

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

Lars Osberg
Economics Department
Dalhousie University

*ECONOMIC AND SOCIAL
INEQUALITIES: CAUSES*

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

<u>Illustrative Statistics - 2009</u>			
	<u>CANADA</u>	<u>MEXICO</u>	<u>U.S.</u>
Population - (millions)	33.7	107.4	307.0
GDP (Billion current U.S.\$)	1,336	883	14,044
GDP per capita (PPP 2005 \$)	34,600	12,500	41,700
Life expectancy at birth, total (years)	81.2	75.3	78.7
Agriculture (% of total employment)	2.5	13.5	1.4
Crude Birth Rate Change (1980 to 2009)	-3.9	-15.8	-2.1

Different trends in Inequality?

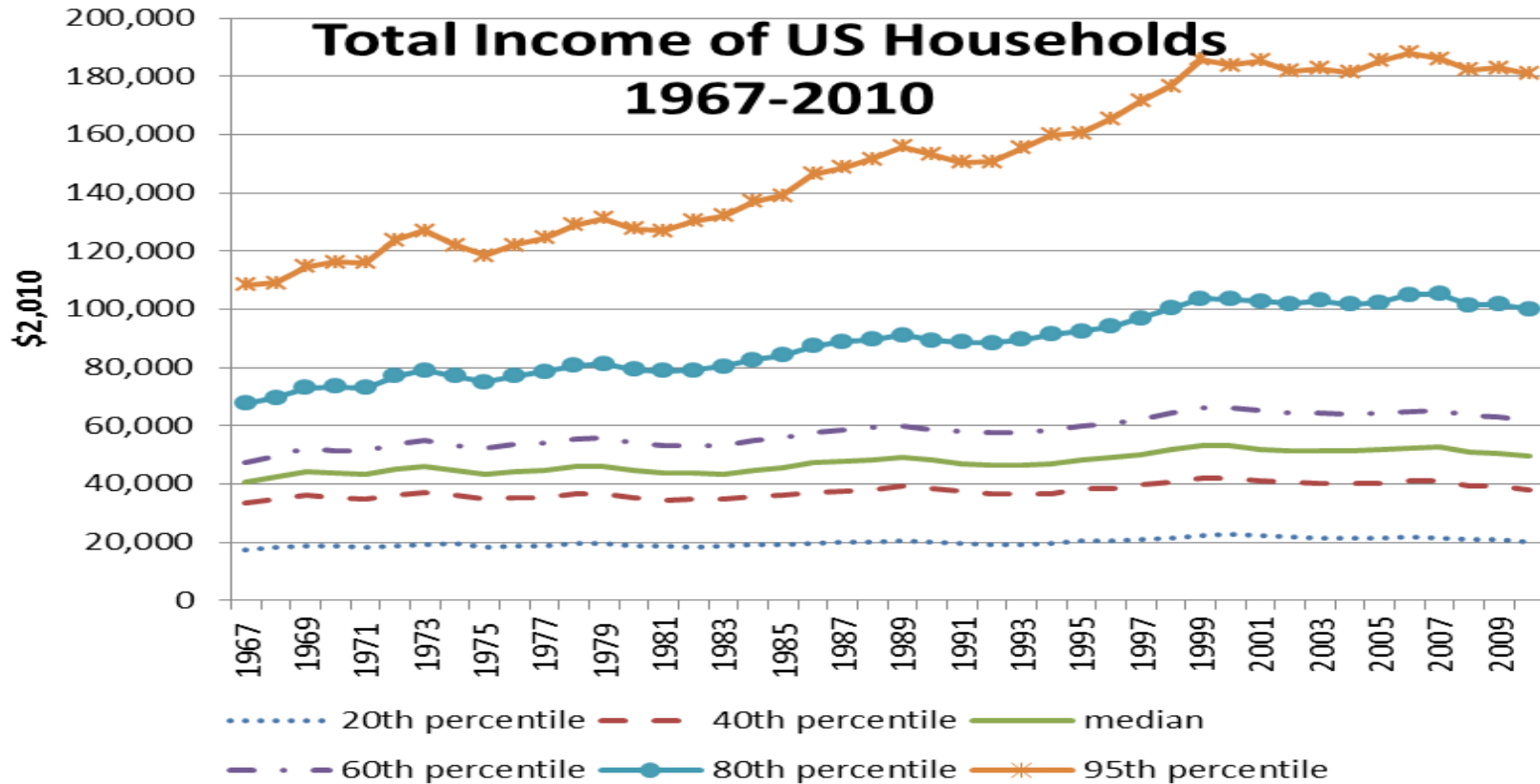
- Mexico
 - ↑ then ↓
- Canada
 - ↓ then ↑
- USA
 - ↑ then ↑

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

Top1% incomes did not fall – just grew more slowly

– Relative Growth \Rightarrow Changed Share

Much Higher Real Income Growth @ Top

Balanced Growth \Leftrightarrow 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

- $\text{Income} = \text{Consumption} + \text{Savings}$
 - *Income Increases @ top \Rightarrow Savings \Rightarrow Increase Loanable Funds*
 - *Real Expenditure Balance iff \uparrow Savings of top 1% = \uparrow spending rest*
 - *Escalating Consumption Norms – set @ top and ripple down*
 - *“Expenditure Cascades” \Rightarrow \uparrow consumption norms for stagnant middle*
- *U.S. \uparrow inequality of consumption < \uparrow inequality of income*
 - *Mitigated short run welfare implications of \uparrow inequality*

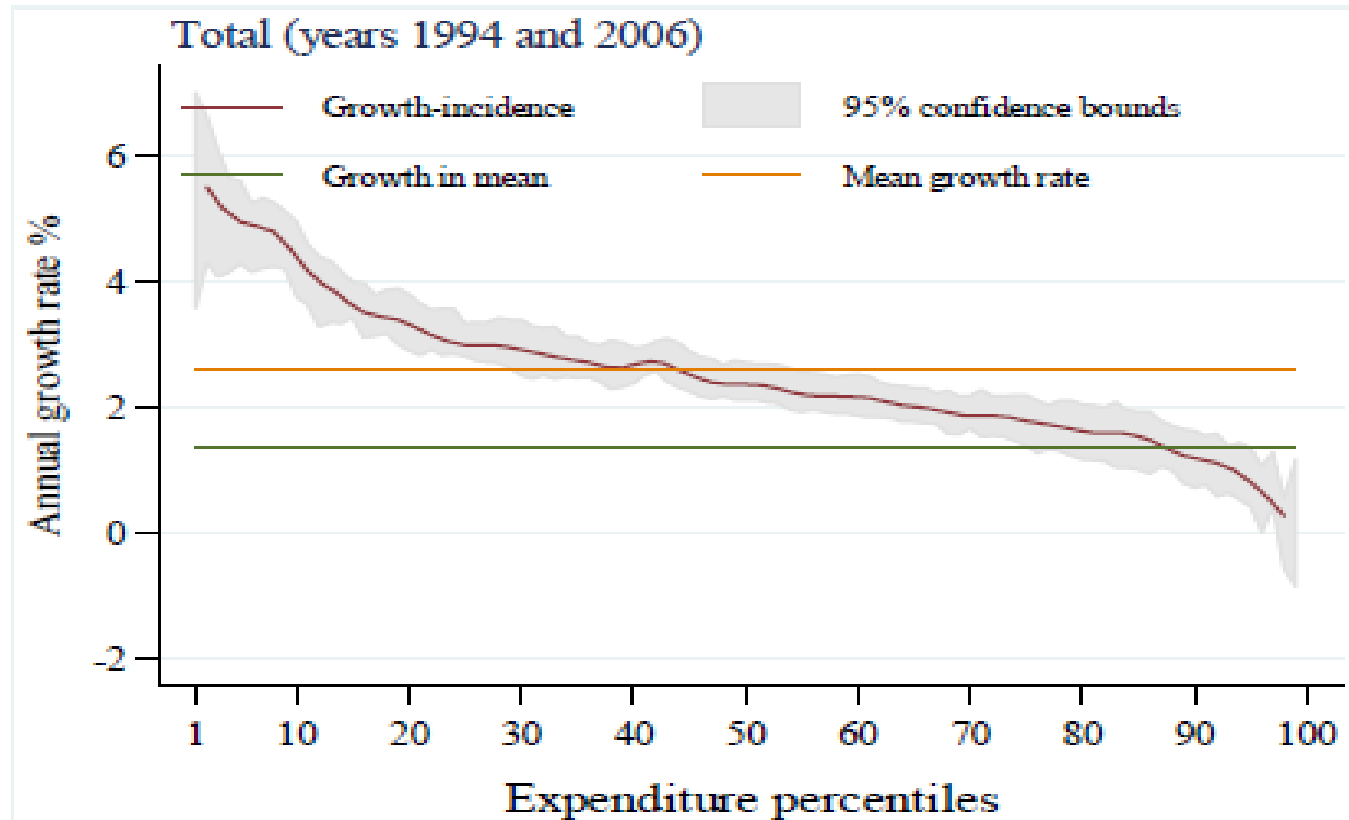
Debt Instability

$$D_t = (1 + r_t) * D_{t-1} - P B_t$$

$$\Delta (D/Y)_t = (r_t - g_t) * (D_{t-1}/Y_t) - (P B_t / Y_t)$$

- 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 ↓

redistribution

Tendency to ↑ 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”
 - $\uparrow \neq \$ \rightarrow \uparrow \neq$ influence

The unsustainable does not last

– but what follows?

- Unbalanced Income Growth \Leftrightarrow 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

$$D_t = (1 + r_t) * D_{t-1} - PB_t$$

D_t = Debt in period t

r_t = average rate of interest in period t

PB_t = Primary Balance in period t

= (Tax_{est} – Program Expenditure_{est})

$$\Delta (D/Y)_t = (r_t - g_t) * (D_{t-1}/Y_t) - (PB_t / Y_t)$$