The Global Economy and Inequality

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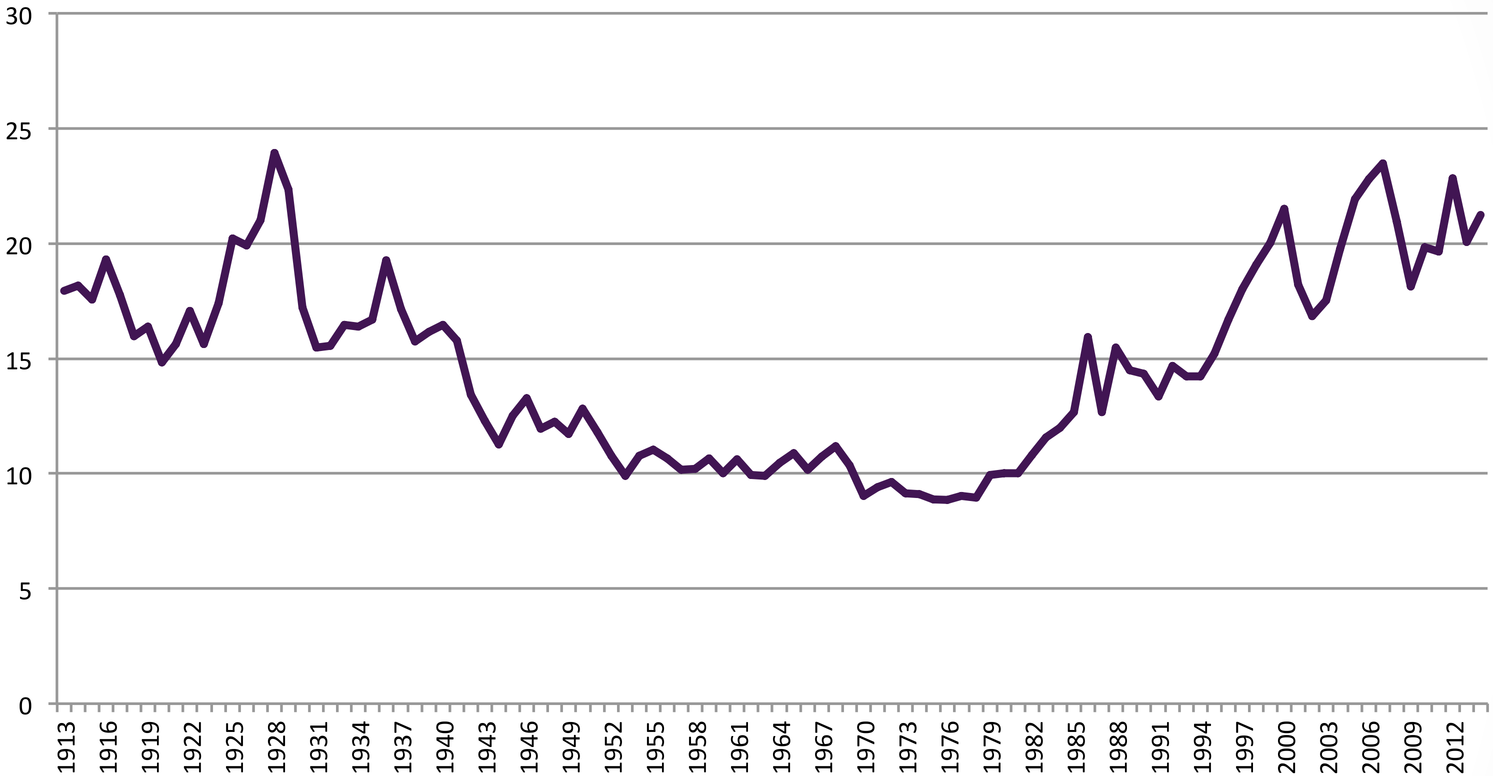
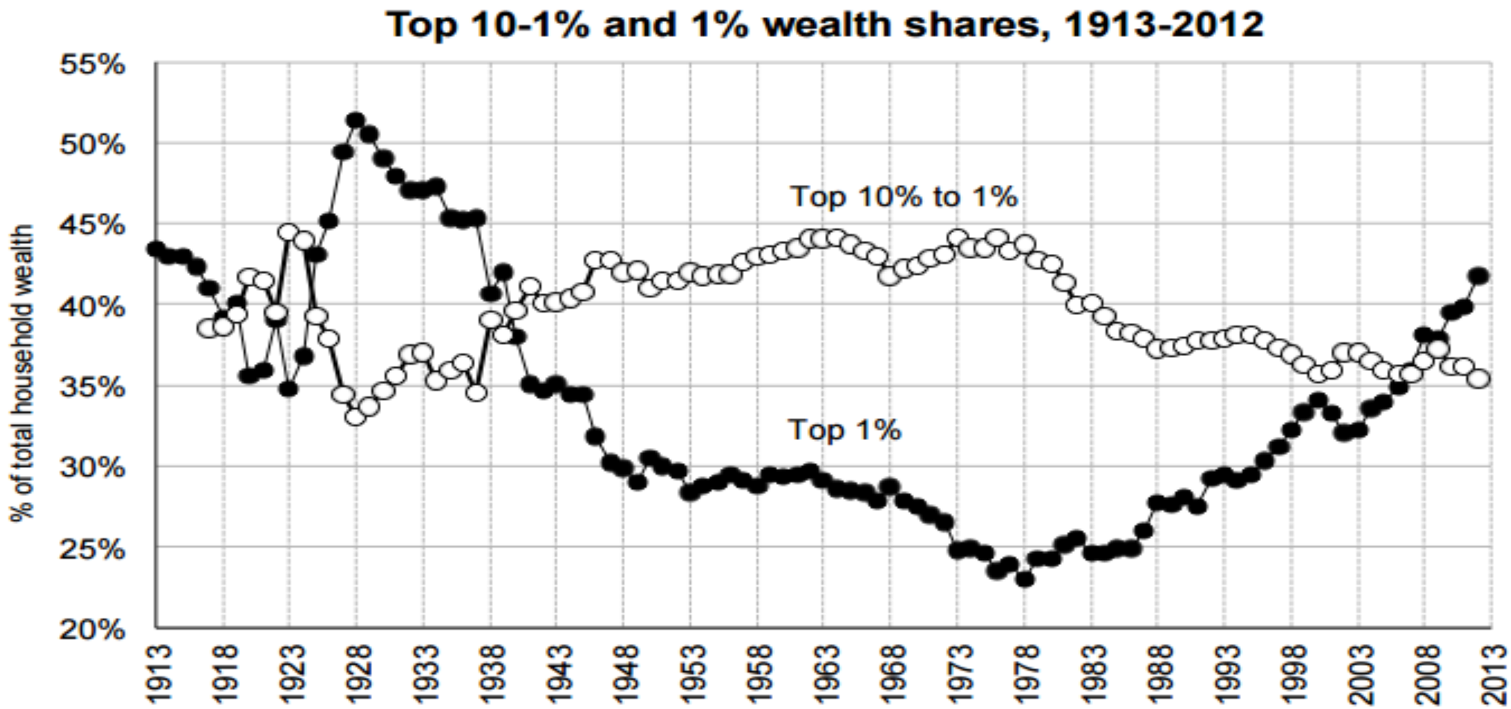
Enormous growth in inequality

- Especially in US, and countries that have followed US model
- Multiple dimensions of inequality
  - More money at the top
  - More people in poverty
  - Evisceration of the middle
  - Inequalities in wealth exceed those in income
  - Inequality in health—especially large in US
  - Inequality in access to justice

US Top 1% income share-including capital gains

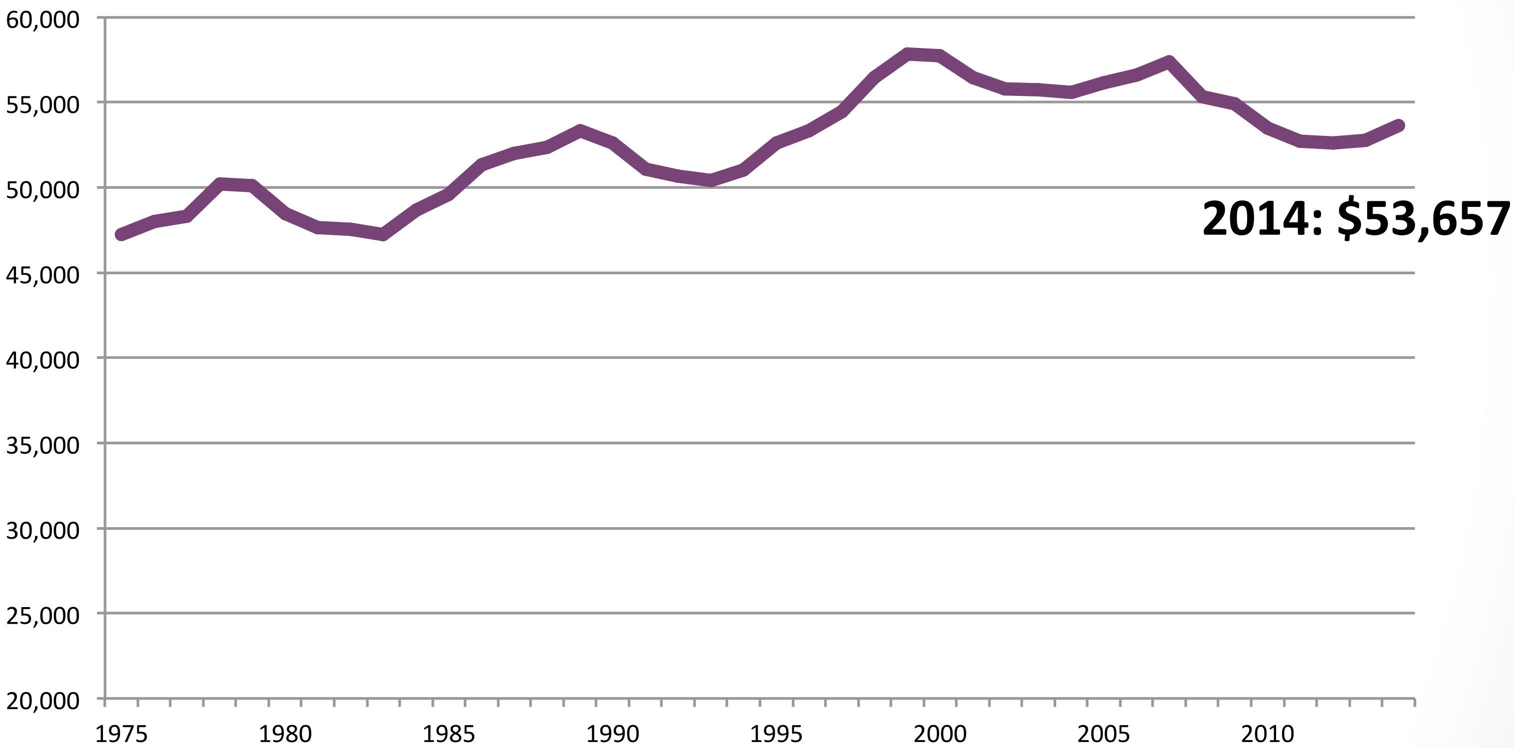


Source: Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States, 1913-1998" *Quarterly Journal of Economics*, 118(1), 2003, 1-39 (Longer updated version published in A.B. Atkinson and T. Piketty eds., Oxford University Press, 2007) (Tables and Figures Updated to 2013 in Excel format, January 2015) . Series based on pre-tax cash market income including realized capital gains and excluding government transfers.



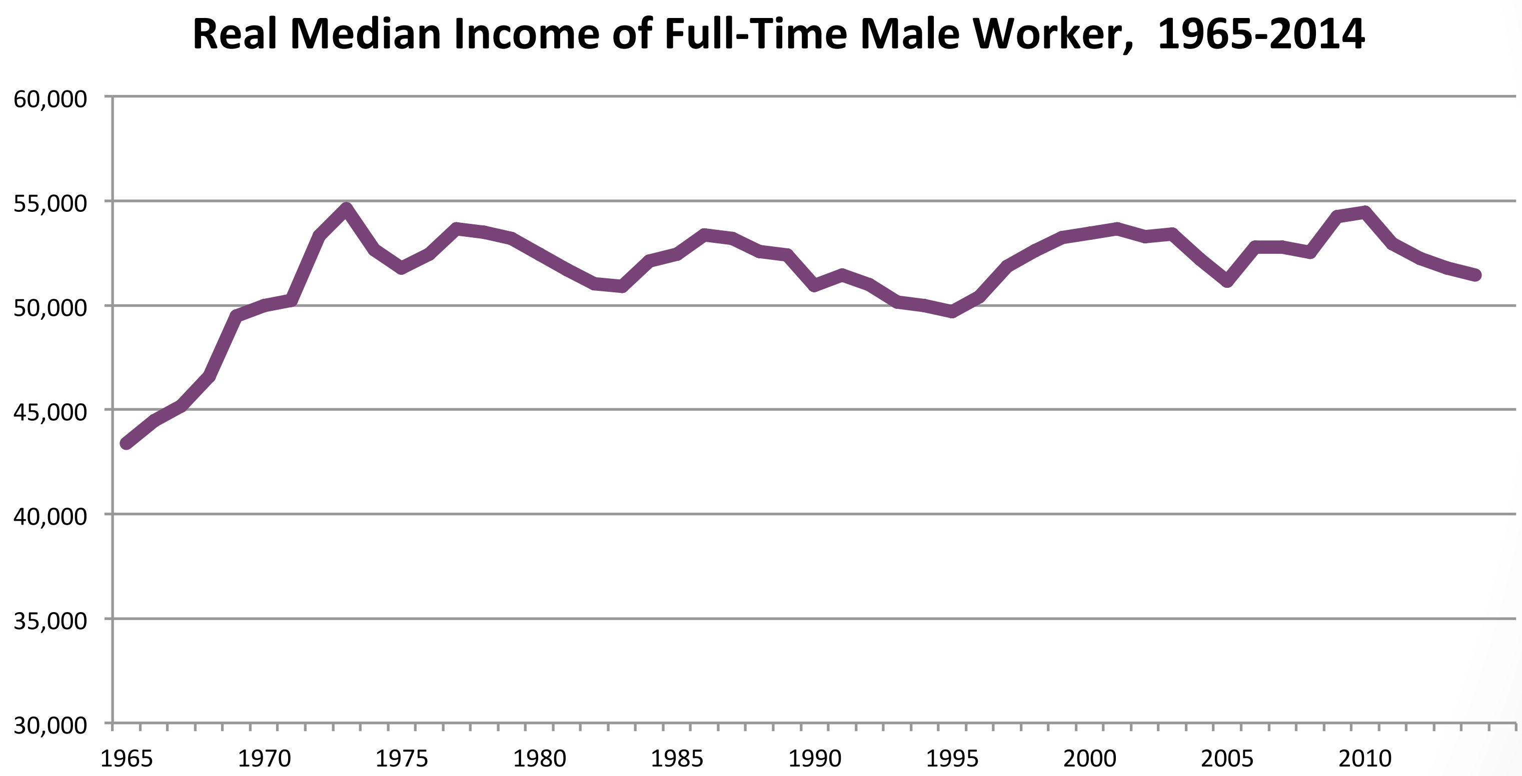
Source: Emmanuel Saez and Gabriel Zucman, 2014, "Wealth Inequality in the United States since 1913: Evidence from Capitalized Income Tax Data" NBER Working Paper, October, revise and resubmit *Quarterly Journal of Economics.*

Stagnation: U.S. median household income
(constant 2014 US$)

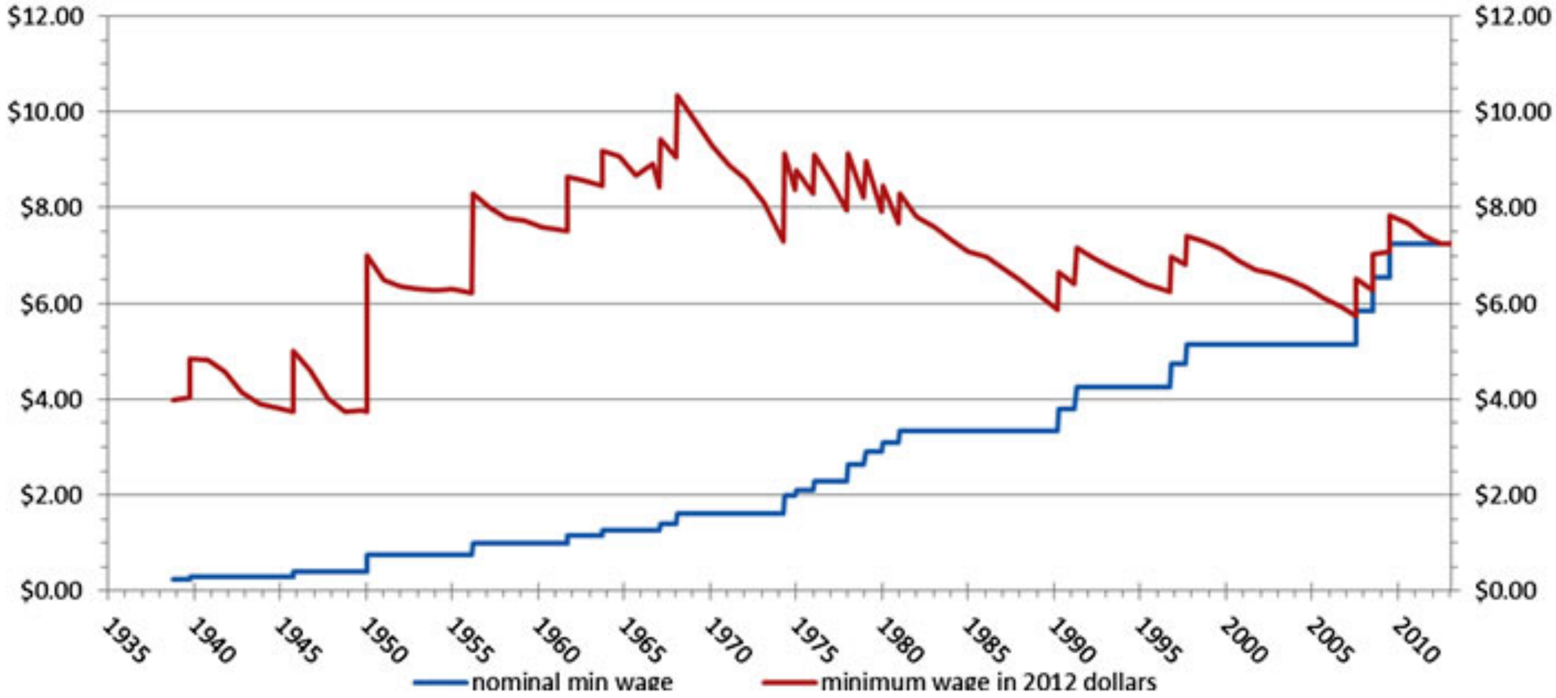


Source: U.S. Census Bureau

Decline in median income of full-time male worker



U.S. minimum wage, 1938-2012

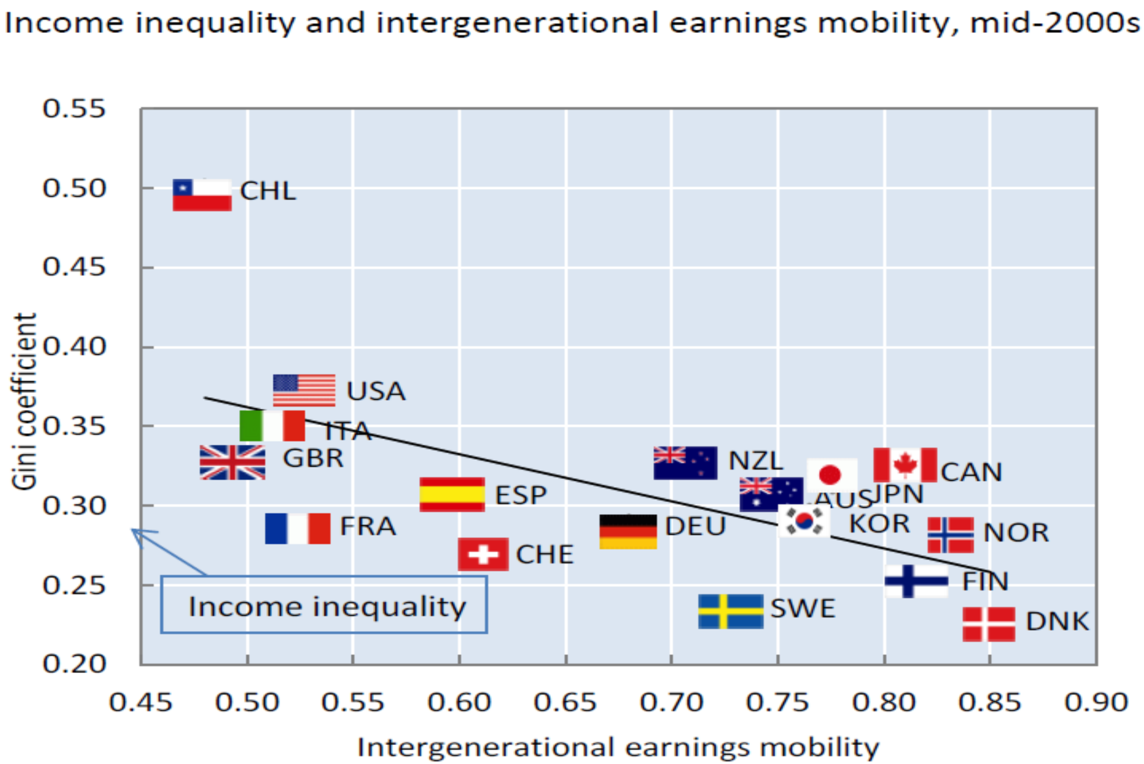


Source: U.S. Department of Labor. http://www.dol.gov/minwage/minwage-gdp-history.htm

Most invidious aspect: inequality in opportunity

- Not a surprise: systematic relationship between inequality in incomes (outcomes) and inequality of opportunity

Income inequality and earnings mobility



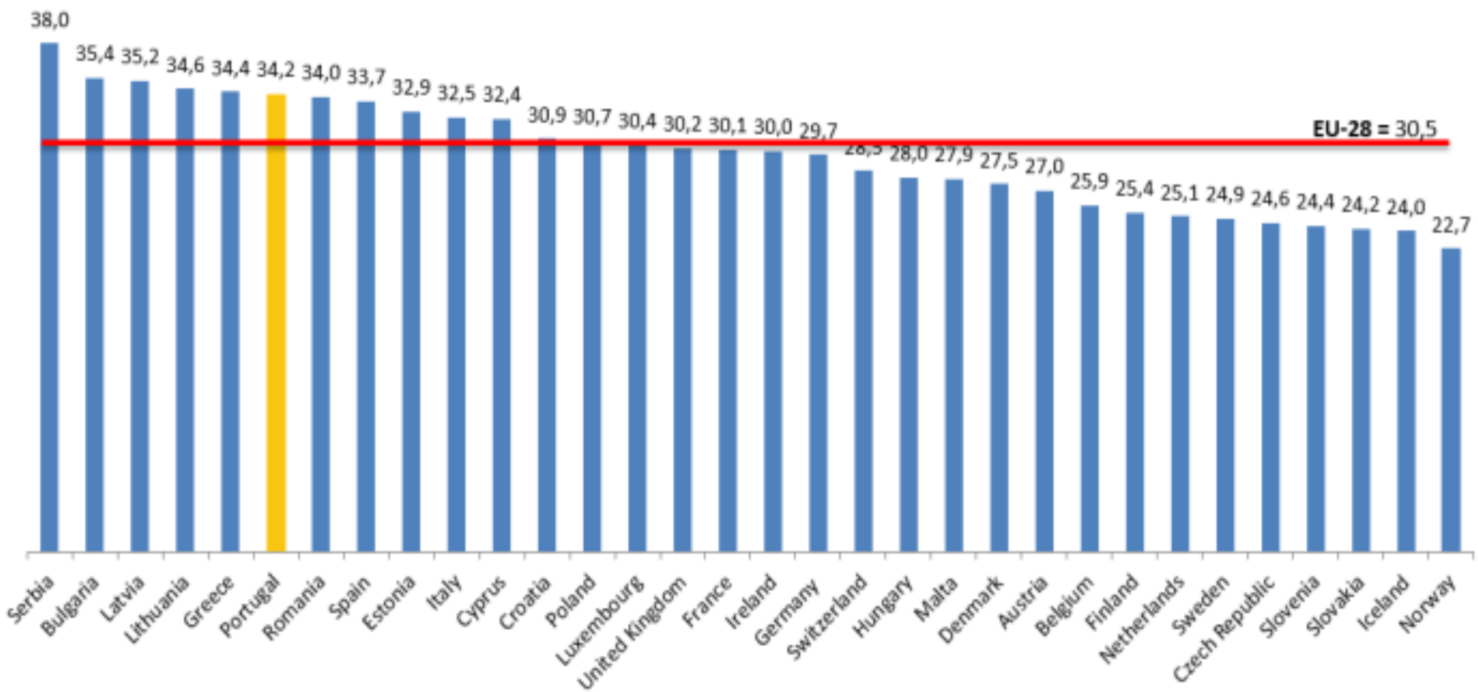
Source: "United States, Tackling High Inequalities Creating Opportunities for All", June 2014, OECD.

Global inequality

- Almost all OECD countries have seen increased inequality in last 30 years
- The trend around the world is somewhat mixed, but remains a concern almost everywhere

Global inequality: Ginis

Figure 1. Gini Coefficient in EU-28, Serbia, Switzerland, Iceland and Norway, in 2012



Source: Statistics on Income and Living Conditions, EU-SILC 2014 (Eurostat).

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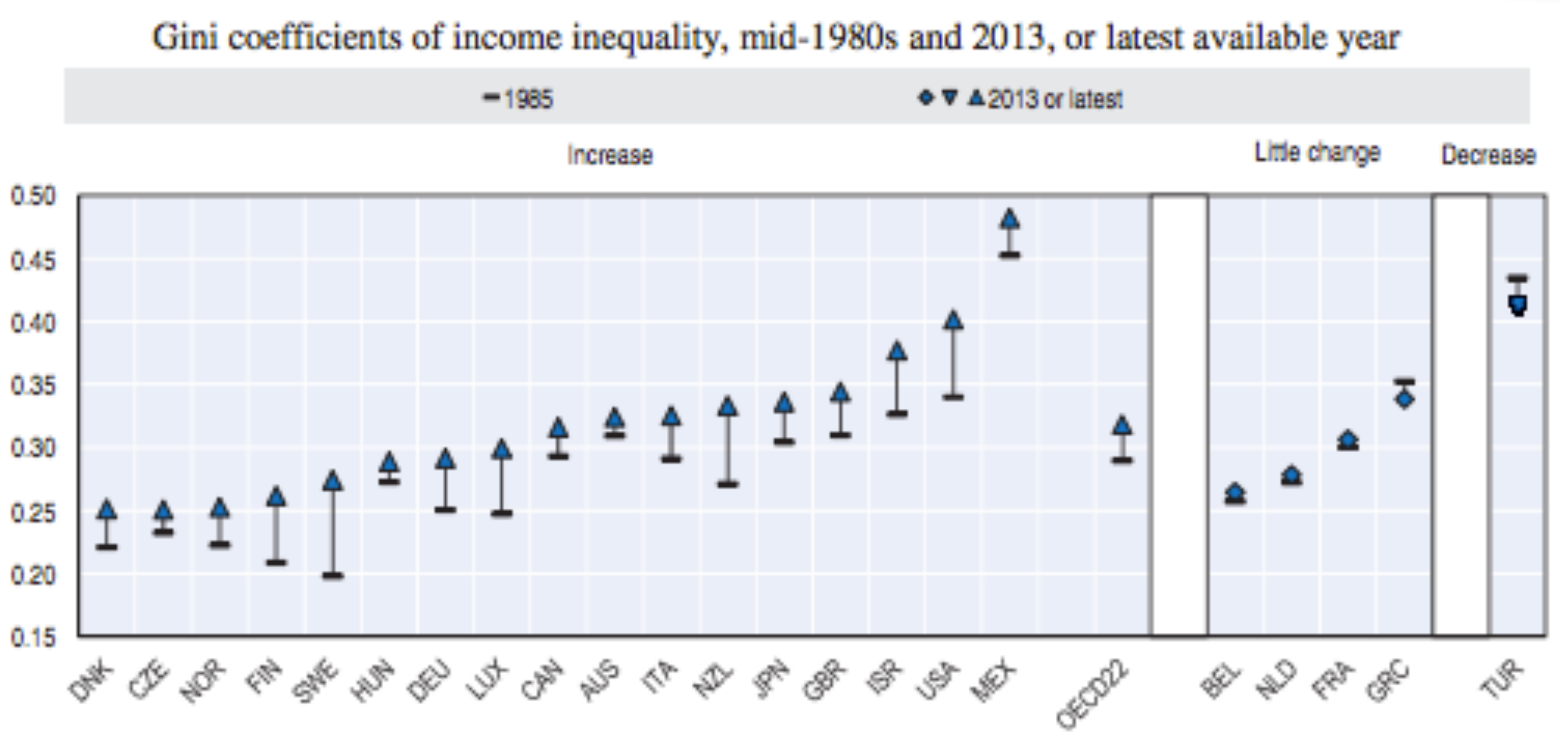
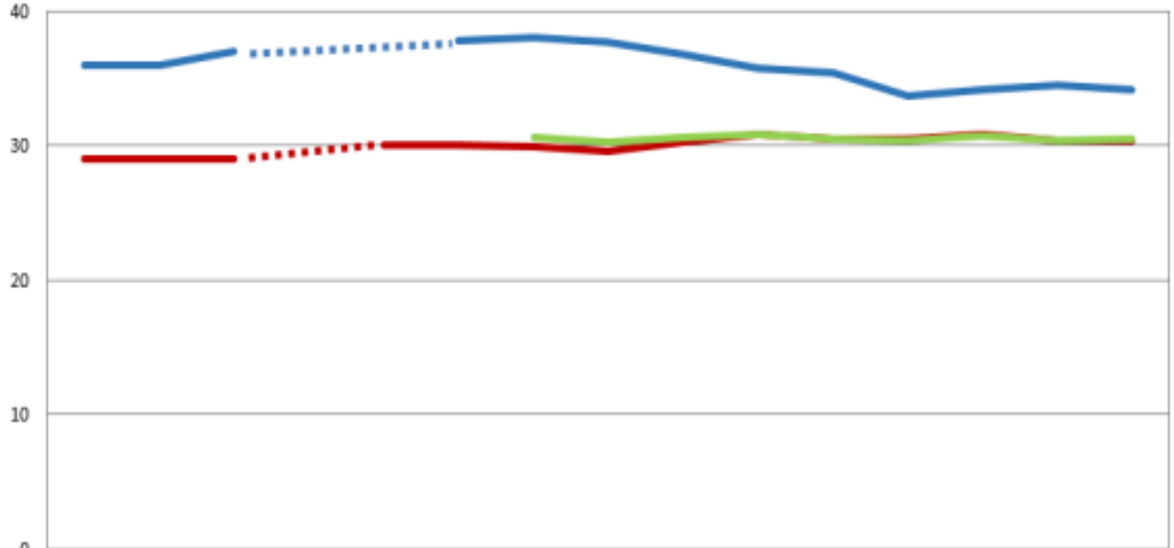
Gini changes in OECD



Source: OECD 2015, *In It Together: Why Less Inequality Benefits All,* http://www.oecd.org/els/soc/OECD2015-In-It-Together-Chapter1-Overview-Inequality.pdf

Figure 2. Trends in the Gini Coefficient in Portugal and EU-15/27 (1998-2012)



	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Portugal	36	36	37			37,8	38,1	37,7	36,8	35,8	35,4	33,7	34,2	34,5	34,2
EU-15	29	29	29		30	30	29,9	29,6	30,3	30,8	30,5	30,5	30,8	30,4	30,4
EU-27							30,6	30,3	30,6	30,9	30,5	30,4	30,7	30,4	30,5

Source: Statistics on Income and Living Conditions, EU-SILC 2014 (Eurostat).

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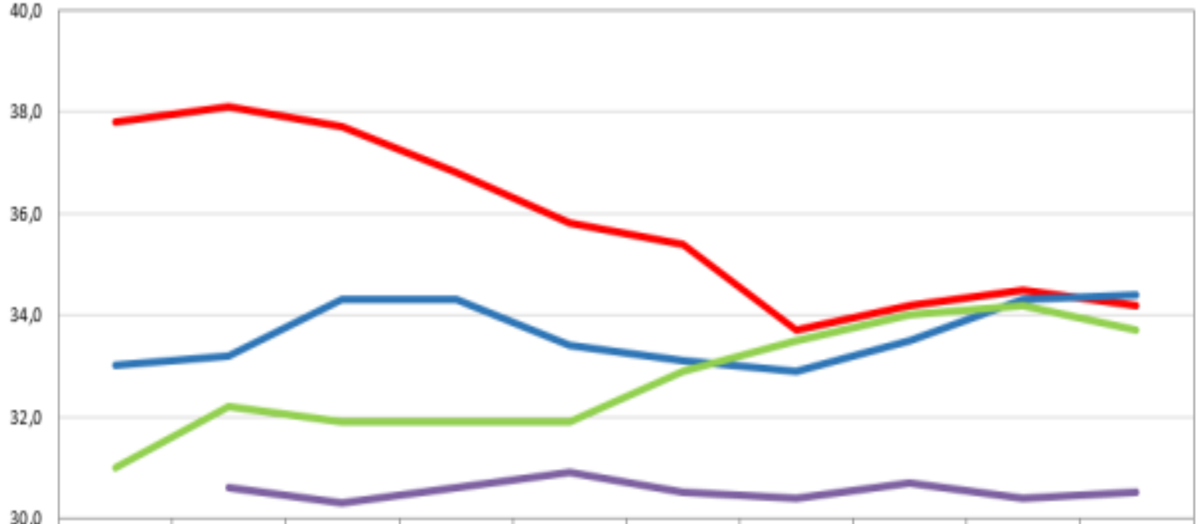
Figure 3. Trends in the Gini Coefficient in the South European countries (2003-2012)



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Portugal	37,8	38,1	37,7	36,8	35,8	35,4	33,7	34,2	34,5	34,2
Greece	33,0	33,2	34,3	34,3	33,4	33,1	32,9	33,5	34,3	34,4
Spain	31,0	32,2	31,9	31,9	31,9	32,9	33,5	34,0	34,2	33,7
EU-27		30,6	30,3	30,6	30,9	30,5	30,4	30,7	30,4	30,5

Source: Statistics on Income and Living Conditions, EU-SILC 2014 (Eurostat).

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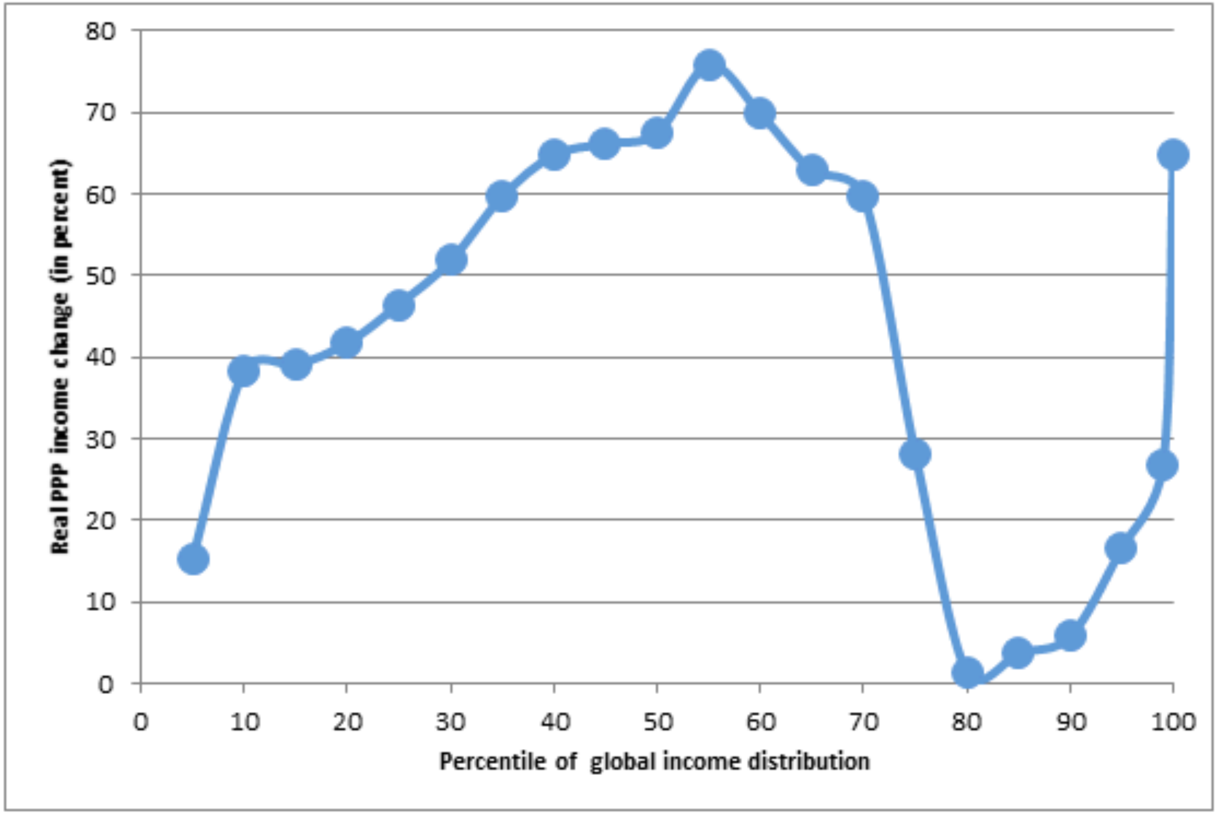
Global inequality: Ginis worse in many countries, late 2000s vs. 1980s

	1985-90	After 2008	Change
Average Gini	36.3	38.8	+2.5
Pop-weighted Gini	33.9	37.3	+3.4
GDP-weighted Gini	32.2	36.4	+4.2
Countries with higher Ginis	32.0	36.2	+4.5
Countries with lower Ginis	42.8	39.5	-3.3

Branko Milanovic

Source: Branko Milanovic, http://glineq.blogspot.co.ke/2015/02/trends-in-global-income-inequality-and.html

Global inequality: income growth by percentile, 1988-2008



Source: Branko Milanovic, http://glineq.blogspot.co.ke/2015/02/trends-in-global-income-inequality-and.html

Global inequality: income growth by percentile

- What previous chart means is that, globally:
  - Very rich—those at far right of graph—have seen their incomes grow at a high rate
  - Developing Asian middle class (especially China) has also grown at a fast rate. This is represented by those in middle-left of the graph.
  - The incomes of the world's very poor—those on the far left of the chart—have not kept pace.
  - Advanced country middle class incomes—those around the 80th percentile—have stagnated completely
  - (This is the analysis that Branko Milanovic has put forward)

Major changes in understandings of inequality

- Trickle down economics doesn't work
  - There never was good theory or empirical evidence in support
  - In a way, Obama administration and Fed tried it again: bail-out to banks was supposed to benefit all; QE would work by increasing stock market prices, benefitting mostly those at top
- "Repeal" of Kuznets law
  - Was period after WWII, the "golden age of capitalism," an aberration, the result of the social cohesion brought on by the war?
    - With the economy now returning to the natural state of capitalism?
  - Or is the increase in inequality after 1980 a result of a change in policies?

Major changes in understandings of inequality

- Large differences in outcomes/opportunities among advanced countries
  - Suggesting that it is policies, not inexorable economic forces that are at play
  - Inequality is a choice
  - A result of how we structure the economy through tax and expenditure policies, through our legal framework, our institutions, even the conduct of monetary policy
    - All of these affect market power, bargaining power of different groups
    - Even access to jobs and able to participate in labor market
    - Resulting in different distributions of income and wealth before taxes and transfers

Major changes in understandings of inequality

- “Repeal” of Okun’s Law
  - Economies with less inequality and less inequality of opportunity perform better
  - Equality and economic performance are complements
  - Many reasons for this
    - Lack of opportunity means that we are wasting most valuable resource
    - Macro-economic
      - Instability: Link between inequality and frequency of crises has been shown by IMF as well as others.
      - Weaker growth
        - Richest consume a smaller proportion of their incomes than the poor or middle
        - Greater equality would strengthen aggregate demand
        - Small and medium-sized businesses, buoyed by strong middle class, are drivers of economic growth

- Weaker growth (cont'd)
  - Political economy
    - Harder for divided society to make needed public investments in infrastructure, technology, education, etc.
    - As democratic processes are skewed (e.g. in U.S.), policies that protect interests and rents of wealthiest replace those that support broad-based growth
  - Erosion of trust

Major changes in understandings of inequality

- We can afford to have more equality
  - In fact, it would help our economy
  - Some much poorer economies have *chosen* more equalitarian policies
- Because inequality is the result of policies, it is shaped by politics
  - Economic inequality gets translated into political inequality
  - Political inequality leads to economic inequality
  - Vicious circle

Broader consequences

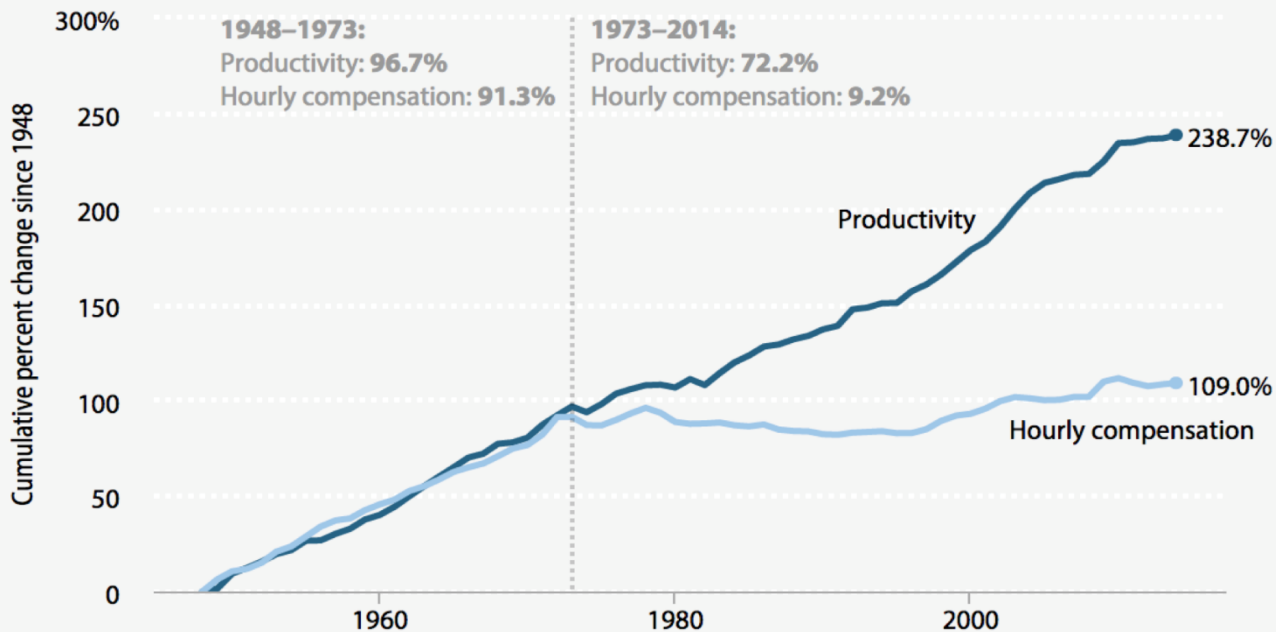
- Undermining democracy
- Dividing society
- Especially when inequalities are on racial and ethnic lines
- Resulting in basic necessities of a middle class society being increasingly out of reach of large proportion of population
- Retirement security, education of one's children, ability to own a home

Critique of Piketty's interpretation

Piketty: Because r (the return on capital) exceeds the growth rate (g), capitalists wealth and income will increase relative to national income

- But what matters is s r, and in standard models, $sr < g$
- Return on capital is endogenous
  - Models need to have macro-/micro- consistency
  - If W *were* K (wealth and K were same), then law of diminishing returns would imply r would fall
  - And wages would rise
- Can't explain large differences between growth in average wages and productivity
  - Even if technical change is skill-biased

Disconnect between productivity and a typical worker's compensation, 1948–2014



Note: Data are for average hourly compensation of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services minus depreciation per hour worked.

Source: EPI analysis of data from the BEA and BLS (see technical appendix for more detailed information)

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Explaining stylized facts

- Can only explain ½ to ¾ of growth in wealth income ratio by national savings
- Wealth “residual” explained best by growth of rents
  - Land rents
  - Exploitation rents (monopoly power, political power)
  - Intellectual property rents
- Wealth can go up even if “K” is going down
  - And many increases in wealth associated with rents lead to decreased productivity

Explaining growth of land rents

- Urbanization
- Positional goods
- Bubbles
  - On bubble paths, wealth may go up, even as K decreases
- Monetary and financial policies affect value of land
  - Rules governing collateralization

- In modern economy, key distinction is not so much between debtors and creditors, but between life cycle savers and inherited wealth
  - Differences in portfolio composition
  - QE has benefits inherited wealth at expense of life cycle savers, contributing to inequality

Further question: distribution of wealth *among* individuals (e.g. of inherited wealth)

- Balance between centrifugal and centripetal forces
  - Policies and other economic changes have changed that balance
  - Leading to an equilibrium with more inequality

Consequences of inequality for the global economy

- Growth in 2015 weakest since Global Financial Crisis and one of poorest performances in recent decades
- Underlying problem: lack of global aggregate demand
- One of reasons: high level of inequality
- Inequality also affects aggregate demand indirectly
- Increases instability
- Realization of this creates uncertainty
- Uncertainty leads to lower investment

Concluding comments

- Addressing inequality is a vital step in bringing global economy back to health
- Incremental changes will not suffice
  - There is a comprehensive agenda which will significantly reduce inequality and increase equality of opportunity
- Key issue: Beginning about a third of a century ago, we began a process of rewriting the rules
  - Lowering taxes and deregulation was supposed to increase growth and make everyone better off
  - In fact, only the very top was better off—incomes of the rest stagnated
- Urgency—decisions today will affect inequality decades later
  - Key is rewriting the rules once again
- Real question is not economics: it is politics