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

- 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

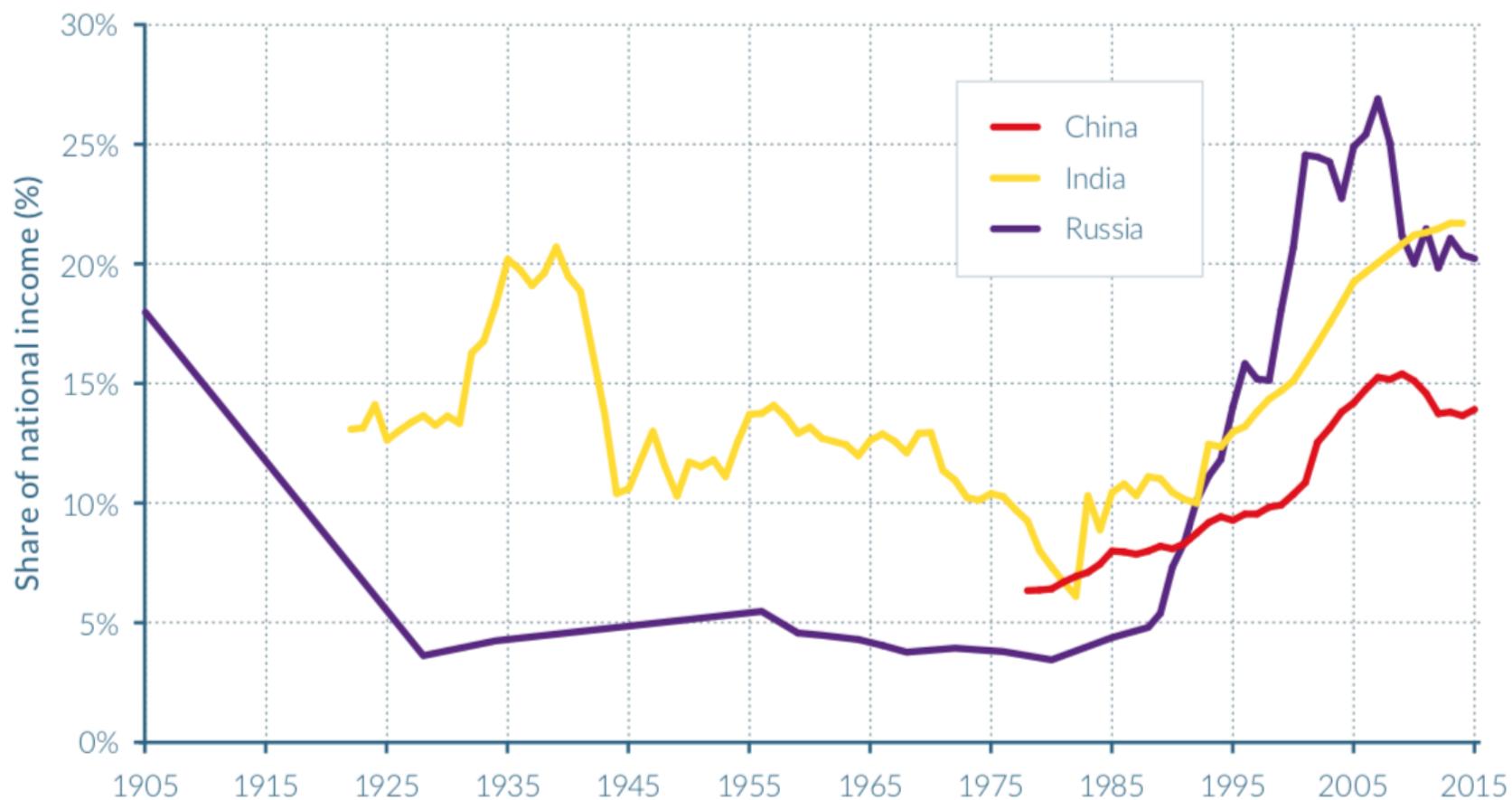## Top 1% national income share in Anglophone countries, 1920–2015
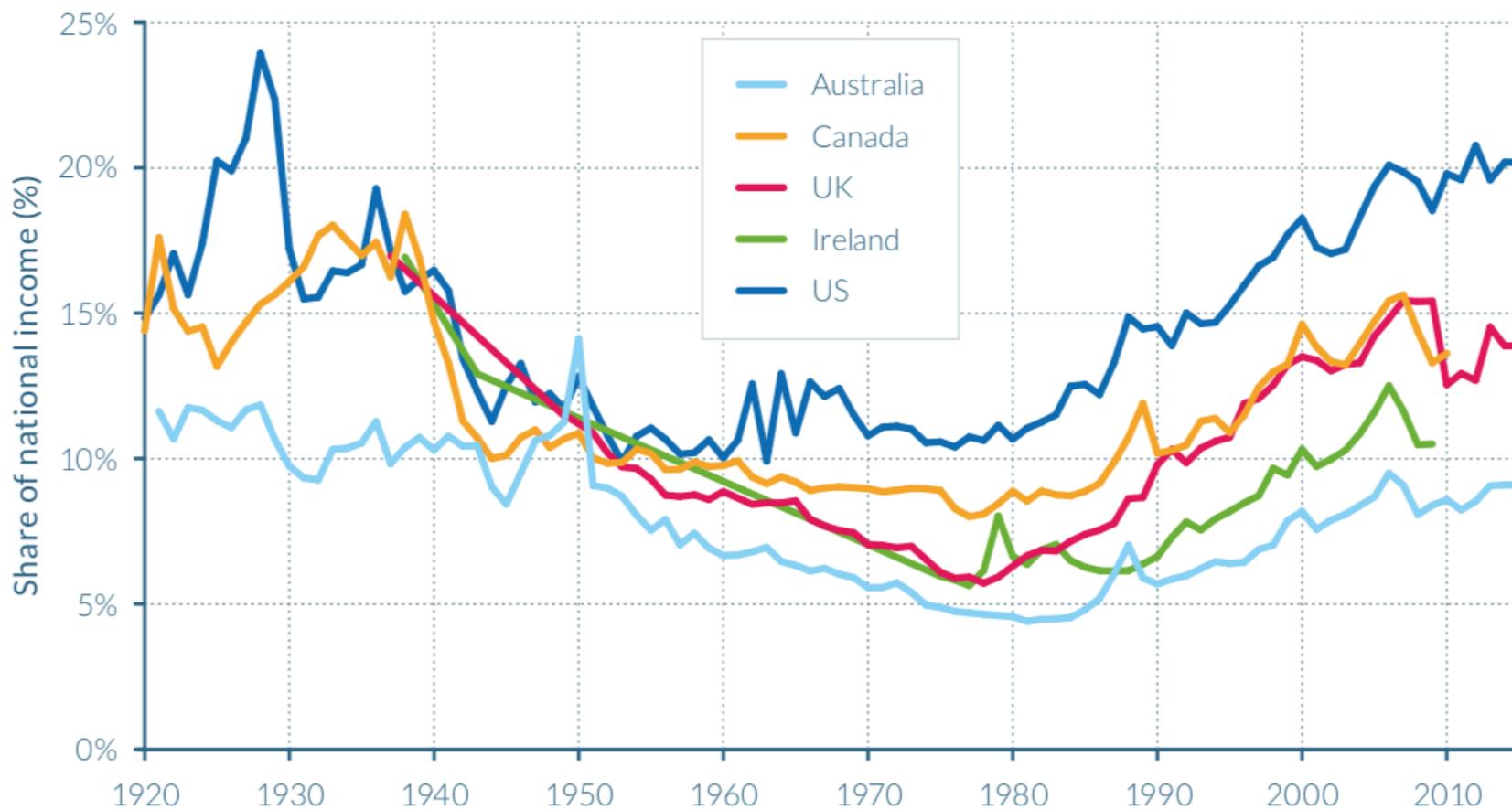
Source: Novokmet, Piketty & Zucman (2017). See wir2018.wid.world for data series and notes.

Top 1% national income share in European countries, 1890–2014
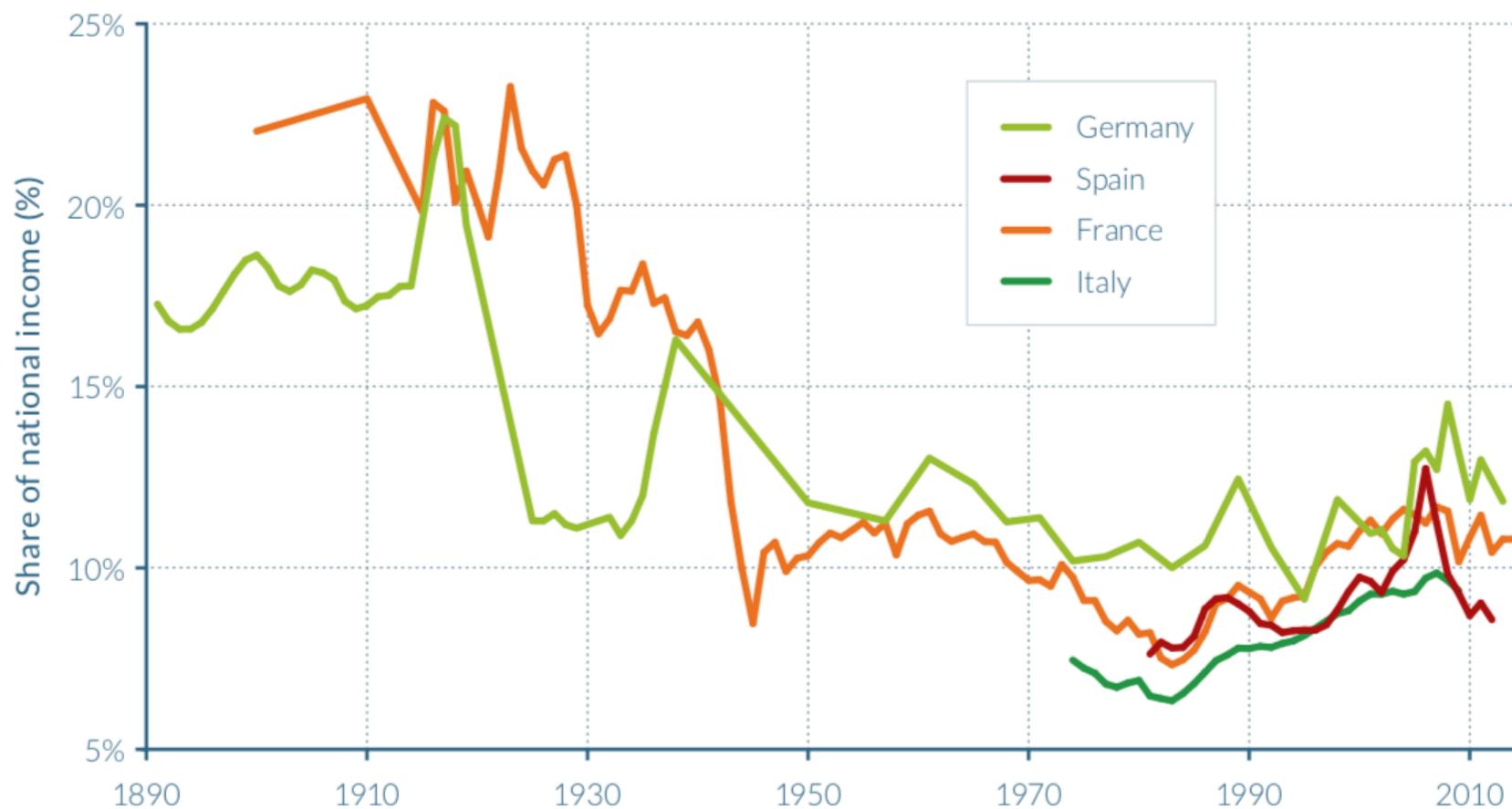
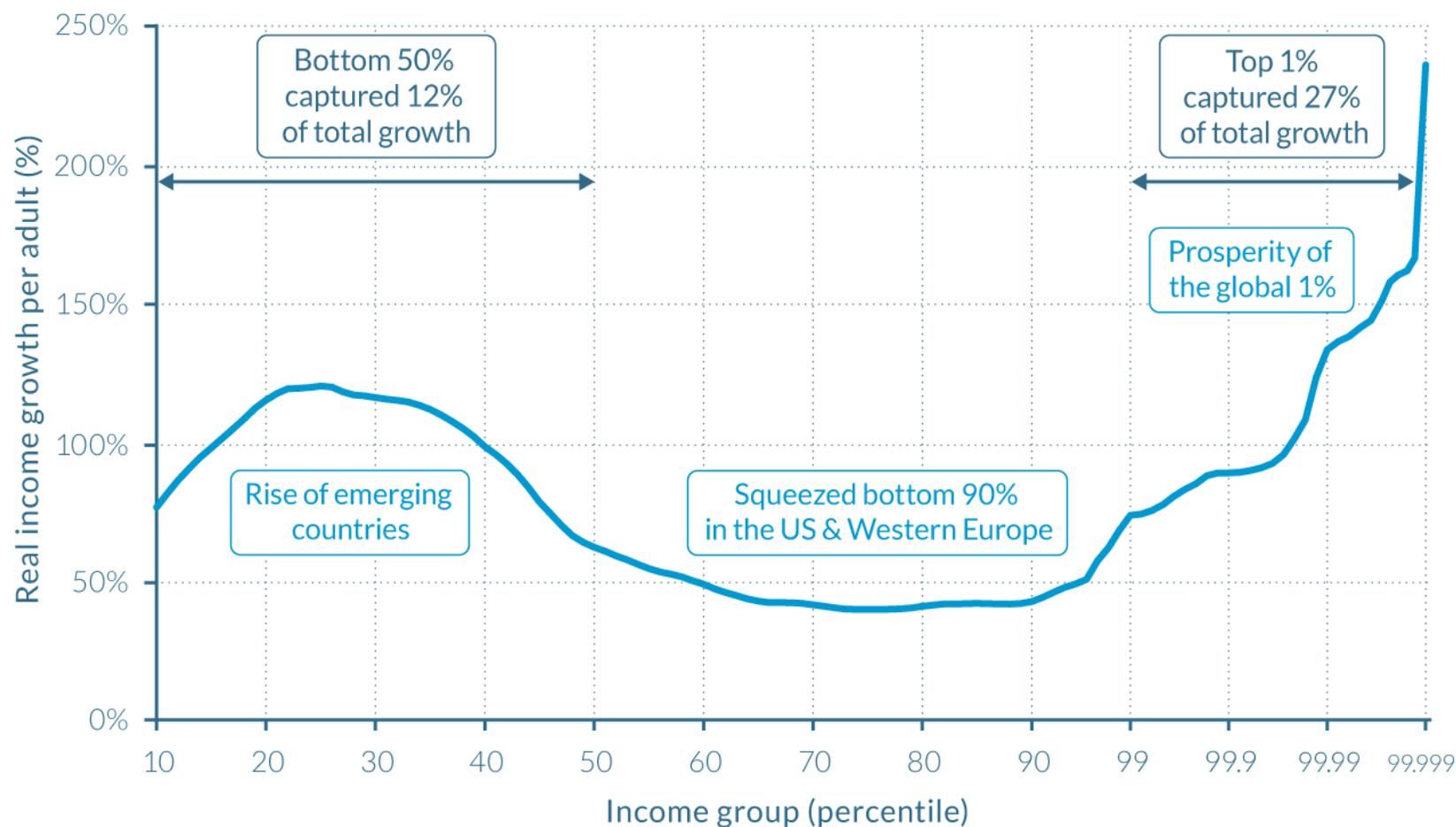Source: WID.world (2017). See wir2018.wid.world for data series and notes.

Top 1% national income share in emerging countries 1900–2015

Source: WID.world (2017). See wir2018.wid.world for data series and notes.

Source: WID.world (2017). See wir2018.wid.world/methodology.html for more details.

On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level. The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size. The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016. For percentile group p99p99.1 (the poorest 10% among the world's richest 1%), growth was 74% between 1980 and 2016. The Top 1% captured 27% of total growth over this period. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

1.2   History and policies matter

- Diversity of national trajectories:

    – US used to be more equal than Europe, now much more unequal

    – Booming top labor income mostly a U.S. phenomenon

    – The decline of wealth concentration during the 20th century: largely the result of wars, destructions, Depressions

- Dramatic changes in policies have played a key role in the history of inequality:

  – Non-tax policies: changes in bargaining power, unions, share of capital publicly owned, ...

  – Highly progressive taxation from 1940s to 1970s limited dynastic wealth

  – Decline in progressive taxation since the 1980s contributed to rising inequality

Top marginal income tax rates, 1900-2013
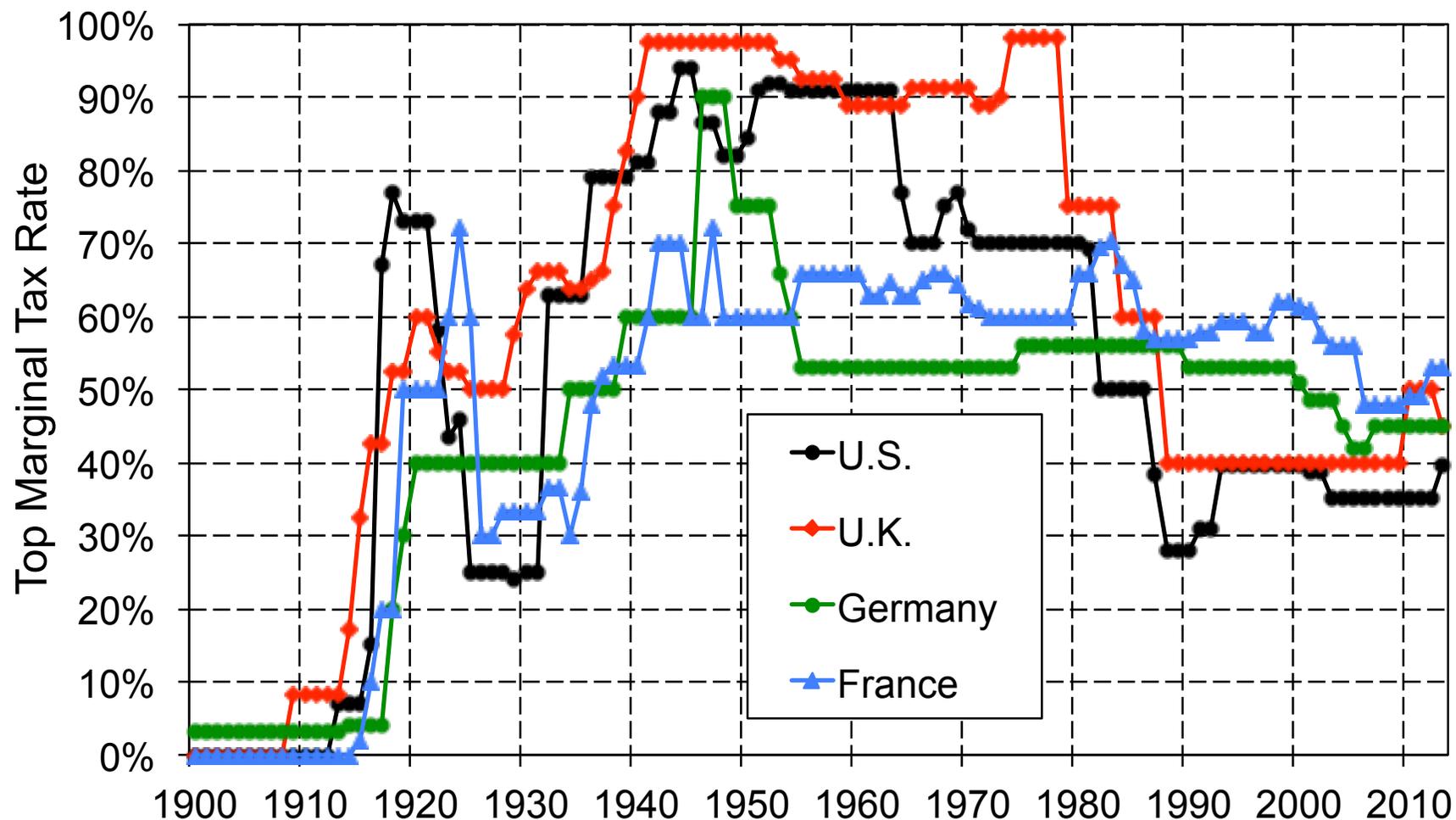
1.3   The laws of inequality and what they mean

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, bargaining power

- 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

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 $\rightarrow$ international cooperation is key

- Technological change $\rightarrow$ who owns the robots?

- Rise of algorithms, patents, etc. $\rightarrow$ need to find new ways to regulate capital (patents, time limits to private ownership...)

- Global demo. transition, climate change $\rightarrow$ may lead to low g

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

- New ways to produce: corporation with sole goal of max. shareholder value not always best way to organize econ activity