Capitalism, Inequality & Globalization

Public University of Navarre
Pamplona, Spain
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J. E. Stiglitz
In many ways, most advanced economies not been performing well

US worst example, most European countries showing similar patterns, a few “resisting” trend

• While income at the top has been rising, the average income of the bottom 90% has been stagnating
  • It hasn’t always been this way

• Men, and those with less education, have had a particularly hard time

• Those at the top have done very well

• Those at the very top have done especially well

• Inequality has been increasing dramatically in the US since 1980
US: bottom 90% have seen little increase in income over last third of a century

Source: World Wealth and Income Database
Spain

Average income

Constant 2016 PPP Euros

Source: World Wealth and Income Database
Europe: less increase in inequality in some countries than in others

Source: World Wealth and Income Database
Top 1% income share in the United States 1913-2015

Note: Fiscal income is defined as the sum of all income items reported on income tax returns, before any deduction. It includes labour income, capital income and mixed income. The concept of fiscal income varies with national tax legislations, so in order to make international comparisons it is preferable to use the concept of national income. The population is comprised of individuals over age 20. The base unit is the individual (rather than the household) but resources are split equally within couples.

Source: World Wealth and Income Database.
Global Inequality:
Top 1% income share, 1975-2015

Source: World Wealth and Income Database
Inequality even at the top 0.1%

CEO compensation has grown faster than the wages of the top 0.1 percent and the stock market
Cumulative percentage change in CEO compensation, wages of the top 0.1 percent, and the S&P 500, 1978–2015

Notes: Wage data for the top 0.1 percent is not yet available for 2015.
Source: EPI analysis of Compustat Execucomp, Social Security Administration, and Federal Reserve Bank of St. Louis databases.

Economic Policy Institute
US: Median income of a full time male worker is at the level that it was more than 4 decades ago

(constant 2016 $)

Note: Data is adjusted for the methodological change of 2013.
Source: U.S. Census Bureau.
Median household income in Europe

Source: Eurostat
US: Real wages at the bottom are at the level that they were roughly sixty years ago

Source: Federal Reserve
Wages at the bottom globally

Annual real minimum wages

Source: OECD
Some global perspectives

• US has more inequality than any other advanced country

• Not all countries have been experiencing an increase in inequality—some have had a decrease

• Globally, wealth inequality is worse than income inequality
Source: OECD Income Distribution Database.
Global inequality: Ginis worse in many countries, late 2000s vs. 1980s

<table>
<thead>
<tr>
<th></th>
<th>1985-90</th>
<th>After 2008</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Gini</td>
<td>36.3</td>
<td>38.8</td>
<td>+2.5</td>
</tr>
<tr>
<td>Pop-weighted Gini</td>
<td>33.9</td>
<td>37.3</td>
<td>+3.4</td>
</tr>
<tr>
<td>GDP-weighted Gini</td>
<td>32.2</td>
<td>36.4</td>
<td>+4.2</td>
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<tr>
<td>Countries with higher Ginis</td>
<td>32.0</td>
<td>36.2</td>
<td>+4.5</td>
</tr>
<tr>
<td>Countries with lower Ginis</td>
<td>42.8</td>
<td>39.5</td>
<td>-3.3</td>
</tr>
</tbody>
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Global Income Growth by Percentile

The elephant curve of global inequality and growth, 1980–2016

- Bottom 50% captured 12% of total growth
- Top 1% captured 27% of total growth
- Prosperity of the global 1%
- Rise of emerging countries
- Squeezed bottom 90% in the US & Western Europe

Global Inequality in wealth

- Oxfam reports on wealth concentration at the top: how many of the richest people have as much wealth as bottom 50% (3.8 billion people!)
  - In 2010: 388
  - In 2017: just 42
- 82% of all growth in global wealth in 2016 went to the top 1%, while the bottom half saw no increase at all.
- The richest 1% continue to own more wealth than the whole rest of humanity.
- Big winners during last quarter century: global 1% and global middle class (middle class in China and India)
- Big losers during last quarter century (not sharing in gains): those at the bottom and the middle class in advanced countries
Inequality in Wealth: Share of Wealth by Top 1%, 1920-2015

Source: World Wealth and Income Database
Spain’s richest 10% hold more than half the country’s wealth

In 2014, the top 10% of Spain’s wealthiest households held 52.8% of the country’s wealth, discounting the national debt. The number in Spain is comparable to France and the UK.

Source: Bank of Spain Survey of Household Finances, El País.
Many other dimensions of inequality

• Health
• Opportunity
The Walton Family and The Koch Brothers have a net worth of $212 billion in 2016.
That’s the net worth of 115 million Americans or 35% of the country.
Figure 1.1 All-cause mortality by race and ethnicity, ages 50-54

Figure 1.9 All-cause mortality, white non-Hispanics, ages 45-54

Figure 1.5 Drug, alcohol and suicide mortality, men and women ages 50-54

Income inequality and earnings mobility

Intergenerational Elasticity
Correlation between a child’s income and his parents’ income

FIGURE 3
Intergenerational Mobility (Parent-Rank and Child-Rank Income Correlation)

Notes: This figure maps CZ coefficients from OLS regressions of adult children’s income rank on their parents’ income rank, with rank defined by income centiles within each CZ. Darker areas represent lower intergenerational mobility. See Section 2.2 for details on the construction of local IGE measures.

II. The macro-picture

- Share of labor down (particularly if one excludes top 1% of labor)
  - Disconnect between growth of productivity and compensation
- Share of capital is down
- Share of investment down while rate of profit is up
  - Share of corporate profits varied between 3.9% to 4.1% from 1986 to 1993, now hovers around numbers that are more than 50% higher—6.4% to 7.0%
- Wealth-income ratio up while capital income ratio down
- Difference is growth in rents
LAWOR SHARE

Source: Giovannoni (2014) based on NIPA and WTID data
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)

Economic Policy Institute
Europe: Disconnect in Productivity and Compensation

![Graphs showing productivity and compensation trends in Germany, France, Spain, and the United Kingdom.](image-url)
The capital share of gross value added is declining

The figure shows the capital share of gross value added for the U.S. non-financial corporate sector over the period 1984–2014. Capital payments are the product of the required rate of return on capital and the value of the capital stock. The capital share is the ratio of capital payments to gross value added. The required rate of return on capital is calculated as $R = (i - \frac{\mu}{\sigma} + \delta)$. Capital includes both physical capital and intangible capital. The cost of borrowing is set to Moody’s Aaa and expected inflation is calculated as a three-year moving average.

Source: Simcha Barkai, University of Chicago
Growing profits and low business investment

Graph from: Concentration trends in Europe, Tommaso Valletti, Chief Competition Economist, European Commission, 2017
Growing profits and low business investment

US Business Investment (% GDP)

Source: Federal Reserve Bank of St. Louis
Growing profits and low business investment

Source: Eurostat
Simulated national wealth-income ratios in the absence of capital gains: U.S. 1970-2010

Authors’ computations based on 1970 wealth-income ratios, 1970-2010 national saving flows (including other volume changes) and real income growth rates.

Explanation: growth of rents (capital gains: capitalized value of increased rents)

- Source of rent flows
  - Land rents
  - Knowledge rents
  - Monopoly rents/monopsony rents
    - High prices (mark-ups), low wages help explain increase in inequality
    - Weakening of bargaining power of workers
      - Globalization
      - Changing in labor laws
      - Weakening of unions
  - Appropriation of public resources
  - Other forms of exploitation
  - Quasi-rents: short term rents earned on assets while supply increases; arises from costly adjustment of stocks
Rents and well-being

- Some forms of rent seeking redistribute rents among rentier
  - Corporate governance rents
    - Could even show up as a decrease in corporate market value
- Not all rents are included in R
  - Only those reflected in capital assets that can be bought and sold
  - Labor rents are not included
- Transfers of wealth from ordinary citizens to “capitalists” shows up in an increase in R, but social welfare likely reduced
  - Exploitation of public sector (bank stocks)
  - Increased ability to extract consumer surplus (through Big data)
  - Social welfare reduced through inefficiencies
  - Social welfare reduced through transfers from ordinary citizens to well-off
Multiple pieces of evidence on the increase in monopoly power

- Increased concentration in many sector
- High rates of return
- High mark-ups

Consistent with evidence on high rates of return with low levels of investment
Increase in rents part of cause of economic weakness

- Monopoly power lowers real incomes of wage earners, decreasing aggregate demand (in the absence of countervailing measures, e.g. by Fed)
- Monopoly power distorts the economy
- Monopoly power discourages investment—marginal returns lower than average returns
- Monopoly power creates barriers to entry, leading to a less dynamic economy
- Rent-capital (capitalized value of rents) crowds out real investment, helping to explain the decrease in capital-income ratio
- Curbing monopoly power would lead to a more efficient, more dynamic economy, with less inequality
  - Part of new perspective on inequality: inequality harms overall economic performance
General Comments on Alternative theories of inequality

• Some of inequality is a result of changes in competitive forces
  • Skilled biased technological change
  • Globalization
    • Predicted that it would lower real wages of unskilled workers

• But this cannot explain much of what has been going on
  • Stagnation of average wages and even skilled wages in last fifteen years
  • Technology and globalization are global—but the extent of inequality is uniquely American

• Piketty’s theory focused on higher savings rates of “capitalists”
  • Part of story, but can’t explain macro-economics
    • He assumed rate of return would not decrease even as capital labor ratio increased
Inequality is partly the result of policies

• Different countries have different policies—and systematic relationship between policies and inequality

• Markets don’t exist in a vacuum: they have to be structured, through our legal system and how laws are enforced
  • Competition laws, corporate governance laws, bankruptcy laws, labor laws, etc

• We’ve structured them in ways that lead to greater inequality—and restructured them extensively since 1980
  • Rewritten the rules of the economy, in ways, for which that
  • Weaken bargaining power of workers
  • Globalization, especially investment agreements, which give American firms investing abroad more property rights than they have at home have further weakened workers’ bargaining power
There are many ways which we can circumscribe market power

- Better enforcement
- Assumption that markets are “naturally” competitive has led to wrong anti-trust standards
  - Presumption against predatory pricing
- European standard of “abuse of market power” preferable to American standard—but more needs to be done
  - Would have stopped huge increases in drug prices
- Laws haven’t kept up with changing technology (market power of internet firms) and new problems
Concluding comments

• Twenty-first century capitalism is different
  • Capital doesn’t play role that it once did
  • Market power, exploitation, rents are now more central
• Many of the old presumptions no longer hold
  • Market is not efficient
  • Trickle down economics doesn’t work (if it ever did)
• The way the economy has been working has benefited relatively few
• One can have more equality and more economic growth