Instability Implications of Increasing Inequality: What can be learned from North America?

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Road Map

- Review of Empirical Trends
- U.S. & Canada
  - Increasing Inequality $\Leftrightarrow$ Unbalanced Growth by Income class
  - Increasing inequality cannot be a steady state
- Mexico
  Structural Changes of Development can grow low incomes
  Political Economy of Social Policy – if Elites threatened
- Economic Implications
<table>
<thead>
<tr>
<th>Illustrative Statistics - 2009</th>
<th>CANADA</th>
<th>MEXICO</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population - (millions)</td>
<td>33.7</td>
<td>107.4</td>
<td>307.0</td>
</tr>
<tr>
<td>GDP (Billion current U.S.$)</td>
<td>1,336</td>
<td>883</td>
<td>14,044</td>
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<tr>
<td>GDP per capita (PPP 2005 $)</td>
<td>34,600</td>
<td>12,500</td>
<td>41,700</td>
</tr>
<tr>
<td>Life expectancy at birth, total (years)</td>
<td>81.2</td>
<td>75.3</td>
<td>78.7</td>
</tr>
<tr>
<td>Agriculture (% of total employment)</td>
<td>2.5</td>
<td>13.5</td>
<td>1.4</td>
</tr>
<tr>
<td>Crude Birth Rate Change (1980 to 2009)</td>
<td>-3.9</td>
<td>-15.8</td>
<td>-2.1</td>
</tr>
</tbody>
</table>
Different trends in Inequality?

- Mexico
  - ↑ then ↓

- Canada
  - ↓ then ↑

- USA
  - ↑ then ↑
Unbalanced Growth ↔ Increasing Inequality

- **U.S. & CANADA** – similar market Income growth 1987-2007:
  - Top 1% @ 4%;
  - Bottom 80% @ 0.5%
  - Canada – 1995 = shift in redistribution by government

- **Mexico since mid 1990s** – declining inequality
  - Structural changes + Social transfers (*Progresa*)
    - Similar to U.S. & Canada post 1940?

- **Steady State Equilibrium = Special Case of Balanced Growth**
Canada – nil real growth for most
U.S. – real growth only at top
Long Swing in Top 1% Share
Top 1% incomes did not fall – just grew more slowly
– Relative Growth => Changed Share
Much Higher Real Income Growth @ Top
Balanced Growth $\iff$ Same Rate Income Increase @ Top & @ Bottom

- U.S.: Annual Income growth 1987-2007: Top 1% = 4%; Bottom 80% = 0.5%

- What chances for bottom quintiles to grow @ 4% cumulatively?
  - U.S. – Unemployment > 9%; Poverty @peak; Return of Recession?
  - Canada & US: Unions weak; Low-wage competition strong; small marginal returns to HK investment & structural change
Income & Wealth Accounting

- Income = Consumption + Savings
  - $Income \text{ Increases @ top} \Rightarrow Savings \Rightarrow \text{Increase Loanable Funds}$
  - $Real \ Expenditure \ Balance \ iff \ up \ Savings \ of \ top \ 1\% = \ up \ spending \ rest$
  - Escalating Consumption Norms – set @ top and ripple down
    - "Expenditure Cascades" $\Rightarrow up \ consumption \ norms \ for \ stagnant \ middle$

- $U.S. \ up \ inequality \ of \ consumption < up \ inequality \ of \ income$
  - Mitigated short run welfare implications of $up \ inequality$
Debt Instability

\[ D_t = (1 + r_t) \cdot D_{t-1} - PB_t \]

\[ \Delta (D/Y)_t = (r_t - g_t) \cdot (D_{t-1}/Y_t) - (PB_t / Y_t) \]

- **The compounding of debt overhang**
- \( r_t > g_t \)
  - Accumulated Deficits \( \Rightarrow \) \( \uparrow \) Debt/GDP \( \Rightarrow \) \( \uparrow \) Deficit \( \Rightarrow \) \( \uparrow \) Debt
Mexico: More growth @ bottom
Mexico: Structural Change & Growth

- 1995: recession => un(der)employment
- High % agriculture => rural out-migration => wage gains
  - Mexico: 2 step process: rural poverty → informal urban → formal urban
- Low % employed women => big impact ↑ female jobs
- % enrolled primary & secondary => high marginal HK returns
- Capital deepening => ↑ MPL
Canada: 1990s fiscal crisis $\Rightarrow \downarrow$ redistribution
Tendency to $\uparrow$ inequality reinforced
USA: What chance for a New “New Deal”? 

- 1930s: FDR & “New Deal”

- U.S. Policy Innovation Stabilized Growth & Inequality
  - Cyclical: Public Works Stimulus
  - Structural:
    - Bank Regulation + NLRB + Social Security + Progressive Taxation

- U.S.: Systemically stabilized for 50+ years
  - Eroded in stages since early 1980s
Conflicted attitudes + $ politics

- Bimodal distribution → small migration tips
  majority balance
  - BUT short terms + division powers + courts
    → soon tips back

- “Deeper Pockets”
  - ↑ ≠ $ → ↑≠ influence
The unsustainable does not last – but what follows?

- Unbalanced Income Growth ⇔ Increasing Inequality
- Cannot be a steady state equilibrium
  - Produces Interacting Instabilities – cumulative impact
- U.S. & Canada: Parallels with 1930s but many structural changes

- No Automatic Economic Tendency to self-correction is obvious
Debt Instability
– The Power of Accounting Identities

\[ D_t = (1 + rt)^* D_{t-1} - P_{Bt} \]

- \( D_t \): Debt in period \( t \)
- \( rt \): average rate of interest in period \( t \)
- \( P_{Bt} \): Primary Balance in period \( t \)

\[ = (\text{Taxest} - \text{Program Expenditure}_{\text{est}}) \]

\[ \Delta (D/Y)_t = (rt - gt)^*(D_{t-1}/Y_t) - (P_{Bt} / Y_t) \]