

# Inequality and growth\*

*Some policy considerations for “income-led growth” strategies*

KDI conference on income-led growth policies of the Moon Administration: Evaluation and challenges

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*\* The views expressed in these slides rest solely with the author and do not necessarily reflect those of ILO.*

# Purposes and outline

Complementing Professor Blecker's presentation on "wage-led growth", this presentation will review a growing body of evidence, including from international financial organizations (IFIs), which points to the macroeconomic effects of inequality. It will then identify a range of possible determining factors of inequality, and will turn to potential areas for policy interventions.

## I. Why is inequality a macroeconomic issue?: Inequality and growth

- Recent thinking and empirical evidence

## II. What is behind inequality?: Determining factors

- Economic, social and institutional, at both national and global levels

## III. What dimensions of income distribution for policy interventions?

- Primary distribution: Three dimensions (between capital, between labour, and between capital and labour)
- Secondary distribution: Fiscal, social protection, and labour market

## IV. How to design policy interventions?: Question of policy/institutional interactions

- Need for an integrated and coherent policy framework, without "overburdening" certain policies
- The case of minimum wages

# Prelude: New thinking, new approach

## *Call for new policy thinking*

“It is now evident that some of the recommendations of more traditional economics were not valid. Policymakers cannot rely on simple policy guides such as holding the fiscal balance in check, using monetary policy to control inflation, providing macroeconomic stability, and then leaving it to the market to do the rest. Assuming that such an approach will promote growth that trickles down to the poor is not a tenable premise. Indeed, we owe some of our current predicament to too close an adherence to that dated advice.” (*Stockholm Statement*, Nov 2016, p. 2)

*And more recently,*

## *The Commission on Global Economic Transformation*

(co-chaired by Stiglitz and Spence, with Basu & Rodrik; forthcoming report)

### Stockholm Statement

15 November 2016

Towards a Consensus on the Principles of Policymaking for the Contemporary World

*Thirteen economists, which included four former Chief Economists of the World Bank, met over two days in Stockholm, Sweden, on 16-17 September, 2016, to discuss the challenges faced by today's economic policymakers. The meeting was hosted by the Swedish International Development Cooperation Agency (Sida) and the World Bank. The group consisted of Professor Sabina Alkire (Oxford), Professor Pranab Bardhan (Berkeley), Professor and former Chief Economist of the World Bank Kaushik Basu (New York), Professor Haroon Borhat (Cape Town), Professor and former Chief Economist of the World Bank Francois Bourguignon (Paris), Professor Ashwini Deshpande (Delhi), Professor Ravi Kanbur (Ithaca), Professor and former Chief Economist of the World Bank Justin Yifu Lin (Beijing), Professor Kalle Moene (Oslo), Professor Jean-Philippe Platteau (Namur), Professor Jaime Saavedra (Lima), Nobel Laureate Professor and former Chief Economist of the World Bank Joseph Stiglitz (New York), and Professor Finn Tarp (Helsinki and Copenhagen). At the end of the meeting the group decided to issue a statement of the consensus reached among them: the "Stockholm Statement." What follows is this statement.*

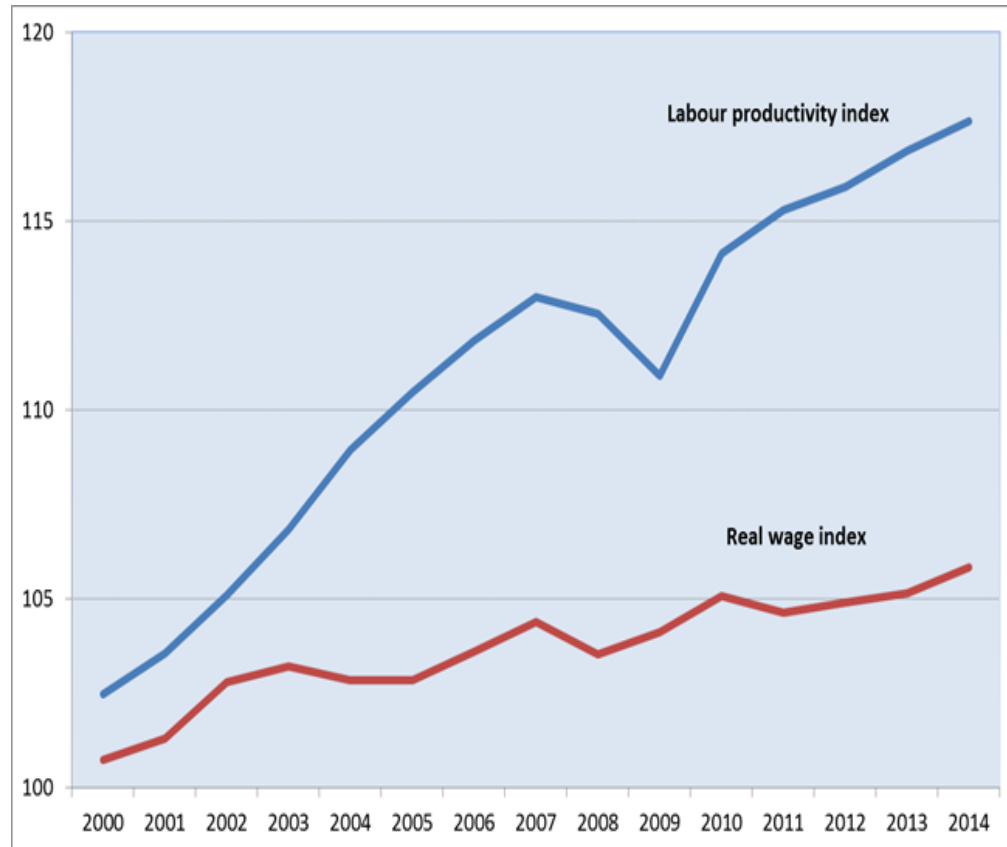
Full text available at:

<https://www.sida.se/globalassets/sida/eng/press/s/stockholm-statement.pdf>

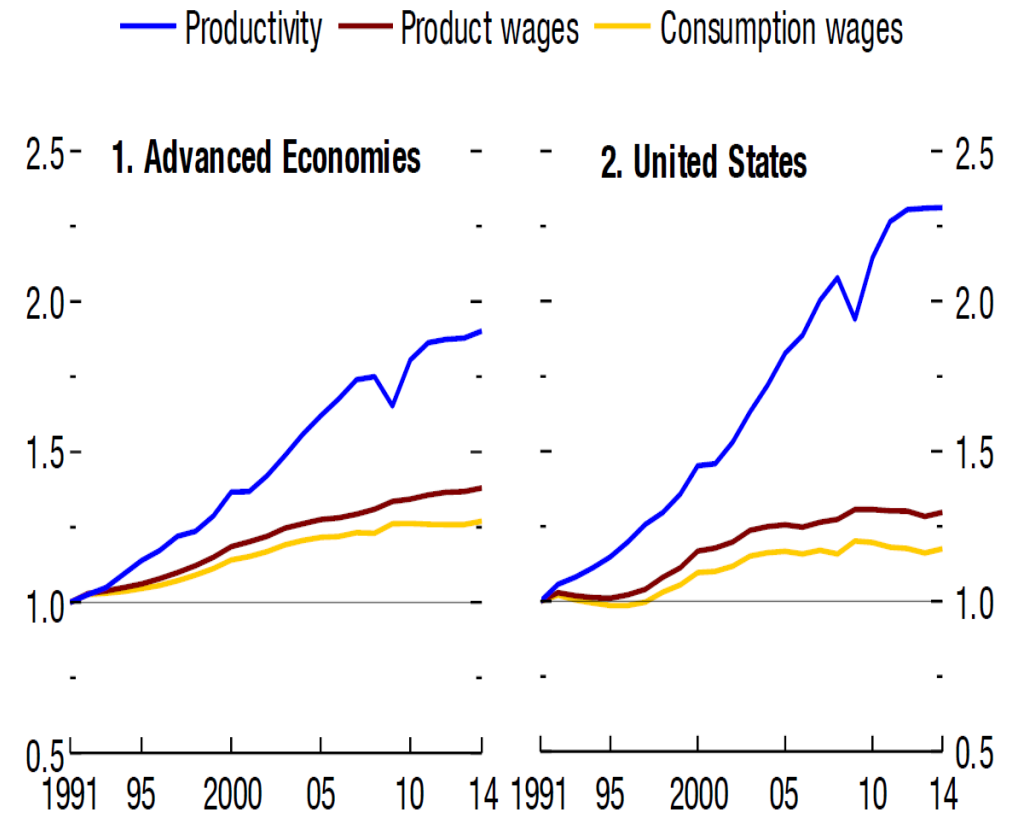
# I. Inequality and growth

## Trend (1): productivity-wage gaps (declining labour income share)

(a) ILO estimates



(b) IMF estimates

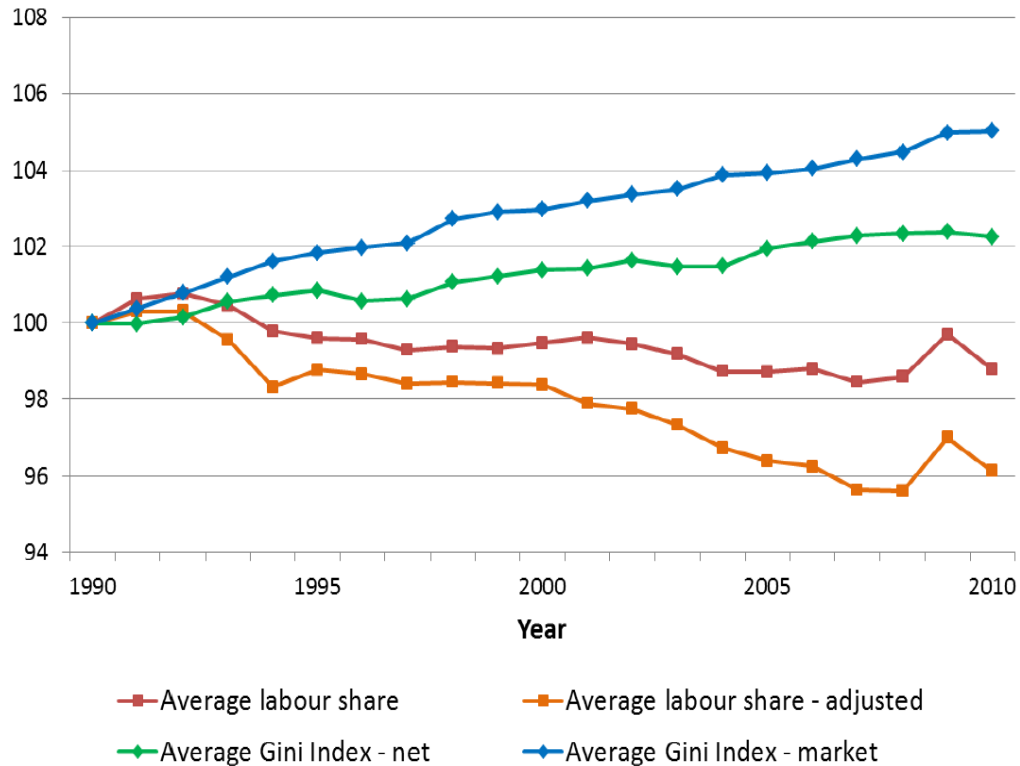


# I. Inequality and growth

## Trend (2): Functional and personal income distribution tend to move together

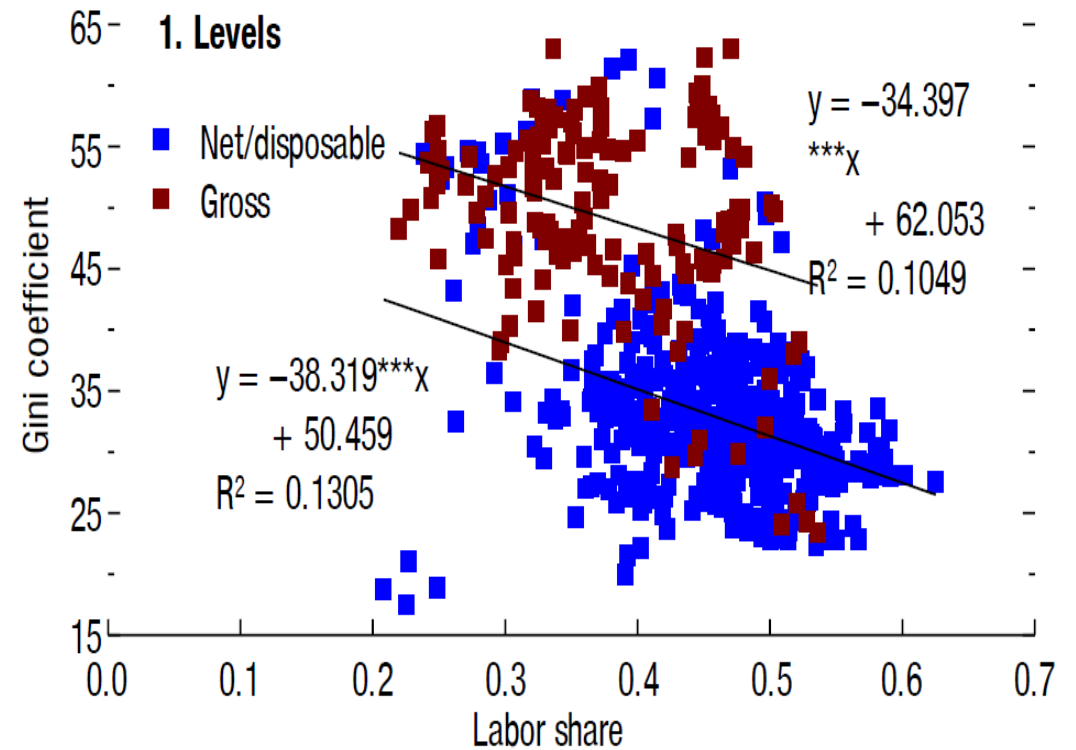
### Labour income share and Gini coefficients:

(a) ILO: G20a advanced countries



Note: base year 1990  
Source: ILO estimates

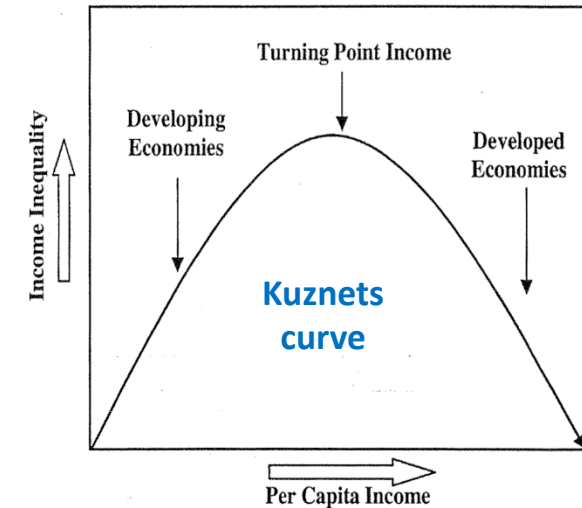
(b) IMF: All countries for which data are available



Source: Dao et al 2017

# Analyzing inequality trends: Evolution in economic thinking

- Inequality and Kuznets Curve
  - Often interpreted as implying that growth will look after inequality
  - Yet, Kuznets's turning point is the outcome of “voices” and policies in reducing inequality rather than an automatic process
- Inequality as a secondary or “normative” concern
  - Inequality (or “heterogeneity”) has no significant impact on growth
  - Excessive inequality can be a matter of social policy or politics”: a weak version of “inclusive growth”
- **Taking inequality seriously**
  - Advances in theory and modelling (Ahn, Kaplan, Moll, Winberry and Wolf 2018)
  - Potential impacts on consumption, household balance-sheet, productivity, & others, with implications for fiscal/monetary policies
  - *Stagnequality* (Posner & Weyl 2018)
  - A strong version of “inclusive growth”
  - Need to harmonize macro and micro data on inequality (e.g. Picketty)



## J. Yellen on inequality (October 2016)

“... [S]tudying the effects of household and firm heterogeneity might help us better account for the severity of the recession and the slow recovery ... While the economics profession has long been aware that these issues matter, their effects had been incorporated into macro models only to a very limited extent prior to the financial crisis. I am glad to now see a greater emphasis on the possible macroeconomic consequences of heterogeneity.”

# I. Inequality and growth

## New empirics

- A joint overview by ILO, IMF, OECD and World Bank for G20 countries (2015) identified:
  - Evidence on the relationship between the two (with country variations)
  - Possible *channeling* mechanisms (e.g. consumption, investment in human and physical capital, productivity)
- More recently, there has been a growing body of evidence, including:
  - IMF (Grigoli et al. 2016): *Median* response of GDP to income inequality “shocks” is negative, with a large dispersion. This cross-country dispersion has much to do with *institutional quality*
  - OECD (Cingano 2014): Rising inequality by 3 Gini points (i.e., the average increase in the OECD) would drag down economic growth by 0.35 percentage point per year
  - ILO (Charpe 2017; Charpe & Bridji 2017): *Long term* relationship between labour share and growth, using the data from late 19<sup>th</sup> century; *Non-linear* relationship between top income share and economic growth.
  - World Bank (2018): Non-linear relationship between inequality and growth, with significant negative impacts of inequality on growth



### Income inequality and labour income share in G20 countries: Trends, Impacts and Causes

International Labour Organization  
International Monetary Fund  
Organisation for Economic Co-operation and Development  
World Bank Group

Prepared for the G20 Labour and Employment Ministers Meeting and Joint Meeting with the G20 Finance Ministers, Ankara, Turkey, 3-4 September 2015

## II. What is behind inequality

# A wide range of factors, both economic and institutional

Many studies (e.g, ILO,OECD, World Bank and IMF 2015) identify a wide range of factors underlying inequality, which include:

- **Technological** changes
  - Skill-biased technological changes
  - Further pressure from the current wave of technological changes
- **Sectoral** shifts and “within-sector” changes
- **Globalization** (and global supply chains)
  - Typically combined with other factors (e.g., technological, financial)

Also, other important factors which deserve special attention for their policy implications

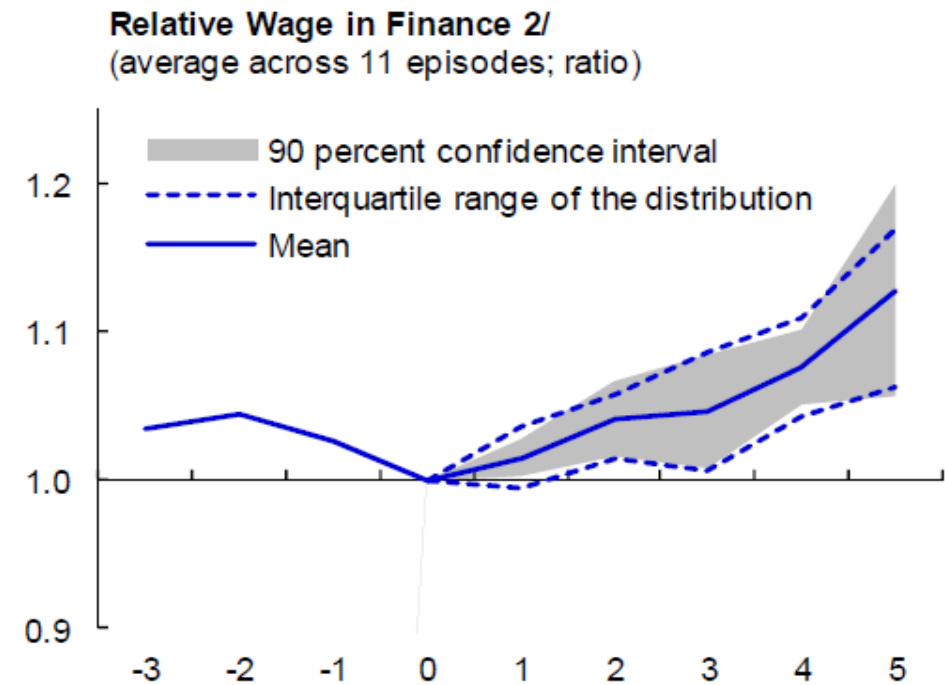
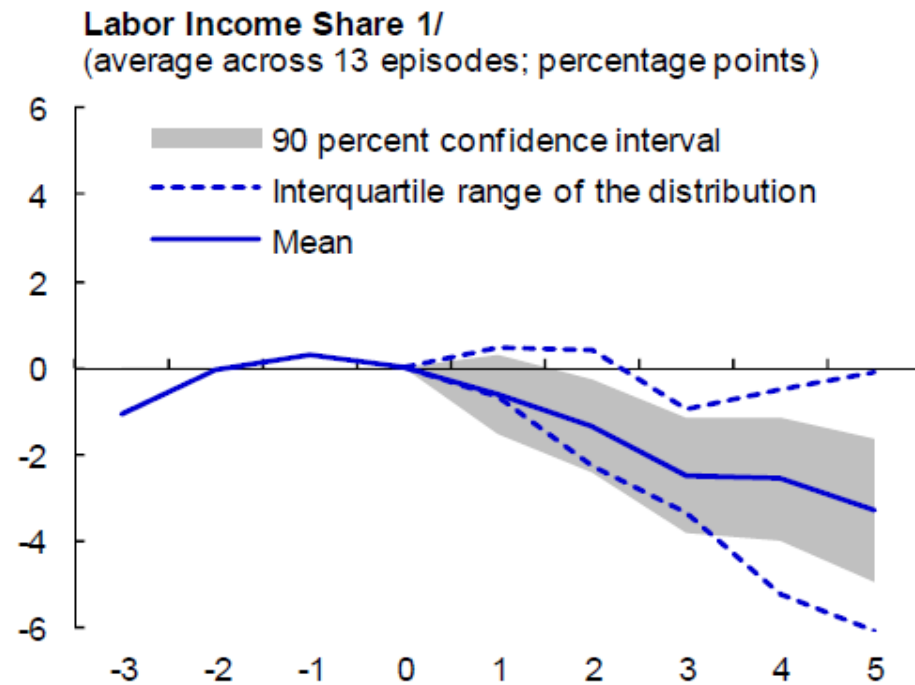
- Changes in **labour market** policies and institutions
- **Product and service market** competition
- **Financial** deepening (e.g. financialization)

## II. What is behind inequality

# The role of labour market institutions

e.g., decline in trade unions reduces labour share and increase wage inequality

**Effects of lower trade union density on labour income share and wage inequality over time (five years):  
Event analysis – IMF**



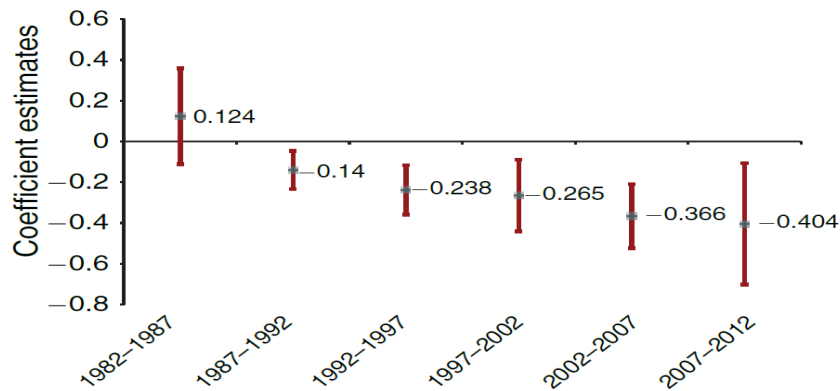
Source: Jaumotte & Osorio-Buitron 2015

## II. What is behind inequality

# Market concentration, growing market power, and inequality

### Autor et al's "superstar firm model: US

**Correlation between changes in labour share and changes in industry concentration in the US manufacturing sector at five year intervals**



Note: CR20 index for concentration; payroll to value-added ratio for labour share; based on weighted OLS regressions

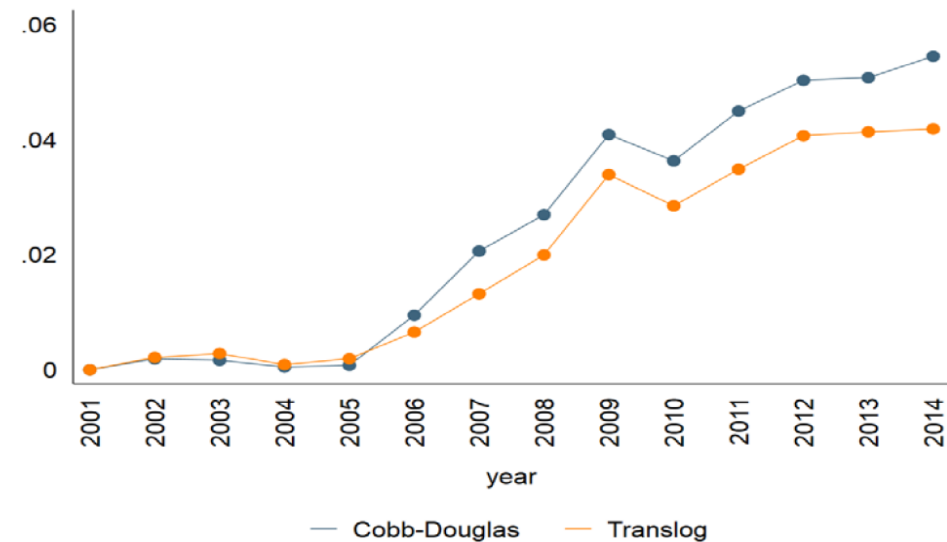
Source: Autor et al. 2017

### Korean cases

Similar results are reported in Kim (2016) and Shim et al (2017) which examines the manufacturing sector, pointing to the importance of competitive product market.

### Growing mark-ups: OECD

Average firm log mark-up (2001-14)



OECD 2018, Unconditional averages of firm-level log mark-ups, for all firms in the manufacturing and non-financial market service sectors included in the sample. 2001 is indexed to 0, the vertical axes represent log-differences in growth rates.

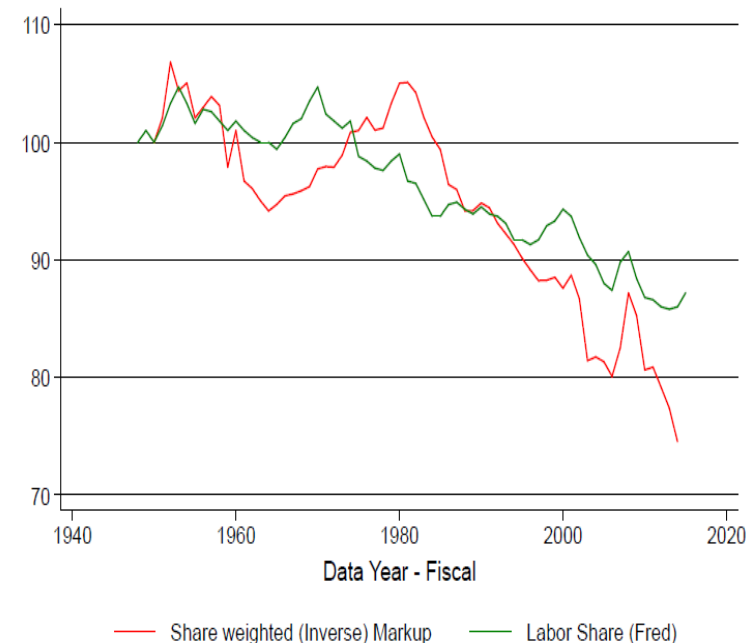
## II. What is behind inequality

# Macroeconomic implications of growing market power

Growing market power can lead to secular changes (e.g. De Loecker and Eeckhout 2017):

- Decline in labour income share
- Decline in Capital investment
- Skill composition of workforce towards growing wage inequality
- Decline in labour force participation
- Decline in labour market flows
- Decline in migration rates
- Slowdown in output and GDP

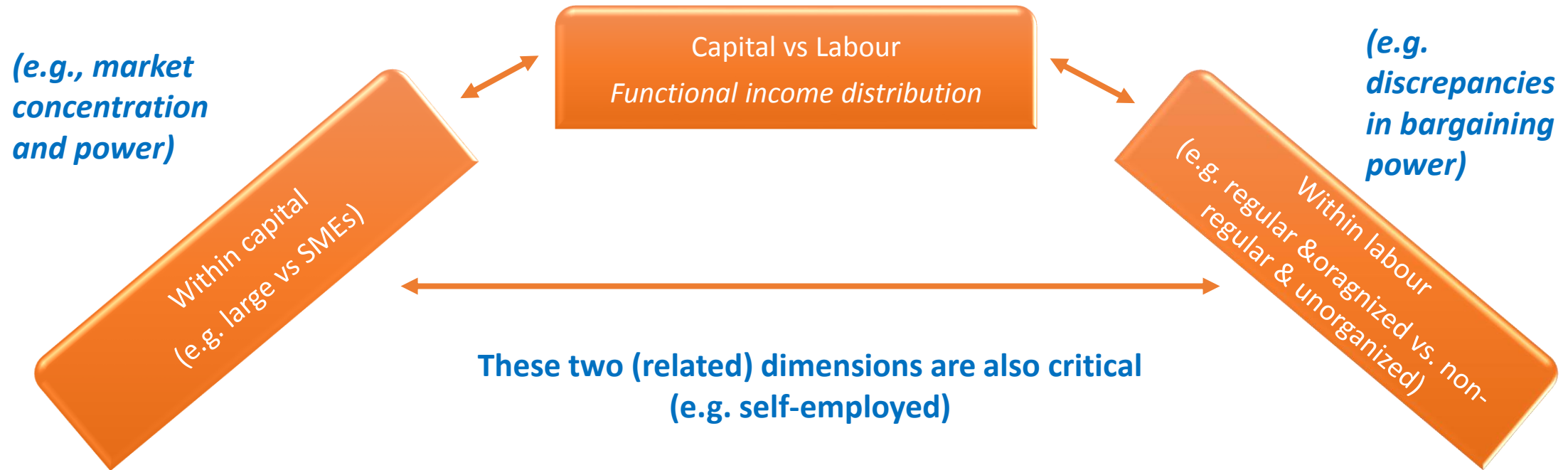
Labour share, and inverse of the markup (1960-2014)



### III. Dimensions of inequality

## Primary distribution and rent-seeking: Three dimensions

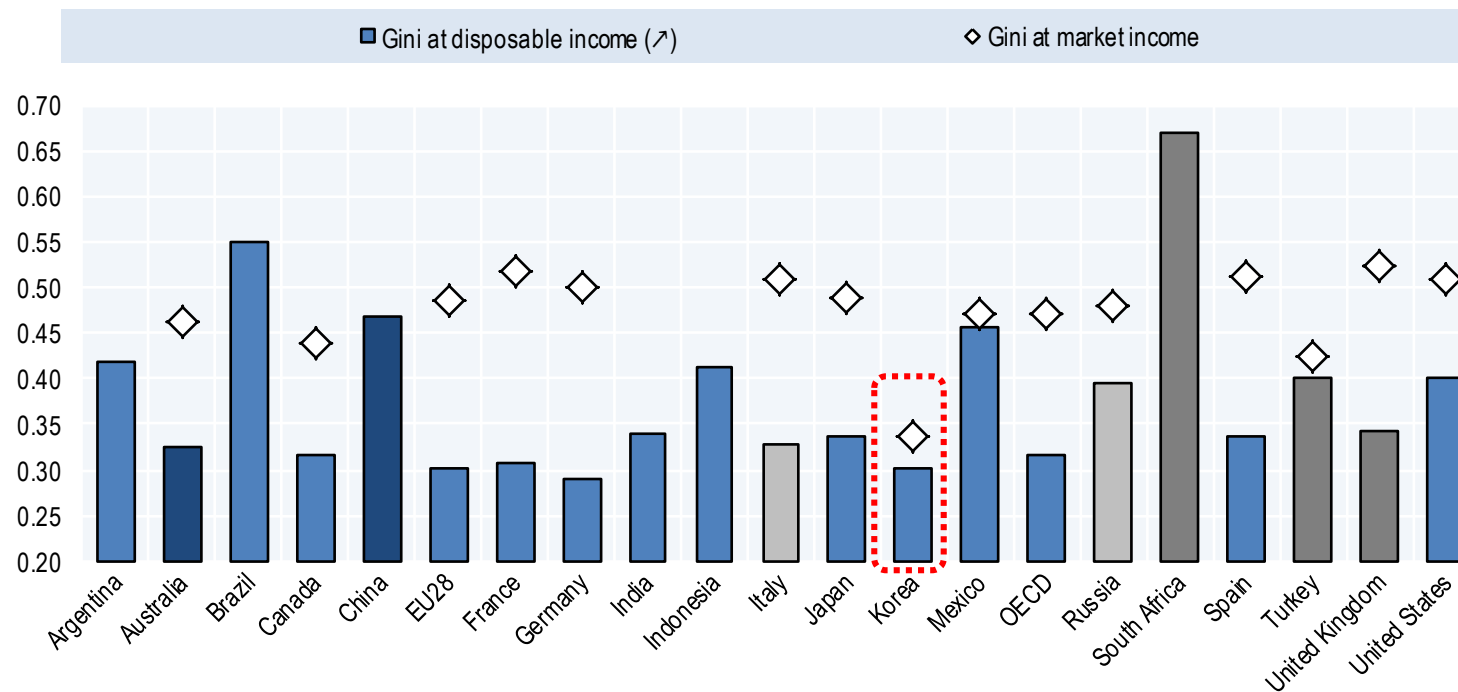
**Rent-seeking** is prevalent along these three dimensions



### III. Dimensions of inequality

## Redistribution: Fiscal, social protection, and labour market

### Market vs disposable income (latest year)



Notes: Data are based on equivalised income from the OECD Income Distribution Database <http://oe.cd/idd> for all countries except for Argentina, Brazil, China (income based, in dark grey) and India and Indonesia (expenditure based, in light grey) for which inequality at market income is not available. Market income is disposable income before receiving social transfers and paying income taxes, except for Mexico and Turkey where it is before receiving social transfers but after paying taxes. No data for Saudi Arabia.

Source: ILO, IMF, OECD and World Bank 2015

### III. Designing policy interventions

## Implications for “income-led growth”

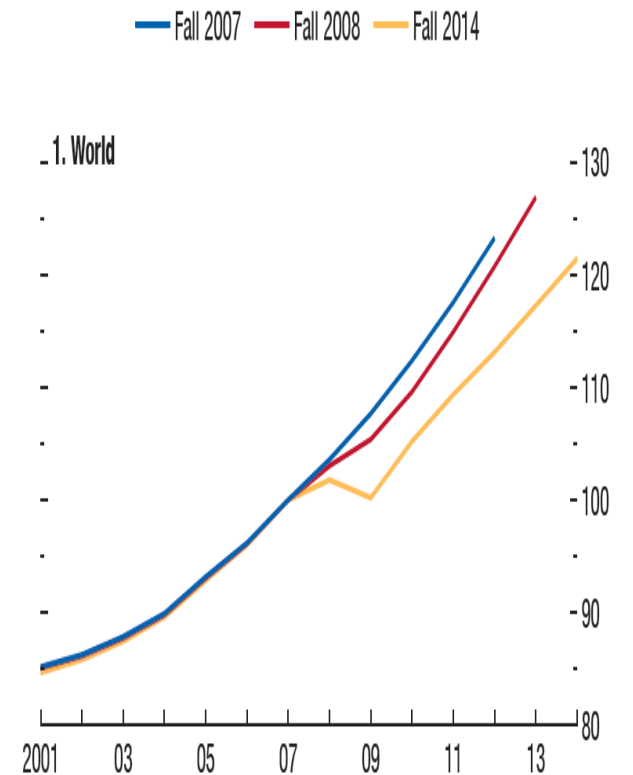
- Given the significant macroeconomic impacts of inequality, “**income-led**” growth (ILG) strategies can be understood as a coherent set of policies to facilitate economic growth and stability through reducing inequality.
  - Distribution impacts growth in a non-trivial way
  - Particularly in the *structural* conditions of demand shortage
  - Specific policy choice can’t be drawn from theory and comparative analysis. Outcomes are determined not only by **what** policies but also by **how** policies are designed and implemented.
- For its success, ILG need to influence both primary and secondary income distributions through an **effective policy mix**
  - Economic policies (macro, sectoral, and competition policies), especially for discouraging “rent-seeking” and boosting investment
  - Social protection for consumption smoothing and economic transition
  - Labour market and job creation programmes

## IV. Designing policy interventions

# Some misconceptions: ILG vs. supply, innovation, investment

- ILG (like any other economic strategies) recognizes the importance of **supply-side policies** (e.g. innovation and R&D)
  - With noting the risk that “potential persistent shortfalls in aggregate demand could adversely affect the supply side of the economy--an effect commonly referred to as **hysteresis**” (J. Yellen 2016): Particularly through diminishing physical and human capitals
  - And need to create better environments for innovation, particularly through **addressing structural and institutional constraints** (e.g. market power)
- ILG also recognizes the critical importance of **investment**
  - With noting the recent experiences that **higher profits have not translated into higher investment** when consumption demand is suppressed (or financed through cheap credit): Charpe and Lee 2015
  - And need for stronger **public investment**, including in social service and green technology
- In both cases, it is important to move **away from narrowly-conceived deregulatory approaches**

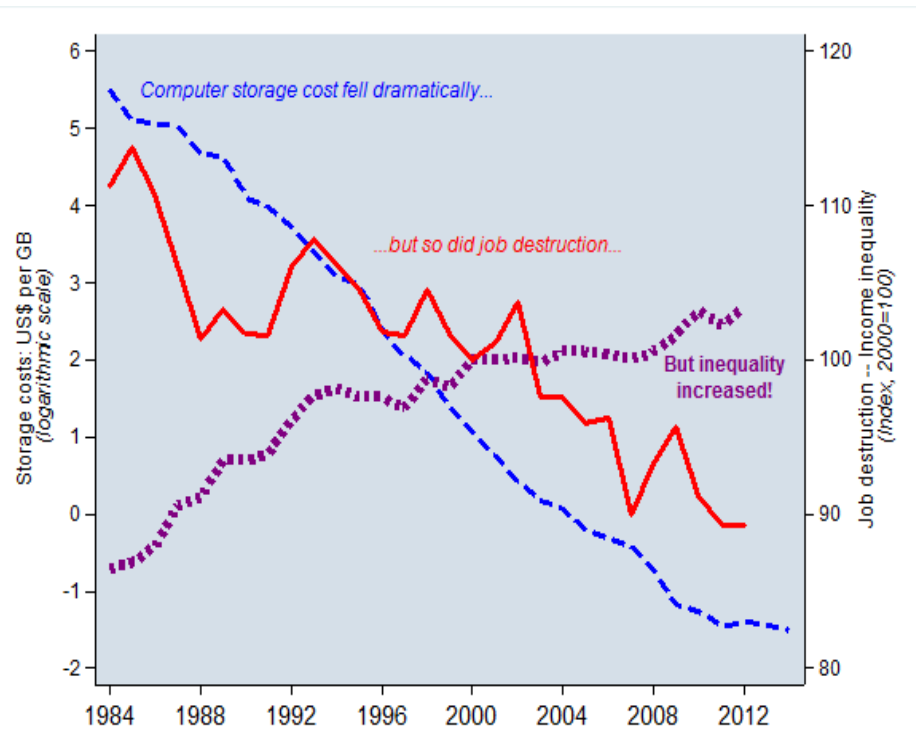
IMF's adjustments to economic forecasts since the Great Recession (2007=100): *Hysteresis may play a role*



## IV. Designing policy interventions

# Policy interactions: The case of the “4<sup>th</sup> industrial revolution”

Technology, job destruction, and inequality: *No doom scenario on jobs, but the real question is how to share gains ...*



Note: Job destruction rate is a weighted average of Australia, Belgium, Canada, Denmark, France, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, Sweden, United Kingdom and United States

Source: ILO, Labour Flows database, 2013; tenure rates: OECD, Labour Force Statistics

Realizing the full potentials of new technological changes require more and better investment in **people** as well as technology, and sharing “**technological dividends**” broadly.

“We must invest in human capital and increase skills in ways that complement technology and hence **boost labor income**, alongside the rise of technology ... we have to create **new instruments of income transfers** within nations. The fall in the **share of wages in GDP** must not be treated as an inevitable consequence of the rise of technology. Governments have to create systems of taxes and profit-sharing to break this equivalence, and they have to create rules of the game – such as strong enforcement of **competition laws and labor legislation** that enhance workers’ bargaining power and gives them a greater voice in society and within firms” (*Stockholm Statement 2016*, p. 5)

## IV. Designing policy interventions

# Policy interactions: *The case of minimum wages*

- The employment and economic impacts of minimum wages depend on many factors including:
  - Income effects, especially for minimum wage earners
  - Labour cost effects
  - With “ripple effects” (i.e. the extent to which minimum wages affect wages for non-minimum-wage workers)
- Along with these immediate effects:
  - “Rent sharing” (Manning 2003): e.g., franchise shops (Weil 2007)
  - Price effects: “Cost-shifting” to consumers
  - Productivity effects: (a) individual motivation; (b) workplace innovation; (c) “creative destruction” (replacing marginal firms by new entrants)
- These mean that supporting measures in economic and social policies will be critical in realizing the mutually-beneficial potentials of minimum wages.
- Otherwise, there is the risk of “over-burdening” minimum wages with limited impacts

## Concluding comments

- ILG is not just about increasing wages but more about a wide range of policies which can lead to **pro-growth distributional outcomes**.
  - While recognizing **social and political value** of equitable income distribution
- Policy shifts underlying “income-led growth” may require **rebalancing market, state and community**:
  - “The state must prevent the cycles of rising inequality, leading to **state capture**, which in turn enforces social, political economic inequality” (*Stockholm Statement*)
  - For that, the state needs to operate efficiently with clear visions/ strategies
- ILG, which inevitably involves distributional adjustments, requires constructing a new social and political alliance, or a **new social contract**

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