

Wednesday, Dec 3, 2014:

### **Keynote Address by Lord Adair Turner**

- These are important issues but they are complex and we need to be aware of the complexity.
- I'm not going to focus specifically on the financial industry. But I'm going to define areas for further research.
- In order to think about inequality, jobs and stability, we need to think about the changing nature of the economy.
- The new economy is high tech and high touch.
- Inequality has two features.
  - The bottom 30 percent falling away from the median.
  - And the top 1% doing much better than the median and 10%, but the 1% losing out to .1% who are losing out to .01%.
- Why?
- Multi-faceted
  - Globalization does have an impact at the middle end.
  - At the top end, social mores are important. Compensation for top executives is somewhat circular.
  - Financialization of economy is important as it is associated with very high pay rates and the sector can take advantage of high rents.
  - But I will focus on technology. I do think there is something about modern technology that makes it a driver of inequality.
- We know technology is driver of rising GDP per capita.
- In 20<sup>th</sup> century we believed technological progress was a tide that would raise all ships. But that is not necessarily true.
- In the early 19<sup>th</sup> century, average workers did not gain in real wages from rising GDP per capita in Britain. This is described as Engels pause. This is the period of the Luddite revolution. This was over 30-40 years.
- Only in the mid to late 19<sup>th</sup> century does technological progress translate into rising wages for average workers.
- My hypothesis is there is something about communications technology that makes it deeply unequal in its effects.
- The market value of companies compared to employees shows the new challenges of new technology.
- The huge equity value is created with very few jobs and very little capital investment compared with industrial era firms.
- Something about ICT is distinctive.
  - Moore's law allows exponential progress.
  - Zero marginal cost for software.
  - Huge network effects.
- I am convinced they are driving the new economy and it's only going to cause more extreme change.

- I am optimistic we will see growth, but not equitably distributed.
- I think we will see automation at the low end and this will be problematic.
- At the middle end we may see more automation, but the high end may get higher because of returns to making robots, software etc.
- At the high end it is difficult to tell if it's returns to capital, rents, returns to high skills.
- It is difficult to make sense of the \$170 bn market value of companies.
- But these changes don't apply to the whole economy.
- The BLS thinks there will be a small growth in jobs from designing computers or software.
- The jobs will come from face to face service jobs – or high touch jobs that we don't know how to automate. So we will create jobs but because of the army of people in need of work the returns will likely be low.
- As people get richer one of the things they spend money on is things of subjective value. The highest value skills are in creating subjective value – fashion, restaurants, etc. So the other source of value is “high-touch celebrity rents”.
- We see superstar rents to soccer stars, models, etc. Because huge amounts of money can be spent on subjective value as opposed to intrinsic value.
- This world has a pervasive effect on wealth. Land value increases enormously.
- Piketty's story is largely a real estate story. Over the last 40-50 years there has been a dramatic increase in value of urban real estate.
- This means there are two potential sources of wealth:
  - Piketty – savings and investment
  - Relative price effect – if the increase in a price of an asset grows faster than economy then wealth goes up
- The ICT economy creates wealth with very little capital investment. Companies have little capital investment. Land has little capital investment.
- The relative price effect accounts for about 60% of Piketty's story.
- Why has urban land value risen?
- An income elasticity of demand for locationally-desirable land.
- If the supply of the locationally-desirable land is inelastic, then prices go up.
- Then it becomes an asset class.
- Private domestic credit drives further increase in the value of this asset class.
- Banks are doing the easy form of lending – lending against collateral.
- This is very unstable – because there may be no equilibrium.
- The bigger the wealth to income ratio with leverage driving it – the more unstable the economy will be.
- The combination of factors – the need for leverage to acquire an asset, and that those who need most the leverage are likely to be wiped out by instability - magnify inequality.
- Key aspects to consider:
  - Technology
    - Moore's law

- Zero marginal cost
- Preferences
  - Status and scarce supply/subjective goods
- Irreproducible assets:
  - Land, Brands, IPR
- Credit and Money
  - Infinite supply
- We need a new production function that takes into account land – not in its productive capacity but it's luxury good capacity.
- So how can we tackle inequality?
- Accountability and transparency
  - Bringing transparency to remuneration committees drove higher pay.
  - There may be rational private returns to high pay to CEOs, but not socially relevant.
- Skills
  - The all-purpose answer to inequality from rich liberals who want to care but don't want redistribution.
  - Skills have very little connection to success at the top end – because of network effects, winner-take-all etc.
  - At the lower end, we may overstate the ability of lower skilled workers to catch up

### Discussion:

- How does the story of land take into account climate change?
- **Turner:** Important but orthogonal. What I think is important is looking at effects of Urban geography, clustering, and leverage and wealth.
- Germany has had different experience with land than France or England.
- This is not just about population density.
- **Comment:** The real price of housing when you adjust for inflation has increased on average by 0%.
- **Turner:** In the US this varies significantly by location
- **Stiglitz:** Piketty argues capital gains amounts to 22% of gains. I couldn't find that. Wondering if you found that?
- **Turner:** We found that in US we could not explain the rise through capital accumulation. I emailed Piketty and he agreed that real estate was key piece of the story in the US.
- **Stiglitz:** There are models where you can calculate value of land as a function of transportation costs.
- Also, interesting point about the labor market providing private returns that are different than social returns.

- What is the economy if we take techno-optimism to the extreme and everything is done by robots?
- **Krugman**: Data dispute on housing prices showing zero growth. This brings back Henry George.
- **Turner**: You do need to think about taxation responses to this. A tax on land would potentially provide a redistribution effect on something that doesn't change behavior.

## Session VI: Country and Regional Perspectives

Chair: Danny Leipziger

Francisco Ferreira, Nora Lustig, Juan Gabriel Rodriguez, Kalle Moene, Jan Svejnar, Jody Heymann, and Sanjay Reddy

### Francisco Ferreira:

- Inequality and growth affect each other.
- Caldor:
  - Believed with big difference between rich and poor there would be savings and that would cause more growth.
  - So there is a tension here between what we were arguing yesterday.
  - Maybe this is a long term/short term issue.
- In the literature we see three phases:
  - Phase 1: inequality bad for growth – 1990
  - Phase 2: inequality is good for growth – 2000s
  - Phase 3: we shouldn't look just at Gini or just at growth
- Therefore, evidence is suggestive but not conclusive because of endogeneity of effects.
- Inequality is an equilibrium summary of the economy, like growth. At this level of aggregation you won't see clear causality.
- Inequality may be bad for the quality of  $g^*$ .
  - Growth is more poverty reducing in less unequal societies.
  - Maybe lower economic mobility w inequality and more inequality of opportunity.
- It may not be appropriate to look for causality at this level of aggregates.
- Africa:
  - Last two decades there has been growth, but poverty is falling less quickly than we would expect.
  - There has been a lot of inequality in Africa in the levels.
- East Asia reduced poverty much more and more quickly.
- Growth elasticity of inequality reduction is low in Africa.
- Because: high inequality in Africa to begin with. 7 of the top ten most unequal countries are in Africa.
- Also, inequality in the distribution of  $g^*$  low at the bottom, high at the top.
- Great differences between countries, sectors, resources, other.

- More growth in the natural resource rich countries with high inequality.
- But some resource-poor countries have done well.

### **Nora Lustig: Facts puzzles and surprises – Inequality in Latin America**

- Inequality in Latin America –
  - 1990s saw tepid growth, stable high inequality.
  - 2000s, higher growth and generalized decline inequality.
- The decline is true across countries.
  - Regardless of measures
  - Whether the politics are right or left, whether they were commodity or non-commodity producing countries.
- Our aim is to understand what is behind decline of inequality in Latin America. It is a different story. It has been rising in other regions.
  - Labor income inequality decreased, capital – i.e, remittances – increased, transfers increased.
  - Wage structure effect is equalizing.
  - Endowment effect is un-equalizing.
  - Paradox of progress
    - The lowest skilled – people with primary or less saw the most increase.
    - Wages for the highest with tertiary saw decline.
- Brazil
  - At the bottom – rising minimum wage in Brazil, a number of things have narrowed the gaps in gender, race etc.
  - At the top –decline in skill premium with an increase in number of tertiary graduates.
- Mexico
  - Similar in Brazil – wages up at bottom and down at top.
  - At the bottom – no minimum wage, but still saw increase – probably due to integration with the US.
  - At the top – relative supply of people with tertiary education increased.
- Educational upgrade has taken place. That is a common factor in Latin America.
- Markets don't generate equality but families, charities and governments do.
- *Commitment to Equity Project*
- Asia redistributes less, South Africa more.
- Is there a Robin Hood Paradox? More unequal countries redistribute less.
- In fact, in Europe and Latin America: more unequal redistribute more.
- When you add effect of indirect taxes and subsidies, more unequal countries redistribute more.
- After transfers and taxes poverty is higher in several countries.
  - Indirect taxes increase poverty above market income.
  - Tax and transfer systems can be equalizing but poverty increasing – because one is about relative incomes and one is about levels.

- It is important to keep poverty and inequality analyses separate and related.
- Tax and transfer systems can be equalizing but poverty increasing – because one is about relative incomes and one is about levels.

### **Kalle Moene:**

- Large wage differences before taxes and transfers lead to larger welfare state, smaller wage differentials than smaller welfare state.
- Scandinavia fits into a pattern, not particularly special – not about homogeneity or equality ideology.
- Lots of conflict strikes in the interwar period, so homogeneity of population argument is weaker.
- There are differences between countries. Small size of countries is advantageous.
- But great compression in the 1940s - 1960s followed by more inequality since 1980s.
- Homogeneity of income was created by the Scandinavian model
- Real competition occurs in institutions and in creative destruction, not in overall wages
- After Second World War, invest a lot in institutions to promote competition – the economy is very exposed in international competition.
- Employers are highly organized, and have a lot to say for welfare state and wage compression.
- External competition created lots of internal cooperation.
- Political and economic reinforcement.
- Different types of wage earners speed up creative destruction within companies.
- Wage moderation increases creative destruction, wage compression supports profits!
- This has eliminated low productivity firms and invited high productivity firms.
- Reinforcement: compress wage distribution by collective decisions you get high productivity firms, reallocate labor from low to high productivity firms.
- Productivity gap is narrow than in the US.
- More support for policies that are redistributive when wages are compressed.
- There is an equality multiplier because these welfare policies feedback.
- But with shocks you have inequality multiplier operating since the end of the 1980s.
- Socialist security complement capitalist dynamics, which are helped by social insurance and unions.
- Companies, government, and workers share the necessary costs of remaining competitive in global economy.
- Implicit coalition between capital and middle class in order to sustain jobs in the tradable industries.

### **Juan Gabriel Rodriguez: Is there a “Great Gatsby” effect?**

- Great Gatsby Curve:
- Alan Krueger has argued that countries with greater income inequality have less intergenerational mobility.
- Problems –

- Small number of observations
- Short interval of time (mid 80s to mid 90s)
- Heterogeneous databases – reliability is called into question
- Estimates for immobility are based on models
- Attempts to correct:
  - Use data from International Social Survey Program (1992, 1999, 2009)
  - Used 3 different years for 70 countries
  - Measure three different outputs – upward mobility, immobility, downward mobility
  - We used panel data and methods
- Gini is negatively correlated and significant for upward mobility regardless of what other variables are introduced.
- Inequality and economic performance affect each other.
- Inverted U shape: inequality improves performance up to a point, and then hurts performance.
- Problem with that: can't say whether inequality is too high or too low.
- It may be better to distinguish between different sources of inequality.
  - Rent seeking? Bad for the economy.
  - Technological change? Inequality and growth ensue.
  - Individual effort may create inequality and is good for the economy.
  - Inequality of opportunity creates inequality but is bad for economic performance.
- Our analysis has show the last two points. (Marrero and Rodriguez, 2013).
- True in developed economies, but not in developing countries.
- Looking at the relationship between inequality and economic performance at various parts of the distribution yields ambiguous results.
- Some evidence that inequality of opportunity hurts income growth of the poor but not of the rich.
- Recent studies have found evidence for the Great Gatsby curve: a negative and significant effect of past inequality on upward labor status mobility
- And a robust positive and significant effect of past inequality on downward labor status mobility.

### **Jan Svejnar: Wealth Inequality:**

- We used Forbes magazine's data on billionaires over 20 years to investigate the link between inequality and growth.
  - How does presence of billionaires relate to growth by country?
  - Does it matter how wealth was generated (cronyism vs. entrepreneurship)
  - What matters wealth, income or poverty?
  - Wealth inequality vs. GDP, total capital, and population
- Used data from OECD and non-OECD countries.

- 5-year intervals over 20 years of data. So 4 observations.
- To look at cronyism looked at political connections of billionaires.
  - The index correlated with others - more political connected → more corruption as ranked by Transparency International's Corruption Perceptions Index.
- Wealth inequality correlates negatively with growth in subsequent periods.
- Negative effect driven by politically connected billionaires.
- Income inequality effect is weak.
- Initially income distribution matters and then not so much.
- Comparing results with Forbes – in first half of sample income inequality has a positive effect on growth but this disappears in second half of sample.
- Conclusions:
  - High levels of wealth inequality have negative consequences for growth whereas income inequality and poverty do not.
  - Politically generated wealth has an effect whereas unconnected wealth does not.

#### **Jody Heymann Inequality and Growth UCLA Fielding School Public Health**

- How do we test mechanisms of inequality?
- Productivity – around investments in human capital.
  - Investments in children 0-5
  - Education
  - Health
- But if we are going to test this – first thing we need to do is measure policy, then measure policy in a lot of countries, then measure it over time.
- We need to measure **policy** quantitatively and we have not done that, over time.
- At the World Policy Analysis Center – we measure social and economic policies in countries.
- Now we have constructed multilevel longitudinal models.
- 193 countries, with 1200 policy indicators merged onto household survey data.
- For 50 countries they have multiple points in time.
- Sample Indicators:
  - Protections for the elderly
  - Paid sick leave
  - Getting sick means that workers may lose jobs: increases inequality
  - Maternity leave
- Some facts:
  - 170 countries in the world provide paid sick leave, except the US.
    - Getting sick is one of biggest causes of poverty.
    - Health raises productivity, global consensus.
    - US – no constitutional mention of health.
  - 187 countries have paid leave for mothers and infants. The US does not.
    - Paid leave shows productivity gains for parents and for kids.
    - It's mostly provided through social insurance so it is provided to informal economy.



- Teacher training for secondary school teachers is higher in most countries than in the US.
- Propose 2 things:
  - First thing: we should deepen understanding of mechanisms that inequality effects growth, but we should also look at what works.
  - This is rigorous research.
  - Second thing: we have to change dramatically the public dialogue.
  - Who do we have to reach beyond the expert community?
  - The range of people who think inequality is a big problem is from 40%-70%?
  -

### **Sanjay Reddy: India**

- The Lorenz curve for India today is in almost the same place today as 1991.
- There is concern with mismeasurement – especially at the top.
- There are inequalities between urban and rural and professions.
- But the Lorenz curve has not moved. So how do we reconcile?
- The top end in the better performing states is coming closer to the bottom end of the states that had previously done well.
- Over the medium and long term you do have Pareto dominance, although you have increases in some parts that are higher than others.
- So from that point of view growth is working.
- Anecdotal evidence suggests growth its not working.
  - There are Maoist rebellion
  - There are land battles
  - Most billionaires are wealthy through natural resources
  - Primitive accumulation is taking place
  - Governance structures and processes are weak
  - Huge corruption and money skimmed off the top in government projects
- The solutions will have to do with good governance.
- There are some ways the India growth story is compromised by inequality.
- Supply side problems:
  - Shortage of skilled labor – even in IT call centers - so companies moving to the Philippines.
  - Infrastructure development has been high profile but not necessarily the critical less glamorous rural roads.
  - Indian state has been characterized by being business friendly but not market friendly.

### **Discussion:**

- Question for Nora: what about Chile?
- Question for Kalle. You described a social contract where capitalists are allowed to get a lot of money with the assumption that they will save and invest. But

yesterday we saw the story of the financial sector facilitating consumption not investment in the US. Is that spreading to Scandinavia?

- For Jody, how do the maps take into account informal sector and would it make other countries look worse?
- Africa is a unique story where growth has been based on extraction.

**Ferreira:**

- Enormous heterogeneity in growth story in Africa. Some growth from natural resource countries – a lot more growth from natural resources countries. But also some from non-resource rich countries.
- Every sector growing in absolute terms, but manufacturing and agriculture growing very little.
  - Agriculture growth is pro-poor, but there is little growth.
  - Manufacturing is not pro-poor, but there is little growth.
  - Service growth is pro-poor and there is a lot of growth.

**Heymann:**

- Labor market discrepancies may be different in informal market, but a lot of policies are through the labor market (infant care etc).
- Who do these policies cover? When you compare similar countries, the laws make a big difference.
- If you compare at low and middle income settings, still better off to have the law on the books.
- The laws matter.
- The other myth is that this is solved by extended families.

**Lustig:**

- The outlier in Latin America is Colombia and Guatemala.
- Chile is not an outlier, it starts with high inequality but it is moving in the same direction.

**Session VII: Policy Outlook and Research Priorities**

**Chair: Danny Leipziger**

**Robert Triest, Janet Gorick, Heather Boushey, Roland Benabou, and Arjun Jayadev**

**Robert Triest:** Inequality of Opportunity and Aggregate Economic Performance

- Focused on inequality of economic opportunity.
- In the literature the relationship between inequality of outcomes and growth is inconclusive.

- But there is a clear theoretical prediction that inequality of opportunity constrains growth – and the limited empirical evidence suggests that is true.
- Ferreira and Rodriguez have two papers that measure outcomes and growth.
  - Measure inequality of opportunity by parent education etc
  - The residual –can be described as luck, effort or all else
- Rodriguez looks at the US by states
  - Opportunity is measured by father’s race and education. Conclusion are race and father education are bad for growth – “effort et al” good for growth.
- Ferreira looks at cross-country data with 2-5 indices. No firm conclusion.
- Our paper –
  - Use data on 741 US commuting zones.
  - We measure absolute mobility – income rank at age 30 of children whose parents were at 25<sup>th</sup> percentile while children.
- What is relationship between absolutely mobility and growth?
- Distinct positive relationship between absolutely mobility and per capita income.
- Relative mobility positive relationship.
- Absolute mobility in both period (2000-2010 and 2007-2012) is significant.
- Some endogeneity issues similar to what Krugman warned against.
- But take in conjunction with other findings –Rodriguez for example – you are getting the same story.
- Channels?
- Credit market imperfections
  - Unequal access to collateral and insider networks
  - Unequal opportunities for risk diversification
  - Lack of information about investment opportunities - i.e. – private colleges
- Missing markets for job matching and human capital – i.e. –job networks
- Parents
- Unequal access to education and professions
- Unequal human capital investment may hurt society in which market is embedded
- Policies can reverse these trends.
  - Programs to improve nutrition, health and preschool
  - Programs to complement primary and secondary education
  - Better-targeted financial aid programs and outreach
  - Better opportunities for adult education and degree completion
  - Redistributive policies on efficiency grounds
  - Ease of unionization in industries with high rents
  - Policies that promote apprenticeship programs
  - Regulations and incentives for companies to reduce worker turnover and career ladders for low-education workers through learning by doing.
- Paper: Hsieh etc “the allocation of talent and US”

- Relaxation of barriers to entry for women and blacks responsible for 15-20% in growth in output for worker.

### Janet Gorick:

- We commissioned papers for a book 'Income Inequality – economic disparities and the middle class in affluent countries'.
- The book is not about growth – but the literature suggests the middle is such a huge part of growth and a channel for growth.
- Economists stress the role of a large middle class on democracy and growth.
- Three things to point out
  - Measurement issues
  - Descriptive findings
  - Politics
- What do we mean by the middle class?
- Sociologists use multi-dimensional approach, but economists look usually at income distributions.
- Multi-dimensional
  - If you look at the middle 60% - the income share for the middle fell.
  - But by using the middle 60%, you don't allow the middle class to shrink or grow. So then set bands around median.
  - What happened to size of middle band?
  - In 10 different countries, when the size of the middle fell, most of it moved upward.
  - Lane Kenworthy suggests looking at the growth of income of 25%, 50%, 75% - see shift toward higher growth at higher levels.
- Why do we care about middle class? What resonates?
  - In some countries, inequality has limited income growth of the middle class.
  - US, Canada, and Germany, but not in UK, Netherlands and Finland.
  - 16 – 24 year olds in the US are falling behind counterparts in other industrialized countries in literacy, numeracy, and technology skills.
  - American companies pay less in the US than counterparts in other nations.
  - Executives earn higher incomes in the US, while minimum wage is lower.
  - As measured by the Gini coefficient, US is more unequal both before and after taxes than other OECD countries.
- Inequality per se doesn't have traction, but the exploding 1% seems to capture more attention. So does the hollowing or threatened middle.
- One conservative response: the left keeps talking about the weakening middle but that is not true. The middle is experiencing income growth. We can see size of middle declining, and income share declining, but the absolute income still growing.

## **Heather Boushey:**

- A big reason we are here is because of where we are politically.
- Despite sluggish recovery for most Americans there has been no improvement.
- American electorate doesn't know what to do about it.
- Regardless of our belief that inequality is critical and also critical for growth, we have more work to do.
  - Some questions:
    - Should we try to change the conversation on GDP for policymakers?
    - Reminder from Paul Krugman that we should not be too greedy about making inequality points.
    - I would propose focusing on trends in inequality and economic growth and stability as a way to frame a research and policy agenda to inform that debate.
    - We have an opportunity to reframe the narrative in the next two years.
    - We need a message about channels through which inequality affects economy.
    - Crisp stories to tell policymakers, research that will get us to compelling stories.
      - The profession finds this literature inconclusive.
      - This can't be the battle of the economists.
      - What kind of research is going to get us to compelling stories.
    - One message to highlight that comes from the Hsieh study – it is the opening up of professions to women and minorities has been a major contributor to productivity and GDP.
- Some ideas for clarifying the story:
  - Take advantage of presidential debate.
  - While we got a republican congress, ballot initiatives did well – minimum wage passed in 4 states where Republicans were elected. We have 3 states with paid sick leave.
  - Menzi chin – Wisconsin vs. Minnesota found the Minnesota progressive policies improved growth.
  - Elevate case studies
- The question we're asking is what makes the economy grow and we have an opportunity to have some compelling stories to tell.
- What positive stories we can tell about inequality and growth? Use the GLEE TV show ethos.

## **Roland Benabou: Inequality and Performance Theory**

- In the 90s and early 2000s, active literature on growth and inequality.

- Imperfect capital markets particularly for financing human capital leads to idea that tomorrow's wealth depends on today.
- Redistribution reduces future inequality and may increase social mobility.
- Classical economics: equity-efficiency tradeoff, with growth-reducing redistribution imposed by median voter.
- Observed: higher inequality leads to less redistribution.
  - Perhaps initially more distributive.
  - But that changes over time that the more inequality the less redistribution.
  - The 1% takes over politics.
- More equal states have more redistribution (there is a U shape).
- More unequal states are less mobile.
- More spatially segregated cities are more unequal in opportunity.
- History matters, initial distribution of income sets path-dependence.
- Beliefs matter: "effort and willpower versus luck and social circumstances" as determinants of outcomes.
- Missing from rational political economy accounts theory:
  - Cannot attribute lack of support for policies to rational interests.
  - Reactions to redistribution depend on what people think causes initial inequality.
  - Beliefs may be completely out of line with social mobility.
- Douglas North: participants in economic systems develop ideology that rationalizes the economic structure and explains its poor performance, resulting in policies that reinforce existing incentives and organizations.
- You have to bring in behavioral economics or psychology.
- Supply side propaganda is one argument – but the media is not right wing.
- Demand side – people tend to rationalize their own world.
- Ideology is shaped by material world and then continues to shape material world.
- Countries where belief that luck is determinant of inequality are more redistributive.
- Higher inequality shapes views to perpetuate higher inequality.
- We need more work on the determinants of these attitudes and how they change.
- High pay – rents or rewards: our new paper will argue it is both.
- The higher you go in wages structure the more performance pay.
- There is evidence that this is a response to increased competition for talent
- We know short-term rewards can be harmful and so do firms, why do they do it?
- Ends up being a screening device that firms lose control of.
- At low levels of competition, firms offer too little incentives and extract rents.
- At high levels of competition, they offer high incentives that are socially not beneficial.
- Compensation is hump-shaped.
- Space for bonus caps, but may lead to other distortions.

- Argument for progressive taxation.
- Future research: externalities and competition among different firms

### **Arjun Jayadev: Guard labor and inequality**

- Unequal societies devote large resources to protection of property rights.
- Inequality key to necessary guard labor. Strong correlation.
- There is an enforcement-equality trade off.
- That is, societies that share their resources more equally enjoy levels of greater social and political legitimacy and may not require spending large resources on protecting the status quo distribution of property rights.
- We present evidence across countries, across US states, across cities.
- Correlation between high levels of conflict, low legitimacy.
- One way to measure this is the amount of labor devoted to “guard labor”.
  - You can include police – or legal etc
  - We use protective service workers (private guards) and test against inequality
- You see a connection between countries, states, and cities.
- Although strong link, no causality.
- Are there welfare implications?
  - Do guards count as addition to GDP or subtraction to GDP?
  - Long debate – but implication is as people move from production jobs to defensive expenditures then it is not a highly productive economy but same GDP.

### **Discussion:**

- In response to Roland: we do find more redistribution with more inequality.
- Arjun touched on all the dysfunctional behavior societies produce with extreme inequality – and these could have important effects on economic performance.
- Market for soccer coaches in Europe functions similarly to CEO pay in US.
- In terms of Arjun’s paper, rich segregate themselves and opt out of public services.
- **Stiglitz:** Performance pay loophole created in the early Clinton administration by Rob Rubin. But even then Stiglitz had research showing it wasn’t based on performance but rather on rent seeking.

### **Benabou:**

- First step in behavioral agenda on beliefs is what causes distortion. Second is how it spreads.
- For CEOs, it becomes bad for efficiency when it distorts the structure for pay – a multi-task model.

## Wrapping Up and Next Steps:

### Danny Leipziger:

- Take Krugman's admonition to heart. We are talking to like-minded people and we need to separate normative judgments from what is useful.
- When we think about transfers in developing countries we think of them as investments in children. But in the US we consider these to be consumption goods – as Jared Bernstein mentioned
- We haven't proved here that inequality is bad for macro-performance. It's hard to imagine that consumption won't change and that the top shouldn't worry if 80% don't have disposable income
- The developing world has lots of lessons to offer. The debate is not new in the developing world. In World Bank, we have lessons on this.
- This is much more than a US problem. 50% of the gains have gone to the global 5%.

### Jan Svejnar:

- Conference rich in providing stylized facts
- Middle class incomes stagnating
- Questions around MPC for rich vs. poor
- Unemployment above NAIRU 70% of the time after 1980, 30% before
- Then there were issues around measurement
- Gini vs. Palma
- Methodological issues around endogeneity of variables, theoretical perspective is useful
- Diversity of results
- Some fairly robust findings
- Surprising findings from Latin America for example
- We need to worry about or think about different types of inequality beyond just income or Gini

### Joseph Stiglitz:

- How confident can we be about the relationship between inequality and economic performance? One option is to focus on undermining the alternative. Similar to minimum wage, studies discredited conventional wisdom that minimum wages would hurt poor and growth. If there is one goal, we find that the Okun view is clearly wrong.
- The story Nora told about inequality improving in Latin America offers a potential for lessons learned. Are those transferable? Scandinavia has managed to avoid the drastic consequences of US – are there lessons there?
- There is valuable work for theoretical frameworks to understand what is going on – mentioned by Roland and Adair. Starting from the point that markets have failures, private returns will not reflect social returns.



- We could look at natural experiments, but at the bottom line it's about policies. Those are the natural experiments we want to try.
- There are different narratives. The right has incentives, investment, hard work, etc. There is an alternative narrative about opportunity, rents, etc.
- Many of the phenomena we're looking at have multiple causes. Growth and instability are affected by numerous things of which inequality is one. Even the channels – there are many reasons people get in debt and inequality is one.
- Finally, among the short run stories, performance is one. If people don't have incomes its very hard to spend. If you don't believe that then you don't believe in modern macroeconomics.