

Econ 133 – Global Inequality and Growth

Review and conclusion

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Roadmap:

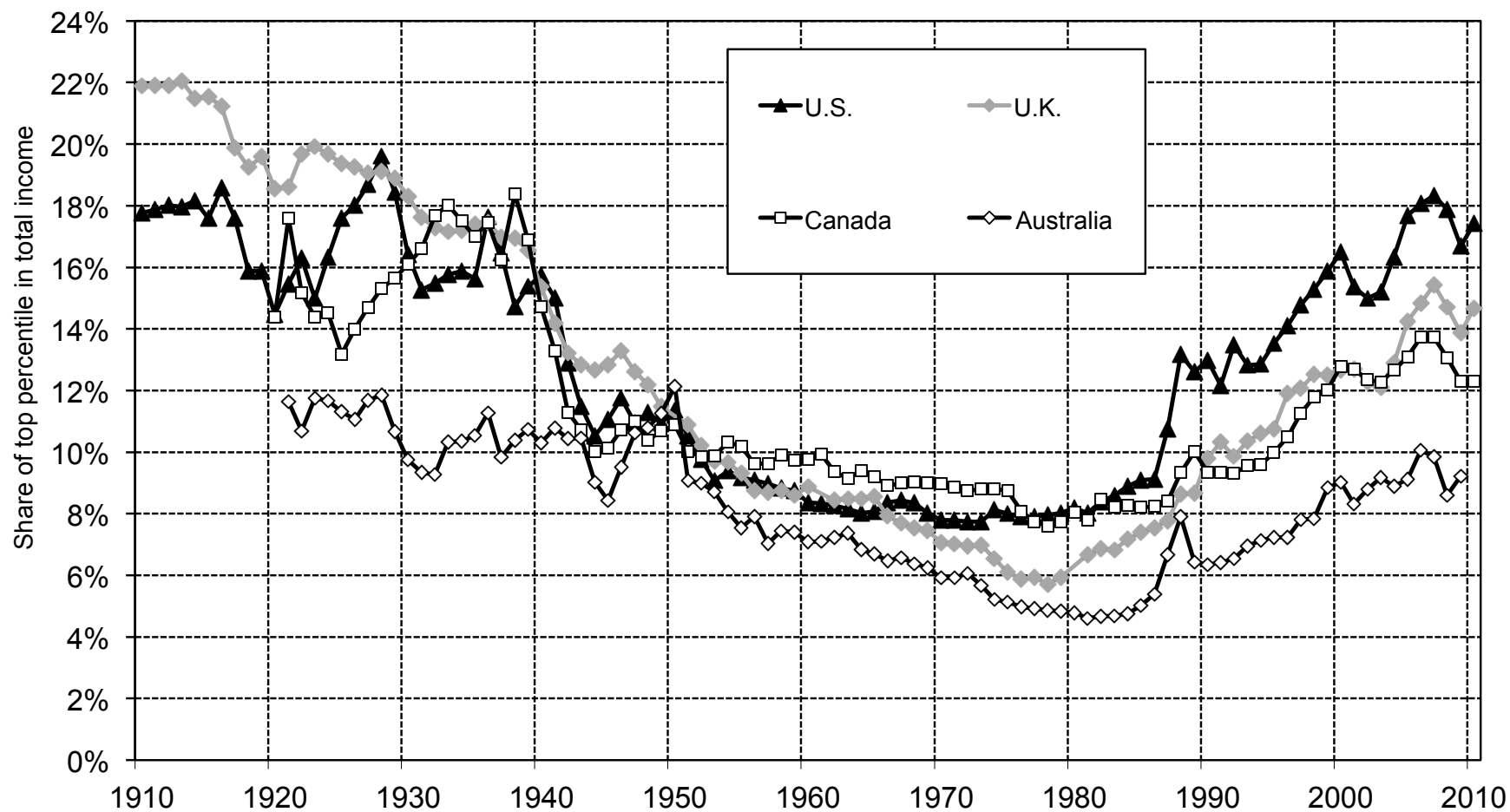
- There's nothing natural in the evolution of inequality: history and policies are key
- The reasons why inequality is rising in the US
- Forces of convergence and forces of divergence at the global level
- The policies that can promote equitable growth

1 There's nothing natural in the evolution of inequality

1.1 The Kuznets curve

- Kuznets had an optimistic theory: inequality first rising, then naturally declining with growth
- With hindsight, this theory does not appear to be supported by the data

Figure 9.2. Income inequality in Anglo-saxon countries, 1910-2010



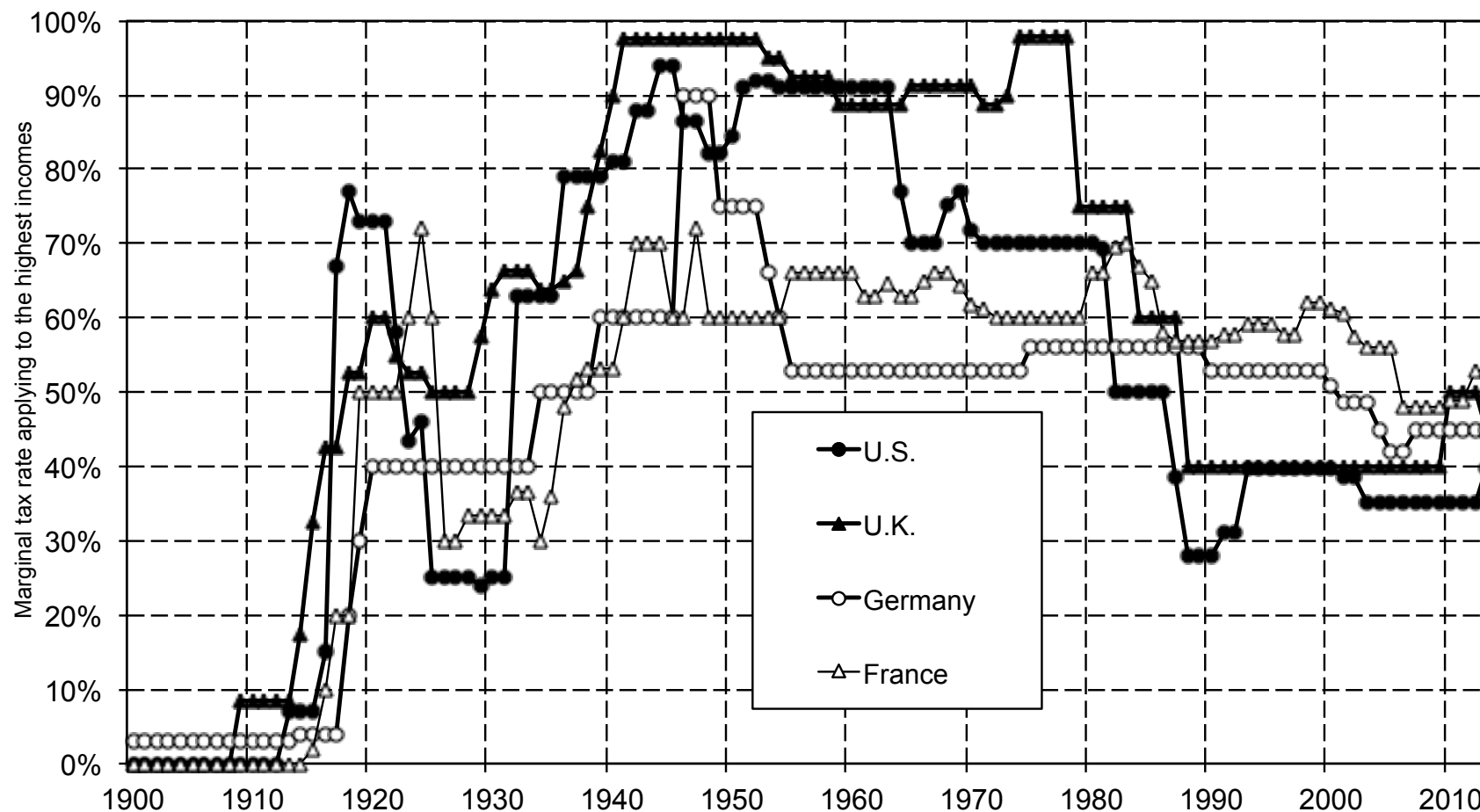
The share of top percentile in total income rose since the 1970s in all Anglo-saxon countries, but with different magnitudes. Sources and series: see piketty.pse.ens.fr/capital21c.

1.2 History and policies matter

- Diversity of national histories and representations:
 - US used to be more equal than Europe, now much more unequal
 - Booming top labor income mostly an Anglo-saxon phenomenon
 - US used to see Europe as “too unequal”; now for many is “too equal”

- Dramatic changes in policies have played a key role in the history of inequality:
 - Highly progressive taxation from 1940s to 1970s limited dynastic wealth
 - Decline in progressive taxation since the 1980s contributed to rising inequality

Top income tax rates, 1900-2013



The top marginal tax rate of the income tax (applying to the highest incomes) in the U.S. dropped from 70% in 1980 to 28% in 1988. Sources and series: see piketty.pse.ens.fr/capital21c.

1.3 The laws of inequality and what they mean

There are a number of laws that govern the evolution of inequality:

- $\alpha = r \cdot \beta$

- $\beta \rightarrow s/g$

- $r > g$

- But these laws do not imply that inequality is bound to rise or fall
- On the contrary: r , g , s are all functions of policies, institutions, shocks...
- Example: r depends on capital taxation, wars, social norm, technology
- So these laws are useful to think about the future, but nothing is set in stone

2 Why inequality is rising in the US

Fundamental distinction: inequality of labor income vs. inequality of capital income (or wealth)

2.1 Labor income inequality

- Rising skill premium, due to rapid increase in demand for skilled labor not matched by equivalent increase in skill supply
- Institutional change: decline in unions, decline of minimum wage,

rising market power

- Explosion of top wages, due to decline in top marginal tax rates and changes in social norms governing pay

2.2 Capital inequality

- Rising labor income inequality and saving rate inequality
- Decline in capital taxation (estates, capital income, corporate tax)

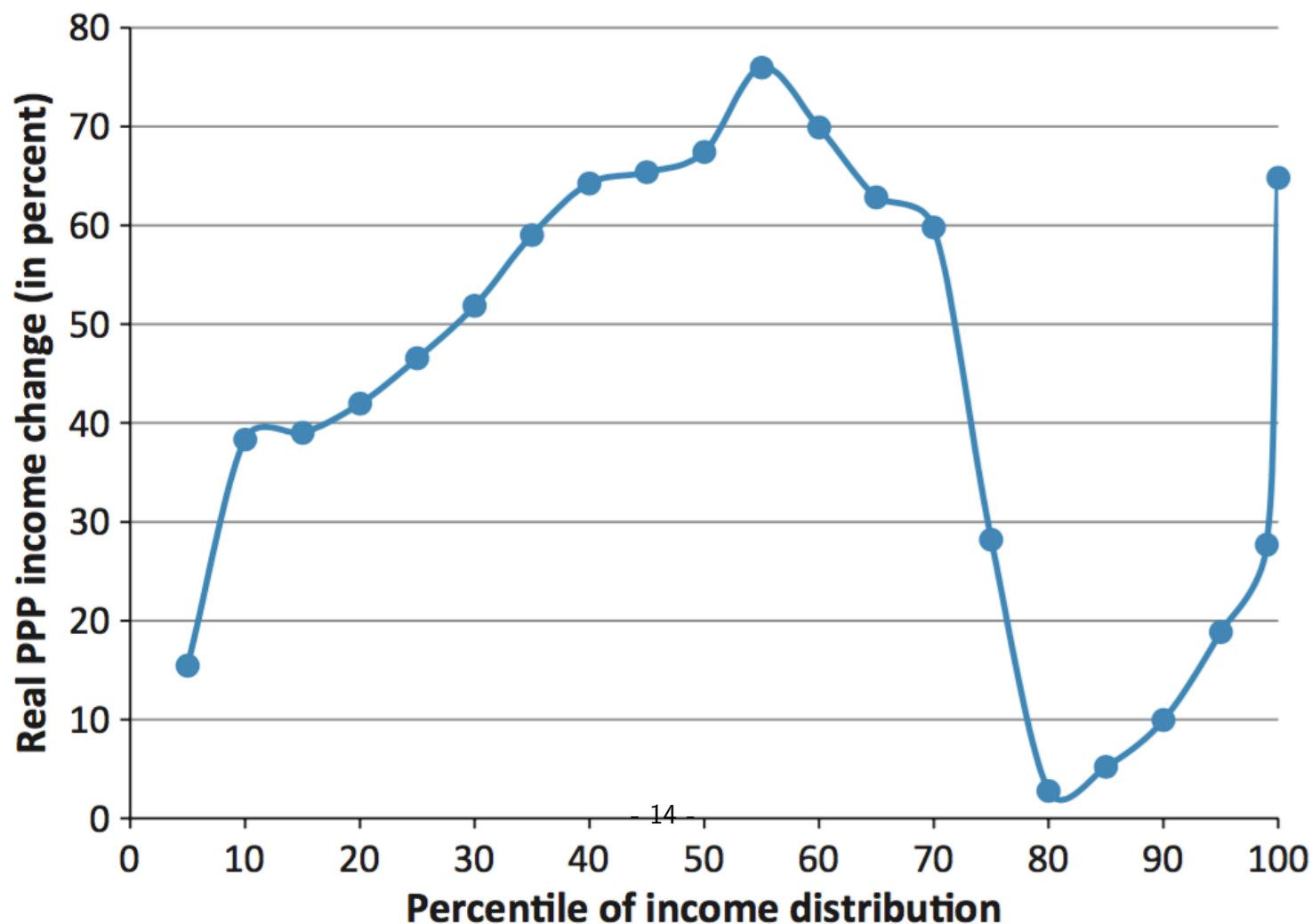
- $r > g$ will be key down the road
- Toward a new world where both super-managers and rentier co-exist at the top?

3 Global inequality: convergence or divergence?

3.1 Forces of convergence

- Catch-up growth in developing countries
- Technology diffusion through trade
- Migration from poor to rich countries

Figure 4. Change in real income between 1988 and 2008 at various percentiles of global income distribution (calculated in 2005 international dollars).



3.2 Forces of divergence

- Rise in top-end inequality within countries
- International tax competition and evasion (role of technology, policies & social norms, in particular in the financial sector)
- Decline in g (pop. + productivity) \rightarrow rise in inherited wealth. Has already started in Europe, might become global phenomenon

4 Policies that can promote equitable growth

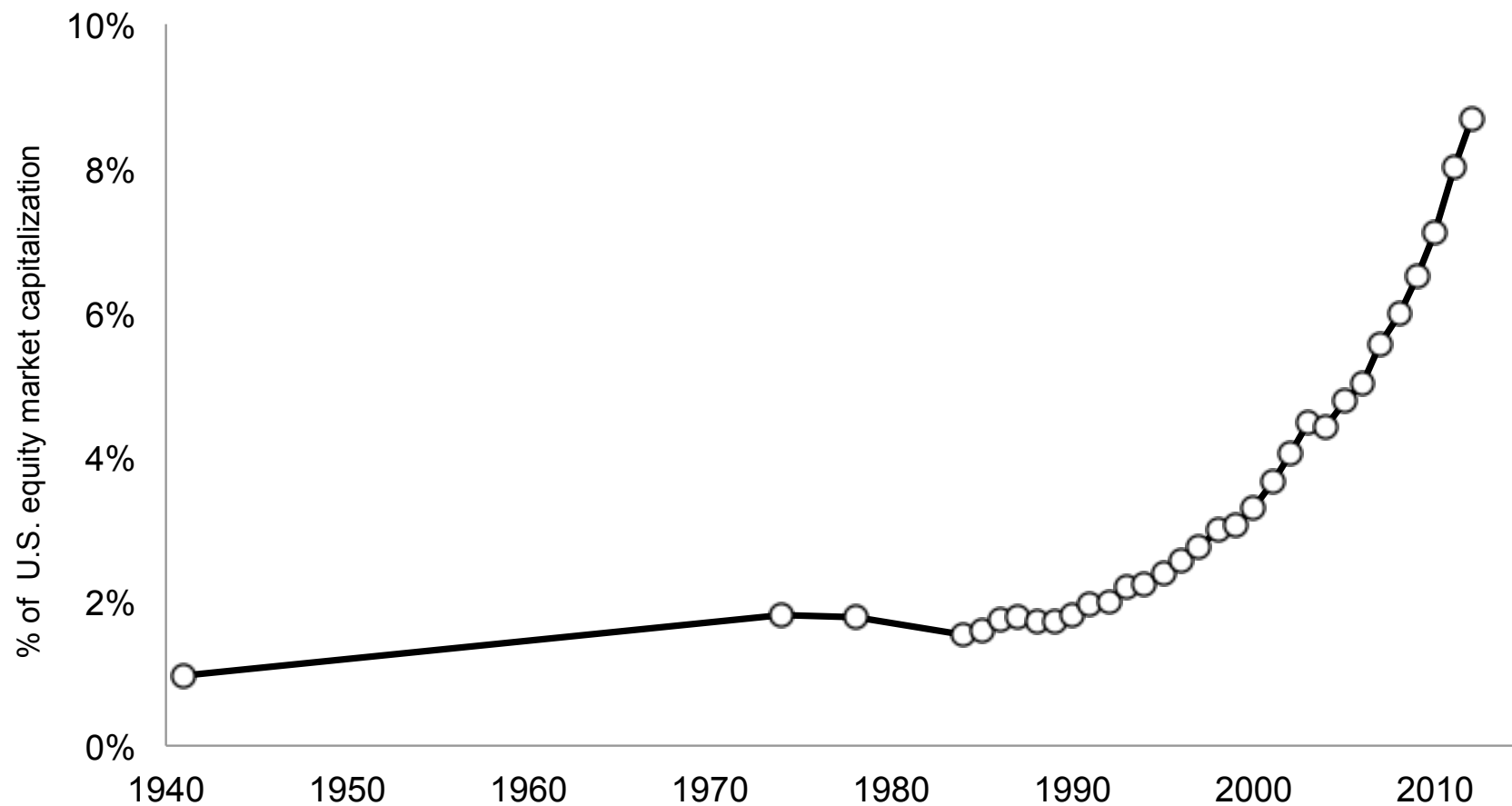
4.1 Policies that worked in the past

- Progressive income and wealth taxation
- Investment in access to education: reduces skill premium and makes it possible to increase minimum wage
- Strong social safety net and transfers to make it possible for poor & middle class to accumulate wealth

4.2 Institutions and policies always need to be reinvented

- World is more globalized → limits unilateral policy changes
- Technological change → may hurt labor more than in the past
- Rise of algorithms, patents, etc. → need to find new ways to regulate capital
- Global demo. transition, climate change → may lead to low g

U.S. equities held by tax haven firms and individuals



In 2012, 9% of the U.S. listed equity market capitalization was held by tax haven investors (hedge funds in the Cayman Islands, banks in Switzerland, mutual funds in Luxembourg, individuals in Monaco, etc.). Source: author's computations using US TIC data

Key policy challenges for the future involve inventing:

- New ways to grow: e.g., through green energy industrial revolution
- New ways to regulate inequality: e.g., global wealth taxation and financial transparency; patent regulation
- New ways to produce: corporation with sole goal of max. shareholder value not always best way to organize econ activity