BUSINESS TRENDS

Week 07: A disparate world: Inequality and poverty

Professor: Omar Maguiña Rivero

GLOBAL TURNING POINTS
for Business and Society

A disparate world: inequality and poverty

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Learning Outcome

At the end of the session, each participant will be able to explain the concepts and measures of inequality and poverty.

Inequality

- Is it on the decrease or on the increase?
- What are its causes?
- What are the consequences?
- What is the impact of income & wealth concentration on consumption, savings, and investment?

Let's Start by Analyzing Poverty

- Poverty has to do with the bottom segment of the income distribution.
- If you draw the line at $1.90 per day:
  - In 1990 there were 1.9 billion poor people.
  - In 2010 there were 1.1 billion poor people.
  - In 2013 there were 0.8 billion poor people.
- Most of the decrease has to do with the growth of emerging economies.
- Meanwhile, poverty has increased in Europe and the United States.

Source: World Bank, *Taking On Inequality* (2015).

Where are The Poor?

- 389 million in Sub-Saharan Africa.
- 256 million in South Asia.
- 71 million in East Asia.
- 34 million in Latin America.

Poverty in Europe and The U.S.

- In the United States, the government calculates that:
  - 43.1 million (13.5%) were under the poverty threshold in 2015 ($24,036 income for a family of four). This rate is 1 percentage point higher than in 2007.
  - Nearly 4 million were in extreme poverty (<$2 per day) in 2011.
- In the European Union, a similar proportion (17.2% of the population) lived in poverty or at risk of being poor as of 2014.

Discussion Question

- What's the difference between the concept of **poverty** and the concept of **inequality**?

Inequality

- Inequality refers to the distribution of income (or wealth) across the entire population, not just the poor.
- Is it on the decrease or on the increase?
- What are its causes?
- Does too little or too much of it reduce the incentive to work hard and to invest?
- What should we do about it?

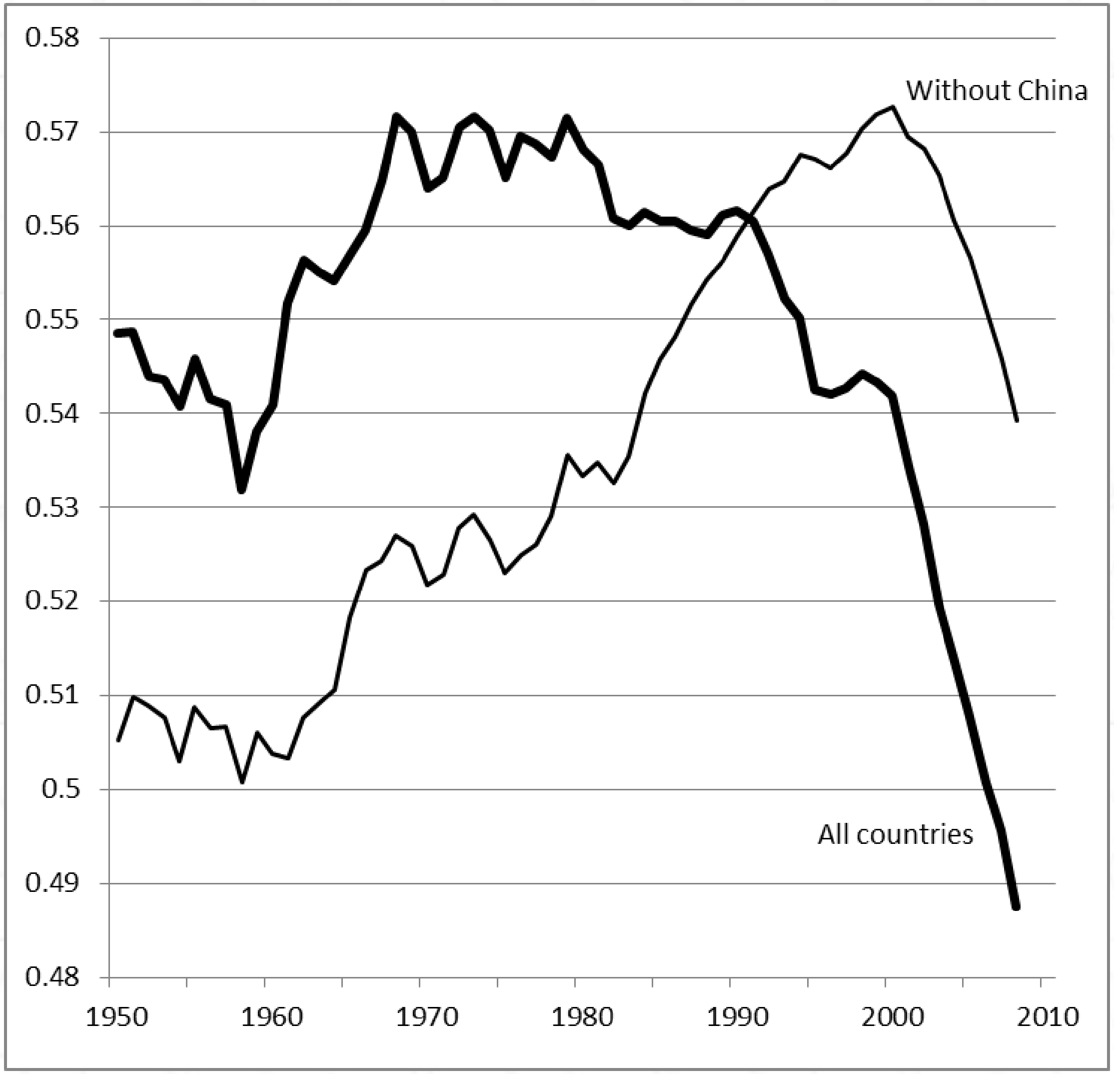
Measuring Income Inequality

- You can just compare the difference in income between those at the top and those at the bottom.
- **Gini coefficient**: A measure of the deviation of the distribution of income among individuals, households or countries from a perfectly equal distribution. A value of 0 means each has the same income, while a value of 100 means that just one of them enjoys all of the income.

Discussion Question

- Is there more or less income inequality in the world than 20 years ago?
- You will notice that the answer is not simple.

Income Inequality Across Countries



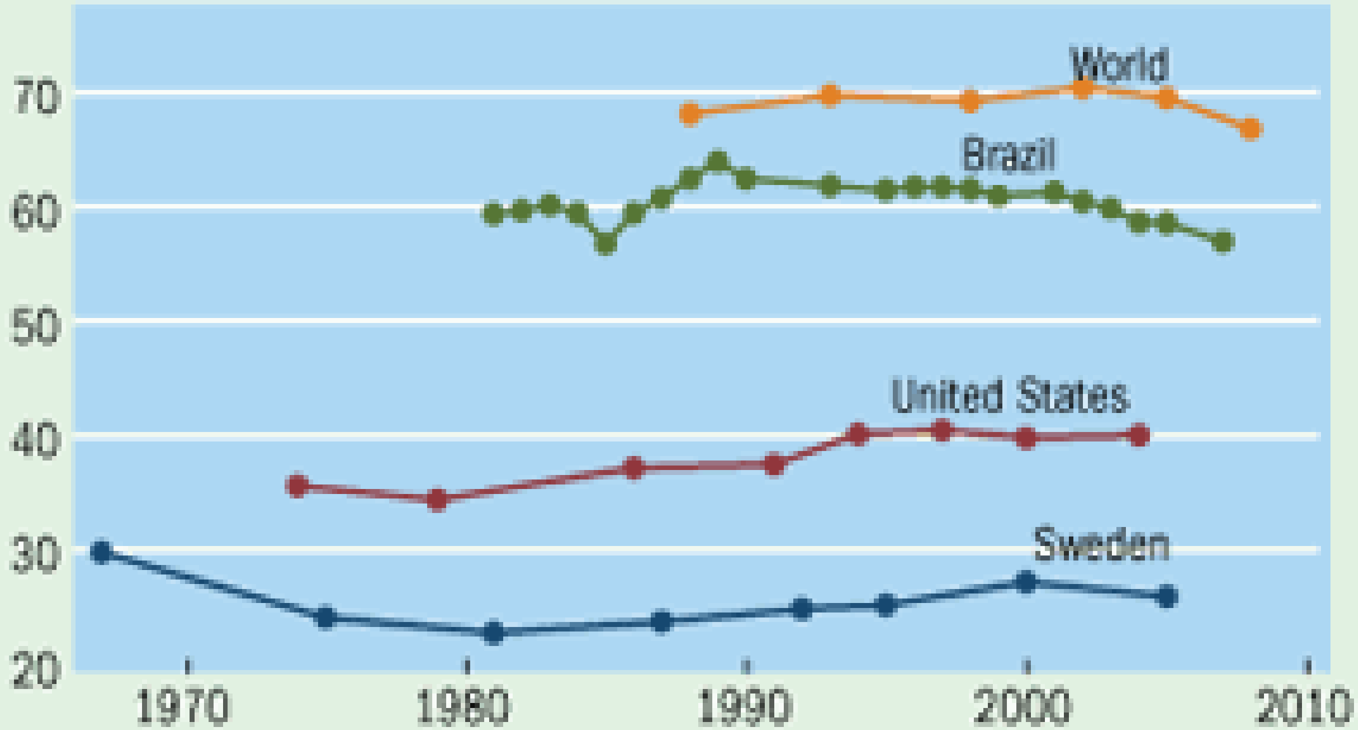
Mauro F. Guillén. Source: World Development Indicators.

Chart 1

Worldwide gaps

Global inequality—between world citizens—is higher than inequality within even the most unequal individual countries.

(Gini coefficient)

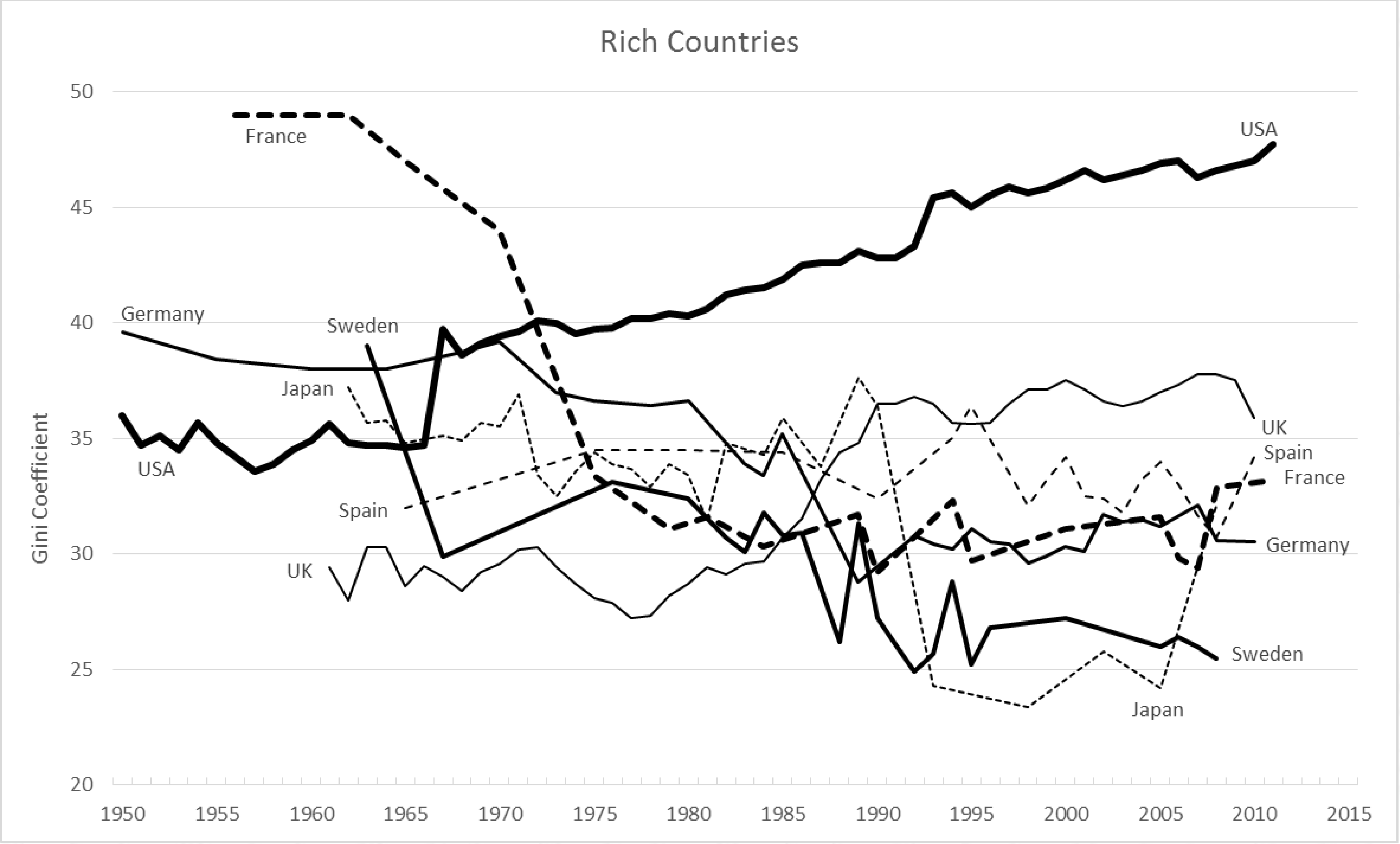


Sources: For United States and Sweden, Luxembourg Income Survey database; for Brazil, Socio-Economic Database for Latin America and the Caribbean (SEDLAC); for the world, Milanovic (forthcoming). The 2008 world Gini is a preliminary estimate.

Note: Gini based on disposable income.

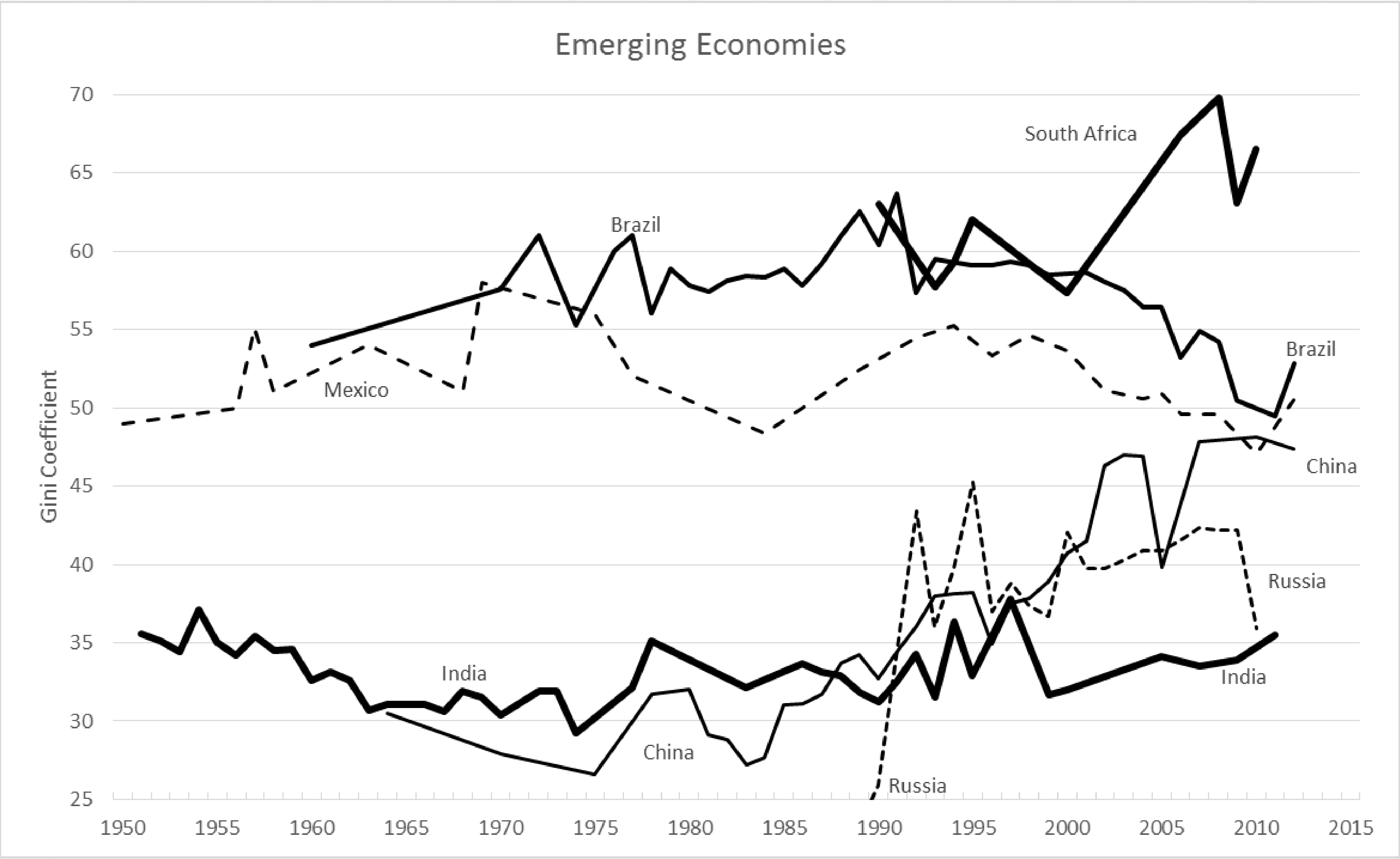
Source: Branko Milanovic, "More or Less?" *Finance & Development* (September 2011).

Gini Coefficients: Developed



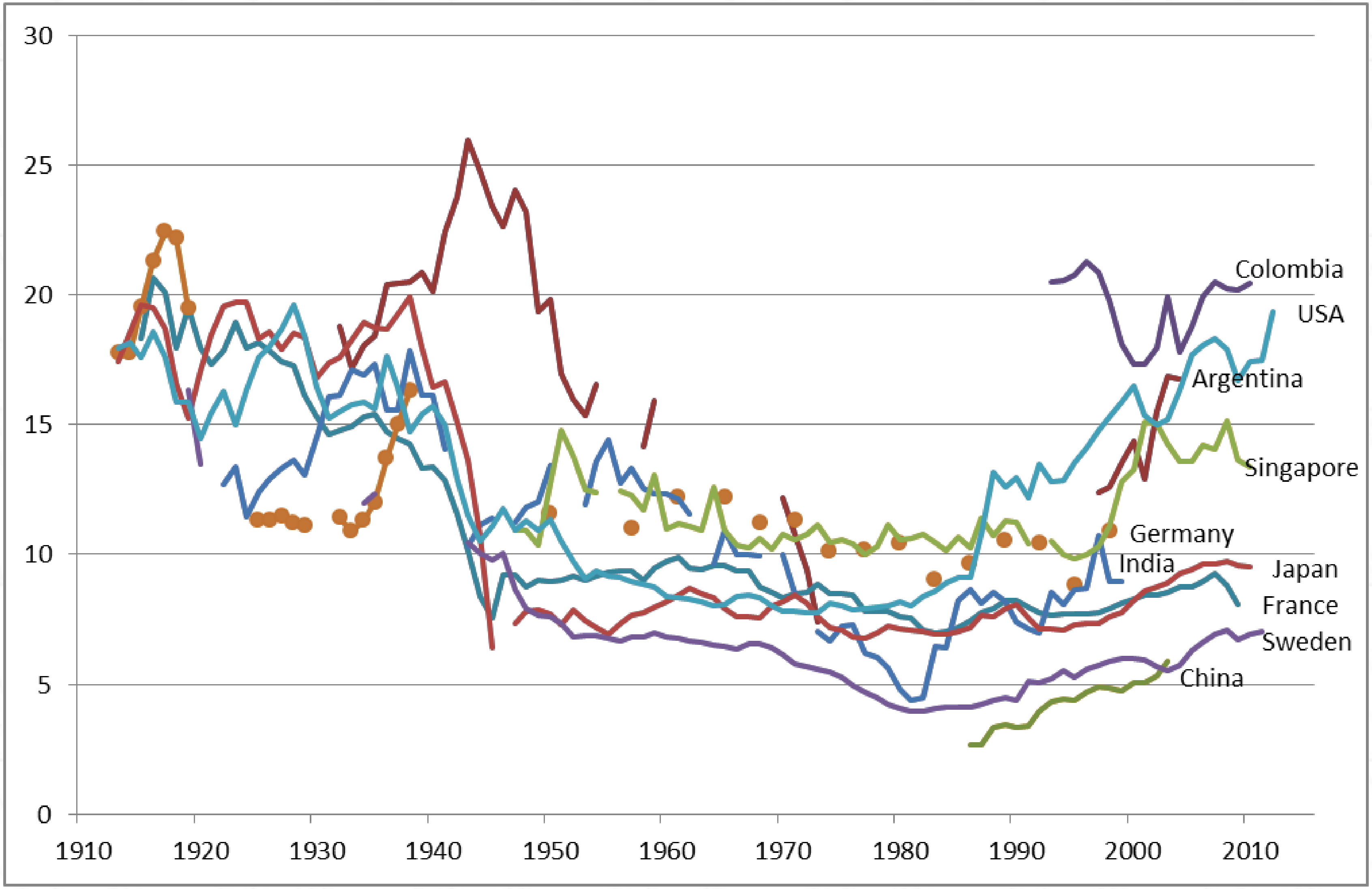
Mauro F. Guillén. Data Source: All the Ginis Dataset, World Bank.

Gini Coefficients: Emerging



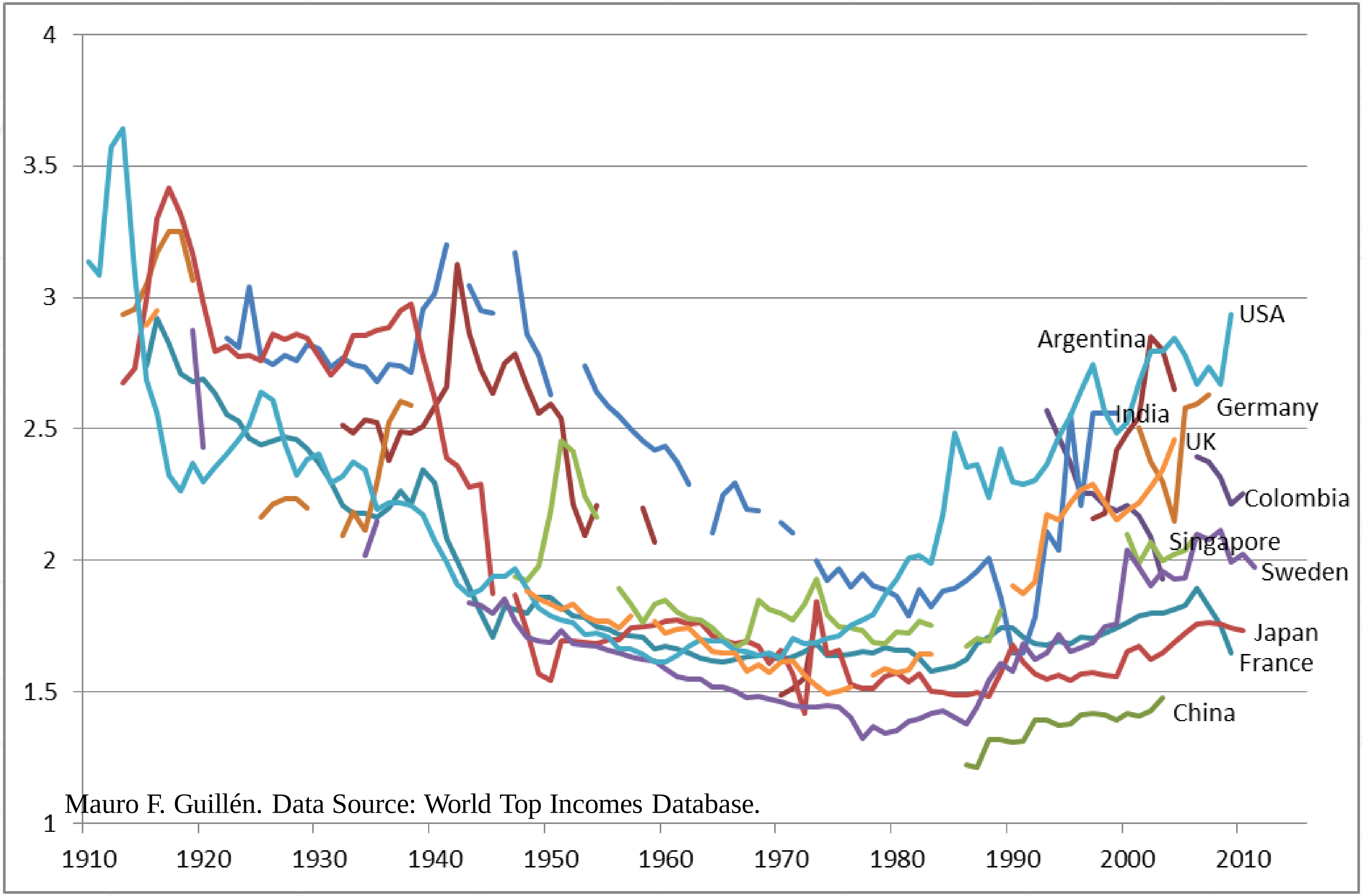
Mauro F. Guillén. Data Source: All the Ginis Dataset, World Bank.

Income Of The Top 1% As A Percent Of Total Income



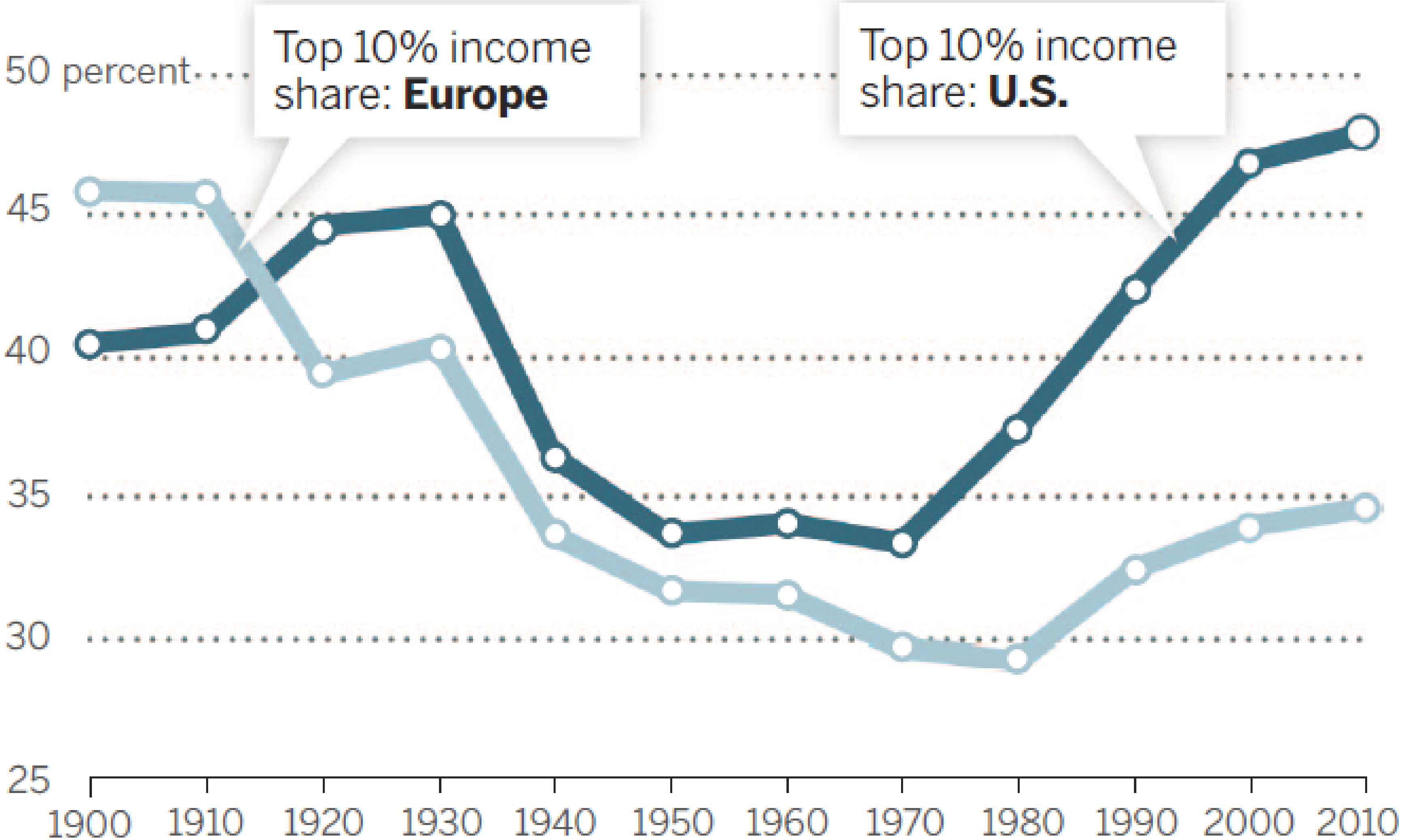
Mauro F. Guillén. Data Source: World Top Incomes Database.

Inverted Pareto-lorenz Coefficients For Top Income Categories



Income inequality in Europe and the United States, 1900–2010

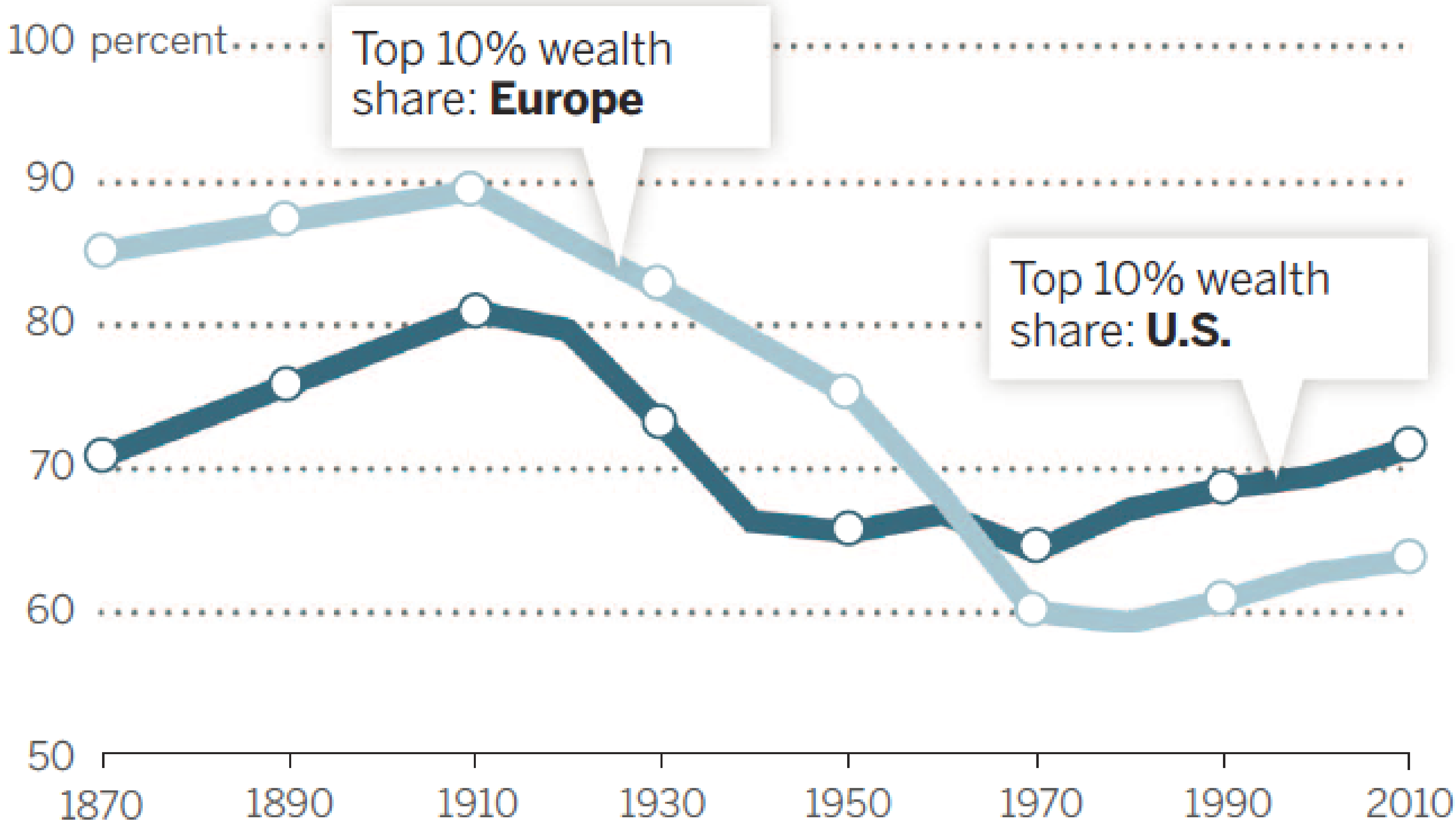
Share of top income decile in total pretax income



Source: Thomas Piketty, and Emmanuel Saez, "Inequality in the Long Run." *Science* 344(6186) (2014):838-843.

Wealth inequality in Europe and the United States, 1870–2010

Share of top wealth decile in total net wealth



Source: Thomas Piketty, and Emmanuel Saez, “Inequality in the Long Run.” *Science* 344(6186) (2014):838-843.

The Causes of Rising Inequality

- Technological change.
- Trade.
- Foreign investment.
- Growth of the service sector.
- Welfare state retrenchment.
- Growth of wealth accumulation (capital gains).
- Changes in taxation.
- Growth of emerging economies.

Technological Change

- The "skills gap," or the mismatch between the technological requirements of jobs and people's skills.
- Technology is not the "great equalizer"…

Trade

- Has reduced inequality in emerging economies by stimulating economic growth.
- Has increased inequality in developed markets due to job migration.

Foreign Investment

- Part of it involves eliminating jobs in the home country of the firm. (That type of foreign investment is called “vertical.”)
- It has been a net contributor to inequality globally, according to the IMF (*World Economic Outlook 2007*).

Effect Of Short-term Capital Flows

- Inefficient allocation of credit leads to inequality as inflows of short-term capital increase.
- Short-term capital flows may lead to financial crises, which affect the poor.
- Short-term capital flows decrease labor's share of total income.
- (Foreign direct investment also predicted to increase inequality due to demand for highly-skilled labor.)

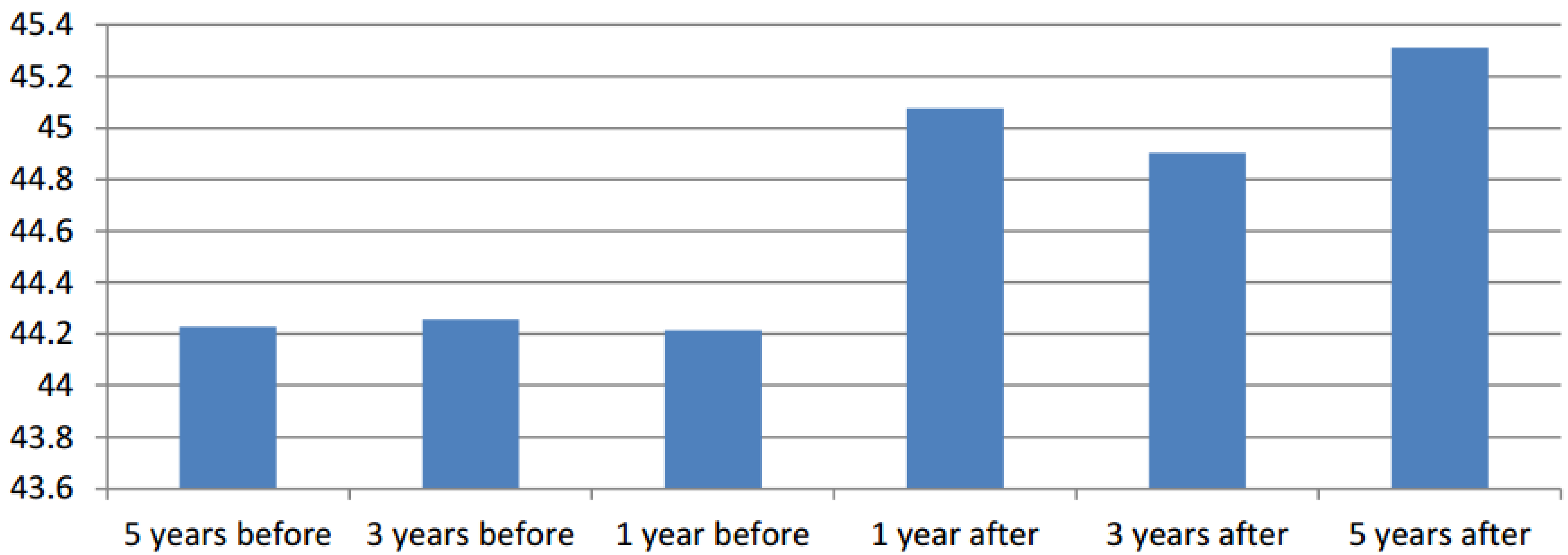
Source: Furceri, Davide, and Prakash Loungani, 2015, "Capital Account Liberalization and Inequality." IMF Working Paper 15/243 (Washington: International Monetary Fund).

Short-term Capital Flows

Source: J. D. Ostry, P. Loungani, and D. Furceri, “Neoliberalism: Oversold?” *Finance & Development* (June 2016).

Short-term Capital Flows

Figure 3. The evolution of inequality before and after capital account liberalizations



Source: Furceri, Davide, and Prakash Loungani, 2015, "Capital Account Liberalization and Inequality." IMF Working Paper 15/243 (Washington: International Monetary Fund).

The Service Sector

- According to Paul Osterman, a Professor at the MIT Sloan School of Management, “The migration of manufacturing jobs to other parts of the world has generated a decline in the share of income accounted for by labor. Meanwhile, jobs created in the service sector have proved to be much more heterogeneous in terms of skill level, stability, and pay than those in manufacturing.”

Source: Lauder Institute Global TrendLab, *Poverty and Inequality* (2013).

Welfare State Retrenchment

- The welfare state reduces both poverty and inequality by making education and healthcare available, by redistributing income, and by protecting children, the elderly, and the unemployed.
- Austerity measures in Europe and the U.S. have cut programs and hence increased both poverty and inequality.

Wealth Accumulation

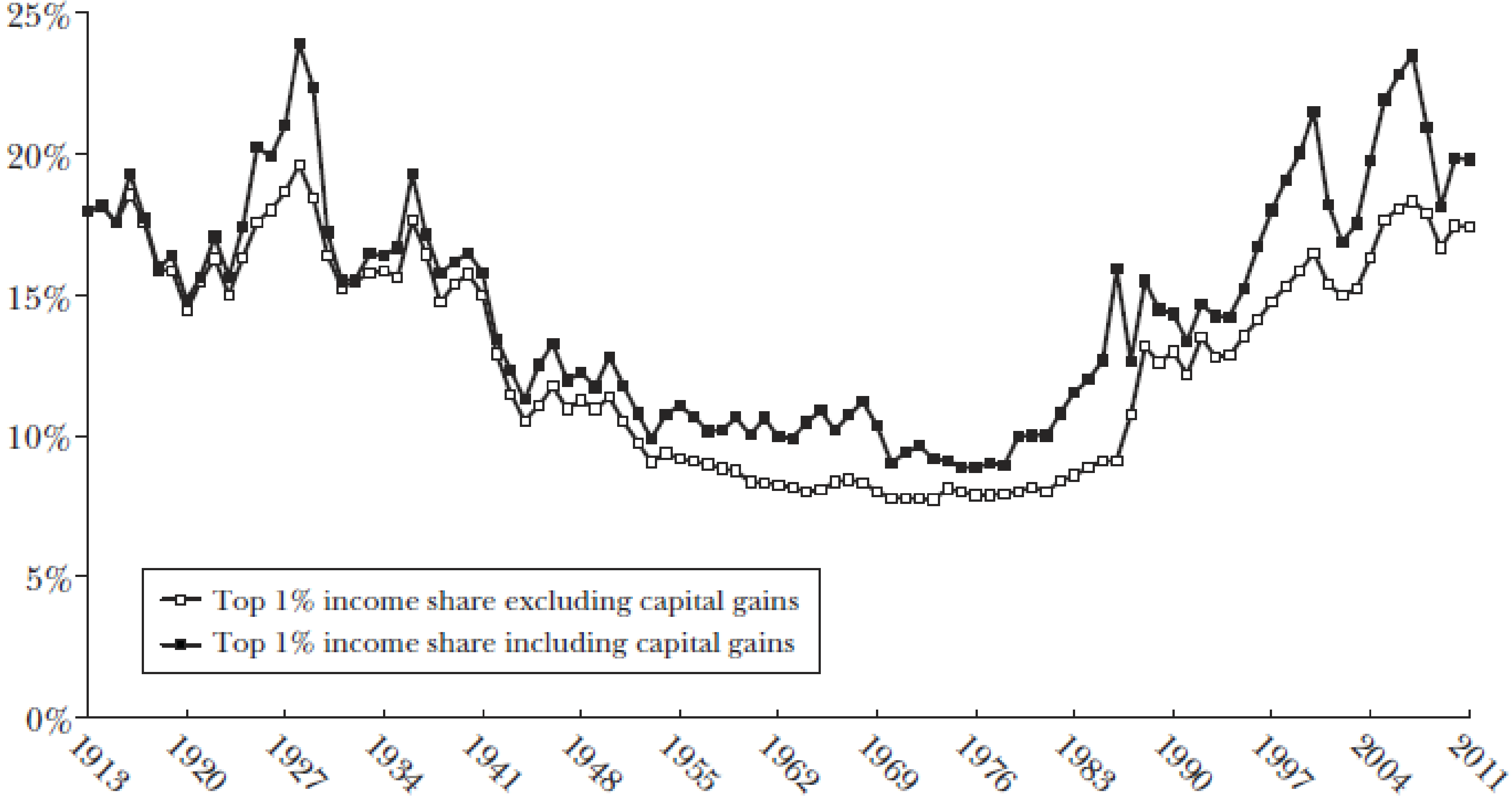
- Labor’s share in national income has dropped in Europe and the U.S. in favor of capital’s share.
- High income often translates into higher savings, and cumulates over time into greater wealth.
- Capital gains often receive better tax treatment than wage income.

Taxation

- I just mentioned that capital gains often receive favorable tax treatment.
- In the U.S. the top 0.1% of taxpayers’ average tax rate for income purposes was:
  - Over 50% in the 1940s.
  - Just under 40% during the 1960s and 70s.
  - Under 30% since the 1990s.

Figure 1

Top 1 Percent Income Share in the United States

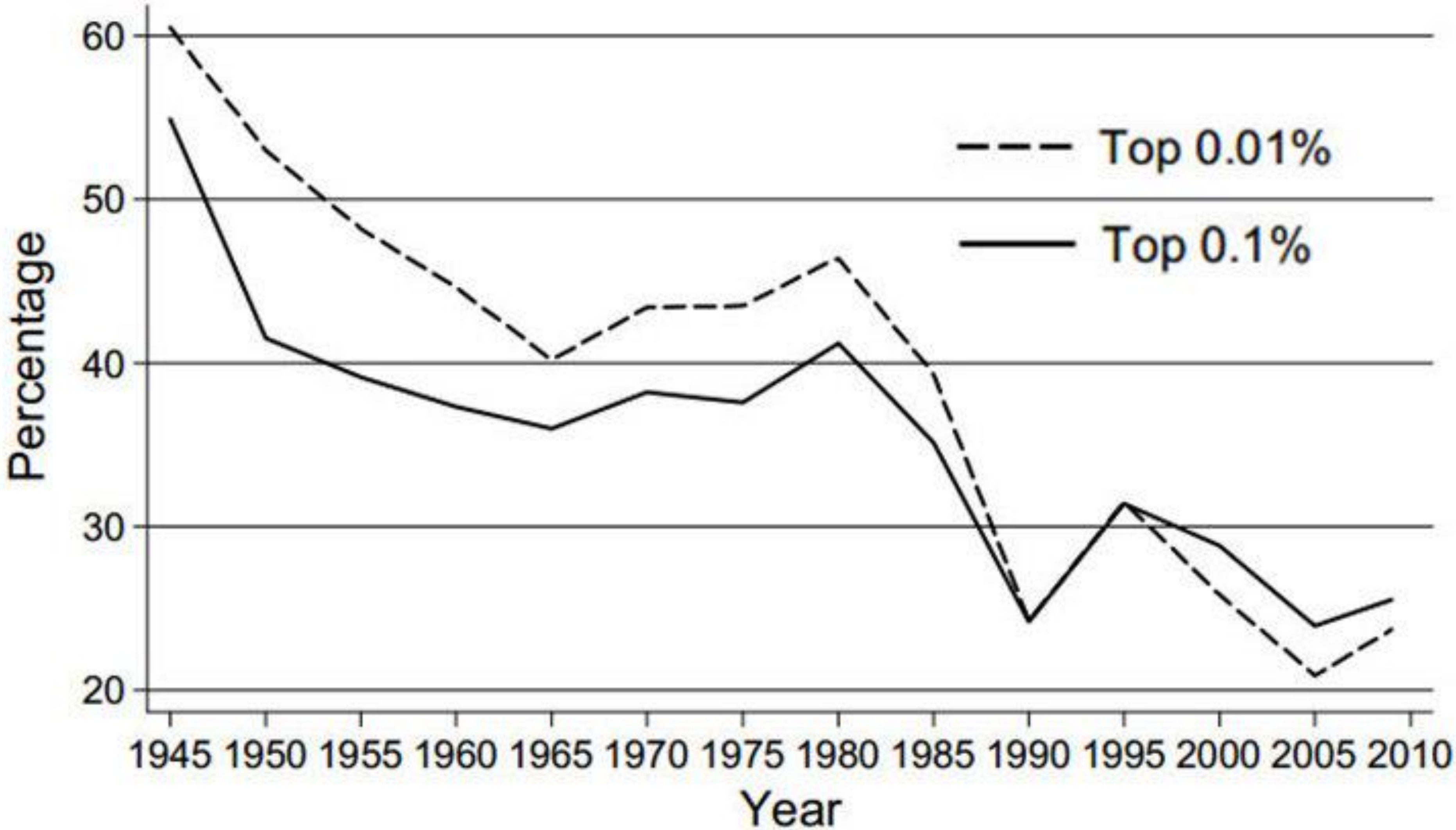


Source: Source is Piketty and Saez (2003) and the World Top Incomes Database.
Notes: The figure reports the share of total income earned by top 1 percent families in the United States from 1913 to 2011. Income is defined as pre-tax market income; it excludes government transfers and nontaxable fringe benefits. The figure reports series including realized capital gains (solid squares) and series excluding realized capital gains (hollow squares).

Source: Alvaredo, Atkinson, Piketty and Saez, "The Top 1 Percent in International and Historical Perspective." JEP (2013).

CEO pay and top 1% income
United States
Ratio of top 1% household income to median*
Average CEO pay†, $m, 2014 prices
30
25
20
15
10
5
0
1979
85
90
95
2000
05
10
14
Sources: Economic Policy Institute; Congressional Budget Office; The Economist
*Before-tax income
†Top 350 public companies by revenue
Economist.com

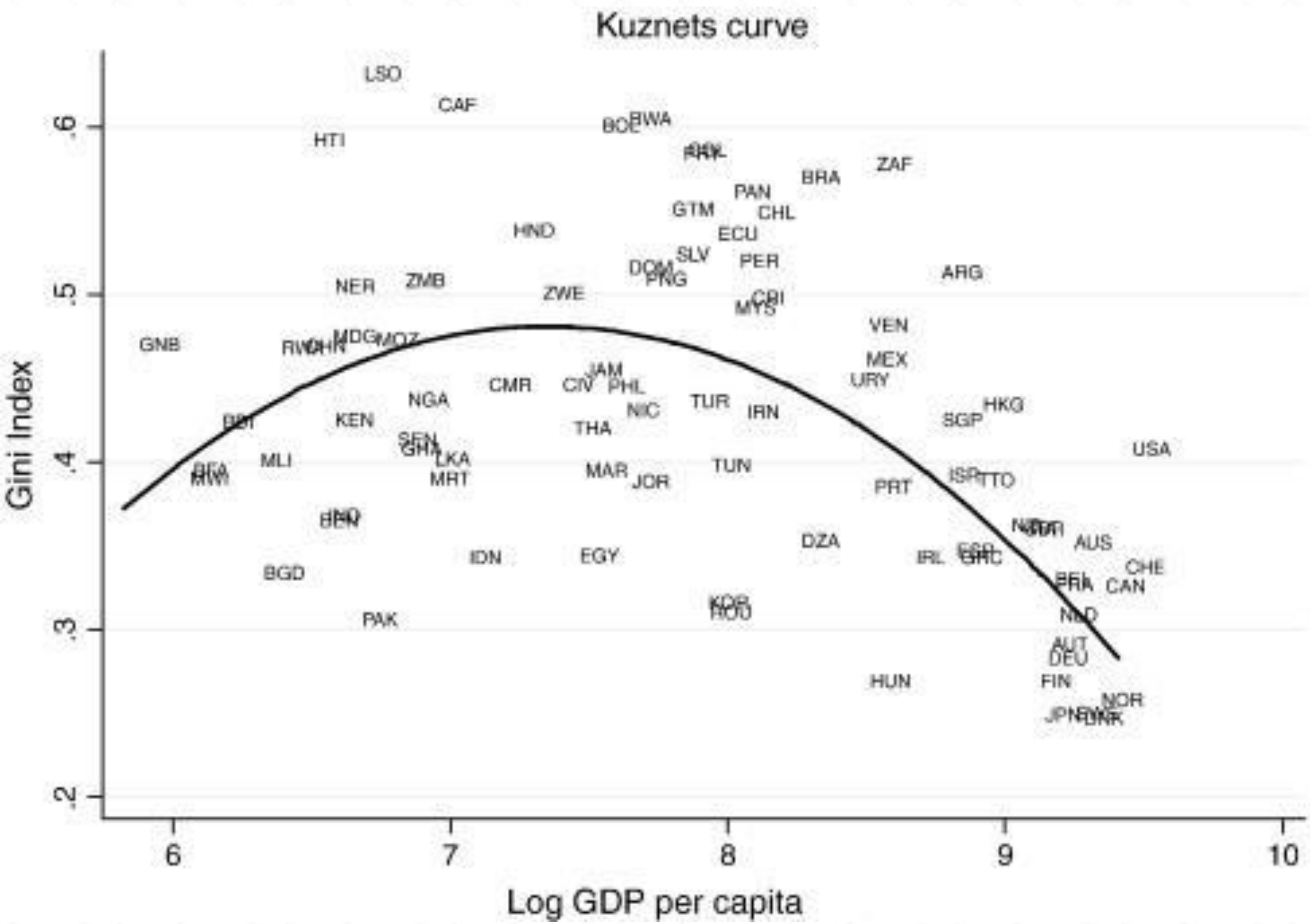
Average Tax Rates for the Highest-Income Taxpayers, 1945-2009



Source: CRS calculations using Internal Revenue Service (IRS) Statistics of Income (SOI) information.

Or Is It Just Because Of The Growth Of The Emerging Economies?

- The Kuznets curve:
  - Inequality is highest when countries are making the transition from developing to developed.


Kuznets curve
Gini Index
Log GDP per capita
.2
.3
.4
.5
.6
6
7
8
9
10
LSO
CAF
HTI
BWA
ZAF
BRA
PAN
GTM
CHL
HND
ECU
SLV
PER
ARG
NER
ZMB
ZWE
PNG
VEN
GNB
MEX
JAM
URY
CMR
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NGA
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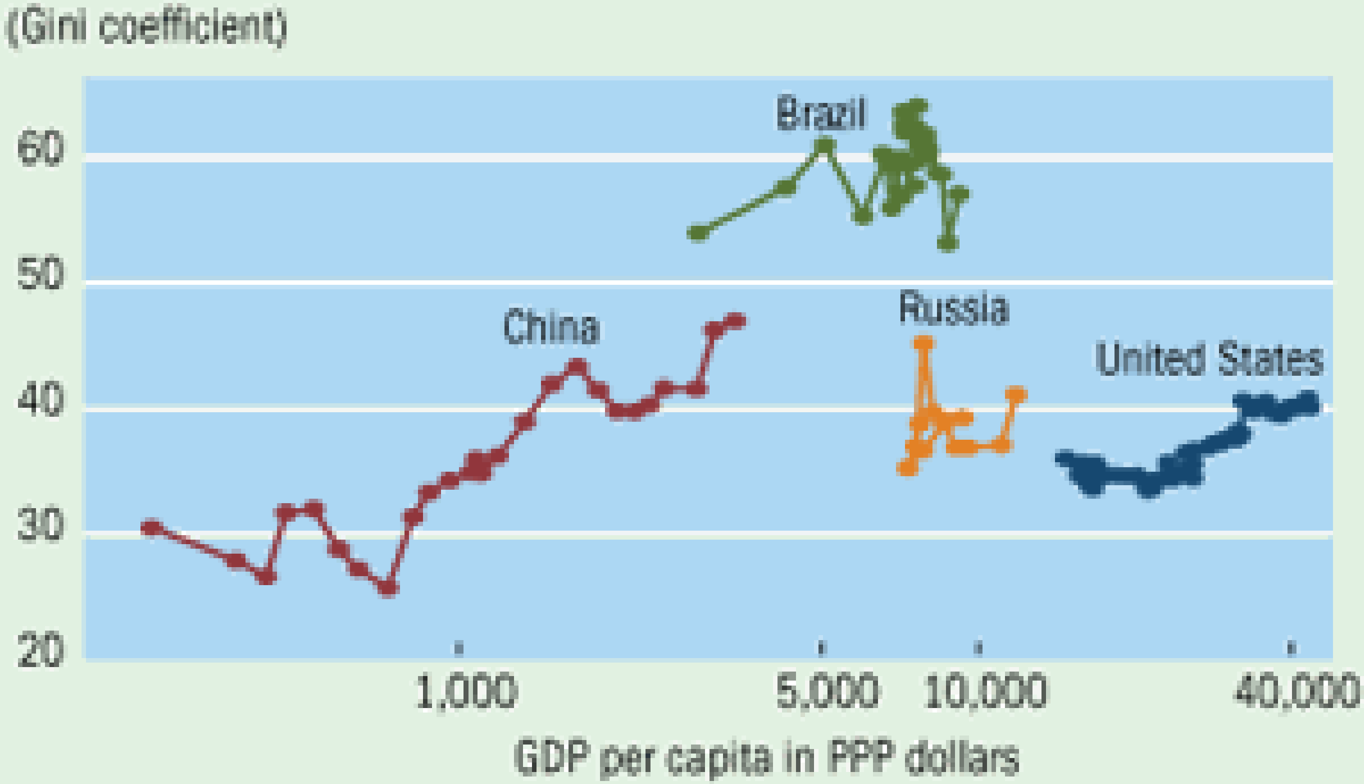
MRT
JOR
PRT
DZA
AUS
IDN
EGY
IRL
BGD
CHE
CAN
PAK
HUN
FIN
NOR

Chart 2

Elusive curves

Inequality has risen in most countries but only Brazil has seen the eventual fall in inequality predicted by the inverted-U-shaped Kuznets curve.



Source: World Income Distribution database.

Note: China (1964-2005), United States (1950-2008), Brazil (1960-2007), Russia (1992-2005).

Source: Branko Milanovic, “More or Less?” *Finance & Development* (September 2011).

One Percenters in The USA

- >$428,000 in adjusted gross income.
- >$7.8 million in wealth.

Piketty/Saez

- Access to education lowers income inequality, but technological change increases it.
- When economic growth is slow, the effect of the capital stock accumulated in the past is strongest.
- In Europe, income inequality normally associated with capital accumulation that yields rents, dividends and/or interest.
- In the U.S., high income inequality is due to both returns to capital and high labor income for certain individuals, with unequal access to education and technological change as drivers.
- But most of the recent changes have to do with dynamics at the very top of the distribution.

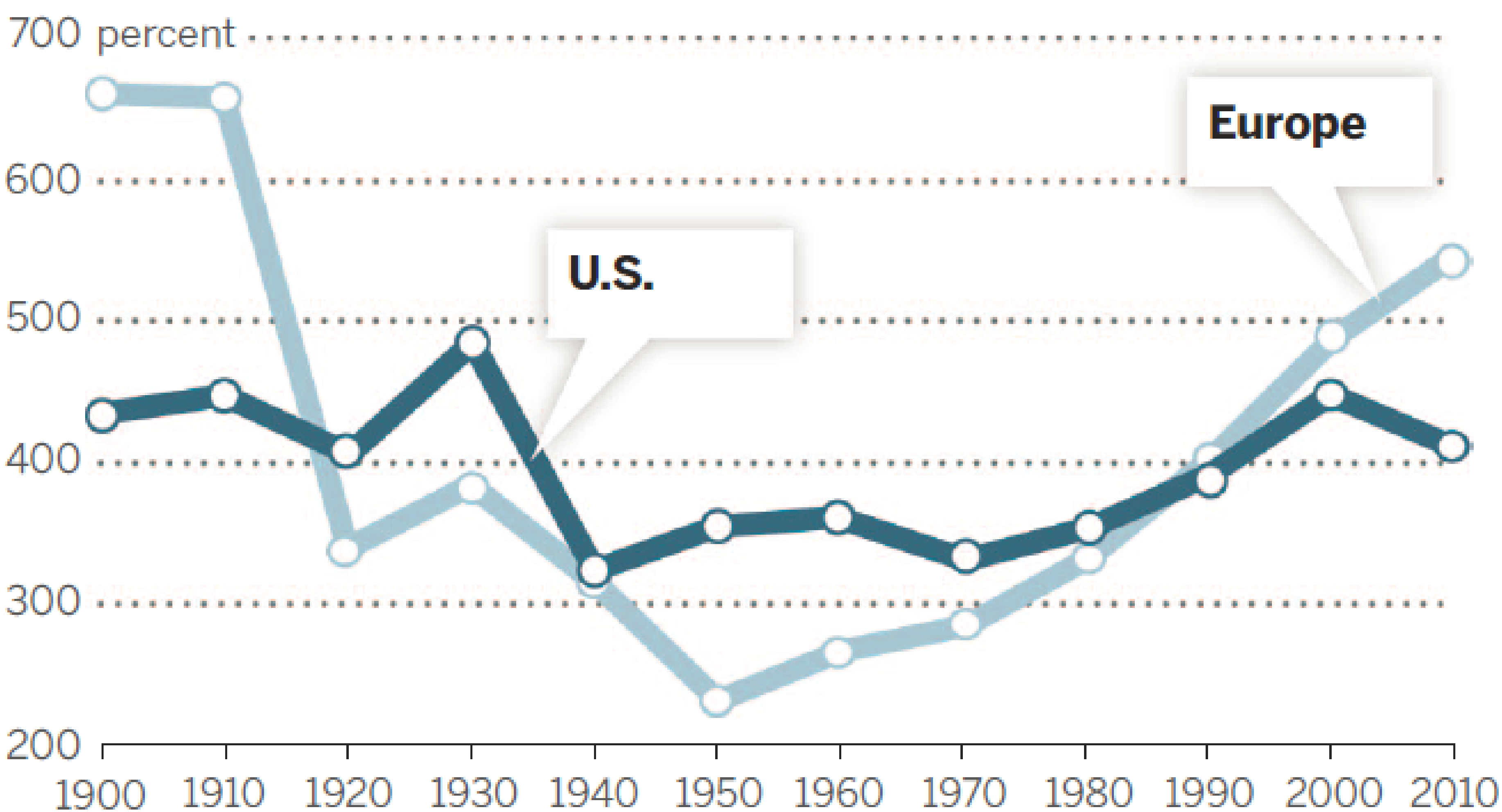
Rate of return vs. growth rate at the world level, Antiquity–2100

Annual rate of return or rate of growth

Source: Thomas Piketty, and Emmanuel Saez, "Inequality in the Long Run." *Science* 344(6186) (2014):838-843.

Wealth-to-income ratios in Europe and the United States, 1900–2010

Market value of net private wealth (% national income)



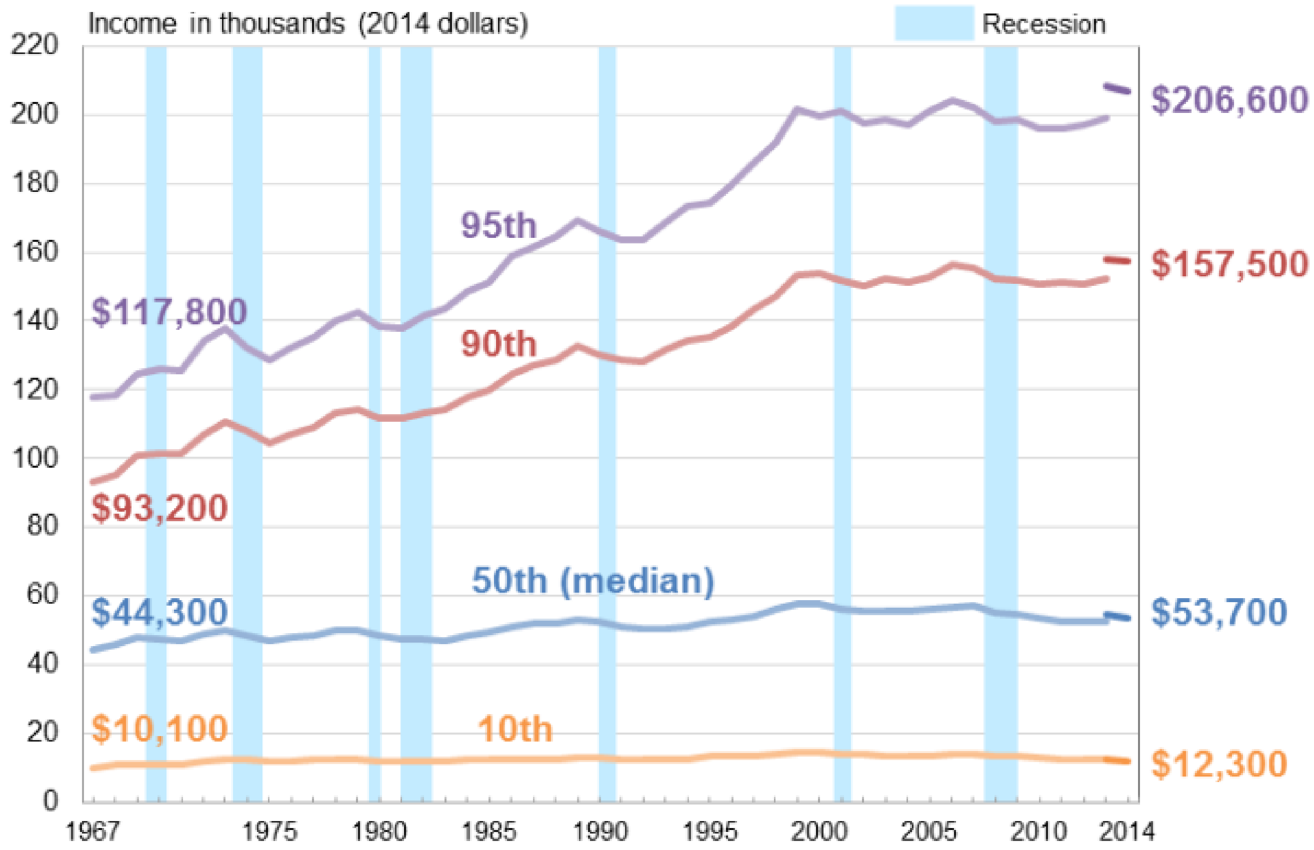
Source: Thomas Piketty, and Emmanuel Saez, "Inequality in the Long Run." *Science* 344(6186) (2014):838-843.

Consequences

- Political and social frictions.
- Rise of populism.
- Diminished purchasing power of the middle class and slower economic recoveries.
- Rise of the affluent and high-net-worth market segments.

Real Household Income at Selected Percentiles: 1967 to 2014

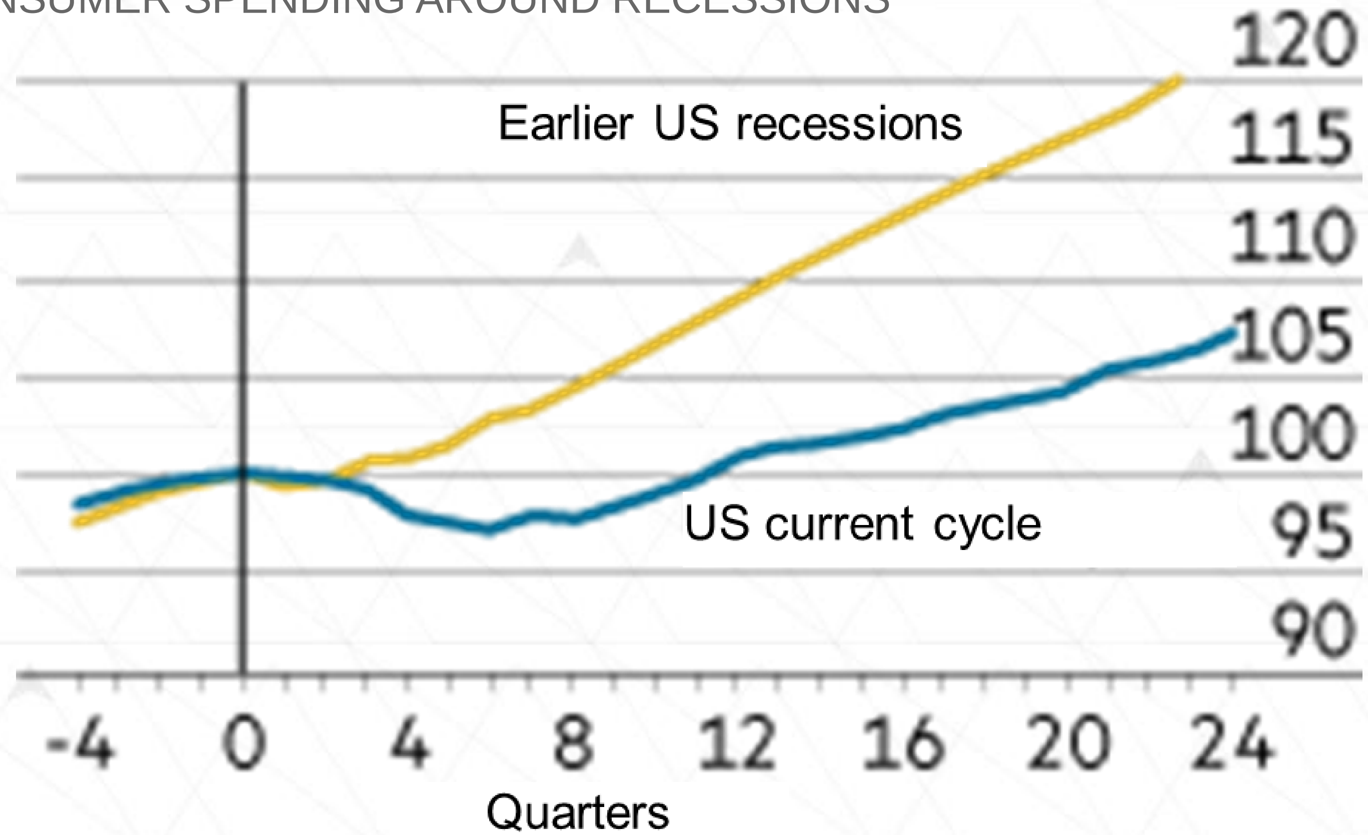
- Th



Note: The 2013 data reflect the implementation of the redesigned income questions. See Appendix D of the P60 report, "Income and Poverty in the United States: 2014," for more information. Income rounded to nearest $100.
Source: U.S. Census Bureau, Current Population Survey, 1968 to 2015 Annual Social and Economic Supplements.

Start of recession=100

- CONSUMER SPENDING AROUND RECESSIONS



Source: Morgan Stanley


TIME FOR QUESTIONS
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