

Inequality is not fate

Joseph E. Stiglitz

Milan

May 12, 2017

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
 - And of the way we have structured globalization—the evolving geo-political situation

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?
- And is it because the way our global governance has worked against ordinary citizens around the world?

The central theses of this lecture

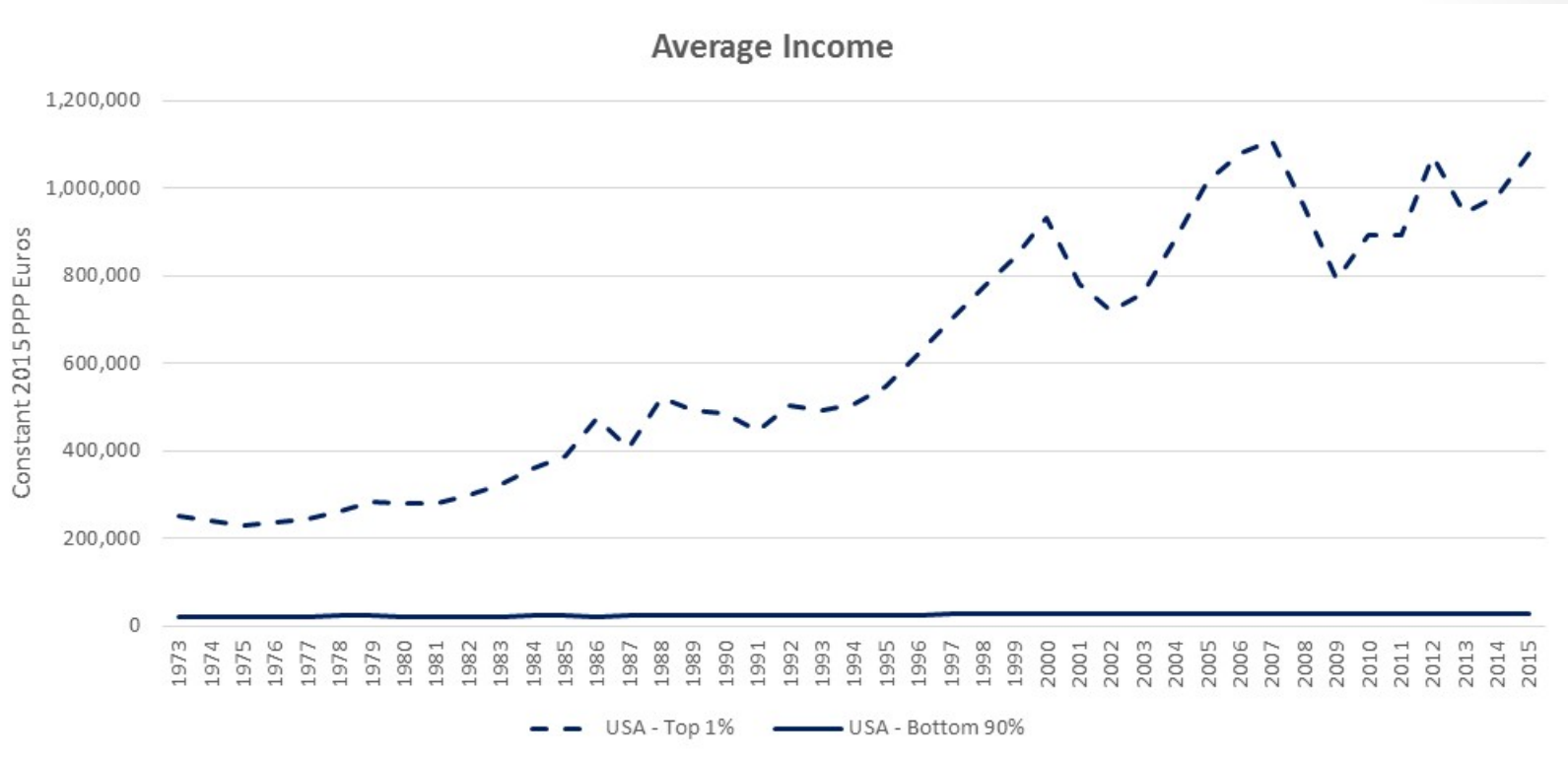
- The growing inequality is largely the result of the “laws of man”
- It is a result of how we have structured the market economy—more precisely, of how we have *restructured* it in the last third of a century
- Inequality has been a *choice*
 - In our democracy, a choice made through our political system
 - 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
- There are reforms—in our economy, in our society, in our political institutions—which can help create a shared prosperity

I. A brief description of what has been happening

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

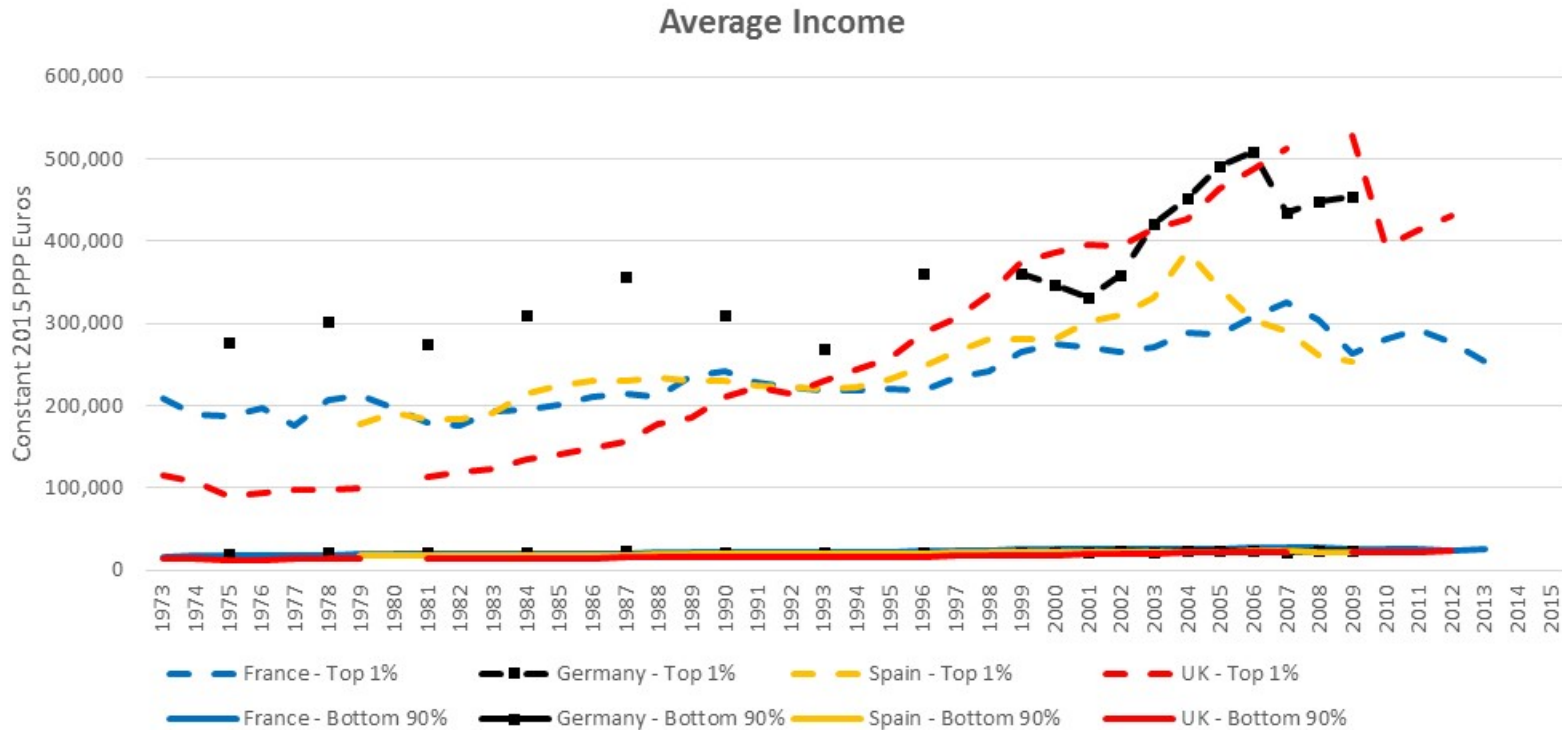
- US provides worst example
- But countries following US economic model are moving in the same direction

US: bottom 90% have seen little increase in income over last third of a century



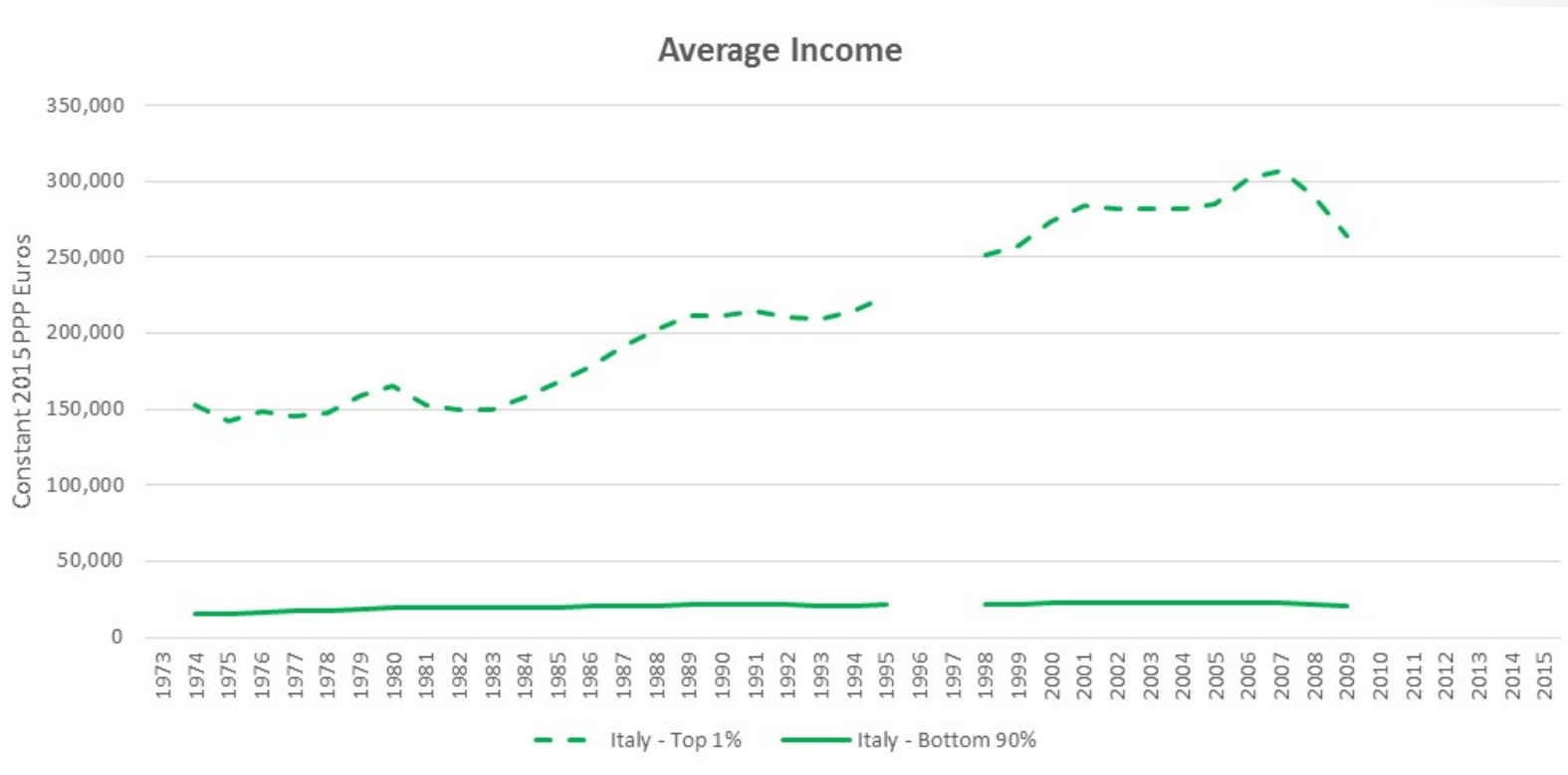
Source: World Wealth and Income Database

Europe: less increase in inequality in some countries than in others



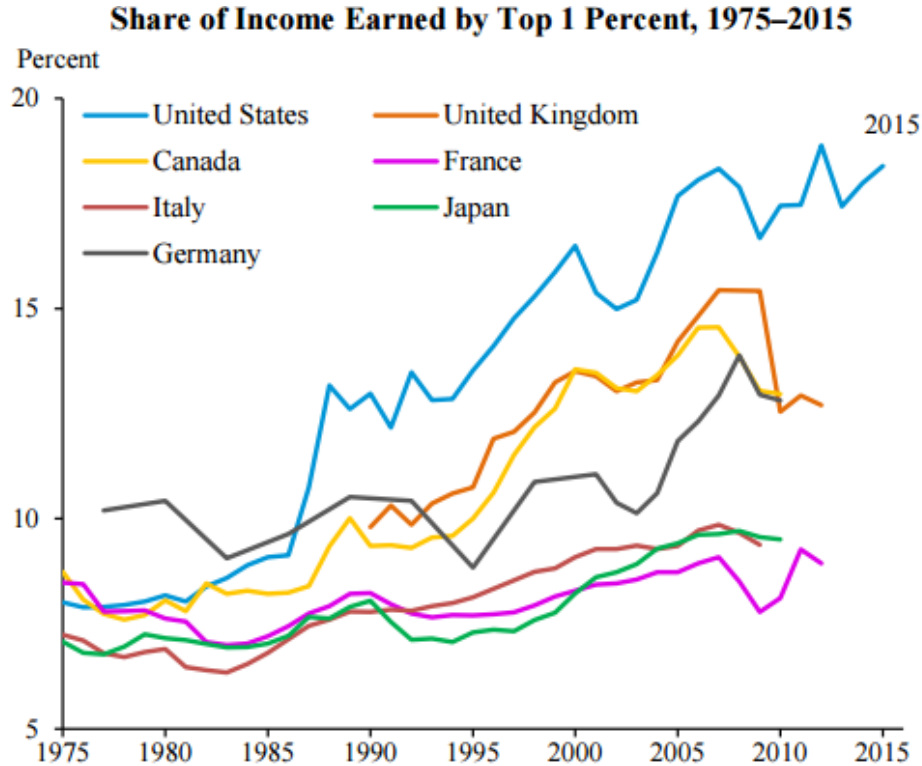
Source: World Wealth and Income Database

Italy: increase in inequality has been less extreme



Source: World Wealth and Income Database

Income share of the richest 1%



Source: World Wealth and Income Database.

Chart from: US Economic Report of the President, January 2017.

CEO pay provides “worst” example

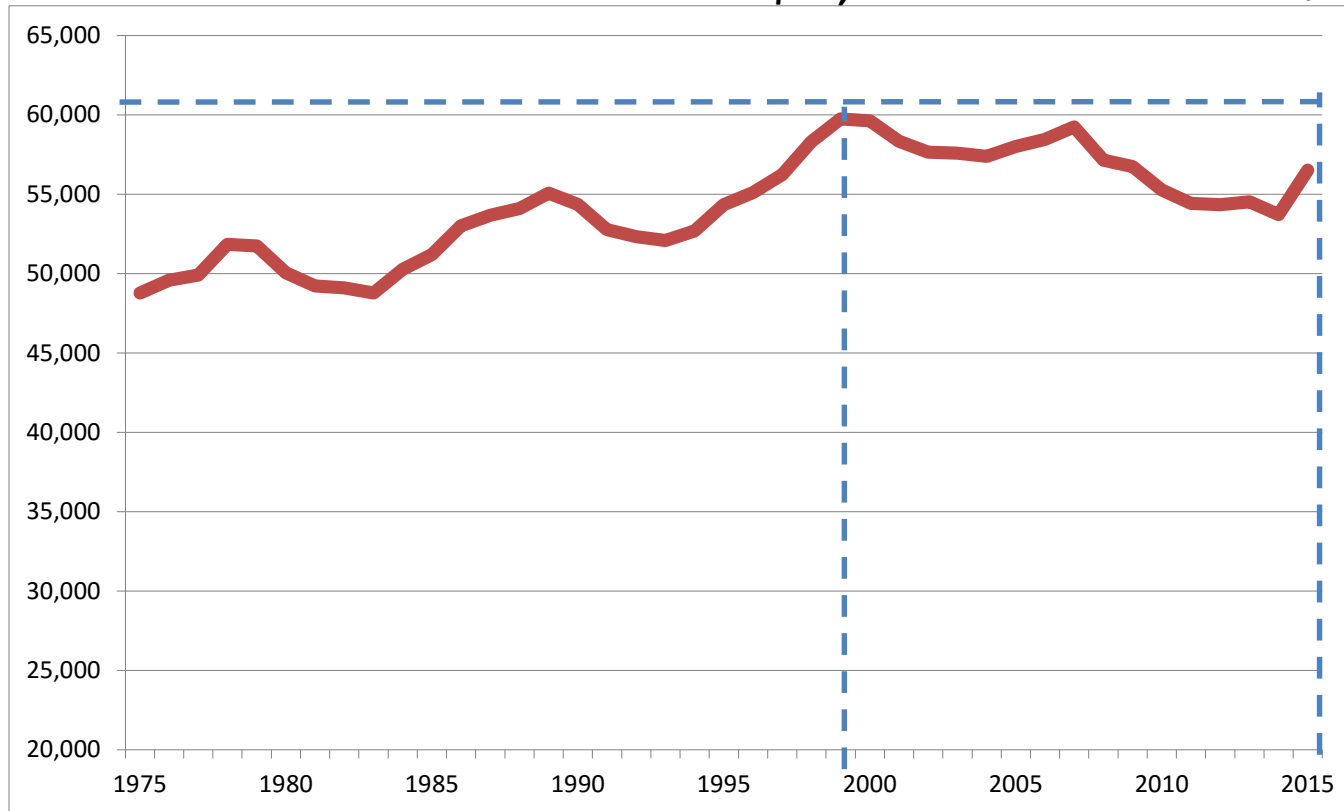
- In US, risen to more than 300 times that of the average worker
- Bankers walked off with major bonuses, even as they brought their firms—and the global economy—to the brink of ruin
 - Undermining “standard” theory that compensation in a market economy is based on social contributions (“marginal productivity”)

Stagnation: U.S. median household income

(constant 2015 US\$)

1998:
\$58,301

2015:
\$56,516

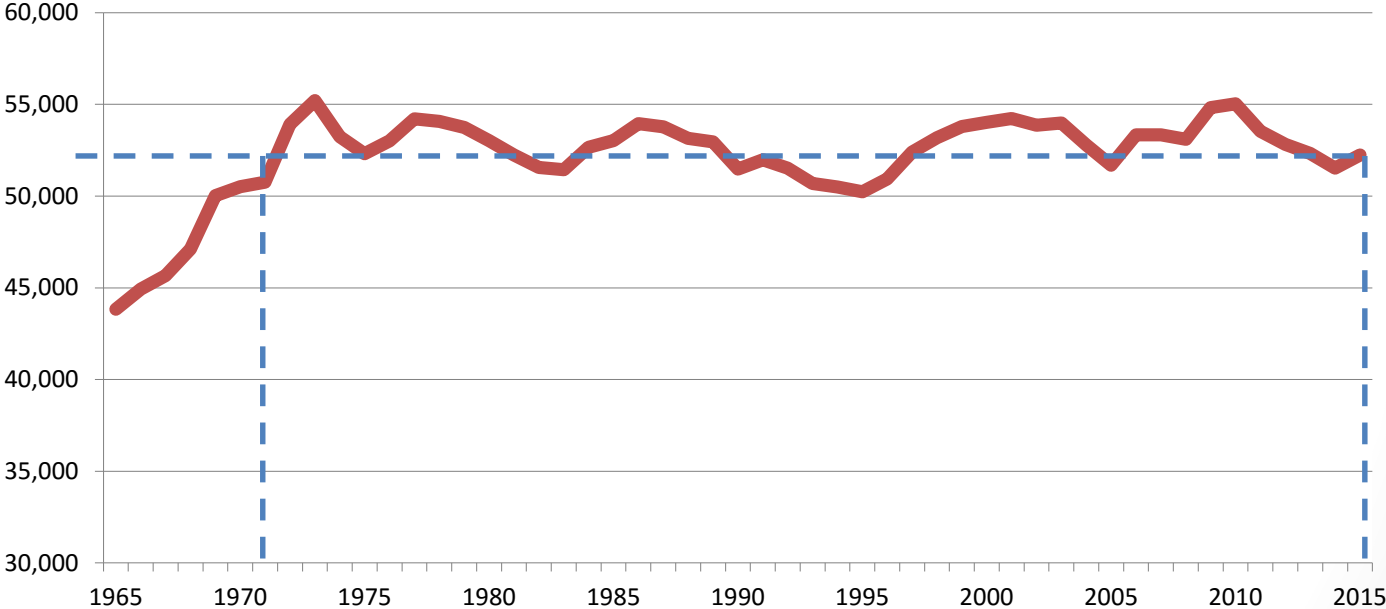


Source: U.S. Census Bureau

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

US: Median income of a full time male worker is at the level that it was more than 4 decades ago

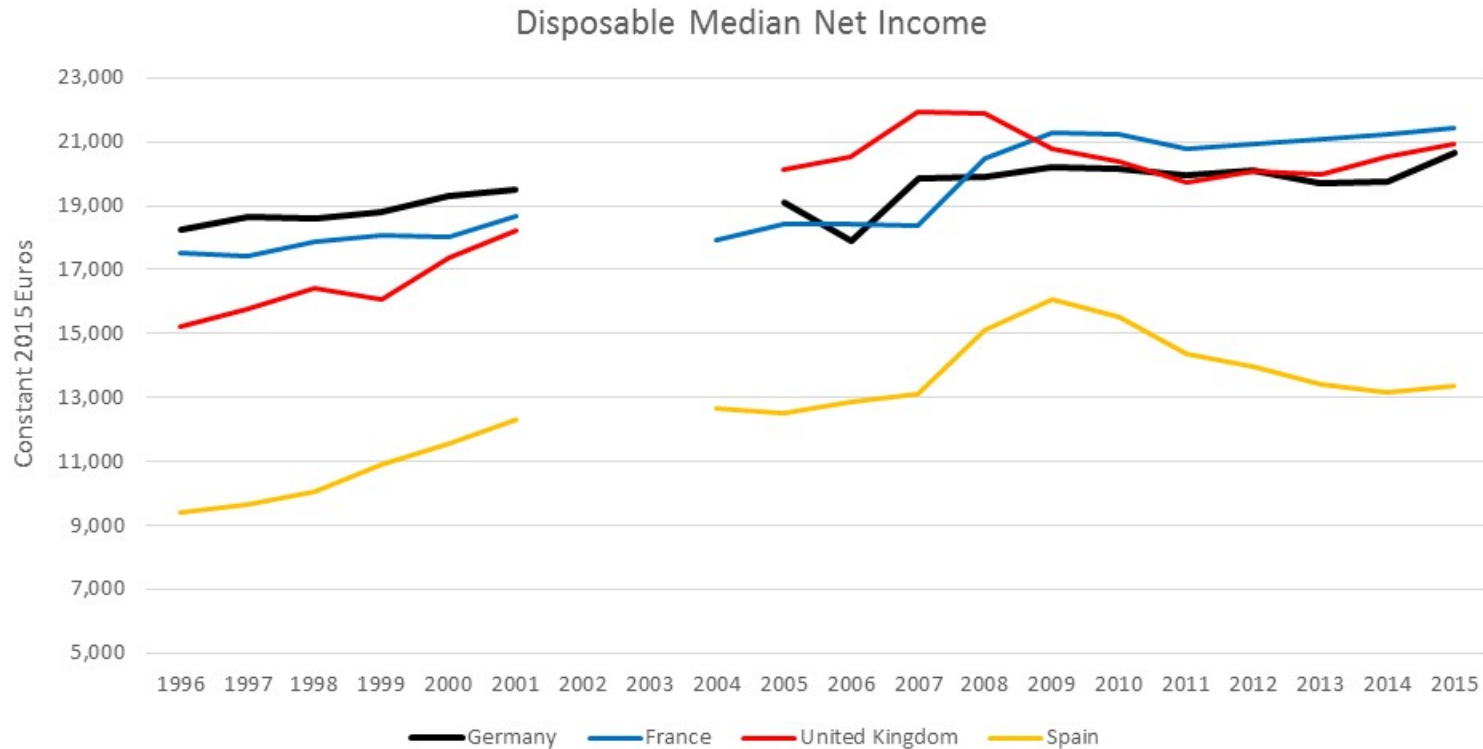
(constant 2015 \$)



Source: U.S. Census Bureau

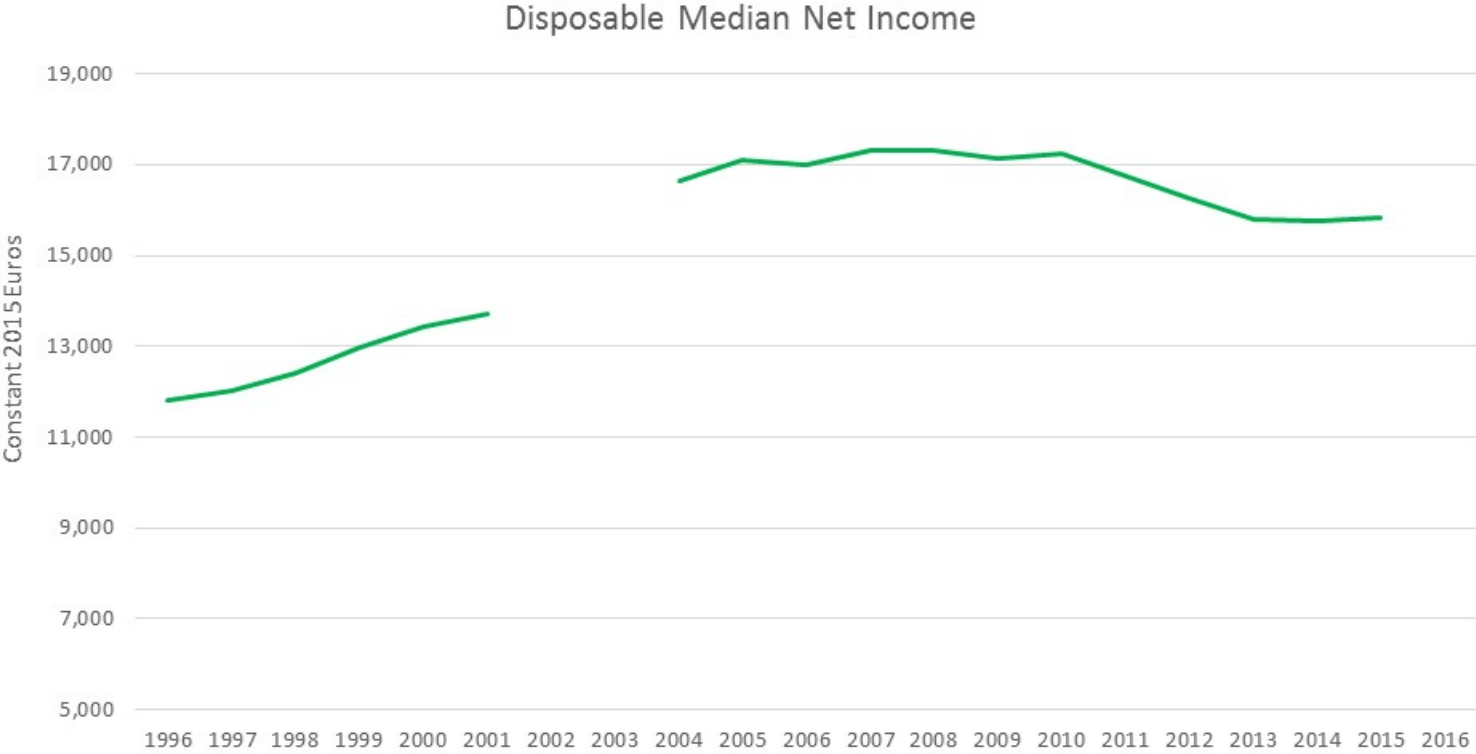
Note: Data is adjusted for the methodological change of 2013.

Median household income in Europe



Source: Eurostat

Median household income in Italy



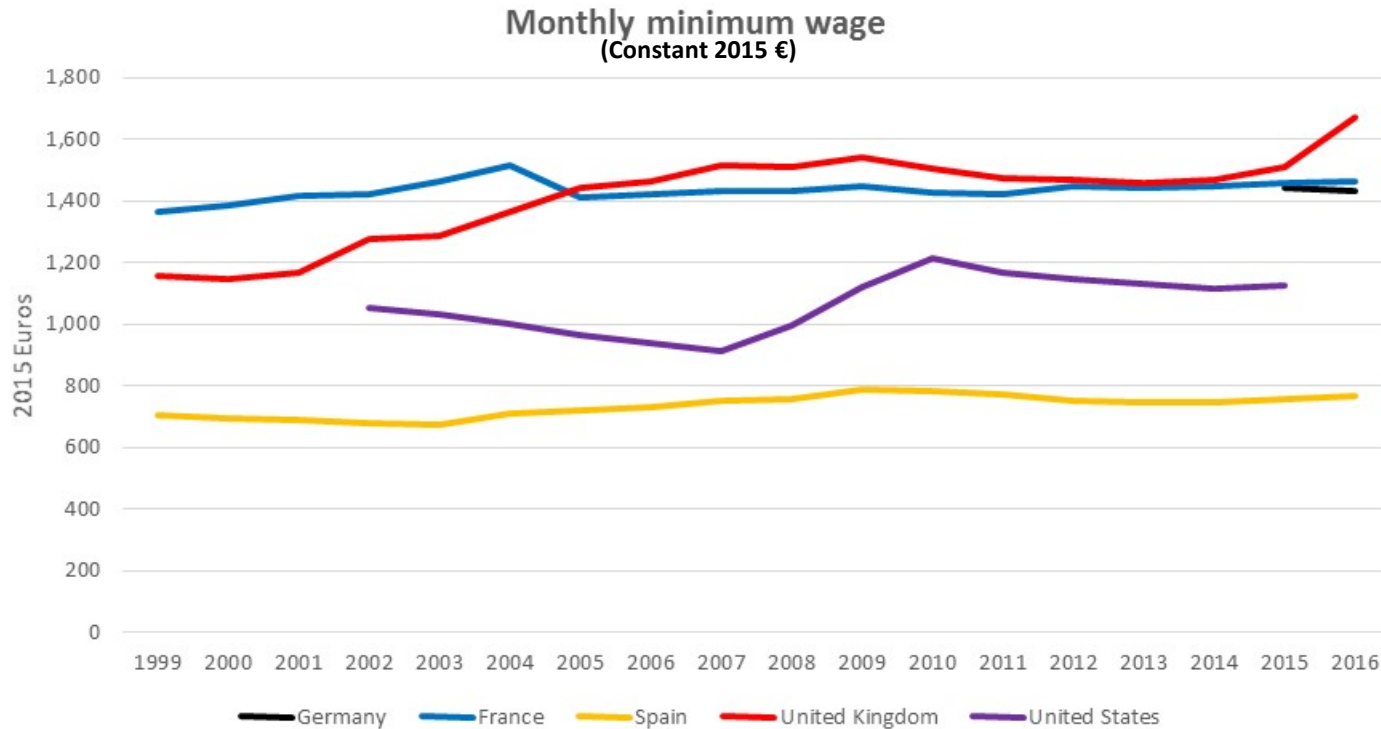
Source: Eurostat

US: Real wages at the bottom are at the level that they were roughly sixty years ago



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

Europe: Real Minimum Wages

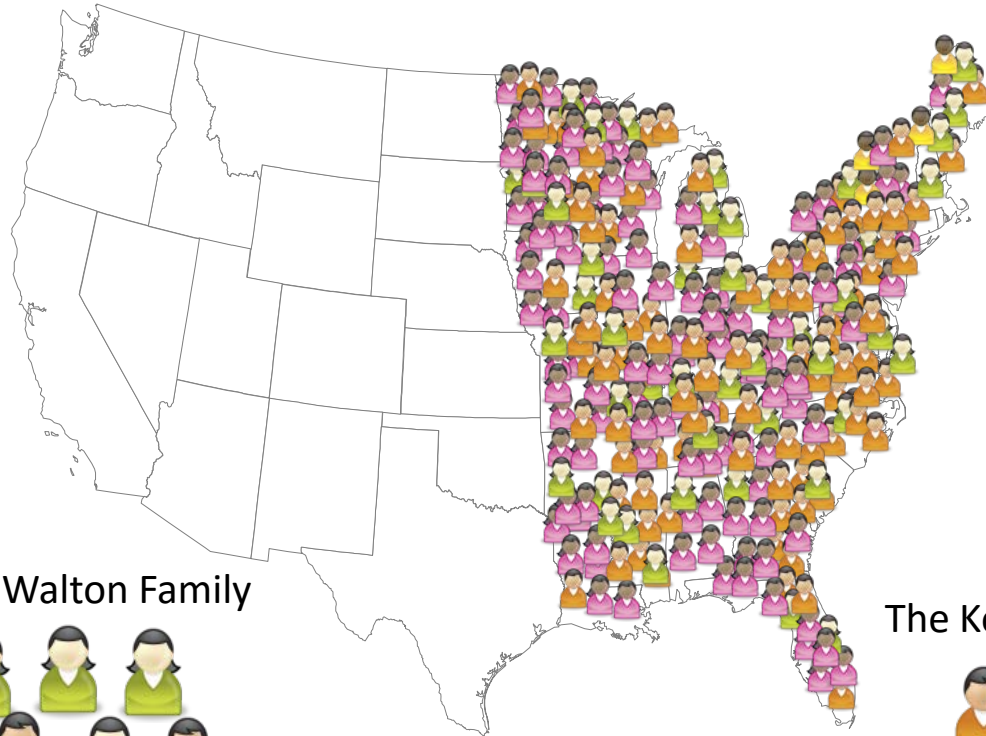


Multiple aspects of inequality

- Voice
 - Attempts in US at disenfranchisement
- Access to justice
 - Mass incarceration
 - Mass evictions
- Wealth inequality greater than income inequality

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



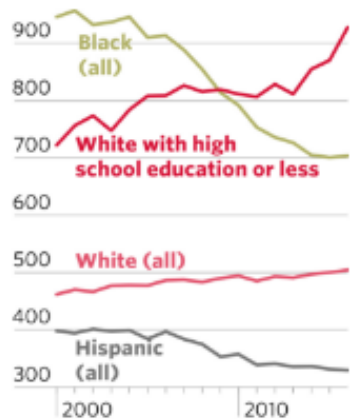
Health inequalities

A Rising Toll

New research shows the increasing mortality rate among white Americans spans age groups and is most acute among the less-educated.

White deaths are rising...

Mortality rate by race, ages 50-54

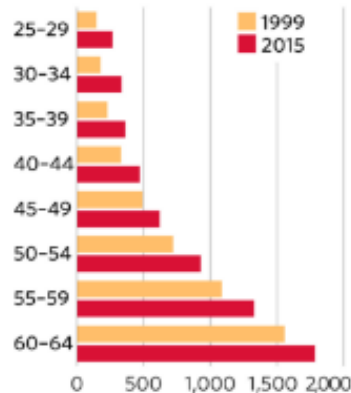


Mortality rate=deaths per 100,000

Anne Case and Angus Deaton of Princeton University

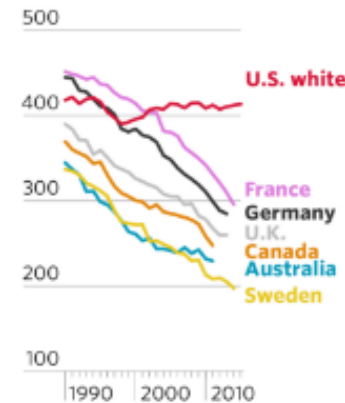
...among all age groups of less-educated whites...

Mortality rate for whites with high school education or less, by age



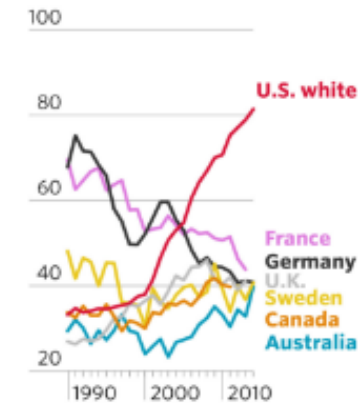
...in contrast to elsewhere...

Mortality rate for all causes, ages 45-54



...due in part to increases in 'deaths of despair'.

Mortality rate due to alcohol, drugs and suicide, ages 50-54

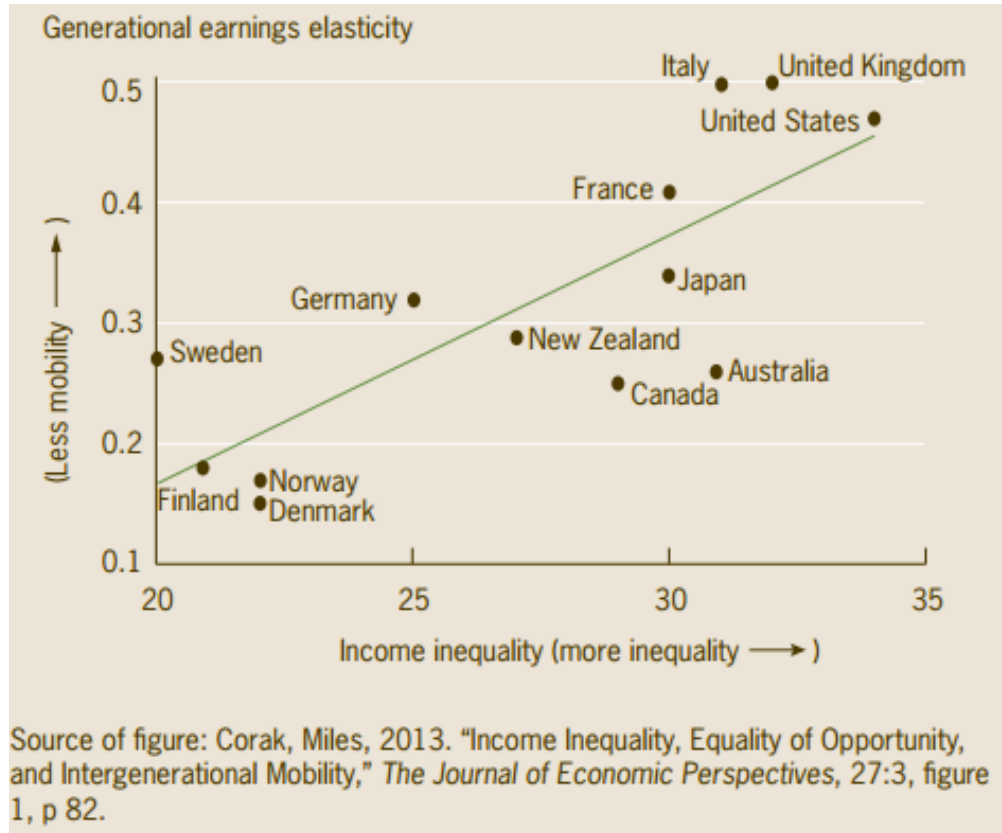


Source: Anne Case and Angus Deaton of Princeton University, charts published in Wall Street Journal.

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
 - Other countries with high levels of inequality also have low levels of equality of opportunity

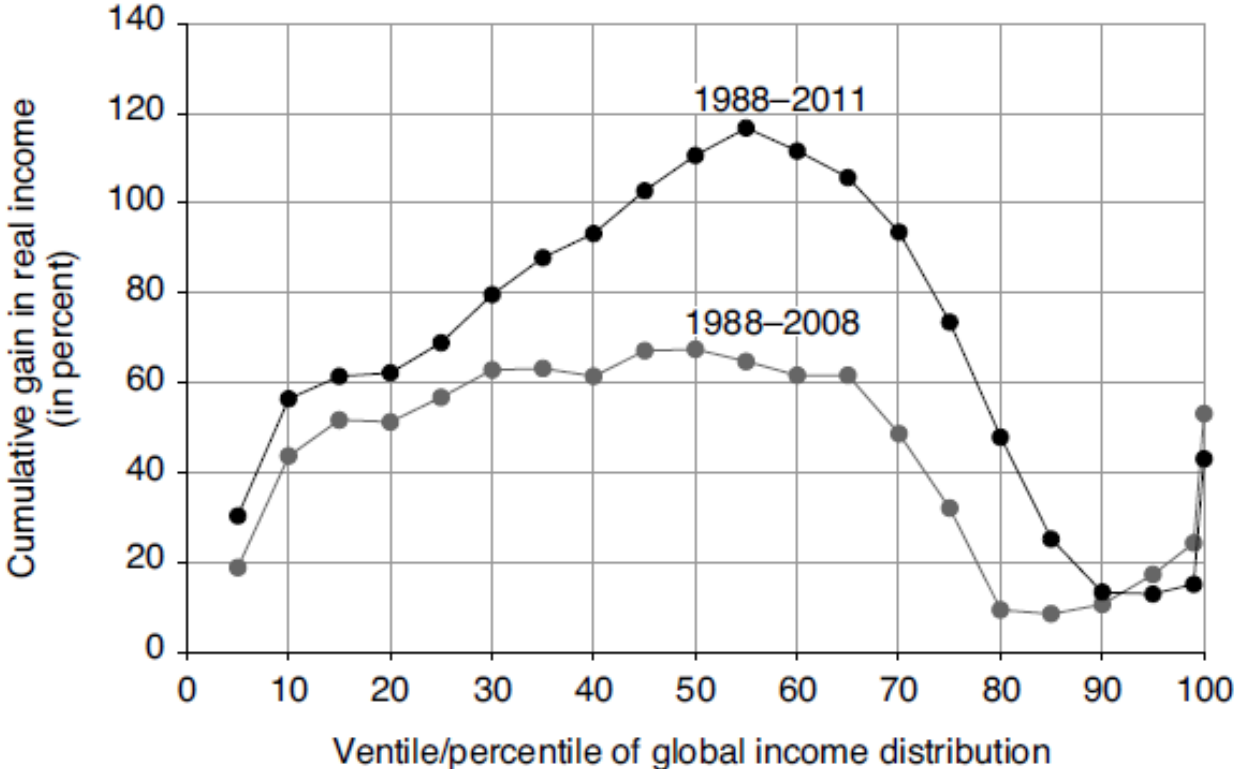
Income inequality and earnings mobility



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
- **Inequality is a choice**

Global inequality: income growth by percentile



Source: Branko Milanovic.

Globally, matters are even worse

Oxfam reports on wealth concentration at the top: how many of the richest people have as much wealth as bottom 50% (bottom 3.6 billion!)

- In 2014: 85
- In 2017: just 8 *men*

Big winners during last quarter century

- Global 1% and global middle class (middle class in China and India)

Big losers during last quarter century (not sharing in gains)

- Those at the bottom and the middle class in advanced countries

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”

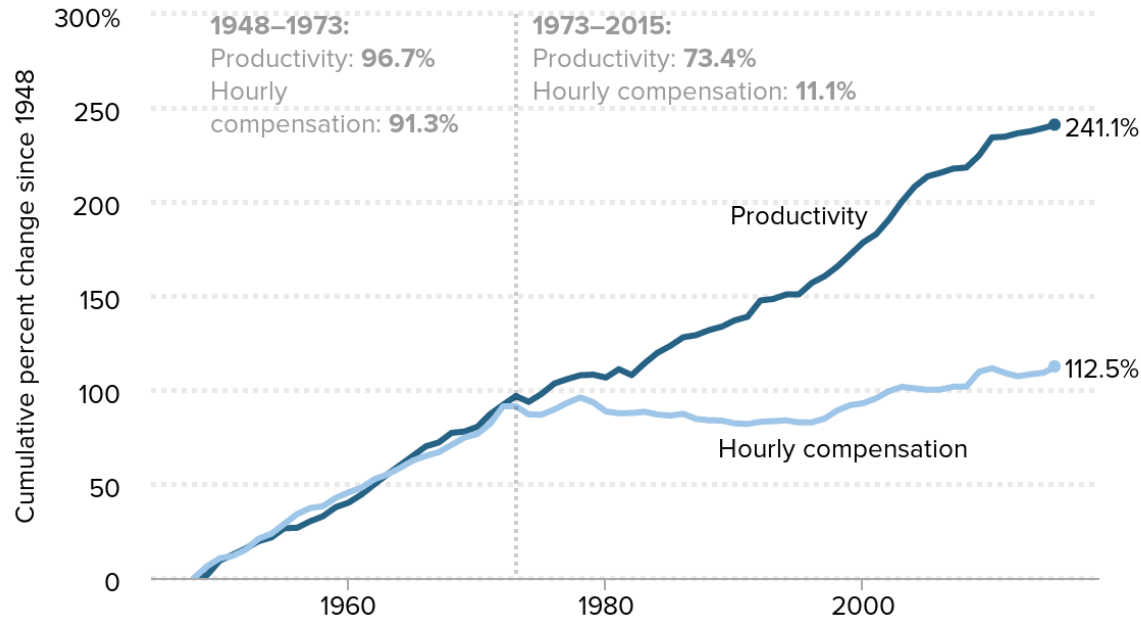
Major changes in understandings of inequality

4. Kuznet's law—that while in the initial stage of development there is an increase in inequality but thereafter, there will be a decrease—has been repealed.

III. 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 and certain changes in the structure of our society?
- Evidence that something “big” happened around 1980

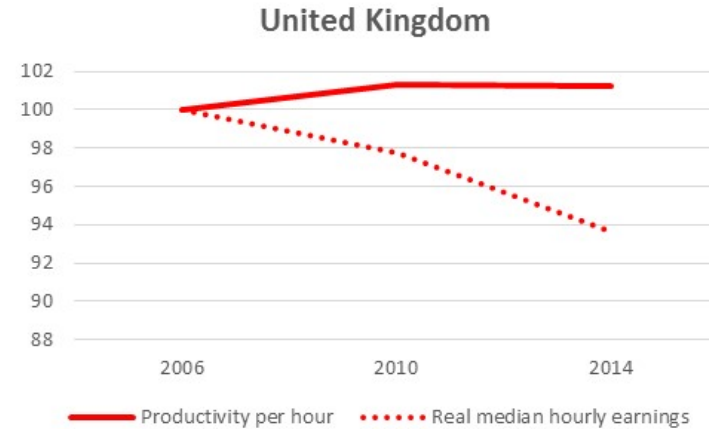
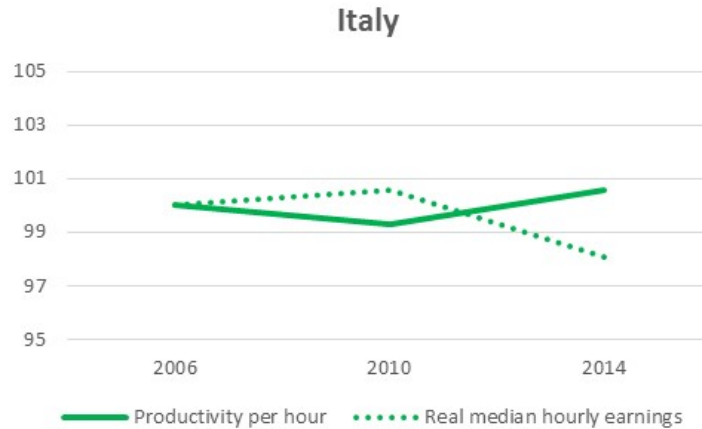
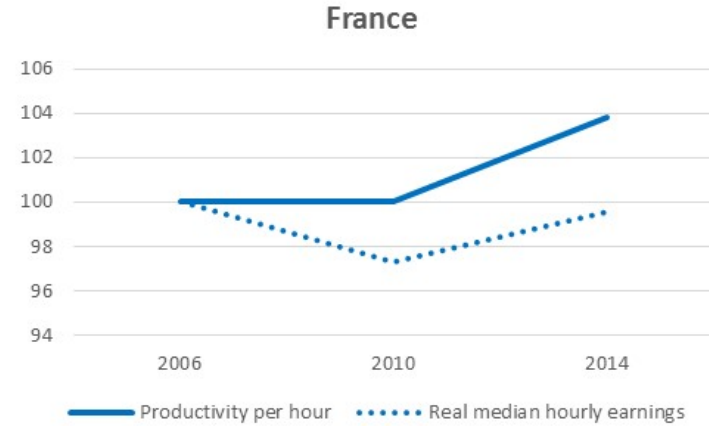
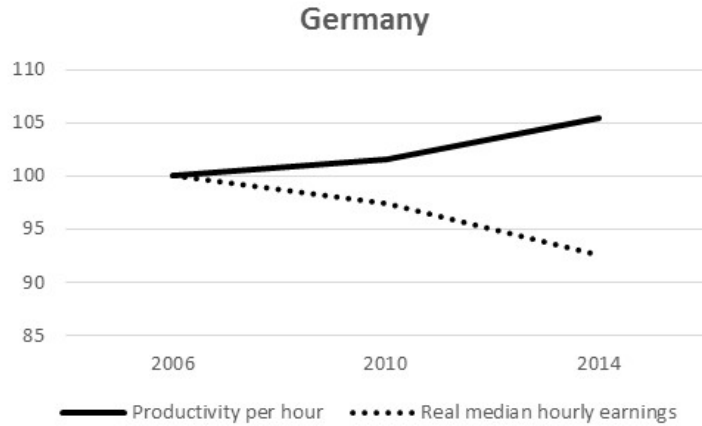
US: Disconnect Between Productivity and a Typical Worker's Compensation, 1948-2015



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 of *Understanding the Historic Divergence Between Productivity and a Typical Worker's Pay* for more detailed information)

Europe: Disconnect in Productivity and Compensation



Source: Eurostat.

Multiple explanations

- 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
- **Markets don't exist in a vacuum—government sets rules of game, and how it sets rules and policies and how it enforces them affects efficiency and distribution**

Rewriting the Rules of the American Economy, with Nell Abernathy, Adam Hersh, Susan Holmberg and Mike Konczal, A Roosevelt Institute Book, New York: W.W. Norton, 2015. In Italian by il Saggiatore

More generally: increasing importance of rents

- Associated with changes in technology, demand and changes in the rules
 - Greater urbanization (land rents)
 - Increased importance of network effects—leading to market power in key new sectors
 - Increased importance of local services—with local monopoly power
 - Weakening bargaining power of unions
 - Weakened enforcement of anti-trust rules
 - Globalization (as its been managed)
 - Changes in corporate governance

Rent seeking within corporations

- Managers have used their managerial discretion to seize a larger fraction of corporate rents
 - Sometimes in the name of “incentive pay”
 - But incentives have actually been perverse
 - Increase in executive pay may come at the expense of investment in people, technology, plant and equipment—i.e. long run performance of enterprise

IV. Solutions

- No magic bullet
- But there are a range of actions
 - Labor market practices
 - Social movements
 - Politics and institutions

Labor market practices and institutions will have to change

- Many implications of the end of lifelong employment
 - Diminished role of employer in providing social protections
 - individuals *on their own* can't manage many of the risks they face
 - Increased role of state—flexisecurity
 - Diminished role of employer in providing training
 - Increased role of state and of individual
 - New technologies (MOOCs) provide new opportunities in many areas
- Rethinking role of formal education
 - Learning how to learn—for life long learning
 - Greater focus on creativity

Real wealth of nations--Abilities and creativity of individuals

- *Creating a Learning Society* and a Learning Economy
 - Agenda in Netherland
 - Structuring interactions
 - clusters
 - Facilitating transmission of ideas
 - In some cases encouraging labor mobility
 - Opposite of what was attempted in Silicon Valley

J. E. Stiglitz and B. Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress*, New York: Columbia University Press, 2014. Reader's Edition published 2015. Italian/World by Giulio Einaudi Editore (Expected end of 2017)

Structure of labor bargaining may change

- Larger percentage of private employment concentrated in small enterprises or self-employment (gig economy)
- Government may need to take more active role in defining what is an employment relationship and ensuring minimal standards (UBER)

Social attitudes may need to change

- Including those associated with gender
- Skills and attitudes valued in market place increasingly related to gender
 - College completion
 - Service related jobs
- Yet wage discrimination persists
- Difficulties especially evident in US in middle age men without college degree—and reflected in health statistics

Social movements

- The public good is a public good—everyone benefits from a well managed society
- In general, there will be an undersupply of public goods—basic insight of modern economics
- Another basic insight: the key importance of collective action, especially in modern economy
 - Importance of environmental externalities
 - Importance of education
 - Importance of knowledge
- Social movement part of solution to collective action

New technologies have had mixed effects

- Facilitated ability to organize collective action
- But also facilitated ability of those working against public interest to undermine collective well-being
 - Spreading fake-news
 - Undermining foundations of our society—our views of truth and trust
 - Undermining basis of knowledge, the scientific method, core to the success of our economy and society since the enlightenment

Institutions—and the role of government

- Inequality has been increased by the rewriting of the rules during the last third of a century, and the failure to write new rules reflecting changes in the economy and society
- We now need to rewrite the rules once again, for the twentieth century
 - Including the rules that define how our institutions work
 - The central bank, our education system, family law
 - Rules that define how our market work
 - Anti-trust, labor law, corporate governance, finance and banking
 - Intellectual property, bankruptcy, rights to privacy, rights to information

Most importantly—the rules of democracy

- That affect ability and desire to participate meaningfully in political decision making
- Again, technology can have mixed effects
- Key battles in US are over disenfranchisement and disempowerment
 - Deliberate attempt to discourage certain segments of population from voting, making a mockery of the democratic process
 - Deliberate attempts to distort information received by certain segments of population
 - Disproportionate role of money in politics
- No simple answer—on going debate
- But there are ways to make political system more democratic and more responsive
- Critical if we are to achieve shared prosperity

V. Severe Economic and Political Consequences

- Inequality itself led to more instability and poorer economic performance
- Economic inequality led to political inequality
- Leading to even worse “rules of the game”—favoring the 1%.
- The discrepancy between promises and what has been delivered too has had consequences
 - Citizens know that the “establishment” has either lied to them, or been totally incompetent
 - They feel (rightly) that the economic system is rigged
 - They saw how the bankers were saved in the economic crisis—but not the rest: they have lost trust in their government and the fairness of our *economic and political system*

Even worse moral and societal consequences

- Single minded focus on profits and financial incentives has changed who we are
 - Preferences and beliefs are endogenous
 - Society has become more selfish
 - Moral turpitude pervasive—from the bankers to the auto industry

VI. Key message of this talk:

There are alternatives

- Alternative ways of organizing our economy and society
- Alternative institutional arrangements, such as cooperatives and not-for-profits
- Institutional innovations
- Policies which give greater scope for new institutions and encourage better performance of existing institutions
- These “reforms” likely to reduce inequality, and even lead to faster overall growth
 - Partly because of a growth in trust and loyalty—important for economic performance
 - Lower turnover, greater effort
 - More shared prosperity

Alternatives to for-profit model based on selfishness

- The best performing institutions in the US are its not-for-profit universities
 - Among the worst performing are its for-profit universities
- Micro-credit schemes in Bangladesh based on non-profit cooperative model have brought tens of millions out of poverty
 - Micro-credit scheme in India based on for-profit model re-invented old-style money lender, and became India's sub-prime lender
- Profit-sharing has become central in 2016 US presidential campaign
 - Based on wealth of evidence that firms with profit sharing actually perform better, especially for workers and especially over the business cycle

Broader need for collective action

- But there is a broader need for collective action to ensure middle-class living standards are attainable for most citizens, and that our economy works for all
 - Regulations to prevent abuses
 - The Entrepreneurial State to promote innovation
- There is room for innovation both in the policies that deliver these public goods and services and the governance structures through which they are delivered

We have choices

- There are alternatives to the current system
 - Even if the advocates of the system suggest there are not
 - And seem to suggest that, at most, we need just minor tweaks on the system
- The problems are deep and fundamental
- Some of these alternatives have proven their value over decades
- We should learn from these experiences
- Many of changes made in the rules over the past third of a century have made matters worse
 - And we have not kept up with changes presented by changes in technology, by globalization, and by changing societal attitudes
- We can reshape our economy and construct a world where the economy performs better for all, or at least for the vast majority