

Introductory Comments Conference on Inequality

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Implications of inequality for economic performance

- Only one part of inequality-economic performance nexus
- Exploration of the many channels through which inequality affects the economy
 - Some of them are complementary and reinforcing
 - Financial sector major source of rents in the economy
 - Financial excesses lead to more instability; instability leads to more inequality
 - Dysfunctional financial sector may lead to less *productive* investment, leading to lower wages

- Picture complicated by the fact that there are some factors which simultaneously increase inequality and affect economic performance
 - Globalization is an example
 - Globalization may also affect other institutions which affect both inequality and economic performance (unions)

Part of the argument for why our society should be concerned with inequality

- But only part of the argument
 - Consequences for the functioning of democracy
 - Consequences for the functioning of society
- But even if someone is not concerned about moral issues, issues of social justice, the fact that inequality has an adverse effect on economic performance should be of concern

Many dimensions of economic performance

- Not just growth as measured by GDP
 - GDP is not a good measure of well-being
 - Main message of the international Commission on the Measurement of Economic Performance and Social Progress
- Particularly poor measure of economic performance when inequality is increasing
 - Median income may be a better measure
- A number of other factors are also important
 - Health
 - Education (capabilities)
 - Security
- When account is taken of these factors, the increase in inequality may be even larger than suggested by income data

Exploring the relationship between inequality and economic performance

- There are many measures of inequality
- And many measures of economic performance
- Some measures of inequality may be more related to some measures of economic performance
- And particular channels through which the effects are realized

Example: inequality and macro-stability

1. Increase in inequality leads would lead to reduce aggregate demand in the absence of other interventions
 - Predicated on evidence that MPC of rich is lower than that of poor
 - Empirically, big break is high in the income distribution
2. Weak aggregate demand leads monetary authorities to have low interest rates and lax regulatory policies
3. These lead to excess indebtedness, inducing crisis
 - If (1) is true, suggest relevant measure of inequality is not gini coefficient, but fraction of income going to top
 - There are other ways that government *could* respond to increase in inequality, e.g. increase in public investment
 - Political economy argument for why government has often responded in the way it has

Some insights provided by cross country comparisons

- Economic forces similar in different countries
- But economic outcomes differ
 - Both inequality and economic performance
- Policies matter
 - Try to identify policies that have led to less inequality and better economic performance

Overview of some of the channels

- Rent seeking—broadly understood
 - Increase in rent seeking would lead to more dysfunctional economy, more inequality and poorer growth
 - Essential message of the *Resource Curse*
 - Increase in profits does *not* imply an increase in societal welfare
 - Question: to what extent have advanced countries become rent seeking societies?
 - Monopoly power
 - Abuses of corporate governance
 - Diverting resources that otherwise would have been spent on investment
 - Many aspects of financialization
 - Market manipulation/exploitation
 - “Fishing for fools”

Lack of opportunity

- Not using fully one of society's most valuable resources, its human resources
- Inequality of education
 - Including pre-K
 - Higher education systems that preclude the poor
 - Other ways of passing on advantages across generations
 - Networks, interns
- Inequality of access to food, health
- Because inequality of opportunity is linked to inequality of outcomes, all of the adverse consequences of inequality of outcomes are associated with inequality of opportunity

Other Channels

- Political Economy
 - Underinvestments
 - Deregulation
 - Long term instability
- Macro-economic channels
- Broader societal channels
 - Hard to measure, but nonetheless important

