EC9AA Term 3: Lectures on Economic Inequality

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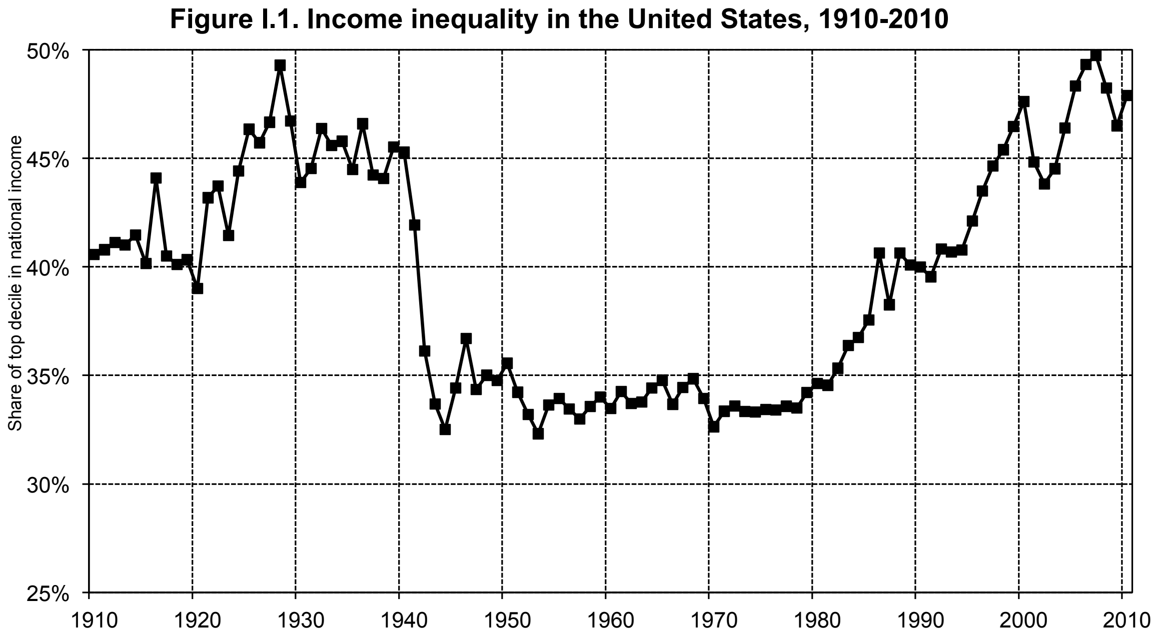
- **Slides 1**: Growing Inequality: An Introduction

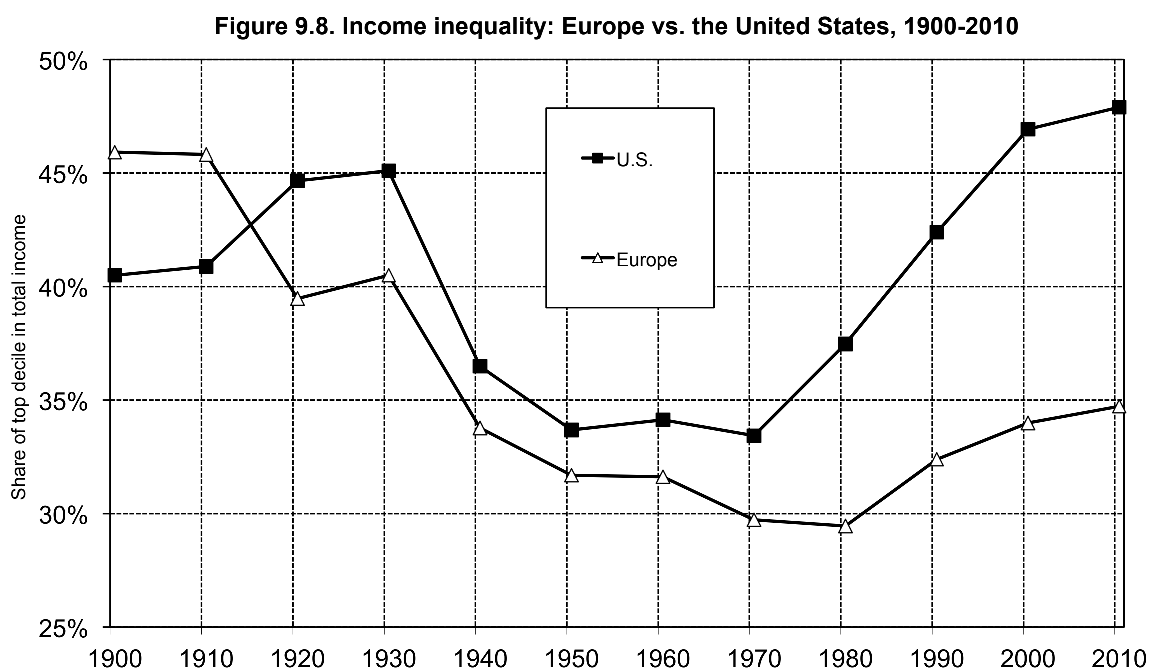
Growing Inequality

- The financial crisis sparked a new interest in inequality.
- But inequality has been historically high
- Growing steadily through late 20th century

Wolff, Piketty, Saez, Atkinson, many others



Source: Piketty (2014)



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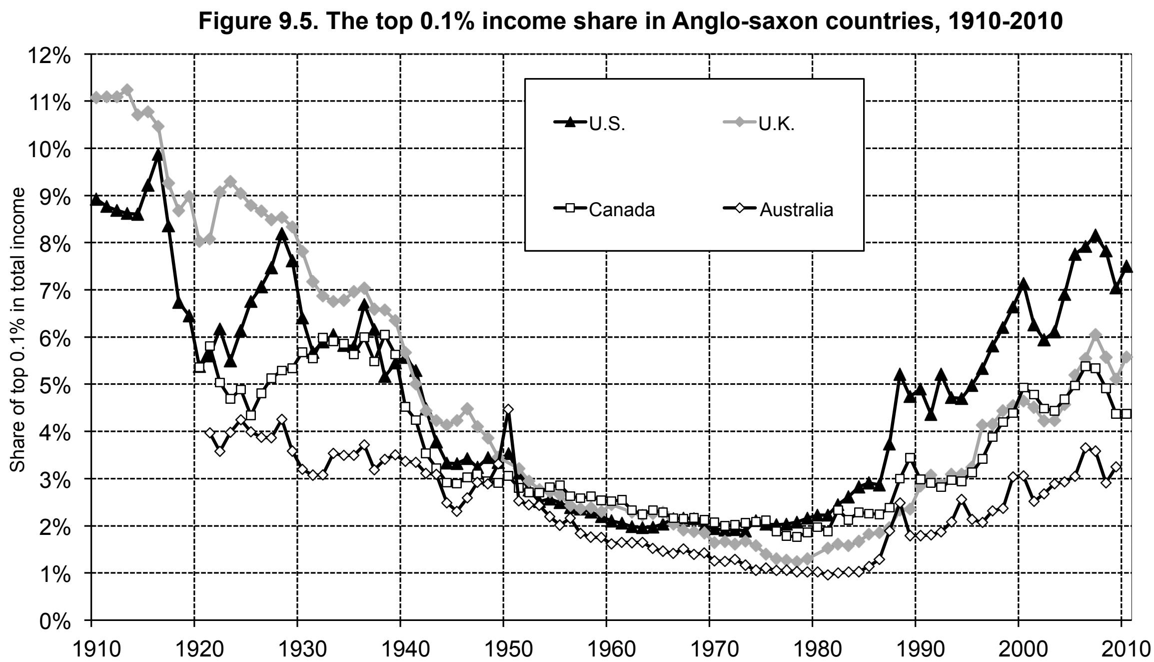


Source: Piketty (2014)

The Great U-Turn

- A classical view (due to Kuznets 1955, 1963)
  - Inequality rises and then falls with development
- Instead: The Great U-Turn
  - Uneven versus compensatory changes

Capital in the 21st Century

- Piketty's *Capital in the 21st Century*:
  - summarizes the evidence (compelling and useful)
  - describes **three "fundamental laws"**

Piketty's Laws

- **First Fundamental Law** (or accounting identity):

$$\frac{\text{Capital Income}}{\text{Total Income}} = \frac{\text{Capital Income}}{\text{Capital Stock}} \times \boxed{\frac{\text{Capital Stock}}{\text{Total Income}}}.$$

- **Second Fundamental Law** (another accounting identity):
  - "Growth rate equals savings rate divided by capital-output ratio."

$$K(t+1) = K(t) + I(t) = [1 - \delta(t)]K(t) + s(t)Y(t) \Rightarrow G(t) = \frac{s(t)}{\theta(t)}.$$

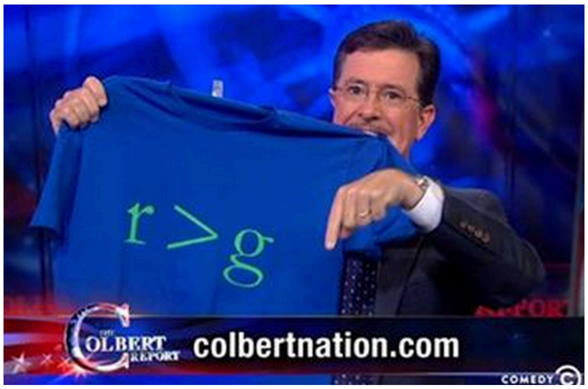
"One particularly clear case is that of Japan: with a savings rate close to 15 percent a year and a growth rate barely above 2 percent, it is hardly surprising that Japan has over the long run accumulated a capital stock worth six to seven years of national income. This is an automatic consequence of the [second] dynamic law of accumulation." (p.175)

  - Compare to Harrod-Domar or Solow.

Piketty's Laws

- **The Third Fundamental Law:**

- $r > g$: "Whenever the rate of return on capital is significantly and durably higher than the growth rate of the economy, ... wealth originating in the past automatically grows more rapidly than wealth stemming from work."
- This assertion is just plain wrong; see **Supplement 1**.



The Growth of Inequality

- What explains the growth in inequality?
  - Obviously, a plethora of forces: behavioral, functional, personal ...
- **Behavioral:**
  - Time preference and risk attitudes, higher rate of savings (see **Supplement 2**)
- **Personal:**
  - issues of access: imperfect capital markets + lack of scaling
  - endogenous information-gathering (see **Supplement 3**)
- **Functional:**
  - the falling labor share