

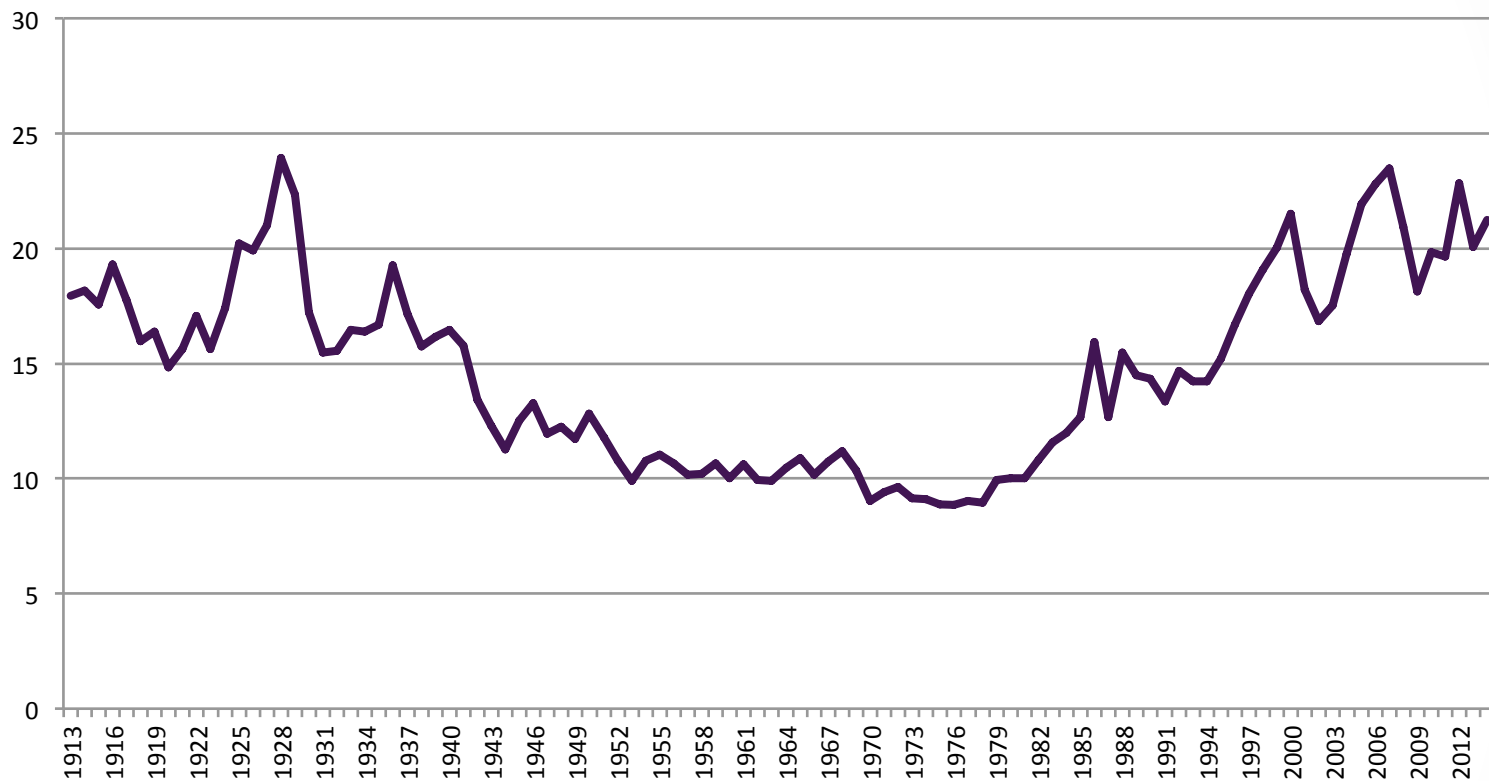
The Great Divide: America's Inequality, Its Causes and Consequences

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Enormous growth in inequality

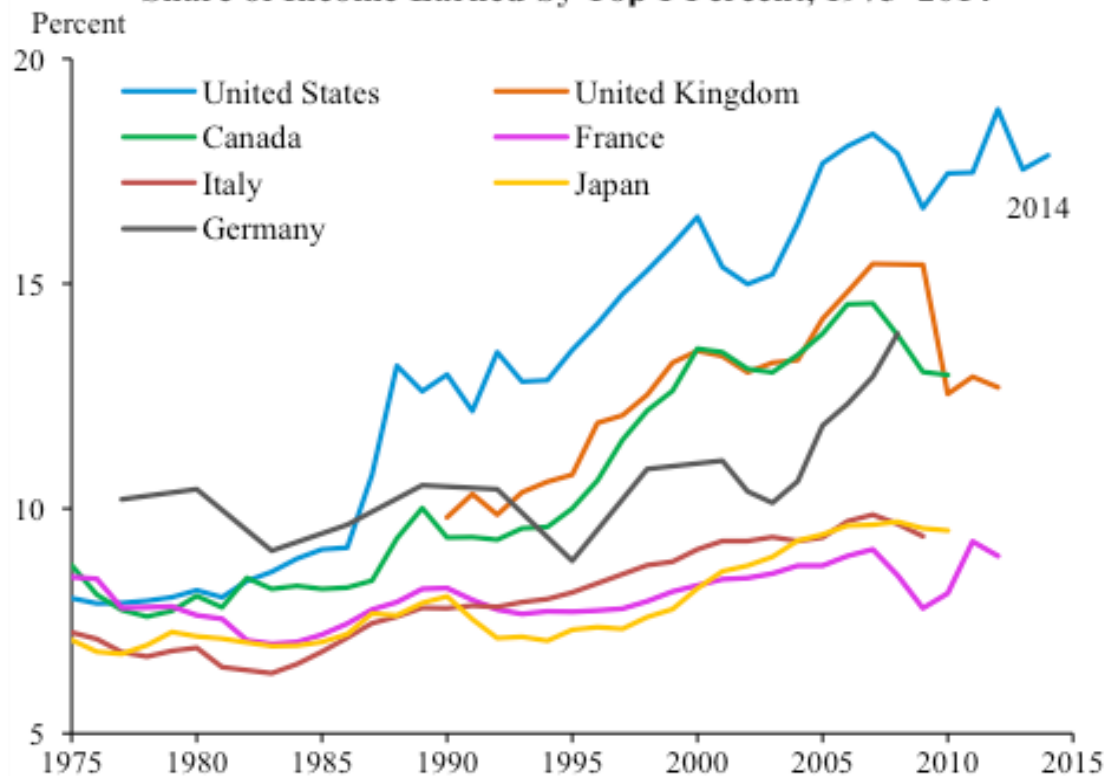
- Especially in US, and countries that have followed US model
- Multiple dimensions of inequality
 - More money at the top
 - More people in poverty
 - Evisceration of the middle
 - Inequalities in wealth exceed those in income
 - Inequality in health—especially large in US
 - Inequality in access to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

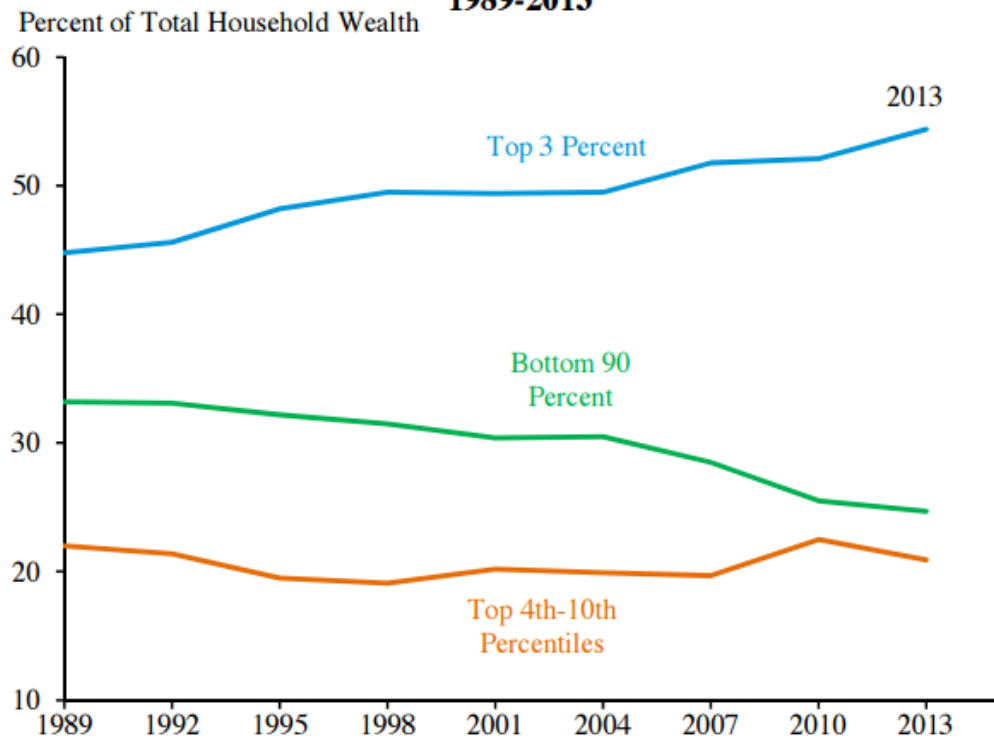
Share of Income Earned by Top 1 Percent, 1975–2014



Note: Data for all countries exclude capital gains.

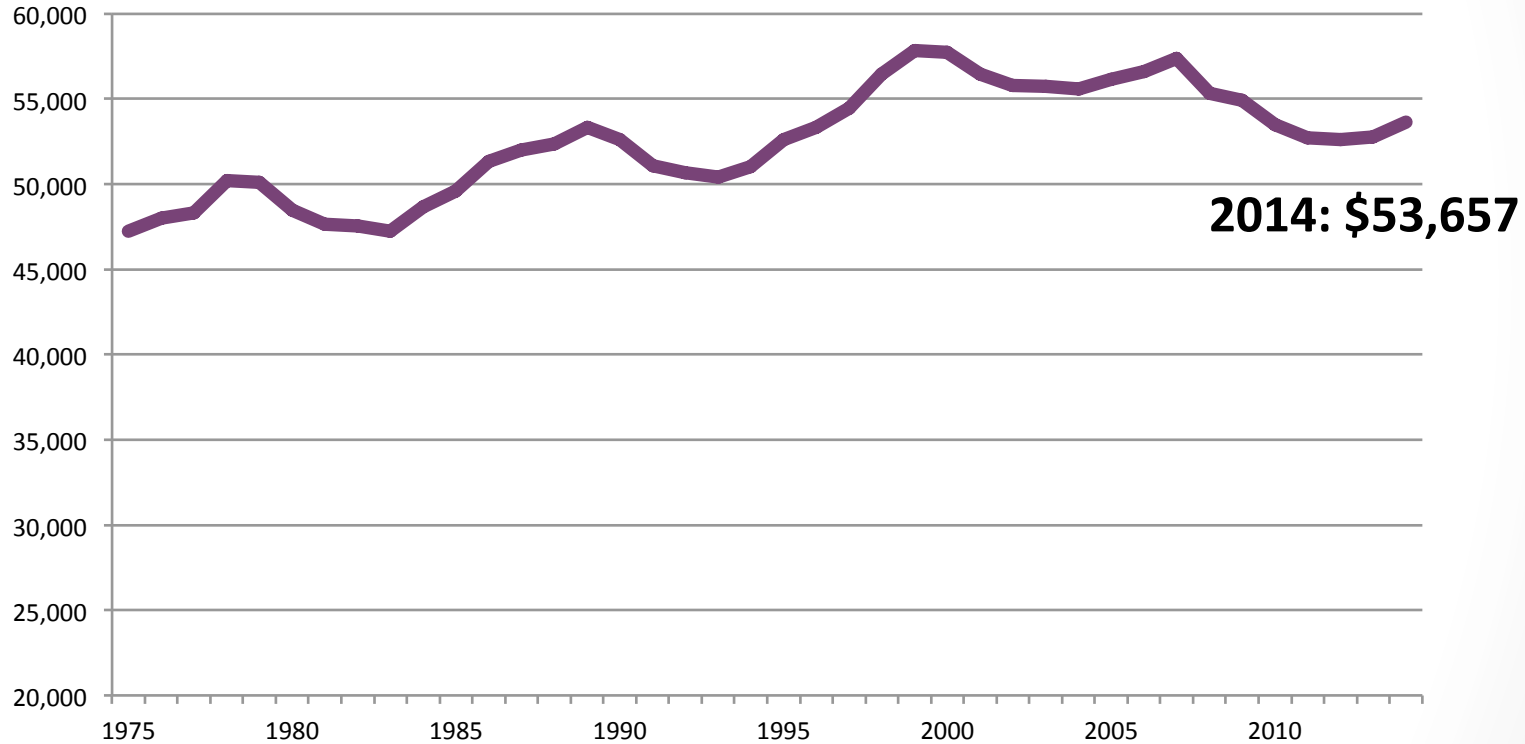
Source: World Top Incomes Database (Alvaredo et al. 2015).

Distribution of Household Wealth (Survey of Consumer Finances), 1989-2013



Source: Federal Reserve Board of Governors, Survey of Consumer Finances.

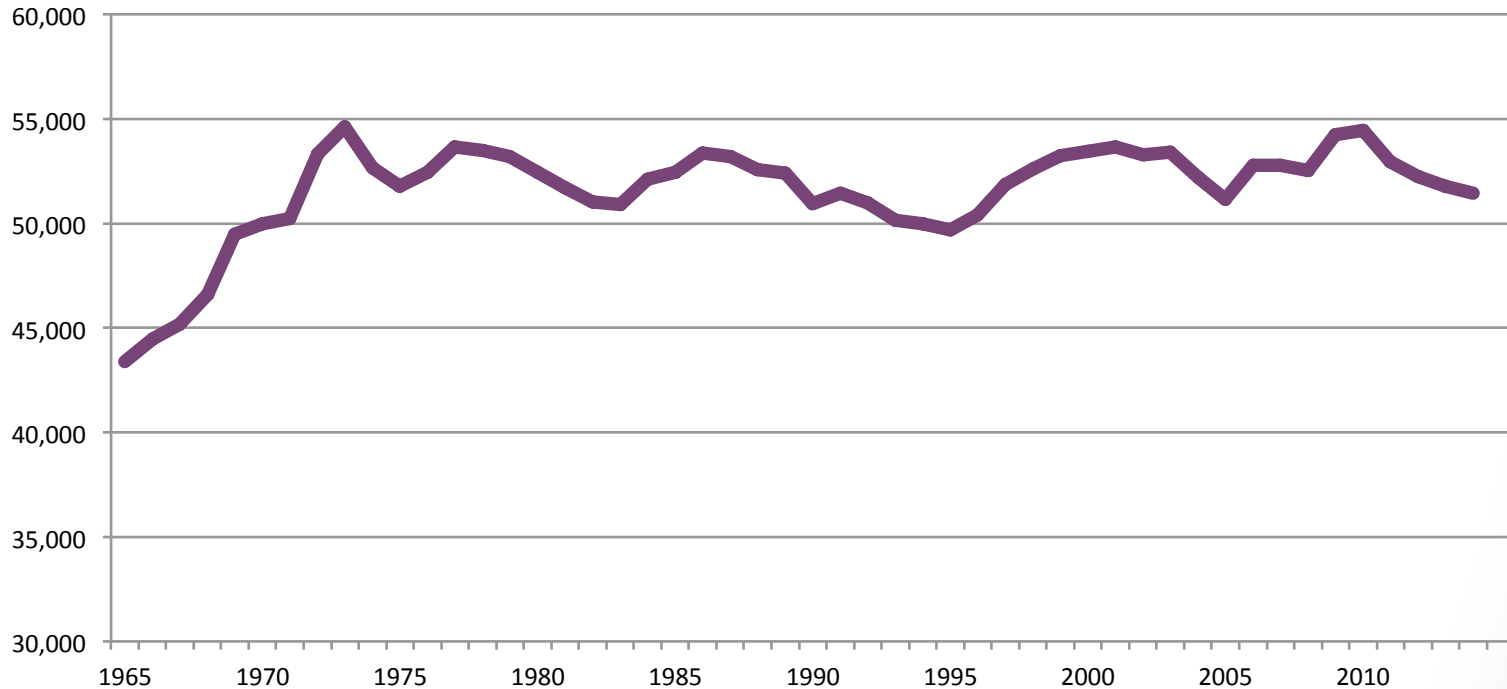
Stagnation: U.S. median household income (constant 2014 US\$)



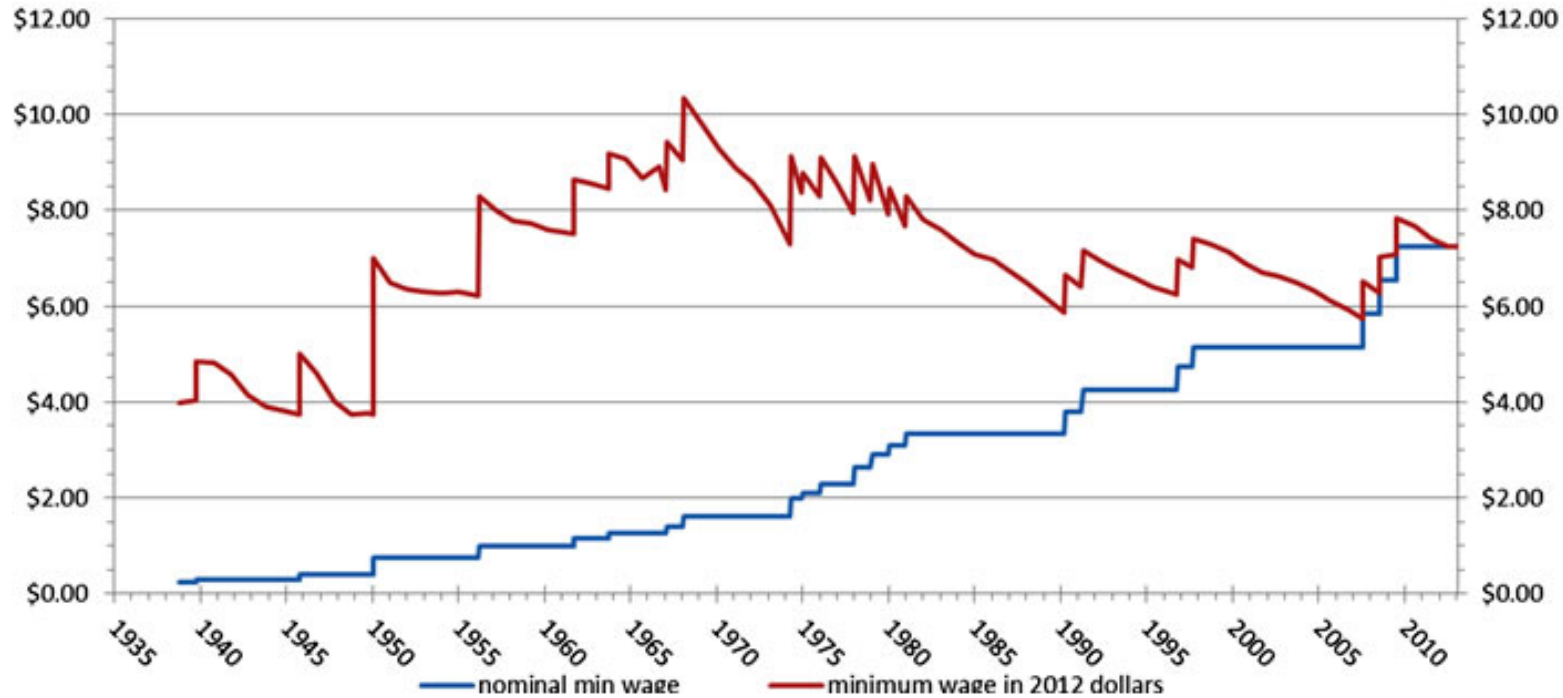
Source: U.S. Census Bureau

Decline in median income of full-time male worker

Real Median Income of Full-Time Male Worker, 1965-2014



U.S. minimum wage, 1938-2012



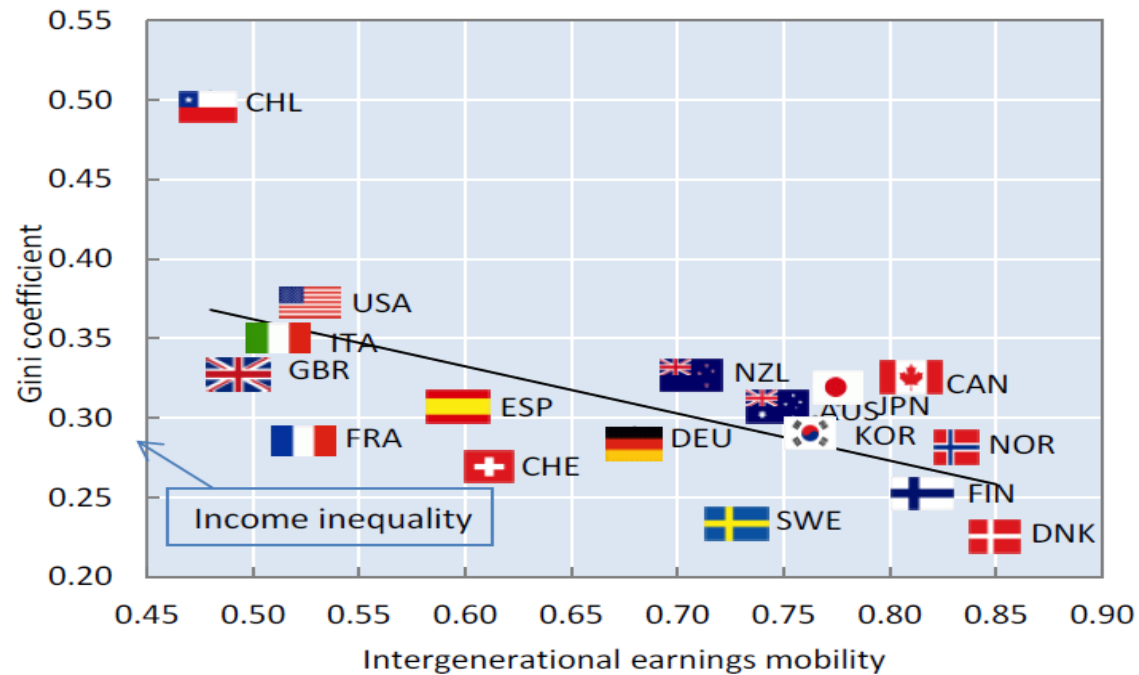
Source: U.S. Department of Labor. <http://www.dol.gov/minwage/minwage-gdp-history.htm>

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

Income inequality and intergenerational earnings mobility, mid-2000s



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

Gini changes in OECD

Gini coefficients of income inequality, mid-1980s and 2013, or latest available year



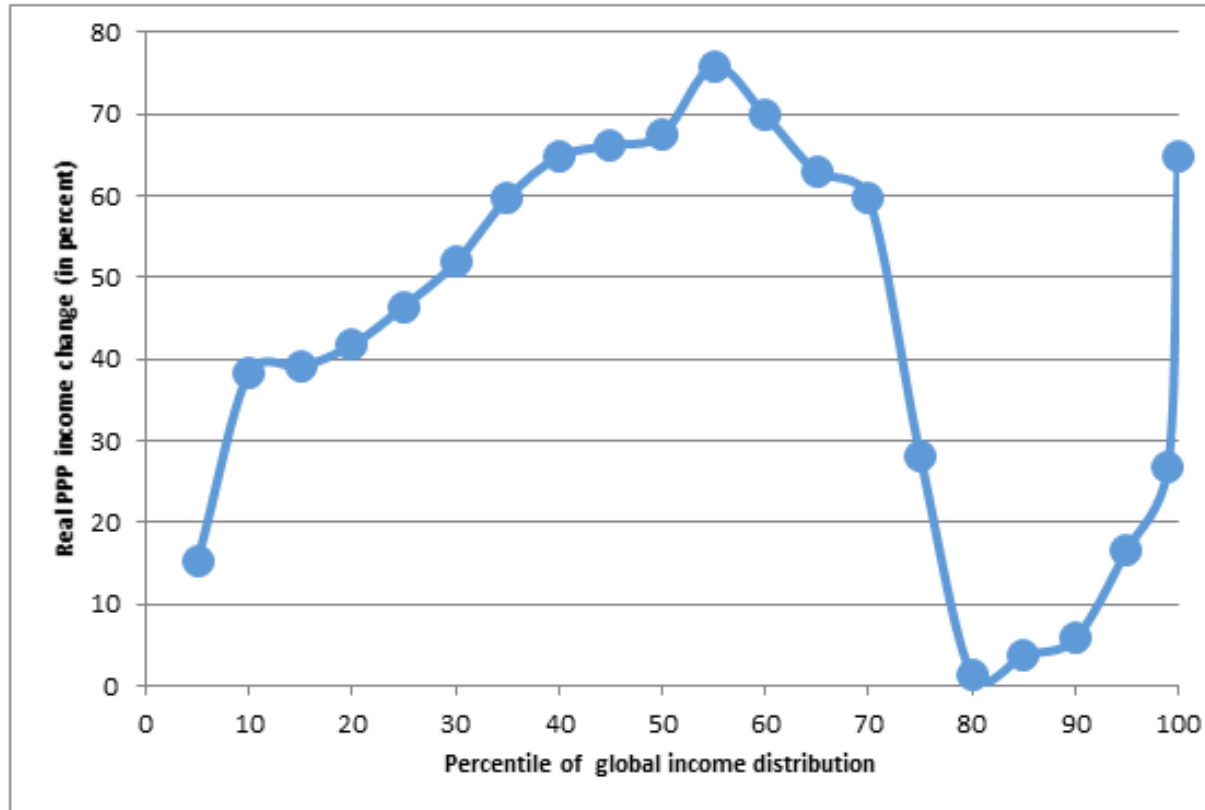
Global inequality: Ginis worse in many countries, late 2000s vs. 1980s

	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

- 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, performance of the economy as a whole slowed

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

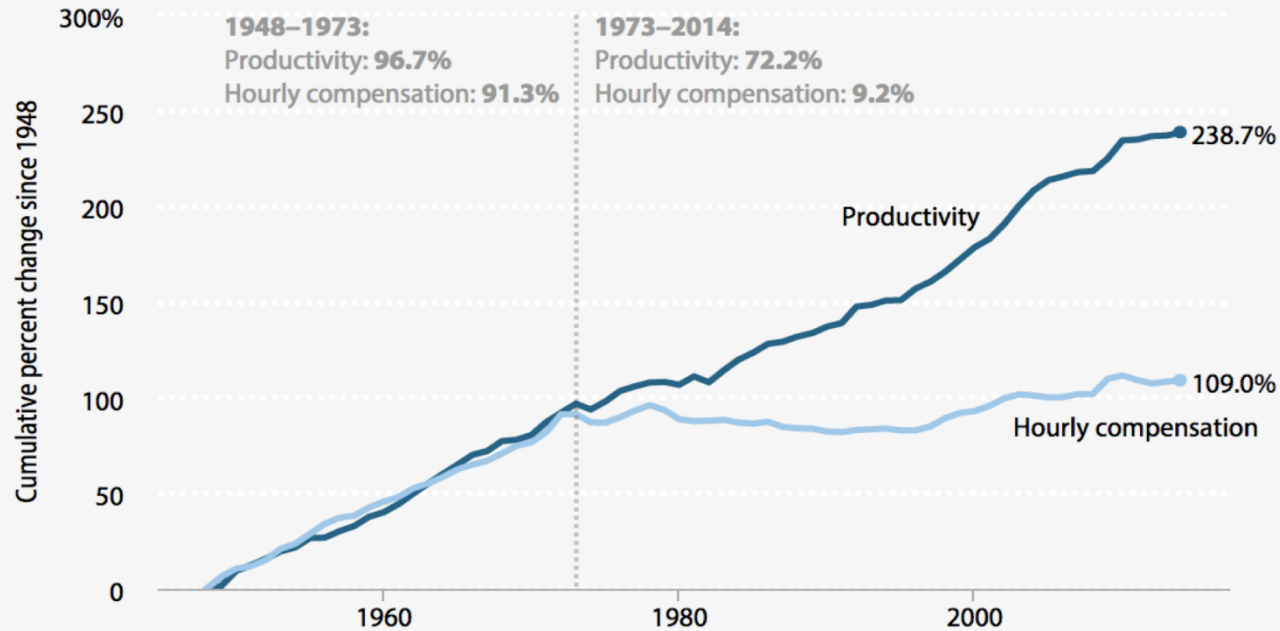
- Undermining democracy
- Dividing society
- Especially when inequalities are on racial and ethnic lines
- Resulting in basic necessities of a middle class society being increasingly out of reach of large proportion of population
- Retirement security, education of one's children, ability to own a home

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, $s r < g$
- 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)

Explaining stylized facts

- Can only explain $\frac{1}{2}$ to $\frac{3}{4}$ 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
- Urgency—decisions today will affect inequality decades later
 - Key is rewriting the rules once again
- Real question is not economics: it is politics