Globalization and Inequality: Coping with the Consequences

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There has been growing inequality within most countries of the world

• Is this growth a result of forces of nature—the basic laws of economics?

• Or is it result of “the laws of man”—what we ourselves are doing?

• Is it the result of the basic workings of the market?
  • An inevitable, if unpleasant, side effect?

• Or is it the result of how we have structured markets, of how we have changed the rules of the game in our market economy, in some cases undermining the market economy
Explaining the growing inequality

• Is it because we have not done enough to *counter* the forces of nature?

• Is it because, rather than trying to stand against the tide, we have reinforced the effects of nature, of the laws of economics?
The central theses of this lecture

• The growing inequality is largely the result of the “laws of man”

• It is a result of how we have structured the market economy—of how we have *restructured* it in the last third of a century

• Inequality has been a *choice*
  • In our democracy, a choice made through our political system
  • But our political system has often exhibited a “democratic deficit”

• What we have done has resulted not only in more inequality, but in lower growth, more instability, and overall poorer economic performance
  • Including extensive environmental destruction
I. A brief description of what has been happening

• More money at the top
• More people in poverty
• The evisceration of the middle

• US provides worst example
• But countries following US economic model are moving in the same direction
Top 1% vs Bottom 90% Average Income

Income share of the richest 1%

CEO pay provides “worst” example

• In US, risen to more than 250 times that of the average worker

• Bankers walked off with major bonuses, even as they brought their firms—and the global economy—to the brink of ruin
  • Undermining “standard” theory that compensation in a market economy is based on social contributions ("marginal productivity")
Stagnation: U.S. median household income (constant 2015 US$)

Source: U.S. Census Bureau
Note: Data is adjusted for the methodological change of 2013.
In light of gains to top incomes, stagnation even more dramatic

(Household income, constant 2015 US$)

Source: U.S. Census Bureau
Note: Data is adjusted for the methodological change of 2013.
Decline in median income of full-time male worker (constant 2015 US$)

Source: U.S. Census Bureau

Note: Data is adjusted for the methodological change of 2013.
U.S. minimum wage, 1938-2016

Minimum wage in 2016 Dollars

Disconnect between productivity and a typical worker’s compensation, 1948–2014

1948–1973:  
Productivity: 96.7%  
Hourly compensation: 91.3%

1973–2014:  
Productivity: 72.2%  
Hourly compensation: 9.2%

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 for more detailed information)
Multiple aspects of inequality

- Health—and access to health care
  - Worse in countries without good public provision
  - Death rates rising for middle-aged white Americans (Case Deaton 2015 Study)

- Voice
  - Attempts in US at disenfranchisement

- Access to justice
  - Mass incarceration
  - Mass evictions

- Wealth
  - 62 individuals owned as much wealth as the bottom half
  - Top 1% owned more than the bottom 99%
The Walton Family and The Koch Brothers’ net worth = $230 billion

That’s the net worth of 150 million Americans or 44% of the country.
Most invidious aspect: inequality in opportunity

• America among the countries with the least opportunity—in spite of the notion of the country being the land of opportunity (American dream)
  • Life prospects of a young American more dependent on the income and education of his parents than in other advanced countries

• Not a surprise: systematic relationship between inequality in incomes (outcomes) and inequality of opportunity
Income inequality and earnings mobility

Source: “United States, Tackling High Inequalities Creating Opportunities for All”, June 2014, OECD.
Global inequality

• Almost all advanced countries have seen increased inequality in last 30 years
  • But some have seen much greater increase than others
  • Cannot explain these differences by “economic laws”

• The trend around the world is somewhat mixed, but remains a concern almost everywhere
  • Some countries (especially in Latin America) have even managed to reduce inequality
Regional comparison: Income Inequality

(Net Gini Index; in Gini points; year of 2013; population-weighted average across the region)

- Middle East and North Africa
- Industrial Asia
- NIEs
- LICs Asia
- Emerging and Developing Europe
- OECD
- ASEAN-5
- Sub-Saharan Africa
- Latin America and the Caribbean
- India
- China

(Net Gini Index; in Gini points; change since 1990; average across the region)

- Sub-Saharan Africa
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Sources: SWIID Version 5.0; IMF, WEO database; and IMF staff calculations.
Global inequality: income growth by percentile, 1988-2008

Understanding global discontent

- Very rich—those at far right of graph—have seen their incomes grow at a high rate.

- Developing Asian middle class (especially China) has also grown at a fast rate. This is represented by those in middle-left of the graph.

- The incomes of the world’s very poor—those on the far left of the chart—have not kept pace.

- Advanced country middle class incomes—those around the 80th percentile—have stagnated completely.
II. Major changes in understandings of inequality

1. Trickle down economics doesn’t work

2. Large differences in outcomes/opportunities among advanced countries
   • Suggesting that it is policies, not inexorable economic forces that are at play

3. Economies with less inequality and less inequality of opportunity perform better
   • Many reasons for this
     • Lack of opportunity means that we are wasting most valuable resource
     • Erosion of trust—which is important for the functioning of the economy
   • In last few years, this view has become “mainstream”
Historical perspective

• In initial stage of development, typically inequality increases
• It was thought that in the next stage of development it should decrease
  • Evidence supported hypothesis—through 1975
• Broader theory and evidence called “Kuznets Law”
• Beginning in 1970’s, Kuznets law was repealed
Explaining change

• Key question
  • Was period after WWII, the “golden age of capitalism,” an aberration, the result of the social cohesion brought on by the war?
    • With the economy now returning to the natural state of capitalism?
  • Or is the increase in inequality after 1980 a result of a change in policies?

• Beginning about a third of a century ago, we began a process of rewriting the rules
  • Lowering taxes and deregulation was supposed to increase growth and make everyone better off
  • In fact, only the very top was better off— incomes of the rest stagnated, performance of the economy as a whole slowed

• Resulting in basic necessities of a middle class society being increasingly out of reach of large proportion of population
  • Retirement security, education of one’s children, ability to own a home
III. Alternative interpretations of growth in inequality: Market forces—based on competitive markets

(a) Changes in supply and demand for different factors just turned out badly for poor—decreasing wages of unskilled workers and increasing returns to capital and skilled workers
   • changes in technology and globalization have played some role
   • But cannot explain what happened

(b) Increased inequality in the intergenerational transmission of advantages leading to increased inequality in ownership of productive assets (human and financial capital)
   • Rich leave their children with more human and financial capital
   • Equilibrium wealth distribution reflects balance between centrifugal and centripetal forces
   • Increased inequality reflects an upsetting of previous balance
   • Contrary to principle of *equal opportunity*
Alternative explanation: increase in rents

• Increased monopoly, monopsony power shifts distribution of income and wealth to those with these powers

• But also other reasons for an increase of rent— with increased income and wealth to those who control assets generating rents generating more inequality
  • Land rents
  • Intellectual property rents
  • Rent extraction from government
  • Rent extraction from consumers
Our economy is marked by increasing rents

- Some a result of technology
  - Network effects
  - Localized services

- Some a result of changes in economy
  - Urban land rents

- Some a result of policies
  - Change in IPR laws
  - Deregulation—allowing extraction of more rents from government and consumers

- Some a result of market “innovation”
  - Better ways of exploiting consumers and exercising market power
All of these are affected by policy, by rules of game

• Incentives for skilled biased technological change vs. resource saving technological change
  • Fed policy—low interest rates—encourage capital intensive technologies
  • Absence of climate change undermines incentives for resource saving technological change

• The way we structured globalization encouraged outsourcing of jobs
  • Especially in absence of industrial policies
  • And weakened bargaining power of workers
    • Just as we were weakening unions

• Weakening of public education reduces “centrifugal” force pulling economy together

• Monetary policies, land use policies, tax policies, anti-trust enforcement, IPR rules may all have contributed to growth in rents
Concluding remarks

• Attempts to explain the growth of inequality have led to a rethinking of some of the foundations of economics
  • There are many aspects of inequality that the standard models cannot explain
  • Increasing evidence that competitive model does not provide good description of the economy

• Growing recognition that this growing inequality and low levels of opportunity in most of our societies is not only weakening the economy, but undermining democracy and dividing society
  • With deep consequences, some of which already appear to be evident
  • Reduced health (increased death rates) among middle-age white Americans—counter to the trend elsewhere
    • Reflecting social and economic distress
Concluding remarks

• But this inequality is not inevitable

• It is not the result of inexorable laws of nature
  • Or even those of the market

• It is a result of how we have changed the rules of the game
  • In some cases leading to more market power for firms
  • In many cases leading to weaker bargaining power for workers
  • Overall, leading to a more poorly performing economy, marked by greater inequities

• The growing recognition that inequality is the result of the “laws of men” rather than the laws of nature is leading to a growing sense of social injustice and a lack of trust in institutions—including those entrusted with creating and maintaining a just society