

The Global Economy and Inequality

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Increase in inequality *within* most countries

- Relevant, because people live *within* communities (nations) and they are more sensitive to inequalities that they confront directly, than to “global inequalities”
- Within country inequalities may affect national economic performance

Increase in inequality *within* most countries

- Large differences across countries, even at similar stages of development
- Large differences in changes in inequality
 - Reductions in inequality in many Latin American countries, though from a high level
- Suggests that it is *not* universal laws of economics that are major determinant of what is going on
 - Though they do play some role
 - But rather policies
 - Countries that have followed American model have high and increasing inequality

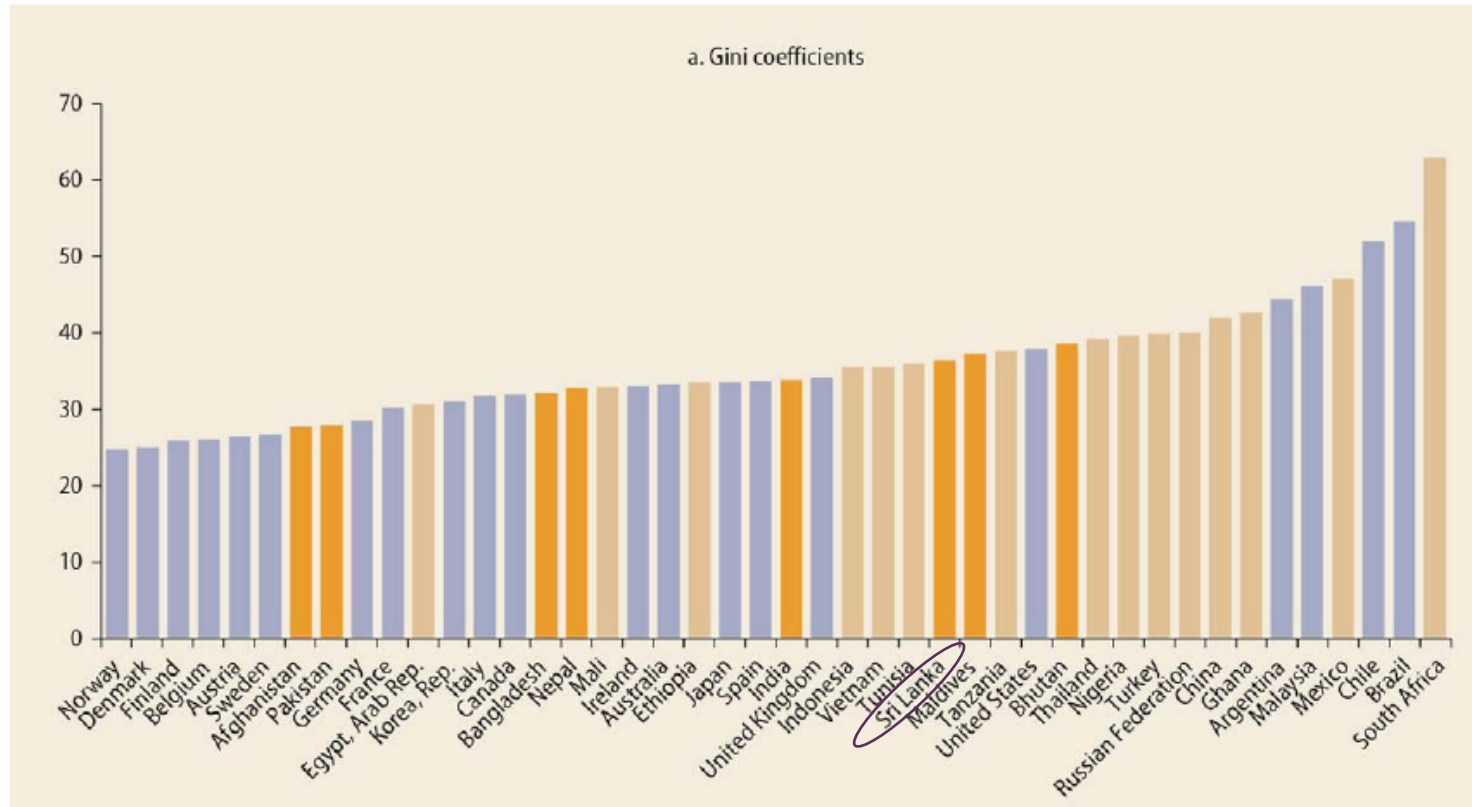
Multiple dimensions of inequality

- 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

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

Based on standard monetary indicators, South Asia has moderate levels of inequality

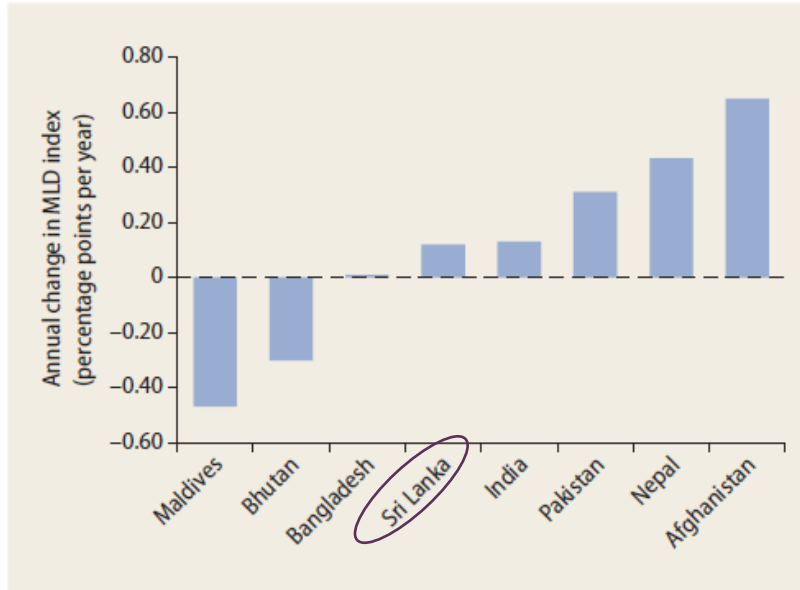


Sources: Based on World Bank's *World Development Indicators* (WDI) database, and the Organisation for Economic Co-operation and Development's (OECD) Income Distribution and Poverty data series.

Addressing Inequality in South Asia, Rama et al, World Bank Group, 2015.

South Asia Inequality

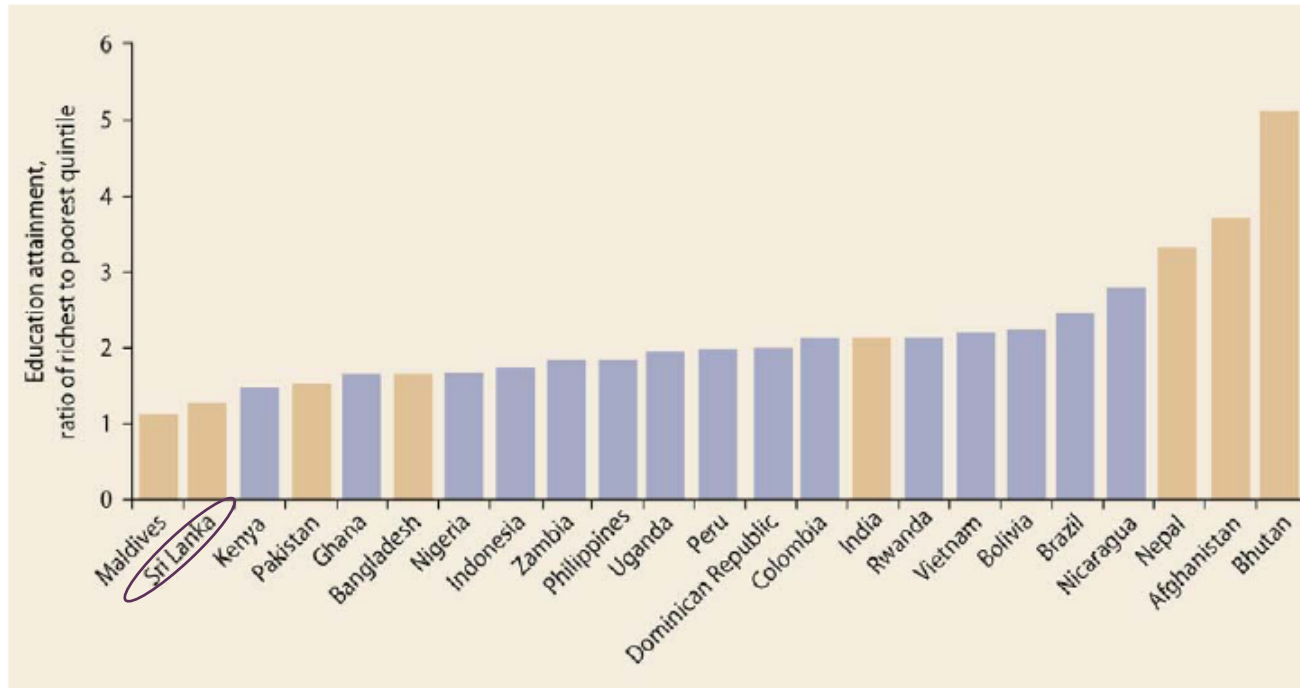
- But monetary inequality is increasing across most of South Asia



Sources: Based on NRVA 2005 and 2007 for Afghanistan; HIES 2000 and 2010 for Bangladesh; BLSS 2003 and 2007 for Bhutan; NSS 1993–94 and 2009–10 for India; NLS 1995 and 2010 for Nepal; HIES 2002–03 and 2009–10 for Maldives; HIES 2001–02 and 2010–11 for Pakistan (Punjab); and HIES 1995–95 and 2009–10 for Sri Lanka.
Note: MLD = mean log deviation.

- Also inequalities in human development outcomes such as infant mortality or educational attainment are wide, and similar to other developing countries

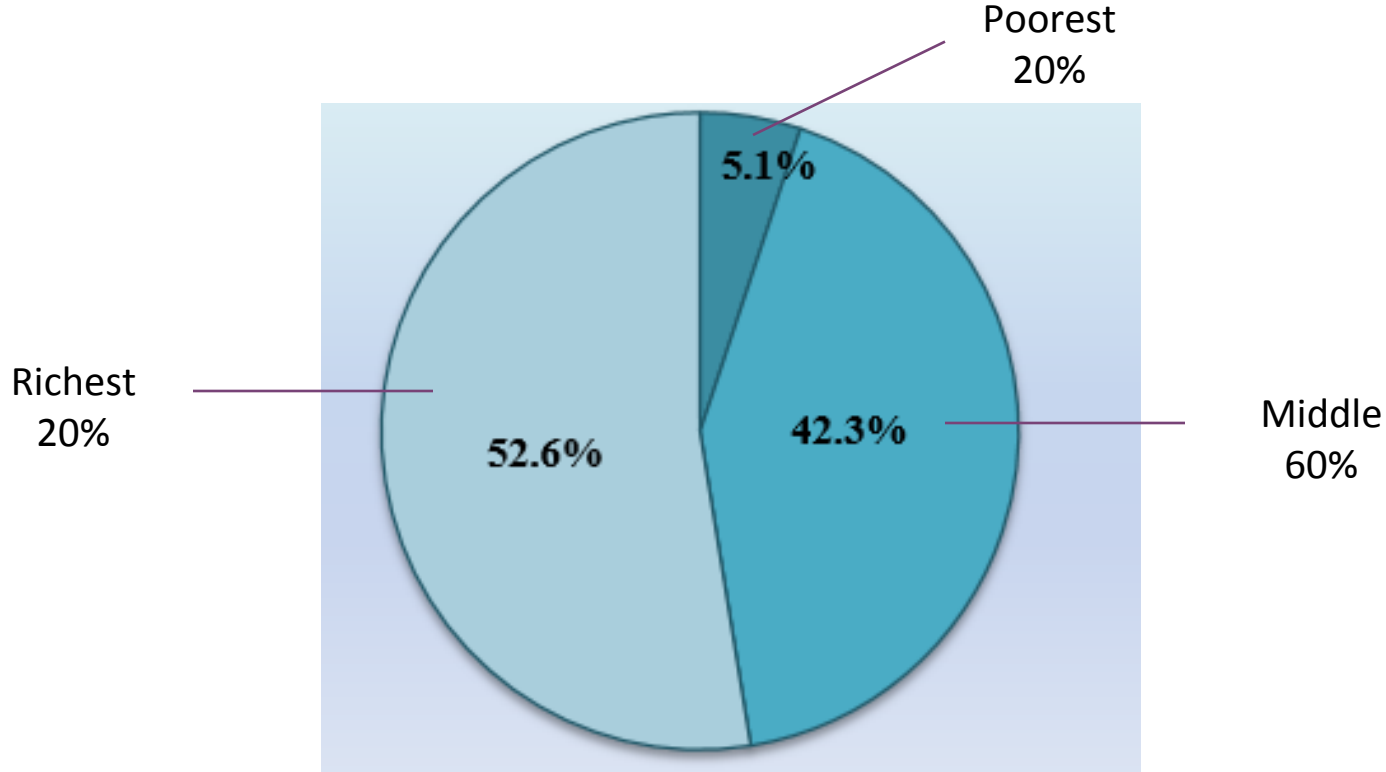
Schooling among young adults is highly unequal in some countries in South Asia



Sources: Based on National Risk and Vulnerability Assessment (NRVA) 2007 for Afghanistan; Household Income and Expenditure Survey (HIES) 2010 for Bangladesh; Bhutan Living Standards Survey (BLSS) 2007 for Bhutan; NSS 2009–10 for India; HIES 2009–10 for Maldives; Nepal Living Standards Survey (NLSS) 2010 for Nepal; Household Integrated Economic Survey (HIES) 2010–11 for Pakistan; HIES 2009–10 for Sri Lanka; and World Bank Education Equality Country Profiles database.

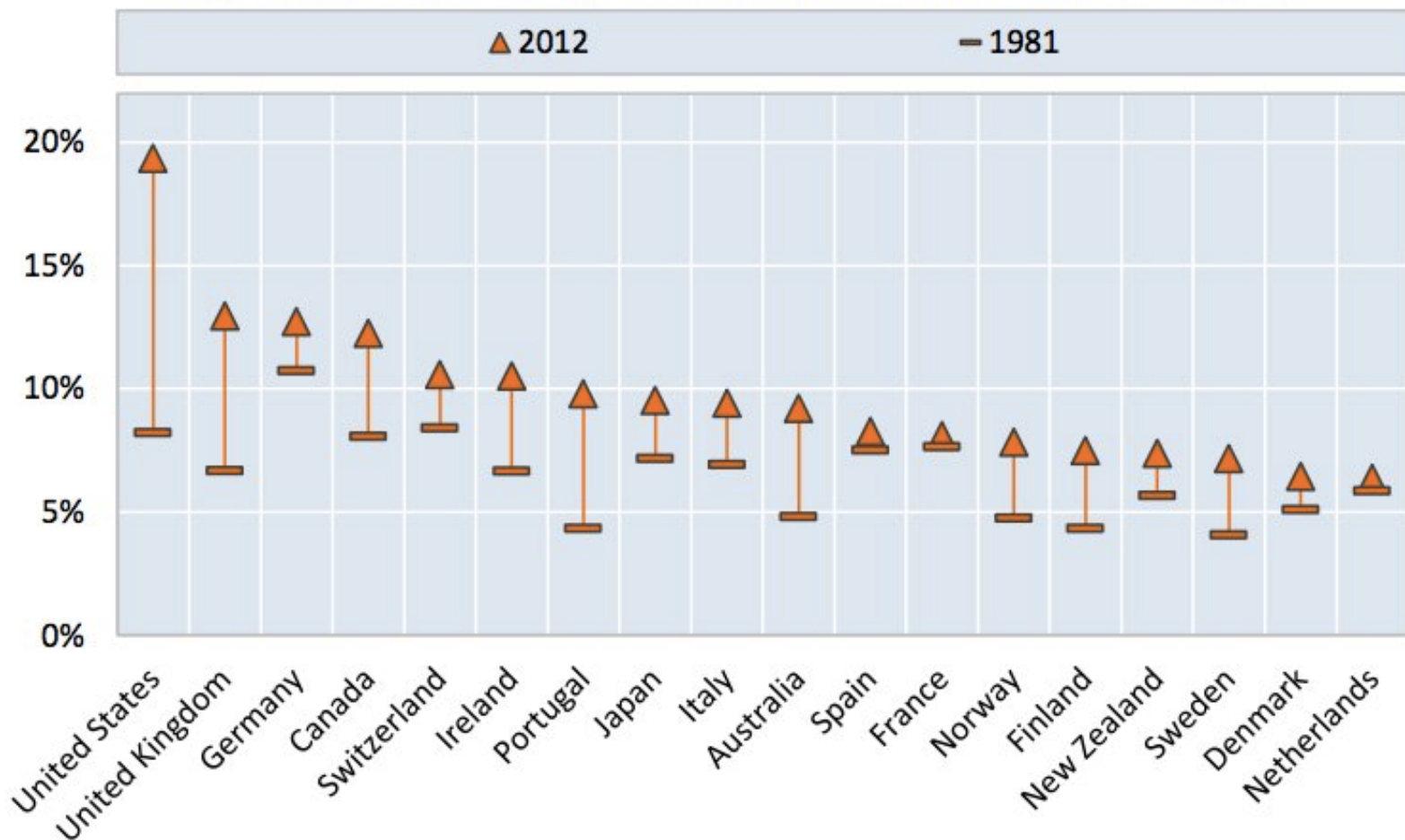
Addressing Inequality in South Asia, Rama et al, World Bank Group, 2015.

Share of household per capita income in Sri Lanka



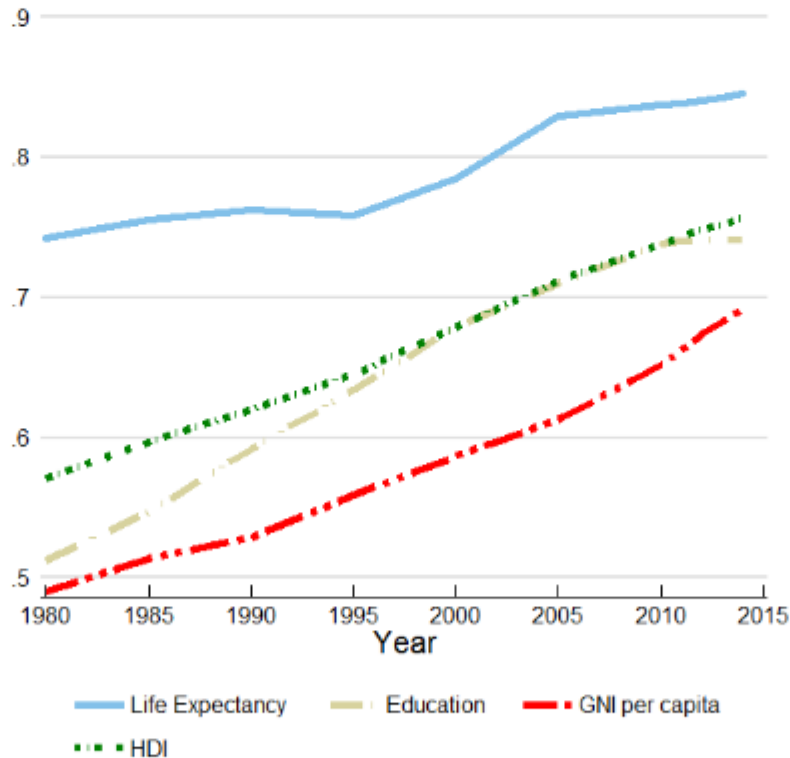
Source: Sri Lanka Department of Census and Statistics, *Household Income and Expenditure Survey 2012/13*.

Shares of top 1% incomes in total pre-tax income, 1981-2012 (or closest)



Source: OECD.

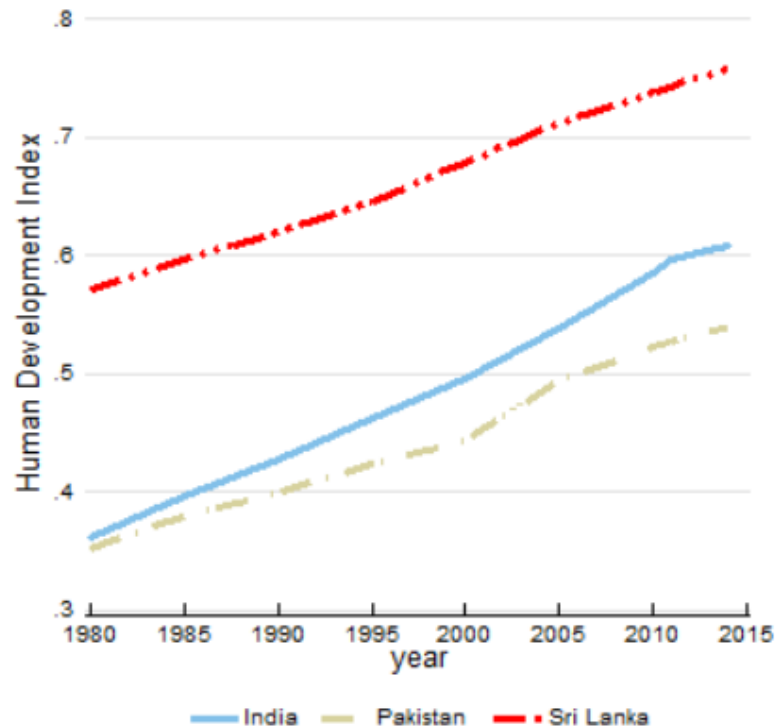
Trends in Sri Lanka's Human Development Indicator (HDI) Component Indices, 1980-2014



Source: UNDP, Briefing Note for Countries on the 2015 Human Development Report.

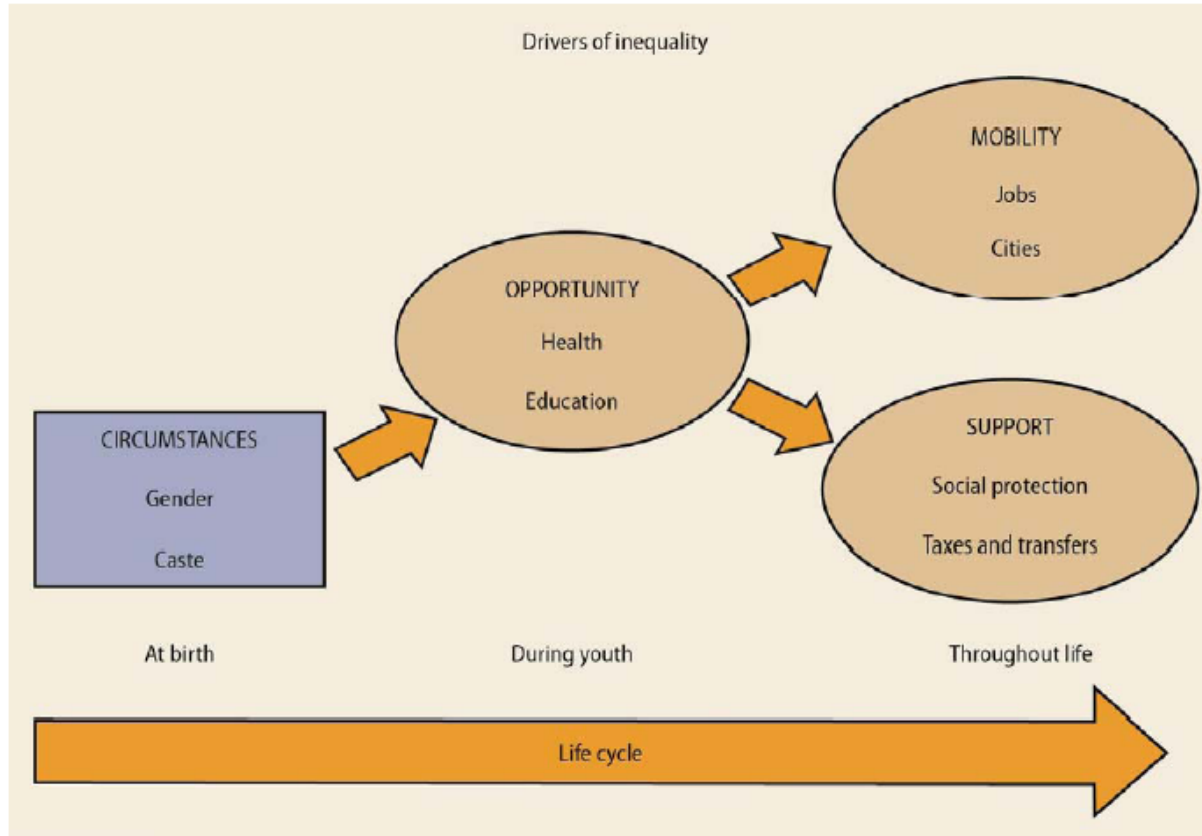
HDI Trends for Sri Lanka, India and Pakistan, 1980-2014

Figure 2: HDI trends for Sri Lanka, India and Pakistan, 1980-2014



Source: UNDP, Briefing Note for Countries on the 2015 Human Development Report.

Multiple factors affect household outcomes relative to others in society



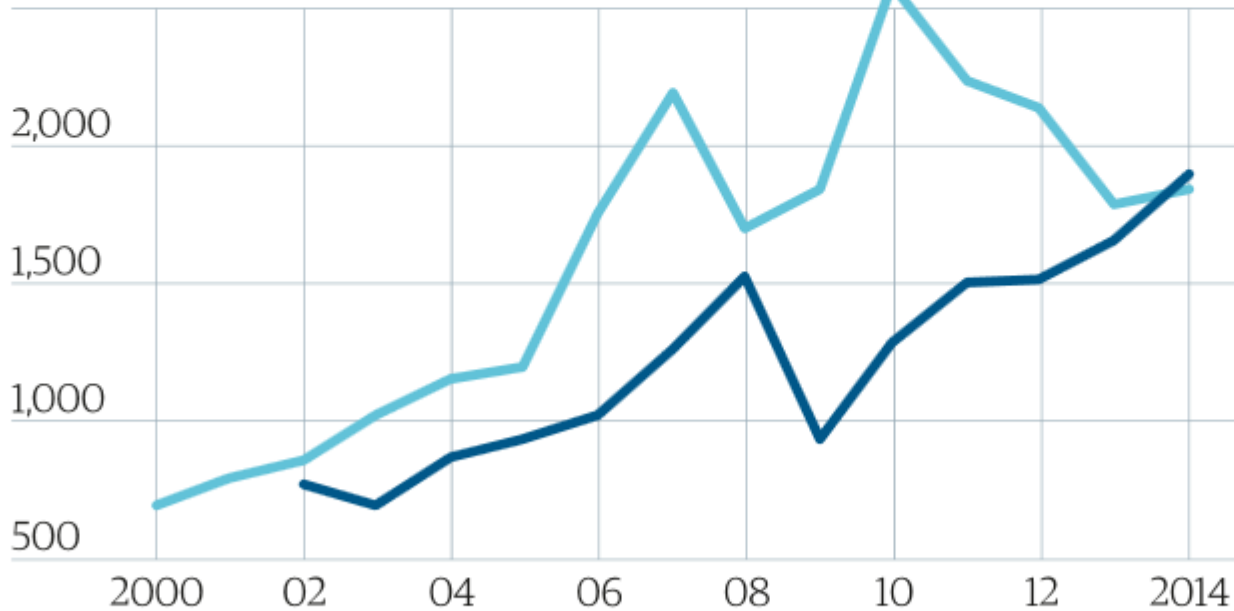
Source: *Addressing Inequality in South Asia*, Rama et al, World Bank Group, 2015.

Global inequality

Wealth of the richest 80 people

Combined wealth in current \$bn

● Richest 80 people ● Poorest 50% of world



GUARDIAN GRAPHIC

SOURCE: OXFAM, FORBES

Source: *The Guardian*, "New Oxfam report says half of global wealth held by 1%", December 2015.

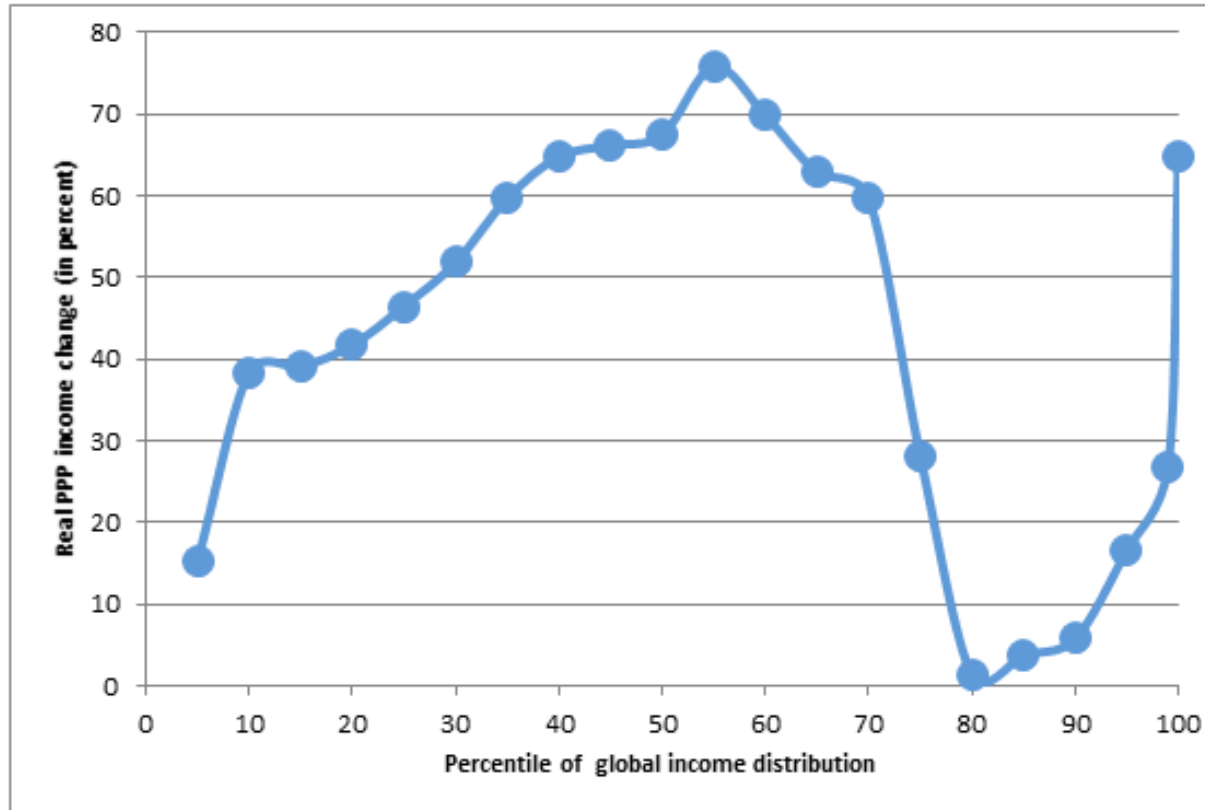
Global inequality: Ginis worse in many countries, late 2000s vs. 1980s

	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)

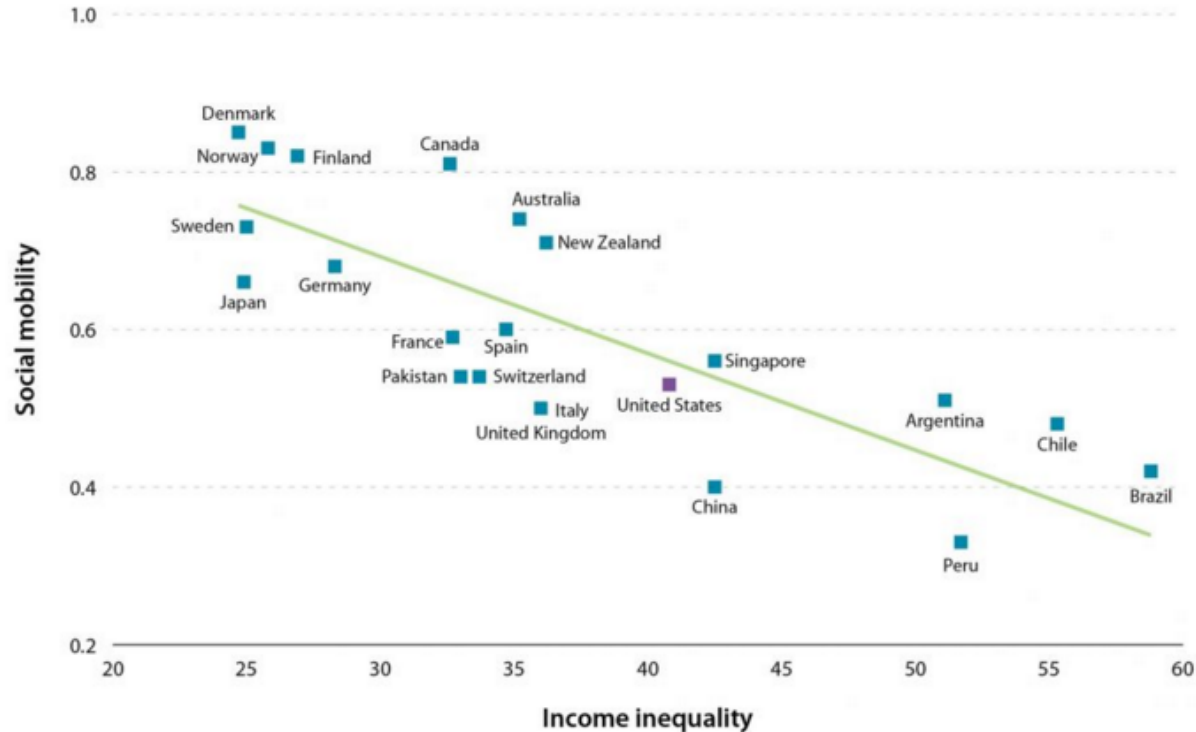
Most invidious aspect: inequality in opportunity

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

Income inequality and earnings mobility

The Relationship between Income Inequality and Social Mobility

Around the world, high income inequality is associated with low social mobility.



Source: Corak (2013); World Bank (2013).

Note: Reproduction of figure 2 from Corak (2013). Data points for Italy and the United Kingdom overlap. The x-axis shows Gini coefficients as reported by the World Bank. The y-axis is a measure of social mobility and is equal to 1 minus the intergenerational earnings elasticity for each country.

Some common elements

- Unemployment is bad for inequality
 - Direct effect
 - Unemployment more concentrated at the bottom
 - Indirect effect through downward pressure on wage
 - And cutbacks in government spending
- Instability is bad for inequality
 - Hysteresis effects—losses in downturn not made up in the recovery
 - Probably related to central banks focusing on inflation

Some common elements

- Financialization
 - Contributed to instability
 - Related to increases of income/wealth at top
 - Exploitation of the bottom of the pyramid
- Globalization
 - Has contributed to instability
 - Related to financialization
 - Both related to magnitude of fluctuations and the exposure of countries to shocks
 - In advanced countries—reduced demand for unskilled labor (traditional trade argument)
 - In developing countries—integration of the top in global economy led to increased incomes at the top; those at the bottom hurt by unfair trade agreements (advanced countries agricultural subsidies)

Some common elements

- Growth in rents
 - Land rents
 - Monopoly rent
 - Intellectual property rents
- Growth in rents explains why in many countries, wealth income ratio is increasing while ratio of productive capital to income is falling
- Difference between wealth and capital helps explain numerous anomalies
 - Disparity between increases in wages and productivity
 - Failure of rate of return on capital to fall
 - Movements in share of capital and labor
 - But standard measures of labor share include CEO and bankers compensation
 - Marked decrease in wage share excluding top 1%

Explaining growth of rents

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

Monopoly and other exploitation rents

- Technology
- *Anti-trust laws and their enforcement*

Policies matter

Large differences in outcomes/opportunities among similar 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

Stiglitz, J. E., N. Abernathy, A. Hersh, S. Holmberg, and M. Konczal (2015). *Rewriting the Rules of the American Economy*, New York: W.W. Norton, 2015.

Alternative view from that of Piketty

Who attributes growth of inequality to differential savings

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

- 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 wealth 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
- 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

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 (Cont'd)

- “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

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
 - Economic inequality leads to inequality in political power
 - Which translates into more economic inequality