

Income Inequality and Social, Economic, and Political Instability

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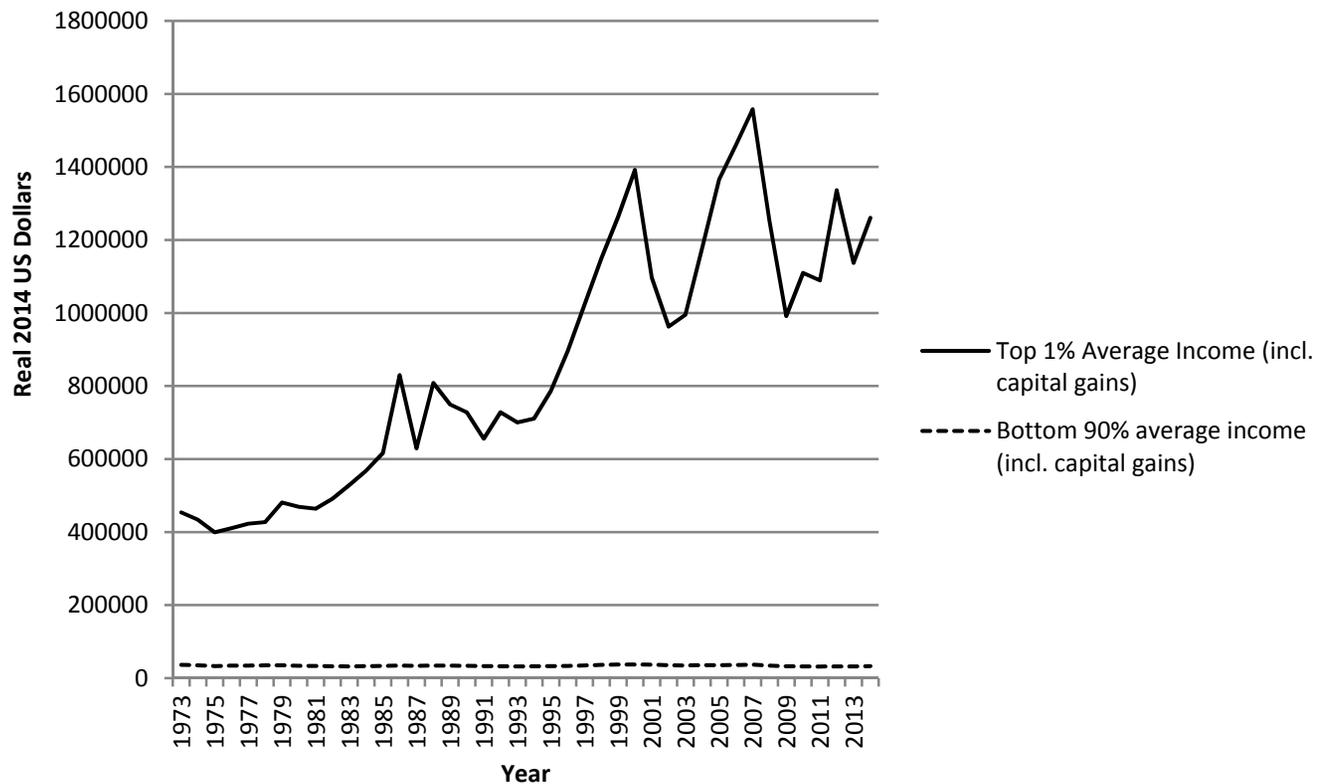
Dubai: World Government Summit

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Growing inequality

- In most countries around the world
 - Even though convergence of many middle income countries (China and India) towards advanced countries means that global inequality has been relative unchanged
- Middle classes in Europe and America having especially hard time
- While those at the top have been doing very well

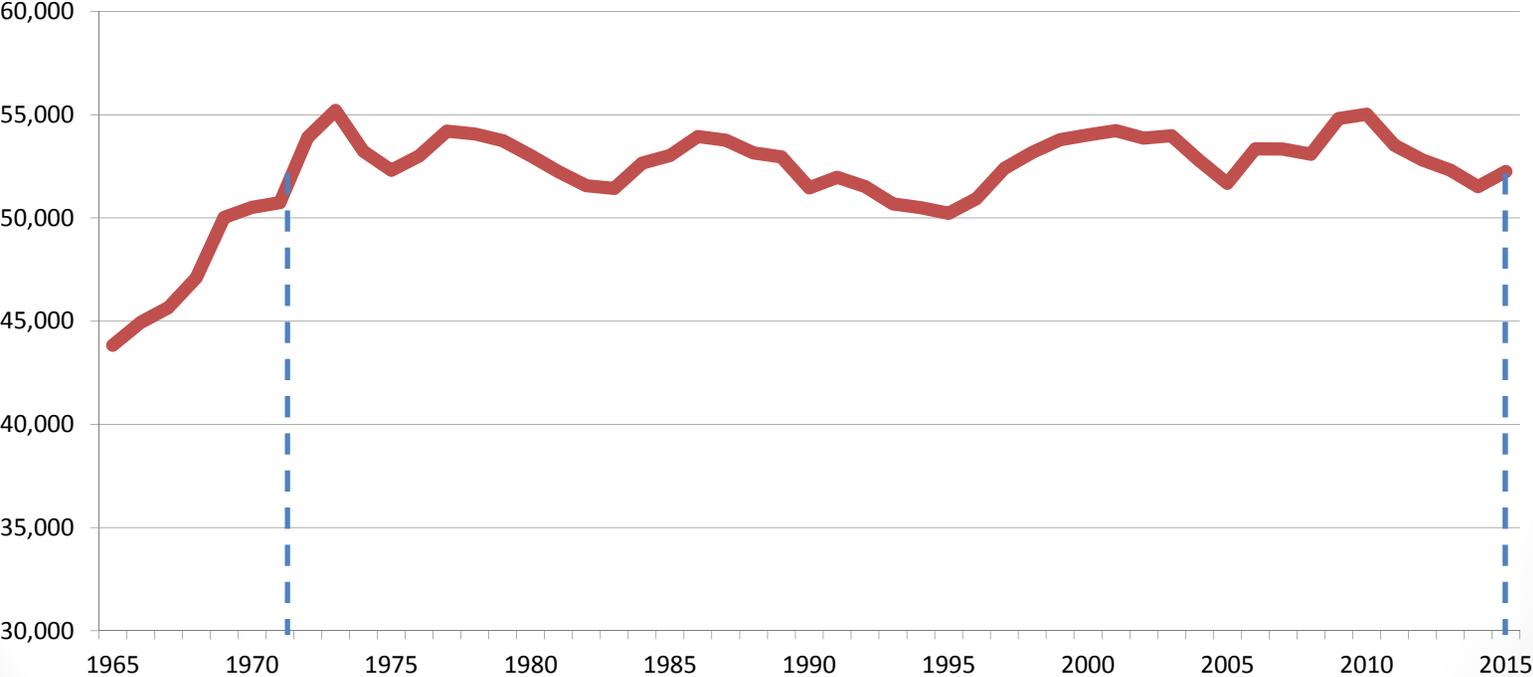
US: bottom 90% have seen little increase in income over last third of a century



Source: The World Wealth and Income Database (latest data available at <http://www.wid.world/>).

Median income of a full time male worker at the level that it was more than 4 decades ago

(constant 2015 \$)

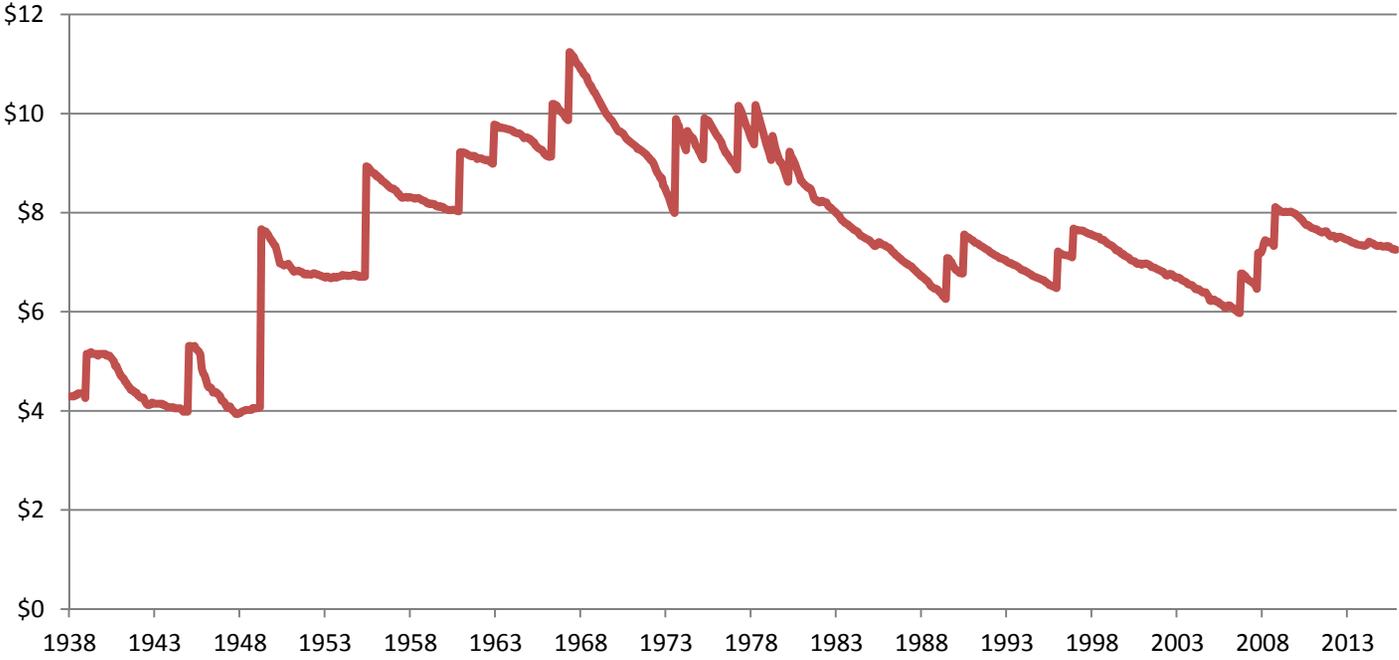


Source: U.S. Census Bureau

Note: Data is adjusted for the methodological change of 2013.

Real wages at the bottom are at the level that they were roughly sixty years ago

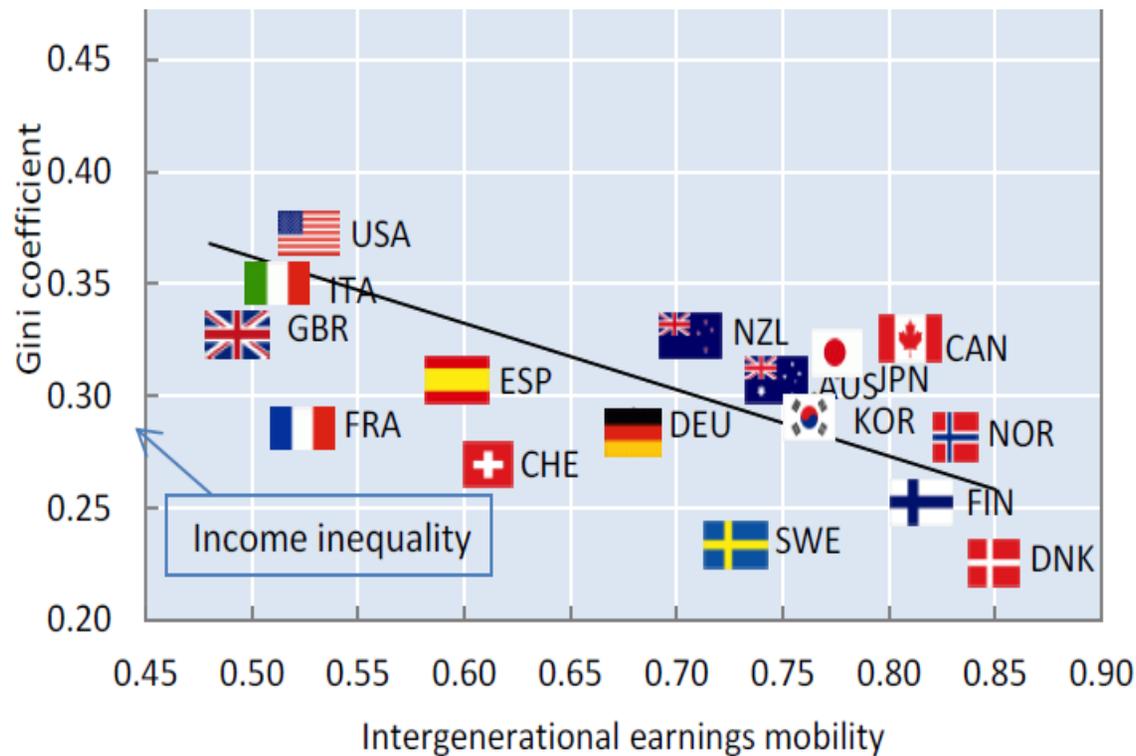
US Minimum wage in 2016 Dollars



Source: Federal Reserve. <https://www.quandl.com/data/FRED?keyword=>

Levels of opportunity correlated with income

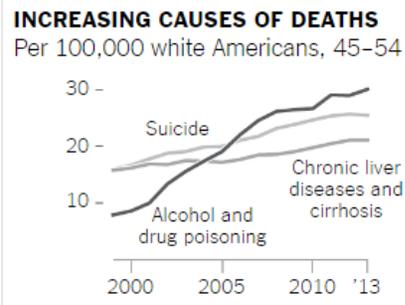
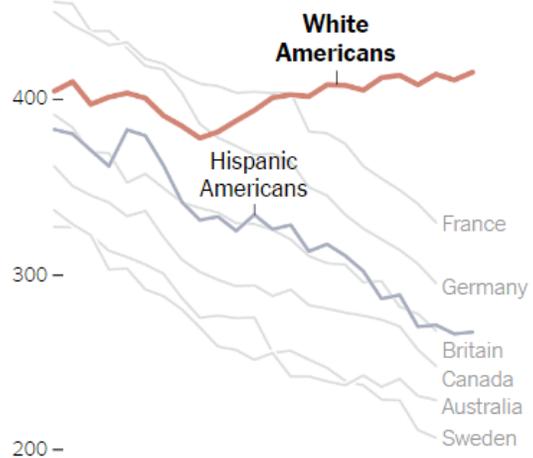
Income inequality and intergenerational earnings mobility, mid-2000s



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

Even health and life expectancy is in decline

DEATHS per 100,000 people aged 45–54



1990 1995 2000 2005 2010 '13

Sources: Anne Case and Angus Deaton; PNAS

By The New York Times

- Especially surprising data on white males
- Reflecting social diseases—alcoholism, drugs, suicide

Globally, matters are even worse

Oxfam reports on wealth concentration at the top: how many of the richest people have as much wealth as bottom 50% (bottom 3.6 billion!)

- In 2014: 85
- In 2017: just 8 *men*

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

Over last decade growing recognition of economic consequences

- Lower growth and more instability
- Multiple reasons
 - Lack of aggregate demand as money shifts towards top
 - Large fractions of population not able to live up to their potential—underinvestment in human capital for those below the top
- This has become a mainstream view
 - Explains increasing focus of IMF on inequality

Social consequences

Increasingly divided and polarized society

- With different groups having less interaction
- Lower interaction leading to less trust, less sense of social solidarity
- Lower interaction even leads to different perceptions of the world
- Those at the top have begun to feel entitled

Political consequences may be even more serious

- Whatever the nature of political system, those who are well off have disproportionate political influence
 - In America's political system, matters are worse because of the direct influence of money in political campaigns
- This leads to a vicious circle—
 - Economic inequality leading to political inequality
 - Political inequality leads to economic rules of the game that amplify economic inequality
 - And to political rules of the game that amplify the political power of elites
- Basis of “progressive movement” a century ago which embraced (in US) both democrats and Republicans (like Teddy Roosevelt)

Political consequences may be even more serious

Among the important rules of the *economic* game are those restricting monopoly power (leading to increased rent-seeking), ensuring labor rights, structuring corporate governance (determining limits on the power of corporate executives), and governing globalization

- Whether the country as a whole benefits depends on how globalization is managed
 - Pace of job creation vs. job destruction
- Even when the country as a whole benefits, there will be winners *and* losers
 - Even if the winners *could* compensate the losers, they often don't
 - In the US they didn't—as a result there were *many* losers
- But technological change—not globalization—is a major cause of the decline in the middle class in advanced countries
 - So protectionism won't restore the middle class

Limits of markets long been recognized

Even by Adam Smith—father of modern economics

- *People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices*
- *Masters are always and everywhere in a sort of tacit, but constant and uniform, combination, not to raise the wages of labour above their actual rate [...] Masters, too, sometimes enter into particular combinations to sink the wages of labour even below this rate. These are always conducted with the utmost silence and secrecy*

Adam Smith recognized importance of rules of the game

- when workers combine, *“the masters [...] never cease to call aloud for the assistance of the civil magistrate, and the rigorous execution of those laws which have been enacted with so much severity against the combination of servants, labourers, and journeymen.”*
- *When the regulation, therefore, is in support of the workman, it is always just and equitable; but it is sometimes otherwise when in favour of the masters*

Economic Consequences

- Often rules of the game that don't work even for those at the top
- In US, rewriting the rules of the game over the last third of a century have led to an economy which not only is more unequal, but in which there is slower growth
 - Those at the top often don't use public services
 - Part of their separation from the rest of society
 - Helps explain their lack of concern for good governance and adequate public investments (in technology, infrastructure, education)
 - In US, has also led to rules which have induced excessive financialization and short termism
 - Firms also are underinvesting in technology, capital, and their workers

Political and social consequences

Growing disillusionment on the part of most citizens with the “system”

- Belief it is unfair, rigged, unjust
 - This is true even if there is no outright corruption
 - More subtle form of corruption marking US system, with *seemingly* good governance
 - Huge transfers to corporations (trillion dollar gift to pharmaceutical industry)
 - Regressive taxation—loopholes for the rich and tax avoidance devices (“fiscal paradises”) not available to ordinary citizens
- Belief that government cannot be trusted
- Undermining any sense of solidarity

Adam Smith: *No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable.*

Political and social consequences

- Without a modicum of trust, social solidarity and a sense of fairness, it is impossible for society (including government) to function
 - Even our tax system relies to a large extent on voluntary compliance
- One of reasons that one of SDGs (Social Development Goals) adopted by the United Nations includes a reduction in inequality/shared prosperity

Disillusionment opens way for populist alternatives, and social and political instability

- Seen so clearly in US
 - Where basic principles of knowledge and science are even being questioned
 - Especially peculiar since America's success is based on innovation and science
 - A society in which the rules of the game for ascertaining truth cannot function—or at least function well
- Opens up way to authoritarianism

Concluding remarks

- Over past third of a century, around the world, in most countries, there have been marked increases in inequality
 - Increases that cannot be “justified” in terms of conventional economics (e.g. “just deserts,” “social contribution”)
- Though this happened gradually, it has increased to a point where underlying political and social fiber of our society is being put at risk
- Only with a broad societal consensus that something should and must be done can this inequality be effectively attacked
 - It is even in the “enlightened” self-interest of those at the top that this should be done
- Shared prosperity is the only sustainable kind of prosperity.