to offset inequality and to reward jobs that the market does not. Closing tax loopholes would also be a good place to start.
- **Launch a green industrial policy.** We have an unprecedented opportunity to make environmental progress while also addressing wage inequality. The time has come for a new industrial policy, creating green jobs to replace the middle-income, semi-skilled jobs that have been wiped out in manufacturing.
- **Encourage new forms of ownership.** Mutually owned building societies, co-operatives and land trusts are all models in which ownership takes a more collective form, and benefits are more evenly shared.
- **Radically reform the role of the City.** It is time to return finance to its role as servant, not master of the economy. Instead of a monoculture of mega-banks deemed too big to fail and answerable only to the demands of private shareholders, we need a range of different financial institutions that are focused on social value creation. Initiatives such as a financial transaction tax would also reduce the harmful effects of trading.
- **Invest in universal child care and paid parental leave.** Child care provision in the UK often reflects and reinforces socio-economic and gender divisions. Making high-

quality, affordable care available to all gives parents – particularly women – a better choice over returning to work and provides children with greater equality of opportunity. Extending parental leave, especially to fathers, would be a further investment in positive child development for the benefit of society. These provisions could be entirely met by recouping the money lost to society through tax avoidance by the wealthiest. This valuable investment would also increase gender equality by improving career options for women.