The Global Economy and Inequality

Joseph E. Stiglitz
Hong Kong, The Chinese University of Hong Kong
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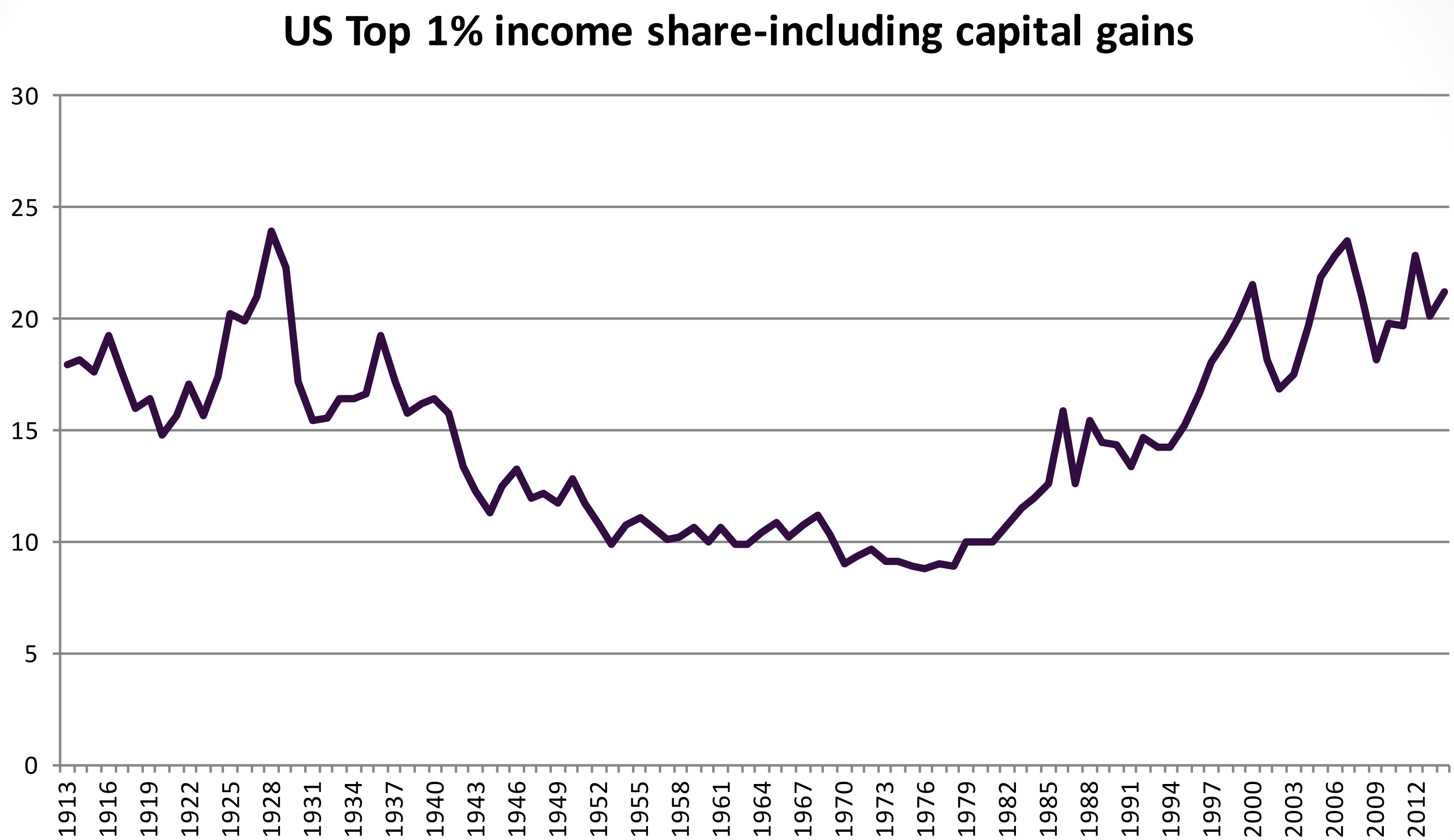
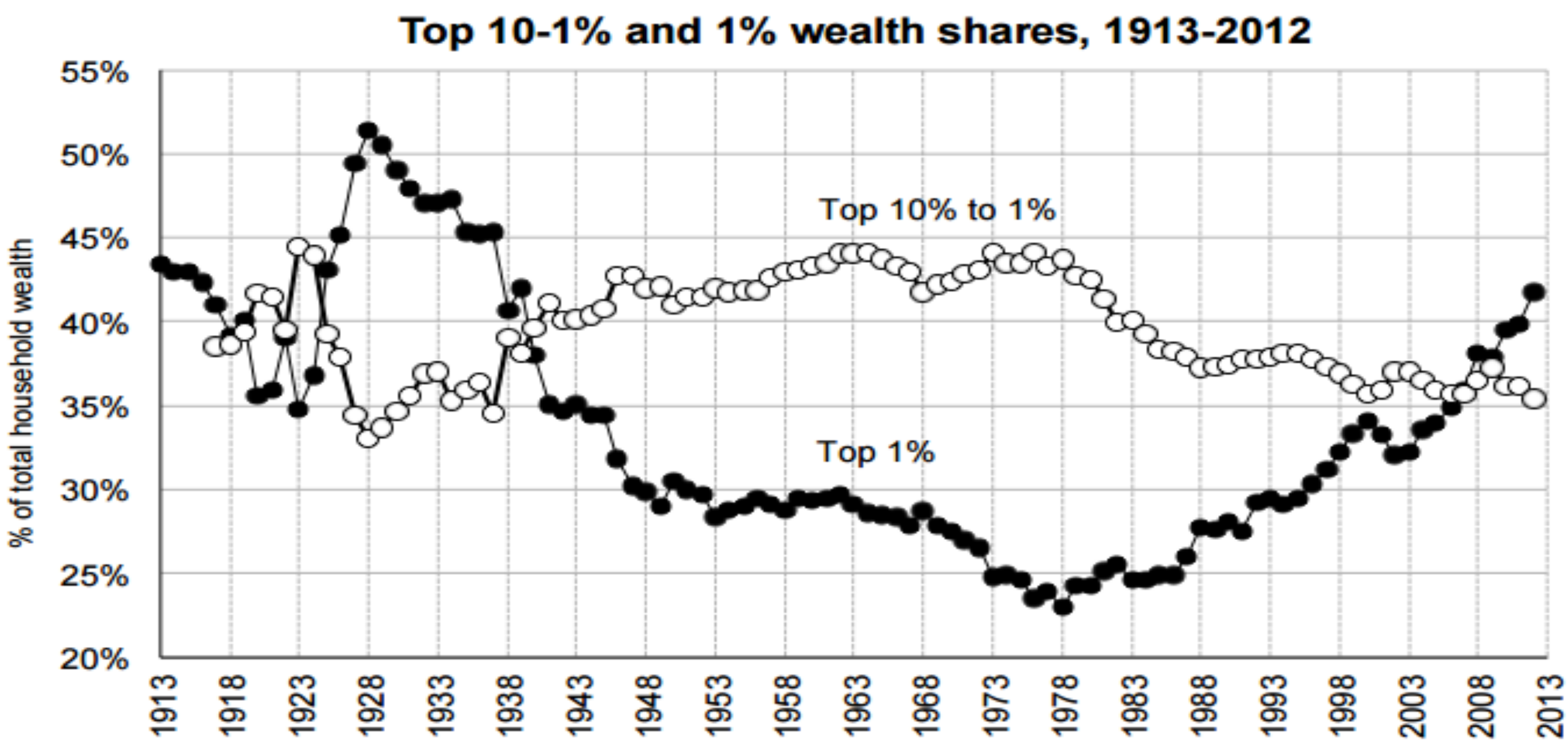
Enormous growth in inequality

- Especially in US, and countries that have followed US model
- Multiple dimensions of inequality
  - More money at the top—especially the very 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

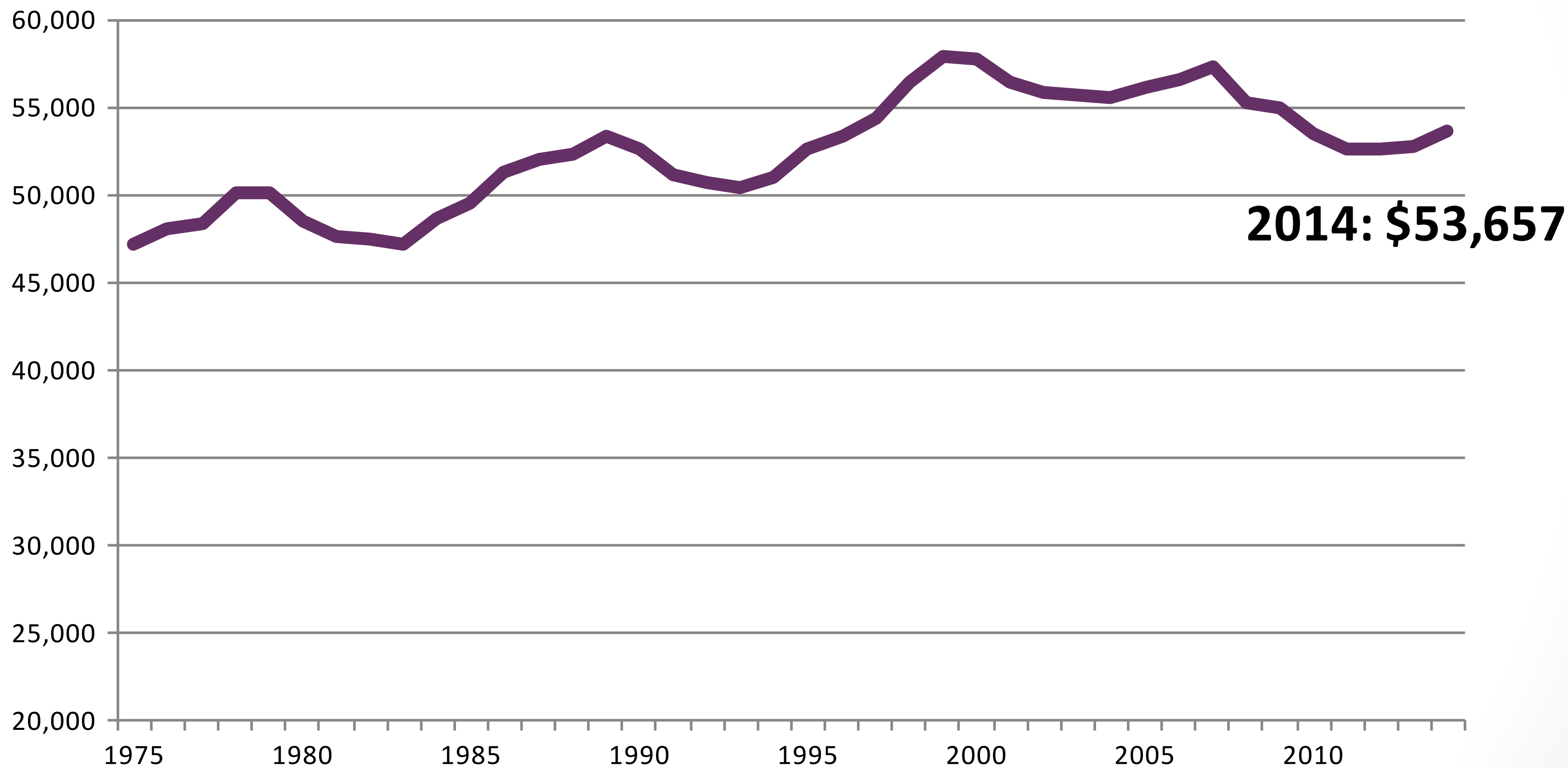


Source: Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States, 1913-1998" *Quarterly Journal of Economics*, 118(1), 2003, 1-39 (Longer updated version published in A.B. Atkinson and T. Piketty eds., Oxford University Press, 2007) (Tables and Figures Updated to 2013 in Excel format,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



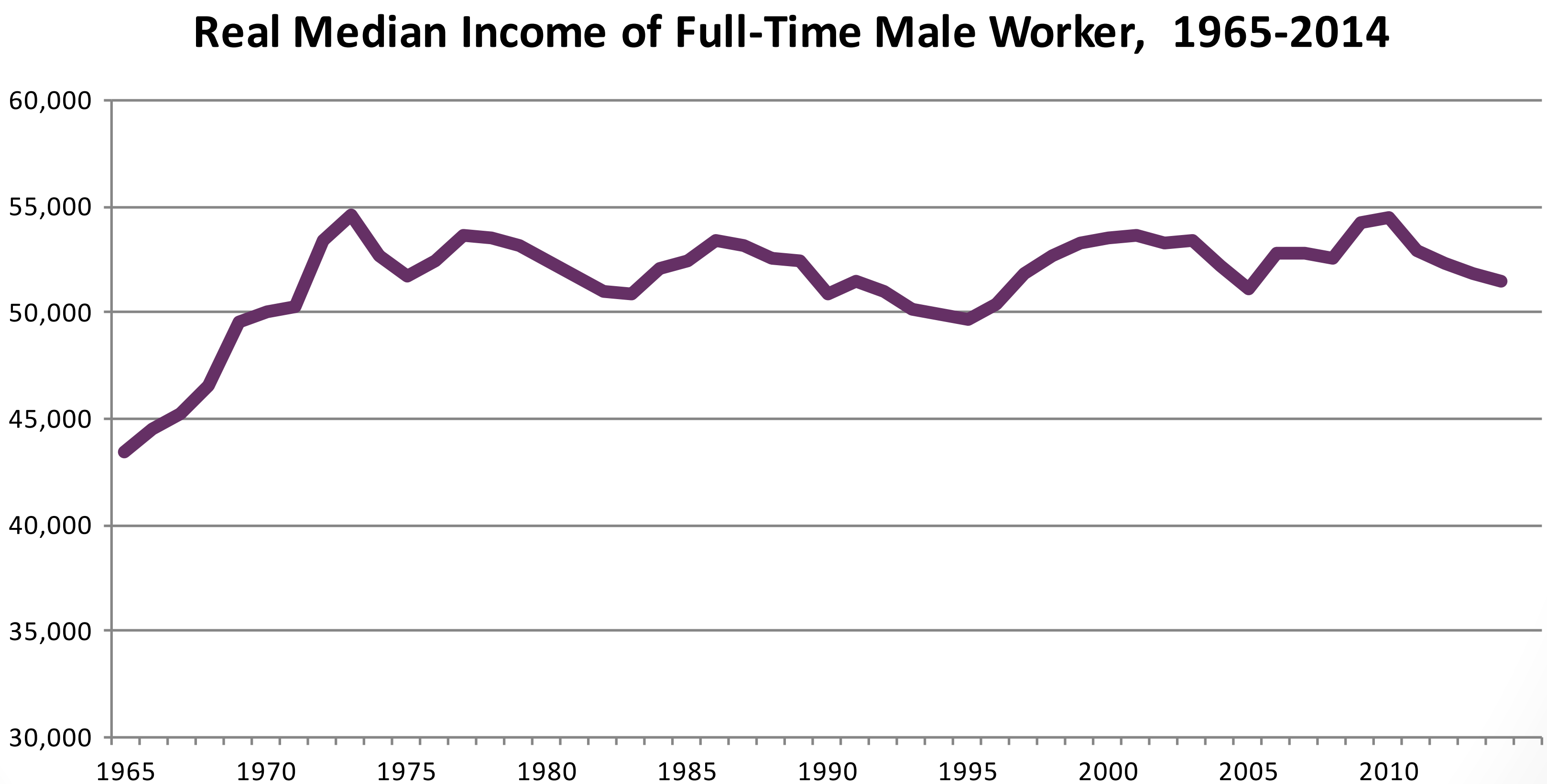
Source: Emmanuel Saez and Gabriel Zucman, 2014, "Wealth Inequality in the United States since 1913: Evidence from Capitalized Income Tax Data" NBER Working Paper, October, revise and resubmit *Quarterly Journal of Economics.*

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

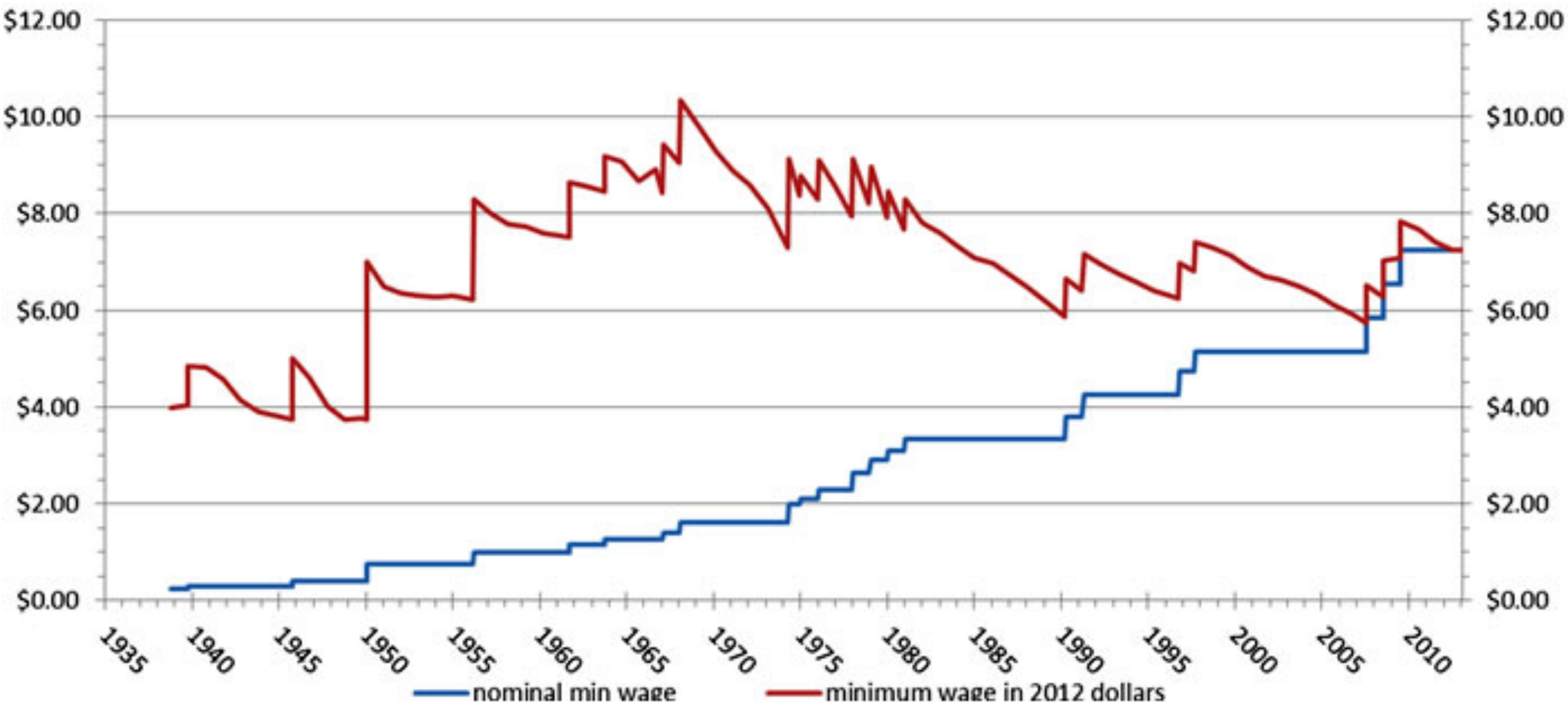


Source: U.S. Census Bureau

Decline in median income of full-time male worker

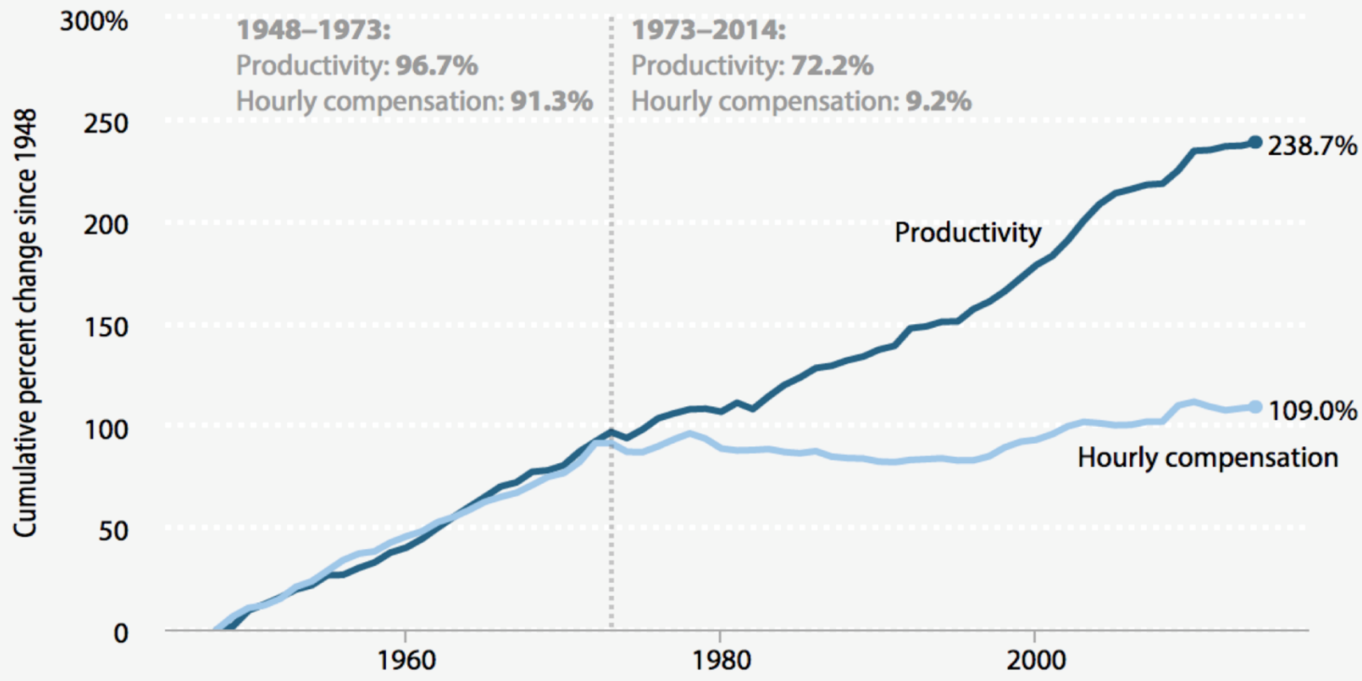


U.S. minimum wage, 1938-2012



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

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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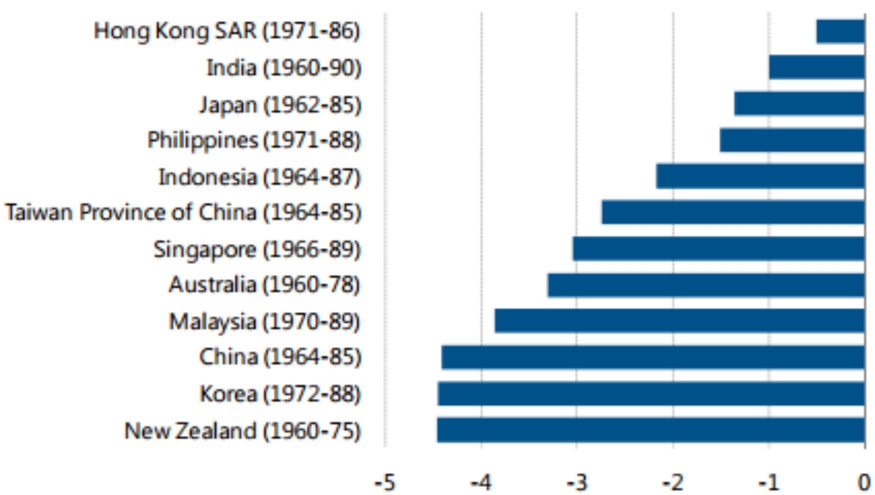
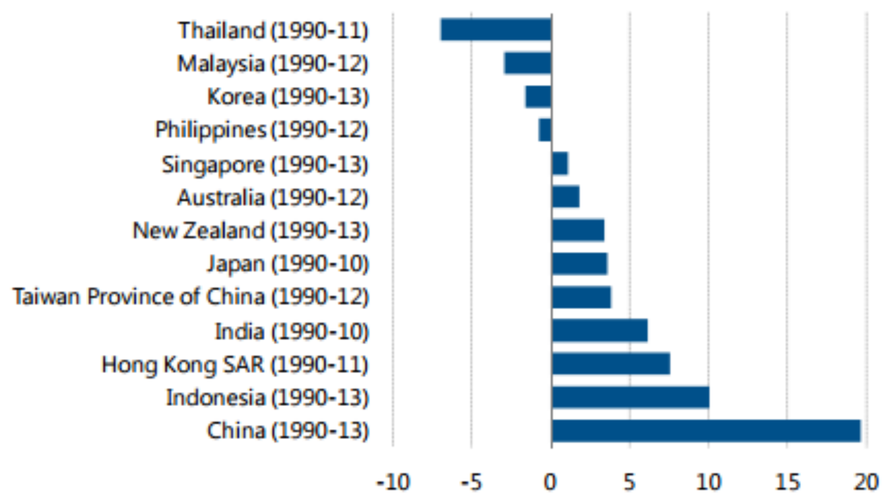
Inequality in Asia: on the rise since early 1990s

Figure 1: Selected Asia: Income Inequality, Pre-1990
(Net Gini Index; in Gini points; change during the period indicated in parenthese)



Sources: SWIID Version 5.0; and IMF staff calculations.

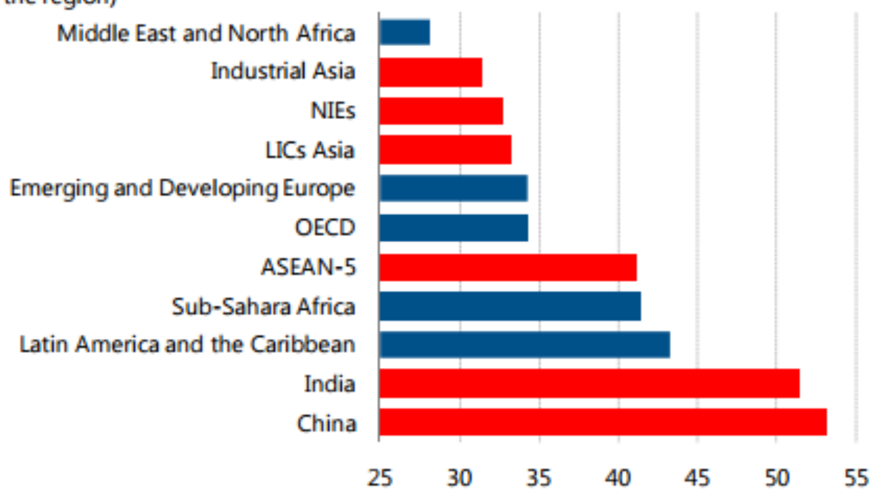
Figure 2: Selected Asia: Income Inequality, 1990-Latest
(Net Gini Index; in Gini points; change during the period indicated in parenthese)



Sources: SWIID Version 5.0; and IMF staff calculations.

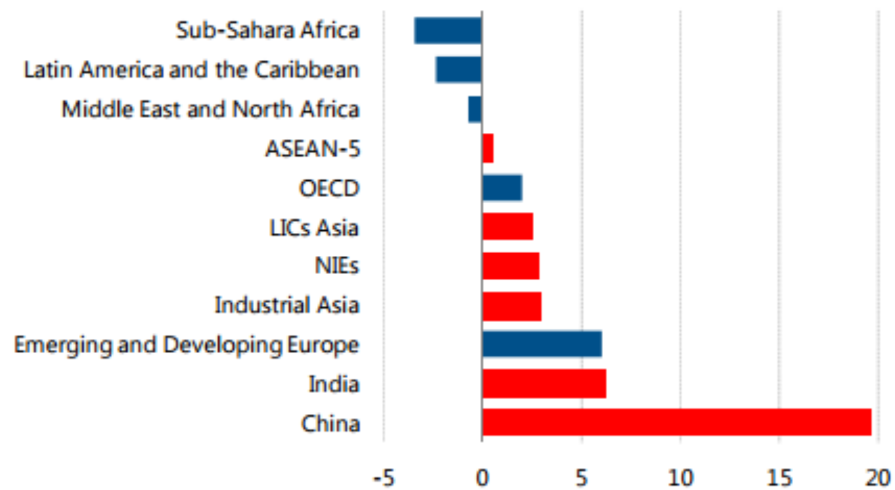
Regional comparison: Income Inequality

(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)

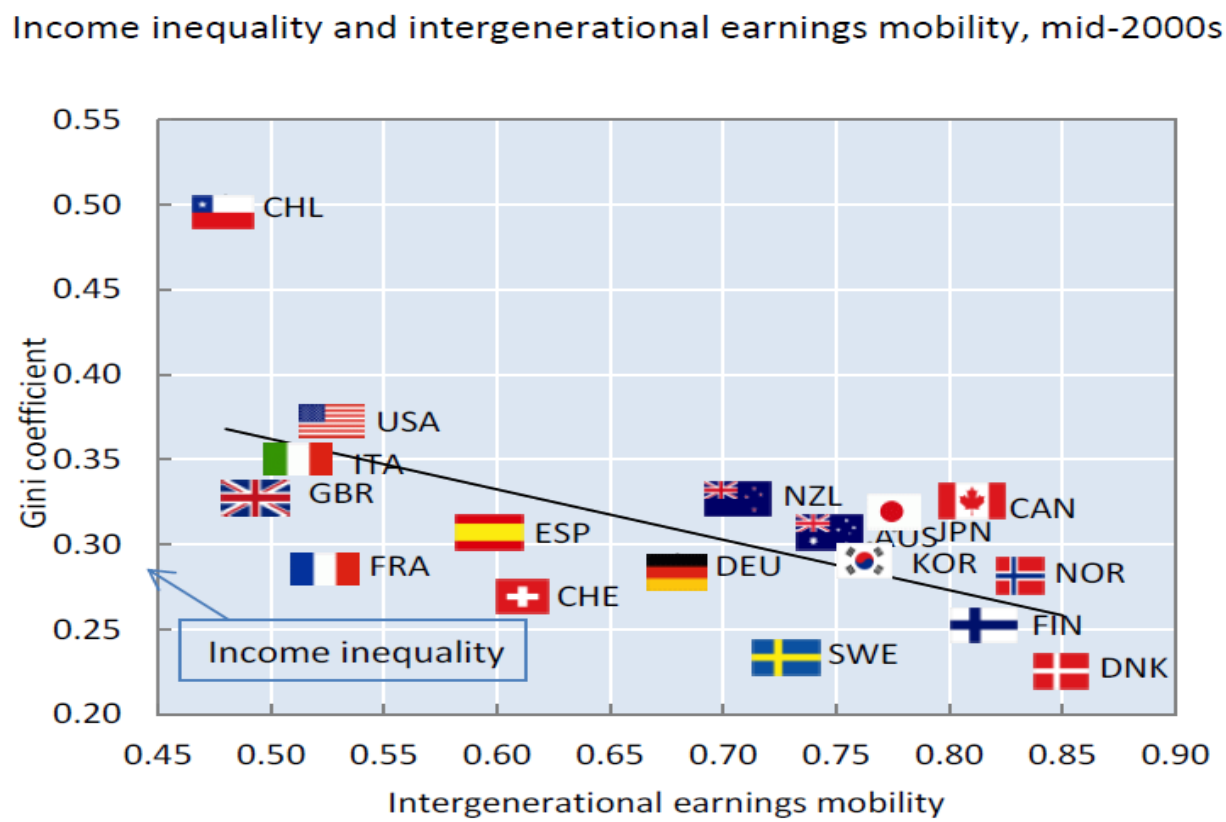


Sources: SWIID Version 5.0; IMF, WEO database; and IMF staff calculations.

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

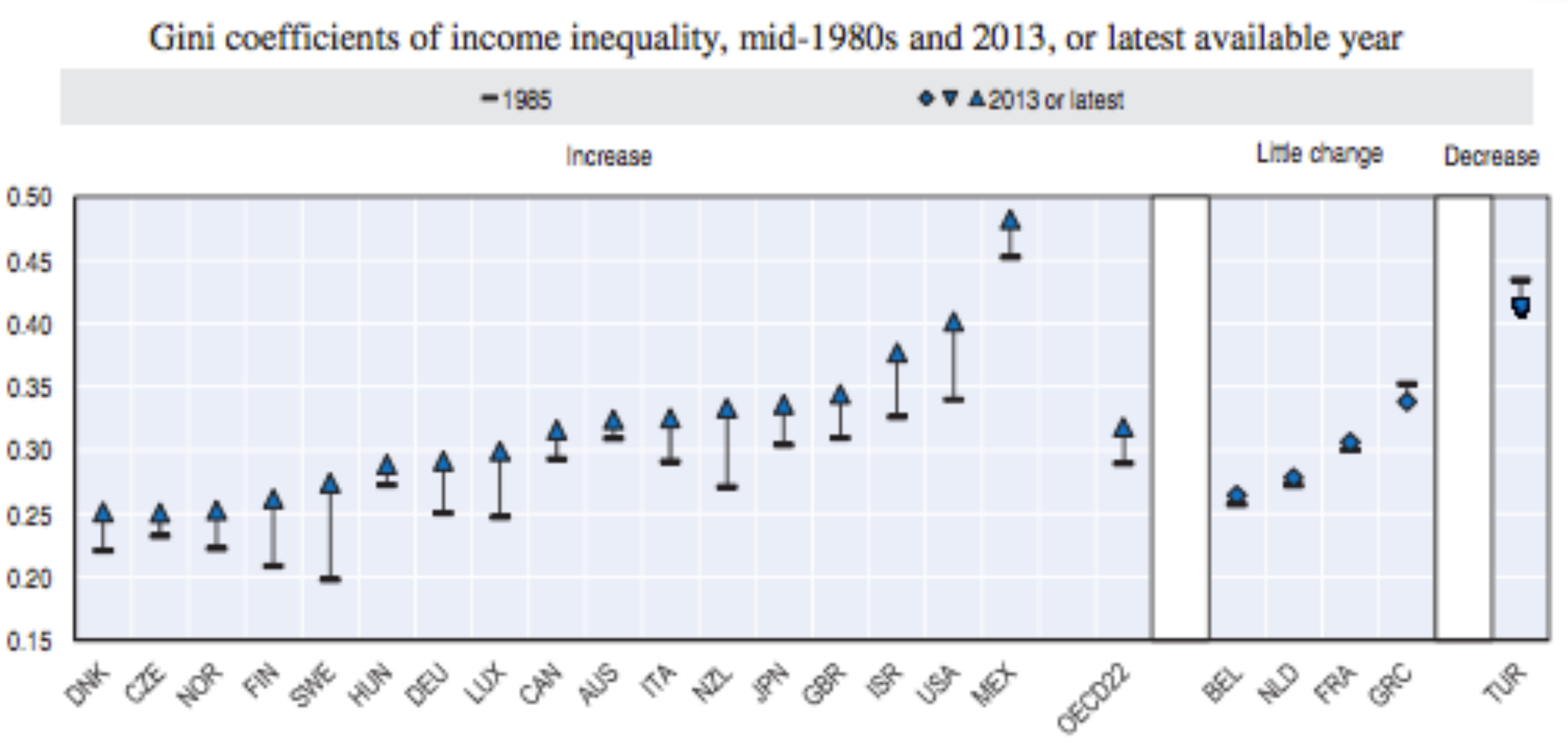


Source: "United States, Tackling High Inequalities Creating Opportunities for All", June 2014, OECD.

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

Gini changes in OECD



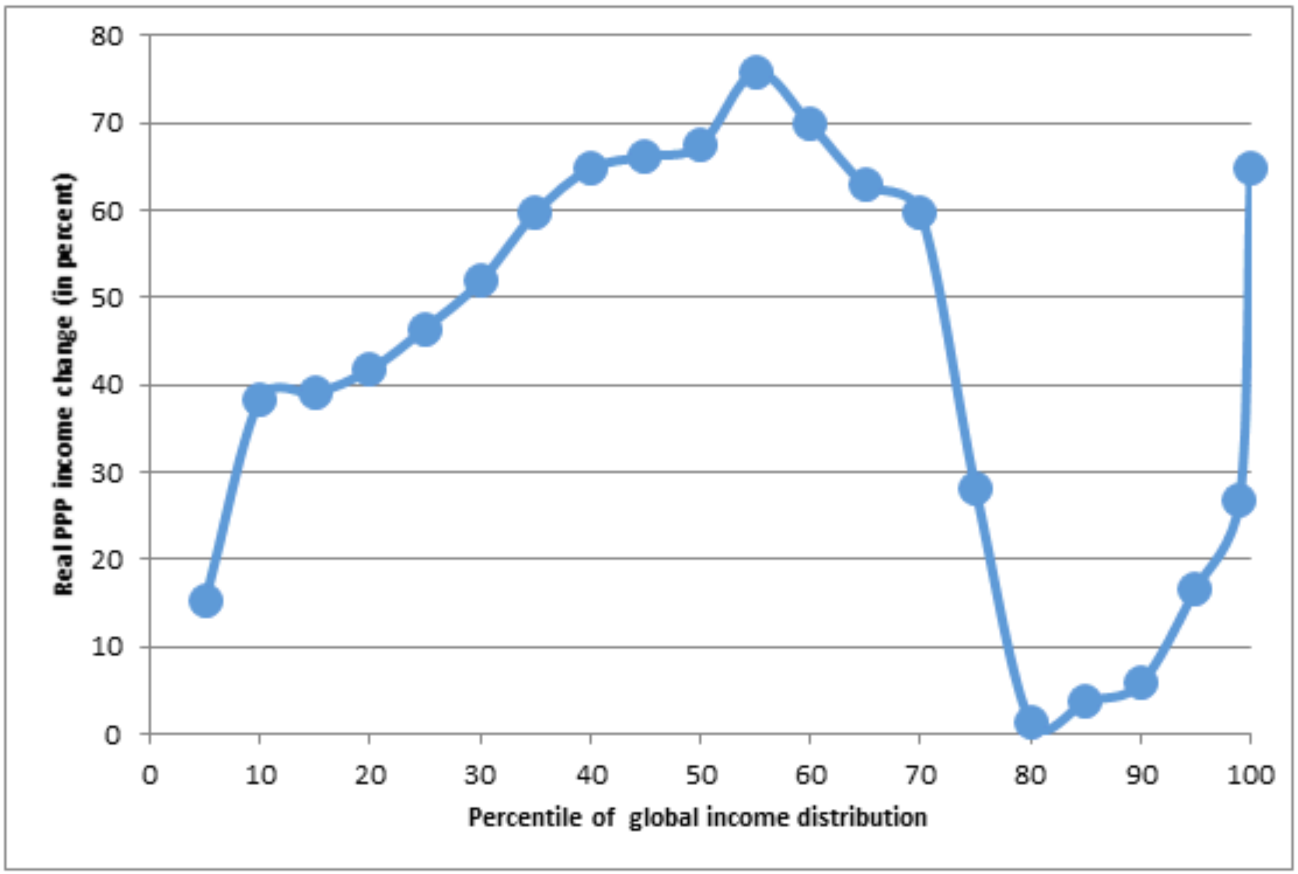
Source: OECD 2015, *In It Together: Why Less Inequality Benefits All,* http://www.oecd.org/els/soc/OECD2015-In-It-Together-Chapter1-Overview-Inequality.pdf

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

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
- 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

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

Alternative interpretations of growth in inequality

1. Market forces--Based on competitive markets--Changes in supply and demand for different factors just turned out badly for poor:

(a) skill biased biased technological change

- Overwhelming impact of increased number of educated individuals

Unpersuasive

- Skilled workers' wages going down
- Doesn't explain gap between *average productivity* and *average wages*
- Doesn't explain wealth inequality

Competitive market explanations

(b) Globalization

- Predicted by standard theory
- Evidence that it has played an especially important role since 2000

(c) Intergenerational transmission of advantage

- Rich leave their children with more human and financial capital
- Equilibrium wealth distribution reflects balance between between centrifugal and centripetal forces
- Increased inequality reflects *increased* intergenerational transmission—an upsetting of previous balance
- Contrary to principle of *equal opportunity*

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
- Regressive taxation and weakening public schools leads to increased intergenerational transmission of advantage

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
  - 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
- Some a result of changes in economy
  - Increased role of services, much of which is localized, with limited competition
  - Increased 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

Piketty's explanation is a variant of intergenerational transmission hypothesis

- Two classes, capitalists save everything, wealth grows at r, return on capital
  - Workers save little
- With r > g, growth of economy, if r does not fall, share of income of capitalists grows

Technical critique of Piketty

- Savings rate of capitalists far less than 1
- Return on capital endogenous, and should be declining as capitalists accumulate
  - 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
- In fact, virtually all models show that in long run $sr < g$: Piketty's result cannot hold
  - In fact, Piketty's model had been well-studied in older growth literature

What Piketty's model cannot explain

- Growth in life-cycle wealth
- Gap between average wages and productivity
  - Even if technical change is skill-biased

Failure to explain 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

Consequences of inequality for the global economy

- Growth in 2015 weakest since Global Financial Crisis and one of poorest performances in recent decades; 2016 on track for being equally weak
- 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

New dimensions of 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
  - At same time, implying QE may have little effect on aggregate demand—or adverse effect
    - Adverse effect on consumption of elderly
    - Adverse effect on consumption of those saving for retirement (other target savers)
    - May outweigh slight positive effect on 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