INEQUALITY IN AMERICA: A GLOBAL PERSPECTIVE

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ZANNY MINTON BEDDOES: Good afternoon. Welcome to this extremely timely seminar. I'm Zanny Minton Beddoes, from The Economist. I'm delighted to moderate this session on income inequality in the U.S., the international perspective. I think it’s probably no exaggeration to say that the question of income inequality is becoming one of the – and perhaps becoming the central issue in this year’s campaign, it has – presidential campaign.

It’s an economic problem, an economic issue that has come front and center to the policy environment in a country which has traditionally believed in a rising tide lifting all boats. And I think there’s a fundamental shift in the U.S. on attitudes to its income inequality and it’s a subject that’s enormously controversial, enormously complicated.

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And to wit, the fact that there was a long discussion just now before we started among three members of the panel about data. So the question of what’s actually happening to income inequality, what’s the best measure, why is it happening, I think is hugely important one in this country. It’s one, as I said, central to the campaign – one side accusing the other of social Darwinism, the other side accusing the Democrats of a politics of envy, if you will.

At the same time, the U.S. is not alone. And I think in the rather introverted debate that we sometimes find ourselves in in this country, it’s easy to forget that the question of income inequality and rising inequality is a huge one in many, many other countries. It’s a huge one in Europe where François Hollande, the presidential challenger in France, is proposing a 75-percent tax on top income.

It’s a huge one in China where the leadership is extremely worried about social harmony and very sharp increases in inequality. It’s a huge issue in India for much the same reason. And the one part of the world that seems to be an exception to this is Latin America, where it’s still a very big political issue, but actually is one part of the world where in many countries income inequality has been coming down, albeit from a very, very high level.

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So I think it’s enormously useful what to Uri and Kemal have planned to do today, which is to lay out what a global perspective can – what light that can cast, if you will, on the U.S. debate, because I think it’s important to remember that not only is this conversation happening in this country, it’s happening around the world.

And I think to the extent that some of the causes of rising inequality are part of the broad global changes going on across the world economy, then that makes you think differently about what one does to address them. And so to have a clear sense of the facts, to have a clear sense of what’s going on in the U.S. and how that compares with the rest of the world, and how that then leads you into understanding causes and offering remedies is what I hope the two of you are going to do.

Certainly, in your excellent paper you provided some very, very interesting fact base, as the McKinsey people like to call it. I think it’s important to have a clear fact base – some interesting
examination of potential causes and some good ideas for solutions. And so I hope that’s what we will discuss today.

So first of all, Uri and Kemal will lay out what their paper is about, what they – what they found. And then we have two superb discussants, two panelists to react to this; two – I might say, two of the world’s experts on income inequality – Branko Milanović at the World Bank has written I think probably more than anyone on this subject.

BRANKO MILANOVIĆ: No, no there are people who wrote more than I.

MS. BEDDOES: Really? I haven’t found them yet.

MR. MILANOVIĆ: (Chuckles.)

MS. BEDDOES: Certainly one of the most prolific writers. But actually he’s being chased fast by Prakash Loungani from the IMF – the IMF not traditionally known to be an organization that has cared a huge amount of (money ?) – (laughter) – but it has certainly become very front and central in this debate.

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And so after Kemal and Uri have laid out their arguments, we will have reactions from the two panelists. We’ll then have some discussion, and then very soon I hope we open it up to a broad discussion with all of you because we’re a small enough audience that we can really have a discussion. So Uri, why don’t we start with you?

URI DADUSH: No; Kemal will start.

MS. BEDDOES: Oh, Kemal, I’m so sorry. Kemal, you go first.

KEMAL DERVIŞ: All right. Well, I’m really happy that, Zanny, you could come and moderate this. Thank you very much, and thanks to all of you for being here. I’m also super happy that Prakash and Branko are here. I mean, I must say, Uri and I are beginners in this field, I would say – you know, coming more from the trade and the overall macro side.

And Branko is really somebody I’ve learned a huge amount over the years from, and whose work continues globally. And Prakash has emerged, as you said, Zanny, from the IMF side and really we shared some meetings with Prakash. And his thoughtfulness is really very special. And I’m very glad that the IMF is taking this very seriously and cooperating, for example, with the ILO, which of course had always had a great focus on this.

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Now, just to start the – to give an overview – I mean, the first thing that obviously one has to kind of tackle – and that paper tries to tackle it – is, you know, what do we mean by inequality? I mean, you can look at inequality from various angles and various measures, various definitions, OK. I think there are three which are particularly interesting.
One is the Gini, which kind of gives you a feel for the overall distribution across the population. But it doesn’t necessarily give you what’s happening at the extremes. And so depending on what you’re interested in, the Gini may be, you know, a very useful or not such a useful measure. There is the difference between the American discussion, has come up quite a bit between the mean and the median.

MS. BEDDOES: I think you should explain what they are. Does everybody know the Gini coefficient? OK, all right, everybody’s considerably a higher level of knowledge than in my editorial meetings. (Laughter.)

MR. DUDASH: Well, he doesn’t know. OK, explain.

MS. BEDDOES: It may just be worthy explaining what the Gini coefficient is.

MR. DERVIŞ: Well, it’s the ratio, if you like, between a situation where there would be totally equal income versus totally unequal income. That’s probably the easiest way to grasp it.

MS. BEDDOES: Zero – if everybody has the same income in a country, it’s zero; if one person has all the income, it’s one.

MR. DERVIŞ: One.

MS. BEDDOES: And you can then – you get a number between zero and one, which is a kind of summary measure of inequality.

MR. DERVIŞ: Yeah. The median is, in a sense, the person in the middle of a population. You know, it’s not the – the mean is the average but of course the mean goes up. If somebody is extremely rich at the top, you get a higher mean. And what’s happened in the U.S. quite clearly is an increasing divergence between the median and the mean.

Now, depending exactly on what figures you use – you know, and there’s no point in going – I mean, if we had PowerPoint we would do it, but to go into all the details of the figures. But basically a very shocking kind of statistic that comes through in much of the discussions is that the median income in the U.S. has hardly risen – now, it has risen a little bit according to some measures, none at all according to others – since the late ’70s.

OK? Which is really – I mean, when you think about it – a very dramatic statement. I mean, there’s been productivity growth. There’s been economic growth. And yet, the median income – the median person, if you like, has had very marginal increases in the way that the figures are measured – whereas the mean, of course, has gone up with the average. So this divergence between the median and the median (sic) is another very important aspect, I think, of income distribution.
And finally – well, not finally – well, two more things. I mean, what happens at the very bottom and what happens at the very top – the extremes, OK? The Gini gives you an overall story. The median and mean gives you another kind of look at that story. And then you have to look at the very bottom and at the very top, which is also extremely interesting, of course.

And at the very bottom, there actually have been losses over the last 10 years and hardly any movement over the last 30 years. And at the very top – and this is increasingly a big story – you know, everybody talks about the 1 percent and 99 percent. At the very top, the concentration has risen really quite dramatically.

And Pickety and Saez were – have been following this through the income tax data. When they did one of their original studies – one of their earlier studies – they showed that share of the top 1 percent in the U.S. households filing income, because again, we don’t have time to go into all the data, but it’s very important to know which figures exactly one is referring to, OK, whether it’s wages, whether it’s tax figures, whether –

Anyway, their figures is (sic) households filing tax returns. The share of the top goes from about 8 percent to 23 percent. Now, that has fallen in – during the crisis to more than 17 percent and is now again rising. We don’t have the latest numbers. One think I think to emphasize here is that the 23 percent as well as the 8 percent includes realized capital gains, not unrealized capital gains, of course, but capital gains that are actually realized.

And a fairly big chunk of the extremely high ratio of 23 percent is other realized capital gains in 2007. Without that, it would be closer to 19 percent. So if you like, these are the kind of measures that one can look at. In terms of what is measured, that’s also very, very important. You can have, of course, market income – in other words, income before taxes and transfers – or income after taxes and transfers.

And the two obviously are quite different, OK. And here, the key point is that in the U.S., as in all other countries, taxes and transfers are redistributed. OK, so if you take the Gini or you can take other measures, you find that the income after taxes and transfers and benefits is more equal than the market income.

So the combination of government activities does redistribute. However, the degree to which it redistributes has diminished over time. The gap between the two figures has diminished over time, and I think that’s one important point to mention.

Now, there is a lot of variation in terms of what – the axes are fairly easy. But on the benefits side, there is quite a bit of variation of what is counted as a benefit.

Actually, on the tax side also there was an interesting New York Times article the other day, because if you make the mental experiment of abolishing what’s called tax expenditures in the U.S. – the kind of special benefits that many taxpayers get – and if you compare a situation without that
but the normal tax system to assist them with these tax expenditures, it turns out the tax expenditures are highly regressive.

OK – so again, when we kind of look at the numbers, we have to be careful to remember what measure we’re actually talking about. Now, let me concentrate, before I hand it over to Uri, on one aspect which I’m particularly interested in. And that is one can look at the income distribution story from an ethical point of view, from a political point of view. One can like a particular distribution or dislike it.

I think most people would agree that a totally equal distribution is not desirable because of incentive effects that would not be there. And most people would agree that, you know, that a completely unequal one, a kind of Gini of .8 or .9 is certainly not desirable. But I think there can be lots of variation as to what is an acceptable or desirable or kind of, you know, sustainable income distribution.

I don’t think there is a – you know, what is an optimal Gini is not something that one can easily answer. So there is a whole debate on that. There is also a debate on the link to mobility. I won’t go too much into that. But it is also true that there are correlations between mobility – low mobility and inequality, OK?

They’re not the same concept because inequality measures income at a point in time whereas mobility – at least relative mobility – the measures show what the chances are of somebody from, let’s say, from a poor household in the first 20 percent to move to the next 20 percent or to move up further.

And in fact, the somewhat surprising findings that have come out over the last decade is that the U.S. is actually not one of the more mobile societies – although very interestingly, the perception is very different. And it’s kind of, you know – France is probably quite mobile. And if you ask the French, they’re terribly immobile and, you know, will complain bitterly about it. And if you ask Americans, in general they will still think that it’s quite the mobile society.

But when you actually look at the figures, in terms of relative mobility it’s actually one of the least mobile among the advanced countries. Most of the comparative data that we have are on advanced countries. But Branko has a lot more data that also brings in the developing countries. So let me just make the point about macroeconomic policy.

You know, there was a time in the early part of the 20th century when the critics of capitalism were saying that capitalism will lead to increasing concentration of income. Those at the top are saving much more – a much larger fraction of their income than the others. So it will lead to a chronic deficiency in aggregate demand à la Keynes – in a kind of Keynesian context, OK?

And some post-Keynesian economists like Kaldor and so on repeated some of these models – Kalecki in Poland and so on – repeated some of these models into the middle of the century. They also predicted the fact that there would be this chronic lack of demand – would lead countries
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to look for demand elsewhere outside of their borders to try to export oriented-development strategies – undervalue their exchange rates, you know, export their unemployment.

And it would lead to conflict in the world around trade and these kinds of macroeconomic policies. Now, what happened since the ’30s is quite the opposite, until the late 1980s. Income distribution actually improved in most of the advanced countries. And the most dramatic period of improvement in the U.S. was actually during the war and the immediate aftermath of the war.

But even into the ’50s and ’60s, the prediction that income would be more and more concentrated at the top was wrong. And in fact, the opposite happened. Income was much less concentrated in the ’50s and ’60s than it was in the 1920s. Productivity growth led to broad-based middle class income growth and demand growth. So this whole theory of chronic deficiency of demand kind of collapsed and evaporated.

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Now, it has reappeared in the last few years. Authors like Joe Stiglitz, Robert Reich and others stress – are stressing it. Stiglitz is coming out with a new book in May called “The Price of Inequality,” which I haven’t ready but I’ve talked to him about it. And I think this will – that book will stress that point quite a lot.

The standard macroeconomic theory, or neoclassical mainstream theory answer to the chronic deficiency in demand is that – even in a Keynesian framework, where you, you know, you can’t have unemployment and so on – there is always a macroeconomic policy mix – among that an interest rate, if you like, that’s low enough to stimulate enough demand investment and consumption demand to create a macroeconomic equilibrium.

So the fact that interest rates have gone basically during the crisis and the aftermath of the crisis in many of the – in the U.S. in particular, somewhat lesser degree in Europe – have come basically to zero, in a way, have put a floor on that kind of macroeconomic answer, OK.

And therefore, it may be – and I’m saying it may be because I think this requires a lot more work and thinking and modeling and so on and one has to specify the kinds of models, you know, degree of price and wage flexibility and so on that one assumes.

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But there is, if you like, a view now that the increasing concentration of income combined with a monetary policy that in a sense cannot be much more expansive than it is, is creating a chronic deficiency of demand, OK – and that in fact fiscal policy is caught by the high debt ratios.

So you can’t really without scaring the markets and running into debt problems have very expansionary fiscal policy. You can’t do very much on interest rates anymore. You can still do, you know, QE3s and Q4s maybe, but that also has its limits.

So that the answer to starting demand again could well be that you actually have to have a redistributive fiscal policy and other policies that might help income distribution so that you support private demand, since public demand is constrained by the fiscal problems and challenges that the
advanced countries face. So that you can actually correct the fiscal deficit and reduce public debt, but while you do that you have to stimulate private demand.

And to stimulate private demand in a sustainable way you actually have to do it through some income redistribution. And I think this is one of the more interesting discussions and avenues for research in the future. It’s very much linked with employment, of course, because one way to redistribute is to have strong employment and decent jobs, as the ILO would say. And the ILO has done excellent work on that. So I think I’ll stop at this point.

MS. BEDDOES: Well, you certainly raise some controversial issues, which I hope we come back to. But not only have you laid out what’s happened, I think, very clearly in the U.S., which let me put my kind of simplistic journalist’s hat on, which is that by ever measure inequalities got worse, the Gini coefficients got considerably worse, and the main measure in which things have got really bad here, or considerably worse, are the concentration of incomes at the top.

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And that’s where the U.S. is a real outlier compared to the rest of the industrial world. And by – almost by definition, the share going to the very bottom has decreased more than anywhere else. And so that’s a sort of caricature portrait of what’s happened in the U.S., as you laid out. It’s come at the same time as a decline in mobility which is already actually lower than most people think it is.

And then you mentioned the very interesting potential cost – which I think I’m going to turn to later to Prakash to discuss this a bit – that it’s not just a question of equity. It actually could be a question of the functioning of the economy is worse because of this income inequality. Uri, let’s turn to you now. I hope in amongst all the many points you’re going to make you will give us a sense of how this compares with others and why it might be happening.

MR. DADUSH: OK. (Chuckles.) So I have the easy job. So it’s – I have to describe what is causing this and what to do about it. The causes – there’s actually broad agreement about some things among economists, that skill-based technological change – machines, robots, et cetera – are a – is a very major force behind the inequality trend.

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There’s also a fair amount of agreement that financialization – the importance of Wall Street, et cetera – is – also helps explain the gap – the widening gap between the top 1 percent and the rest. But there is much less agreement on many other factors that are often cited – demographics, for example, trade and migration.

But perhaps the most important point that I want to make, and I think it’s made in the paper fairly clearly too, is that the big increase in inequality not just in the United States but in the world as a whole is best understood as a combination of many factors working in combination and reinforcing each other – not as a list of separate factors, but the interaction.

And the clearest example of the very powerful interaction of factors is that between technology and trade. So if you look at trade in isolation – and many have done it – it cannot
explain the big shifts – for example, the fall in manufacturing employment which you observed in all advanced countries and now, increasingly, in many developing countries.

This cannot be explained by trade. And in the United States, it cannot be explained, for example, by increased trade with developing countries. And there’s been a big increase in trade in developing countries. So if you just look at the size of trade and the shifts of trade, you cannot relate this to the very large decline in employment that you have, for example, in manufacturing.

Also, the increase in the current account deficit does not correlate easily with reduced employment in manufacturing, in part because, actually, in the United States when the current account deficit increases, usually unemployment is very low. That’s because the current account deficit is increasing because of domestic demand in the United States, not because of increased competition from overseas.

However, if you dig deeper, skill-based technological change – machines, et cetera – is clearly not independent of trade with poor countries. Now, skill-based technological change would probably be happening anyway, yes? It would be profitable anyway. But increased competition from lower-wage countries which achieve a certain level of productivity makes automation a matter of survival for companies.

So even though trade may not cause inequality directly, it does so indirectly by forcing skill-based technological change – an example of how trade, globalization and technology interact. However, the links between trade, technology and inequality interact very powerfully in other ways because then you should ask, how do low wage countries become more productive and threaten established industries in advanced countries, anyway?

Well, that is by learning and adopting technologies from advanced countries. And how does that happen? Through the interaction created by trade, foreign direct investment and migration – interaction with the diasporas.

So, note also that the interconnection – all these interconnections are themselves made vastly easier by the reduction in cost of communication and transportation, which are themselves a result of technology. OK, so I’ve tried to explain how these factors are very, very interactive.

And I believe that a big reason economists – and for that matter politicians – often cannot agree on whether trade, migration and FDI cause inequality to increase and hurt the poor is that all these forces are not independent forces. These are not exogenous factors. They are instead an adaptation to technological change and other more fundamental forces. And they’re spread in the whole world.

And because this technological change is often skill-based technological change, it is inherently disequalizing all over the world. Manufacturing employment is falling in China as well as in the United States. However, trade, FDI and migration are adaptations to these shifts and can actually be beneficial not only to society as a whole but also to the poorest in many cases.
I may have totally confused you by now. If I have, I apologize. But I tried to bring out the very complex interactions between these forces, and why it’s difficult to separate them.

Now, some of the other factors that are believed to cause inequality are intimately linked to technology and globalization interacting.

A very clear case is the winner-take-all phenomenon. These have always existed. The winner of Wimbledon, which I always wanted to do when I was young, by the way – the winner of Wimbledon or the fellow or lady who gets the leading role in movies or the CEO of a big company have always done much better than number two, even if number two was almost as good.

But now, the whole world is available to them, hugely increasing the reach and reward of success of the top person so that, for example, modern technologies today enable billions – billions to watch the final of the soccer World Cup – another thing that I very much wanted to do as a young man – and the – or the Oscars, whereas not –

MS. BADDOES: Did you want to do that too? (Laughter.)

MR. DADUSH: I was not that ambitious. (Chuckles.) Or you know, Zanny, I went to a British boarding school. In a British boarding school, you always want to win at sports, so – or the Oscars. These are people – these now reach billions, whereas they used to reach thousands; and a hundred years ago, maybe hundreds only – so another example of the interaction of globalization and technology in spreading inequality.

Financialization – another example. It used to be that finance was a pretty staid business. I remember when I graduated from business school a long time ago. People told me don’t go into banking – you know, it’s a bad industry, you know, it’s very conservative and nothing happens, et cetera, et cetera.

And at the time, you just made loans and you had some venture fund management, et cetera, but it was relatively straightforward investment, buying shares and equities. And today, with the click of a mouse, billions of dollars are transferred using very, very complex derivatives, most of which most people can’t even understand.

So it’s a combination of – a combination of the widening of the market and – the global market – and both information technologies but also financial technologies that help explain the extraordinary returns on Wall Street, which one day I hope will be arbitrated away just like the salaries in think tanks. The – (laughter) – the – then now, what about the remedies? Do I have time to talk about remedies?

MS. BADDOES: You do, briefly.
MR. DADUSH: Briefly. So once I describe what is causing it, it’s fairly evident that this is tough to deal with. I mean, what are you going to do? Can you stop technology, trade or FDI? And if you could, would you? There will obviously be gains that are coming from technology and trade, et cetera, which are translated into lower prices for all of us. Of course, if you lose your job as a result of trade, you’re worse off.

But the average of society is better off because of trade and technology, et cetera. So the answer cannot be to deal with the fundamental cause – even if we could, which would be very difficult to do. So there are really two big avenues to deal with it. One is to improve the market outcomes by preparing workers for globalization and technological change. And here, there are two main elements.

One is the kind of standard – you improve the business climate, you improve the infrastructure in the economy, make the economy generally more productive and efficient. And the second is, invest in people, education, health as well – but education, very, very important. So that’s one set of measures.

Now, bear in mind, however, when I speak about the set of measures, that these are things you really would want to do anyway and not only are they things that you would want to do anyway because they make the economy more efficient and better, but actually more importantly, everybody’s doing it. So I worked a long time at the World Bank, as did Kemal, and wherever we went around the world, we always said you have to invest in education and improve your business climate.

So everybody’s doing it. OK, that doesn’t mean you shouldn’t do it. You have to do it. It’s a horse race. But really, you would do it whether you had the inequality trend or not. Maybe you’d invest. Given the inequality trend, you’d invest a little more in education than you would otherwise, certainly in the advanced countries.

So this leaves you with the second avenue, the second big avenue, which in my view is much more pertinent because it applies very specifically to inequality, and because countries can do them essentially independent of other countries. It’s not a horse race as much as it is – an international horse race as much as it is a domestic reform specifically designed to deal with the inequality problem.

And that is of course redistribution of income. And Kemal has already mentioned that the U.S. doesn’t do particularly well in this regard. It does redistribute incomes, market incomes more unequal than post-tax and transfer incomes, but less so than other countries.

And also have become less redistributive – the U.S. has become less redistributive over time. The U.S. spends proportionately less on benefits to people in general, whether it’s social safety nets or health expenditures or education expenditure, et cetera, et cetera.
And also, its tax system is generally less progressive and certainly much less progressive once you take into account the big loopholes that you – that you have.

Last point is about politics and inequality. The paper talks about politics and inequality because we believe that, you know, obviously you cannot talk about inequality without relating to politics. And there are many issues here, but where the U.S. stands out is not that the rich are powerful. The rich are powerful everywhere. And they have always been powerful in the U.S. But the U.S. mainly stands out for the cost of its political campaigns, which really have very little resemblance to the costs in other countries for various reasons.

And also, it stands out for the size and organization of its lobbies. Increasingly, also, for the important role that corporations can play directly in its political campaign. And obviously, very high inequality in the U.S. – the U.S. may not be a total outlier in the advanced countries but it is an outlet in the advanced countries. The fact that you have very high inequality combined with large importance of money in the system – these factors interact.

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The fact that you have a high proportion of politicians – congressmen, et cetera – who are really among the wealthiest people in society; the big influence that the very important financial sector has in the United States and, generally, their ability to influence all these factors, to influence campaigns on the part of high net worth individuals. These are some of the areas where it’s not completely unique and there are societies that are much more corrupt than the United States and where governance is much weaker than in the United States.

But among the advanced countries, the United States stands out in this respect. And the fact that, as Kemal documented, you actually have much less mobility in the United States than people generally believe – social mobility and also less mobility than in other countries – makes one concerned about how this situation is going to develop in the future.

Whether, in other words, there isn’t a self-reinforcing cycle here at work of increasing inequality, reduced mobility and increased influence on government policies that favor, disproportionately, certain sectors.

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MS. BEDDOES: Gosh, well, on that really uplifting note – (laughter) – I think we’ll turn to the panelists. I just wanted to pull together your excellent comments with those of Kemal a bit, because you started off, Uri, by laying out very deep-seated global trends, whether it was technology, skill-biased technological change, winner takes all in the global economy.

And as I heard you go through them, I thought, well, this may explain why inequality is going up in large chunks of the world. And it’s pretty deep global trends. And it’s got very little to do with what I hear or read, actually, in the newspapers in the press here about, you know, decline of unions, power over politics and so forth. And then you move to the question of redistribution.

And the striking thing there in the U.S. is not only that the U.S. is relatively less redistributionist than many other rich countries – and we can discuss quite how much less
redistributive it is. It is true that it is extraordinary that the U.S. is now discussing becoming even less redistributive, if you look at one party’s platform, at a time when everywhere else in the OECD the debate is about going in the opposite direction.

And I think that’s where the U.S. really stands out in the nature of the debate its having right now about taxation – more tax cuts, which you really don’t see anywhere else and kind of understanding why that is the case is very interesting about, you know, why the U.S. is different.

And Branko, hopefully you can – I’d like you to bring some real international knowledge to this. And you know – you’ve developed more measures of inequality than anybody else and you’ve looked more closely at the international experience. So what’s happening around the world and how does that make you think about what’s going on in the U.S.?

MR. MILANOVIĆ: Well, thank you very much, Zanny. So I will – the economists used to be actually divided into economists who actually, you know, on the left hand, left arm, then right arm. But now, they are all in between the PowerPoint or not PowerPoint. I prepared my PowerPoint. Now, of course, I have to present my PowerPoint without a PowerPoint. So I will actually draw some circles in the air to describe what I had in mind.

[00:52:48]

First, I thought it was, of course, an excellent paper which actually brings together – I think it’s going to be much read and quoted because it brings together basically all that we know and all that we don’t know about rising inequality in the U.S. and the rest of the world. So since Zanny asked me about, of course, the rest of the world, let me just make very clearly several points.

First of all, it’s absolutely true that actually over the last quarter century, rising inequality has been a trend in practically most of the world – with the exception, as Zanny mentioned, over the last years Latin America is a big outlier in that respect because there was a decline in inequality. But one should not forget that Latin American inequality is still the highest in the world.

So that’s a very, very high level of inequality – much higher than in the U.S. but on the declining trend. Everywhere else, you have had basically 17 out of 22 OECD countries with such numbers, you have had an increase. And then you just look. You know, OECD countries most increase inequality – China and India, although the data for India are a little bit different. But you know, also an increase in inequality.

[00:53:52]

All the transition economies had very large increase in inequality. Africa we know less, because the data are not good and Africa always has a fairly high level of inequality. So basically this is the story everywhere. Now, the question you ask yourself is why is it, you know, happening. Actually, Uri mentioned some of the reasons. You know, the paper gives many of the, you know, explanations.

To some extent, we have an over-determined system, because we have really lots of explanations. They can apply to each individual country, several of them, or we can actually pull explanations from left and right and apply them to different countries.
So we can say in the U.S., as we have heard, skilled technological, skill-based technological change or it could be globalization or it could be openness in China, it could be transformation from an agriculture society into industrial society. In Russia, it could be the movement from a planned economy to a market economy.

So we have really one – I mean, different theory for different country and we seem to explain it. But there is something I believe in that, ultimately unsatisfactory, for an economist who would like to have some broader view. So let me just propose – this is not something that I actually have written but just sort of perhaps one way of thinking about that which would be as follows.

You know, the workhorse of inequality economics until relatively recently has been the Kuznets curve, the idea being is that inequality goes up as economy moves from being essentially agricultural-based where people are more or less have similar incomes and then you have industrialized economy where you have essentially big gap between rural and urban incomes plus very high differentiation of wages in the urban sector or industrial sector.

And then you have a decline because you introduce – the country becomes richer. You introduce more transfers. Education becomes more widely spread and so on. And if you look at the data, although, you know, obviously it depends who looks at the data. But if you look at the broad picture of Western societies where we have data going back particularly for U.K. going back to 1850, you do actually face something which goes like that and then you have – I think that Kemal mentioned this long decline from the end of World War I practically to 1979, 1980.

So this was a long decline. U.S. actually more or less charts the same thing with sort of a delay of maybe 40 or 50 years, which is explained by globalization number one and movement of labor from Europe to the United States. So basically most countries chart something like that.

The problem becomes, then, when you actually have the situation that in the last quarter century we have an increase. So we now have a chart which goes like this, reaches a top somewhere like end of the 19th century, goes for a long decline and then there is an increase. So the question – actually this whole discussion comes together because we actually have a problem explaining this increase.

And one part – and particularly when you look now – and I’d like to look at China as the U.S. as two really sort exemplars or antipode. And they are both actually – if you look at their increase in GDP, it’s remarkably similar. When you put it on a chart, U.S. in the last 25 years have gone up – and not as much as China but the plot is like that. Inequality goes up. China, you plot GDP per capita, of course going up enormously; and also you plot the Gini coefficient, it’s also up.

So I am wondering to what an extent we may not be and that goes back to the story of the skill-based technological change. We’re maybe witnessing a sort of the second technological revolution. Like the first one, the Kuznets one, maybe now we have a movement that goes from manufacturing to services and the second one.
So maybe, we are basically witnessing sort of a wave – the second Kuznets wave – which we never thought of that before because we thought there would be one wave because there was a structure transformation. You increase inequality, then you reduce it. So it could be that we are now in a – maybe it's actually a wave-like movement so that maybe in 50 years or a hundred years we may be in the third technological revolution or whatever number it could be.

And in that case, we would explain possibly the fact that the U.S. is on the peak because it is of course the leader in the technological change. China can be explained, of course, by the old Kuznets story of the structure of transformation. The problem which I have with that explanation is that I cannot see – you know, I like Kuznets who could see the forces that would lead to the declining portion because, as I said before, he would see greater wealth redistribution, greater spread of education.

I cannot see other than education what would be these additional forces. I can see maybe there should be redistribution. But there are no – in the Kuznets story, there are obvious reasons why people have their wealth redistributed.

But as Zanny mentioned, now we seem to have a situation, particularly in the United States, that even if the economy is very rich, the demand for redistribution, at least as reflected in the political process, is for less of it, not for more of it. So I think that we are now in a – I'm a person that's sort of in a quandary of what can one say – how – what would be the forces. And it goes back to the ending part of the paper. What would be the forces that would bring this inequality down because clearly it has, of course, large implications for the stability of the economic system, for ability to get out of the crisis. I think Kemal talked about that before. So I will not repeat.

So this is what I would actually say from the sort of a global perspective with just one small note also is that you have to distinguish that although inequality in all the – in most countries in the world went up and global inequality sort of increased and might have peaked, you haven’t to distinguish clearly between what happened within nations from what happened globally.

Within nations, as the paper shows, you essentially – particularly U.S. is a good example – you had very large increases concentrated in the top 1 percent of the income distribution and very small increases in median or even the mean and so on. In the world, it's a little bit different because of China and India, which really are poor countries growing up, though in the world you had large increase at the top.

But then you had the very large increase in real incomes around the median, and even up through the mean, because of massive push of people who were very poor in India and China. So they are actually now going up the ladders and they are – you have large increases, for example, of the median world income.
And as we have heard, for the United States that’s not the case. So basically the story line there for the world we have had over last quarter century a plateauing global inequality with large increases in the median income.

For the U.S. and many individual countries in the West, we have had large increases in the mean, stagnating median and very large increase at the very top. So that the picture is a little bit different if you look at the individual countries and the world as a whole.

MS. BEDDOES: Thank you, Branko. I think we’re going to come back. That’s a very important question – what will bring inequality down, particularly to the extent that this is a global trend. And I definitely want to come back to that, but first, Prakash, give us your perspective on the paper. And I hope you’ll focus on – in part on Kemal’s point about the macroeconomic consequences. I mean, why is your institution so interested now in income inequality?

[01:01:39]

PRAKASH LOUNGANI: Thanks very much, Zanny, and thanks to your organizers. Kemal, thank you for having somebody from the IMF on this panel, which is unusual in itself. I think that my institution has indeed been taking a lot of interest in it – in this topic. I should say that I’m perhaps more interested in it than the average person there. Sometimes they call me the conscience of the IMF – (laughs) – in my institution.

But in general, people have become more interested. And I think it is for sort of the reasons that this paper talks about, which is that people do worry about its macroeconomic consequences, and I’ll also try to address that in my remarks.

But first, let me start out by saying that the traditional sort of gambit for a discussant is to say that rather than discuss the specifics of the paper I’m going to put it in the broader context of my own work. (Laughter.) That is a difficult gambit in a paper like this one which his very comprehensive, very nicely done, covers all the bases.

So what I’m going to do is put my work and my institution’s work in the context of the work that Kemal, Uri and the co-authors have done. It’s a very nice paper. I want to make three points and I’ve written them down so that unlike Rick Perry, I don’t forget the third. (Laughter.)

[01:03:09]

The first is that even though, as I said, I personally have worked on and worried about inequality – many at my institution are doing so. I think we don’t want to give up our sort of moral outrage at things like absolute levels of poverty, which institutions – both the IMF and World Bank and others – have been focused on for a decade and more.

So much as I like the paper’s focus on inequality, I think – and they do mention it – I think the focus on relative versus absolute levels must be maintained. I think it’s still quite shocking that even after all the progress in reducing poverty over the last decade that we still have a billion people living sort of on the edge of marginalization. So that’s one point.
And I think it also goes a little bit to what Branko was saying which is that in the measure of inequality, I think we should keep in mind what he said about the distinction between what is happening between within nations and what’s happening globally. When we look within the U.S., we sort of worry about increasing inequality but even people at the bottom in the U.S. are still fairly affluent by the standards of the rich in other countries.

And I think we should, in a sense, obviously worry about what goes on within countries because the political process often can only deliver progress within countries, as Uri was saying. But if you look from a global perspective, if there was kind of what I call this kind of John Lennon definition of inequality – which is to imagine there is no countries or imagine there’s no country – then as Branko said, there has been a lot of progress because of the progress in China and India.

So let me sum up what this first point is. The first point is, I think – I would like to say as much of a focus on poverty reduction as inequality and then I would like within the definition of inequality to have as much of a focus on global inequality as what’s going on within nations.

The second point is related to Kemal’s point about what is the optimal level of Gini. And that’s sort of something that’s come up a lot as I’ve talked to my colleagues at the IMF. You know, we stir up all this concern about inequality and sooner or later the person working on the desk for Uruguay or the desk for Burkina Faso asks you, well, OK, so the Gini for my country is .37. Is that good or bad or what should I be shooting for, what should I be discussing with the authorities, what is their target level of the Gini?

So I think once we start shaking up this – or unlocking this Gini from this bottle, people are going to ask us these kinds of questions. Now, in the case of things like debt, you know, we have at least a rough guidance.

I mean, we have debt sustainability analysis that tells you whether or not a certain level of debt is going to be sustainable. We have kind of rules of thumb developed by Rogoff and Reinhart on what debt intolerance level is. You know – 40 percent of debt to GDP, you start worrying; 60 percent, you may run into – have an increased risk of financial crisis and so on.

So I think at some point people are going to ask us what the Gini intolerance level is and at what point do you have to start worrying about risk of social crisis if the Gini goes beyond a certain level. And I think – I would think that step two of this analysis has to try to kind of give people at least guidance.

And my third point is that having said that we should give guidance on this topic, it’s obviously not very easy for the reasons that Uri mentioned, that there is kind of good and bad inequality, if you will, because the forces that generate inequality are very complex. There’s lots of interactions among various forces, as he mentioned.

Some of these forces are certainly forces for good, like international trade. Others may be less so. But as he said very correctly, this is three or four factors acting together, some very
exogenous factors, some policy-driven factors, which all interact to produce a given level of inequality. So our ability to, I think, say something about what the optimal level of the Gini is is going to be very difficult because of this sort of good and bad inequality.

And let me do a bit of promotion for some sort of new work that I've been doing with a colleague of mine at the IMF, David Fulcheri (ph), in which we have been trying to look at some of these forces behind the Gini and we find some very complicated interrelationships and ones that don't lend themselves easily to policy conclusions because they involve very complex trade-offs.

So for instance, we find that if – countries which have a high government size tend to have lower Ginis. So government acts as a force for perhaps redistribution and declines in Gini. But as Kemal and Uri discuss in the paper, people have different views about what the optimal size of the government should be. And not everybody agrees on what that should be. So you might want for inequality reasons to raise the size of government, but for efficiency reasons or other reasons you may not be in favor of that.

[01:09:19]

Another thing which is – looking here at my ILO colleagues, with whom I've been working for several years now – two years at least if not more – on trying to rid the IMF of using slogans like labor market flexibility and rigidity and looking actually at specific reforms. And again, this is very preliminary work. But I throw it out because my ILO friends are here and Kemal who has been working with us is here.

It turns out that many of these reforms – many of these measures of labor market flexibility turn out also to lower inequality. So if you have – if you reduce employment protection or other countries that have lower employment protection also have lower inequality. So again, this is a complex trade-off because we've been working with our ILO friends to say let's get away from the rigid IMF position. Let's recognize that employment protection plays a useful role and, you know, we should not be against it just for doctrinal reasons.

But it also turns out that it – actually having less employment protection from these results helps you on the inequality front. So I think that this is a very interesting paper. I think it does do a wonderful job of summarizing what we know about the topic.

[01:10:44]

But it raises for me a next set of questions which I hope we can discuss in the remainder which is how do we decide on an optimal level of Gini and then how do we sort of distinguish between good and bad forms of inequality.

MS. BEDDOES: Thank you, Prakash. I think those are excellent directions to take the discussion in. What I'd like to do is to sort of focus the discussion back in on the U.S. And I think the panelists have given a very comprehensive overview of what the data say, and also put it into the global context which I think is very important, both Branko and Prakash. I think your point about – Prakash, about not forgetting that from a global context, inequality is declining.

That's very – and Branko has the measure of this.
MR. : (Inaudible.)

MS. BEDDOES: And it is – if you put everybody in the world in a long line, the gap between them has narrowed between the first and last – has narrowed because poor countries are growing much faster. And for me, that raises the question of whether it makes the typical person in the U.S. feel better or worse, that the typical Indian or Chinese is wealthier.

But I think that’s an important thing to bear in mind. At a global level, inequality is declining. But within countries, inequality – many countries, inequality is increasing. And then I think, Prakash, this gets very much to your point: What is – is there a kind of optimal level of inequality, or is there too much inequality? And let me – because I think you all agree with each other. So I’m going to slightly play devil’s advocate here.

[01:12:15]

I think one can make the point that more egalitarian countries are becoming less egalitarian, and highly unequal countries, particularly in Latin America, are becoming less unequal. So for example, the country in the OECD that has seen the biggest rise in inequality in the last 25 years is Sweden, from an extremely low base.

But it’s gone up percentage-wise rather dramatically. So couldn’t one say that in this new world of technology and so forth that you’ve laid out, we’re simply seeing a shift towards a kind of new level – a sort of global level of inequality which is higher than it was for many countries but is lower than it was in many countries in Latin America.

And if so, is that level too high? And let me put it very much in the context of the U.S., where inequality has clearly risen. Is it too high now? Do both of you think inequality is too high in the U.S.? Should more – should we have as a policy goal to reduce it?

MR. DERVIŞ: Well, I mean, as most normative questions, you know, much depends on value judgments which are not necessarily objectively demonstrable.

[01:13:16]

MS. BEDDOES: But do you think – it would be interesting to get from all of you, do you think it’s true?

MR. DERVIŞ: Yeah, no, no, I mean, I'll answer it. I think, again, one has to think of the three things somewhat separate – the overall distribution – the Gini, if you like – the – and the two extremes.

I fully agree with what Prakash said. At the very bottom, I mean, the outrage of having absolute poverty is something very important and it’s something that has to be fought against. However, I would say that while there is still a lot of absolute poverty, there’s been a huge progress on that front. So in a sense, you know, I mean, the fight against poverty is ongoing and, you know, it’s linked to conflict, disease and all kinds of things.
But in terms of the economic mechanisms, it seems that the global economy has the means to fight absolute poverty. OK, I may be overstating it a little bit, but just to make the point. To me, where the big problem is, is at the other extreme. And here, I don’t see any mechanisms that are actually likely to mitigate it.

MS. BEDDOES: Too much income is concentrated at the top.

MR. Derviș: At the very top. I mean, you know, 8 percent – let’s take the U.S. numbers. Roughly 8 percent – let’s say 20 percent, you know, the capital gains, one can either include it or not include it – but I think the dynamic is all in one direction. And if we look at what’s happening now, you know, profits are increasing, certainly in the large corporate sector.

Wages are not increasing. Even though employment is – we have some good employment – not good, but at least better employment numbers – they are at wages which are lower than before the crisis, OK. If we look at some of the factors that Uri was talking about, winner take all mechanisms, all these things are going in the same direction.

And there – I mean, if I said, OK, 20 percent going to – from 8 to 20 percent seems a lot, but maybe people will say 20 percent – well, maybe it’s acceptable.

MS. BEDDOES: The total income going to the top 20 percent, just to clarify.

MR. Derviș: The top 20 percent. What if it goes to 30 percent? I mean, what if you have a society where the top 1 percent has almost a third of the income, OK? I mean, if you extrapolate the trend, one is going in that direction and I think – you know, I’m an economist so this is more of a political point. The political capture of the system point becomes very, very crucial here. In other words –

MS. BEDDOES: Well, let’s get to that in a minute.

MR. Derviș: Yeah.

MS. BEDDOES: But just to make sure, do you think the current concentration of income at the top – and it’s somewhere between 18 to 20 percent of all income goes to the top 1 percent – in your view with your – in sort of political economy terms, is that too high?

MR. Derviș: Way too high.

MR. DADUSH: I completely agree. I mean, I think what the paper does is it actually – I mean, I’m a little less diplomatic than my friend, Kemal. So what the paper does is it really presents – we didn’t start out that way – I promise. I swear. We really wanted to really get a picture and try to do it in a – you know, as objective and fact-based way as we could.
I think the paper paints, really, a striking indictment of the way the trends are moving in the United States. I mean, in just about all the respects, the poverty, the – I mean, last year according to the last data, the 1 percent got 93 percent of the additional income. And you know, the 1 percent, you know, are just enormously rich in this country by any standard.

And so there’s that. There’s the whole argument we didn’t even discuss about positional goods, the kind of arms race to have the bigger houses and cars and – et cetera, et cetera. And then there’s the whole – the whole aspect of how policies have moved. I mean, you know, in the last 10, 15 years we’ve reduced the tax on dividends and capital gains. We’ve reduced the taxes on higher incomes.

And then there are these huge loopholes that you see. We didn’t put it in the paper – the OECD – according to OECD statistics, U.S. corporations paid less tax than Greek corporations do and Italian corporations, et cetera, et cetera, et cetera.

So there’s a whole, you know – why do we have 1 million – $1.1 million – I just checked with my accountant – $1.1 million mortgage interest deduction in this country, two people together – $1.1 million by four times the average house in the United States. The average house in the United States costs less than a quarter of $1.1 million.

Why do we have those? I mean, you know, there’s just one after another. And then, Zanny – and then we have lousy – we have a lousy – I should be careful. You know, I’m not even an American citizen. (Laughter.)

MS. BEDDOES: You won’t become one either at the rate you’re going.

MR. DADUSH: We have a lousy education – I mean, the public education system is very, very bad for a country this wealthy. Sorry, yeah.

MS. BEDDOES: Uri, you raise a lot of very interesting and important points and I hope we come to all of them. Since we have a reasonably small audience, I’m going to continue this conversation with all of you. If you have a question that is pertinent to the topic we’re currently discussing, please put your hand up and we’ll include you. Gentleman, you had one there?

Q: Matthias Rumpf from the OECD office. Just a question on this last point on the share of the – share in GDP for the top 1 or top 0.1 percent. What I find striking from our data, actually, is that the increase of the share for the 0.1 percent, that’s something that where the U.S. is an outlier compared to all the other OECD countries who have the data available.

If we look at France, there has been – their share of the – the share of the 0.1 percent has been virtually stable over the past 20, 30 years and they have been exposed to the same forces you describe in terms of trade, technology.
So there must be something special in the U.S., what brought this high concentration of income for the very top. Is it may be related to corporate governance? Is that an issue that might play a role because, you know, a lot of people on the top is (sic) not actually entrepreneurs. It’s employees.

MS. BEDDOES: Can I just ask you a question? You make the point that the share going to the top 0.1 percent is much, much higher than anywhere else in the world. In your data, the share going to the top 1 percent, has that increased as much in other rich countries as it has in the U.S.?

Q: The – (inaudible) – the U.S. is the real outlier as to the 0.1 percent. It has – I mean, income has increased for this very top end of the income scale in all countries. But it has quadrupled more or less over the past 20 years in the U.S. and it has increased by maybe 10, 20 percent in other countries.

[01:21:14]

So there is a huge concentration at the very top of the income scale, and if you look at the data for who are the people behind that, it’s not necessarily the Bill Gates or the Steve Jobs. It’s the CEOs. It’s actually employees or people who – you make the income as an employee in Wall Street. So there might be a corporate governance issue behind that. And the second point I want to make that’s on the other end of the income scale.

What I find – what’s also interesting from our data is that if you look at the before-tax income distribution, the U.S. is not that much of an outlier if you look at – if you take the broad definition, like a Gini coefficient or the share of the top 19 to top 10 percent. It becomes an outlier after you take into account taxation and benefits.

If you leave out benefits, it’s not that much of an outlier either. So the tax system is fairly progressive. So what makes it – what makes it less redistributional, the system, is the lack of redistribution through benefits. So that’s, I think, another area of –

[01:22:29]

MS. BEDDOES: That’s – question there, just one second – that’s a very important point to make but because quite often in the U.S. debate you hear these talking points – actually the U.S. has the most progressive tax system in the rich world, which is in narrow terms almost true. The income tax system is very progressive. But if you put the whole tax system and you add benefits, it’s much, much less progressive.

Q: There’s one factor which is always left out that is also coming from our data and this is why I took a lot from the previous study in 2008 where we had a figure which is quoted by many people over here that the U.S. has the most progressive tax system.

But it leaves out a number of factors. The biggest factor which is left out of this calculation that in most countries, in the tax system health care is included whereas over here it’s excluded and contribution to health care is usually regressive. So it overstates the progressivity of the U.S. tax system.
MS. BEDDOES: Very good. The gentleman there?

Q: Thank you. Pretty basic political question, why do the arguments for a greater redistributive system not resonate amongst the 99 percent apparently? I mean, why is this politically unacceptable? (Laughter.)

And then a follow-up. If that’s the answer that I suppose we expect on a political basis, you made some interesting points about how from an economic – macroeconomic point of view, there are compelling arguments for a more redistributive system. So is that something that will – can be talked about more than in the past?

MS. BEDDOES: I think I’m going to ask Prakash – you – to comment, on the second one. If anybody wants to comment on the first part of that question, please do. But I suspect it’s not anybody – actually, Kemal, it may be your comparative (lunch ?), since you’re the only person who’s actually been a serving politician here.

[01:24:12]

MR. DERVIŞ: Well, not in the U.S. but –

MS. BEDDOES: It was a general question.

MR. DERVIŞ: Yeah, no, actually, when you look at – there’s somebody at Carnegie, Steve Koll, who has some data on this. When you actually ask the question in the U.S. population, there is quite strong support for a more redistribution, particularly vis-à-vis the top – I can’t remember the exact number, but something like 67 percent of the people, you know, support something like the Buffet rule and things like that.

So there is that support. However, I think there is general – I mean, you know, I’m not a professional on this. There is a general aversion to taxes that translates into anything that kind of, you know, has to do with it. But when you get specific, the general – I mean, there is actually some support and that support is increasing.

MS. BEDDOES: Prakash, could you – we’ll get to more questions in a second. I’d like Prakash to comment on the second part of that question, which is whether you think the macroeconomic arguments for more redistribution are gaining credence in the U.S., but more broadly, in the countries that the IMF is in.

[01:24:22]

MR. LOUNGANI: Well, I can’t speak for very broadly about the other countries. Let me sort of answer on a more somewhat personal level from my experience from teaching at Vanderbilt University, in their executive MBA program. My students are very sensible, hardworking people and I think they would have not a view in common with most of you here – (laughs).

These are the people who had no support for redistribution. And when I ask them, what they say is that they have seen nothing about what government does that they find particularly
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reassuring or useful. They see redistribution as basically a mechanism for a higher size of government and they feel that it’s their money taken away and given to Washington.

And these are – you know, it’s easy to demonize these people as Tea Party people and, you know, they are kind of sometimes are even called not intelligent. They’re not. These are students who got into a, you know, good executive MBA program. They are middle managers at good companies like FedEx and Southwest and so on. They’re very sensible people, if you run into them.

To me, the great recession was an opportunity for government to show that it could do differently. And many of these people feel that the stimulus program, they couldn’t see that it delivered the kinds of benefits that would shift their views of government. And so there was a moment at the start of the great recession when I felt like these people were very scared and their views might change and they are watching what government does.

And it seems to me that even though as economists we agree that the stimulus programs worked, I think there was not any kind of flashy deliver– something that delivered – that people really changed their minds of government.

So this is a very sort of a more personal answer than perhaps you were seeking. But these are people who I interact with, just as I interact with this audience. And I find it difficult to go against them and say, well, you guys are idiots for not being in favor of redistribution.

MS. BEDDOES: Are they more convinced at the end of your lectures?

MR. LOUNGANI: Well, I don’t try really to convince them. I try to kind of, you know, have a dialogue with them. I do – going back to how Kemal started, I think that I’m not convinced, despite the work that the IMF has done in the last few years and what my colleagues have done, that the macro consequences of inequality – the adverse consequences – have been proved beyond a doubt.

We clearly have these two cases of great depression, and then this recent period where you had the same kinds of mechanisms – the world that my colleagues Kumhof and Ranciere have described, where inequalities associated with excessive borrowing on the part of the poor because that’s kind of how you’re buying them off, the poor and the middle class. You let them kind of over-leverage themselves and that raises the risk of financial crisis.

And so that is very good work. But it, I think, relies sort of on these two data points. And to me, the consequences – adverse consequences are still very much open to debate. So Kemal, when you describe the increase of poverty in the United States, that distresses me because a tiny bit of redistribution would keep people from sinking into poverty.

When you – I cannot bring the same outrage to even, you know, your stats about 20 percent of the income going to the top 1 percent. We demonize them by saying these are bankers, but
they’re also surgeons in there and I hope brain surgeons and heart surgeons continue to get excessive incomes because they deserve every bit in my view, so –

MS. BEDDOES: Thank you. There was a gentleman there. Yeah, a question?

Q: Thank you very much. George Dragnich, (late ?) of the ILO, and a retired American civil servant. U.N. and civil service salaries have stayed stagnant or gone down. Matthias Rumpf over here from the OECD raised a very interesting point. And I don’t know, because we don’t have your full paper, whether it was addressed there – the difference between entrepreneurs and employees.

In America, we all value the entrepreneurs, foreign entrepreneurs as well. I think of people like Vinod Khosla from India, Andreas von Bechtolsheim from Germany who quit their Ph.D. program at Stanford and helped form Sun Microsystems, and Andy Bechtolsheim then taking his profits and investing in Google. These people were risking their money. In America, everybody loves an entrepreneur that makes that kind of risk.

[01:30:39]

But Matthias over here raised an interesting question about employees. These are people who have gotten ahead by so-called compensation committees and they played the global game exceptionally well. I could see this living in Europe, how everybody in Europe said, oh, we have to pay American-like salaries because people will go there.

Does your paper address this phenomenon of compensation committees? That is fundamentally different than what it was when I entered the labor market many years ago. Thank you.

MR. DADUSH: No.

MS. BEDDOES: It doesn’t. But do you have a view on it? I’m sure you do.

MR. DERVIŞ: Well, the data – I mean, I don’t think the data – I don’t think the data are available to be able to make that distinction among the 0.1 percent, but –

[01:31:22]

MR. DADUSH: Do I have a view on it? Yeah, I have a view. The – I think the governance at the top of corporations, not just in the United States – although it’s particularly bad in the United States – but in other countries, it’s terrible. I mean, it’s very simple. I was actually once in business. I was, you know, CEO of a small company.

And I – you know, when you get to the very top of these organizations, basically it’s the chief executive who appoints the board and it’s the board that decides on the compensation. And then the compensation is done and the board is comprised and the compensation committees are comprised of the chief executives – very often chief executives are related, that are, you know, also either active chief executives or who were once chief executives or play golf with chief executives, et cetera.
It's an extraordinarily, in my view, distorted system. And the shareholders – the board and shareholders actually have very little voice. And they’ve made some changes. But I think the system remains. And so long as there’s a CEO who’s appointing the board, the system will become – will continue to be completely incestuous.

MS. BEDDOES: We have a question here.

Q: Thank you. I’m Peter Herron, half-time a lawyer, corporate governance lawyer. And I wondered whether you would have any comments about the experiment in Germany where they required the – (in German) – unions on the board, whether this is a way of kind of equalizing or avoiding the excesses that we supposedly see in the United States.

And another aspect of this is that there’s been a tremendous effort in the United States to require shareholder approval of these salaries but it’s had absolutely zero impact as far as I’ve been able to see, that the shareholders support the board’s determination.

[01:33:42]

So while you may regard it as excessive, the people who have a stake in it support it. In a free economy, maybe that in indeed the way that it needs to be done. But those are two aspects of the corporate governance issue that I would be interested in your thoughts.

MS. BEDDOES: Uri?

MR. DADUSH: Well, I understand the workings of the market. I’m a trade economist by training. What I am reflecting on is the system for setting compensation. I am saying it is not an objective system. It is a highly incestuous system.

When you get to the very top, not when you are, you know, perhaps two – a couple of layers below. But at the very top, it’s just a very incestuous system. And I’m sure there are ways of doing it better. I actually haven’t devoted a lot of thought to that recently. But there are ways of creating – and I’m not terribly surprised about, you know, the shareholders not intervening in the way that you might expect.

[01:34:55]

I mean, you know, most of the shareholders own very little, et cetera. It’s just not going to be – not going to be a central issue for them. So I am very concerned about the objectivity of the system. And anybody who’s seen it at work at high levels.

And just the very fact that the board is appointed. And over time, you know, there are situations where the whole board has been appointed by the one person that they’re supposed to judge. Just that makes it a very bad system.

MS. BEDDOES: Uri, I’m going to abuse my moderator privilege for a second and press you on that a bit more and say, well, an alternative view, and you make yours very forcefully but an
alternative view is that the argument that you laid out earlier about an increasingly global economy and winner takes all phenomenon could be playing out perfectly well in firms, too.

You have companies now competing for talent on the global stage, companies selling for a global market. Therefore there is likely to be an increasingly level global playing field for CEO compensation. And the tightness of compensation committees within one country is much less relevant than the fact that you are now, you know – you’re playing a much bigger global field.

And so, for example, in the U.K., which I know much better than the U.S., CEO compensation is currently still lower than the U.S. but is becoming much higher relative to average wages.

And the main reason is that companies are competing in a global marketplace. And so they are having to, you know, go toward global norms. So it may be less the distortive incentive system that you’re talking about and the much broader global shift that you were discussing earlier.

MR. DADVUSH: Again, I have no doubt that the globalization and the winner-takes-all is affecting, you know, wages of these top people worldwide. And I think it is a factor. But again, having observed these processes, you know, closely, you just can’t get away from – and the incestuousness of the system is not limited to the United States. It’s – you find it in – you find it in many places.

But it would be interesting. You know, it’s – again, this is not something I’ve devoted a lot of time on. But it would be very interesting to take – to do an analysis and look at how these compensation of very high level people compare in different contexts where, for example, unions are represented or where the government is represented or where perhaps, you know, large pension funds or whatever that the shareholders are playing a more important role. That would be very interesting. You know, you could verify that in particular.

MS. BEDDOES: Vikram, did you have a question?

Q: Thanks a lot, Zanny. I’m Vikram Nehru, from Carnegie. There have been many issues and points raised. I just wanted to see if I could connect some of the dots by quoting a colleague of mine, Moises Naim, when at a similar such panel which you were in fact moderating, Zanny. He made the very interesting point that inequality is like cholesterol.

There’s good cholesterol and there’s bad cholesterol. And he was saying that there’s good inequality and there’s bad inequality. Good inequality comes about as a result of people’s inherent hard work, their intelligence, the fact that they’re able to do better than others.

And bad inequality comes about because of policy distortions of various kinds, the fact that people are discriminated because of their ethnicity, their nationality, gender, race and so forth. So the big – I think one of the reasons why we can’t get to an optimal inequality of outcomes is because we’re mixing up these two concepts. What we really want to ask is: What is the inequality of
opportunity for people? To what extent do people have the opportunity to rise vertically, as Kemal has mentioned.

When we did this analysis in China for the China 2030 project, you know, we found that there are a lot of reasons why rising inequality was in fact a good thing, because this came about as a result of increased competition, structural change, rising technological progress, returns to skills.

But there was a significant amount of that increase in inequality that came about as a result of increased inequality of opportunity for health, education, access to jobs, to finance – whether you were born in a rural or an urban area made a huge difference, whether your parents were rich or poor made a big difference.

[01:39:48]

And we really should be tracking the inequality of opportunity rather than the inequality of outcomes because that way we can then – and there, Prakash, we have a clear policy objective where the Gini coefficient for the inequality of opportunity should be zero. And there’s no – it’s unequivocally zero, and you don’t have to guess, you know, what is the appropriate inequality of outcomes because we are mingling these two concepts. Thank you.

MS. BEDDOES: Does anyone want to react to that?

MR. DERVIŞ: Yeah, I mean, I agree in principle. But of course there are – you know, the more there is inequality in terms of income and power and influence, the more difficult it becomes to have inequality of opportunity beyond a certain point. So I think one of the – I mean, I think we – all authors of the paper and maybe all of us here sitting believe that really the equality of opportunity, you know, within reason.

Because somebody is sick, that person should be condemned to eternal poverty, so there has to be a social – I mean, even though that person may not be able to work as hard as a healthy person and so on. So there is some equalizing values, if you like, that have nothing to do with equality of opportunity per se.

[01:41:04]

But setting that side, I think the equality of opportunity is very important in, you know, the mobility. But as we said and as is quite clear from the data, the mobility is not very good in the U.S. and, you know, has marginally become worse, and is worse in many more equal societies. So there is a link. The two things are not delinked. I don’t remember, Vikram, at which period in China you covered.

But clearly China came from a very equal society to one – you know, a more unequal one with more competition and more incentives. And that probably was a good thing for Chinese growth. Whether or not at this point it has reached a danger zone in terms of, you know, the same kind of statistics that one finds in the U.S., I think, is a separate story.

But I want to make again one point or two points. I think, you know, there is envy everywhere and OK, it’s not a very admirable thing. Just to envy somebody who is rich, I don’t
think that’s what it’s all about, OK. I think there are two – in terms of the top concentration argument, there are two arguments which I think seriously have to be addressed strongly.

One is the macroeconomic argument – and I agree with Prakash, a lot more research is needed. But if one takes a fairly simple Keynesian model where the top income earners save a lot, OK, and the low income earners don’t save – or the very poor dis-save, there is a prima facie case that if you increase the income distribution, you generate the Keynesian problem. By the way, technically what’s important is the increase, the delta, not the actual level.

But – you know, so there is a macroeconomic policy issue which continues to be discussed – you know, you can counteract with the policy, maybe, or whatever. But I think it exists. And it’s not that important if the top has 10 percent or 8 percent or 12 percent. But when the top gets 20 or 25 percent, I think the macroeconomic issue becomes serious.

And the second reason why I think one should be really concerned is political capital, OK? I mean, in a society – and I’m exaggerating a little bit because what worries me is that the tendency is always in the same direction. There’s very little counter – counter-tendency, you know, in labor markets, in technology, in financial sector.

So in a society where the top 1 percent controls 25 percent of income, you’d have to have extraordinary kind of democratic counterweights for that group not to have an outsized influence on the policy process, OK. And I think that has nothing to do with envy or with, you know, competition.

On the contrary, I mean, that group will be able through its political influence and power to tilt the balance of power of policies, of subsidies, of taxes, of tax exemptions, you know, towards itself. And I think – frankly, I think this is a serious danger for democracy.

MS. BEDDOES: Thank you. There’s a lady there that’s been extremely patient.

Q: Thank you. My name is Carol – (inaudible) – I’m a current – (inaudible) – but I’m not an economist. I have two things to tell you. One, about – (off mic).

My original point was something along the lines of what someone did. Could you argue that when distribution is – (off mic) – because there is more demand? And do – (off mic).

And there was also a sort of moral – something – left over from the war, that – (off mic).

MS. BEDDOES: Thank you. I think those are both extremely important points. Kemal, you were laying out an argument which is basically exactly reinforcing what Kemal said about the macroeconomic potential of having a more redistributive income distribution.

There’s a lot of questions and we haven’t got a lot of time. So I want to go straight to Reza. You have a question?
Q: (Off mic.)

MS. BEDDOES: Would you wait for the microphone?

Q: (Off mic) – I mean, one point is reacting to Kemal’s last point on the macroeconomic impact of high inequality. I mean, you know, the fact that maybe there is more saving in the economy does not mean necessarily there has to be low growth. I mean, the saving can be invested and can result in future higher growth. So that’s one thing.

Also – I mean, I wonder – in the U.S. which as you said is sort of very high income inequality at the top. The saving rate is not very high, quite the contrary. So I’m not sure I really buy the line of Stiglitz and so on. I would like to read the paper in more detail before.

[01:47:05]

The other point is more of a political point. Does anybody on the panel – can anybody on the panel actually explain to me why in the U.S., with such high inequality – you know, the Republican Party, I mean, those who advocate less redistribution or less taxes get so much support in the lower parts of the population. This is something I just fail to understand.

MS. BEDDOES: That’s a question that was just made earlier as well. It seems to be one that’s very important. And the panel wasn’t leaping to answer it. Is there actually anybody in the audience who feels – let’s just stick with this specific question for the moment. What explains the politics in the U.S.?

Q: Money and politics.

MS. BEDDOES: Would you like to elaborate?

Q: Well, yeah, I mean, if the Occupy Wall Street panel channel their efforts the way that the Tea Party people did, we’d have a different – I think we’d have a different situation with respect to inequality because these issues are resolved in the political arena, not with economic models.

[01:48:11]

And then the political arena in this country – unfortunately, everything amounts to money. We just had an article in the paper last week. Some unnamed individual gave $10 million to a super PAC that will run ads against Obama and the Democrats – $10 million.

MS. BEDDOES: You make an important point. Uri makes this point too about the political – the concentration of wealth impacting political capital and so forth. But I’m not sure that that still explains why many, many millions of poorer Americans vote for policies which are not directly in their own interests. I mean, there’s something beyond money that must explain that.

MR. DERVIŞ: Here comes the explanation. (Chuckles.)

Q: I can’t promise to have an explanation but one thing that I have been wondering –
MR. DADUSH: Who are you?

Q: – was that is it possibly that this idea of the American dream or achieving something further – that is so ingrained in our society that, I mean, for even me it was a shock to hear things like mobilization is decreasing in the United States.

So could it be that people who believe that they will one day become a part of that 1 percent don’t want to undermine their future, that their future investments would be undermined, that they would suffer. And then the example that you brought up about Vanderbilt, could it be that students in an MBA program, their primary concern is making more money in the future and to go against their own future they would undermine future investments or future incentive to grow?

MS. BEDDOES: Prakash, when you discuss with your students, which I’m sure you do, what are the explanations, because I think that’s a very, very important point that you make. Is that the logic that’s going on, the great American dream?

[01:49:55]

MR. LOUNGANI: I think that that’s certainly part of it. I mean, I think that people do believe that there is a fair amount of mobility, more so than the stats would reflect probably. But what I was trying to – let me take a second stab at this – is I also feel that these are folks who do not have much faith in government as a mechanism for delivering anything to them.

And I know it’s very difficult in this audience to kind of say why people should have that view. But that is what people said. They say: I don’t trust any part of my income or anything going on in Washington. This is a transfer of power, and they don’t want any part of it. They don’t want policies that redistribute. They don’t want to be associated with things that – you know, money that will just vanish from their pockets, so –

MS. BEDDOES: The gentleman there?

[01:50:53]

Q: Just a quick point on the question of why people don’t vote for their economic interests. Actually, I think the American political science establishment has come up with a lot of answers.

And one thing I would highlight is there’s this new word called the “submerged state,” where this political scientist essentially argues that the reason why, you know, Americans are what they call philosophically conservative but operationally, on specific policies, liberal is because they don’t see the operational part of the government.

They don’t see how the home mortgage interest deduction is actually a massive subsidy on the part of the government or amounts to a massive social welfare program in a certain way. And so the problem is that this has two effects, I think the argument goes. First of all, you know, people, as you say, have no faith that they’re actually receiving any concrete benefits from these alleged social programs that the government is doing.
But second of all is that these programs actually have a massive debilitating physical cost on the government which further constraints its ability to actually provide and deliver benefits to the average American. So I think there’s this argument essentially that the government is working in America but it’s working, you know, in a submerged, invisible capacity and this is what’s undermining the broad faith of people in the government to do its job.

MS. BEDDOES: Thank you. The gentleman at the back there, you’ve been very patient too. I’m sorry. I’m going to get to everyone eventually.

Q: This is a very short, simple question. Is the full draft someplace on one of your websites or since the –

[01:52:19]

MS. BEDDOES: That is an important question. Is it up on the website?

MR. DADUSH: It is. No, it’s not.

MS. BEDDOES: It should be.

MR. DADUSH: It’s an important question. It is not up on the website. The – unfortunately, after the invitation went, Brookings Press decided to publish this as a small book. So they wanted to hold back on it. And so we – it will be available but it’s going to take a little while for it to come out.

Q: No free place for racing them out? No – (laughs).

MR. DADUSH: Well, yeah, yeah. If you really very badly want it, give me your card and I will not reveal to my Brookings colleagues that we do. (Laughter.)

MS. BEDDOES: It sounds like the U.S. government.

[01:53:00]

MR. DADUSH: Yeah, sorry about that; apologies.

MS. BEDDOES: The gentleman here?

Q: (Off mic.)

MS. BEDDOES: Can you wait for the microphone?

Q: (Off mic) – redistribution and the role of government. I just wanted to ask our authors and panelists what your feeling is about the pre-tax and transfers inequality, because I think it has been widening. And you offered some explanations. But what about a couple of points that were sort of thrown in almost as asides in the discussion?
One is that the profit share and income seems to be rising and the wage share falling. And Kemal made the macro argument that that might affect the balance of savings and consumption. But what also is happening inside the wage distribution, I think in the United States and in many countries, you’ve had a widening of wage dispersion.

That has been accompanied by a weakening of collective bargaining coverage in a number of countries – not all, but a number – not so strong minimum wages, although there’s been a kind of comeback on minimum wages in the last couple of years. And what’s your view on all these things? Prakash started to talk a little bit about it.

And again, it would seem to me that you’re looking at a package of things. The United States has very low employment protection legislation – well, it’s nonexistent. Denmark also – but in Denmark you have a lot of things that make it easy for people when they are changing jobs to find a new one very quickly and with a great income loss.

And, it would seem to me that you’re looking at a package of things. The United States has very low employment protection legislation – well, it’s nonexistent. Denmark also – but in Denmark you have a lot of things that make it easy for people when they are changing jobs to find a new one very quickly and with a great income loss.

[01:54:37]

Spain, you have very stringent employment protection legislation until a few weeks ago but very weak mobility measures. So I just would like to know, is there something that we ought to be doing before, if you like, spending all our time on taxes and transfers, as important as that is.

MS. BEDDOES: Thank you. That’s a very important question. Branko, I’m going to turn to you for that because – partly because we haven’t heard enough from you but secondly put this into a global context because I think you gave lots of examples from lots of countries. What institutional factors in the pre-tax distribution of income?

MR. MILANOVIĆ: Yeah, I was actually going to actually raise my hand to answer that question. I think it’s a very, very pertinent question. Let me give you something we know from the data – it seems that we know.

This is done by Luxembourg income study which probably for cross-country purposes is the best database because you really have harmonized surveys from basically most of the advanced countries plus a few Asian countries. And the Asian countries are important here for the following reason.

[01:55:37]

There are only two of them, Taiwan and Korea. When you look at pre-fifth – which is pre-before social transfers and before taxation, which means essentially distribution of assets, be it human assets or human – I mean, human capital or financial capital, ownership, whatever – U.S. is not – I mean, Western countries are fairly similar.

You know, people are surprised that Sweden is almost as unequal in market income – which is called market income terms which is distribution of assets – as the United States.

The thing that happens is that of course Sweden and the Netherlands and Denmark and so on, as was pointed out before, they redistribute much more and particularly as the OECD – the gentleman from the OECD said, through transfer system they become more equal.
Now, one interesting thing which puzzled me and I have no – I have not worked on that. I have no answer. But what I noticed for these two countries that we have, you know, this is South Korea and Taiwan, they are actually very different. Their Gini coefficient of market income is not very different from the Gini coefficient that at the end happens at a disposable income stage. And they don’t redistribute much because it seems that the assets are already fairly – I mean, fairly equally distributed. So if you have fairly equal distribution of education and financial assets, you don’t need to have a huge state to redistribute.

So I think it’s an interesting issue which – you know, it has not been picked up very much. You know, this is a database that is known but relatively obscure for macroeconomists. So I think it’s an important issue. Now, a second point on the U.S. – of course it is really we talk here mostly about the U.S.

[01:57:16]

But we should not end the U.S. political system and we have all different views and there are lots of studies on the U.S. political system. But this is the process of this rising income inequality, which is really a worldwide process. So there must be – maybe U.S. is leading that process. It’s quite possible. But there are really obviously factors that are not U.S.-specific which are behind that. So I think that, you know, there is an aspect there which we should not forget. It’s actually not only about compensations in the U.S. There is something much more deeper, I believe, than that.

MS. BEDDOES: Thank you, Branko. We are running out of time. Can I just ask people who have not asked a question before? The lady here, you’ve been extremely patient.

Q: I’m Martha Holdrege; I’m a Foreign Service widow.

I’m Martha Holdrege, a Foreign Service widow. I would like to ask if this paper that you’re preparing, I believe, could also measure benefits inequality because I think it would give – you know, if we could get a feel for that it might help to move the politics more so that lower income people would have greater opportunity and higher income people would not have benefits so excessive compared to what their needs are.

[01:58:30]

MS. BEDDOES: I think that’s a very important point. Uri, your paper –

MR. DADUSH: Well – sorry, go ahead.

MR. DERVIŞ: No, no.

MR. DADUSH: We do just touch on it. We – you know, we’re using statistics from OECD and others to compare. We just touch on it. But I agree it is – it would be good in further work to do that.

Q: I think it should get in the popular press and the news media. You know, that term – benefits inequality – and it might help to move, you know, for tax reform and that sort of thing.
MS. BEDDOES: It’s a very good point. One last question, and I’m sorry for those of you who haven’t had them, but the lady over there, or we’re going to run out of time. The last brief question?

Q: Hi. I’m Nancy Donaldson, with the ILO. So I read Michael Kumhof’s work, your colleague, and I found it very interesting to see his work and others’ coming from the IMF about looking at part of this issue as a loss of labor voice, not defined too precisely.

So it’s not just union representation or ability to influence access to housing. I mean, it seems to be a variety of things. But I found myself being in the United States in this context thinking about the rise of labor voice, where that’s happening and how that might show up in the macroeconomics, and I would be interested in your thoughts.

[01:59:59]

One thing I want to say is that I was talking with a colleague who’s an expert in the changes in China around labor rights and labor issues. And he said, you know, it doesn’t matter whether people think international labor standards and ability for middle class and for the union voice to come in.

It’s going to, and where it’s going to come from is Chinese workers – I mean, the equivalent. And that this shift, in having the rise from poverty, as you were talking about in China and India and other places, where there are massive rises – and in the Middle East in a different way – is going to come back potentially. Maybe it’s the wave that you’re talking about to have a redistribution. And I think it’s going to be related to jobs and employment. Do you agree?

MS. BEDDOES: Thank you. That’s a very interesting note to end on, both perhaps for the – we’ll give the respondents the last word, for Prakash and for Branco. Is this – is the rise of the middle class, to just elaborate a little bit, the rise of the scarcity of the Chinese worker, the rise of the middle class around the world going to be the push that changes this towards greater redistribution?

MR. MILANOVIC: It could be. I have not thought of that, actually. But let me – I mean, my first reaction is, you know, it could be. But you know, I haven’t thought of that.

[02:01:16]

MS. BEDDOES: Prakash?

MR. LOUNGANI: Yeah, I didn’t know if there were going to be closing statements so I’ll use my half-a-minute for a closing statement. I was going to close on exactly this note, Nancy, that I think that what Michael’s work and Roman’s work shows is that, I think what is behind the problem is the loss of workers’ voice, their loss of bargaining power.

And that has clearly eroded, not just because Reagan killed the airline unions but because of a whole host of factors. And I think that it’s important to say that that’s wrong and that that needs to be reversed. And again, like Branko, I’m intrigued by your suggestion that where the push will
come is from the rising middle class in China and in India. That’s an optimistic note on which to end. I certainly hope that’s the case. (Laughter.) 

[02:02:08]

MS. BEDDOES: It’s also a very ironic note on which to end, that U.S. rising inequality may ultimately be alleviated with the rising middle class in China. (Laughter.) Thank you all very much for a terrific discussion. (Applause.)

MR. DADUSH: Thank you.

(END)