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

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ECONOMIC AND SOCIAL
INEQUALITIES: CAUSES

Road Map

- Review of Empirical Trends

- U.S. & Canada

  - Increasing Inequality ⬄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

Illustrative Statistics - 2009			
	CANADA	MEXICO	U.S.
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

Total Income of US Households 1967-2010
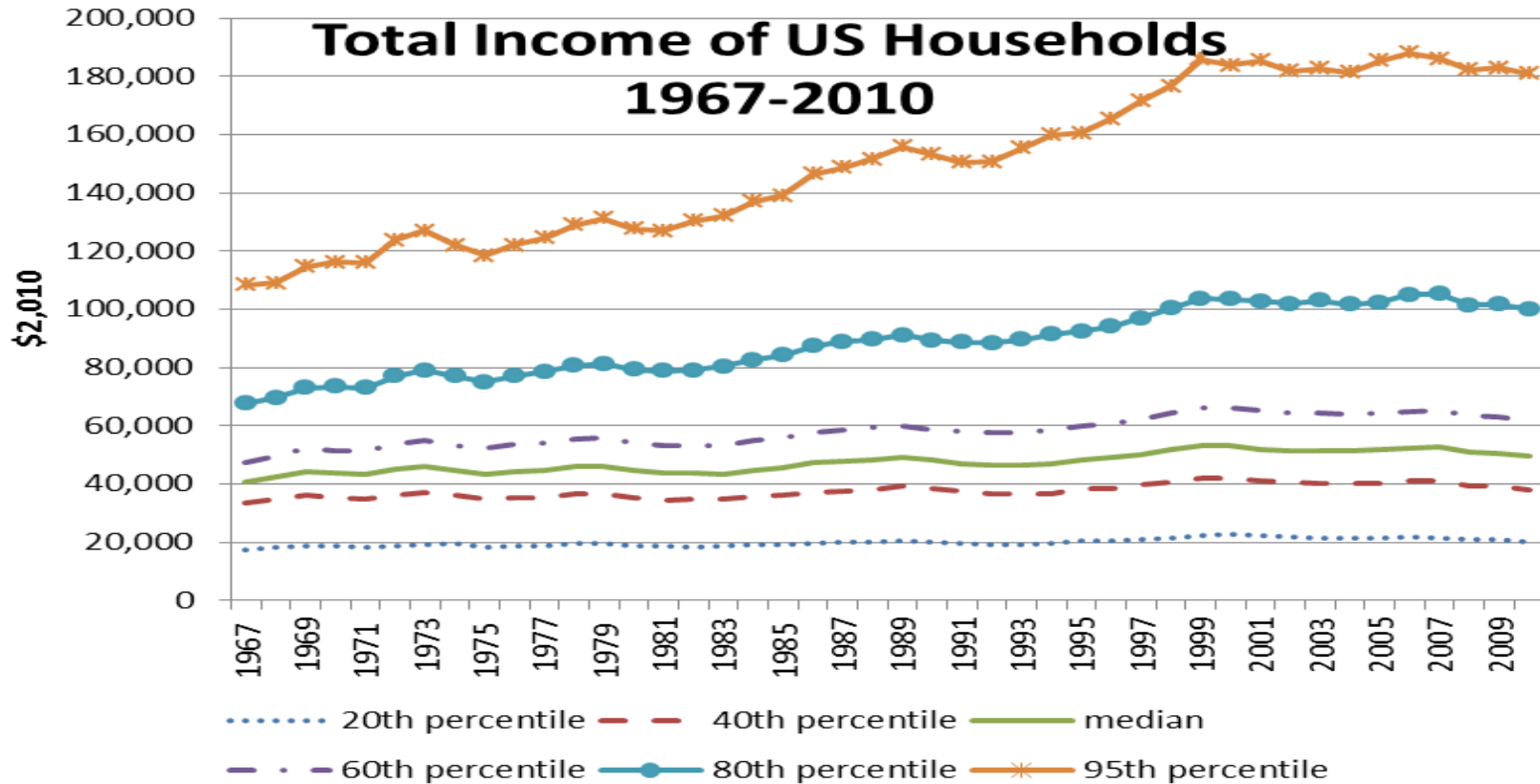
Long Swing in Top 1% Share

Top1% incomes did not fall – just grew more slowly
– Relative Growth => Changed Share

Much Higher Real Income Growth @ Top

Balanced Growth ⇔ 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 Increases @ top => Savings => Increase Loanable Funds*

  - *Real Expenditure Balance iff ↑ Savings of top 1% = ↑ spending rest*

  - *Escalating Consumption Norms – set @ top and ripple down*

    - *"Expenditure Cascades" => ↑ consumption norms for stagnant middle*

  - *U.S. ↑ inequality of consumption < ↑ inequality of income*

    - *Mitigated short run welfare implications of ↑ inequality*

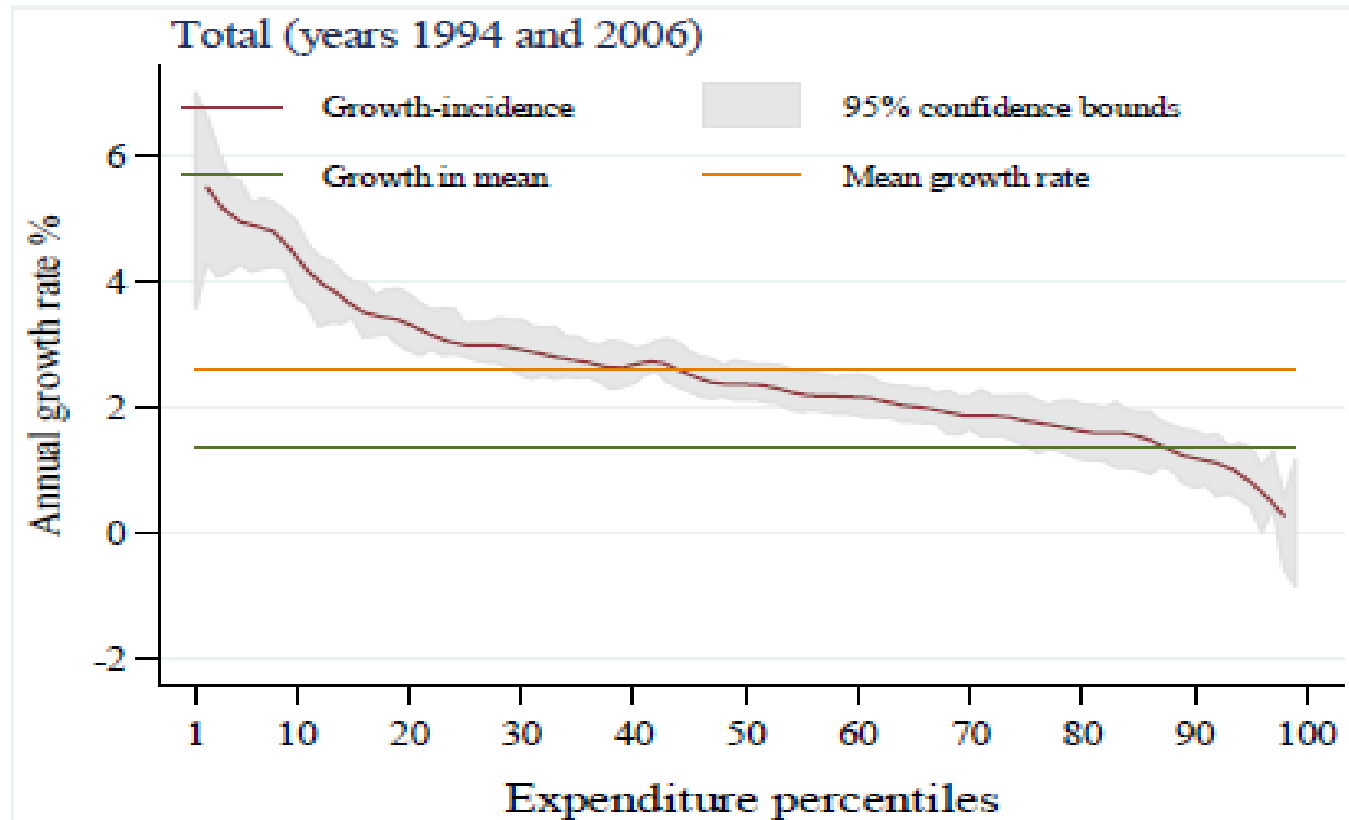# Debt Instability

$Dt = (1 + rt)* Dt-1 - PBt$

$\Delta (D/Y)t = (rt - gt)*(Dt-1/Yt) - (PBt / Yt)$

- _The compounding of debt overhang_

- rt > gt

  - Accumulated Deficits => ↑ Debt/GDP => ↑ Deficit => ↑ Debt

Mexico: More growth @ bottom

Total (years 1994 and 2006)

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 => ↓ 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"

  - ↑ ≠ $ → ↑≠ 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

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

D_t = Debt in period t

r_t = average rate of interest in period t

PB_t = Primary Balance in period t

$$= (Taxes_t – Program\ Expenditures_t)$$

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