1

Introduction: Prosperity with Inequality in the Age of Globalization

The precipitous rise in global and national economic inequalities which the inexorable and transformative power of globalization promised to relegate to the dustbin of history with rising affluence and abundance has come back to haunt the world with a vengeance. A chorus of voices representing a wide spectrum of viewpoints has placed the problem of worsening socioeconomic inequalities – with a small percentage of households accumulating a disproportionate share of income and wealth and the majority experiencing falling or stagnating incomes – and how best to ameliorate this pernicious resurgence back to the center stage of national and international politics.

Deep resentment, indeed visceral anger, against the fast-widening income and wealth gap between the alleged "1 percent" hedonistic and pretentious "haves" and the "99 percent" disenfranchised and dispensable "have-nots" has served as a lightning rod for popular discontent and a rallying cry for the "Occupy Wall Street" movement in the United States – which began symbolically in Manhattan's Zuccotti Park. Seeing it as their inalienable right to end such inequalities by whatever means possible, the occupiers, often with unrestrained vehemence, have called for the destruction of the "new Gilded Age" with both punitive and compensatory redistribution of wealth and power to the dispossessed majority.[1] Although eschewing the incendiary language and methods of the "occupiers," Pope Francis nevertheless preaches and chastises with equal measure at every opportunity that vicarious "inequality is the root of social ills" which can only be cured by "rejecting the idolatry of money and the absolute autonomy of markets and financial speculation." Admittedly finding inspiration in the Pope's words, President Barak Obama called "inequality the defining issue of our times." In his 2014 State of the Union address, Obama was unapologetic when he noted that "after four years of economic growth, corporate profits and stock prices have rarely been higher, and those at the top have never done better. But average wages have barely budged. Inequality has deepened. Upward mobility has stalled." The President promised to use his "executive order privilege" to correct this "unfairness" – beginning with raising

American workers' minimum wage from $7.25 to $10 an hour. This, the President claimed, would combat the twin evils of widening inequality and poverty.

The multitude of voices has precipitated a seismic shift in attitudes towards the problem of rising inequality. Even the world's premier financial institution, the International Monetary Fund (IMF), long accused of representing the interests of the "1 percent," seems chastened. In recent months the IMF addressed the problem of rising worldwide inequality head-on (an issue that, in the past, it left to its sister-organization, the World Bank) by acknowledging that "there is growing evidence that high income inequality can be detrimental to achieving macroeconomic stability and growth" and that "reform of expenditure and tax policies" can "help achieve distributive objectives ... " (IMF 2014, 2–3). The Fund's conclusion was based on an internal "Staff Discussion Paper" (see Ostry, Berg, and Tsangarides 2014), which, after exhaustive analysis of a large dataset covering some 150 countries over 40 years, found a negative correlation between income inequality and future economic growth – showing that societies with more unequal income distributions grow at a slower pace, and that a more equitable distribution of income does not have a negative effect on economic growth. Perhaps this explains why Christine Lagarde, the head of the IMF, broke with the organization's usual cautious reticence to solicitously warn that "rising inequality and economic exclusion can have pernicious effects ... in the years ahead, it will no longer be enough to look simply at economic growth ... we will need to ask if this growth is inclusive."

Apparently, even those most oblivious and disconnected from the objective reality of human want and anguish – whom Freeland (2012) has called the world's "super-rich" – billionaires, corporate CEOs, heads of state, celebrities, and the nouveau-riche who make the annual pilgrimage to the very exclusive World Economic Forum in Davos, have become decidedly uncomfortable with the growing economic divide. During the 2014 Davos, these cloistered elites found inspiration in an exaggerated, if not alarmist, 2013 Oxfam report that with zealous certitude asserts that the world's 85 richest people have more wealth than the poorest 3.5 billion – the vast majority of whom exist on less than a dollar a day. It seems that the Davos elites were so moved by the plight of the have-nots, not to mention the many risks associated with such capricious inequalities, that they departed from their usual issuance of standard press briefings to release a lengthy programmatic action plan on how best to narrow the widening economic divide (WEF 2014). Beyond their usual exhortation of the innate superiority of the market system as best antidote to sustained economic growth and poverty reduction, they did acknowledge that free-market capitalism could do with some fine tuning. In the end, the Davos participants endorsed a benevolently paternalist form of wealth redistribution, including strengthening of social safety nets to ameliorate the suffering of those precariously trapped in poverty and destitution and to substantively narrow the gap between haves and have-nots. For good measure, they rhetorically warned that failure to heed their words could trigger a tsunami of violence and instability the likes of which the world has not seen.

The release of Thomas Piketty's (2014) *Capital in the Twenty-First Century* in early 2014 with its trenchant indictment of the growing income inequality both nationally and globally gave intellectual legitimacy to the widespread perception that economic inequalities had grown to such disproportionately ostentatious levels that dichotomy of "1 percent" versus the "99 percent" was no exaggeration. Moreover, punitive expropriation of income and wealth of the so-called conspicuous and pretentious nouveau-riche (who lack the traditional bourgeois restraint and propriety) via increased taxes – that Piketty unflinchingly advocates – as entirely justified. Hailed in near-reverential terms as the new "Marx," Piketty soon acquired the mantle of a new "progressive" hero, and his dense, 700-page academic tome became an international bestseller. Drawing meticulously on a prodigious data base, Piketty provides a scrupulous assessment of how and why since the latter part of the 1970s income and wealth inequality have risen to astronomical levels in the OECD or the advanced industrial economies, and in particular in the United States and the United Kingdom. Specifically, Piketty rigorously documents that not only the share of the richest 1 percent in total pre-tax income increased in most OECD countries over the past three decades, overall, the pre-tax/pre-transfer "market" inequality as well as inequality in disposable incomes has risen in most rich countries over the last three decades. Moreover, although the top 1 percent in the United States and the United Kingdom captured a disproportionate share of overall income growth, countries that traditionally have enjoyed a more equal income and wealth distribution, including Finland, the Netherlands, Canada, Norway, Sweden, and other Nordic countries have also seen a sharp increase in the share of income going to the most affluent, in particular, the top 1 percent. Indeed, the old distinction between "Social Europe versus Liberal America" is increasingly a misnomer, as even the traditionally egalitarian Scandinavian economies are faced with rising inequality (Kvist et al. 2012).

According to Piketty, the widening income and wealth inequalities in the advanced industrial economies (indeed, the widening inequalities worldwide) is fundamentally rooted in the pathology of the capitalist system. Specifically, capitalism operates according to inexorable laws – in Piketty's inimitable formulation as $r>g$. That is, "r" is the rate of return on capital whereas "g" is the rate of economic growth. The "central contradiction of capitalism" is that the rate of return on capital (r) will always exceed the rate of economic growth (g). Because the rate of return on capital is higher than the economy's overall rate of growth, widening income and wealth inequality is intrinsic to capitalism. Drawing on Marx's famous critique that the impersonal and dehumanizing calculus of the capitalist system ensures that the returns on capital (which to Piketty are mainly wealth in the form of financial assets and equity) tend to be far greater than the growth rate of the economy, Piketty concludes that the owners of equity will always see their wealth grow much faster than those depended on earning income from labor. And since capital tends to be concentrated in very few hands while income generated from labor is more widely dispersed, it is hardly surprising that the relatively small capital-owning class have seen their incomes and overall wealth grow at an exponential rate, whereas the vast majority who sell their labor for a living have become pauperized as their incomes have either stagnated or declined in real purchasing terms.

Again, in step with Marx's pessimistic *Zeitgeist*, Piketty argues with almost missionary certitude that capitalism's fundamental nature – indeed, its irreducible essence – means that income and wealth inequality are not only transmitted over time, they also worsen over time. Drawing assiduously from an enormous volume of comparative data, Piketty notes that although advanced capitalist economies have grown at a rate of 1 to 1.5 percent per year, the average return on capital has been between 4 to 5 percent per year. He argues that the sharp rise in income inequality in the OECD economies, and in particular in the United States and the United Kingdom, has been driven mainly by steep increases in "wage inequality." Moreover, since income and wealth inequality increase as the economy's long-run rate of economic growth slows (as it has in the aftermath of the Great Recession and the ensuing slow recovery), Piketty warns that the trend towards slower growth in the advanced economies in years ahead will make inequalities in income and wealth even more pronounced and irrevocable. In fact, Piketty predicts a sustained increase in economic inequality because, as he argues, the distribution of wealth is mainly the outcome of the after-tax rate of return on capital minus the growth rate of GDP (i.e., r – g). Since wealth grows irrevocably along with the after-tax return on capital (r), while wages grow along with GDP growth (g), and because wealth will inevitably become more important than earned income, inequality will also sharply increase.

Just as it was for Marx, to Piketty the capitalist system characterized by impersonal, hierarchical, and exploitative market relations is the principal determinant of socioeconomic inequalities. In sharp contrast to the Nobel prize-winning economists Paul Krugman's impassioned *The Conscience of a Liberal* (2007) and *End This Depression Now* (2012) and Joseph Stiglitz's iconoclastic riposte, *The Price of Inequality: How Today's Divided Society Endangers Our Future* (2012), both of whom blame "market imperfections" for the widening wealth and income inequality, Piketty unequivocally argues that the rise in inequality "... has nothing to do with any market imperfection: the more perfect the capital market (in the economist's sense), the more likely *r* is to be greater than *g*" (Piketty 2014, 24). In other words, the higher the ratio, the wider the inequality gap. Given this, Piketty fatalistically concludes that inequality under capitalism is not some remediable contingent problem. Rather, even the well-intentioned reformist and redistributionist prerogatives of liberal democracies have failed and will continue to fail to meaningfully ameliorate income and wealth inequality.

THE NATURE OF ECONOMIC INEQUALITY

Although inequality can be deconstructed into separate categories based on "income," "wealth," "consumption," and "opportunity," income and wealth inequality usually receive the most attention. Income inequality (measured by the Gini coefficient, which takes values between 0 and 1, with 0 representing perfect equality) measures the distribution of income at a moment in time.[2]

Following Saez and Zucman (2014), wealth can be defined as "the stock of all the assets people own, including their homes, pension saving, and bank accounts, minus all debts. Wealth can be self-made out of work and saving, but it can also be inherited." Moreover, wealthier households are not necessarily high-income households. Thus, wealth is different from income – which measures the annual wages, interests, profits, and other sources of earnings. However, "income" is not always the best measure of inequality, and, contrary to conventional wisdom, neither is it easy to measure income inequality. Not only has income inequality historically fluctuated, the potentially several sources of income such as from wages, capital gains income, employer-provided health insurance, and other non-salaried compensation, not to mention that an individual's (and household's) income can vary significantly based on their access to credit, government welfare assistance, or family wealth, make measuring income inequality a challenge.[3] Yet, income is the most widely used indicator – with researchers and policy makers continuously refining the quantitative data by employing various metrics and definitions of income. For example, in many countries (including the United States), income inequality measures use income before taking into account taxes and transfer payments such as Social Security, food stamps, and unemployment benefits. Research confirms that "wealth" is more unevenly distributed than "income," while "consumption" tends to be less concentrated at the upper end than either wealth or income. Indeed, research often finds that consumption inequality is less than income inequality.[4] Adding further complexity, an individual's "net worth" (defined as household assets less liabilities) with assets that include both financial and non-financial (car, house) assets are not adequately factored in when measuring inequality.

It is well accepted that if an economy is to function relatively smoothly, individuals need incentives to work, innovate, consume, and save and be rewarded according to their intrinsic or marketable skills, intellect, and knowledge, as well as perseverance and grit. Certainly, the potential for a large economic reward plays an essential role in motivating innovators and entrepreneurs to take personal risks – their success benefiting not only themselves, but also the broader economy. Hence, conventional macroeconomic theory teaches that there is a "trade-off" between equality and growth – for example, since high-income individuals and households save more, greater inequality translates into more savings and investment – which, in turn, translates into higher output. Given this, the argument goes, some level of inequality is inevitable, if not desirable. Indeed, some degree of inequality in income and wealth is inevitable in a market-based economic system, even with completely equal opportunity, because variations in effort, skill, and luck will generate variations in outcomes.

The late economist Arthur Okun (1975) famously pointed out that some level of inequality may be necessary to generate economic growth because without the promise of economic gains, individual enterprise and innovation would suffer. Thus, Okun's apt warning that societies cannot have both perfect equality and perfect efficiency. Thus, the essential question is not whether inequality is "good" or "bad." Rather, as long as there is emphasis on "equal opportunity" (not "equal outcomes," as unequal outcomes may provide incentives for greater individual effort and determination), and as long as economic growth is broadly "lifting all boats," inequality may not be a problem.[5] Moreover, who could possibly object to the celebrated "Pareto criterion" – that is, if some people become better off without making anyone worse off, what is the problem? However, it is a problem if policies are designed to reduce income inequality by redistributing income from the productive to the less productive in the name of "fairness," or if inequality level keeps widening because of stagnant or declining income for the majority, or has reached the so-called "tipping point" and begins to act as a threat to economic growth and social and economic mobility, and in particular, intergenerational mobility.[6] As Panagariya (2010, 23) has succinctly noted, "inequality is certainly more tolerable in a growing economy. When everyone is moving up on an escalator, the fact that some manage to walk or run up on it is less bothersome than if the escalator is stuck, leaving some with no hope of reaching the top."

Although it is clichéd, it is important to reiterate that inequality is relative – influenced undoubtedly by the peculiarities of geography, politics, and level of economic development. Furthermore, inequality, and in particular wage inequality, has followed a broadly U-shaped pattern from its extreme in the early twentieth century to a period of more shared and equitable prosperity from the end of WWII to the mid-1970s (a period called the "Great Compression") and its sharp rise since. Hence, inequality is not only relative, the extent of measurable income gap varies, sometimes significantly, from country to country, and the levels of economic polarization depend on what evidence one looks at and how one interprets the data (Milanovic 2007; 2011; Radelet 2015). For example, the levels and extent of inequality can vary (sometimes sharply) depending how one puts controls for government taxes and transfers, household size, and the differences in the cost of living in the case for geographic comparisons. Also, in sharp contrast to Piketty, who views the self-perpetuating nature of income and wealth inequality as the natural equilibrium of capitalism (barring unprecedented events such as wars and economic crisis), or follows the "Kuznets curve" (the hypothesis developed by the Nobel Prize-winning economist Simon Kuznets), which claims that economic growth first increases income inequality within countries before reducing it – Milanovic (2016) proposes the idea of "Kuznets waves" to suggest that over time inequality rises, falls, and rises again in an endless cycle.

Even as income and wealth inequality has seen sharp increases in most countries, the absolute level of economic well-being has also improved, in many cases, immeasurably since the onset of the Industrial Revolution (Kenny 2011). In other words, although the fruits of economic growth (such as income) are not always evenly shared, overall all deciles of the income distribution have benefited from economic growth, even when inequality has increased. For example, although over the past two decades real household incomes in China have averaged annual growth of 10 percent and more, this growth has also been accompanied by an exponential rise in income inequality. Yet, this rise in inequality does not mean a stagnation of incomes for the poorer households or those in the lower income quintiles, but rather strong income growth among the richer households. According to the United Nations *Millennium Development Goals Report 2015* (United Nations 2015), the proportion of people living in extreme poverty in the developing countries declined by 50 percent over 1999 and 2011 – albeit, progress remained uneven, with sub-Saharan Africa making a modest reduction of just 21 percent, while in East Asia extreme poverty declined by 82 percent.[7] It is agreed that this reduction in global inequality has been driven by a convergence in average incomes across countries – propelled by rising incomes in large, populous countries such as China and India. This explains why global inequality has declined, but within-country inequality has increased. Indeed, in contrast to Piketty's rendition, Milanovic's (2016) *Global Inequality*, which focuses more on global than on national inequality, including more emphasis on income than wealth inequality, finds that while inequality is rising within most countries (in particular, the high-income countries), global income inequality has been steadily falling since 2000.[8] To Milanovic (2016) this is because global inequality or the sum of all national inequalities plus the sum of differences in mean incomes across countries (that is, the sum of intra- and inter-country inequality) has been declining due to the rise of emerging economies (especially in Asia) even as intra-country inequality is rising in many countries.

Similarly, Radelet (2016, 85–86) notes, "since the early 1990s, daily life in poor countries has been changing profoundly for the better: one million people have escaped extreme poverty, average incomes have doubled, infant death rates have plummeted, millions more girls have enrolled in school, chronic hunger has been cut almost in half, deaths from malaria and other diseases have declined dramatically . . . This unprecedented progress goes way beyond China and India and has touched hundreds of millions of people in dozens of developing countries across the globe . . . the number of extreme poor has fallen by more than 400 million. Since the 1980s, more than 60 countries have reduced

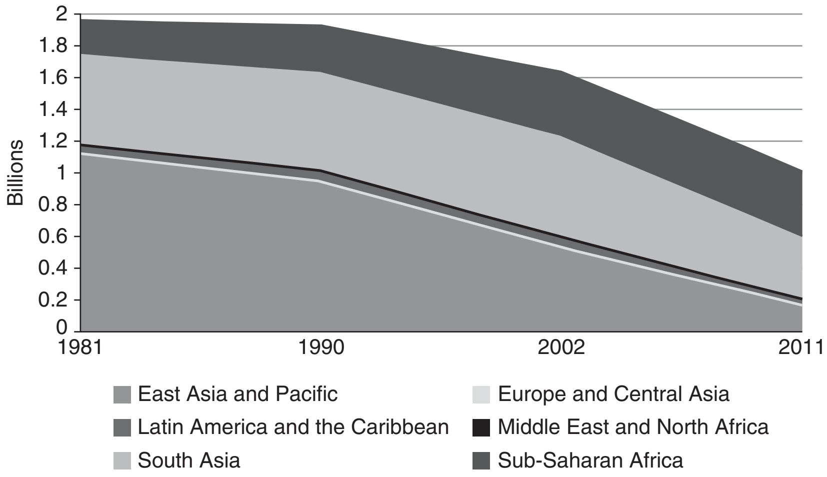

FIGURE 1.1 Global extreme poverty level
Source: World Bank, Our World in Data 2015.

the number of their citizens who are impoverished, even as their overall populations have grown." Thus, the growing income and wealth inequality does not necessarily mean a rise in poverty or declines in disposable income, purchasing power, and living standards for those at the lower end of the income distribution (Figure 1.1). Rather, it means that even as incomes have grown for most individuals and households, the rich are getting richer faster because the gains have been proportionally larger at the higher end of the income levels.

This explains the current trend of declining inequality among countries, but rising inequality within countries. As Bourguignon (2015) and Deaton (2013), among others, have noted this is partly because the "great divergence" in the average incomes that occurred during the nineteenth and early twentieth centuries was followed by a rather long period of postwar stability, including the unprecedented global economic integration of the past decades, which resulted in the "great convergence" of income and wealth. Specifically, as predicted by the "neoclassical convergence growth theory," technology spillovers, international capital flows, deepening trade links, and huge economies like China and India moving rapidly up the global income distribution have contributed substantially to income convergence across countries, including greater economic convergence between the developed and developing nations (Bourguignon 2015; Solow 1956). Indeed, according to Barro (2015), there is an "iron law of convergence" suggesting that both low-income (or the so-called "least developed countries") and developing nations can constantly reduce their income gap with the developed economies by half every 35 years. The extraordinarily rapid economic growth in China and India (which together make up about two-fifths of humanity), and the resultant meteoric rise in income and wealth (especially in China) that were simply unimaginable just a few decades earlier, explain the sharp decline in global household inequality, including changes in the distribution of relative average incomes of countries, weighted by population. This also explains why the proportion of the world's population living in extreme indigence has fallen from 32 percent in 1990 to about 16 percent in 2010.[9] Second, because economic growth is highly correlated with poverty reduction, growth matters. Therefore, even if the top 10, the top 1, or the top 0.1 percent of the population enjoy a disproportionately bigger share of the economic pie, the size of pie has also become bigger, enabling even the bottom or poorest percentile of the population to improve their overall economic well-being (Radelet 2015). Tyler Cowen (2011) cogently captures this paradox, noting that although income inequality is rising, the inequality of personal well-being has been declining:

> the inequality of personal well-being is sharply down over the past hundred years and perhaps over the past twenty years as well. Bill Gates is much, much richer than I am, yet it is not obvious that he is much happier if, indeed, he is happier at all. I have access to penicillin, air travel, good cheap food, the Internet and virtually all of the technical innovations that Gates does. Like the vast majority of Americans, I have access to some important new pharmaceuticals, such as statins to protect against heart disease. To be sure, Gates receives the very best care from the world's top doctors, but our health outcomes are in the same ballpark. I don't have a private jet or take luxury vacations, and – I think it is fair to say – my house is much smaller than his. I can't meet with the world's elite on demand. Still, by broad historical standards, what I share with Bill Gates is far more significant than what I don't share with him.

Yet, this paradox – that of declining economic inequality among countries, but the widening of income and wealth disparities within countries alongside impressive gains in aggregate GDP growth and improvements in living standards of broad cross-sections of the populace – is not something one would glean from Piketty's rendition. Nevertheless, the empirical reality of the last several decades unequivocally confirms that in almost every country, including the poorest, even as the income and wealth gap has dramatically widened with the most affluent and the middle and upper-middle income groups capturing a disproportionately large share of the overall gains, sustained economic growth has also translated into higher incomes for the lower-middle, the working class, and the poor – for the latter, at least in terms of perceptible and measurable improvements in their purchasing power and ability to respond to the everyday adversities of life. In China and India (and many countries), sustained economic growth has not only created new classes of millionaires and billionaires, but also rapidly expanding middle classes who have seen an astronomical expansion in their incomes and wealth (Freund 2016). Similarly, as noted, growth has also translated into sharp reductions in crushing or "absolute" poverty – and in the process fundamentally transformed the lives of millions of people for the better.[10]

Thus, we are witnessing a counterintuitive and paradoxical phenomenon that can best be described as "growth with rising inequality, but declining poverty" – with many countries becoming less poor and more prosperous, but also more unequal in terms of income and wealth distribution. This trend is quite pervasive – confined not only to China, India, and the United States, but also the OECD countries like Denmark, Norway, and Finland with traditionally low levels of inequality.

Given this, how then to reconcile Piketty with the other face of "capital" and "capitalism": namely, that laissez-faire or "neoliberal" capitalism and the deepening global economic integration it has created in its wake has generated unprecedented levels of growth that is directly responsible for higher living standards in the advanced economies and for the dramatic reduction in worldwide poverty – lifting millions out of abject poverty in China, India, and elsewhere in the developing world. Economics Nobel laureate Angus Deaton's (2013) *The Great Escape* persuasively argues that worldwide "life is better now than at almost any time in history." What explains the startling divergence in Piketty and Deaton's renditions? In short, although at first glance these two narratives seem irreconcilable, in fact, they are both correct as each portrays a different aspect of a multifaceted reality. The evidence confirms that economic growth can generate simultaneous sharp increases in income inequality and equally sharp declines in poverty. Second, contrary to popular perception, Piketty's study is not about the trends in the global economy. Rather, his study provides an aggregate portrait of within-country inequality in the advanced OECD countries – most, if not all, of which have experienced modest growth rates (including sharp economic declines during the global financial crisis), yet an exponential widening of the income and wealth gap.

BRINGING POLITICS IN

Although the pivotal role market forces play in creating and distributing wealth and in the process shaping the fortunes of nations is undeniable, the dangers of single-minded and dogmatic focus on economic variables to explain such complex processes are also well known. Clearly, Piketty is cognizant of this as he notes that "one should be wary of any economic determinism in regard to inequalities of income and wealth. The history of the distribution of wealth has always been deeply political, and cannot be reduced to purely economic mechanisms" (Piketty 2014, 20). Yet, Piketty's account – which come perilously close to ignoring its own advice – remains unabashedly doctrinaire and monocausal.

Piketty not only views inequality as a natural outcome of capitalism, he is so fixated on "capital" that the non-economic exigencies of rising income and wealth inequality such as political influence and control are conspicuously absent in his analysis. In fact, Piketty's exclusive focus on "capital" leads him to present a rather rigid and starkly narrow picture of the sources, nature, and extent of income disparities, their socioeconomic and political implications, and how best to address this problem.