

**GLOBALIZATION:
PAST, PRESENT AND FUTURE**

Manuscript of the lecture; Part V

**Global Inequality: National Trends and Global
Dynamics**

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V Global Inequality: National Trends and Global Dynamics

In this chapter, we review two remarkable books which had a major impact on the public debate on globalization and distribution in recent years. The first book (the one by Branko Milanovic) is to date the most comprehensive analysis of whether and how the personal income distribution in the world as a whole has changed in recent decades and over longer periods of history. It is today the best source when it comes to ask the popular question whether the rich have become ever richer and the poor ever poorer. The second book (the one by Thomas Piketty) puts forward one of the boldest hypotheses about the long-term distributional consequences of global capitalism. It contends that there is a systematic trend towards an ever more unequal distribution of income in most advanced industrial societies, and the driving force of this trend is a stunningly simple “eternal inequality” between the rate of return on capital and the growth rate of output, with the former being persistently higher than the latter.

1 Branko Milanovic’s Comprehensive Empirical Evidence (2016)

1.1 The Rise of the Global Middle Class

In his 2016-book, Branko Milanovic pursues a seemingly modest aim with a huge statistical apparatus. He wants to check whether and, if so, in what direction the distribution of personal incomes in the world have changed over the last few decades. Bluntly speaking, he wants to answer the popular questions: Do the rich get ever richer and the poor ever poorer? Or does the opposite hold? And if either trend prevails, how strong is it, and by how much have things changed in the course of the globalization of the last few decades?

To answer these questions, he makes an important distinction: between (1) inequality among nations and (2) inequality within nations. Drastically simplified, the former denotes the difference between the average incomes of nations; and the latter denotes the deviations from the respective national average, however measured in detail. As it turns out, this distinction is of crucial importance to understand his results that he obtains by analyzing a vast pool of data sources, which we do not describe and analyze at this point. It may be sufficient to say that his study – stretching over a huge number of countries – is by far the most comprehensive and erudite that has been delivered so far.

FIGURE V.1 is probably the most well-known graph of the book, which has been dubbed the “elephant curve”. What does it describe? On the horizontal axis, the percentiles (and ventiles) of the global income distribution are displayed – from the lowest to the highest, i. e. from the poorest to the richest. E. g., at the number 50, we find the people which are just in the middle of the global income distribution, at 25 we find the people who have one quarter of the highest income, at 75 three quarters. On the vertical axis, we can read up the cumulative gain in real income (in percent) of all these income groups – from poorest to richest – over the 20-year

period 1988–2008, i.e. roughly the first 20 years of modern globalization stopping right at the onset of the world financial crisis.

The message of the picture is straightforward and basically threefold:

1. The winners have been what may be called the global middle class, i.e. those people in the world who have an income of about 30 to 70 percent of the maximum, with the peak to be found between 40 to 60 percent. The global middle class experienced a real income increase of 50 to 75 percent for the percentiles 30 to 70 and 65 to 75 percent for the 40 to 60. Who are they? Mostly people living in large fast-growing catching-up countries like China, Indonesia and India, who started in 1988 very poor and got massively wealthier – and forming, by 2008, a sort of global middle class.
2. The losers are equally clear, at least in relative terms. Roughly between 75 and 90 percent of the maximum income is a group of people whose incomes grew only very moderately or almost stagnated altogether. Who are they? Mostly middle class people by the standards of advanced western countries, who are, however – by global standards – relatively rich. Apparently, they came under competitive pressure from world market competition, notably from the fast-growing large catching-up countries mentioned above (under point 1). These losers are joined by a group of “very poor” (0 to 10 percent) mostly from Africa that also did not profit much – probably because their countries did not really participate in the globalization process, for whatever reason.
3. There is a second group of winners to be found at the very top of the income distribution – let’s call them the “super-rich” (from 95 to 100). They gained massively, and the richer they are, the more so. Who are they? Mostly very rich individuals in a few countries in the world, notably in the United States, who profited from the information technology boom or from any other massive sectoral expansion (like the so-called “oligarchs” in Russia who own natural resources like oil and gas reserves and draw income from their exploitation).

This is it: the core of the effect of globalization on the world distribution of income. Note first of all that it is a differentiated picture with the three characteristics mentioned above. Leaving one or two of these out of consideration necessarily distorts the picture. Clearly, a large global middle class, which was poor in the first place has gained – at the expense of a globally richer layer of people in the advanced nations of the world, with the (not so many) very poor not keeping pace and thus also belonging to the group of (relative) losers. On the winning side, however, are also the global plutocrats, as Branko Milanovic calls them.

1.2 The Rise of Global Plutocrats

It is worth taking a somewhat closer look at this group of “plutocrats”. FIGURE V.2 shows how strongly their income destiny depends on the boom of financial markets. The FIGURE V.2 shows the same graph as in FIGURE V.1, but for two periods: 1988–2008 (on the eve of the global financial crisis) and 1988–2011 (after the global financial crisis). Remarkably, the 1988–2011 is an accentuated version of 1988–2008, with the gains of the global middle class being larger and the gains of the super-rich smaller. This means: It was above all the “global plutocrats” who profited from the earlier boom of financial markets and suffered most under the subsequent crash – not surprisingly because a disproportionate share of their income are returns on capital assets.

Of course, even if the percentage gains of the very rich are smaller than of the poorer strata of global society, the absolute gains are larger as FIGURE V.3 indicates. It displays the percentage of absolute global income gain over 1988–2008, and that distribution is, of course, massively skewed to the right. This is very plausible: the rich start from an already high level of income, and income increases – however small the percentage is – add up to large absolute numbers.

However, it would be wrong to conclude from FIGURE V.3 that world income distribution has become more unequal. For that matter, it is relative changes that count. FIGURE V.4 makes this clear. It shows the distribution of world population by real per capita income: 1988 vs. 2011. The area under the curve adds up to one so that, on the vertical axis, we measure “densities”. Clearly, from 1988 to 2011, the distribution has become flatter and the peak has moved up, which confirms all our prior conclusions.

1.3 Inequality among Nations

It is very important to recognize that our conclusions on the dynamics of the global income distribution are mostly determined by the changes among nations – and not within nations. FIGURE V.5 makes intuitively clear why this is so: as late as 2013, the largest countries are still in the lower income range – and they were in even lower ranges in the late 1980s. With them having moved up, the most powerful force of global distribution change is identified.

Note that this does not mean that the “new” middle class now comes close to the level of income of the “old” middle class. FIGURE V.6 makes this abundantly clear: By 2011, even relatively rich Chinese (in the 8th decile!) were poorer than relatively poor Americans (in the 2nd US-decile). Clearly, since 1988, the gap has narrowed, but it still persists.

Note also that the very rich are concentrated in only a few countries –all of which are very affluent (FIGURE V.7): 12 percent of the top-1%-richest in the world are to be found in the US, followed by a number of small countries that deliberately attract rich people’s assets by low tax

policies and other favourable regulatory instruments. Among them are Singapore (9 percent), Switzerland (9 percent) and Luxemburg (7 percent). As there is considerable capital flight of rich plutocrats and oligarchs from Russia and other countries, it is very likely that the statistics of the small “safe haven” countries are very much dominated by this type of capital import. Note finally that, between 1987 and 2013, the share of wealth in total global wealth of what may be called the “hyper-wealthy individuals” has grown: from below 3 to above 6 percent (FIGURE V.8). Clearly, there has been a trend towards a concentration of wealth, which is mostly due to booms of information technology shares and stocks (Amazon, Facebook, Google, Twitter ...) in the hands of a few private tycoons.

1.4 Inequality within Nations

So much for a selection of major results that Branko Milanovic presents in his important book. Again, it is important that all major trends that he identifies – with the possible exception of the rise of the super-rich in the US – are global phenomena to be observed between countries. As the general public is hardly interested in these matters, but closely watches what is happening within one single home nation, it is not surprising that the national discussions are typically dominated by the rise (or decline) of inequality within countries, which are small by global standards. As Milanovic shows, the big global picture is a different one – determined mostly by between-country changes.

2 Thomas Piketty's Theory of Rising Inequality (2014)

2.1 Growth Rate vs. Interest Rate

The central idea of Thomas Piketty is remarkably simple. He claims that, in normal peace times of economic growth, capitalist economies display a trend towards ever higher inequality of their income and wealth distribution. Note that, when making this major claim, Thomas Piketty is exclusively focusing on inequality within a given nation – and not between nations. To be sure, he explains something completely different from what Branco Milanovic statistically describes.

How, in Piketty's theory, does the trend towards inequality come about? The threefold answer is straightforward:

1. In a growing economy, the real rate of return on capital (roughly, the long-term market interest rate) is systematically higher than the real growth rate of the economy.
2. Typically, capital income is more unequally distributed than labour income because richer people tend to save a higher share of income than poorer people – and thus hold a greater wealth in the form of interest-bearing assets.

3. Besides, richer people tend to obtain higher rates of return on their assets because they tend to have a more professional portfolio management (as, e.g., American universities like Harvard or Stanford).

Prima facie, these three points look innocently plausible. As Piketty shows, they have far-reaching consequences. Notably, in long-term peace-time economic growth,

- the capital/income ratio rises,
- the capital share rises and the labour share declines,
- there is a trend towards an increasing importance of inherited wealth relative to wealth that is accumulated by work over one's lifetime, and
- most importantly: there is a trend towards an ever more unequal distribution of personal wealth.

Note that, under Piketty's own assumptions, all this is very plausible. The logic runs like this: As the interest rate is higher than the growth rate, capital income grows faster than labour income if the latter roughly grows at the rate of the economy (which is normally the case). Thus the capital-income ratio grows and the capital share of income rises while the labour share falls (loosely speaking, capital "gains" in weight relative to labour). Over longer periods, this necessarily means that inherited wealth plays an ever more important role and the personal wealth distribution becomes more unequal.

2.2 The Evidence

Piketty goes on to test his theory over long periods of time with tax data (in fact, he is one of the world-leading experts for compiling and using tax data on income and wealth). He does this only for a small number of countries for which the relevant data is available, but his results are quite robust between countries.

We start with a look at the capital/income-ratios in Britain, France, Germany, the United States and Canada for different historical periods that begin mostly some time in the 19th century (FIGURES V.9–13). The picture – with gradual differences is the same for all countries: a rise or stagnation in the long peacetime-period until World War I, then a downswing in the interwar period and thereafter an upswing again. About the same holds for the capital/labour-split for Britain and France (FIGURES V.14–15), although, in the post-World War II-period, the increase of the capital share does not set in until the 1970s. In fact, from this time on, there is an unmistakable trend in many countries towards an increase of the capital share (Figure V.16). As to income inequality in the 20th century, the statistical evidence shows all throughout a decline from the 1920s down to the 1970s/80s and then a rise again (see FIGURES V.17–19 for an assortment of countries and country groups). Annual inheritance flows in France, a

country with fairly good statistical sources in this largely uncharted field, also show the expected results (FIGURES V.20–21): an increase from 1820 to the eve of the first world war, then a decline that lasted until the 1970s, and then again a continuous rise up to the present.

Most importantly, the path of wealth inequality is roughly consistent with Piketty's theory. FIGURES V.22–25 shows this for the last two centuries that passed since the Napoleonic war, with statistics for France, Britain, Sweden and the United States. The pictures reveal a common pattern: increase in the 19th century up to World War I, then decline until roughly 1970, and then again a significant rise.

To sum up, there is hardly any doubt that Piketty is able to show empirically that, by and large, the statistics of economic history, as far as available, support his theory.

2.3 Policy Recommendations

From his analysis, Thomas Piketty draws far-reaching conclusions. As he believes to have discovered a sort of long-standing inherent trend of capitalism, he makes a strong plea for a massive taxation of wealth – either through the introduction of a (preferably global) tax on wealth and/or an inheritance tax. We do not discuss these proposals here as this would go well beyond the scope of this lecture.

2.4 Critical Assessment

The core of any critique of Piketty's theory must focus on the scope and meaning of his empirical and historical evidence. Fundamentally, his evidence can be subdivided into rather clear-cut periods: (1) the time until World War I, (2) the time from there to roughly the 1970s, and (3) the time thereafter. Periods (1) and (3) are considered as the capitalist normality with the interest rate greater than the income growth rate, both in real terms; in contrast, Period (2) is abnormal – in the sense that the interest rate was not higher than the growth rate. In the first “bad” part of Period (2), this was mostly due to the Great Depression and the massive losses of capital values induced by it (plus, of course, the twice occurring war-time destruction of capital values). In the second “good” part of Period (2), growth was temporarily exceptionally fast, the trend rate of growth very high and thus surpassed an – otherwise normal – interest rate.

Given this simple structure of the evidence, a number of questions remain unanswered by Piketty. We pick three of them:

- Firstly, it is undisputed that the decades before World War I – as we discussed in this lecture – were an economically successful time for most countries. A similar judgement can be made for the past few decades. Hence the normative question arises as to how

problematic or even devastating a (moderate, though stable) trend towards some wealth inequality really is compared to other substantial gains in society from which everybody profits. After all, a trend towards inequality is much more tolerable in circumstances when the general income level rises so that those who lose in relative terms still gain in absolute ones.

- Secondly, and in the same vein, the massive macroeconomic disturbances of the interwar period (plus two wars!) are a very bad period to illustrate the positive effects of a more equal distribution of income brought about by massive capital losses of the rich – and very high unemployment of the poor, which does not sufficiently show up in the wealth statistics. Also, the boom period from the late 1940s to the early 1970s was also a unique event – in a way a bouncing-back of the European economies in the world division of labor after the misery of earlier times. Hence this was also an unusual period – not to be repeated.
- Thirdly, with a view to the future it is far from clear that present trends will continue forever. Note that, in the last two decades, we went through a period of continuously declining real interest rate. Given the demographic and technological changes in the future, it may well be that the interest rate stays low while wages rise fast – much faster than GDP – in view of the emerging scarcity of labor as was the case in the 1960s. Therefore, it may well be that Piketty's forecasts will be falsified by reality in due course. While, in the 19th century, the rate of return of capital was persistently higher than the growth rate of national income (see FIGURE V.26 for France), this may not be so for the rest of the 21st century.

To sum up: Piketty leaves many questions open. His theory and evidence are most inspiring, but not quite convincing – at least not as a solid ground for far-reaching policy recommendations.