Policy, not capitalism, is to blame for the income divide
By James Galbraith

In his feted book Capital in the Twenty-First Century, Thomas Piketty contends that wealth inequality rises inexorably under capitalism. The Financial Times has reported that, once various apparent errors are corrected, the European numbers show no tendency to rising wealth inequality after 1970. A judgment on this issue must, of course, await Prof Piketty’s response. Whatever the outcome, we are reminded that economic knowledge, especially in this area, is forged in long hours of work with sketchy and ambiguous statistical sources.

For the past two decades, the University of Texas Inequality Project has been contributing to this work. We did not set out to make, prove or disprove any grand theoretical claim.

Our main goal was to provide information, to clarify a factual record that was sparse, inconsistent and noisy. Our data on pay inequality, with estimates of income inequality, now cover most of the world from the early 1960s until (in some cases) as recently as 2012. We also find that inequality, measured within countries, rose in recent decades. But we do not find anything inexorable about this. We think that global circumstances and national policies were largely at fault. When policies and circumstances change, the rise of inequality can be stopped. Our data show that rich countries are more equal than poor countries. No surprise: to be rich is to have a large middle class. Communism defied this rule for a while, but not any more.

In rich countries “market income”, which reflects the income people receive from paid work, is very unequal, but this is because strong welfare states permit many households to exist without market income. Once taxes and transfer payments are factored in, disposable incomes are much more level. In poor countries the distinction is less clear. In some countries with weak welfare states and light taxation, measures of market and disposable income inequality do not appear to differ very much.

Finance has driven income inequality, because credit booms accelerate economic growth and because bankers tend to be rich. In the US income inequalities sharpened in the information-technology boom in 2000, again in the housing-finance bubble in 2007, and yet again as the banks and the stock market recovered after 2010.

Across the world, income inequality became more marked in the two decades from 1980. The trend started with the global debt crisis in Latin America and Africa, swept through central and eastern Europe, and moved on to Asia. Only countries that were outside the global financial system (notably China and India) were largely unaffected in the 1980s – though in the 1990s inequality rose with market reforms in both places. Worldwide, as a very broad generalisation, it seems that inequality peaked in 2000.

Political structures matter: social democracies are more egalitarian. Institutional changes matter: military coups (Chile in 1973, Argentina in 1976) precipitated rising inequality. Revolution (Iran in 1979) brought a sharp fall. The rise in the 1980s and 1990s was stronger in countries with weak institutions and weaker in countries with strong ones. In a few sturdy places, such as Denmark, inequality barely rose at all.

Since 2000, inequality has declined in the post-neoliberal countries of South America, and we believe it has been falling since 2008 in China. There, ever more comprehensive urbanisation plays a major role. In Europe and the US, inequality fell after the financial crisis, but rose again as stock markets recovered.

Rising inequality is not necessarily a sign of bad times. The boom creates jobs, reduces poverty and expands wellbeing. But high inequality tends to prefigure a crisis. After a crisis inequality falls – like blood pressure after a heart attack. But that is a bit late.

Inequality, like blood pressure, can be controlled. We do not find an unstoppable trend – not even in the past 40 years. Much depends on global forces, bearing against the strength and determination of national policies and institutions.

Data work is difficult. We made many tweaks in order to arrive at reasonable measures. We have tried to document them, and we think they are consistent and justified. As with everything in this field: use with caution.
The writer is a recipient of the 2014 Leontief Prize for advancing the frontiers of economic thought

Letter in response to this article:

Inequality statistics are of limited use / From Mr Alexander Ineichen