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Justice for All:
Defining and Measuring Inequality

This disposition to admire, and almost to worship, the rich and powerful, and to despise or, at least, neglect persons of poor and mean conditions, though necessary both to establish and to maintain the distinction of ranks and the order of society, is, at the same time, the great and most universal cause of the corruption of our moral sentiments.

—Adam Smith, *The Theory of Moral Sentiments* (1759)

When professional economists think about economic problems we generally start with the Pareto principle that a change is good if it makes someone better off without making anyone else worse off. . . . A change that increases the incomes of high-income individuals without decreasing the incomes of others meets that test: it makes some people better off without making anyone else worse off.

—Martin Feldstein, "Is Income Inequality Really a Problem?" (1998)

John Rawls (1921–2002) grew up in a family of modest means in Baltimore. His father lacked a law degree but managed to practice law and even argue before the Supreme Court, and his mother was a powerful advocate for women's rights. He initially aspired to become a minister but gave up that goal after serving as a combat infantryman in the South Pacific in World War II. Perhaps more influential on his life and sense of justice was the fact that during his youth two younger brothers died of infectious diseases that some biographies said were caught from him. Self-effacing and understated, Rawls often recalled that he turned to moral philosophy because he was not good enough in music or mathematics. It was in graduate school at Princeton that Rawls began his inquiry into the subject that preoccupied his career and led him to become the preeminent modern theoretician of justice.[1]

While teaching at Harvard, Rawls outlined his philosophical vision in his book *A Theory of Justice*, published in 1971. He later amplified that vision in his works *Political Liberalism* (1993) and *The Law of the Peoples* (1999).[2] Rawls set forth two major principles of justice: (1) an equitable social order must secure basic liberties for its citizens, and (2) any action taken by a society must not hurt the least well-off of its most vulnerable citizens. The attribute of social and economic justice, however, is evoked by what is known as Rawls's "difference principle," which holds that an unequal distribution of the benefits of a society is morally justified only if its worst-off members accept their own gain as a result.

This chapter discusses the importance of Rawls in the debate over economic justice and why he might have surprising things to say about the issue of inequality introduced in recent years—in US political discourse especially—by a parade of economic writers, most notably Thomas Piketty. Although lifting the lives of the poor and achieving economic equality throughout a society are not necessarily incompatible goals, they do not necessarily go hand in hand based on recent economic history. Indeed, economic justice may hinge more on lifting the lives of the poor than on eliminating inequality per se.

Rawls Redux

Rawls's noteworthy metaphor for thinking about justice was his definition of the so-called veil of ignorance—that is, the idea that the social arrangement must be acceptable to someone who would not be able to know where he or she was in the system. Thus citizens must accept a system only if it is predicated on their theoretically not knowing whether they would be its beneficiary or its disadvantaged party. Economists might compare the difference principle in such a society to the term *Pareto-optimal,* named after the Italian economist Vilfredo Pareto (1848–1923). A Pareto-optimal improvement posits an allocation of resources in which no one is made worse off even if some are better off. Rawls's insight was so striking that Robert Nozick, the libertarian critic of Rawls's philosophy and a proponent of the free exercise of personal liberty and property rights, paid homage to its importance. In his book *Anarchy, State, and Utopia* (1974), Nozick declared, "Political philosophers now must either work within Rawls' theory or explain why not."[3]

Although he is not considered a political philosopher, French economist Thomas Piketty's writings have certainly fostered a somewhat different perspective on economic justice, in part because his book *Capital in the Twenty-First Century* tapped into the zeitgeist created by the Occupy Wall Street movement's anger directed at "the 1 percent" of wealthiest Americans. Piketty's implicit assumption is that the most important measure of economic justice is income inequality rather than how the poor fare in a given society. Using reams of tax records and other statistical measures of wealth and income going back 200 years, Piketty argues that economic justice is weakened when the expansion of the wealthy class permits it to dominate the political system. He finds, for example, that the share of national income in the United States for the richest 1 percent grew from 9 percent in the 1970s to 20 percent in the decade 2000–2010, with inevitable consequences for the nature of US democracy.[4]

According to Piketty, the growing enrichment of those at the top derives from three sources: (1) the increasing share of income from salaries and wages paid to the super rich and corporate "super managers," accounting for two-thirds of inequality in the United States; (2) the disproportionate share of capital held by those at the top of the ladder; and (3) the increasing share of national incomes derived from capital as opposed to wages and salaries. In particular, Piketty focuses on what he calls "patrimonial capitalism"—that is, the fact that owners of assets—whether equity, bonds, retirement accounts, homes, or other kinds of property—have become a larger portion of society than wage earners owning and saving little or nothing. These disparities, he asserts, "radically undermine the meritocratic values on which democratic societies are based."[5]

Is it too much to say that Rawls and Piketty symbolize two schools of thought about the nature of economic justice? Not really.

Rawls has spawned a variety of critics. On the one hand, Nozick and other libertarians argue, as just noted, that inequality in society is an acceptable outcome of a system that allows its citizens to pursue their economic freedoms and reap the advantages of their talents, hard work, discipline, and gifts. Rawls and his supporters argue, on the other hand, that many of the rewards in such a system stem from luck, birth status, and other arbitrary advantages. A second line of criticism—advanced by Amartya Sen, the Nobel Laureate economist, among others—is that Rawls's definition of a just distribution of goods is overly restrictive because people have different wants, needs, and capabilities. Like Nozick, Sen has also argued that Rawls overlooks the obvious importance of a poor person's responsibility for his or her own state of affairs, or of the possibility that individuals, including the poor, may have goals other than economic gain or self-interest.[6] A third category of critics of Rawls, no less influential than the libertarians, belongs to the "communitarian" and "cosmopolitan" schools of thought, discussed later in this book, which hold that justice must also factor in loyalty to one's own community (communitarian) or to the world as a whole even if the effect on one's own community is detrimental (cosmopolitan).

Piketty's Charge: Sorting Through Different Definitions of Economic Justice

Of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution.

—Robert E. Lucas Jr., Nobel Laureate economist (2004)

In warning of a calamity or revolution if inequality is not addressed, Thomas Piketty has become heir to a tradition of economic doomsaying dating at least from Reverand Thomas Malthus, whose doctrines in the late 18th and early 19th centuries theorized that disaster was in the offing as population growth outstripped society's ability to feed the masses, especially the poor. Malthus's contemporary, David Ricardo, predicted equally pessimistically that landed elites would become increasingly and perhaps dangerously wealthy and dominant. And, of course, Karl Marx later forecast a system that would relentlessly enrich the owners of capital, impoverish the masses of workers, and spark a revolution of the proletariat. "Let the ruling classes tremble at a communist revolution," Marx and Friedrich Engels declared in their *Manifesto of the Communist Party* in 1848. "The proletarians have nothing to lose but their chains. They have a world to win."[7]

Piketty's goal is more analytical than prophetic. But he does explicitly make a case against what he terms the "fairy tale" put forward by the Nobel Laureate economist Simon Kuznets, who theorized in the 1950s that economic growth in the United States would lead to greater economic *equality*. In the first decades after World War II, the Kuznets theory seemed true, in part because so much wealth had been wiped out in the previous decades by the Great Depression and two world wars. But in recent decades, Piketty's evidence demonstrates, the trend in the United States and other advanced countries has gone back to the Gilded Age of the pre–World War I era. The top 10 percent of earners claimed 45–50 percent of national income in the 1910s and 1920s, for example. Their share dropped to 30–35 percent after World War II, but has now returned to what it was a century ago.

Piketty's central point revolves around the formula that r (return on capital) is and will continue to be 4–5 percent, whereas g (economic growth) is likely to remain stuck at about 2 percent. Thus with $r > g$ likely to prevail for the foreseeable future, capital becomes increasingly important, and the owners of capital will increasingly be those who inherited it rather than those who built it up in the first place. After its release, Piketty's book, *Capital in the Twenty-First Century,* was widely praised for its path-breaking assemblage of data. But some of that praise was qualified by questions about his methodology and even some of his basic assumptions. The *Financial Times* argued that flawed statistics and extrapolation led Piketty to conclude incorrectly that inequality had risen in Britain.[8] Conservative-leaning economists found additional grounds for dispute. Harvard professor Martin Feldstein contended that Piketty misread the US tax code as it applies to small business owners, in particular a revision that encourages individuals to shift their income out of taxable corporations and onto their personal tax returns, which would show an increase in their income on paper but not in reality.[9]

A noteworthy aspect of *Capital in the Twenty-First Century* is that, despite the title, Piketty's research reveals that two-thirds of inequality in the United States results from skewed labor compensation, not capital—that is, skyrocketing compensation for those in the top income brackets. Conservatives argue that such high-end earners are generally compensated in relation to the value they add to their companies and therefore the economy in general. "When a high-frequency trader figures out a way to respond to news a fraction of a second faster than his competitor, his vast personal reward may well exceed the social value of what he is producing," asserts economist Gregory Mankiw. "The key issue is the extent to which the high incomes of the top 1 percent reflect high productivity rather than some market imperfection. . . . My own reading of the evidence is that most of the very wealthy get that way by making substantial economic contributions, not by gaming the system or taking advantage of some market failure or the political process."[10]

But even among economists sympathetic to Piketty's concerns, questions have been raised about, for example, his certitude that $r > g$ would continue in the same proportion as in the past. Robert Solow, the Nobel Laureate economist, has said that "maybe a little skepticism is in order" in light of the probability that the rate of return may decline in the future.[11] Still others have cited a number of countries where $r > g$ has persisted for decades without increasing inequality. Lawrence Summers expressed "serious reservations" about Piketty's theories, contending that $r > g$ could easily be undermined by the dissipation of fortunes over generations and by returns being consumed rather than reinvested. "As capital accumulates, the incremental return on an additional unit of capital declines," Summers argued, contending that Piketty misread the literature on the subject.[12] Two widely cited studies by an economics graduate student at the Massachusetts Institute of Technology (MIT), Matthew Rognlie, also have found that Piketty greatly overstates the inevitability of growth in the returns from capital. Moreover, by breaking down capital into disaggregated categories, Rognlie has shown that the growth in both capital and wealth contributing to inequality (in the United States as well as in other developed countries) has been driven almost entirely by the housing sector—not the stocks, bonds, or other assets usually thought of as capital. Because housing is owned more broadly by the public, Rognlie has suggested that "the consequences for inequality may be less severe" than Piketty claims.[13]

An important shortcoming in Piketty's analysis is his exclusion of the impact of existing redistributive government programs such as food stamps, housing assistance, free health benefits, Pell grants for undergraduate education, income support (i.e., welfare), the earned income tax credit (EITC), heating subsidies, and other transfer payments that put cash or the equivalent in the pockets of low-income Americans. The Congressional Budget Office, in its measurements of inequality, has tried to compensate for these omissions and has shown that after the late 1970s Americans in the bottom fifth of the income ladder saw their incomes climb by almost 50 percent, whereas the incomes of Americans in the middle fifth grew by 36 percent. "To disregard the impact of transfers and progressive taxation on the distribution of income and family well-being is to ignore America's most expensive efforts to lessen the gap between the nation's rich, middle class, and poor," wrote Gary Burtless, a senior fellow and labor economist at the Brookings Institution.[14] A separate Brookings study found that, after adjusting for inflation, spending on the 10 biggest means-tested federal programs had increased from $126 billion in 1980 to $626 billion in 2012. Part of this increase was driven by an increase in the population and the number of poor people, but spending had increased from about $516 to $13,034 per person over the previous five decades, the Brookings study said.[15] Because the wealthiest 1 percent of Americans pay nearly a quarter of all federal taxes, one could well argue that, far from gaining greater political control as a result of their wealth, their tax dollars are being used to redistribute income to the poor and even the middle class through entitlement programs.

An even more deeply puzzling aspect of Piketty's work is his dismissal of the importance of investment in a modern industrial economy. His disdain is symbolized by his use of the word *rents* to describe all earnings derived from profits, dividends, interest, royalties, or capital gains, including the gain in value of one's home.[16] He acknowledges that the word *rents*—and the class of people the French would call *rentiers*—is used by economists nowadays to refer to "undue or unjustified income" derived from a monopoly or lack of competition.[17] But Piketty prefers to apply the term to any income other than that derived from labor, noting that over the centuries it has been considered "an affront to common sense" that people should earn income without working.[18] (The American usage would be "earned" versus "unearned" income, but most Americans would regard their pension income as "earned" over a lifetime of work.) Piketty thus dismisses the value of private investment in creating jobs—implying perhaps that the only legitimate investment should be undertaken by government or government-controlled companies—while he consigns people who work hard and use their earnings to save and invest, even pensioners, as a less legitimate sector of society. That sector is what he describes as rent seekers, *rentiers*, the "patrimonial class." The middle 40 percent of the national income range is labeled the "patrimonial middle class."[19]

Yet for many years economists and policymakers have worried that Americans do not save and invest sufficiently for themselves or for the nation, which needs their savings to invest productively in new businesses (thus the logic behind "supply side" tax cuts). Although it is true that the poorest half of the US population owns very little and cannot save or invest, the United States does not have the elaborate government pension systems that France or other European countries enjoy, and so Americans do have to save.

Piketty also rarely acknowledges or discusses whether capital can be a valuable thing. Nowhere does he address the argument that capital is needed to promote entrepreneurship, innovation, modernization, advances in technology, increases in productivity, and standards of living except in a backhanded way, such as when he notes that capital "is always risk-oriented and entrepreneurial, at least at its inception, yet it always tends to transform itself into rents as it accumulates in large enough amounts—that is its vocation, its logical destination."[20] So capital, in his view, starts out as legitimate but quickly ends up less so as it grows.

Piketty's writing seems laced with a bit of religious fervor that is reminiscent of ancient writings against profits. His bottom line is to consign all savers, pensioners, people with 401(k)s and other retirement systems, not to mention homeowners—that is, people who work hard during their working years and use their earnings to save and invest—as belonging to a less legitimate sector of society.[21] Indeed, Piketty's aversion to income earned from capital was likened by a reviewer in the *Wall Street Journal* to "an almost medieval hostility to the notion that financial capital earns a return."[22] Elsewhere, the columnist Clive Crook suggested that Piketty's message seems to be that inequality overwhelms all other moral imperatives or considerations, as if everyone is better off in a more equal society even if the poor are less well off. As Crook saw it, moreover, Piketty seemed almost ghoulishly nostalgic about the fact that greater equality in the postwar years resulted from the wiping out of wealth by two world wars and the Great Depression. "In the frame of this book, the two world wars struck blows for social justice because they interrupted the aggrandizement of capital," the columnist commented sarcastically. "We can't expect to be so lucky again."[23]

Piketty is not the only one to note the rise of income derived from capital as opposed to labor. In 2011 the Organization for Economic Cooperation and Development (OECD) reported that from the early 1990s to the late 2000s income from labor declined as a share of overall national income in virtually every advanced economy—in fact, more in other countries than in the United States. Specifically, it found that the median labor share of income dropped from 66.1 percent in the early 1990s to 61.7 percent in the late 2000s, following a trend that began 30 years ago. Blaming the forces of technology and globalization for causing the shift to capital, the OECD cited another factor as well, the privatization of many formerly government-owned companies, especially in energy, transportation, and telecommunications.[24] In another report, the OECD said, "Young people who see no future for themselves feel increasingly disenfranchised. They have now been joined by protesters who believe they are bearing the brunt of a crisis for which they have no responsibility, whereas people on high incomes appear to have been spared."[25]

However, there is much evidence that growth resulting from globalization and other factors has reduced inequality on a global scale, not increased it. In a rare admission but almost as a throwaway line, Piketty acknowledges as much: "To be sure, the very rapid growth of poor and emerging countries, especially China, may well prove to be a potent force for reducing inequalities at the global level."[26] As Branko Milanović, former lead economist at the World Bank's Development Research Group and more recently a visiting professor at the City University of New York Graduate Center, has demonstrated, those in the bottom third of the world's population except for the very poor, who earn as little as $1.25 a day, have become significantly better off in recent decades.[27] The gains have affected as well the middle third of the world's population and, of course, the very richest 1 percent. Left behind is the working class in advanced countries, which is the equivalent of the upper middle class on a global scale.

What all these figures add up to is a paradox economically, but also morally.

A pointed criticism that could be directed at the focus on inequality is that it leaves out Rawls's definition of an acceptable result: that it must help, or at least not hurt, the condition of those at the bottom of the income ladder. Leaving aside the condition of those at the very bottom, it appears that the majority of the world's poor are better off in recent decades, despite widening inequality within countries and in some cases among them. Does it matter that the rich are a lot better off if there is a payoff in the improved livelihoods of most of those at the bottom? Piketty argues that for all the gains in the economic status of the poor, their losses in a more unequal society derive from a diminished ability to participate in it. Even if a rising tide were to lift all boats, according to this view, there is a danger when it also widens the gap between rich and poor in poor countries. "I am not convinced . . . that the least advantaged would not choose truly equal opportunity over an increase in their relative income," argues Nancy Birdsall, president of the Center for Global Development. The dangers of inequality go beyond the moral challenge, she asserts—inequality not only dampens growth but also limits the equal opportunity necessary in a stable and democratic society.[28]

China offers an especially compelling case study. According to Thomas Pogge, professor of philosophy and international relations at Yale University and director of its Global Justice Program, China's growth in per capita income was a spectacular 236 percent from 1990 to 2004, but there was also "a stunning increase in inequality" over the same period. The national income share of the top 10 percent of the Chinese population rose from 25 to 35 percent in this period. By contrast, the share of the poorest 5 percent fell from 7.3 to 4.3 percent. On the other hand, the poorest fifth of the population saw their income grow by 98 percent over the14-year period. "Not bad at all," Pogge comments. But he adds that "China's poor paid a high price for it in terms of marginalization, humiliation, and oppression by the emerging economic elite whose greatly expanded share of Chinese household income gives them much greater opportunities to influence political decisions, to give unfair advantages to their children, and to dominate the poor in direct personal interactions. They would have been much better off with more equal economic growth, even if this would have been somewhat less rapid."[29]

It can, of course, be argued that the Chinese generally have better access to medical care and better life expectancies under their currently more unequal economic system. Indeed, there is empirical evidence that in China and other emerging-market economies, as opposed to more developed countries in the West, the very rich have added to economic efficiencies and job opportunities for the poor, especially peasants who had formerly eked out hard livings in the agriculture sector. The economist Caroline Freund of the Peterson Institute for International Economics studied the examples of hundreds of billionaires and concluded that in many countries their riches resulted from innovation, competition, and entrepreneurial genius rather than "rent-seeking" behavior or inheritances, as is often the case in the West.[30]

In recent years, some leading liberals in the United States have sought to defuse the sensitivity of the inequality issue by focusing more on helping the poor with government programs than on whether to tax the rich for having allegedly benefited excessively from the modern economy. For example, in 2015 Governor Andrew Cuomo of New York, in calling for a higher minimum wage, declared, "Some argue that we can close the income gap by pulling down the top. I believe we should do it by lifting up the bottom."[31] And as Senator Charles Schumer of New York, a Democrat who represents the nation's financial capital, has commented, Americans "don't mind if incomes of people at the top go up 20 percent as long as theirs go up 3 to 4 percent."[32] Bill Clinton has defended his presidency on the grounds that those at the lower end of the income scale improved their income status even as the rich may have benefited even more.

"You can say, 'Well, inequality has still increased,' because the top 1 percent did better," he commented at a forum on his presidency. "But I don't think there's much you could do about that unless you want to start jailing people."[33]

In fact, reinforcing this point of view, some evidence suggests that the incomes of the wealthiest Americans are so great that lifting the economic lives of the poor is not enough to reduce inequality. An analysis by the *New York Times* in 2015 revealed that if the United States had increased the minimum wage to $15 between 2009 and 2014, such a move would have been insufficient "to undo the escalation in the income gap" over that period. The reason, the *Times* said, is that the incomes of the top 10 percent of families "rose by much more over the same period." The conclusion reached was that "if reducing inequality is the goal, there's no alternative to slowing the income growth of the highest earners, say, by raising upper-income tax rates or limiting the favorable tax treatment of pay for corporate executives."[34]

Psychologists have weighed in on the issue of whether people in fact care more about equality than about elevating their own material well-being. A well-known survey of graduate students and staff members at the Harvard School of Public Health in the 1990s asked which status respondents would prefer: (1) earning $50,000 a year if their peers earned only $25,000 a year or (2) earning $100,000 if their peers earned $200,000. Perhaps surprisingly, 50 percent of the respondents preferred to earn a *lower* salary if it placed them at a *higher* level among their peers. "Many seemed to see life as an ongoing competition, in which not being ahead means falling behind," the study said. "In their view . . . a higher relative standing leads to such desirable outcomes as access to better jobs and education, improved marital prospects and the opportunity to pass these advantages to one's children. . . . Both absolute well-being and relative position seem to matter to people."[35]

The study noted its implications for public policy by quoting from a comment made by Martin Feldstein, former chairman of President Reagan's Council of Economic Advisers, who wondered why anyone would oppose a cut in the capital gains tax, since such a cut, while helping the rich, would not hurt the poor. "But benefits to the rich will hurt the poor if the poor, like everyone else, care about their relative standing," said the Harvard School of Public Health study. "The majority of respondents to our survey rejected the prospect of everyone becoming richer if it was accompanied by a fall in their own relative standing. For them, a policy that increased their absolute income but lowered their relative income did not make them feel better off."[36]

Other academic studies have addressed the same issue as the one at Harvard. In what is known as the "ultimatum game," a player is given $10 and told to bargain with another player (not known to the first player) over dividing up the money. If they do not agree, neither side gets to share the $10. Presumably, the first player might first offer the second $.01 and keep the $9.99. Why would the second player reject that offer? After all, he (or she) would be one penny richer. But in three experiments in one study, the minimum acceptable offer for the second player was $3 (or more). In other words, the second person would rather not have anything if it amounted to only a small portion of what was to be allocated. "The willingness of people to resist what they consider to be unfair allocations has implications for economics that go well beyond bargaining theory," observed Richard Thaler, behavioral economist at the University of Chicago. "In general, consumers may be unwilling to participate in an exchange in which the other party gets too large a share of the surplus. . . . *Homo economicus* is usually assumed to care about wealth more than such issues as fairness and justice. . . .The research on ultimatum games belies such easy characterizations."[37]

Measuring Inequality as a Symbol of Economic Injustice

This [inequality] is not the type of thing which a democratic society—a capitalist democratic society—can really accept without addressing.

—Alan Greenspan, testimony before the Joint Economic Committee, US Congress (2005)

How helpful are moralistic tenets in making judgments about the actual effects of globalization on the world's economic distribution? Has globalization produced the inequalities that critics claim? Inequality in the world economy, and within countries, can be criticized on moral, political, and ethical grounds. Morally, it clearly offends many people that there is such a wide chasm between rich and poor throughout the world. Politically, such inequality can give rise to instability, protest, and even war. Ethically, the question arises as to whether inequality is a necessary by-product of economic growth and the price that must be paid for a system based broadly on markets, trade, and investments. The evidence of the economic consequences of inequality is mixed and a matter of dispute, and that dispute is unlikely to be resolved by the evidence presented here. But one must begin somewhere, presenting at least some of the evidence.

To deepen understanding of a highly complex (and morally charged) issue, Milanović has applied analysis to three concepts of global inequality. Each is based not on dollar terms but on what economists call purchasing power parities (PPPs). PPPs are used instead of market exchange rates to convert currencies, which makes it possible to compare the output of economies and the welfare of their citizens in real terms—that is, controlling for differences in price levels.[38] Measured by the so-called Gini index, in which a value of 0 expresses total equality and 100 expresses maximum inequality, the three categories of inequality are as follows:

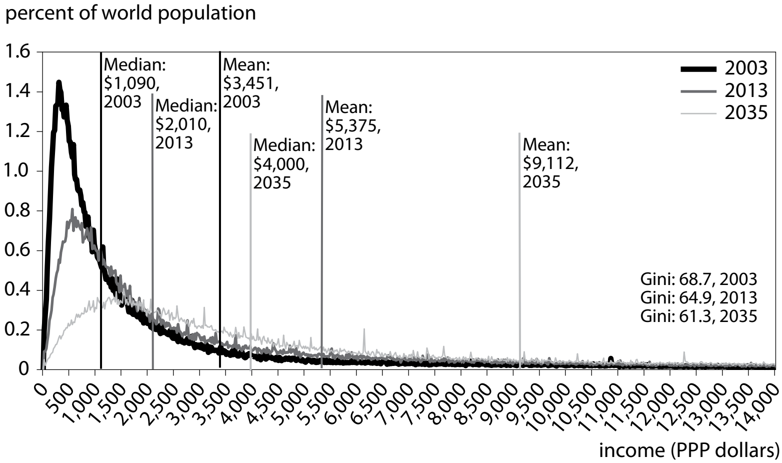
1. inequality between and among the world's nations, drawing on information from 150 countries, irrespective of the size of their populations,
2. inequality between and among the world's nations, weighted according to the size of their populations, and
3. inequality based on the condition of a cosmopolitan or "imaginary community" of all the world's individuals, irrespective of the nation in which they live.

Efforts to measure these types of inequality, along with the trend over time, have been hampered by a lack of data, particularly on households. In a 2013 update of his studies, Milanović found that inequality among nations, undifferentiated by size (first category), has *risen* in the era of globalization. In the second category, however, inequality has *declined*, largely because of the success of Brazil, China, India, Indonesia, and some other countries in achieving higher growth rates as a result of their integration into the global economy. Inequality among the world's citizens, undifferentiated by where they live (third category), can be calculated only from the mid-1980s because of the unavailability of comprehensive data. However, the trend shows a moderate *increase* in inequality after 1990 and a moderate *decrease* in inequality since the middle of the first decade of the 21st century. Thus over the last several years, says Milanović, "we see something that may be historically important: perhaps for the first time since the Industrial Revolution, there may have been a decline in global inequality. . . . [W]e do not know if the decline in global inequality will continue over the next decades. So far it is just a tiny drop, a kink in the trend, but it is indeed a hopeful sign. For the first time in almost 200 years—after a long period during which global inequality rose and then reached a very high plateau—it may be setting onto a downward path."[39]

A similar conclusion was reached in 2015 by Tomas Hellebrandt and Paolo Mauro of the Peterson Institute for International Economics. They studied household surveys in more than 100 countries and found that the Gini index of worldwide global inequality improved from 69 in 2003 to 65 in 2013. And it was projected to improve further to 61 in 2035, indicating that on a worldwide basis inequality was declining, not rising—again in large part because of gains in China, India, and sub-Saharan Africa (see figure 4.1). This future decline, they said, is likely to increase worldwide consumption or use of consumer goods such as cars and appliances and of food and natural resources.[40]

Taking a longer view, Milanović recognizes that global inequality has been a growing fact of life since the dawn of the Industrial Revolution and the first phase of the integrated global economy that reached a peak in the late 19th century. His findings force a rethinking of the earlier conclusions of Kuznets, whose empirical research, largely in the 1950s and 1960s, delineated the dramatic expansion of growth globally, starting in the mid-18th century. That expansion led to a remarkable new era of prosperity that the world—previously dependent on agriculture and before that on hunting, gathering, and fishing—had never before seen. The trend was driven by industrialization, of course, but also the growth of individual incomes and the resettlement of populations to take new jobs in the manufacturing and services sectors. Kuznets found, however, that in poor countries this growth had widened the gap between rich and poor. In wealthier countries, especially the United States, economic growth was producing greater economic *equality* and would continue to do so. Using what was deemed to be the best data available at the time, Kuznets put forward the comforting idea that in the new age of postwar prosperity, the rising tide not only lifted all boats, but also lifted them in fairly equal proportion. Kuznets

Figure 4.1 Economic growth brings millions out of poverty



Note: The percentage of world population for each $20 interval is reported on the vertical axis. Individual incomes on the horizontal axis are expressed in US dollars at 2011 international prices (purchasing power parity, PPP). Figure shows that in 2003 nearly half of the world's population had incomes of less than $1,000, adjusted for PPP. Their incomes increased to $2,000 in 2013. As economic growth brings millions out of poverty, the global income is more equitably distributed. This process is expected to continue into the future. The Gini index is the most commonly used measure of inequality in income or consumption expenditure. The index ranges from 0, which reflects complete equality, to 100, which indicates complete inequality (one person has all the income or consumption, while all others have none).

Sources: Tomas Hellebrandt and Paolo Mauro, *The Future of Worldwide Income Distribution*, Working Paper Series 15-7 (Washington: Peterson Institute for International Economics, April 2015). Forecasts for growth: Organization for Economic Cooperation and Development, Consensus Forecasts, International Monetary Fund/World Bank, and authors' forecasts; population projections: United Nations; household survey data on income distribution: Luxembourg Income Study (LIS) and World Bank.

acknowledged that much of his basis for this conclusion was speculative and even "wishful thinking."[41] However, his findings were certainly politically important in an era in which Communists were trying to denigrate the fruits of capitalism and threatening to bury the West economically.

Although in the first decades after World War II the Kuznets theory seemed true and thus was widely accepted, more recent data suggest that inequality within countries such as the United States has grown. Thus the issue of the stagnant or declining wages in the advanced countries has become a major cause of concern over the last several years, underscoring the existence of winners and losers.

The Winners

Living standards for hundreds of millions of the world's poorest people have risen in the globalization era. The World Bank estimates that nearly 2 billion people lived on less than $1.25 a day (World Bank's poverty line) in 1981, but that by 2008 that number had dropped to under 1.3 billion (even as the world population increased from 4.4 billion to 7 billion).[42] (A similar finding was reached by the International Labour Organization.[43]) A separate report at the end of 2014 by the World Bank and the IMF found that the share of the world's population living on $1.25 a day dropped from 36.4 percent in 1990 to 11.5 percent in 2015—and that this share was projected to drop to less than 5 percent by 2030, all because of global economic growth.[44]

According to development experts at the United Nations, these higher incomes have brought about dramatic improvements in health, education, and opportunity in recent decades.[45] The once-poor countries are now home to about 2 billion people earning $3,000 to $20,000 a year, which translates into $12 trillion of purchasing power, just a bit below the size of the US economy.[46] In 2015 the United Nations hailed the halving of the number of people living in poverty and the tripling of people in "the working class" since 1991 as "profound achievements" that had also promoted gender equality and reduced the child mortality rate by more than half.[47] A separate study projected that a billion people are likely to enter the global "consuming class" between 2010 and 2025. Six hundred million of this class are expected to live in 440 cities in emerging-market countries, where they will likely generate nearly half of global GDP growth between 2010 and 2025.[48]

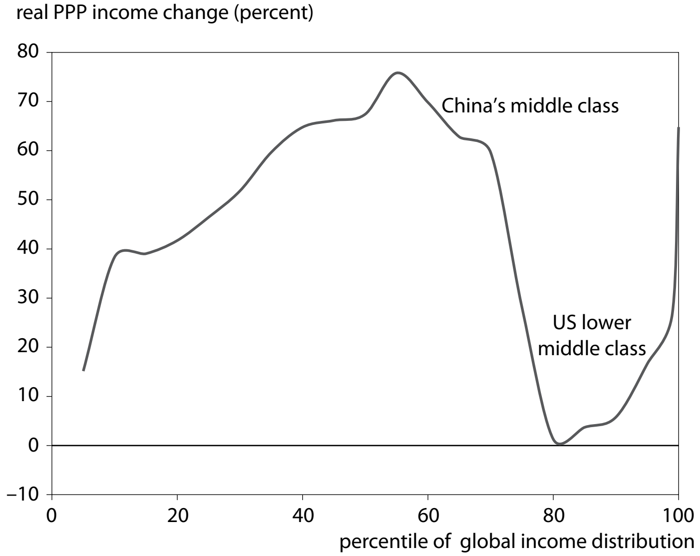
The McKinsey Global Institute estimates that by 2025, out of a projected 8.2 billion people around the world, 1.8 billion (more than 20 percent) will be part of this "consuming class," spending $30 trillion a year compared with $12 trillion today, thereby creating huge new demands for global production that could help nearly everyone.[49]

Immigration, another feature of globalization, is also believed to have brought benefits to poor countries. More than 200 million people have sought livelihoods outside the country of their birth, many of them sending remittances back home, in the process helping their families weather the storms of downturns, crises, stagnating poverty, and lack of opportunity.[50]

Thus there is clear evidence that over the last few decades globalization has fueled advances toward global equality, not inequality, even though there is greater inequality *within* the United States and many other countries, as documented in myriad other studies.

Milanović, for example, finds that the big winners over the last two decades have been the very wealthy in rich and poor countries alike, and also the hundreds of millions of people in the middle classes of emerging-market economies, especially Brazil, China, India, and Indonesia, who account for perhaps a third of the world's population (see figure 4.2). In addition, the bottom third of the global income distribution has also made "significant gains, with real incomes rising between over 40 percent and almost 70 percent."[51] An important exception is the very poor, or the poorest 5 percent of the world's population, even though the number falling under the World Bank's definition of "absolute poor"—those living on less than $1.25 per day in PPP dollars—has declined over the last two decades. Not that the number is anything to be satisfied with. According to the World Bank, nearly 1.3 billion people remain below

Figure 4.2 Globally, the middle class and the superrich gained the most while the upper middle class gained the least between 1988 and 2008



PPP = purchasing power parity

Note: The vertical axis shows the percentage change in real income measured in constant 2005 international dollars. The horizontal axis shows the percentile position in the global income distribution. The percentile positions run from 5 to 95 in increments of five, whereas the top 5 percent are divided into two groups: the top 9 percent and those between the 95th and 99th percentiles. The figure shows that those in the middle ranges of global income distribution—for example, the emerging global middle class—gained the most in those two decades. Those in the upper ranges of world income—but in the global upper middle class—gained the least. The super-rich in the world also gained the most.

Source: Christoph Lakner and Branko Milanović, *Global Income Distribution: From the Fall of the Berlin Wall to the Great Recession*, Policy Research Working Paper 6719 (Washington: World Bank, December 2013).

the extreme poverty line, living on $1.25 or less a day. Another 2.6 billion live on less than $2 a day.[52] All in all, the glaring inequities of the world economy remain shocking. A recent study by Oxfam concluded that nearly half of the world's wealth, or $110 trillion, was owned by the top 1 percent of the population. Indeed, "the bottom half of the world's population owns the same as the richest 85 people in the world."[53]

The Biggest Losers (or Nonwinners)

Along with the absolute poor, the biggest losers or biggest nonwinners in the era of globalization are those whose income is between the 75th and 90th percentiles of the global income distribution. This category applies to the working class or middle class of more advanced countries, particularly those in the former Soviet Union, whose welfare plummeted after the fall of communism. It is this category that also captures the wage and income stagnation and declines in the United States, which have become an urgent matter of concern for politicians and policymakers, many of whom eye globalization as the cause of these problems.

Thus a dramatic reshuffling has occurred in global income, with the evidence suggesting that globalization has contributed at least some of the change. With the exception of the very poor, the bottom third of the world's citizens have gained, with many of them escaping destitution. The middle third or more have become much richer, with their incomes growing at a remarkable 3 percent a year. The top 1 percent, and to a lesser extent the top 5 percent, have gained significantly. The next 20 percent down have gained very little or have had stagnant real incomes. They are at the high end of the world's income distribution because of the wealth of the United States, where even the poorest Americans have incomes higher than those of most of the world's population. But they represent the working class in the United States and other advanced countries.

Implications of a Mixed Bag of Winners and Losers

The mixed bag of winners and losers around the world raises profound questions about the relationship between equality and economic growth in the era of globalization—and between justice and liberty on the broadest possible scale. It would be easy to say that globalization-driven economic growth, underpinned by the freeing up of trade and investment, would be morally unacceptable if it benefited the rich and hurt the poor. But growth that benefits both the rich and the poor (leaving out the middle class in the developed world) is harder to assess on a moral scale. Even harder to assess is whether inequality is a necessary by-product of economic growth or an impediment to it. In other words, is the unequally distributed economic growth in the world today good for the poor?

Since Adam Smith and the dawn of capitalism, economists have agreed that wealth translates into capital investment, and that capital is one of the three primary factors of production, or inputs, that energize an economy. (The other two primary factors are land and labor.) The implication is that capital is essential to the equation because it spurs growth and jobs while providing incentives to investors. Thus the economist John Maynard Keynes, in his landmark *The General Theory of Employment, Interest, and Money,* observed in 1935 that "there is social and psychological justification for significant inequalities of incomes and wealth," although he insisted that the disparities in the Great Depression were not justifiable.† In light of the crucial role of wealth and

† Keynes argued, for example, that it was better for humankind that "dangerous human proclivities" be channeled into wealth accumulation rather than finding "their outlet in cruelty, the reckless pursuit of personal power and authority, and other forms of self-aggrandisement." John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (1935), chap. 24.

investment in an economy, conservatives and libertarians therefore contend that government and tax policy must encourage the accumulation of capital, or wealth, as a force for job creation and as a hallmark of economic liberty.

A 2013 study by the World Bank argued that because of the recent unprecedented economic gains for the world's poorest people, economic growth in the era of globalization has been good for the poor.[54] The Bank reported that absolute poverty has fallen dramatically in the developing world over the most recent three decades. In 1980, 52 percent of the world's population lived below the World Bank's poverty line, defined as $1.25 a day. By 1990 the incidence of poverty had fallen to 42 percent, and then to 21 percent in 2010. Based on these favorable trends, the World Bank broadened its focus to helping those in the bottom 40 percent, not simply those below the poverty line. The Bank's study of 118 countries over four decades concluded that the bottom 20 percent and 40 percent tended to grow economically in proportion to overall economic growth. "The result holds across decades, including in the 2000s—hence the conclusion that 'growth still is good for the poor.'" The study did find that growth was somewhat better than average in Latin America and somewhat worse in Asia, but that growth at the bottom did rise along with the tide that lifted all boats. However, it did arrive at an even more important and startling conclusion: Measured on a country-by-country basis, the fact that so many previously poor countries had lifted themselves out of poverty and achieved economic gains indicated that "there is no worldwide trend towards greater inequality."[55]

Many economists support the "growth is good for the poor" axiom, even when such growth also heavily benefits the rich. "More people have exited poverty globally in the past 30 years than in all of prior human history, precisely because the rich world steadily grew at potential rates for most of the time," Adam Posen, president of the Peterson Institute for International Economics, wrote in a debate in the *Economist* in 2015. "That rich-country growth led to the diffusion of innovation to poorer countries and the expansion of markets for their exports."[56] Lawrence Summers, while serving as Treasury secretary, tried to make the same point in a speech in 2000 at Oberlin College, although he was drowned out by protesters. "No country has achieved significant and lasting reductions in poverty without rapid economic growth," he declared. "No country has grown rapidly in the past 50 years without substantial growth in exports, supported by integration with the global economy and a move to accept the norms of the global marketplace."[57] Summers later told an interviewer that jobs created by globalization for poor people represented the best opportunities they had ever had. "There are children who are working in textile businesses in Asia who would be prostitutes on the streets if they did not have those jobs," he said. "Of course we should be appalled by, revolted by, and turn absolutely against slave or coerced labor of any kind, but where goods are produced by workers who are free and who make their choices, [it] seems to me very wrong for us to say that those choices are wrong and to limit them."[58]

Accordingly, as a simple matter of moral justice, some economists argue that it is misplaced to concentrate on equality rather than poverty reduction. Martin Feldstein calls such priorities "spiteful egalitarianism," arguing that a result that makes everyone better off without making the poorest worst off is morally acceptable. (This is not to say, Feldstein notes, that tax and spending programs that redistribute income further to the poor are inappropriate.[59]) "Inequality of outcomes is said to be the Achilles Heel of globalization," adds Anne Krueger, the former first deputy managing director of the International Monetary Fund. "This characterization is misleading in several respects. At the very outset, one has to wonder about the preoccupation with inequality . . . . Poor people are desperate to improve their material conditions in absolute terms rather than to march up the income distribution. Hence it seems far better to focus on impoverishment than on inequality."[60]

Yet the evidence that excessive inequality does indeed impede growth has grown in recent years. A series of empirical studies by the staff of the IMF have led to the conclusion that lengthy periods of economic growth are "robustly associated with" more rather than less equality in income distribution, for example. "Some inequality is integral to the functioning of a market economy and the incentives needed for investment and growth," said one such study in 2011, echoing the long-standing view of economists since the rise of capitalism. "But inequality can also be destructive to growth, for example, by amplifying the risk of crisis or making it difficult for the poor to invest in education."[61] The staff paper concedes that some efforts to help the poor and reduce inequality can impede growth, an echo of the Arthur Okun axiom of the "leaky bucket" in which some of the money transferred from the rich to the poor simply disappears in transit. The evidence is mixed as to whether growth is good for equality, or equality is good for growth, the study says. But on balance, it finds that "attention to inequality can bring significant longer-run benefits for growth."[62]

Echoing that point, the Nobel Laureate economist Joseph Stiglitz has argued that inequality has been a significant factor in holding back the recovery in the United States. He asserts that because of inequality, the middle class is too weak to support consumer spending, invest in the future of their children, and generate tax revenues, and their excessive borrowing has contributed to the volatility America's economic performance.[63] Similarly, Raghuram Rajan, governor of the Reserve Bank of India since 2013 and a former chief economist at the IMF, contends that increased inequality helped precipitate the Great Recession by encouraging people to go too deeply into debt, only to suffer the consequences when the housing and debt bubbles burst in 2008.[64]

Does this mean that government efforts to reduce inequality will work and will automatically produce greater growth? Not necessarily. Not only are many programs aimed at alleviating inequality compatible with economic growth, but they can actually encourage growth. "Poorly designed" programs intended to aid the poor, such as massive subsidies for consumers and for inefficient state-owned enterprises or restrictions on certain economic activities, however, can undermine growth *and* hurt the poor. In such cases, "inequality may impede growth at least in part *because* it calls for efforts to redistribute that themselves undercut growth," such as imposing high taxes, regulations, and wasteful subsidies, according to IMF studies, which argue that the best way to help the poor without introducing costly inefficiencies into the economy is to improve infrastructure and access to education and health care for the poor.[65] The United States and other advanced countries seeking to do the same should, meanwhile, consolidate social assistance programs to target the neediest, offer more cash transfer programs, improve pensions and education and health programs, as well as implement a more progressive income tax system.[66] Not everyone favoring such programs agrees that they come without a tradeoff, however. Douglas Elmendorf, former director of the Congressional Budget Office, has evoked Okun's leaky bucket and cautioned that paying for worthwhile government programs might require more borrowing, higher taxes, or lower government spending for other purposes. "Those changes might well *hamper* growth or equity," he said.[67]

The Bottom Line?

Piketty's book presents a number of proposals for leveling off inequality, suggesting that there is an overriding interest in curbing the growth of wealth and capital as a public good in individual countries as well as the world as a whole. Staff experts at the International Monetary Fund argue similarly that rich and poor countries should adopt tax, fiscal, and regulatory policies that curb the power and wealth of those at the top of the ladder while distributing help to the lower half so they have greater opportunities to gain in their societies. Whether the use of taxes to curb the influence of capital is workable is a matter of dispute. Instead of advocating curbs on the expansion of economic globalization or technological progress, the OECD recommends investing in *human* capital to counter the trend, reducing school dropouts, and promoting tax and transfer policies to help those at the lower end.

There is no doubt that inequality matters, even if its injustice results from what Martin Wolf, the *Financial Times* columnist and editor, calls a "just process" such as economic liberty. And despite inequality, many poor people around the world in increasingly unequal societies are better off than they used to be, and many struggling Americans have a higher standard of living and enjoy many goods and services that were unavailable even to the rich of decades ago. "For me the most convincing argument against the ongoing rise in inequality is that it is incompatible with true equality as citizens," Wolf concludes. "Inequality cannot be eliminated. It is inevitable and to a degree even desirable. But, as the Greeks argued, there needs to be moderation in all things. We are not seeing moderate rises in inequality. We should take notice."[68]

But how much curbing of inequality's excesses is too much? Piketty advocates an 80 percent marginal income tax rate in advanced countries and a global wealth tax of 2 percent. He estimates that 80 percent is the "optimal" tax rate for developed countries, but that rate would not be acceptable to most mainstream American economists, to say the least.[69] Milanović has proposed three sensible rules to achieve greater progressivity among income groups. First, ensure that funds generally flow from rich countries to poor countries. Second, ensure that the beneficiary in the poor country does not turn out to be a rich person in that country: "It is precisely the perception that many transfers end up in the pockets of the rich elite in poor countries that is fueling the current discontent with multilateral and bilateral aid." Third, reduce inequality *within* countries by, for example, creating a global governing body financed by a tax raised from the rich in rich countries—similar to Piketty's global wealth tax—to oversee assistance for poor people in poor countries. Preferably, such assistance would be in the form of cash transfers rather than cumbersome programs that would benefit those running them.[70]

It is not the purpose of this book to explore or define ideal government programs to help the neediest. But it would seem that helping those at the lower end of the income scale achieve economic benefits is a far more likely path to success than making the reduction of inequality the be-all and end-all of public policy. That objective should guide the economic and moral imperatives in rich countries and poor countries alike.

That said, how do countries pursue the goal of helping people in need without discouraging them from helping themselves? This is the subject of part II. The larger question of what rich countries owe poor countries, or what rich individuals in rich countries owe the poorest of the poor in poor countries, is addressed in part III on how globalization has redefined citizenship in the modern world economy.