

# A Transition to Sustainable and Shared Prosperity

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# Brief diagnosis of the current situation

- This century has been marked by slow growth
- And what growth that has occurred has gone disproportionately to the top
- In some countries, the bottom 90% has seen incomes effectively stagnate
- In US, even life expectancy is in decline
- Globalization, “reform,” and technological progress has not delivered on what was promised
  - In some ways, just the opposite
- This is having enormous political consequences
  - Upending the global geo-political and geo-economic order established after WWII

# Most of the plight of declining middle has to do with changes in technology

- Gives little comfort to those in the middle who have seen their incomes stagnate to say that only part of their suffering is due to globalization, that most of the decline of the middle class is due to technological change.
- Just as there is little comfort to know that on the other side of the world, many people have never seen it so good.
  - contrast is likely to fuel the view that the gains of those elsewhere have been at their expense.
  - reinforces a zero-sum view of the world, where one country's gain is another's loss

# Critical norm: Change is desirable only if it improves “social welfare”

- Taking into account distribution
  - Objective is not to maximize GDP
- And that individuals value work—*decent* work at decent pay
  - Implying that a system without work, relying *just* on redistribution should not be viewed as acceptable
    - Criticism of Universal Basic Income proposals
- Under this standard, changes/reforms of last quarter century may have been welfare decreasing

# Need to restructure economy

- Economy will be evolving towards service sector economy
- Among key service sectors are education, health, and other public services
- Value of those services is largely socially determined—not “just” a market process
- If we value those services highly—pay good wages, provide good working conditions, and create sufficient number of jobs—that will limit growth in market income inequality
  - Including jobs with limited skill requirements
  - Higher pay will result in such jobs having higher “respect”
  - Private sector wages will follow public sector wages
  - May need also to provide wage subsidy for low wage jobs, to encourage demand for such jobs and increase wages

# Helping economy adjust to new economy

- We are moving from manufacturing to a service sector economy
  - **Markets don't do such transformations well on their own**
    - Great Depression striking example
      - With mobility frictions and rigidities and capital market imperfections, technological change can be welfare decreasing
      - Government macro- and industrial policies (partly part of war effort) is what enabled transition to occur
    - **Trying to recapture manufacturing is largely a will-of-the-wisp**
      - Global employment in manufacturing in decline
      - Share of advanced countries will be declining
      - Even if *production* returns, jobs will not: it will be capital intensive manufacturing
      - But there still may be niches from which country can benefit
  - Enormous benefits from **creating a learning economy and society** (*Creating a Learning Society: A New Approach to Growth, Development, and Social Progress*, Columbia University Press, May 2014. Reader's Edition published June 2014.)
  - Education and retraining program—can work *if there are jobs*
  - Shift government expenditure towards the sectors that one thinks of as those of the future

# What is needed for Japan: a new industrial policy for the twenty-first century

- Key problem is lack of productivity growth—growth in output per hour worked, particularly in service sector
  - This is what matters for standards of living
  - Improving productivity in agriculture will only have marginal benefits
- **Industrial policies worked in the past**—responsible for Japan’s strong growth in earlier era
- **Can be made to work again**—adapted to 21<sup>st</sup> century
  - Again based on industry-government cooperation
  - This time with greater involvement of academia and research institutes—a knowledge-based industrial policy
  - Taking advantage of Japan’s dynamic comparative advantages, e.g. engineering skills
    - Example: Using technological capabilities to develop diagnostic instruments for healthcare for the aged
- **Industrial policy needs to focus on other central issues of 21<sup>st</sup> century**
  - Global warming
  - Aging population
- If technological change works as it should, as wages get low, focus is on capital and resource-augmenting technical change
  - Limiting decline in share of labor (in stable equilibrium) and in inequality
  - But **government plays central role in shaping the national innovation system and the direction of technological change**

## Other elements of a successful policy response to today's dilemmas

1. Improving equality—ensuring benefits of growth are more equitably shared
2. Maintaining economy at near or full employment
  - End in its own—necessary for economic efficiency
  - Will also help ensure equality
3. Creating revenue streams necessary to support these and other efforts
  - Globalization has increased demands on governments
  - But sometimes circumscribed ability to raise revenue—facilitating tax avoidance and evasion



# 1. Improving equality

- A. Improving the distribution of market income
- B. Improving the distribution of after tax and transfer income
- C. Providing social insurance

# A. Improving the distribution of market incomes

- Rewriting the rules
- In all economies, **rules of the game** are critical and especially so in an innovation economy
  - Similar economies exhibit markedly different patterns of distribution of market and after-tax and transfer income—**inequality is a matter of choice**
  - **Innovation gives rise to rents—both** from IPR and monopoly power
  - **Who receives those rents is a matter of policy**
  - Curbing market power, abuses of corporate governance, making financial sector perform functions it's suppose to perform
  - Strengthening unions/workers bargaining rights
  - Helping women participate in labor force—especially important for Japan
  - Making sure that financial markets provide finance to SMEs—to give more opportunity

# Improving the distribution of market incomes

- Other policies to increase wages
  - Running the economy more tightly—with less unemployment
  - Increasing minimum wage
  - High wages in public sector—to help drive up wages in economy more generally
    - Other policies to encourage attractiveness of such jobs and increase respect for them
- Reducing the intergenerational transmission of advantage and disadvantage
  - Public education—including pre-school and universal access to colleges
  - Estate taxes

## B. Improving equality of after tax distribution of income

- Progressive taxation
  - Actually make corporations and individuals pay taxes that they owe
  - Global minimum corporate income tax
  - Formulaic approach to corporate income tax—ending abuses of transfer price system
  - Carrying out other parts of successful government program will require more revenues
  - Earned income tax credit
- Monetary policies need to be oriented towards increasing the flow of credit, especially to SMEs, preventing abuses of financial sector, and preventing instability (costs borne disproportionately by poor)
  - Most of new regulation aimed at preventing financial sector from doing what it shouldn't
  - More attention on getting the financial sector to do what it should

## C. Social insurance

- **Protection without protectionism** (*The Quest for Security: Protection without Protectionism and the Challenge of Global Governance*, Joseph E. Stiglitz and Mary Kaldor, eds., New York: Columbia University Press, 2013.)
  - **Market provides inadequate insurance for many risks—that's why we have social insurance**
  - Provide greater protection both for workers and **communities** that are adversely affected by globalization and technological change, perhaps through some form of insurance against shocks.

## 2. Better macro-economic performance

- Global problem of lack of aggregate demand
- Caused in part by growth in inequality—those at the top consume smaller fraction of income than those down below
  - Problems associated with structural transformation
- Greater sense of insecurity
  - To which problems in globalization and cutbacks in social insurance have contributed
- Monetary policy has largely reached its limits
  - Japan's monetary policy has been well-designed, but not much more it can do to stimulate economy
    - Lower interest rates (negative interest rates) will not have any significant effect

# 3. Resolving Debt-tax dilemma

- Many worry about excessive Japanese debt
  - If there were a large increase in interest rates, government might face a problem
  - But raising VAT or Consumption Taxes to reduce deficit will be counterproductive
- Three steps forward
  - Carbon tax—raises revenue, improves the environment, and stimulates economy *all at the same time*
    - Higher carbon price will induce firms to make investments to retrofit the economy
    - Increasing support even in US
  - Cancelling government debt owned by government (BOJ)
    - Overnight reduction in gross government debt—allaying some anxieties
  - Restructuring debt towards perpetuities and long-dated paper
    - Shifts risk of interest rate increases away from government
    - Government would pay little for this restructuring
    - Issuing perpetuities low cost way of raising additional revenues to provide necessary government expenditures and to stimulate the economy

# General observations about increasing taxation

- Tax revenues are necessary if the major challenges we've identified are to be addressed
  - Restructuring the economy
  - Reducing inequality
- Evidence is that economy may actually perform better with more progressive tax system
  - Economies with less inequality have better overall performance (IMF)
  - Many reasons (set forth in *Price of Inequality*), but including
  - Reduces incentives for rent-seeking
  - Likely little effect on entrepreneurial activity—and tax reforms can reduce impacts further
    - Greater focus on taxing rents—taxing capital gains on land won't effect land supply; will encourage more innovative activity
    - Pollution tax will encourage entrepreneurial activity to reduce pollution
- Globally, more needs to be done to curb fiscal paradises and tax competition
  - Will need to move away from multinational enterprise tax systems based on transfer pricing



# Some observations about globalization

- Evidence is that growth benefits have been exaggerated and distributive consequences underestimated
  - Evidence in US that surge of imports is associated with lower wages and more unemployment
  - Standard models ignored labor market imperfections, unemployment (job destruction often occurs faster than job creation, especially with dysfunctional, short-sighted financial markets), risk, imperfections of competition, and issues of dynamic comparative advantage
  - Standard competitive theory predicted large distributive effects
  - But in addition, there have been significant adverse effects from weakening workers' bargaining power
  - Even US government estimates of TPP were that growth benefits were negligible
    - Independent estimates even smaller, job impacts worrisome, welfare effects (access to generic medicines, adverse regulatory effects) negative

# The new world order without the US

- The US has stepped back from the global order which it helped create
  - Do not expect any quick reversal
- Good news: global institutions are likely strong enough to carry on on their own
- Good news for Japan: Administration focusing attention on Mexico and China
- The world needs Japan's leadership—this could be a time of opportunity
  - Japan is democracy with second largest economy
  - There may be scope for better trade agreements without the US, where special interests dominated at USTR
  - Can advance trade agreements with environmental, and labor and human rights standards
  - Without undemocratic investment agreements and drug provisions increasing drug prices and reducing access to generics

# Concluding remarks: Key messages

Economies in advanced countries (including Japan) have not been doing well

- Low rates of productivity growth—necessary for increases in standards of living
- What growth there has been has gone to relatively few
- Technological progress, reforms, and globalization have not brought benefits hoped for
- There will be serious political consequences to not addressing these issues

# For the advanced countries in general, there are alternative policies

- Which are more likely to ensure sustainable shared prosperity—faster growth from which all will benefit
- These will include an important role of government
  - Policies which will increase equality of market income
    - Rewriting the rules of the market economy
  - More active role in redistribution
  - Policies to help the economy restructure to a modern service sector economy
    - Including paying a higher wage to provide services the value of which is *socially determined*—education, health, care of the aged
  - And creating a learning society, promoting innovation
    - Ensuring that innovation is more directed at key social needs

# This is a time of opportunity and challenge for Japan

- Most of these policies can be adapted to the circumstances of Japan
- Japan has many advantages
  - Long experience in industrial policy, lower levels of unemployment, inequality
- But it also faces especial challenges with declining workforce, and an increase in inequality among the aged
- Monetary policy has reached its limit and Japan needs to have a carbon tax to raise requisite revenue without adverse effects on growth
- Most important are the structural policies—including those necessary to recreate Japan's leadership in innovation
- As the world's second largest democracy, the world will especially need Japan's leadership in the coming years