

Achieving Shared Prosperity for Korea

Joseph E. Stiglitz

Kyunghyang Forum 2018 (Global Economic Forum 2018)

June 19, 2018

Seoul

First principles

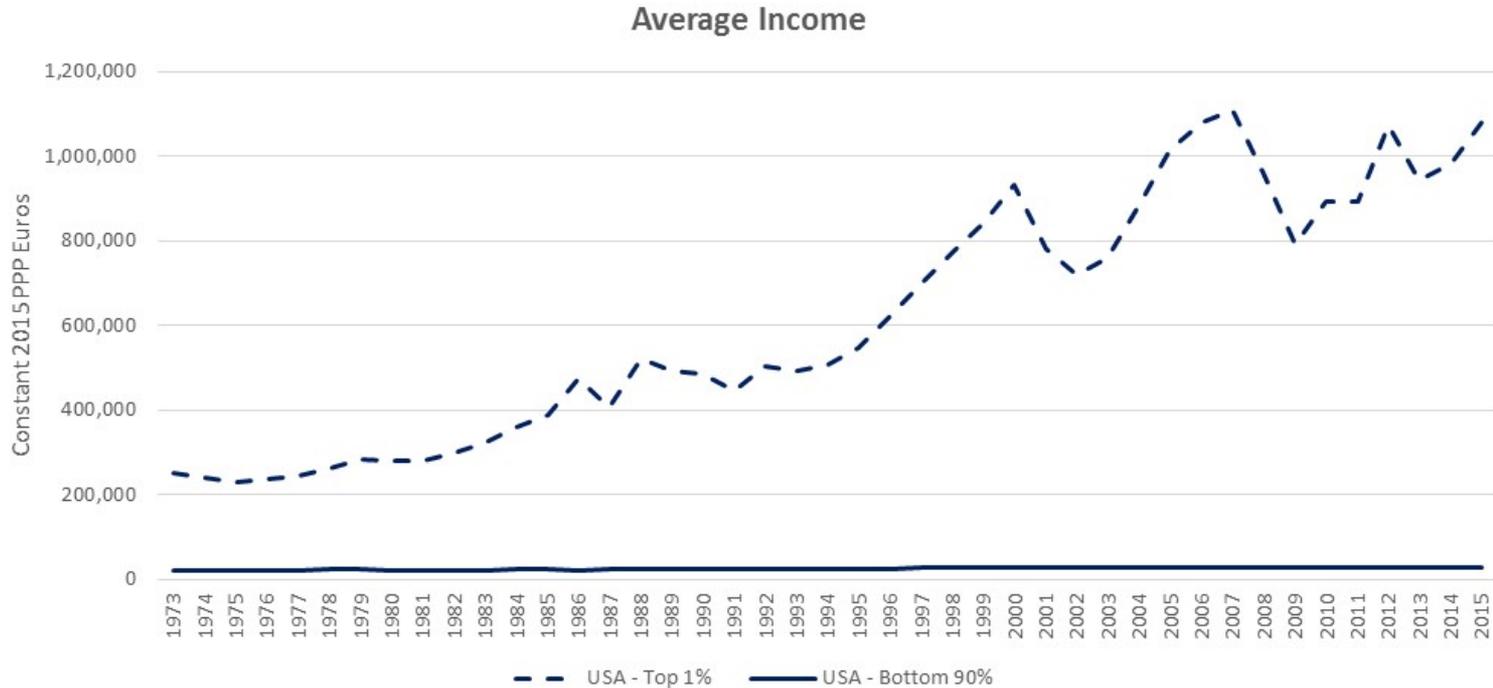
- Objective of economy is to increase well-being of citizens
 - Market economy means to an end not an end in itself
 - GDP itself does not measure well the performance of the economy
 - It doesn't reflect how fruits of economy are shared, whether growth is sustainable, whether it promotes individual and societal well-being
- Market economy that is wrongly structured fails
 - Markets don't exist in a vacuum
 - They have to be structured
 - Beginning with Reagan/Thatcher, were restructured in ways that slowed growth and increased inequality
 - Thus law must *underlay* economics—sets rules of game
 - Key battles are about the rules of the game

J. E. Stiglitz with Nell Abernathy, Adam Hersh, Susan Holmberg and Mike Konczal, *Rewriting the Rules of the American Economy: An Agenda for Growth and Shared Prosperity*, A Roosevelt Institute Book, New York: W.W. Norton, 2015. Also published in in Korean by The Open Books Co.

Mismeasuring Our Lives: Why GDP Doesn't Add Up, Commission on the Measurement of Economic Performance and Social Progress, The New Press, 2010. Published in Korean by Dongnyok.

The result: slow growth with all fruits of growth going to the top

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



Source: World Wealth and Income Database

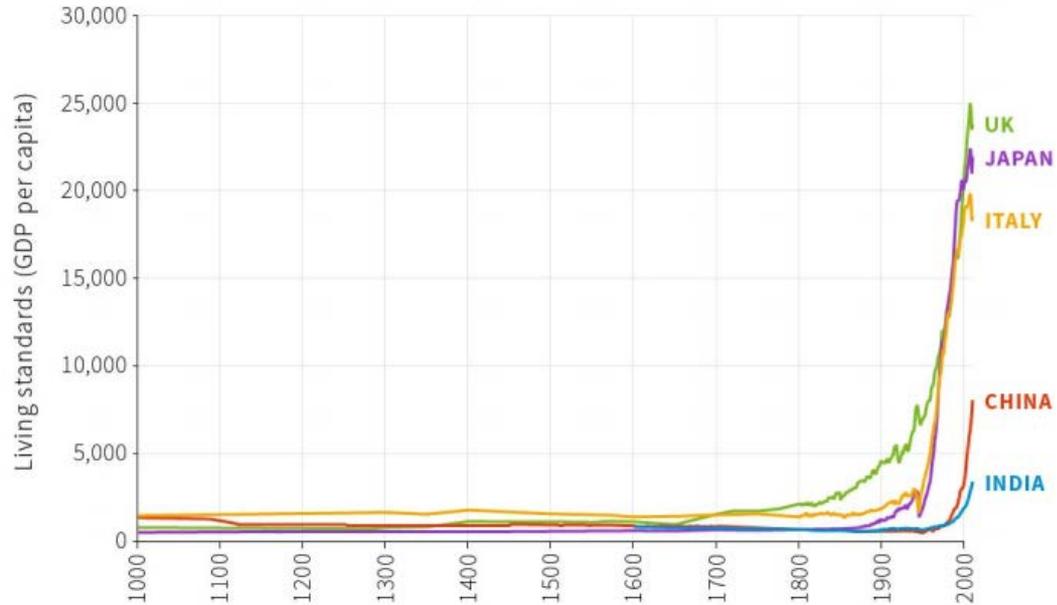
Worse: American style capitalism has been changing who we are

- More materialistic
- More selfish
- Unprecedented level of moral turpitude exhibited by those in the financial sector—preying on those at the bottom
- Dishonesty exhibited in other scandals: VW
- Research in behavioral economics has confirmed these results

Creating a Learning Society: The Real Basis of the Wealth of Nations

- Resulting improvements in productivity was the basis of the wealth of nations
 - Growth not based on the exploitation of others
 - Changing the stagnation that had lasted for centuries
 - Adam Smith couldn't have fully understood this: he was writing at the onset of a new era, before the advent of the knowledge economy

Historical living standards



Source: INET

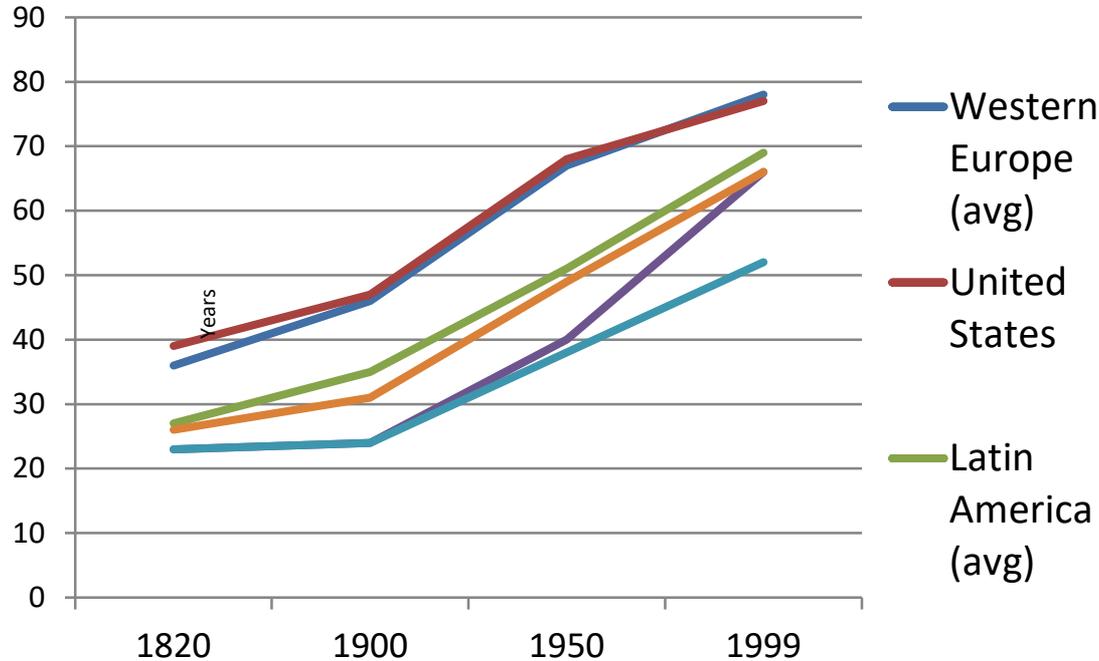
Real wages of London craftsmen, 1200-2000



Figure 3. *Real wages over seven centuries: craftsman (skilled worker) in London (1264-2001).*

Source: INET

Improvements in life expectancy since 1820



Data are estimates from A. Maddison, 2001, "The World Economy: A Millennial Perspective," OECD.

The critical role of the Enlightenment

- Development of science
- Development of basis of social organization not dependent on authority
 - Rule of law
 - Many subtleties in what that means
 - Evident in transition of regimes
 - Based on reasoned discourse/deliberation
 - Couldn't engage in "controlled experiments"
 - Had to employ thought experiments
 - Advancing our understandings of social interactions

Key message of J. E. Stiglitz and Bruce Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress*, 2015.

Key insights of thinking about social organization

- Importance of coordination
 - Stop lights simplest example
 - Massive coordination failures
- Necessity of regulation
 - Pervasive social externalities
 - One person's freedom is another person's unfreedom
 - Especially important in modern, urban, interdependent, complex societies
 - Limitations of markets, where private and social interests are often not aligned
- Necessity of collective action
 - Setting the rules of the game—imposing regulations
 - Many problems where markets won't suffice—public goods, *including the provision of basic research and supporting advances in technology*

Dangers of inequality

- Weakens the economy
 - Large fractions of the population are not able to live up to their potential
 - Waste of human resources
 - Inability to get political support for key public investments
 - Supply side effects
 - Especially when inequality arises out of market power and exploitation
 - Innovation and investment directed at creating barriers to entry and enhancing ability to exploit market power
 - Demand side effects
 - Those at the top spend a smaller fraction of their income than those at the bottom

Key message of J. E. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future*, New York: W.W. Norton, 2012, in Korean by Open Books; and of *The Great Divide: Unequal Societies and What We Can Do About Them*, New York: W.W. Norton, 2015, in Korean by The Open Books Co.

Divides society and undermines democracy

- Economic power gives rise to political power
- Which results in rewriting the rules of the economic and political game to favor the rich
- Moving from a system of one person one vote to one dollar one vote

Making Democracy Work

- Democracy was part of Enlightenment project
- Particular form of social organization—collective action
- Can easily be corrupted by money
- Can be multiple equilibria: “good” equilibrium with high levels of economic and political equality, bad equilibrium marked by political and economic inequality
 - US may be in bad equilibrium

The rise of populism and demagoguery in US perhaps understandable

- Economic and social system had failed large parts of America
- Myths had been undermined
 - American dream: those at the bottom and middle never made it to top, real risk was falling down a ladder the rings of which were increasingly far apart
 - Justice for all: justice for rich White Americans
 - Wrongful convictions, even for murder
 - Mass incarceration
 - No system of justice in disputes with large corporations
 - Private arbitration
 - In crisis, people were thrown out of their homes who did owe any money

- “Stories” told by educated elites—globalization, liberalization would benefit all: things didn’t turn out as expected
 - But elites were excessively confident, closed to open discussion
 - Seemed self-serving: they benefitted from policies
- US and other advanced countries going through multiple transitions/transformations
 - From manufacturing to service sector
 - From export led growth to domestic demand
 - Especially important in new world of protectionism
 - Demographic transition to an aging economy
 - Knowledge economy different from traditional economy
 - “Creating a Learning Society”
 - Increase in knowledge basis of enormous increase in standards of living over past two centuries

Markets on their own don't make such transformations well

- Great Depression can be viewed as part of the failure of the transition from agriculture to manufacturing
 - Easily explained by theory of market failures
- Failures of transition—and failures of promises of elites—has given rise to backlash
- **Now “education” “Enlightenment values” “reasoned discourse” are blamed for the problems**
 - Governance by “emotions,” gut feelings
 - Role of a strong leader
 - Most Republicans think universities are bad!
- Enlightenment has to be relitigated every day
 - Attack on most fundamental values and understandings of Progress
 - Even an attack on whether there is climate change

These demagogues represents an existential threat to our economic and political system—to democracy and progress

- And to the Enlightenment Project which has underlay advances in economy in the past two hundred years and to our economy
- Not even based on good market economics
 - **Rent seeking marked by exploitation of others and of political system**
 - **Markedly different from the real bases of the wealth of nations**
 - Fail to understand difference between the creation of wealth with innovation and learning and the accumulation of wealth through exploitation
 - Worse: attacked our education, science, and other “truth telling” institutions

Key role of truth-telling institutions

- Social organizations can't function without some way of assessing truth of competing claims (necessary for deliberations over “fairness,” resolution of disputes)
- Multiple and complementary truth-telling institutions
 - Universities, research institutes, and other education institutions
 - Media
 - Judiciary
 - “Administrative Bureaucracy”
 - Intelligence agencies
- While science emphasizes the inherent uncertainty with which we know things, there is no alternative reality, no alternative “facts”

The real danger of these demagogues

- Most serious threat is to our “epistemology” and to the rule of law, the premises on which our democracy and our economy rest
 - Has sown doubt about both well established truths and our truth telling institutions
 - If one can sow doubt about whether cigarettes cause cancer and have other adverse effects, if one can sell bad products, one can sell bad ideas
 - Damage may be long lasting
 - We are just beginning to see its corrosive effects

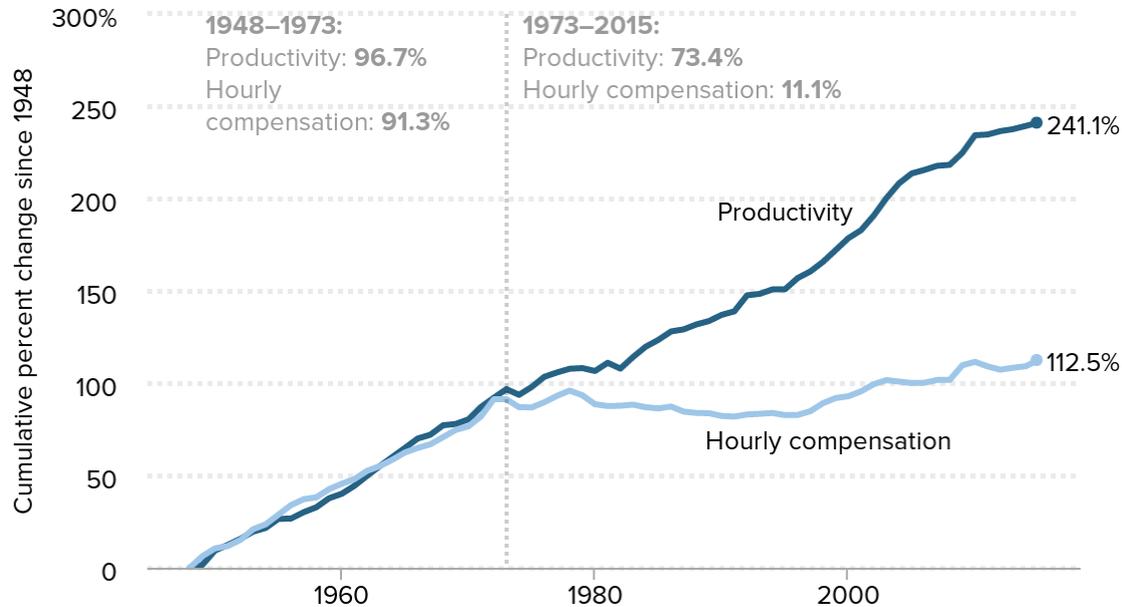
Remedies

- Not inherent in capitalist system?
 - Need to rewrite the rules of the economy
 - Need to rewrite the rules of democracy—take out the influence of money
 - Rethink the balance between “expertise,” independent agencies, and parliamentary processes
 - Reinforcing systems of checks and balances—preventing abuse of power
- Understanding sources of inequality and addressing each
 - Inequalities in market income
 - Greater inequalities in ownership of assets
 - Greater disparities in returns to assets—larger share of capital, higher returns to skilled labor
 - Inequalities in after tax and transfer income

Inequalities in market income (“pre-distribution” rather than “redistribution”)

- Share of rents has gone up markedly, share of workers down
 - While average productivity continued to rise, compensation has stagnated
- Increase in market power of firms, reduced power of workers
- Globalization, labor legislation, changes in structure of economy
- Remedies: strengthening unions and workers’ collective action, higher minimum wages, stronger commitment to full employment, government employment guarantees, changing corporate governance, strengthening competition policy, rewriting rules of globalization
 - Link with progressive taxation: less progressive taxation encourages more rent seeking
 - In a country like US with pervasive racial and ethnic discrimination, stronger anti-discrimination laws, more strongly enforced

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)

Intergenerational transfer of advantage and disadvantage

- Upward mobility increasingly difficult in US
 - Those in bottom likely to remain in bottom
 - Only half will have as much wealth as their parents at same stage of life
- Financial inheritances
- Connections
- Human capital
- With local education system, and increasing economic segregation, children of rich have better education opportunities
- Remedies: better and more equal public education, more progressive inheritance taxation

Redistribution

- Even as inequality has grown in the US and some other countries, efforts to combat it have weakened
 - 2017 tax bill, when fully implemented, will result in higher taxes on majority of middle, to finance lower taxes on billionaires and corporations
 - In a country where life expectancy is on decline, millions more will be without health insurance
 - No evidence that this will have significant effect on investment and wages
 - Vast majority of tax savings went to dividends and share repurchases
 - Consistent with predictions of economic theory: corporate tax rate has little effect on investment in a large economy such as US with interest deductibility
 - Rich pay a lower percentage of their income in taxes than those less well off—a regressive tax system
- Remedies: at a minimum, make the tax system fair; even better, make it progressive
- Key role of progressive expenditure programs (health, education, infrastructure enabling access to jobs, retraining programs, social protection)

Need for a comprehensive government policy to help with transition/transformation to ensure inclusive growth

- Active labor market policies
- Social protection
- Industrial policies
 - Including credit, research, innovation, education, and public investment
 - Place-based policies
- The newly expanding sectors—including health and education and caring for the aged—are sectors in which government naturally plays an important role
 - Wages in those sectors not really market determined
 - They reflect societal values: how much we value the education of our children, the care of our elderly

Major change in our understandings of inequality

- Used to be thought one could only have more equality at the expense of weaker economic performance
- Now realize that equality and performance are complementary
 - Societies with more equality perform better
- Related to our understandings of what gives rise to the wealth of nations and the wealth of individuals
 - Not rent seeking but wealth creation
 - Based on creating a learning society
- Countries like those in Scandinavia that have achieved greater equality have also performed better—especially if one uses the right metrics
 - Greater support for openness and innovation
 - Greater ability to bear risk
 - Better job in ensuring that all individuals live up to their potential

Implications for Korea

- Policies that promote equality, knowledge and innovation (creating a learning society) are most likely to succeed in enabling Korea to leapfrog and to create a shared prosperity
 - Rather than trickle down economics, build the economy up from the middle
 - Rather than relying just on markets, realize the critical role that government needs to play, working in concert with others

- Need to get a better balance in our society
 - Between the market, state, and community
 - Key role of democracy, with its systems of checks and balances
 - Redistribution of wealth: only real check against the abuse of power by the wealthy
 - Between different forms of organization
 - Important role for cooperatives and non profits
 - Between the present and the future
 - Between humans and nature
 - Remembering that the design of our social, political, and economic institutions shapes who we are
- Market fundamentalism/neoliberalism lost the balance

This is the right time for a new human centered economic model—and Korea is the right place

- Because of its highly educated labor force, Korea is in a good place to make a transition to a human centered 21st century knowledge/learning economy
 - While the overall share of college-educated adults is similar in Korea than in USA, Korea's youth are much more likely to be educated: 69% of Korean adults 25-34 years of age have tertiary education, compared to 46% of young Americans
 - Korean students outperform American students on the math PISA tests, averaging 524 vs. 470 (#2 vs. #30 in the OECD)
- South Korea R&D spending accounts for 4.2% of GDP, compared to 2.8% in the US

New models of capitalism and the market economy

- Sad reality is that the American model has failed
 - Though it has some areas of impressive strength (e.g. higher education—where the private for-profit sector plays no important role: all of the major universities are either state or not-for-profit)
 - Evidence of a third of a century
 - Political consequences now evident
 - Should be an important warning for others
- There is a need for a new social contract
- Korea is charting an alternative path
 - Based on strengthening its highly educated middle class
 - Creating an innovative and dynamic economy
 - With every prospect of creating a new shared prosperity