NCAER Podcasts: Episode – 2

Transcript:

Topic: Global Challenge of Economic Inequality: The Road Ahead

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UD:

Welcome to the NCAER podcast. I'm your host, Udaibir Das, a visiting professor here at the NCAER, the National Council of Applied Economic Research.

Remember the saying, 'tell me and I forget, teach me and I remember, involve me and I learn'. Now that is the spirit we are bringing to the NCAER podcast series. We are embarking on a collaborative journey with you to explore the fascinating intersections of macroeconomics, global economics, finance and policy. We will dive into policy puzzles, explore new global initiatives with macro and financial impact, and unravel analytical conundrums. We will peel back the layers of complexity through engaging conversations, diverse perspectives, and thought-provoking counterfactuals. We will illuminate how some of the issues, past, present, and the future, impact emerging markets and the broader global South.

We hope each episode sparks your curiosity and brings you something new. So, let us embark on this journey of discussion, discovery, and debate with NCAER podcast.

In today's NCAER podcast, we will have a conversation about the compelling, critical, and often a controversial topic of global economic inequality, a topic as vast as it is complex. There is inequality everywhere, and economic inequality is one dimension of global inequality. It has a unique face in every corner of the world, and the mention of inequality invariably stirs up a storm. Scholars locking horns, academics in a tussle, Intellectuals at loggerheads, policymakers turn defensive, and theories clash.

Now, this is understandable. When we look at the history of global economic inequality, two centuries ago, that is around early 19th century, the world was much more equal. Average income was low everywhere, and most people were extremely poor. About a century and a half later, the world had changed. It had become very unequal. Global income distribution was like, I will call, a two-hump-shaped camel. One below the international poverty line and the other hump at much higher incomes. In fact, concerns about inequality had started to build up in the 1950s. Simon Kuznets, an economist and Nobel laureate, had suggested that inequality in poor countries was just a phase. He believed that inequality would take a backseat as these nations grew and developed economically. And now, the last four decades have seen further change and shifts in global economic inequality. That process is still underway. The chatter around income, wage, economic and social inequality has been nothing short of intense.

And guess what? This intensity is not dying down anytime soon. The ongoing round of G20 discussions under the Brazilian presidency are discussing global inequality. The latest edition of the United Nations Human Development Report shows that when you factor in inequality, the Human Development Index score takes a hit for every country. What is going on? How did the world become so unequal? And what can we expect from the future? Does higher growth really mean more equality? Or is it time to reposition the debate on economic inequality? Why has economic inequality become a global challenge that is perhaps on par with the lack of climate resilience challenge? We have a lot more to understand and discuss. And I turn to my guest, who has just published a thought-provoking essay covering many of the issues for some answers and insights.

Welcome, Shekhar. It is great to have you with us. For the listeners of NCAER podcast series, Shekar Aiyar is a Visiting Professor at NCAER, a non-resident fellow at Bruegel, a European think tank, and a visiting scholar at Johns Hopkins University in the United States. The essay that I mention has a rather long-winded and perhaps an enigmatic title. Income inequality and the liberal economic order are not entirely Western perspective. You can find the link to the essay in our podcast show notes. Shekhar, we have a lot to unpack today. I was wondering if we can kick off things first on a personal note. I can almost feel the curiosity buzzing among our listeners about you. Share with us a bit about your journey as an international macroeconomist. What drew you to this field? And do you see the role of international macroeconomists in shaping the future of emerging markets and more broadly, the global south?

SA:

Thank you, Udaibir. It's such a pleasure to be here. Thank you for having me on. So, I guess, you know, if you're asking about my own journey, one place to start might be this famous quotation from Robert Lucas, the Nobel Laureate, who said that once you start thinking about economic growth, it's hard to think about anything else. The per capita income of Luxembourg, which is about $140,000 a year, is more than 800 times the per capita income of Burundi. So, from the point of view of human welfare, nothing is more important than understanding why that is the case and figuring out what policies are needed for living standards everywhere to converge to the West. So, I've always been fascinated with economic growth, and that's what I studied during my PhD at Brown University. And after defending my thesis, I joined the IMF, which is the main multilateral institution for analysing macroeconomic imbalances around the world and for giving policy advice to member-countries. Macroeconomic stability, in my view, is a prerequisite, a necessary condition for economic growth. You certainly aren't going to get growth if the economy is in a balance of payments crisis or if hyperinflation is threatening or if the debt is looming so large that it prevents the normal functioning of the economy. So, my part has really just been an outgrowth of my intellectual interests.

UD:

Thank you, Shekhar, for sharing your story with our listeners. I fully agree with you that it is rather hard these days to discuss anything without considering what is happening around us. The world is constantly changing, and in fact, influencing decisions by governments, businesses, and households. And in that context, international and international macro assumes a very critical function. Of course, this interlinkage or interconnection has both intended and unintended consequences. But let's talk about your essay. So, you have, I must say, really dived deep into a complex issue. And I believe it's going to be a chapter in your upcoming book on defending the liberal economic order.

So, when you talk about the liberal economic order in your essay, I was wondering what exactly do you mean, because there was a study done by IMF economists back in 2016 where they pointed out that while neoliberal policies have had their benefits, they have also led to increases in inequality. And this inequality, ironically, undercuts growth, the very thing that the neoliberal agenda aims to boost. So, what is your take on this, Shekhar? I mean, do you see things differently?

SA:

So, there are probably as many definitions of the liberal economic order as there are economists. But I think it's fair to say that most would agree on a set of distinctive features-- market-based economic activity, private entrepreneurship, and a legal system that impartially enforces contracts between consenting parties. What about the government's role? It's not to micromanage economic production or to second guess the price mechanism, but rather to step in when markets fail, for example, to curb monopolies, to provide public goods and to try to reduce inequality of opportunity among citizens. Generally speaking, liberal economies will seek to engage in free trade. They will do so without favouring domestic firms over foreign firms. They will be welcoming of new ideas and new immigrants. On the international stage, they would be adhering to a rules-based system of dispute resolution and crisis management, even when this system produces outcomes which are not to their liking.

Now, clearly the way that I've described it, that is the ideal. It's not the reality. But the ideal itself has had a profound influence on the organization and institutions of both Western countries and non-Western countries for many decades. So, following the end of the Cold War and the reforms of Deng Xiaoping in China, something like a universal consensus built up around this liberal economic order, even a sense of inevitability, a la Francis Fukuyama, who you will remember, wrote this book called ‘The End of History’. Many countries that were part of the Soviet bloc or were part of the Global South and used to be very enamoured of import substitution and state-led development now aspire towards the liberal ideal.

The picture has completely changed. The liberal economic order is under attack from both left and right on both sides of the Atlantic. Protectionism is on the rise. Non-tariff barriers are being imposed at an extraordinary rate. Immigration is being assailed and demonized. And the old idea of industrial policy is now enjoying a renaissance. Many politicians view trade simply as shorthand for losing manufacturing jobs to low wage competition and to rising inequality within their societies. There's almost a cross-party consensus on turning away from liberal economic principles. And I argue in my book that this is wrong and it's deeply worrying.

UD:

Absolutely, Shekhar. I mean, this tug of war between liberalism and realism is no small matter. In fact, it's like watching a high-stakes chess match unfold. And isn't it that documenting the demise of the liberal international order has become almost a growth industry? Just pick up a list of the most written and read non-fiction books on issues of economy or political economy and see for yourself. It's like everyone has joined the bandwagon. Indeed, I vividly remember when was it, back in 1889, when Francis Foucault declared the triumph of liberalism over its collectivist rivals. And thereafter, critics jumped in and started writing and penning its eulogy, talking about a plot twist. Shekhar, there is something in your essay title that is intriguing me, and it caught my eye. You say not entirely Western perspective. Shed some light on what you mean by that.

SA:

So, this is the departure point for my book. Most of the public discourse about the liberal economic order comes from a very Western perspective, with much less attention paid to the perspective of the Global South, which numerically is far more people, far, far greater proportion of the global population. There's lots of focus in the public discourse on lost manufacturing jobs and rising income inequality within rich countries. But not nearly enough, say, on the opportunities for economic growth and poverty reduction that is offered by the liberal economic order to developing countries. So, my book is an attempt to defend liberal economic principles from the viewpoint of the Global South. So, it's very different from other books, let's say, written by Martin Wolf or Joseph Stiglitz or Danny Roderick.

UD:

Very interesting. And I can now see much more clearly than I did before as to why and how you are seeking to create your own niche in this rather researched and written about topic. I suppose the question that comes up is, how does this perspective that you've just enunciated apply to global inequality? And why is it relevant to a discussion on global inequality?

SA:

It's very simple. Global inequality has fallen sharply over the last few decades, and this is primarily because of the rise of two gigantic countries- China and India. So, what does this mean exactly? Branko Milanovic and his colleagues have created a global income distribution. And they do this by taking national surveys on income distributions and putting them together and making sure that the national surveys are comparable with each other in terms of reflecting real purchasing power and accounting for exchange rate differentials and inflation differentials.

If you look carefully at this global income distribution over several decades, a very interesting pattern emerges. The slowest rate of income growth is at the high end of this distribution, between the 75th and 85th percentiles. Who are these people? Mainly blue-collar workers in rich countries who are incredibly well-off by global standards, even if they are not regarded as particularly affluent within their own countries. On the other hand, there's been very robust growth between the 10th and 70th percentiles, and the fastest rate of growth is near the middle of the distribution. Who are these people? Well, these people are mainly workers in China and India and other developing countries, who started out at a much lower position in the global income distribution, but have made rapid gains over the last few decades. In other words, there's been a relative loss of income and status for a set of people who are extraordinarily privileged by global standards and a relative gain of income and status for a vast number of much poorer people. That is a massive improvement in the global income distribution, something to be celebrated, not mourned.

As I point out in the essay, a lot of it is simply driven by two countries, China and India, because these countries comprise two fifths of the global population. In 1980, just to step back a little, the US and Western Europe, with a mere 15% of the global population, accounted for about 50% of world GDP. China and India accounted for 40 per cent of the population. So, you can see how extreme the inequality used to be.

Now, fast forward to 2020 and China and India now account for about the same share of world GDP, about 30 percent, as the Western countries. So, there's been an enormous improvement in equality between countries. And quantitatively speaking, this more than outweighs the increase in 'within country' inequality in Western countries.

UD:

Shekhar, it'll be good to hear what really happened in your view in China and India that caused their growth trajectories to change and therefore global inequality to start to fall.

SA:

Yes, this is a very good question. And I suppose that in some sense, we probably have a common memory of those days. If you go back to the

1970s, both China and India were insular, plodding economies with a dominant role for the state. China was just recovering from two of Chairman Mao's disasters-- the Great Leap Forward, which led to a famine that took the lives of 30 million people, and the Cultural Revolution, which upended society and expelled intellectuals to hard labour in camps in the rural hinterland.

At the same time, in India, you had the ‘Licence, Quota, Permit Raj’, which governed every aspect of the economy. The commanding heights of the economy, you know, vital industrial sectors like steel and energy and mining were reserved for state monopolies. You had these Soviet-style five-year plans which sought to promote rapid industrialization by channelling resources into favoured sectors. You had the mantra of import substitution, which resulted in the world's highest tariff rates, a host of inefficient domestic producers and close to zero trade. So, all of this fundamentally changed in China in the late 1970s and with a gap of about a decade in India. So, in China, Deng Xiaoping came to power, introduced wide ranging market-oriented reforms starting in 1978. Land ownership was de-collectivized. A little bit of private enterprise started to be allowed, and the sphere of private enterprise gradually became larger and larger. Many state enterprises were allowed to fail rather than being kept artificially afloat. This was accompanied by a larger opening up to the world. The state established a number of these special economic zones with much lighter regulation, and these special economic zones, especially the one in Shenzhen, flourished beyond any expectations.

All of this culminated in protectionist barriers coming down, tariffs being liberalized, and finally China joining the WTO in 2001. In India, you can go back to the Rajiv Gandhi government in the mid-1980s, which introduced a number of liberalizing reforms, including abolishing licensing for the imports of machinery and intermediate goods. But really, the root and branch reform started in 1991, when India had a Balance of Payments crisis. You had the government of Narasimha Rao with a very technocratic finance minister, Manmohan Singh, and they came in and basically swept away industrial licensing altogether. Loosely speaking, India shifted from a mindset of everything that is not specifically allowed is forbidden to one of everything that is not specifically forbidden is allowed. Public sector monopolies were swept away, automatic approval for FDI up to 51%, and at the same time, a massive liberalization of trade ... I mentioned that tariff rates were the highest in the world. In 1991, the top tariff rate was 355%. This had fallen to 25% by 2023. Then the exchange rate was liberalized in stages, allowing the rupee to move towards its market-determined rate and removing this artificial penalty that an overvalued exchange rate has on exporters. So, the results, as we all know, were dramatic in both countries. There were much higher rates of growth post-liberalization in both countries.

And in India, this fatalistic idea that such a large and complex economy can only grow at the so-called Hindu rate of growth was definitively exploded. So, I mean, I don't want to bore you with a statistical analysis of how the growth rate changed exactly, but look at the number of years that it takes to double per capita incomes. That fell in India from 46 years pre-liberalization to 17 years post-liberalization. In China, the time was cut from 26 years to a mere nine years. So, to put those numbers in perspective, by the time a child reaches the age of majority in India, she can expect twice the income that her parents earned when she was born. In China, she can expect four times that amount. So, there's been an immense improvement in living standards.

UD:

And if I can sort of ask you to extend what you're enunciating, what did this do to inequality in China and India?

SA:

So, inequality increased. If you look at the Gini coefficient, which economists use to measure the degree of inequality in income distribution, it increased gradually from the start of liberalization till about 2009, till the global financial crisis. Since then, it has fallen again, but not back to pre-liberalization levels. But I would argue that the Gini coefficient is not the best way to look at inequality in China and India, because the high rates of growth that we talked about a bit earlier mean that even those at the bottom of the income distribution are seeing enormous improvements to their living standards.

Across every decile of the income distribution, growth in India and China has been much faster than the corresponding global decile. The most dramatic evidence of this is, in fact, at the bottom of the income distribution. The number of people living in absolute poverty, which the World Bank defines as less than $2.15 a day.

The steep fall in the number of people living in absolute poverty in China and India since liberalization must count as one of the most sweeping and dramatic improvements in human welfare in the history of the world. In China, more than 90% of the population lived in absolute poverty in 1981. Today, the fraction is close to zero. In India, the poverty had declined from well above 60% in 1977 to just above 10% today. You know, to put some absolute numbers on that, the number of people that were lifted out of poverty in the two countries together was an astonishing 1.1 billion people over the last four decades, so that is 85 percent of the total global poverty reduction of 1.3 billion people that occurred over the period.

UD:

So, Shekhar, let's sort of change tack and move away from the story of China and India. There is a lot being written about income inequality in the US and other rich countries. Would you like to say anything about that?

SA:

Yes, Udaibir. So, indeed, there's a lot of concern about income inequality within Western countries. And I think that is perfectly justified because income inequality in the West is fundamentally different from India and China in the sense that incomes at the bottom are stagnating. And this is the subject of much public discourse. People like Martin Wolf have written a book on this subject called ‘The Crisis of Democratic Capitalism’. And that's largely about rising inequality in rich countries. You look at the labour share of income in western countries that has fallen steeply over time, suggesting that most of the gains from growth are accruing to the owners of capital rather than to workers and even though average incomes are rising because the top earners in society are getting richer very quickly, more than half the households in the OECD actually report flat or falling incomes. So, this is an extraordinary period of rising inequality in the West. Just to give you one statistic, which is kind of jaw-dropping. In 1965 in the US, the average CEO earned about 21 times the compensation of a factory worker. Today that multiple has exploded to 344. So, what can be done?

I would argue that plenty can be done to redistribute income and to make sure that every child has equal opportunities in terms of schooling and healthcare. One idea is universal basic income. This comes in many varieties and some varieties can be very expensive to implement. But as I show in my essay, you know, for a country like the US, you could put in place a UBI that basically abolishes deep poverty while keeping social spending at a level which is very comparable to what European countries are already doing. Apart from a UBI, there are many other measures that could be considered. Public assistance for workers facing unemployment. This can be done through wage insurance or other types of targeted assistance.

At the end of the day, these are the richest societies in the history of the world. And they have ample resources with which to reduce inequality from currently unacceptable levels. And they can and should do this without jettisoning the system that made this extraordinary affluence possible. So, retreating into protectionism and immigrant-bashing will only make these societies poorer and will make it harder, not easier, to tackle inequality.

UD:

I see. So help me out with this one, Shekhar. If there is excellent progress in some parts of the world, like China and India, but at the same time, inequality in the West is soaring, how does one judge whether this is an improvement or not?

SA:

So, there was an American philosopher called John Rawls who thought about how to choose between states of the world when there are many people with many different types of preferences and some are better off and some are worse off. And what he said was, imagine that you are behind a veil of ignorance. You know nothing about your own attributes. You don't know if you are male or female, young or old, Chinese or American, rich or poor. From behind this veil of ignorance, which state of the world would you choose?

So, let's apply that Rawlsian test to the world of the 1970s, before the liberal reforms in China and India, versus the world of today, which society would you choose to inhabit if you knew nothing about your own attributes? I think the answer is very clear. You would choose today's world. You have a two fifth chance of being Chinese or Indian from behind the veil of ignorance and you only have a 120th chance of being an American. So even if you think that conditions in America, say, have deteriorated, that should be completely outweighed by the enormous improvement in your living prospects for any random person living in India or China.

In a way, this argument simply takes us back to the global income distribution that I mentioned at the start of this podcast. Yes, if you're a Western blue-collar worker, you may have lost relative income and status, but this is a tiny sliver of the global population. Much greater numbers of much poorer people have benefited enormously over the last 50 years.

UD:

Very good. Shekhar, now let's turn to... what I call the hard talk segment of this podcast. And I hope you are ready to take my questions and hopefully shoot back at them. So here we go. I mean, after reading your essay, I asked myself that, do you not overlook the significant increase in domestic income inequality within many countries? And of course, the profound social and political implications by stressing the success in reduction in global income inequality. So that's my first point. The second is that in the essay, you also argue against jettisoning the liberal economic order despite rising income inequality in several countries. Is not the liberal economic order itself contributing to inequality and must be reformed? And finally, on protectionism, you say that protectionism is not the answer to rising income inequality. But then we know that there are others who argue that certain protectionism or industrial policy reforms must be part of a strategy to address disparities. How would you like to respond?

SA:

These are excellent points. I think I've already answered your first question. So, let me take the points about whether we should jettison the liberal economic order and embrace protectionism, because this is exactly the argument that is being made right now in many Western countries. In my view, protectionism is the worst possible response for many reasons.

First of all, tariffs are regressive. So, when you look at low-income people in rich countries, they spend a much larger share of their household budget on imports than the high-income people. Think about Walmart, which is this massive chain of cheap supermarkets all over the US. It's often filled with items that are made abroad in China, Vietnam, Cambodia, and other low-income countries. The people who shop there tend to be low-income, not high-income. And these are the people who would be most badly hit by higher import tax.

Second, far from protecting jobs, tariffs tend to destroy them. So, take the example of the Trump tariffs on China. Starting in 2018, the Trump Administration increased tariffs on a range of goods, including washing machines, solar panels, steel, several other products from China. Some jobs were indeed saved in certain sectors. So, if you look at the evidence, maybe 1,800 jobs were associated with the tariffs in companies like

Samsung and Whirlpool. But in terms of the cost of the jobs, in terms of the cost to the American consumer of higher prices, each such job is estimated to have cost $817,000. Moreover, overall employment fell as a result of the tariffs because the job losses in other sectors, which depended on cheap inputs, which were now more expensive, more than outweighed whatever jobs were saved in the targeted sectors.

Meanwhile, China and other countries retaliated forcefully. For example, China imposed a 25% tariff on soya beans, which induced Chinese customers to switch to Brazilian producers. And there was a 74% plunge in American exports of soya beans to China. Again, when you look at economic estimates of the damage in terms of jobs, just that retaliatory measure alone accounts for more job losses than all the jobs that were saved in certain favourite sectors. So, while protectionism may play well to the gallery, it is both regressive and ineffective. It would be much better to focus on some of the areas I mentioned earlier, like a universal basic income, wage insurance, unemployment assistance, the provision of high-quality schooling and health care for every child. These measures may be less glamorous, but they are far more effective than protectionism.

UD:

Thanks, Shekhar. At this point, I would like to move our conversation towards something that is close to my own heart and work that I've done. One aspect that often gets mentioned in the international literature is economic inequality's relationship with finance and money. Some research suggests that inequality deepens where financial systems deepen. And then there are others who say that it leads to opportunities and tightens income distribution, primarily by boosting the incomes of people experiencing poverty. How does this interplay between economic inequality and financial sector surface in your work? Do you have any views on this?

SA:

There's no doubt that financial deepening is an essential component of creating equality of opportunity. Ultimately, you want a credit system that gives loans to people with good business ideas, not just to well-connected, affluent people who are members of the Gymkhana Club. And imagine an unbanked person getting access to a bank account. This is something that can be life-changing in terms of connecting them and giving them access to the formal modern economy.

I haven't worked directly in this area myself, but indirectly, some of my work has been on productivity spillovers from foreign direct investment. And in that literature, there is a lot of evidence that if you want to maximize the benefits of FDI, that happens in host countries which have deep and sophisticated financial systems. This allows the spillovers from FDI to kind of percolate very broadly in the economy and benefit from open.

UD:

I see. We are sort of getting to the end of this episode and I'm mindful that many of our listeners are budding economists and perhaps even passionate researchers. And the world of economic inequality that we have been conversing about is like an uncharted territory waiting to be explored by them. So, we all know, for example, how much more work is needed on data metrics and measurement of inequality. But what about other parts that are less travelled? Could you sort of throw some light on overlooked areas or where fresh perspectives would help?

And of course, how could listeners who are interested in this could dive into these areas and will it really help to better understand the many faces of economic disparity? I mean, I just want to say one quick thing here that let us not forget that in the context of emerging markets and developing nations, I mean, they have some very idiosyncratic socioeconomic landscapes and an obvious question is that if more work has to be done by upcoming researchers and economists, then, you know, do the traditional questions, should they be tweaked or extended so that they can take these special idiosyncrasies into account? Any thoughts, Shekhar?

SA:

I think that there is often too little focus in the global debate on the development prospects of emerging economies, for which things like FDI and a liberal international trading system can be crucial. If many rich countries now turn away from liberalism and embrace protectionism, then the worst consequences are not going to fall on rich countries, which afterall are already rich. They will fall on developing countries. So, there's this well-trodden ladder of development scaled by several countries in the past, which will no longer be available to low-income countries in the future. I think more work is needed to explore the costs for global human welfare and how best to mitigate those costs if indeed we enter a new era of protection and industrial policy. And I hope that my book will spark further interest in this topic, through both an academic and a policy lens.

UD:

Excellent. I think that's precisely the point where we have to sort of bring this conversation to a close. And I dare say that I have learned a lot and it's been very illuminating. Your sort of insights have been nothing short of enlightening. I agree that sort of what comes out of this is that inequality in many ways is like a beast with many faces. And we can see through different lenses. We can see through a country lens only or a regional lens or a global lens. And each of the lenses provide us a unique view, showing us different scales and factors at play. And of course, each one calls for its own set of policy responses. So, I hope you agree, Shekhar, and as you were trying to finish your book, that finding the right balance between these perspectives is key for emerging markets and fast-growing nations like India. So, I just want to say, Shekhar, let me wish you all the best for your book. Some of our listeners and I are just waiting to get our hands on it. And once we have had a chance to read its pages, perhaps we'll get together again and discuss the other themes you are covering in your book. Thank you, Shekhar.

SA:

Thank you very much, Udaibir. That was great fun and I hope we get an opportunity to talk again soon.

UD:

And that wraps up this episode of NCAER podcast. Thank you for joining us. In the spirit of ‘involve me and I learn’, we encourage you to engage with us. We want to hear from you whether you enjoyed listening to the podcast or would like to suggest modifications or wish to join the debate and air your views. We are open to new ideas and topics we could consider for the future episodes of NCAER Podcast. Write to us at ncaer.org and follow NCAER's social media handles and bookmark them for quick access.

Until we meet next, keep exploring, keep questioning, keep learning, and keep wondering. Remember, economics and finance are not just about numbers and models, but about people--you and me, and our behaviour and choices. So together, let us try and make sense of what's going on around us. See you the next time.