

Chapter 1

Inequality, Financialisation, and Risks to the Earth System: In Need for Bold Actions

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ABSTRACT

This chapter examines the issue of growing inequality in developing countries. The first section of this chapter highlights a few key facts regarding the evolution of inequality. The second session asks why equality matters. The third session focusses on the driving forces behind the growing inequality. The fourth section outlines implications for developing countries and their development strategies. The final section focusses on possible international initiatives which might mobilize “green” investments at big scale and foster equality at the same time.

1. AN UNEQUAL WORLD

Piketty documents the evolution of income and wealth over the past 300 years, particularly in Europe and the United States. He demonstrates that the period after the industrial revolution and until the World War I (“the long 19th century”) was characterized by a growing concentration of wealth and income. A similar tendency can be observed since the 1970s as both wealth and income gaps have been rising back towards to their pre-20th-century norms. According to Piketty, the period from about 1914 to the 1970s, in many advanced countries, was an historical outlier in which both income inequality and the stock of wealth (relative to annual national income) fell dramatically.

Let us look first on the evolution of income distribution in the last decades. Between the mid-1980s and the mid-2000s, inequality rose in 16 out of 20 rich OECD countries (Milanovic, 2011, p. 3). Where inequality increased, usually it was due to an unprecedented surge in top wage incomes. The trend is particularly strong in Anglophone countries. For example, in the US, the share of market income captured by the richest 10 percent surged from around 30 percent in 1980 to 48 percent by 2012. In the same

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period, the share of the richest one percent increased even more, from 8 percent to 19 percent, while the share of the richest 0.1 percent increased from 2.6 percent to 10.4 percent (IMF, 2014a, p. 9).

What about developing countries? Inequality is on average higher in these countries than in high income countries. But, can we observe there a similar trend towards inequality? The World Bank claims in its 2014 Global Monitoring Report, that during the 2000s, the bottom 40 percent enjoyed more rapid income growth than the average of the population in 50 out of 78 countries. However, these figures tend to paint a too rosy picture.¹ First, the World Bank is using for most regions consumption data. As rich people tend to consume a relatively small part of their income, measuring income instead of consumption data would be more appropriate.² Besides, the World Bank approach - looking at income growth rates of the bottom 40 per cent compared with overall income evolution - is ignoring the evolution of top incomes. As argued above, at least in advanced countries, growing inequality was very much linked to the exploding income of the highest 1 percent or even 0.1 percent of the population. It is therefore not surprising that other indicators – such as the Gini coefficient or even more the Palma ratio³ - paint a more negative picture about the evolution of inequality in developing countries. Since 1990 the Gini coefficient for disposable income⁴ has increased not only in nearly all advanced countries, but also in many developing countries, in particular in Asia, the Pacific, the Middle East and North Africa (IMF, 2014a, p. 7). Based on the calculation of Gini coefficients, seven out of 10 people live in countries where the gap between rich and poor is greater today than it was 30 years ago (Oxfam, 2014, p.8).

The growing income inequality can also be observed when looking at the share of wages in total income (“the wage rate”). Since 1990, real wages in advanced countries have been flat or increasing very slowly. In contrast to the evolution of real wages profit rates are historically high in many countries and also corporate savings have risen across the rich world in recent years. East Asia is an extreme case. Japanese firms hold 2.1 trillion dollar in cash, a massive 44 percent of GDP. Their South Korean counterparts hold 440 billion dollar or 34 percent of GDP (The Economist, 2014a). Accordingly, the wage rate has fallen steadily the world over (Karabarbounis & Neumann, 2013). This is somewhat surprising as it contradicts conventional wisdom. Kaldor (1957) set out six so-called “stylized facts” about economic growth, one of which was that the shares of national income flowing to labor and capital held roughly constant over time. This “fact” does not hold any longer. The falling wage rate seems to hold also true at least for some important developing countries, such as China.

Wealth is even more concentrated than income.⁵ In the US, the bottom 90% of the population holds just 22% of wealth, about the same than the wealth held by the top 0.1% (The Economist, 2014b). The top one percent controls one-third of the assets in the United States and 40 percent around the world. Today, the world’s 85 wealthiest citizens own more than its bottom three and a half billion. There are 1645 billionaires worldwide, more than double the number compared to before the financial crises (Forbes, 2014). Many of those “High Net Wealth Individuals” are from developing countries.

The growing inequality in advanced and middle income countries is at variance with another important economic building block, the “Kuznets-Curve”. Kuznets argues that in very poor developing countries inequality rises as people start moving from low-productivity agriculture to the more productive industrial sector, where income is higher. But as a society matures and becomes richer, the urban-rural gap is reduced and old-age pensions, unemployment benefits, and other social transfers lower inequality. The documented exacerbating inequality in advanced economies, but also in China and India contradicts this theory. The development in China, India and many other developing countries also contradicts another economic theory, the *Heckscher-Ohlin-Samuelson Theorem*. This theorem posits that as poor countries engage more in global trade, they tend to specialize in the production of goods in which they hold a

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