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New Ideas About Income Inequality in A Digitalizing World

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At a recent INSEAD alumni event in Zurich, Mark Stabile, INSEAD Professor of Economics, spoke about the topic of income inequality, presenting the latest data, while engaging the audience on the changes underway and their causes and solutions. Inequality is one of several emotionally-charged changes underway in society today. The discourse about its negative impact is the least controversial, compared to immigration, racism and so on, said Richard Bissonnet (photo l), one of the event organizers, by way of introducing the speaker, Mark Stabile (photo r).

Stabile is the Stone Chaired Professor in Wealth Inequality, which is part of the broader Hoffman Global Institute for Business and Society at INSEAD. He is a policy advisor and former department head at University of Toronto's School of Public Policy and has a PhD from Columbia. He said that the material used in his Zurich talk is what he teaches in his course at INSEAD. The initiative was led by the Dean of the school and James M. Stone, who has funded significant research into the causes of wealth inequality at INSEAD and other top universities. The aim is to explore the idea that business can play a bigger role in averting some of the economic trends threatening society today.

Looking at growth rate data and income distribution since the financial crisis from various sources, he highlighted the fact that those benefiting from the recovery since 2009 are different from those who benefitted in the previous decades. Only the top 1% has participated in the growth, and this is true around the world with few exceptions. The good news is that globally, poverty has been decreasing consistently since the early '90s. More countries are benefitting from economic expansion, but income levels among the lowest earners have been stagnant in several mature economies.

These trends prompted one member of the audience to ask aloud what everyone was thinking, “So when's the revolution?” From many perspectives, it's already here, answered Stabile, pointing to things like Brexit, the growing popularity of national and rightist movements and the election results in several democracies.

The Past and Present

It is in looking at the global economic trends and where we've come from that we can find a basis to discuss what we could do to promote change. Whenever he starts the course, Professor Stabile takes a poll to understand what INSEAD students think about income inequality, asking if they think it is a big problem.

He was pleasantly surprised that almost all business students think economic inequality is a problem. There is disagreement on whose job it is to fix it. Interestingly, he said that policy students at academic universities assume that government is key.

Looking at GDP growth rates from 2005 to 2017, it is evident that there has been a general recovery since the financial crisis of 2008/9. We are very much where we were before the crisis, according to Stabile. However, while almost all economies have recovered, they have not recovered equally. And within the individual national economies, it is evident that the distribution of average income growth has not been equal either.

Certain groups have participated in growth more than others. In particular, the top 1%. Its share of income growth is going up, while the bottom 50% share is going down. We are back in the world we were in for a most of history, according to Stabile, referencing data collected by the French economist, author and academic Thomas Piketty.

Worrying Trends

Since 1980 until recent years there has been a rise in inequality and it is a global phenomenon. There was a period from the late 40s to the late 70s when the distribution of income changed in favor of the majority. In those few decades, everyone participated in the growth, and this is true with or without capital gains. It is very evident in the Anglo countries, US, Canada, UK and less evident in Switzerland and France.

Beyond the stagnating economies, there has been improvement in India, China, and other emerging countries. Some of the success seems to be driving the reactionary Western headlines and a desire for protectionist trade policies. Such policies are the wrong tool, of course.

Inequality and it Impact on Growth

Economists are worried about the relationship between inequality and growth. It is generally accepted that there will be inequality in the early stages of growth. The theory was that over time the level of inequality would decline, while growth would continue to increase. Data for several countries shows that in fact there is a relationship between inequality and growth of late.

One theory is that institutions have become extractive rather than inclusive. Governments need to avoid making decisions and creating policies or legislation that favor certain businesses or industries. For example, allowing monopolies, propping up big businesses with public money and blocking creative destruction.

More research is required into stagnation trends. There is an issue with productivity ratios and growth in recent years. All the new technologies and digitalization transformations that have been introduced of late are not necessarily affecting productivity positively, or , alternatively, that we are not measuring it somehow.

Why has the rise in inequality taken place?

Despite significant debate by economists around the topic, there are four causes to consider.

1. increased globalization (companies have moved jobs with some regions gaining and some losing)
2. skill-biased technological change (driven by personal computing and increased automation) giving skilled workers more income bargaining power
3. a decline in top marginal tax rates (less distributive taxation)
4. changes in bargaining and political will to reform; decline in power of unions

What can be done about the rise in inequality?
The tools for dealing with income inequality and wealth inequality are different. Policy changes can affect poverty levels. In countries like India, China, and Brazil it is expected that there will be inequality during the early growth phase. An emerging economy is typically dealing with a much wider divide with a high concentration of wealth at the top. There is not yet even a structure in place for redistribution. However once people become wealthier, it is expected that there will be a levelling, either through redistributive taxes or social programs. For example, India recently introduced universal healthcare programs. Where countries can get into trouble with inequality, is when the leveling does not take place.

Questions that need to be answered are what's the right level of inequality and what's the right level of poverty? Can people improve their standing in the income distribution? Is there intergenerational income elasticity or social mobility?

Childhood Poverty and the American Dream

Some experts advocate a focus on poverty alleviation and not inequality. When it comes to wealth inequality, the top decile holds between 60 to 90% of the wealth, and the bottom 50% have almost no wealth. While there are fewer people living on a dollar a day (updated to $1.98 per day), there are still many living on not much more than the threshold. Looking at various sets of data published by the likes of Oxfam and Credit Suisse and WID, the picture is quite similar.

Looking at a chart of world-wide poverty rates for children and the total population dated 2010, Denmark, Finland, and Norway have the lowest levels of poverty. In the middle are New Zealand, Belgium Malta, France, Ireland. The countries with the highest levels of childhood poverty include Turkey, Israel, Romania, Mexico, and the United States. The US and Canada have the highest rates of children living in families with income under the half of the median income, according to Stabile’s calculations using OECD data.

Intergenerational earnings elasticity is an indicator reflecting the degree to which parents’ income determines children's incomes. Elasticity is important for social mobility. Again, looking at the data, Denmark, Norway, and Finland perform well on the social mobility or intergenerational earnings elasticity while Peru, China, Brazil, and the UK perform less well. Switzerland, Pakistan, and Singapore perform better than the United States. Clearly, if one wishes to live the American dream, go to Scandinavia.

Taxes and Other Inequality Alleviation Tools

An understanding of social mobility is important as it is one of the important factors in alleviating poverty. One solution is a basic income law that would act as redistributive. It might make sense in some countries, but it is counter-productive in other countries, such as Switzerland.

Tax and transfer systems are a way to reduce inequality without necessarily negatively affecting the market and business development. Looking at the data, Germany has relatively high-income taxes, but less inequality measured by disposable income. The data shows that it is not always the case that the tax and transfer system has a negative effect on the market.

When it comes to social mobility, historically it was quite different from today. The idea of redistributive taxation did not exist, and aristocracies emerged. Today there are inheritance taxes applied in many countries to avoid aristocracy formation. If countries are worried about wealth inequality and social mobility, there needs to be an inheritance tax. The tax is not for internal revenue purposes as it is a relatively small amount of income, rather it is to avoid creating an aristocracy that would eventually inhibit social mobility.

Business as a Force for Good?

Business makes a lot of policy decisions that affect inequality. Hiring, firing corporate taxation decisions, internal Mobility decisions and environment and sustainability policies programs. to leave business out of the equation in finding a solution would be to lose a really important tool in addition to the state policy tools available.

Speaker and Event Organizers
This event was organized by Richard Bissonnet, MBA'81, and Outi Raty, MBA'02J.

The speaker was Mark Stabile Professor of Economics, INSEAD. He is the Stone Chaired Professor in Wealth Inequality and a Professor of Economics at INSEAD. He directs the James M. and Cathleen D. Stone Centre for the Study of Wealth Inequality. From 2007 to 2015, Professor Stabile was the founding Director of the School of Public Policy and Governance at the University of Toronto and Professor of Economics and Public Policy at the Rothman School of Management, University of Toronto. He is a Policy Fellow at the Martin Prosperity Institute. From 2003 to 2005, he was the Senior Policy Advisor to the Ontario Minister of Finance where he worked on tax, health, and education policy. His recent work focuses on inequality, poverty, child health, health care financing, and tax policy. He advised Governments of the United States, Canada, and Ontario, among others, on health care reform and programmes to reduce child poverty. He serves as an associate editor of the Journal of Health Economics and the Journal of Health Economics, Policy, and Law. Professor Stabile has a PhD from Columbia University and a BA from the University of Toronto.

Impressions

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