

Globalization and Inequality: Coping with the Consequences

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There has been growing inequality within most countries of the world

- Is this growth a result of forces of nature—the basic laws of economics?
- Or is it result of “the laws of man”—what we *ourselves* are doing?
- Is it the result of the basic workings of the market?
 - An inevitable, if unpleasant, side effect?
- Or is it the result of how we have *structured* markets, of how we have changed the rules of the game in our market economy, in some cases *undermining* the market economy

Explaining the growing inequality

- Is it because we have not done enough to *counter* the forces of nature?
- Is it because, rather than trying to stand against the tide, we have reinforced the effects of nature, of the laws of economics?

The central theses of this lecture

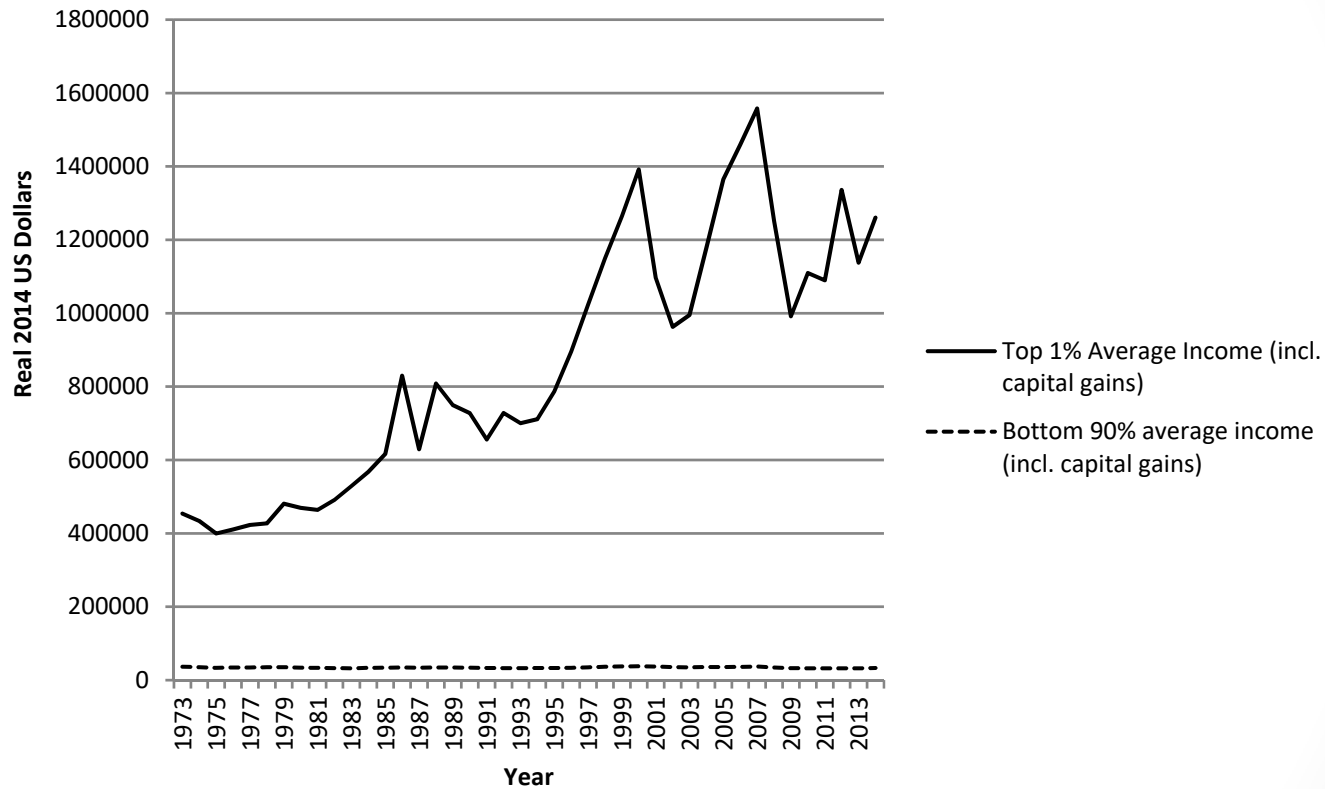
- The growing inequality is largely the result of the “laws of man”
- It is a result of how we have structured the market economy—of how we have *restructured* it in the last third of a century
- Inequality has been a *choice*
 - In our democracy, a choice made through our political system
 - But our political system has often exhibited a “democratic deficit”
- What we have done has resulted not only in more inequality, but in lower growth, more instability, and overall poorer economic performance
 - Including extensive environmental destruction

I. A brief description of what has been happening

- More money at the top
- More people in poverty
- The evisceration of the middle

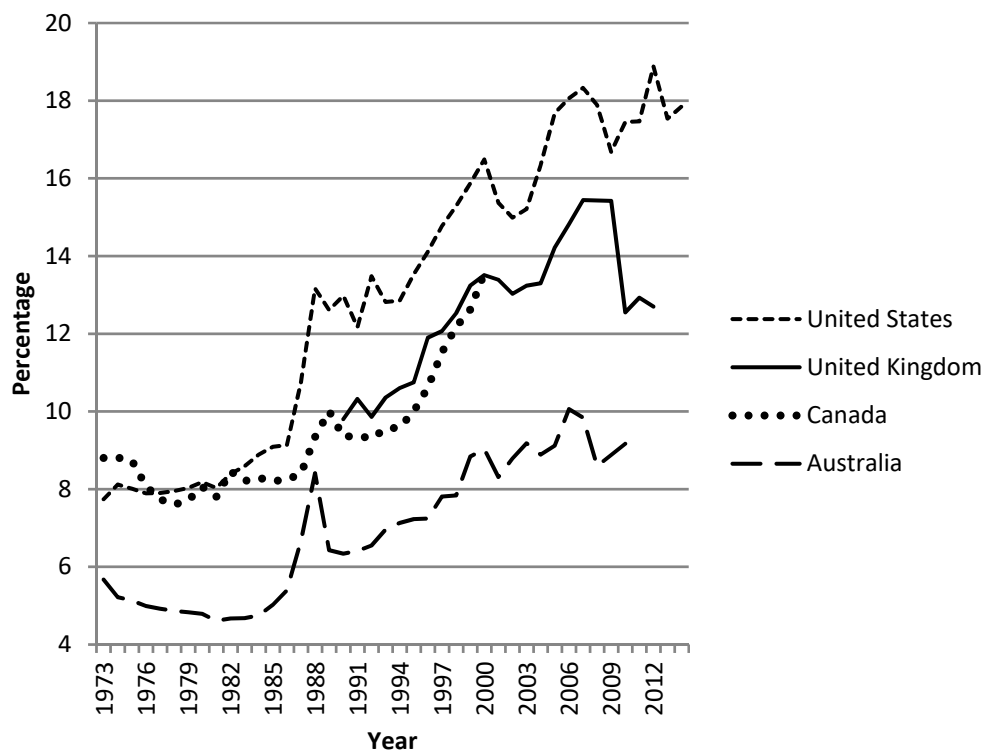
- US provides worst example
- But countries following US economic model are moving in the same direction

Top 1% vs Bottom 90% Average Income



Source: The World Wealth and Income Database (latest data available at <http://www.wid.world/>).

Income share of the richest 1%

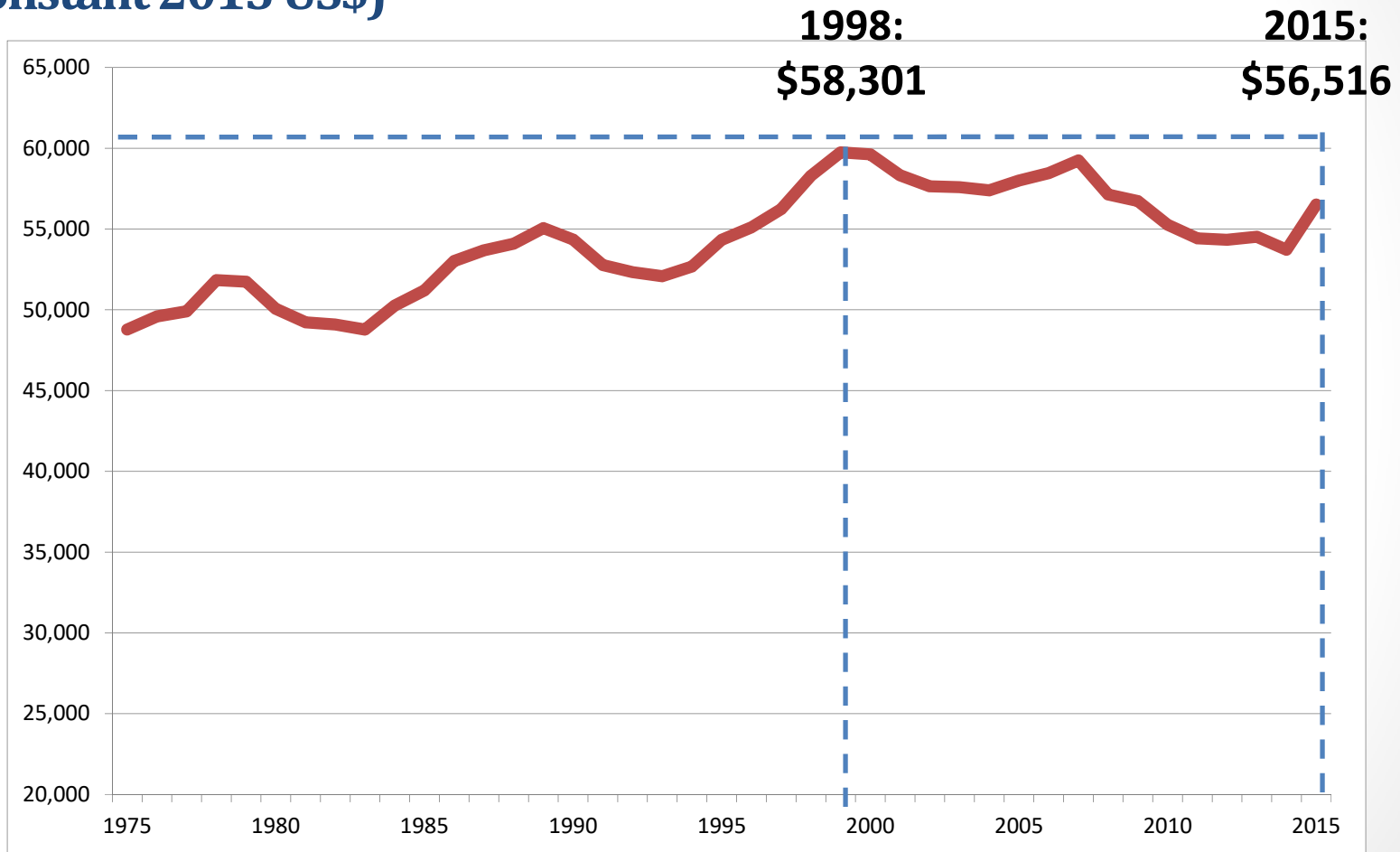


Source: The World Wealth and Income Database (latest data available at <http://www.wid.world/>).

CEO pay provides “worst” example

- In US, risen to more than 250 times that of the average worker
- Bankers walked off with major bonuses, even as they brought their firms—and the global economy—to the brink of ruin
 - Undermining “standard” theory that compensation in a market economy is based on social contributions (“marginal productivity”)

Stagnation: U.S. median household income (constant 2015 US\$)

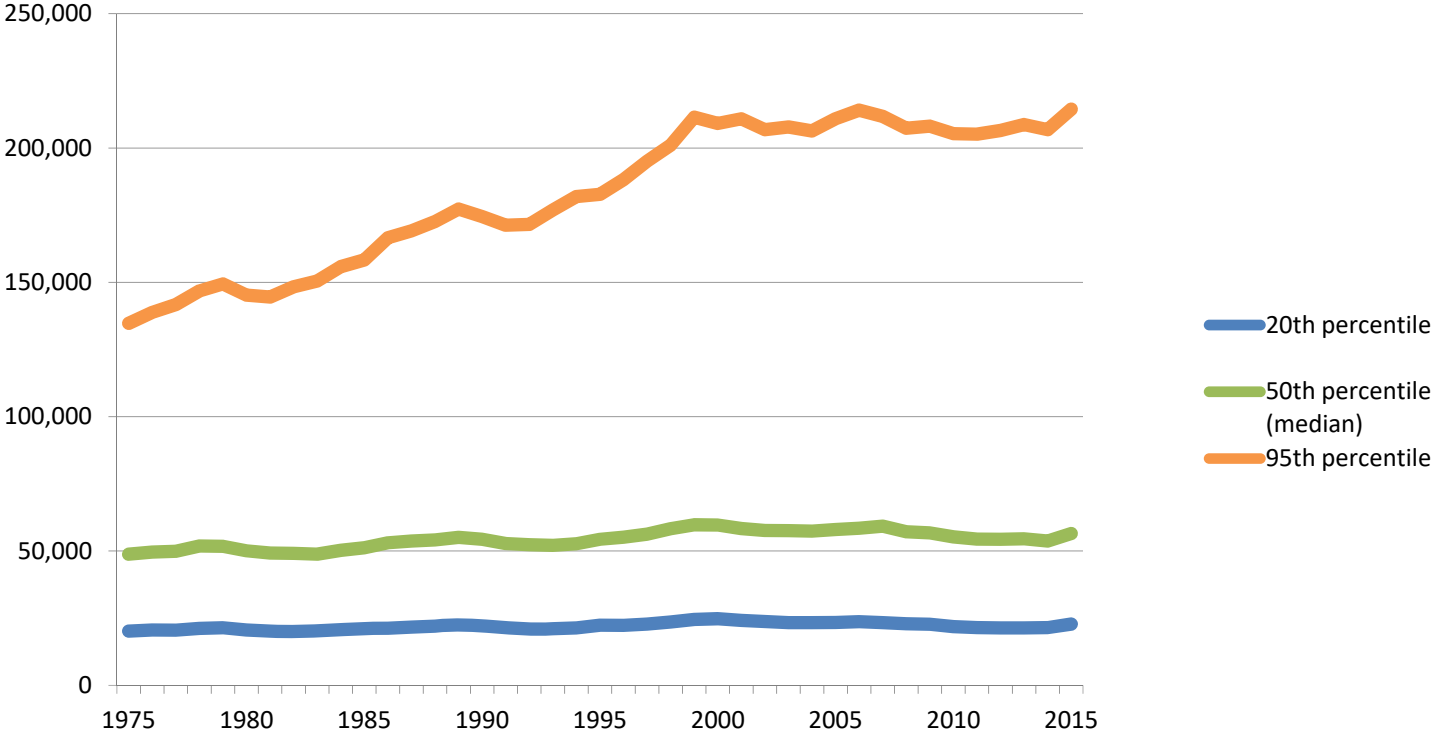


Source: U.S. Census Bureau

Note: Data is adjusted for the methodological change of 2013.

In light of gains to top incomes, stagnation even more dramatic

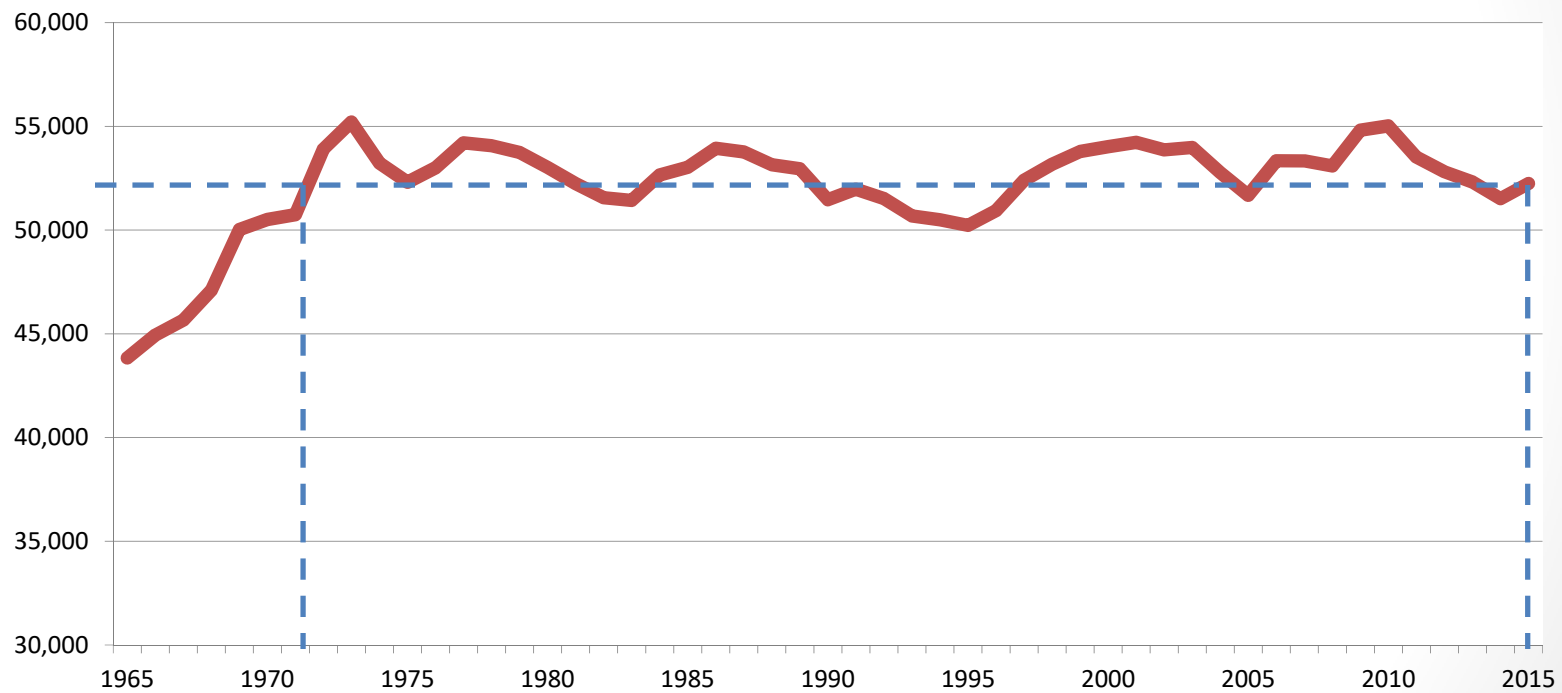
(Household income, constant 2015 US\$)



Source: U.S. Census Bureau

Note: Data is adjusted for the methodological change of 2013.

Decline in median income of full-time male worker (constant 2015 US\$)

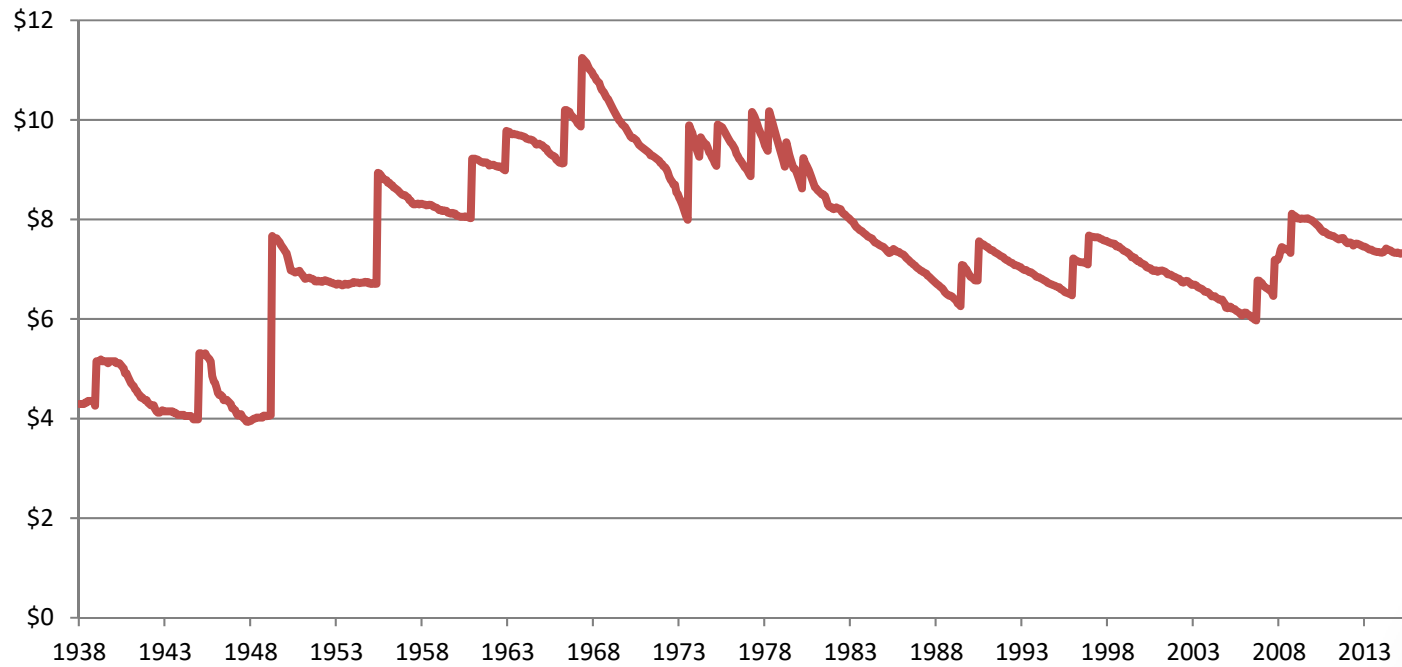


Source: U.S. Census Bureau

Note: Data is adjusted for the methodological change of 2013.

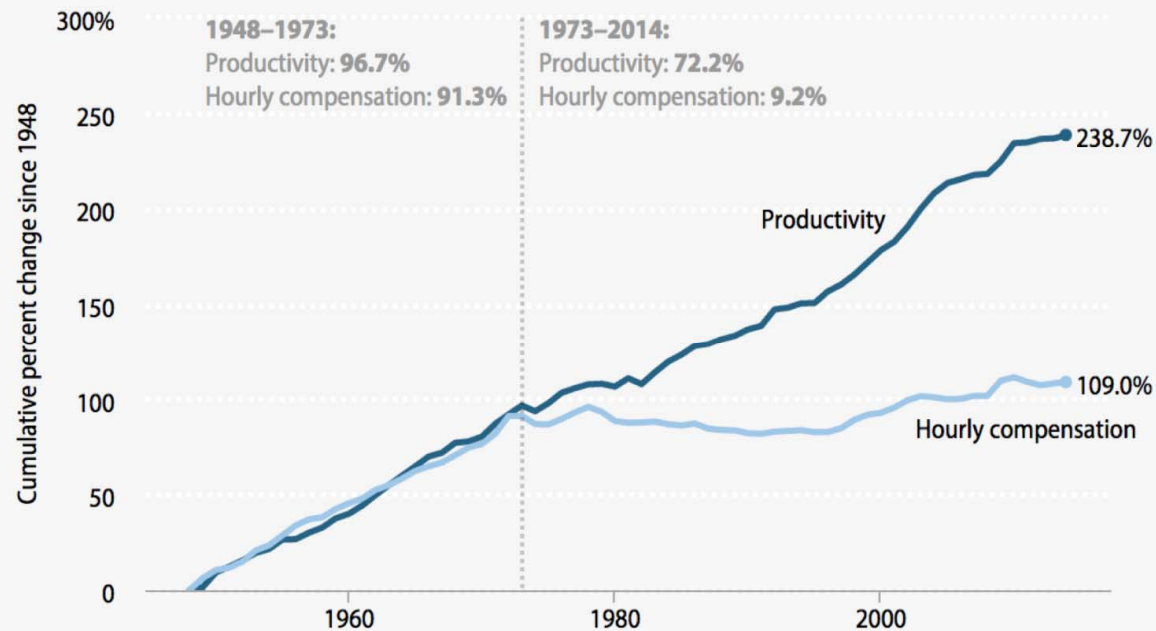
U.S. minimum wage, 1938-2016

Minimum wage in 2016 Dollars



Source: Federal Reserve. <https://www.quandl.com/data/FRED?keyword=>

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.

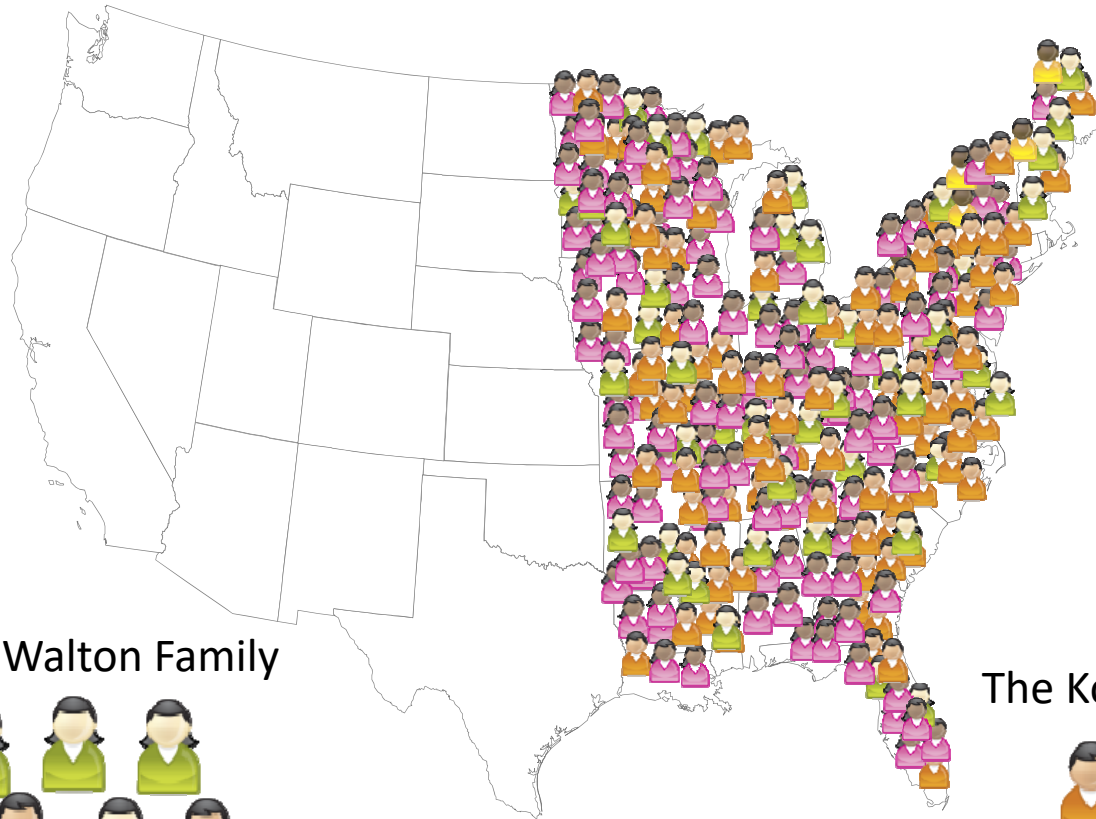
Source: EPI analysis of data from the BEA and BLS (see technical appendix for more detailed information)

Multiple aspects of inequality

- Health—and access to health care
 - Worse in countries without good public provision
 - Death rates rising for middle-aged white Americans (Case Deaton 2015 Study)
- Voice
 - Attempts in US at disenfranchisement
- Access to justice
 - Mass incarceration
 - Mass evictions
- Wealth
 - 62 individuals owned as much wealth as the bottom half
 - Top 1% owned more than the bottom 99%

The Walton Family and The Koch Brothers' net worth = \$230 billion

That's the net worth of 150 million Americans or 44% of the country.



The Walton Family



The Koch Brothers

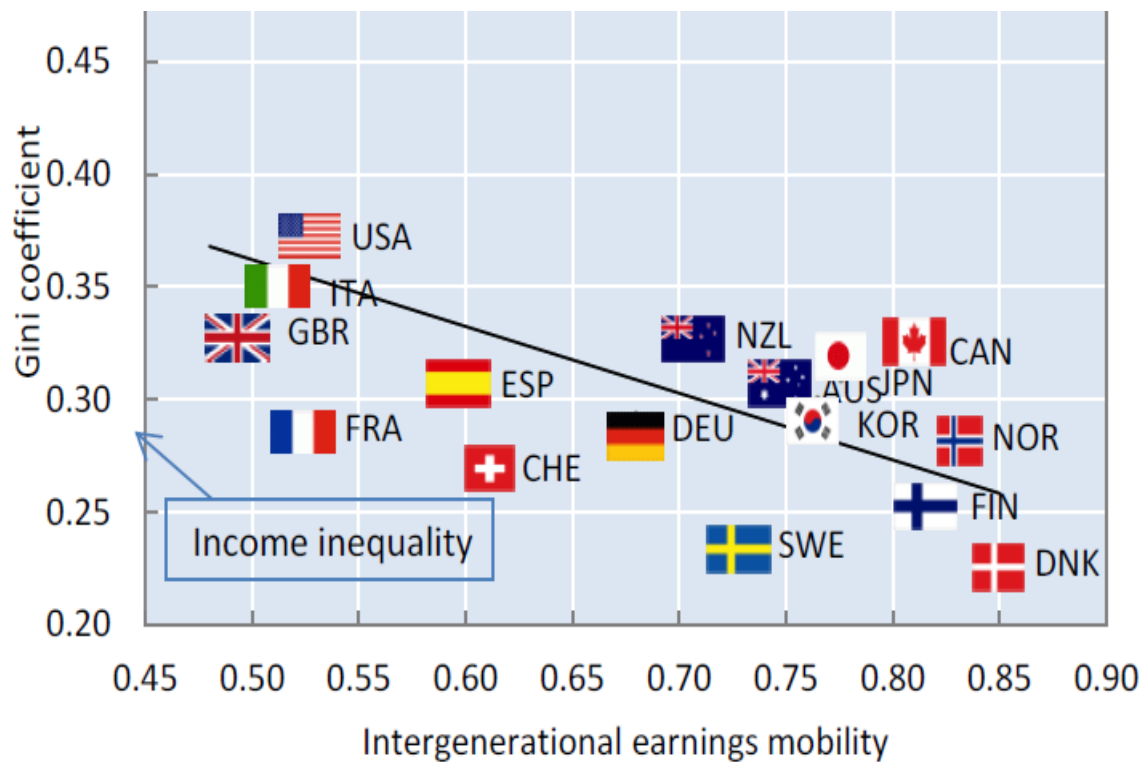


Most invidious aspect: inequality in opportunity

- America among the countries with the least opportunity—in spite of the notion of the country being the land of opportunity (American dream)
 - Life prospects of a young American more dependent on the income and education of his parents than in other advanced countries
- 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



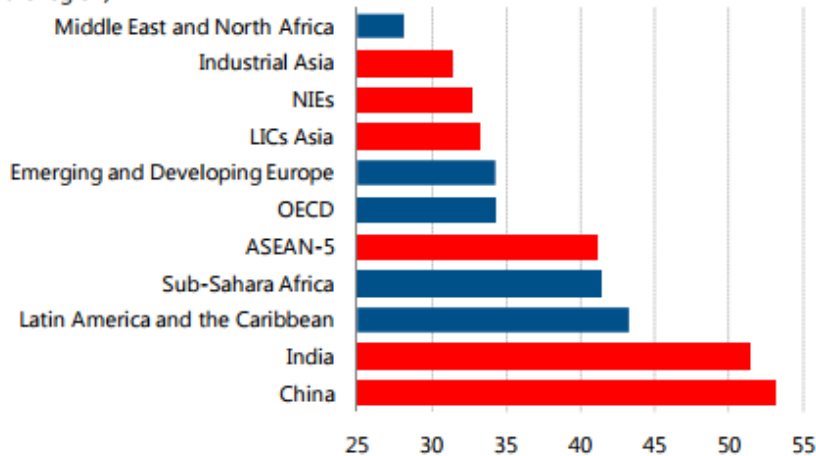
Source: "United States, Tackling High Inequalities Creating Opportunities for All", June 2014, OECD.

Global inequality

- Almost all advanced countries have seen increased inequality in last 30 years
 - But some have seen much greater increase than others
 - Cannot explain these differences by “economic laws”
- The trend around the world is somewhat mixed, but remains a concern almost everywhere
 - Some countries (especially in Latin America) have even managed to reduce inequality

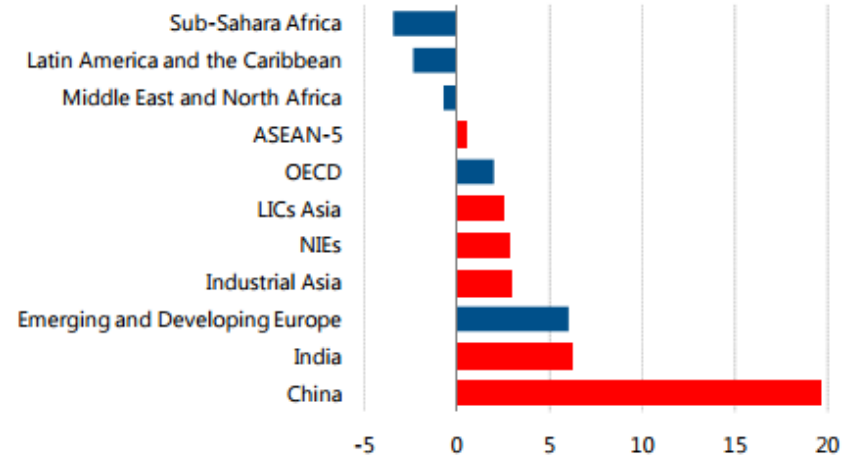
Regional comparison: Income Inequality

(Net Gini Index; in Gini points; year of 2013; population-weighted average across the region)



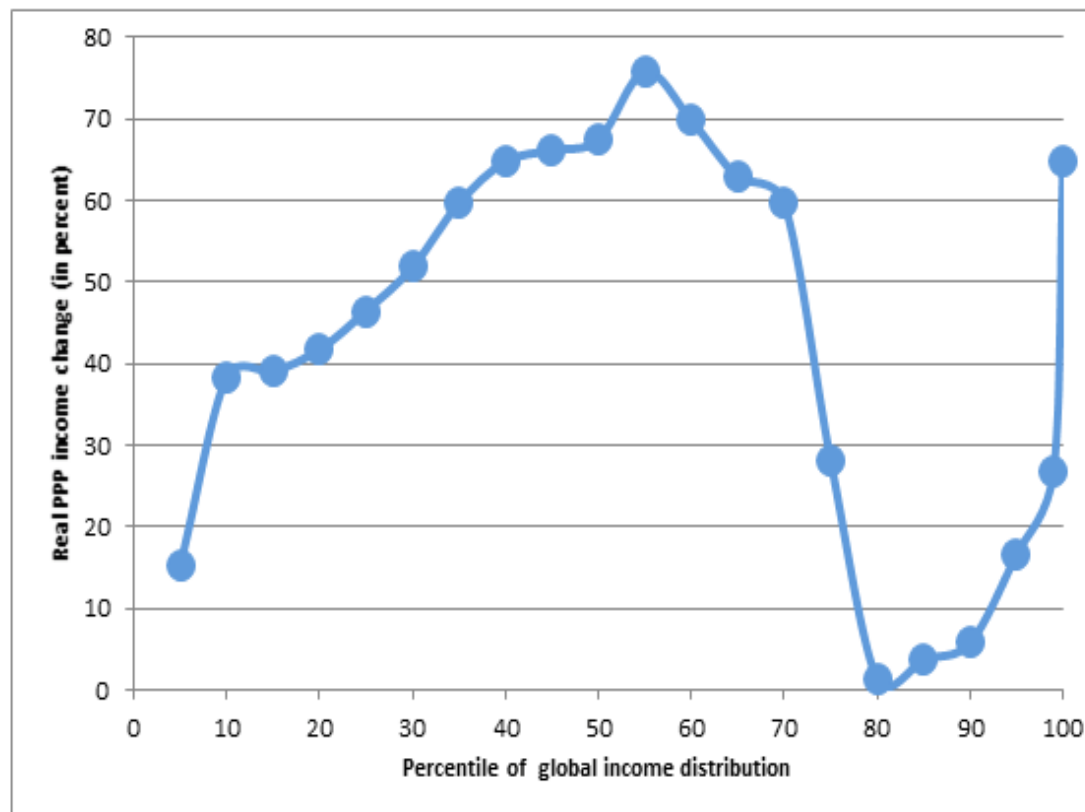
Sources: SWIID Version 5.0; IMF, WEO database; and IMF staff calculations.

(Net Gini Index; in Gini points; change since 1990; average across the region)



Sources: SWIID Version 5.0; IMF, WEO database; and IMF staff calculations.

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>

Understanding global discontent

- 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

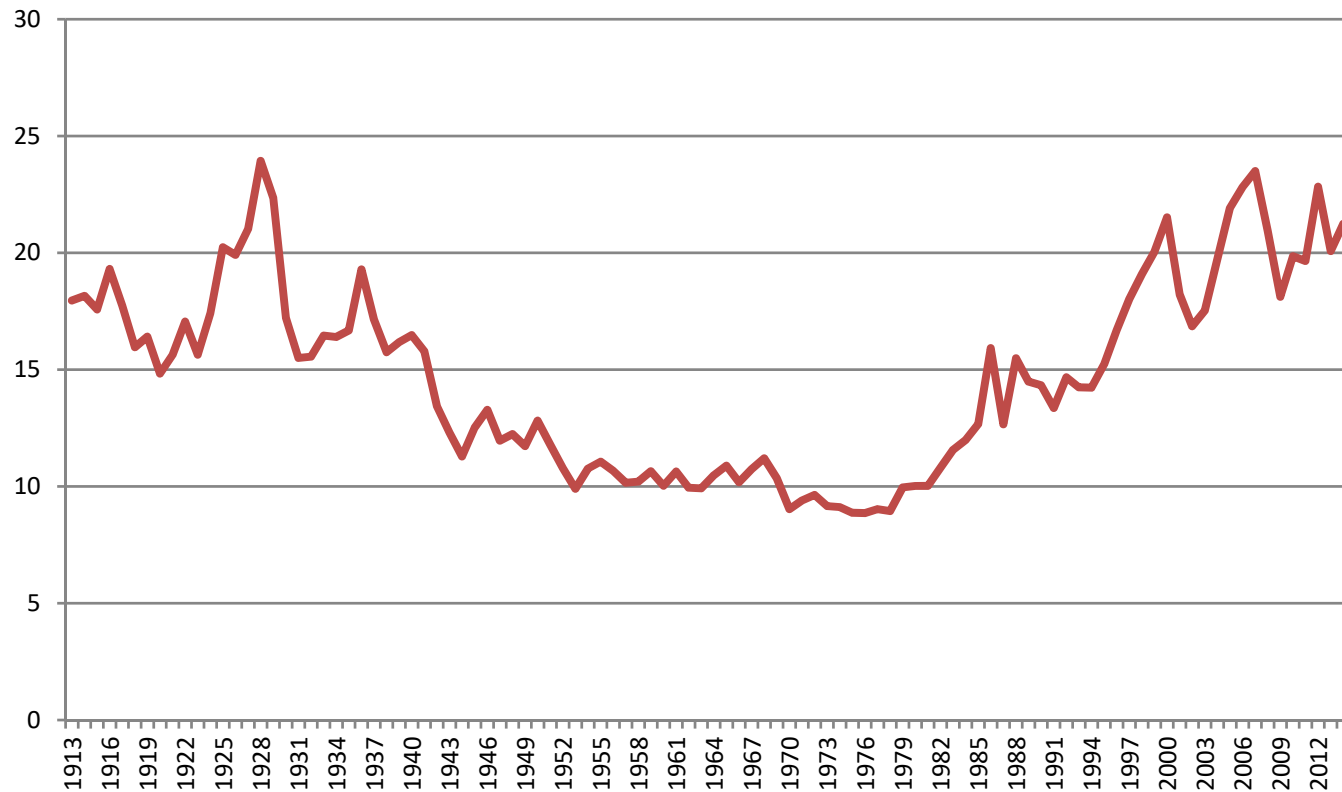
II. Major changes in understandings of inequality

1. Trickle down economics doesn't work
2. Large differences in outcomes/opportunities among advanced countries
 - Suggesting that it is policies, not inexorable economic forces that are at play
3. Economies with less inequality and less inequality of opportunity perform better
 - Many reasons for this
 - Lack of opportunity means that we are wasting most valuable resource
 - Erosion of trust—which is important for the functioning of the economy
 - In last few years, this view has become “mainstream”

Historical perspective

- In initial stage of development, typically inequality increases
- It was thought that in the next stage of development it should decrease
 - Evidence supported hypothesis—through 1975
- Broader theory and evidence called “Kuznets Law”
- Beginning in 1970’s, Kuznets law was repealed

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.

Explaining change

- Key question
 - 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?
- 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
- 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

III. Alternative interpretations of growth in inequality: Market forces—based on competitive markets

- (a) Changes in supply and demand for different factors just turned out badly for poor—decreasing wages of unskilled workers and increasing returns to capital and skilled workers
- changes in technology and globalization have played some role
 - But cannot explain what happened
- (b) Increased inequality in the intergenerational transmission of advantages leading to increased inequality in ownership of productive assets (human and financial capital)
- Rich leave their children with more human and financial capital
 - Equilibrium wealth distribution reflects balance between centrifugal and centripetal forces
 - Increased inequality reflects an upsetting of previous balance
 - Contrary to principle of *equal opportunity*

Alternative explanation: increase in rents

- Increased monopoly, monopsony power shifts distribution of income and wealth to those with these powers
- But also other reasons for an increase of rent—with increased income and wealth to those who control assets generating rents generating more inequality
 - Land rents
 - Intellectual property rents
 - Rent extraction from government
 - Rent extraction from consumers

Our economy is marked by increasing rents

- Some a result of technology
 - Network effects
 - Localized services
- Some a result of changes in economy
 - Urban land rents
- Some a result of policies
 - Change in IPR laws
 - Deregulation—allowing extraction of more rents from government and consumers
- Some a result of market “innovation”
 - Better ways of exploiting consumers and exercising market power

All of these are affected by policy, by rules of game

- Incentives for skilled biased technological change vs. resource saving technological change
 - Fed policy—low interest rates—encourage capital intensive technologies
 - Absence of climate change undermines incentives for resource saving technological change
- The way we structured globalization encouraged outsourcing of jobs
 - Especially in absence of industrial policies
 - And weakened bargaining power of workers
 - Just as we were weakening unions
- Weakening of public education reduces “centrifugal” force pulling economy together
- Monetary policies, land use policies, tax policies, anti-trust enforcement, IPR rules may all have contributed to growth in rents

Concluding remarks

- Attempts to explain the growth of inequality have led to a rethinking of some of the foundations of economics
 - There are many aspects of inequality that the standard models cannot explain
 - Increasing evidence that competitive model does not provide good description of the economy
- Growing recognition that this *growing inequality and low levels of opportunity* in most of our societies is not only weakening the economy, but undermining democracy and dividing society
 - With deep consequences, some of which already appear to be evident
 - Reduced health (increased death rates) among middle-age white Americans—counter to the trend elsewhere
 - Reflecting social and economic distress

Concluding remarks

- But this inequality is not inevitable
- It is not the result of inexorable laws of nature
 - Or even those of the market
- It is a result of how we have changed the rules of the game
 - In some cases leading to more market power for firms
 - In many cases leading to weaker bargaining power for workers
 - Overall, leading to a more poorly performing economy, marked by greater inequities
- The growing recognition that inequality is the result of the “laws of men” rather than the laws of nature is leading to a growing sense of social injustice and a lack of trust in institutions—including those entrusted with creating and maintaining a just society