

Bridging the development gap and addressing increasing inequality

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An essential part of the move to high-quality growth

- **Growth in GDP does not necessarily lead to increases in incomes of most citizens**
 - Trickle-down economics never worked
 - And it has been especially not working in recent decades
 - There are, in any economy, strong centrifugal forces increasing societal divides
 - These have to be complemented with centripetal forces—largely public—bringing it back together
- **Increases in income and GDP do not necessarily translate into increases in standards of living**
 - The “Beyond GDP” agenda that is central to high quality growth

China's success

- China has done a great job in moving people out of poverty
 - But there is increasing inequality
 - With many dimensions, including urban/rural divide
 - Access to health, education
- **There is increasing evidence of adverse effects of inequality**
 - Not just the politics of envy
 - Worries that attacking inequality would reduce growth are misplaced
- Adverse effects on economics and politics
- Adverse effects on the nature of society
- Key questions: What are the dimensions of inequality that need to be addressed? What are the tools, and can it be done in ways that do not hurt overall growth and employment?

Some key ingredients of an inclusive growth agenda

- Education
 - Major determinant of equality of opportunity and long-run productivity
 - Must ensure that everyone lives up to their full potential
 - Not doing so is a waste of a country's most important resource
 - Beginning with pre-school—importance of work of Heckman and China Development Foundation
 - Access to high-quality tertiary education for all
 - Quality of all educational institutions
 - Best high school's in Shanghai score at top of PISA tests
 - Gap between best and rest
 - Hukou system may still impose major impediment

Some key ingredients of an inclusive growth agenda

- Health
 - Has to be provided largely publicly—America’s largely private system delivers worse health outcomes at higher costs than Europe’s
 - Important for ensuring productivity—America’s failures in health part of explanation for low labor-force participation
 - Many dimensions to health—including nutrition and social habits (smoking, alcohol)
- Environment
 - Poor environment (quality of air) exerts greatest toll on poor
 - Pre-natal exposure to environmental hazards (including poor air quality) can have adverse lifelong effects

Some key ingredients of an inclusive growth agenda

- Good environment related to broader agenda of creating livable cities
 - Most Chinese now living in cities (in excess of 51%)
 - Marked change from 1949, when it was just 10%
 - Requires good zoning, public transportation, parks, housing
 - Regulations can have major effect on carbon emissions
- Ensuring access to basic perquisites of a decent life
 - Won't be ensured even by a modicum of equality of income
 - Includes health, education
 - But also housing, retirement, opportunities for work and achieving a work/life balance

Some key ingredients of an inclusive growth agenda

- Decent work for all (ILO agenda, including new report on Work)
 - Access to jobs with public transportation
 - Opportunities for mobility—eliminating Hukou system
 - More time flexibility in labor market
 - Important for bringing in more women and elderly into labor force
 - Which will be of increasing importance with slower growth in population
 - Also critical for achieving better work/life balance

Equalities across all segments of society

- Gender equality—China has some notable successes (female labor force participation), but still relatively few women at top
 - Especially in comparison to best-performing societies
- Between rural and urban, between different regions of China
- Ethnic equality
- Cross-generation equities
 - A problem in all countries, with rising real estate prices, climate change
 - Even more in countries where students are forced to go into debt to finance their education
 - Asset side (investments, including the preservation of natural capital) more important than liability side
 - In many countries there has been excessive preoccupation with debt

Key instruments

- **Achieving greater equality in many of the dimensions would actually lead to stronger economic growth**
 - Part of broader consensus that growth and equality are complements
 - Opportunity agenda and growth agenda are complementary
- Opportunities for small businesses
 - Important part of opportunity agenda
 - Requires curbing **monopoly/market power**
 - Requires access to **finance**
 - More likely to be done by smaller local and regional banks

Tax policies

- Important instrument for shaping economy
 - While simultaneously raising revenues for inclusive public expenditures
 - Important that taxation be progressive (not regressive, as in the US)
- Environmental taxes
 - Especially carbon taxes and others that affect air pollutants
- Land (property) taxes and capital gains taxes
 - To curb unproductive speculative gains, to encourage productive “real” investments
 - Major source of inequality
 - Reduce economic volatility, major source of inequality
- Inheritance taxes—to prevent the creation of inherited oligarchy
- May need to strengthen controls on capital movements out of the country to avoid tax avoidance/evasion

Social Protection

- Market failures—absence of insurance to cover major risks
 - Huge loss of welfare
 - Lack of security cited as major problem
 - Problems in insurance risks: Unemployment, annuities, disability, insurance against inflation
 - Explained in part by theories of asymmetric information
- Good systems, with active labor market policies and industrial policies (including place-based policies) can both enhance well-being and national productivity—facilitating transitions
 - And can do so without undermining individual responsibility
- An integrated national social insurance system (Singapore's provident fund) can mitigate risk and minimize attenuation of incentives and facilitate creation of national labor market, increasing overall productivity

Regulation

- Profits can be increased not just by increasing the wealth of a nation but by exploiting others
 - Akerlof and Shiller: “Phishing for Phools”
 - Too much of market activity directed at exploitation—predatory lending, market manipulation
 - Under-regulated financial market has a tendency towards instability
- Well-regulated market can be both more efficient, more stable, and more inclusive

Full Employment

- Most important social policy
 - Unemployment represents waste of resources
 - But also leads to adverse social consequences
 - Market economies do not automatically lead to full employment
 - And excessive focus on inflation can lead to higher unemployment than necessary

Broader perspective

- Government has a role in promoting equality of market incomes
 - Basic rules of the game
 - Ensuring equal endowments of human capital
 - Preventing excessive transmission of wealth and advantages across generations
- Government has an even bigger role in promoting equality of after-tax and transfer incomes
 - Consistent with maintaining high levels of incentives—and increasing overall growth and well-being
 - Reflecting pervasive market failures—and recognizing markets create problems of inequality, environmental degradation, market power, and exploitation
 - Reflecting even modicum of equality of income may not ensure most citizens have access to perquisites of a modicum of a decent life

Concluding remarks/summary

- In four decades of reform, inequality has grown to a level comparable to the US, the country in the advanced world that has the highest level of inequality
 - Though natural to have higher inequality at lower stages of development
- New view: inequality is bad for economic performance (both growth and stability)
 - So poor “quality” will interfere with quantity in long run
- Addressing inequality requires comprehensive program, based on understanding sources of inequality
 - Corruption, rent-seeking part of the story, but only part
 - Equalitarian expenditure policies: health, education
 - Inclusive tax policies
 - Good regulations—including environment, preventing exploitation
 - Systems of social protection

Concluding remarks/summary

- Have to also address special problems of disadvantaged and their children, including migrants and those living in disadvantaged places
- Also have to address problems of inequality at the top
 - Dangers of unbridled financial sector, real estate
- Government will have to play a central role in this agenda

Much is at stake

- China's decisions will affect not only the performance of the economy
 - Well designed social programs can even increase productivity
 - Making sure that all of the country's talents are given the opportunity to reach their potential
 - Correcting, or mitigating, market failures
 - And with a well-designed safety net, individuals may be freer to take risks than they would otherwise, encouraging innovation (the Scandinavian model)
- But the nature of Chinese society itself