

# The Coming Great Transformation

Joseph E. Stiglitz  
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# Discontent with globalization

- Seems to have played a critical role in recent elections and referendum
- Understandable: Large fractions of population have seen their standards of living stagnate, or even decline, during the past quarter of a century
- Retort that globalization is not to blame, but technical change, provides little comfort
  - Worry is that technical change will continue to make matters worse

# Broken promises

- Promise was that globalization (together with liberalization, lowering tax rates, and advances in technology) would make everyone better off
  - Presumably through trickle down economics
- Now in many countries workers are told they have to accept cutbacks in wages and public services in order to compete in our globalized world
- Disparity between promises and what has happened has deepened distrust of elites (including in politics and academics) and democratic politics

# Economic science was more honest

- It only said that *under certain conditions* winners *could* compensate losers, not that they would
- And if those perfect market conditions were not satisfied, even that might not be true
  - With incomplete risk markets, trade and capital market liberalization could lead to Pareto inferior equilibria (Newbery Stiglitz, 1982, Stiglitz, 2008)
  - With costly redistributions, winners may not be able to compensate losers
  - With macro-economic disequilibria (unemployment), jobs in import competing sectors may be destroyed faster than new jobs are created
  - Evidence that surge of imports from China led to higher unemployment and lower wages

# The future's not ours to see

- Impossible to ascertain precisely pace and direction of technological change and future impacts of globalization
- This much is clear:
  - Manufacturing jobs are not coming back
  - Global employment in manufacturing is declining
  - US share will decline: comparative advantage
  - Even if *production* returns, jobs will not: it will be capital intensive manufacturing
- Important implication: End of East Asia Export Driven Manufacturing Development Model
  - What will replace it?
  - Divergence between countries—between leaders and followers—could increase

# But economic research in recent years has provided a framework for assessing alternative possibilities

Some critical distinctions: Need to distinguish

- “**Equilibrium**” impacts—assuming costless adjustment—from **disequilibrium** impacts, taking account of systemic imperfections and rigidities
  - System may be able to “absorb” small changes; new set of problems arise when pace is too fast
- **Labor saving innovations** from **capital or resource saving** innovations
  - Former reduces demand for labor—lowering wages
  - Labor *augmenting* technological change leads to increase in wages, so long as elasticity of demand for labor is not too low.
  - Factor bias of technological change *should* be **endogenous**

# Critical distinctions

- **Elasticity of entrepreneurial effort**—will higher tax rates reduce pace of innovation?
- In all economies, **rules of the game** are critical
  - Similar economies exhibit markedly different patterns of distribution of market and after-tax and transfer income
- And especially so in an innovation economy
  - **Innovation gives rise to rents—both** from IPR and monopoly power
  - **Who receives those rents is a matter of policy**
- **Political economy**—need to pay attention not only to what is feasible but also to what is likely to happen, given how the political system works

# 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
- Under this standard, changes/reforms of last quarter century may have been welfare decreasing

# Conditions under which evolution of technology is likely to be welfare increasing

- 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
- If elasticity of entrepreneurial services is low, we can impose high taxes to finance these jobs
- If endogenously determined bias of 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

- Under these conditions, benefits of growth can be shared equitably, and in ways that ensure full employment
  - Larger pie—so everyone can be better off
- Such an outcome is economically feasible
- But economy may not go in that direction
  - Politics matters
  - And even the conditions for economic feasibility are restrictive

# Disequilibrium

- **Transition may not be easy**
- Markets on their own are not good at structural transformation
- Great Depression can be viewed as being caused by rapid pace of innovation in agriculture
  - Fewer workers needed
  - Resulting in marked decline in agriculture income
  - Leading to decline in demand for urban products
  - Latter effect was so large that long standing migration patterns were reversed
  - What *might* have been a Pareto improvement turned out to be immiserizing technological change, as both those in the urban and rural sector suffered
- General result: with mobility frictions and rigidities technological change can be welfare decreasing (Greenwald-Stiglitz *et al*)

# Government intervention in transition enabled the successful structural transformation

- By-product of World War II
- It was not only a Keynesian stimulus
- But facilitated move from rural to urban and the retraining of the labor force
  - A successful industrial policy

# Clear parallels to situation today

Economy could be caught in a low level equilibrium trap

Policies to facilitate transition and ensure a welfare enhancing long run equilibrium include:

- Policies to increase wages of even low skilled jobs
  - High aggregate demand—to ensure low unemployment rate
  - Wage subsidy
  - Minimum wage—also would (together with other measures) help encourage innovations that increase productivity of labor at the bottom
  - 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
- Vastly expanded Earned income tax credit—to ensure that no one who works full time is in poverty
  - Does it make a difference whether *individuals* or *jobs* are subsidized?
- High carbon tax—to encourage resource saving innovation, at the expense of labor saving innovation
  - Would simultaneously address two of most serious global problems

# Further policies

- Elimination of tax deduction for interest and the imposition of a tax on capital—to induce more capital augmenting innovation
- “Wage share” tax: profit tax increased if wage share (appropriately defined) is lower
- Narrowing breadth and duration of patents
  - And circumscribing use of patents to create monopolies
- More reliance on public research
  - With government appropriating returns
  - Directing research towards resource saving innovation and away from labor using innovation
- More effective anti-trust laws, more effectively enforced
- An increase in labor-demand increasing public investments

# Transition issues

- May include persistent deficiencies in global aggregate demand
  - Exacerbated by shift in distribution of income
  - But vicious circle: weak aggregate demand weakens wages, increasing inequality
- Government needs to pursue Keynesian *structural* policies—spending that helps restructure economy
- A *social* transformation as well as an economic transformation may be necessary
  - Affecting what kinds of jobs are viewed as “acceptable”
  - Such a social transformation would be more easily navigated if more service sector jobs paid decent wages
- Globally, finance could come from global reserve system, carbon taxes and rent taxes
  - New issuances of SDRs
- Most of these policies have been tried, worked: all of this is economically feasible
- But is it politically feasible within our political systems?

# Both in the transition and in the long run

- There is no reason to be confident that markets will automatically adjust in ways that maintain full employment
  - And even when employment is high, large fractions may be in very low wage jobs without much intrinsic or extrinsic job satisfaction
    - The great divide in our society will become even larger
  - The fact that in earlier transitions *eventually* the economy reached full employment and those at the bottom did well is no assurance that it will happen this time
    - This time could be different
- Government intervention was required to prevent excessive immiseration in earlier episodes
- “Universal basic income” may be necessary as a fall-back
  - But it would be better to create meaningful work with decent pay for as many people as possible

# At the edge of another Great Transformation

- There are alternative paths forward
- I have described one—which holds out the promise of a future of shared prosperity
- But there are others—with ever increasing concentration of economic wealth and economic and political power
- The great debate today concerns which path we should or will follow.