

Inequality:

Empirics, Causes, Consequences, and Implications

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Empirical Background

- Inequality in the US has skyrocketed over the past three-to-four decades.
- At the same time, income growth across the income distribution has worsened for all but the very rich.
- The labor market has steadily slackened, especially since 2000.
- Income for the highest earners has skyrocketed as its stagnated or declined for everyone else.
- Strong evidence that's due to declining statutory and effective tax rates at the top.

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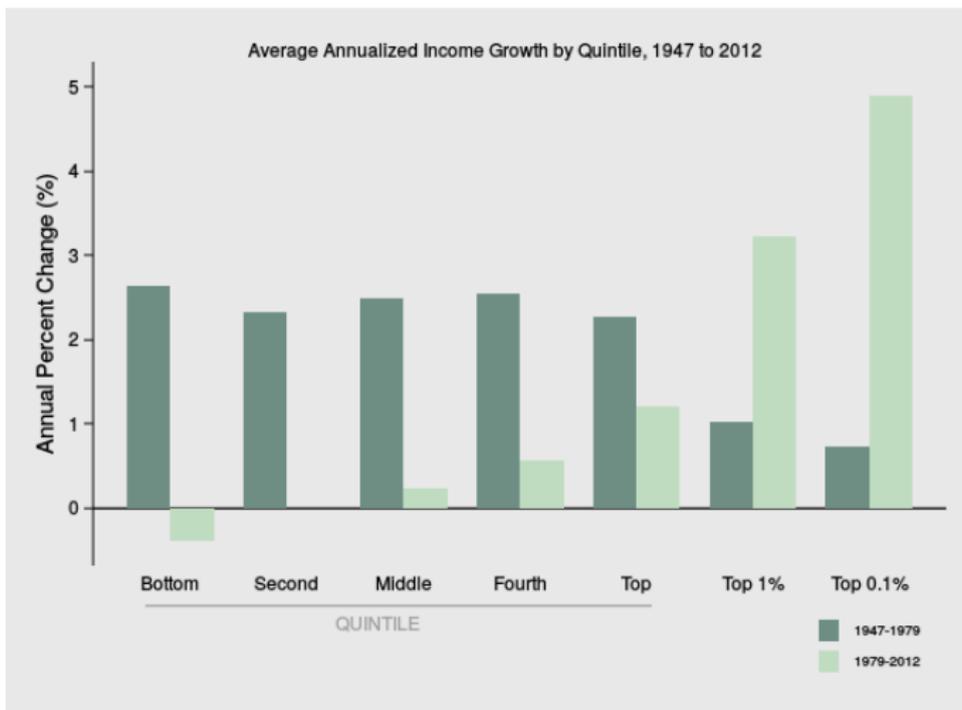
Outline

- 1 Inequality and Growth, past and present.
- 2 Why has inequality increased? Good and bad explanations.
- 3 Where do we go from here?

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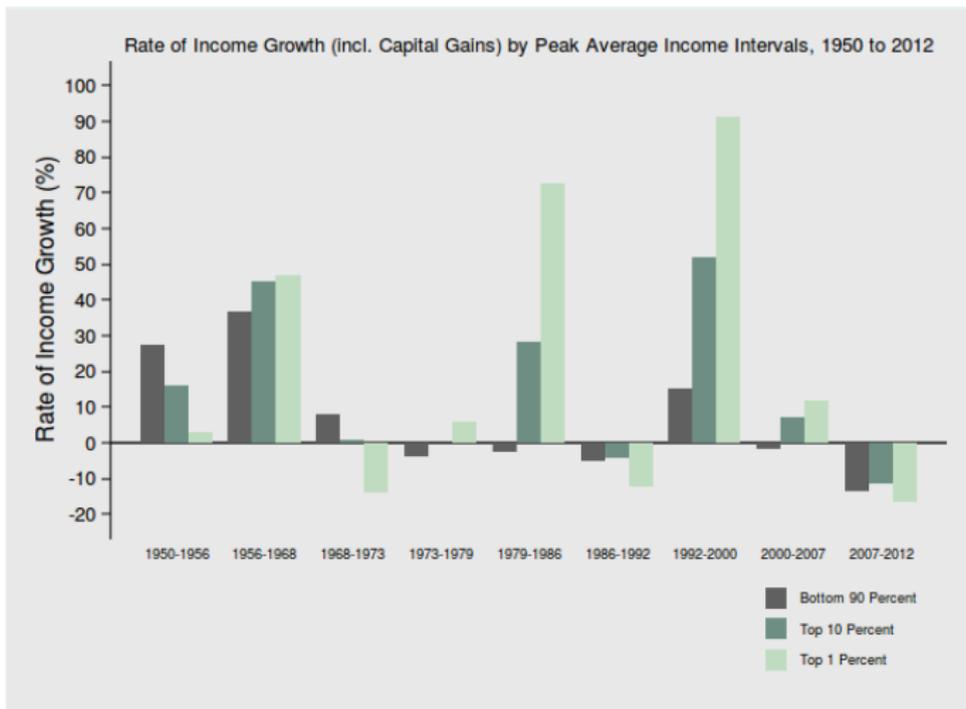
1. Inequality and Growth, past and present.

We Know What Equitable Growth Looks Like



Source: Tabulations of the Current Population Survey (income quintiles) and tax data from the World Top Incomes Database (top 1% and top 0.1%)

Income Gains Are Increasingly Narrowly Distributed

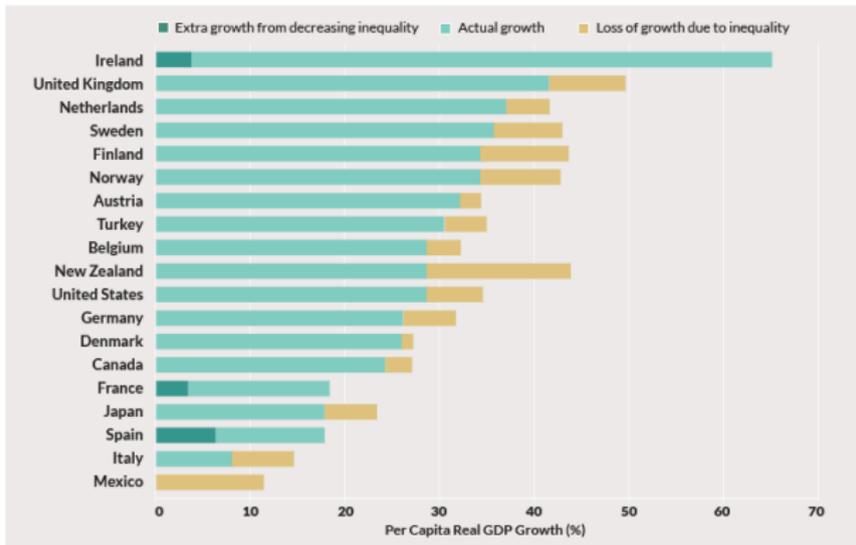


Source: World Top Incomes Database.

Inequality Harms Growth: Cross-Country Evidence

OECD Finds Inequality Hampers Economic Growth

The Organization for Economic Co-operation and Development estimate the consequences of changes in inequality from 1985 to 2005 on per capita real GDP growth from 1990 to 2010. OECD estimate that U.S. economic growth would have been six or seven percentage points higher if inequality had not grown.



Source: OECD, December 2014

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Redistribution Hasn't Changed the Story

- CBO's reports on inequality make it clear that, at most, redistribution is having as much effect on the income distribution now as in 1979.
- Redistribution reduced the Gini Coefficient 26% in 2011, as compared to... 25% in 1979.
- However, the pre-tax-and-transfer Gini is higher now than it was in 1979.

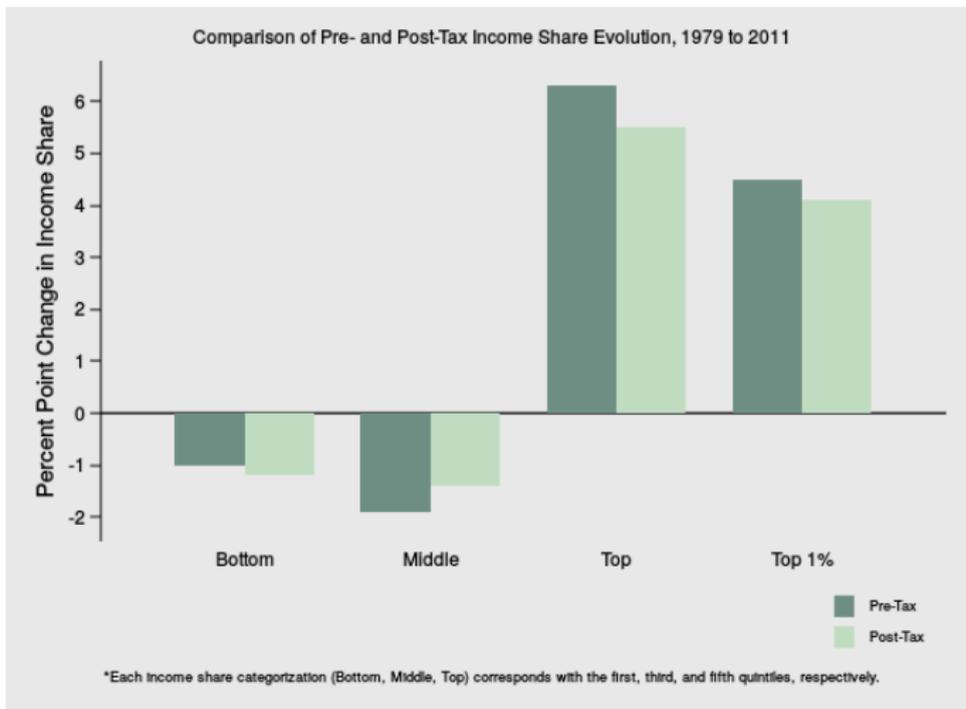
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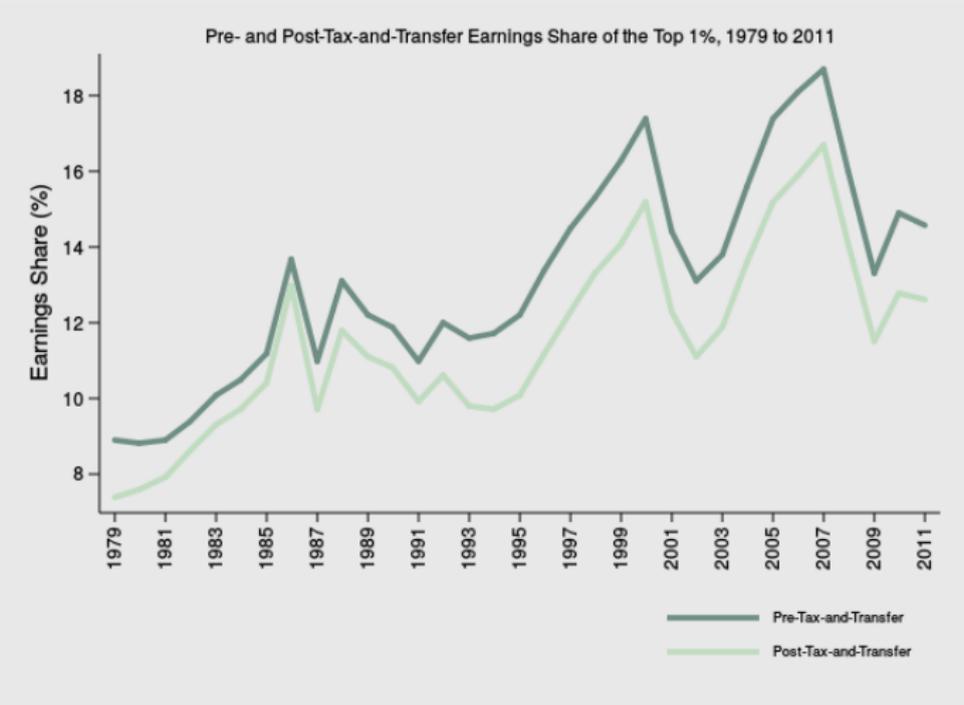
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Income Share Dynamics Pre- and Post-Tax-and-Transfer



Source: Congressional Budget Office

Common Trend in the Top 1% Income Share



Source: Congressional Budget Office

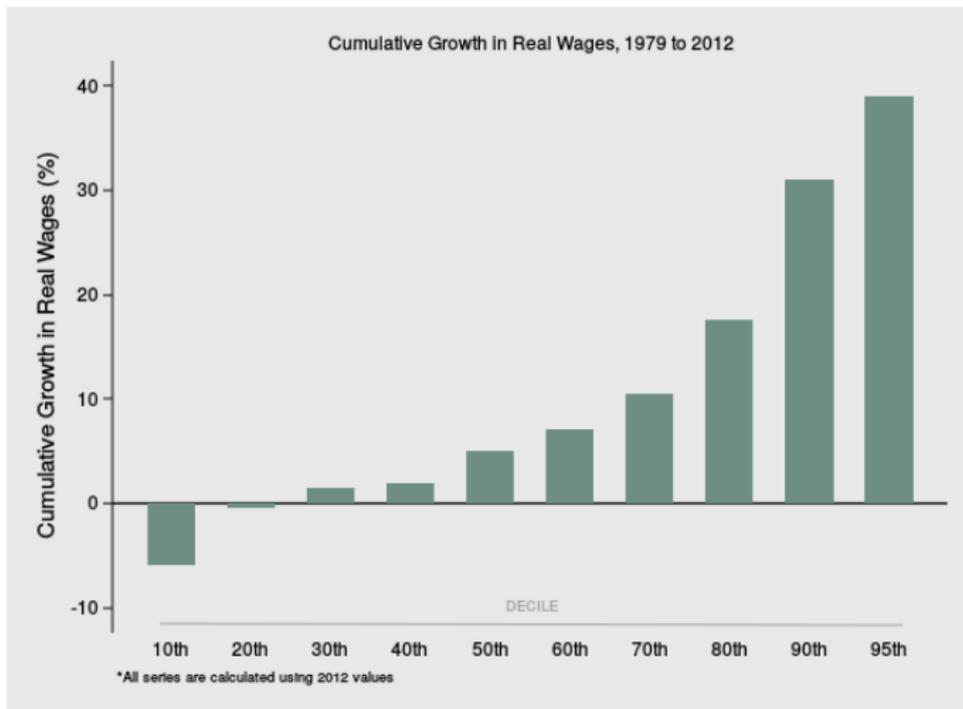
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2. Why has inequality increased? Good and bad explanations.

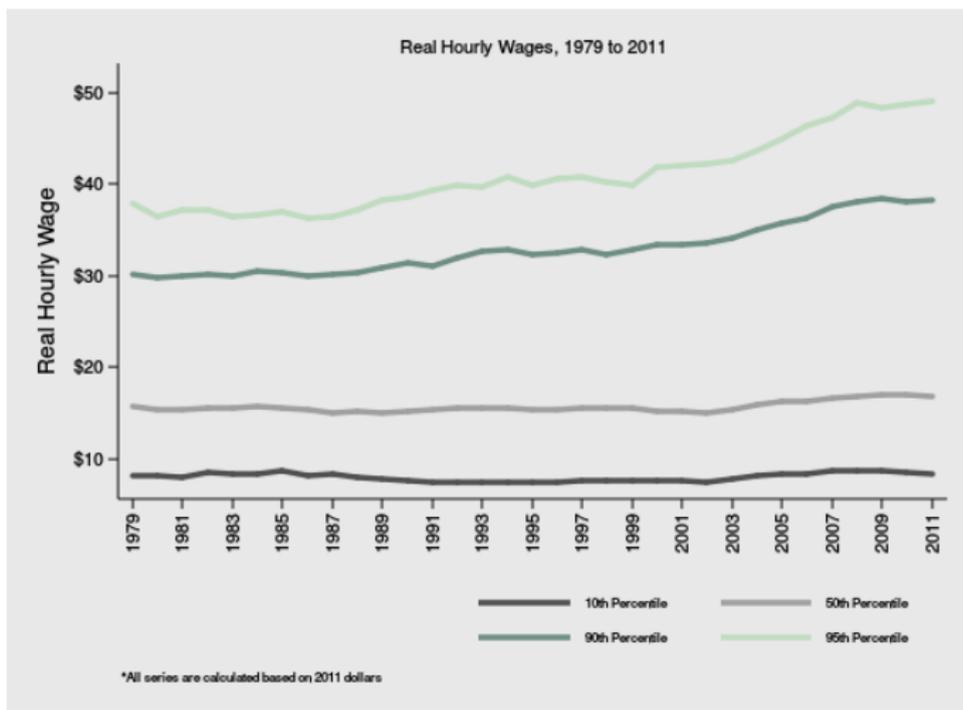
Interpretation of Rising Inequality

- Given the empirics of inequality and growth, why does it matter why inequality has increased?
 - ① If market income inequality were rising due to an exogenous force of technical change that favors skilled workers, and
 - ② If redistribution were rising at the same time to equalize the post-tax-and-transfer distribution,... then the treatment of market inequality as a challenge would be misplaced.
- Unfortunately, this optimistic take just isn't true.
- It's important to get the causes of rising inequality right, so we can understand the nature of the problem (including the fact that it is a problem), and start talking about solutions.
- Given what we know, it's hard to sustain the notion of a tradeoff between equality and growth.

Income Inequality is a Labor Market Phenomenon



Wages Have Been Stagnant for Most Workers



Skill-Biased Technical Change?

- Initial stories of rising inequality stressed diverging returns to different levels of education.
- However, it's becoming increasingly difficult to sustain Skill-Biased Technical Change as a master theory of rising inequality.
 - ▶ Trends in the returns to different education levels are dwarfed by rising tail inequality (top 1% and above), which has no clear cause in any skill or education data.
 - ▶ Workers with higher education qualifications are increasingly taking jobs that previously didn't require tertiary education.

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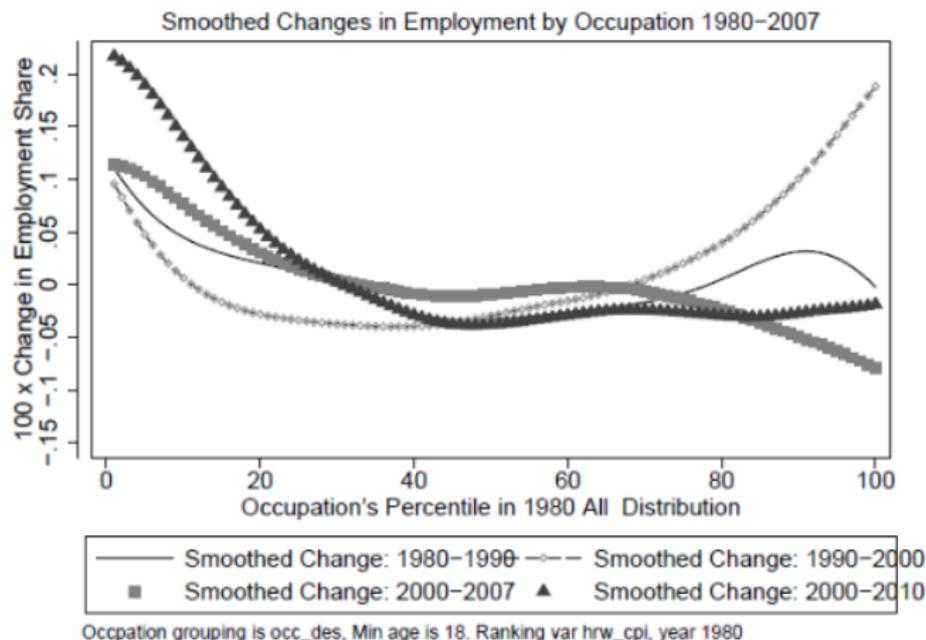
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Rising Inequality Is Not (Solely) Polarization



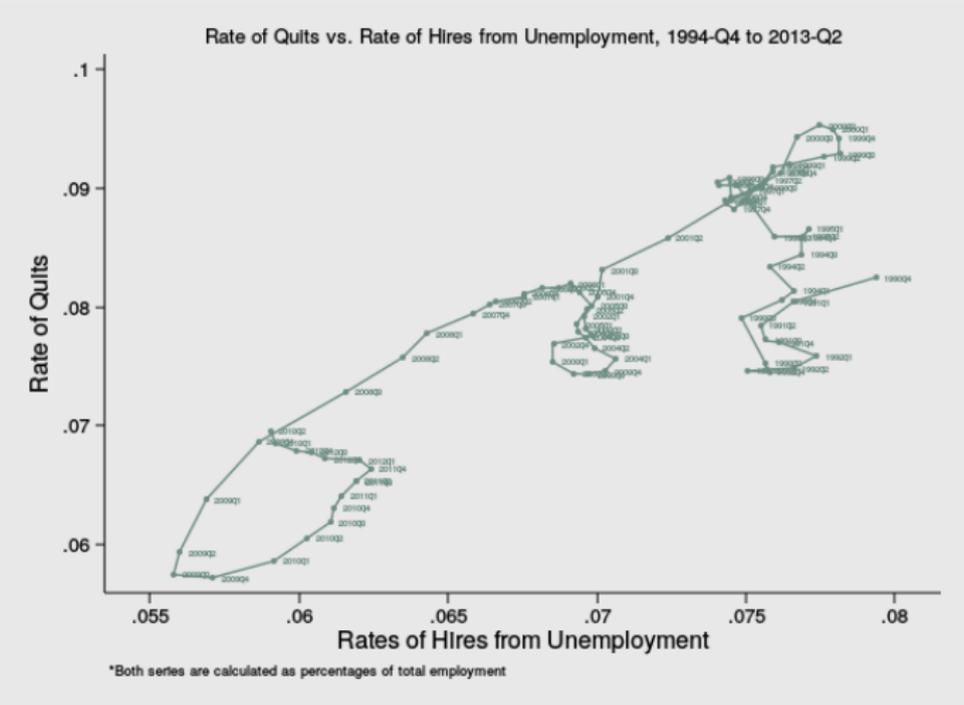
Source: Beaudry et al (2012), "The Great Reversal in the Demand for Skill and Cognitive Tasks."

Manifestations of Labor Market Slack: Declining Mobility



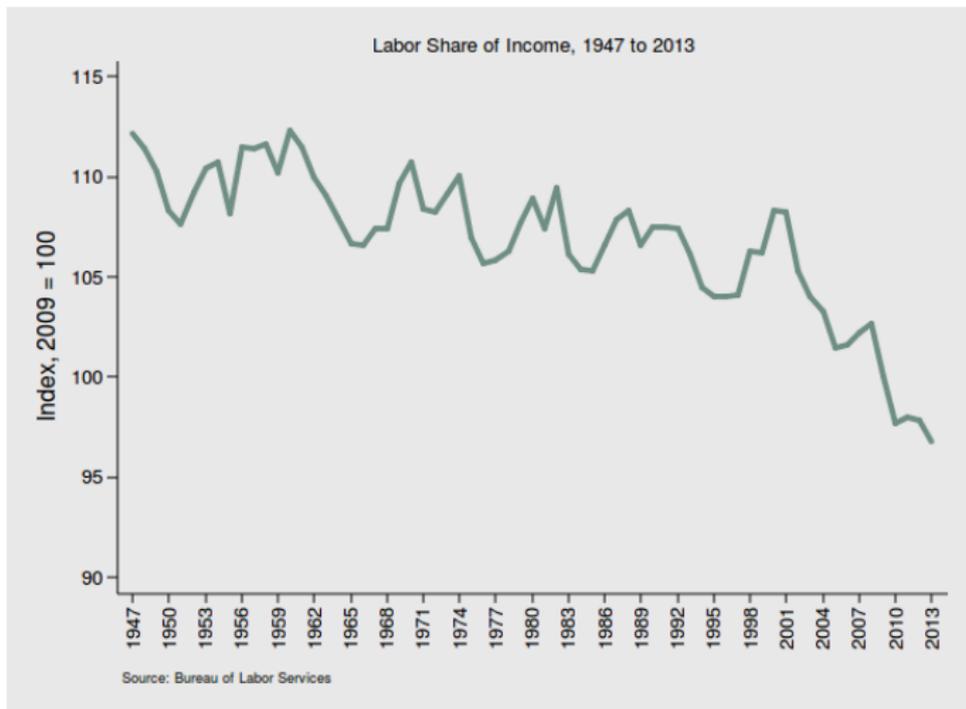
Source: author's tabulations of Current Population Survey and Quarterly Workforce Indicators

Dual Declining Job-Finding Rates for Employed and Unemployed



Source: Quarterly Workforce Indicators.

Labor's Share of National Income Has Declined



Inequality and Taxes

- If the labor market has been slack, what explains rising tail inequality?
- Piketty and Saez (2006) and Piketty, Saez, and Stantcheva (2014) establish that rising inequality is intimately linked to tax system regressification.
- Reductions in statutory and effective tax rates for the rich seem not to have bought any economic growth.
- Instead, Piketty, Saez, and Stantcheva estimate a model in which declining effective tax rates mean that high-income individuals have an incentive to bargain for a larger share of the corporate pie.

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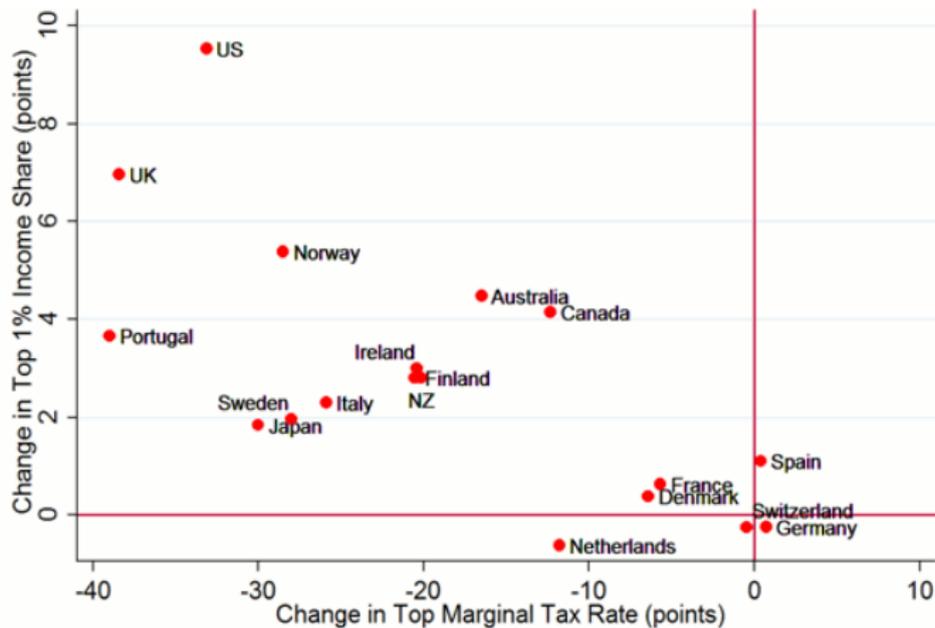
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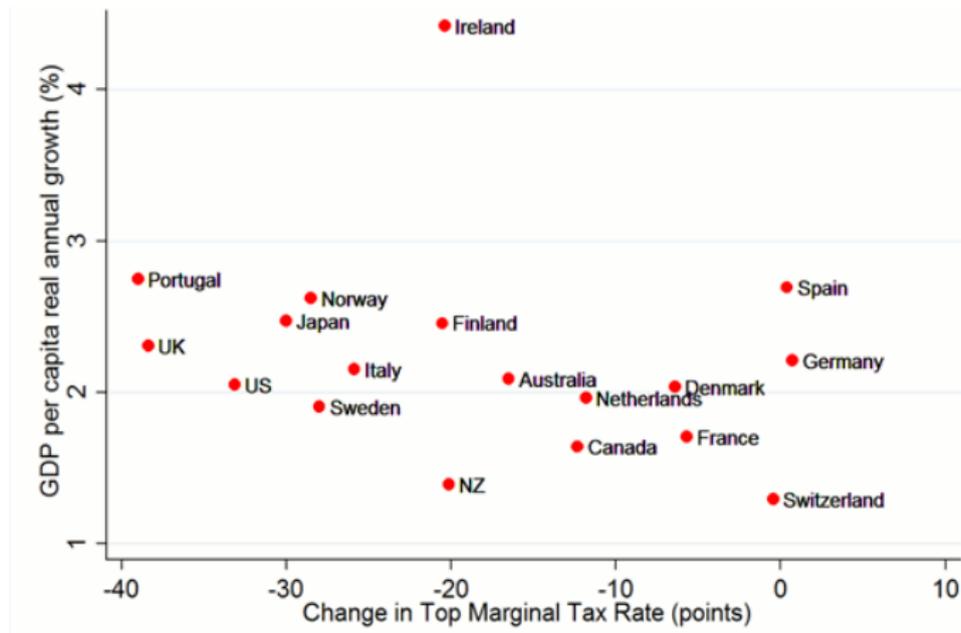
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Inequality and Taxes, Cross-Country Evidence



The interval is 1979-2008.

Growth and Taxes, Cross-Country Evidence



The interval is 1979-2008.

Outline

3. Where do we go from here?

Research Agenda

- Notwithstanding recent studies from the IMF and OECD, plus other literature reviewed by my colleagues Heather Boushey and Carter Price in a paper they released a few months ago, there is no consensus on the bivariate relationship between inequality and economic growth.
- Instead, we need to treat both as multi-dimensional phenomena. The best recent work answering the question “does inequality harm or benefit economic growth?” finds that inequality worsens outcomes for the poor and improves them for the rich.
- Furthermore, we need to look more closely at the mechanisms by which inequality might affect growth:
 - ▶ Human capital development across generations.
 - ▶ Debt and financial imbalances, contributing to Secular Stagnation.
 - ▶ Innovation.
 - ▶ Politics.
 - ▶ Possibly others.

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Policy Implications

- The results relating inequality and taxes imply that the efficiency loss to a tax system that collects a larger share of the economy than we have recently is small-to-nonexistent.
- On the other hand, rising inequality (to date) is mostly a labor market phenomenon, and that implies it can be solved by a robust labor market that works for everyone, without recourse to redistribution policy.
- Piketty's focus on capital in C21 does provide a cautionary tale about what can happen when inequality is calcified, and Saez and Zucman (2014) show strong evidence that the trends Piketty discusses are coming true in the US: the rich accrue wealth at a fast clip while the "patrimonial middle class" disintegrates.

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Conclusion

- Tracing the causes and consequences of rising inequality correctly poses a challenge to received economic models that underlie the theoretical tradeoff between growth and equality.
- It's long past time for economists to get back to the data instead of relying on theory to sustain that tradeoff.
- Getting back to data includes testing the channels by which inequality may or may not affect economic growth.
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