THE USA AS A DEVELOPING COUNTRY
INEQUALITY, INSTITUTIONS AND INFLUENCE

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Applications and cases in international development
MPAID
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with inputs from Kartik Akileswaran, Arvind Nair and Rafael Puyana
Outline

• Motivation and thesis
• Myth and reality
• Dimensions and drivers of an inequality trap
• Lessons from US history?
• Some questions
Motivation and thesis
Long-term: US became incredibly rich e.g. growth far outpaced Latin America since 1700

...even though both regions had similar starting points

Less unequal structures in the US were part of this long-term story

- Failure to introduce oligarchic structures in US settlement
- Extension of the vote
- Extension of education
- Middle class inventors and patents
- Backward, oligarchic, unequal part (the South) defeated in the Civil War
- Political basis for competitive banking

(Engerman & Sokoloff, Haber, Acemoglu & Robinson etc)
But the US Gini coefficient has risen rapidly in recent decades.

The United States was one of the most unequal OECD countries in the late 2000s.

In fact, for labour earnings of the full-time employed, the U.S. had the most unequal distribution.

**Gini Index for Different Population Groups for OECD Countries: Late 2000s**

The thesis

• The standard view: US a canonical, and aspirational, end-point of development
  • Autonomous institutions of regulation, government, judiciary
  • Dynamic, shareholder capitalism; defines technological frontier
  • Equality of opportunity
  • Middle class politically central in a functioning democracy
  • Low tax social contract
  • Efficient, flexible labour market
  • Sound macroeconomic management
...seems divorced from actual conditions

- US state increasingly seems captured by special interests, with distorted and exclusionary institutions, dysfunctional politics
- Over longer-term will sap dynamism
- Financial crisis symptomatic
- In an inequality trap: a new “Gilded Age”; more like developing country oligarchic capitalism plus populist electoral strategy
The world turned upside down?

- US, Europe and Japan all in crisis
- Emerging markets booming
- A new model, or an old one?
Myth and reality
Autonomous institutions?

<table>
<thead>
<tr>
<th>US Myth</th>
<th>US reality</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Limited government.” Rule of law, formal checks and balances, independent judiciary, Fed and independent regulators constrain opportunistic or exploitative behavior by either the government or others</td>
<td>Political decision-making and behaviour of independent institutions state increasingly shaped by powerful interests; populist narratives and action underpin this</td>
</tr>
<tr>
<td><em>Cf. developing countries</em></td>
<td></td>
</tr>
<tr>
<td>Weak formal institutional checks</td>
<td></td>
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<tr>
<td>Populism and/or oligarchic influence</td>
<td></td>
</tr>
</tbody>
</table>
examples

Legislature
• Politican finance and lobbying, “legal” insider dealing of politicians, gerrymandering.

Supreme Court
• Citizens United (unlimited corporate campaign finance)
• Polarization of discussion of Affordable Care Act

Financial sector policy, even of the Fed
Dynamic capitalism?

**US Myth**

Dynamic capitalism, that defines the technological frontier for global production. Powerful incentives and institutions reward productive success and drive innovation. Discipline and reward of shareholder capitalism. Angel and venture capital, technology clusters, social recognition for new entrepreneurs, financial and social networks between universities and firms etc.

*Cf. developing countries*

Oligarchic capitalism: family-controlled conglomerates (think Carlos Slim’s empire in Mexico, the Ambanis and Tata in India); excessive links between business and political elites.

**US reality**

A blend: much still true But increasingly like a sophisticated form of oligarchic capitalism
examples

• Business-based political lobbying has created a distorted tax system, plus wide range of state-mediated special supports.
• “Rent-thick” sectors—oil and gas, health, finance—with more money influence?
• Strategic influence on financial deregulation, plus profound failures on incentives, information and risk allocation created the financial crisis.
Equality of opportunity?

**US Myth**

Talent and effort richly rewarded, “incentivized” safety nets for those who don’t make it.

Upward mobility—including to the top—provided by public and private education, and meritocratic social structures, in politics and business.

*Cf. developing countries*

Exclusionary education systems and social structures, in terms of elite connections; societal discrimination against being indigenous, black, low caste, *favela* (slum) dwellers etc.

**US reality**

*Low mobility* (especially compared with rich countries with extensive social provisioning).

Especially low mobility from the bottom up, and for African Americans.
… in relative terms, there is limited movement of children across the income distribution.

Over 40% of children whose parents were in bottom quantile remain there, and only 6% move to the top quintile.
The narrative of US as high inequality with high mobility is false: higher inequality associated with lower intergenerational mobility

Source: Corak, 2011.
## Middle class central?

<table>
<thead>
<tr>
<th>US Myth</th>
<th>US reality</th>
</tr>
</thead>
<tbody>
<tr>
<td>The middle class (including “working Americans”) rather than oligarchies (or revolutionary social movements) shapes the polity and policy.</td>
<td>A country run in the name of the middle class, along a path that has left both the middle class and poor behind</td>
</tr>
</tbody>
</table>

*Cf. developing countries
Varying combinations of elite-pacts, clientelism and populism.*
## Flexible, inclusive labour market?

<table>
<thead>
<tr>
<th>US Myth</th>
<th>US reality</th>
</tr>
</thead>
<tbody>
<tr>
<td>A labor market of high mobility and flexibility; good for workers as a whole (but not protected insiders) as well as business.</td>
<td>Long-term decline of industrial employment has not been substituted by service employment of similar quality work; a source of social breakdown in some communities.</td>
</tr>
</tbody>
</table>

*Cf. developing countries*

Dualistic labour markets—over labour contracts, and over social insurance (pensions, health, unemployment) linked to the labor contract.

Post-crisis open unemployment is increasingly long-term, “European”, and open and disguised unemployment much worse.
Stable macro?

**US Myth**

Efficient stable macro; independent Fed

*Cf. developing countries*

Populist-fiscal-inflationary crises typical of Latin America; crony capitalist corporate-financial crisis of East Asia

**US reality**

Subprime/Lehman’s crisis like a typical emerging market crisis
Toward a framework: inequality, economic structure and institutions
A consolidating system?

Structural change

Deepening inequalities

Political/state processes

Institutions of capitalism

Institutions of social provisioning
A prism from inequality

Consider the system as a consolidating inequality “trap”—i.e. self-reinforcing.
Explore from three parts of the distribution
• The top (main focus today)
• Middle
• Bottom
The top

![Graph showing growth in real after-tax income from 1979 to 2007. The top 1% has significantly higher income compared to other quintiles.](image-url)
Proximate and deeper stories

(1) Returns to education
(2) Capital income

Driven both by

- Demand and supply; political and social context for education
- Rent-creation and rent-sharing with political process
  (economic rents as returns to scarce factors of production in excess of what could be obtained in alternative fully competitive uses)
Inequality rise especially from top 1% income share in the economy, which started in the mid 1970s.

Share of National Income by Income Brackets: 1913 to 2008

Source: Saez (2012), "Striking it Richer: The Evolution of Top Incomes in the United States"
(...and is not a universal phenomenon amongst rich countries)

Source: Atkinson, Piketty and Saez, 2011
And especially the top 0.1% between 2002 and 2007, (then affected by the financial crisis)

**Share of National Income of the Top 0.1%: 1913 to 2008**

- Including capital gains
- Excluding capital gains

Source: Saez (2012), "Striking it Richer: The Evolution of Top Incomes in the United States"
Top 0.1% gains from salaries (from 1970s) capital and business income (esp. 1990s and 2000s)

Share and Composition of Income of the Top 0.1%: 1916 to 2007

Underlying drivers

Influences on rising concentration at the very top:

• The role of the financial services sector:
  ▪ High compensation (treated as capital gains for hedge fund and private equity firms)

• Super-high executive compensation: set by “compensation committees”, weak link to performance

• Tax Structure:
  ▪ Tax benefits for Capital Gains and Dividends
  ▪ Institutional and political influence
Drivers of Income Concentration: Tax Benefits

The Tax Policy Center estimates Mean Shares of Income from Capital and Labor for 2012:

For the top 0.1%, Capital Income accounts for 63.1% of Total Income. Of that Capital Income, 47.2% is Tax-Favored and 26.6% is Tax-Exempt.

Table 2. Mean Shares of Individual Income from Capital and Labor, 2012

<table>
<thead>
<tr>
<th>Modified Cash Income Percentile</th>
<th>Labor Income</th>
<th>Capital Income</th>
<th>Tax-Favored</th>
<th>Taxable</th>
<th>Tax-Exempt</th>
<th>Business Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest Quintile</td>
<td>91.0%</td>
<td>9.0%</td>
<td>27.6%</td>
<td>40.6%</td>
<td>15.7%</td>
<td>16.1%</td>
</tr>
<tr>
<td>Second Quintile</td>
<td>93.0%</td>
<td>7.0%</td>
<td>18.2%</td>
<td>46.0%</td>
<td>20.3%</td>
<td>15.5%</td>
</tr>
<tr>
<td>Middle Quintile</td>
<td>93.1%</td>
<td>6.9%</td>
<td>19.0%</td>
<td>44.7%</td>
<td>24.2%</td>
<td>12.1%</td>
</tr>
<tr>
<td>Fourth Quintile</td>
<td>89.2%</td>
<td>10.8%</td>
<td>19.0%</td>
<td>34.2%</td>
<td>39.1%</td>
<td>7.7%</td>
</tr>
<tr>
<td>Top Quintile</td>
<td>65.9%</td>
<td>34.1%</td>
<td>31.6%</td>
<td>21.0%</td>
<td>41.2%</td>
<td>6.2%</td>
</tr>
<tr>
<td>All</td>
<td>75.2%</td>
<td>24.8%</td>
<td>30.0%</td>
<td>23.3%</td>
<td>39.9%</td>
<td>6.8%</td>
</tr>
</tbody>
</table>

Detail on Top Quintile

<table>
<thead>
<tr>
<th>Detail on Top Quintile</th>
<th>Tax-Favored</th>
<th>Taxable</th>
<th>Tax-Exempt</th>
<th>Business Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>80-90</td>
<td>19.1%</td>
<td>24.5%</td>
<td>51.1%</td>
<td>5.3%</td>
</tr>
<tr>
<td>90-95</td>
<td>19.0%</td>
<td>21.5%</td>
<td>54.1%</td>
<td>5.4%</td>
</tr>
<tr>
<td>95-99</td>
<td>23.6%</td>
<td>20.1%</td>
<td>49.6%</td>
<td>6.7%</td>
</tr>
<tr>
<td>Top 1%</td>
<td>40.4%</td>
<td>20.6%</td>
<td>32.6%</td>
<td>6.4%</td>
</tr>
<tr>
<td>Top 0.1%</td>
<td>47.2%</td>
<td>20.7%</td>
<td>26.6%</td>
<td>5.5%</td>
</tr>
</tbody>
</table>

Drivers of Income Concentration: Tax Benefits (2)

The largest beneficiaries of the EGTRRA and JGTRRA Tax Cuts of 2001/2003 were the highest percentile of the distribution.

Table T08-0151
Individual Income and Estate Tax Provisions in the 2001-08 Tax Cuts
Distribution of Federal Tax Change by Cash Income Percentile, 2010

Summary Table

<table>
<thead>
<tr>
<th>Cash Income Percentile 2,3</th>
<th>Percent of Tax Units 4</th>
<th>Percent Change in After-Tax Income 5</th>
<th>Share of Total Federal Tax Change</th>
<th>Average Federal Tax Change ($)</th>
<th>Average Federal Tax Rate 6 Change (%) Points</th>
<th>Under the Proposal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest Quintile</td>
<td>25.1</td>
<td>0.7</td>
<td>1.0</td>
<td>-.74</td>
<td>-0.7</td>
<td>4.6</td>
</tr>
<tr>
<td>Second Quintile</td>
<td>81.5</td>
<td>2.5</td>
<td>7.3</td>
<td>-642</td>
<td>-2.2</td>
<td>10.8</td>
</tr>
<tr>
<td>Middle Quintile</td>
<td>94.8</td>
<td>2.5</td>
<td>11.2</td>
<td>-1,079</td>
<td>-2.0</td>
<td>17.1</td>
</tr>
<tr>
<td>Fourth Quintile</td>
<td>95.9</td>
<td>2.6</td>
<td>15.8</td>
<td>-1,826</td>
<td>-2.0</td>
<td>20.2</td>
</tr>
<tr>
<td>Top Quintile</td>
<td>93.1</td>
<td>4.0</td>
<td>64.6</td>
<td>-8,421</td>
<td>-2.9</td>
<td>25.7</td>
</tr>
<tr>
<td>All</td>
<td>73.4</td>
<td>3.2</td>
<td>100.0</td>
<td>-1,934</td>
<td>-2.5</td>
<td>21.6</td>
</tr>
<tr>
<td>Addendum</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>80-90</td>
<td>94.1</td>
<td>2.4</td>
<td>9.9</td>
<td>-2,548</td>
<td>-1.8</td>
<td>23.1</td>
</tr>
<tr>
<td>90-95</td>
<td>89.9</td>
<td>1.9</td>
<td>5.3</td>
<td>-2,822</td>
<td>-1.4</td>
<td>24.6</td>
</tr>
<tr>
<td>95-99</td>
<td>92.9</td>
<td>3.0</td>
<td>11.7</td>
<td>-7,670</td>
<td>-2.2</td>
<td>26.0</td>
</tr>
<tr>
<td>Top 1 Percent</td>
<td>99.0</td>
<td>7.3</td>
<td>37.7</td>
<td>-97,028</td>
<td>-4.9</td>
<td>27.9</td>
</tr>
<tr>
<td>Top 0.1 Percent</td>
<td>99.5</td>
<td>8.2</td>
<td>19.7</td>
<td>-501,517</td>
<td>-5.3</td>
<td>29.3</td>
</tr>
</tbody>
</table>

Drivers of Income Concentration: Institutional and Political Influence

Impact of Lobbying:

- Igan et al. (IMF, 2009) find lenders lobbying more on issues related to mortgage lending had higher loan-to-income ratios and faster growing portfolios.

- Richter et al. (2009) find those firms that spend more on lobbying in a given year will pay lower effective tax rates the following year (from all firms with publicly available financial statements)
The value of the revolving door: the stock market response of firms when individuals affiliated with firms are appointed to the defense department.

Source: Luechinger and Moser (2012)
Broader links between political activity, shareholder value and Citizens United

“After the exogenous shock of *Citizens United*, corporate lobbying and PAC activity jumped, in both frequency and amount, and firms that were politically active in 2008 had lower value in 2010 than other firms, consistent with politics at least partly causing and not merely correlating with lower value”

Cogan, 2011
Are some forms of business influence better than others?

Hypothesis:
Lobby-intensive sectors
--oil and gas
--finance
--health
--agriculture

...distort the pattern of economic change and innovation into domains that are less socially productive or higher cost
The broader top of the distribution

- Returns to education, skill-biases and globalisation more relevant
- Especially elite and post-graduate education
Biggest salary gains for post-graduates

Source: Acemoglu and Autor, 2012

Source: March CPS data for earnings years 1963-2008. See note to Figure 1. The real log weekly wage for each education group is the weighted average of the relevant composition adjusted cells using a fixed set of weights equal to the average employment share of each group.
... inter-generational reproduction of privilege

- 74% of students attending colleges that are classified as “most competitive” (including Harvard, Emory, Stanford and Notre Dame) come from families with earnings in the top income quartile;
- (3% from families in the bottom quartile.)

(Carnevale (2012) reported in Edsall (2012))
The “middle class”

![Graph showing growth in real after-tax income from 1979 to 2007.](url)

Source: Congressional Budget Office.
Note: For information on income definitions, the ranking of households, the allocation of taxes, and the construction of inequality indexes, see "Notes and Definitions" at the beginning of this study.
Median income stagnation as a pattern of growth problem

Source: Lane Kenworthy, post, Sept 2008
Long-term wage decline (exc. 1990s) for males with high school and some college (a bit better for women)

Source: Acemoglu and Autor, 2012
Associated with decline in mid-skill work: driven by technological change...

Source: Acemoglu and Autor (2012)
o/w falls in manufacturing is just one component, and, yes, with a China effect

Source: Autor, Dorn and Hansen, 2012
…in context of low growth in college completion for white and black males


Source: Autor, 2012
The poor
Dismal long run progress in poverty reduction since 1970s

**Number in Poverty and Poverty Rate: 1959 to 2010**

Numbers in millions, rates in percent

- **Number in poverty**: 46.2 million
- **Poverty rate**: 15.1 percent

Note: The data points are placed at the midpoints of the respective years. For Information on recessions, see Appendix A.

Hit by falling wages for high school dropouts—until mid-1990s

Source: March CPS data for earnings years 1963-2008. See note to Figure 1. The real log weekly wage for each education group is the weighted average of the relevant composition adjusted cells using a fixed set of weights equal to the average employment share of each group.
...and higher unemployment in good times and bad

Source: Baum et al, 2010.
Upward mobility hurt by weak progress in access to college

• % college students in bottom quartile graduating by age 24 grew only 2.1 points, from 6.2 percent in 1970 to 8.3 percent in 2009.
• (For students from families in the top income quartile, the graduation rate doubled from 40.2 percent to 82.4 percent over the last four decades.)
• Pell Grants finance poor students college education:
  • In 1979-80, maximum Pell Grant covered 99 percent of the cost of a community college, 77 percent at a public four-year college and 36 percent at a private four-year college.
  • By 2010-11, these percentages had dropped to 62, 36 and 15 percent respectively
The mobility gap between white and African-American families is large.

54% of black children with parents in the bottom quintile are likely to remain there, as compared to 31% of white children.
Poverty is linked to group identity

Poverty Rates by Race and Hispanic Origin: 1959 to 2010

- Black: 55.1% to 22.8% to 16.1% to 27.4%
- Hispanic (any race): 7.5% to 22.8%
- Asian: 12.1% to 9.9%
- White, not Hispanic: 7.5% to 9.9%

Percent


Recession
...as is insurance coverage

Uninsured Rates by Race and Hispanic Origin: 1999 to 2010

<table>
<thead>
<tr>
<th>Race</th>
<th>1999 %</th>
<th>2005 %</th>
<th>2010 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hispanic (any race)</td>
<td>31.9%</td>
<td></td>
<td>30.7%</td>
</tr>
<tr>
<td>Black</td>
<td>18.7%</td>
<td></td>
<td>20.8%</td>
</tr>
<tr>
<td>Asian</td>
<td>17.0%</td>
<td></td>
<td>18.1%</td>
</tr>
<tr>
<td>White, not Hispanic</td>
<td>9.0%</td>
<td></td>
<td>11.7%</td>
</tr>
</tbody>
</table>
State activism in incarceration is deepening the poverty trap, especially for African-Americans

- Black males born in 2001 are more than five times as likely as white males to be incarcerated some time in their lifetime.
- One in 12 working-age Black men was in prison or jail in 2008, compared to one in 87 working-age White men.
- One in nine Black males between ages 25 and 29 is in prison or jail
- Large racial biases in incarceration for same drug offences
- A punitive approach to a social issue (Glenn Loury)
(Data from Child Development Fund, 2011)
Lessons from history? A new Gilded Age…or the potential to break the inequality trap?
The U.S. saw massive wealth concentration in the late 1800s and early 1900s

-- Wealth concentrated in hands of landlords/industrialists; richest 1% held 45% of national wealth in 1900

-- Political connections and corruption enriched "robber barons", even while economic activities sometimes benefited the country more broadly (e.g. railroads)

By turn of 19th Century middle class became wary of big business and turned to government as a counterweight
Leading to a “Grand Bargain” developed between 1890s and 1930s (and beyond)

Capitalism preserved: Government supported business, but took action to manage its excesses (deal with “market failures”)

- Sherman Antitrust Act (1890)
- Pure Food and Drug Act (1906)
- Glass-Steagall Act (1933) (insured bank deposits and separated investment from commercial banking)
- Clayton Act (1914) National Labor Relations Act (1935)
- Minimum wage
- Unemployment insurance (1935)
- Social Security (1935)
- Medicaid and Medicare (1965)
New Deal policies greatly expanded social safety net

- In both US and Nordics, social provisioning a product of conflict
- In 1930s US had moved further than Nordics
- Established capitalists an important part of support for social democratic transition in both cases (Swenson, 2004)
Along with education-technological change dynamics (plus war) led to the Great Compression

Questions
What would a development economist recommend to “Mexico” the United States?

- …a lot
- Tax reform to raise *and* reduce distortions in taxes
- A public-private competitiveness and innovation strategy
- Major infrastructure program
- Reform of old age and health insurance for inclusion and competitiveness—separating provisioning from labor contract
- Deeper regulation of finance to tackle market failures
- Major push on pre-school
- Integrated, participatory program for “excluded” groups
- Tackle socio-economic roots of violence and drugs
- etc…………………………….
And what would a political economist ask?

- Why so little (effective) outrage?
- How can the elite be so successful in resisting taxes?
- What are the political and sociological sources of the education crisis for all but a few?
- Why is the capacity for collective action so unequally distributed in a sophisticated democracy?
- Why are significant parts of the white “middle class” going along with a pro-elite, anti-state narrative?
- Why are “progressive coalitions”, especially middle-poor, so weak?
- Why is there public tolerance for money influence over institutions?
- Why are long-term business interests pushing short-run, pro-billionaire, policies?
Concluding notes

- Structural forces and policy design are creating an inequality trap, that in turn is shifting US to developing country institutional status.
- More “back to the future” than “a world turned upside down”...so far.
- Changes terms of intellectual exchange on interpretations between US and developing countries; now and in history.