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Inequality in Financial Capitalism

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The main ideas

- **The key arguments** in this volume are that income inequality increased since 1980s because a **new theoretical paradigm** took place where labour and welfare are seen as costs to be compressed rather than as a fundamental part of aggregate demand to be expanded.
- This period also witnessed the growth of "financial capitalism", characterised by the strong dependency of economies on the financial sector, by the globalisation and intensification of international trade and capital mobility, and by the "flexibilisation" of labour markets which contributed to the reduction of wage shares and therefore to the increase of inequality.
- However, the welfare state is not a drain on economic performance and competitiveness, or is it a barrier to economic efficiency

Working hypothesis

1970s: Ideological switch, political change and technical progress →

1980s: capital expansion → globalisation and financialisation → change in capital-labour relations →

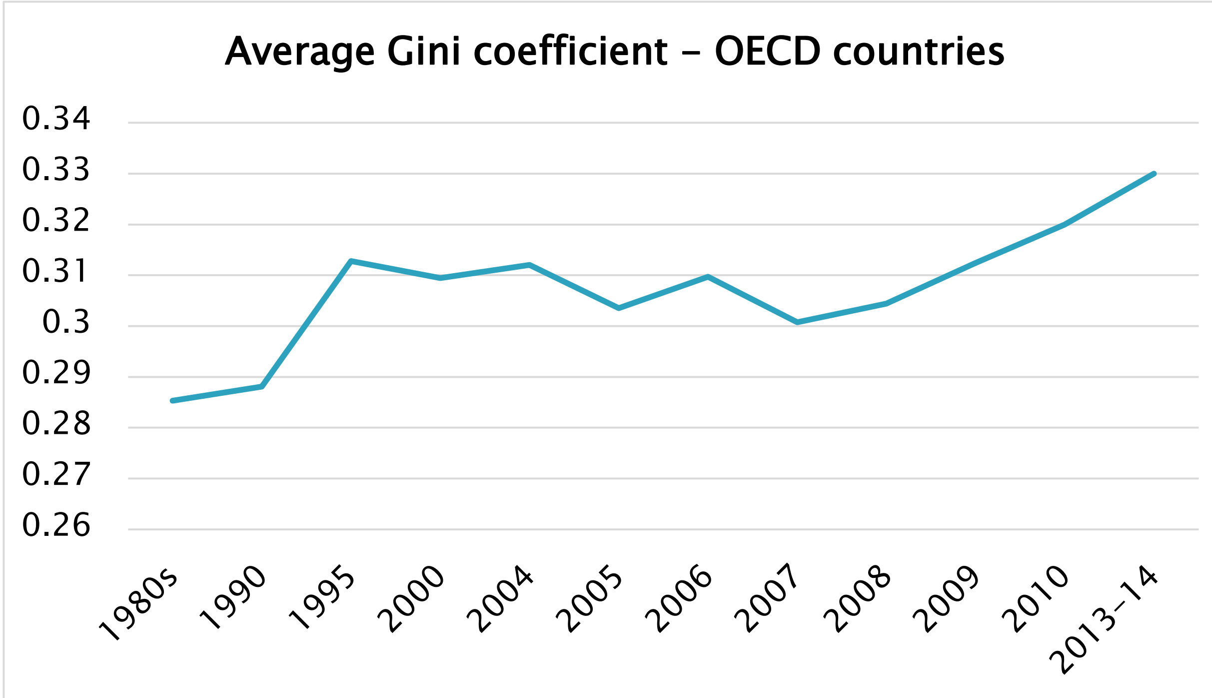
1990s and 2000s: labour flexibility, weakening of labour market institutions and adverse social policies → recovery of profits and soar of financial rents and compensations → wage share reduction

→

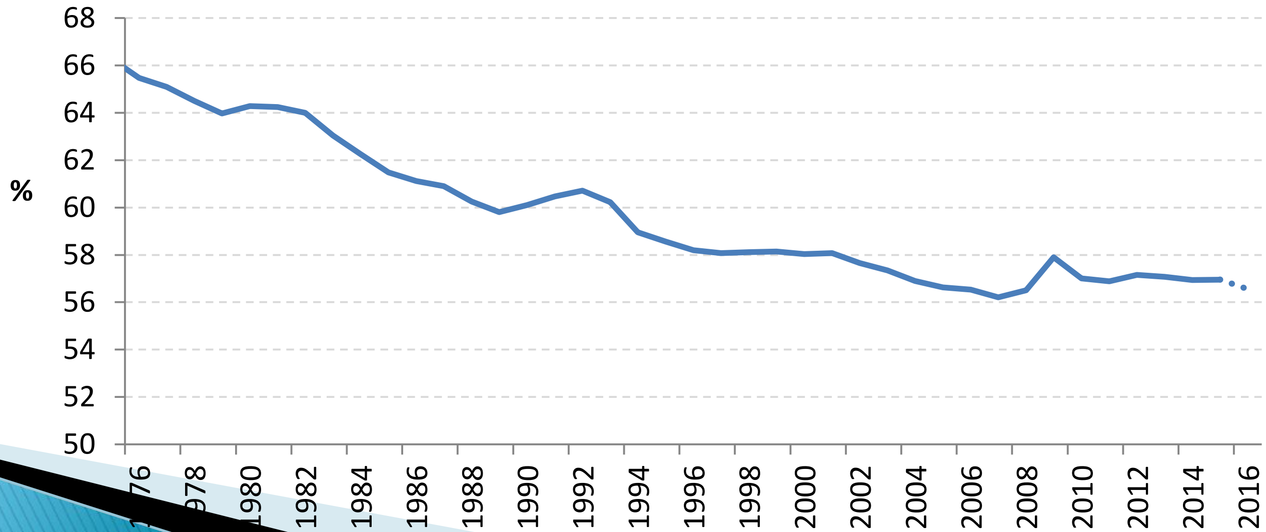
INEQUALITY → moderation of aggregate demand → scarce GDP dynamics → secular stagnation

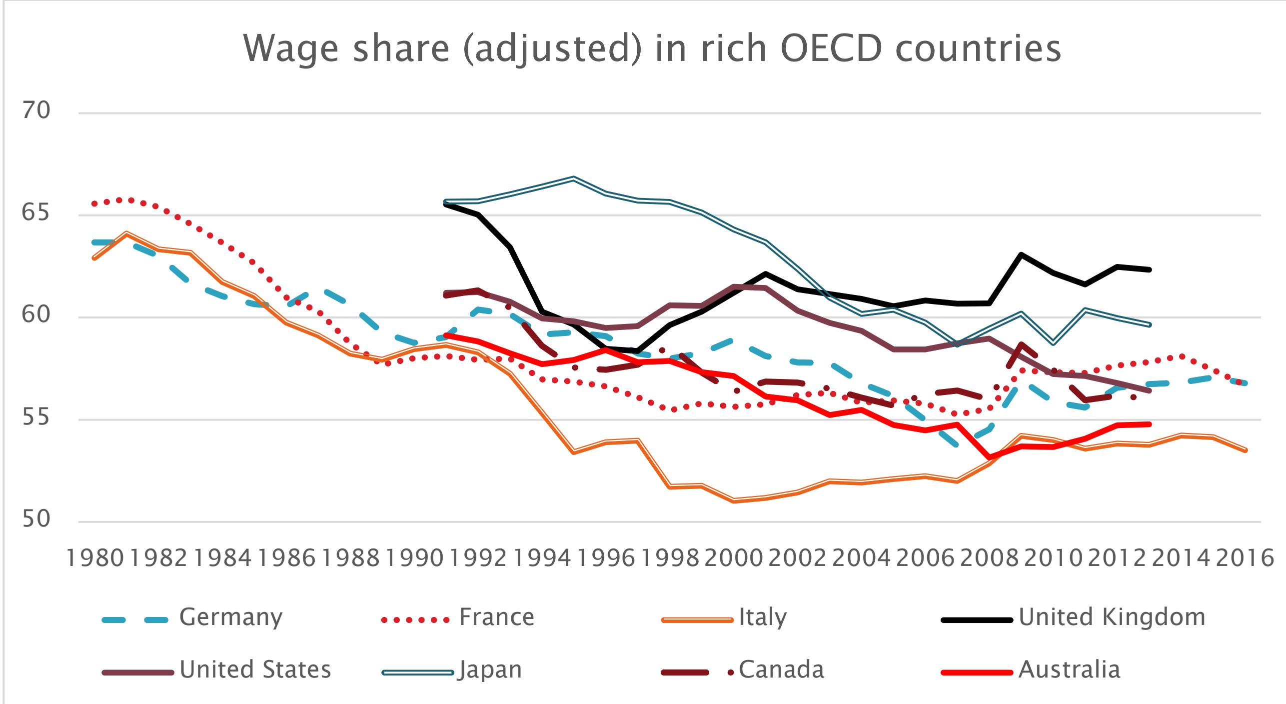
FROM ∩ to ~

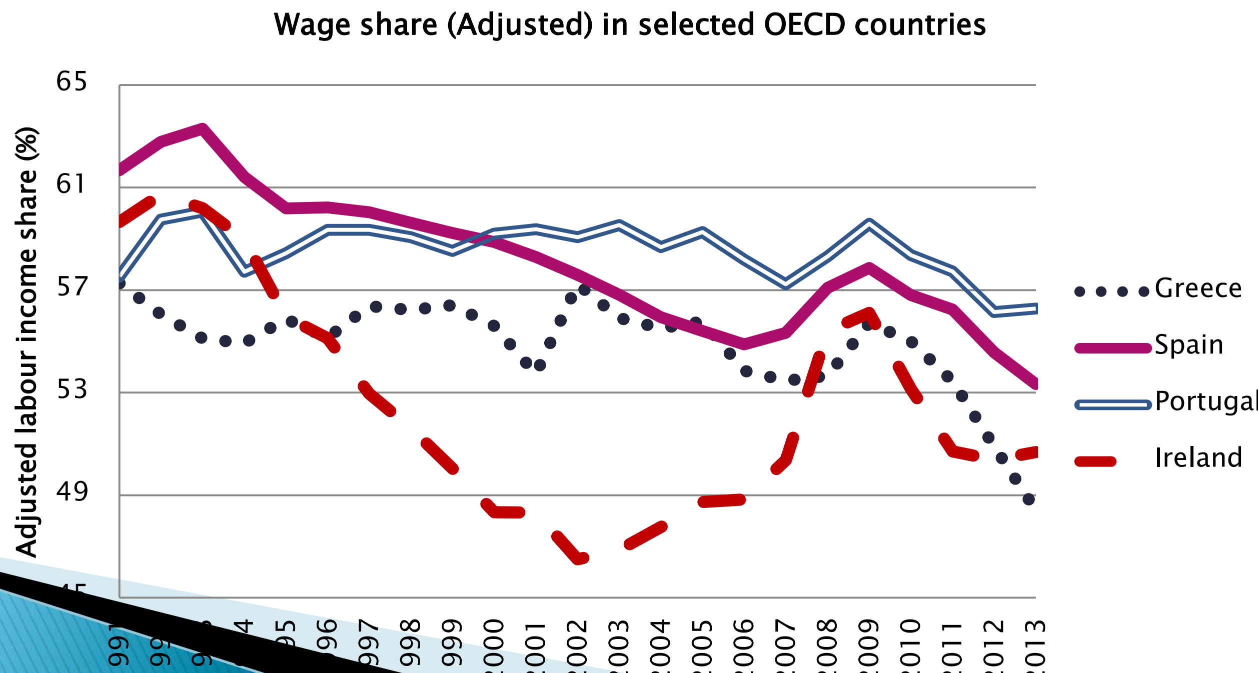
- In OECD: the richest 10% OWNS 10X INCOME 10% POOR
- On the world the top 1% own 48% of global wealth (about US$120 trillion).
- The richest 85 people in the world – the likes of Bill Gates, Warren Buffett, and Carlos Slim – own about US$70 trillion, more wealth than the roughly 3.5 billion people who make up the poorest half of the world's population.
- In the United States, the top 10 % (1%) own about 70% (38%) of wealth in the economy.
- Income (rather than wealth) follows the same trend in proportion: the top 10% (1%) own about 47% (20%) of income in the economy
  - (Source: OECD, OXFAM, Forbes, WB, WID..)



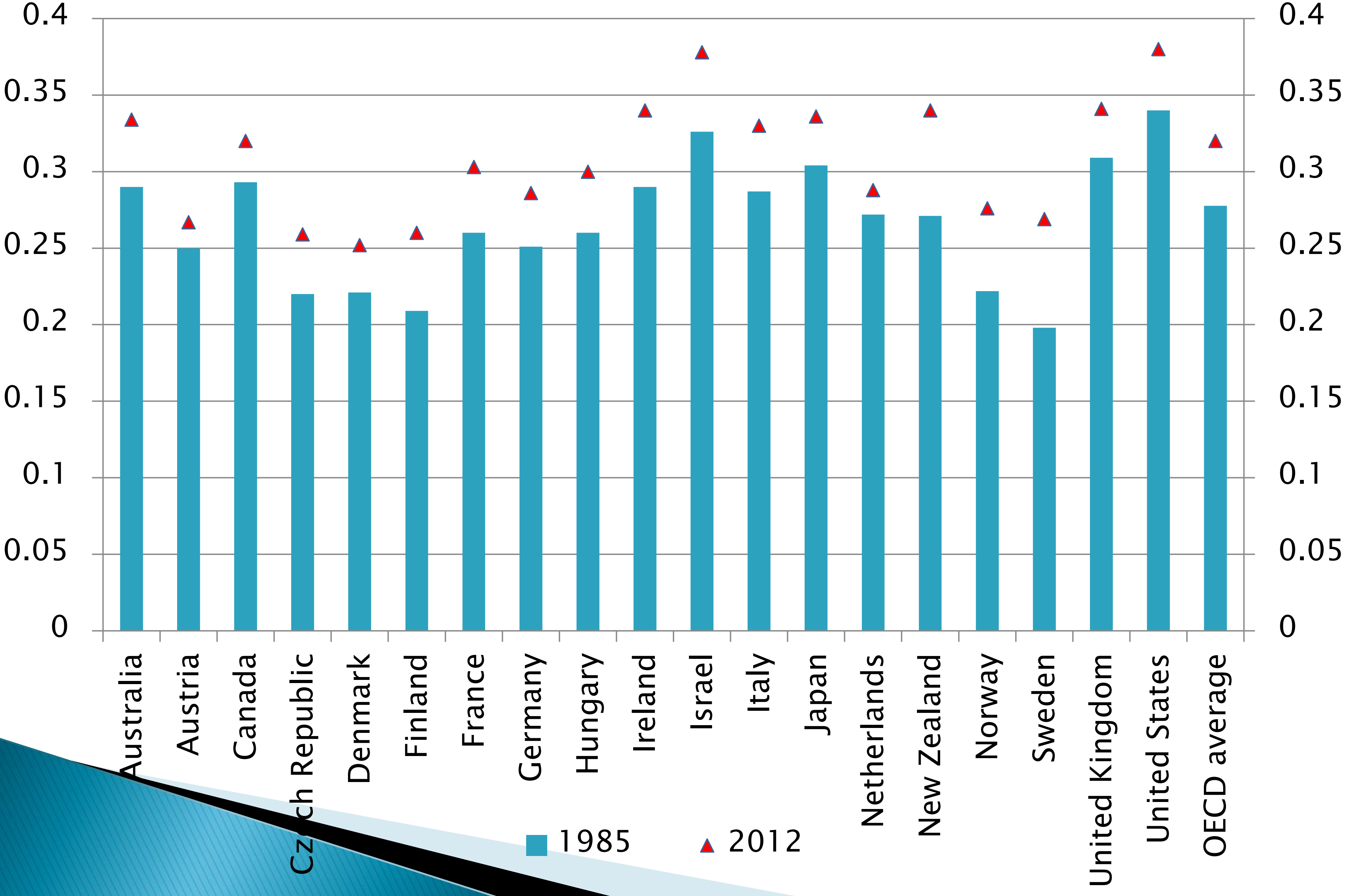
Wage share (adjusted) in G7 economies, from the end 1970s to 2016
(last 2 years projections)



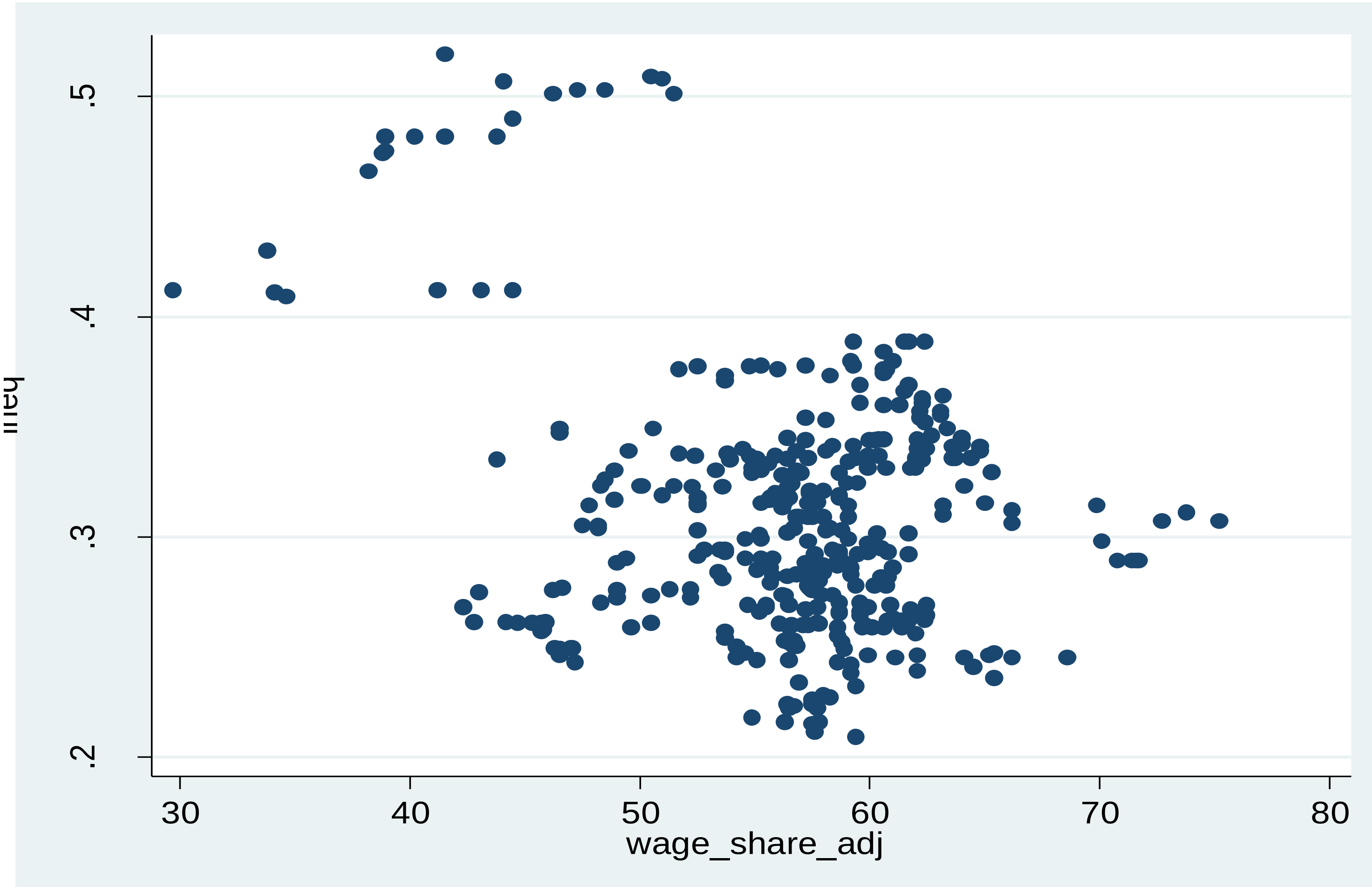

Wage share (adjusted) in rich OECD countries
70
65
60
55
50
1980 1982 1984 1986 1988 1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012 2014 2016
Germany
France
Italy
United Kingdom
United States
Japan
Canada
Australia


Wage share (Adjusted) in selected OECD countries
Adjusted labour income share (%)
65
61
57
53
49
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Greece
Spain
Portugal
Ireland

Inequality (Gini) 1985 and 2012



Inequality and wage share: the expected relation

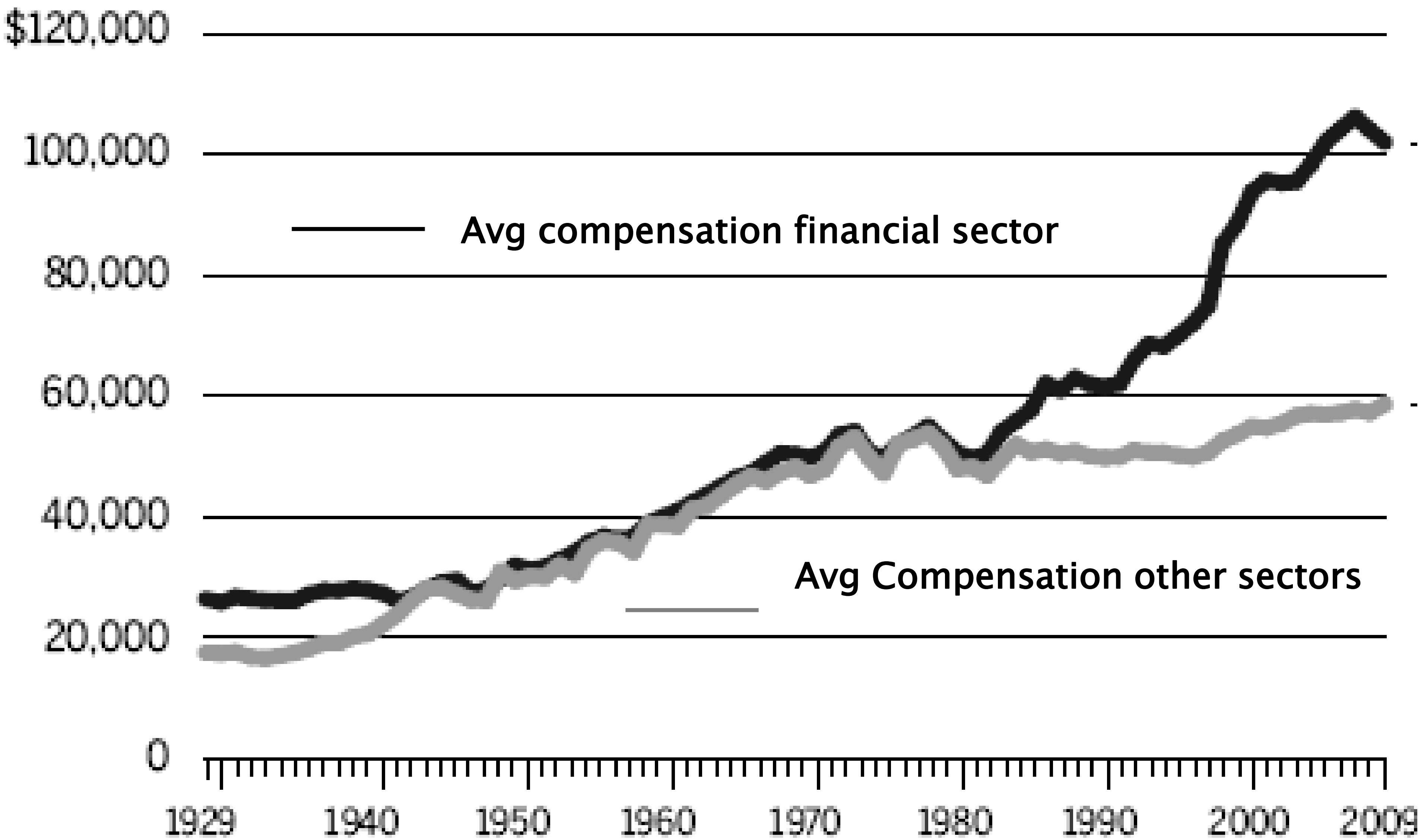


During the crisis…worste

Period	*Income real growth*	*Fraction of total growth captured by top 1%*	*Fraction of total growth captured by bottom 99%*
GDP expansion 1993–2010	13.8%	52%	48%
GDP expansion 1993–2000	31.5%	45%	55%
GDP expansion 2002–2007	16.1%	65%	35%
GDP expansion 2009–2012	6%	95%	5%

Source: Saez (2013).

Compensation financial sector and other sectors (USA)



Source: Financial Crisis Inquiry Commission (2011)

How is financialisation connected to inequality?

1. It favours the aggressive implementation of the principle "**downsize and distribute**" so that corporations' managers have as the only objective to maximize and *distribute* dividends for the shareholders at the cost of squeezing production, cutting wages and *downsizing*. Moreover, assets are wasted in speculation strategies rather than in productive investments.
2. It favours an aggressive **short-term strategy** of corporations' managers interested mainly to sell products and to the maximization of bonus and profits in the short terms at the expenses of the wage bill.
3. **Labour market institutions** and in particular labour flexibility are functional to these strategies.

Relationship between finance and inequality: Postkeynesian views

1. **Finance → (financialisation) and Inequality**

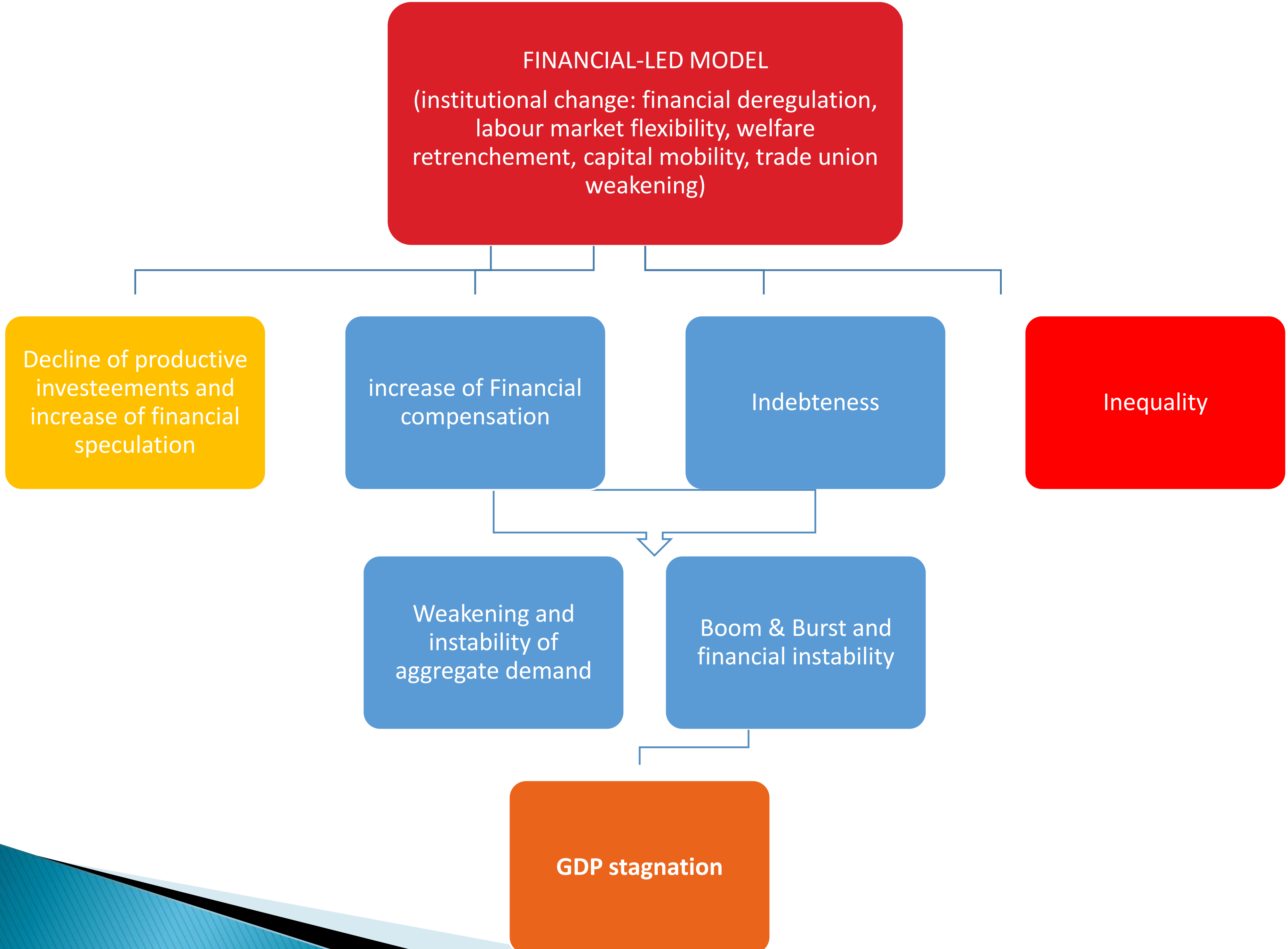
Inequality generated by FC (through labour flexibility and welfare cuts the compression of the wage share the downsizing of workforce and distributing of profits among shareholders) increases income vulnerability and → further financial development credit consumption and the financialisation of the economy which allow for an expansion of the private debt and further inequality [Stockhammer (2013); Galbraith, (2012); Stiglitz, (2012); Hein 2012 & 2015]

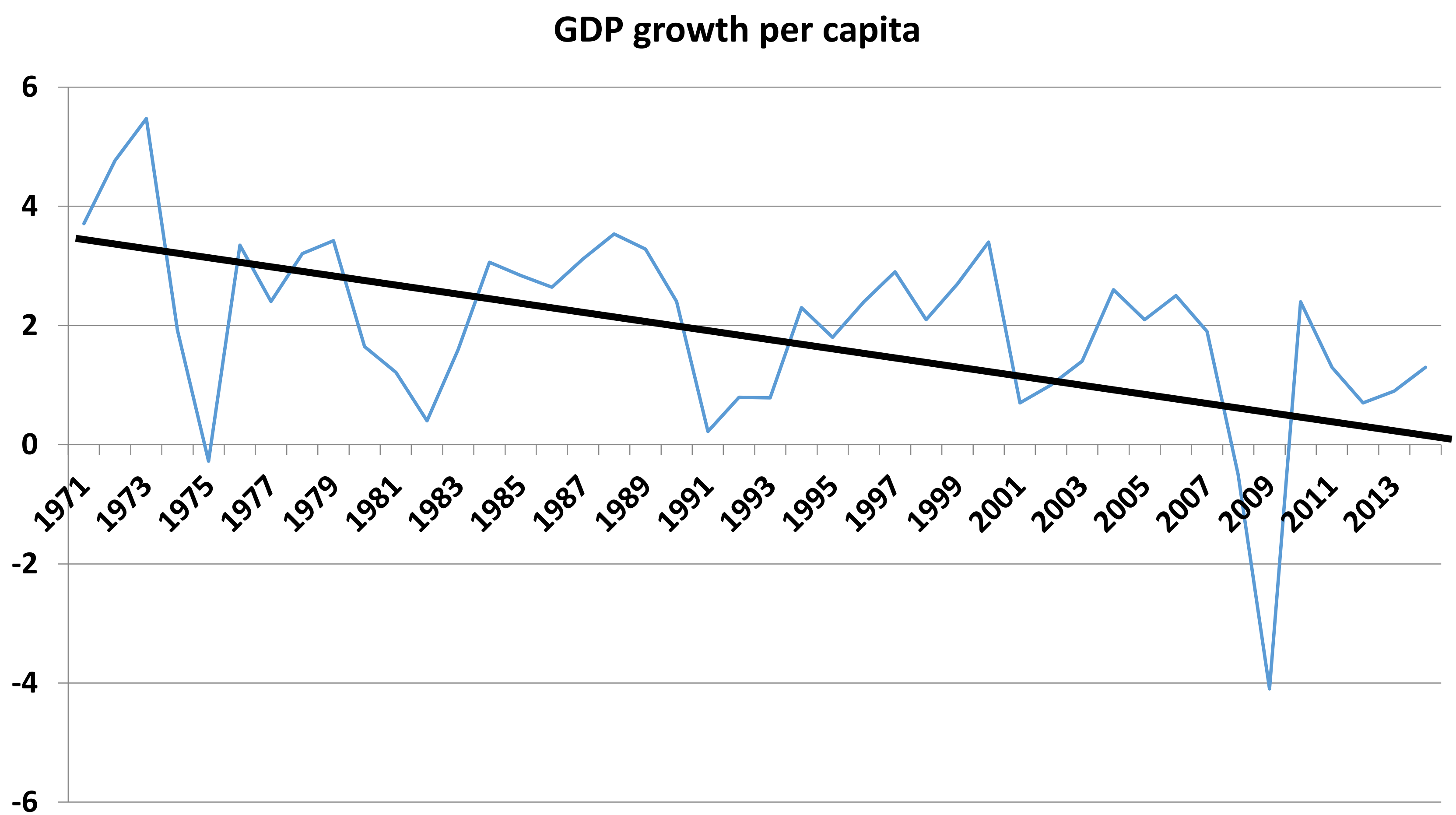
2. **Inequality → (credit availability) and Financial crisis**

Inequality may weaken aggregate demand and drag on the economy since higher income groups spend a smaller share of the income; moreover, income inequality boosts financial instability because it increases demand for credit and this may destabilize the aggregate demand, in particular during credit rationing time [Rajan, 2010; Cynamon and Fazzari (2013); Palley, 2012]

…or marxian approach

- Wage compensation, which is shrinking, affects the labour capacity whose value is generally less than the value of the output produced.
- The excess of supply (which is also the surface of worker's exploitation) is compensated by credit-consumption.
- Workers suffer twice from these crises (being exploited and paid less, and being encouraged to increase credit consumption)
- Capitalists gain twice (because they gain from the exploitation which however produces excess of supply, and obtain returns from financial products). Goda and Lysandrou (2014);
- In this way the crisis is endemic to capitalism and to inequality


FINANCIAL-LED MODEL
(institutional change: financial deregulation, labour market flexibility, welfare retrenchement, capital mobility, trade union weakening)
Decline of productive investeements and increase of financial speculation
increase of Financial compensation
Indebteness
Inequality
Weakening and instability of aggregate demand
Boom & Burst and financial instability
GDP stagnation

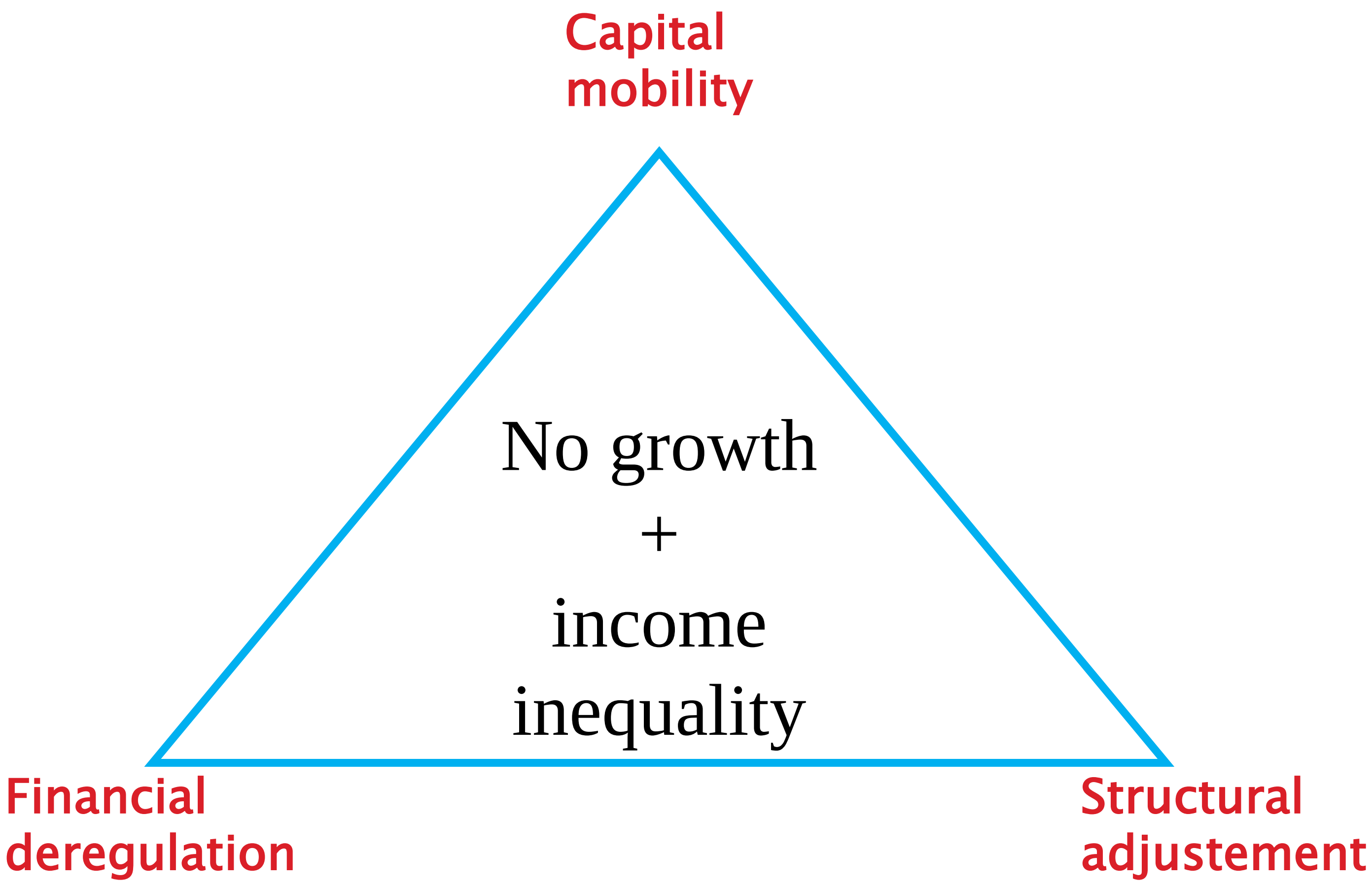


OECD countries, Source: OECD

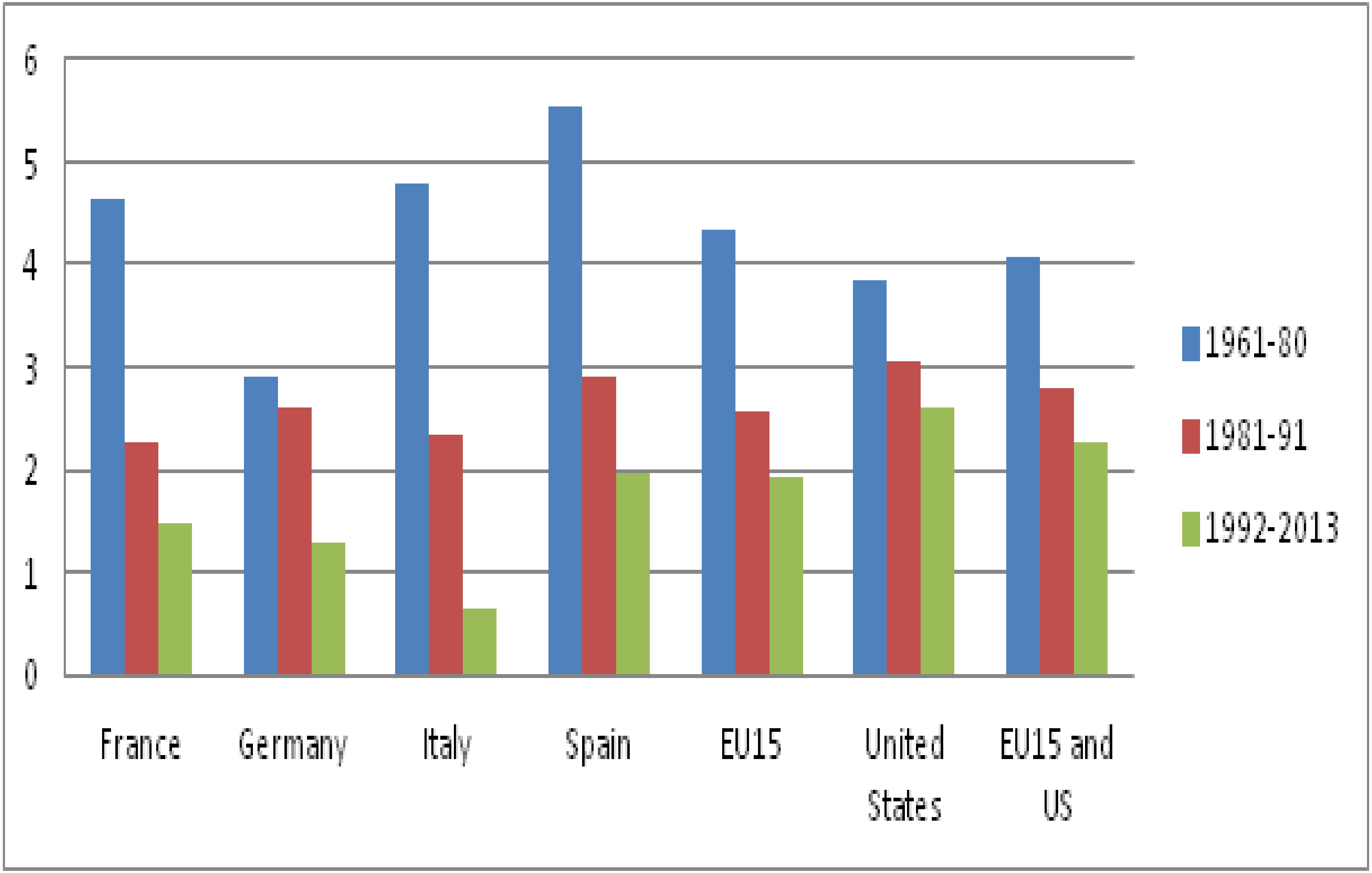
Secular stagnation and inequality

- The secular stagnation is intimately related to policies and features that shaped the financial-led model.
- Excess of S is a consequence of an excess of income going to the wealthiest part of the society, which has a lower propensity to consume (Kaldor, 1956, 1961).
- Second, the imbalance is a consequence **of lower wages** for workers and in turn of lower consumption and demand by them.
- Third, it is a consequence of a **retrenchment tendency of public expenditure** and welfare expenditure occurring among advanced economies in the last two decades and intensifying in the last years after the crisis, known as fiscal adjustments and austerity program (see Hein 2015).
- Hence, the solution to the secular stagnation can be found from one side in the **fiscal policy and government deficit** rather than in monetary policy and quantitative easing, which would absorb the excess of S. From another side, **income distribution policies** and wage increases would compensate the negative drag on the aggregate demand operated by excess of S.
- Finally, **a program of public investment** would increase the stock value of I.

The IMF Triangle → no growth + inequality

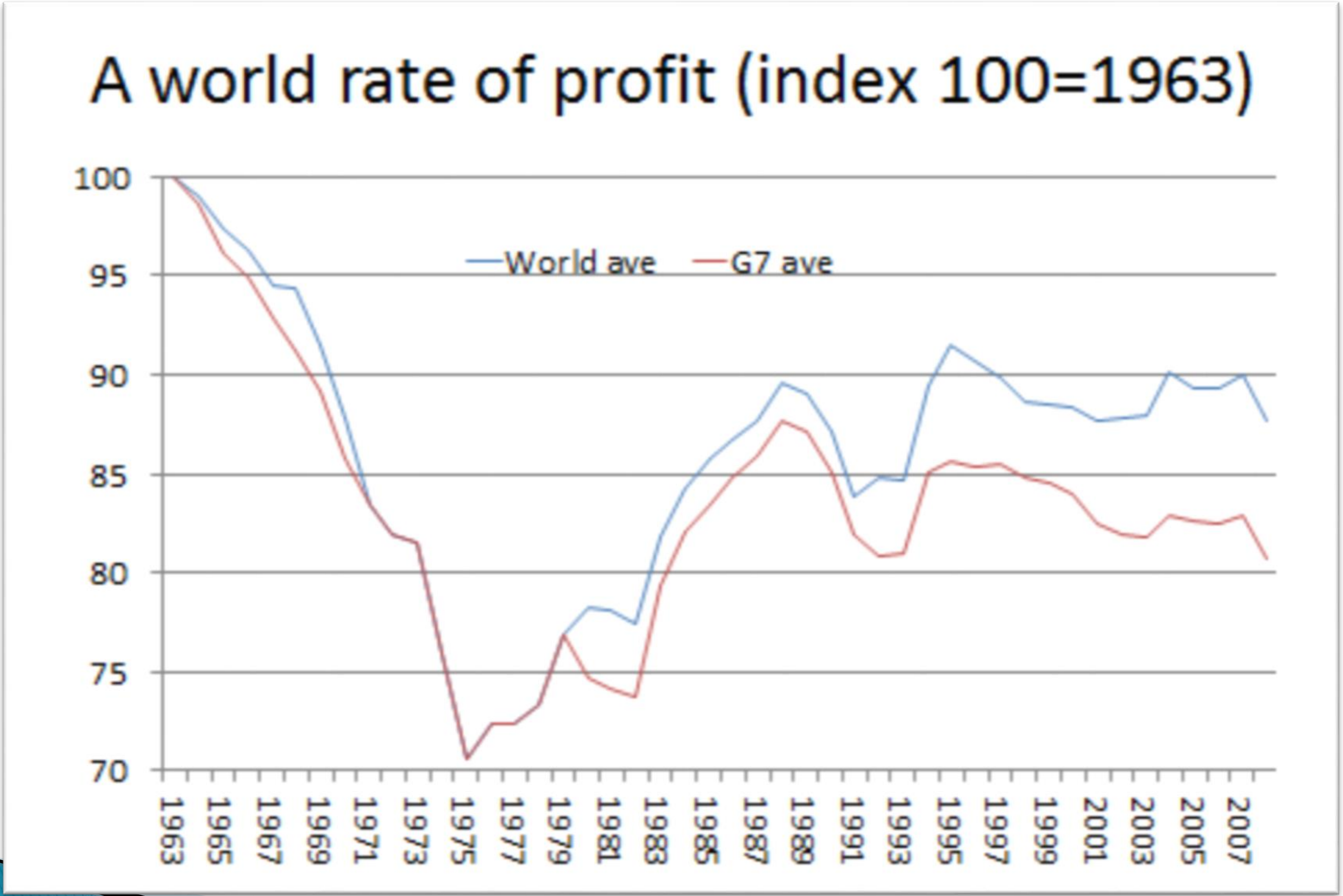


GDP performance before and during financialisation



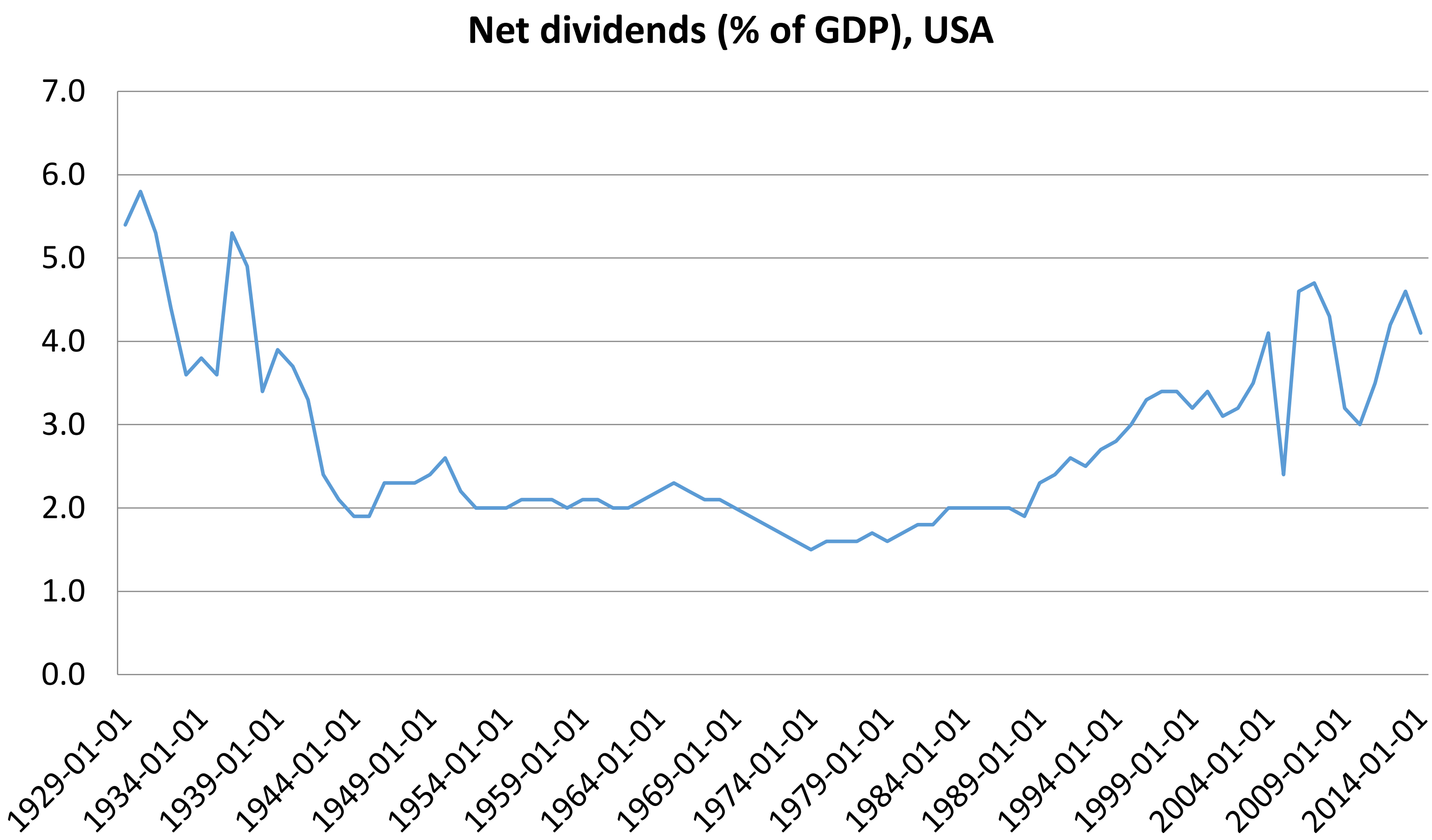
So then, why?

The decline…and the recovery of profits



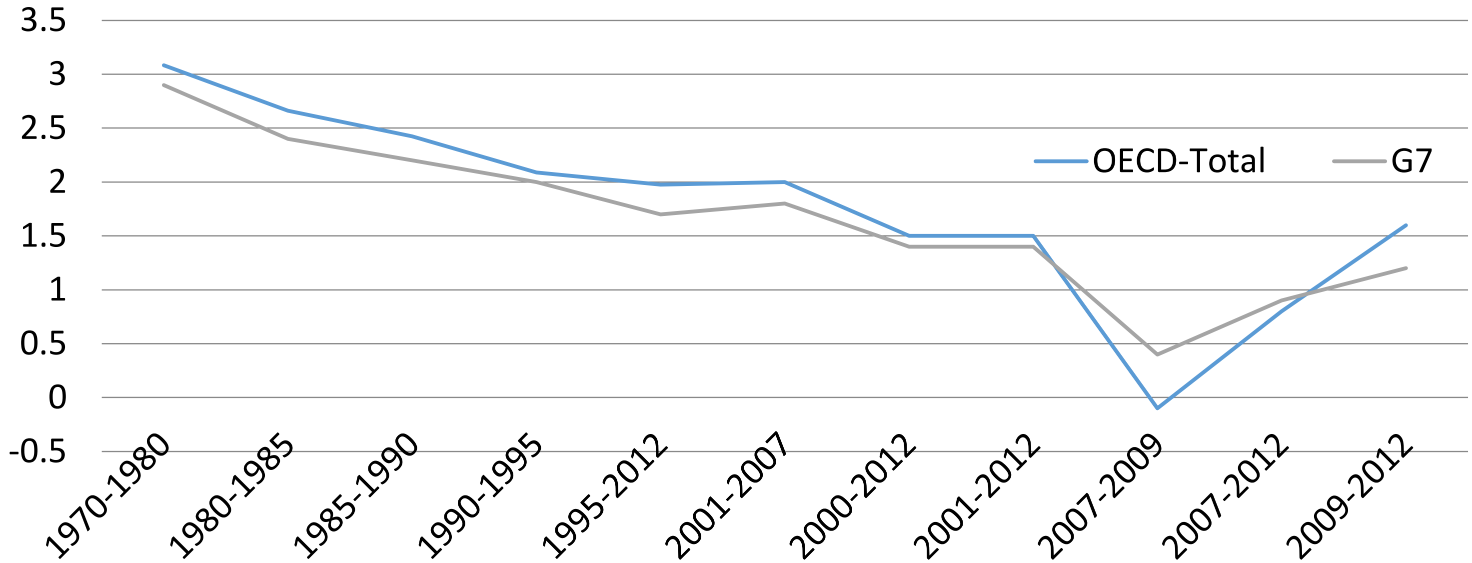
Source: Michael Roberts, 2015

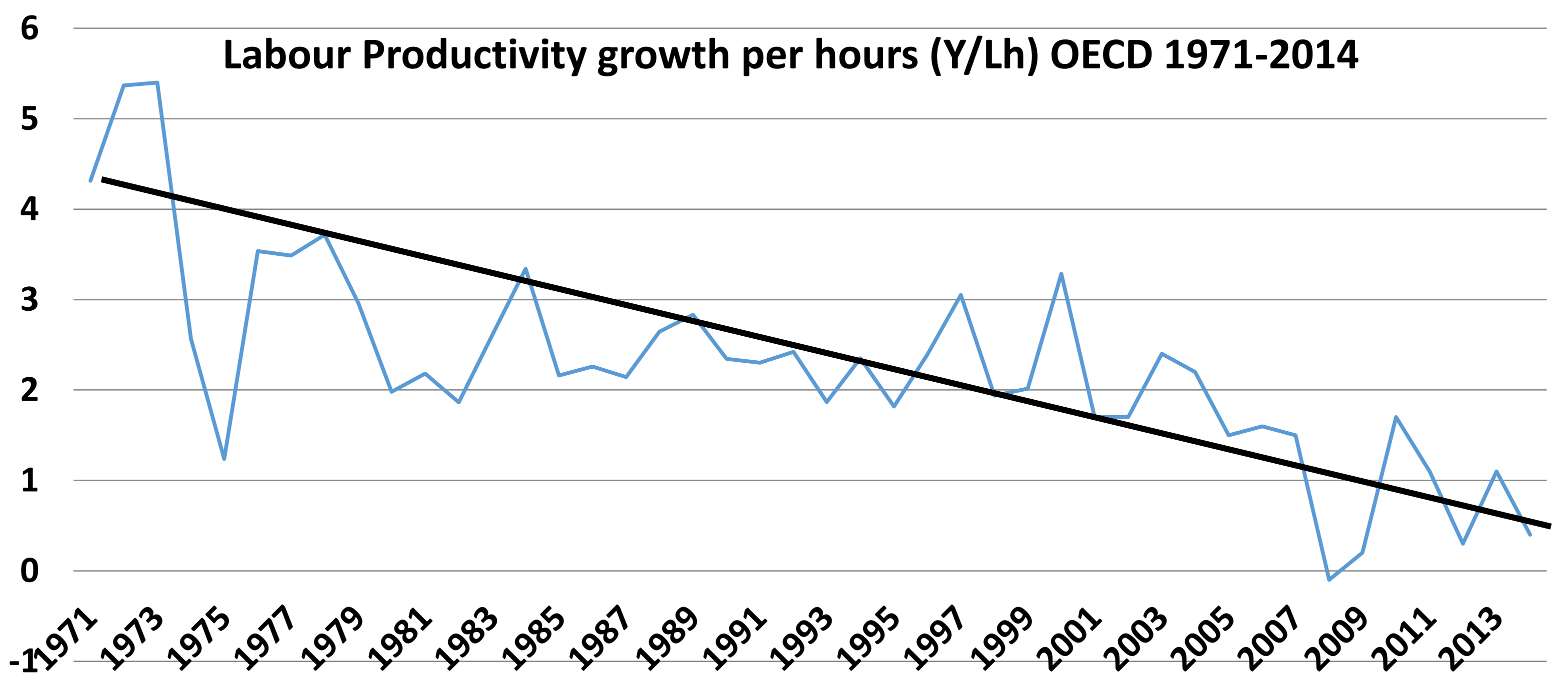
The decline…and the recovery of Dividends.



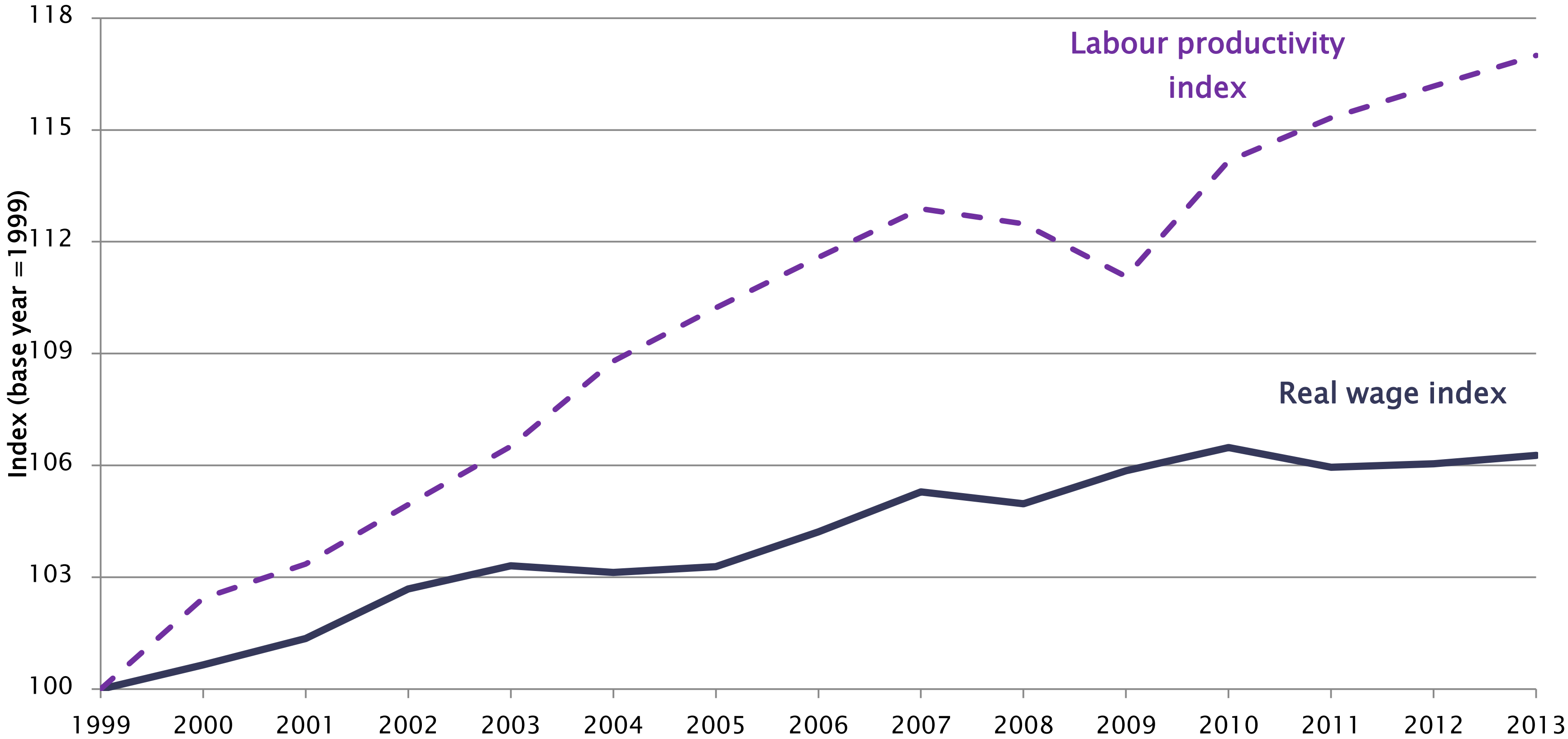
Source: FREED database.

Labour productivity decline (OECD source)

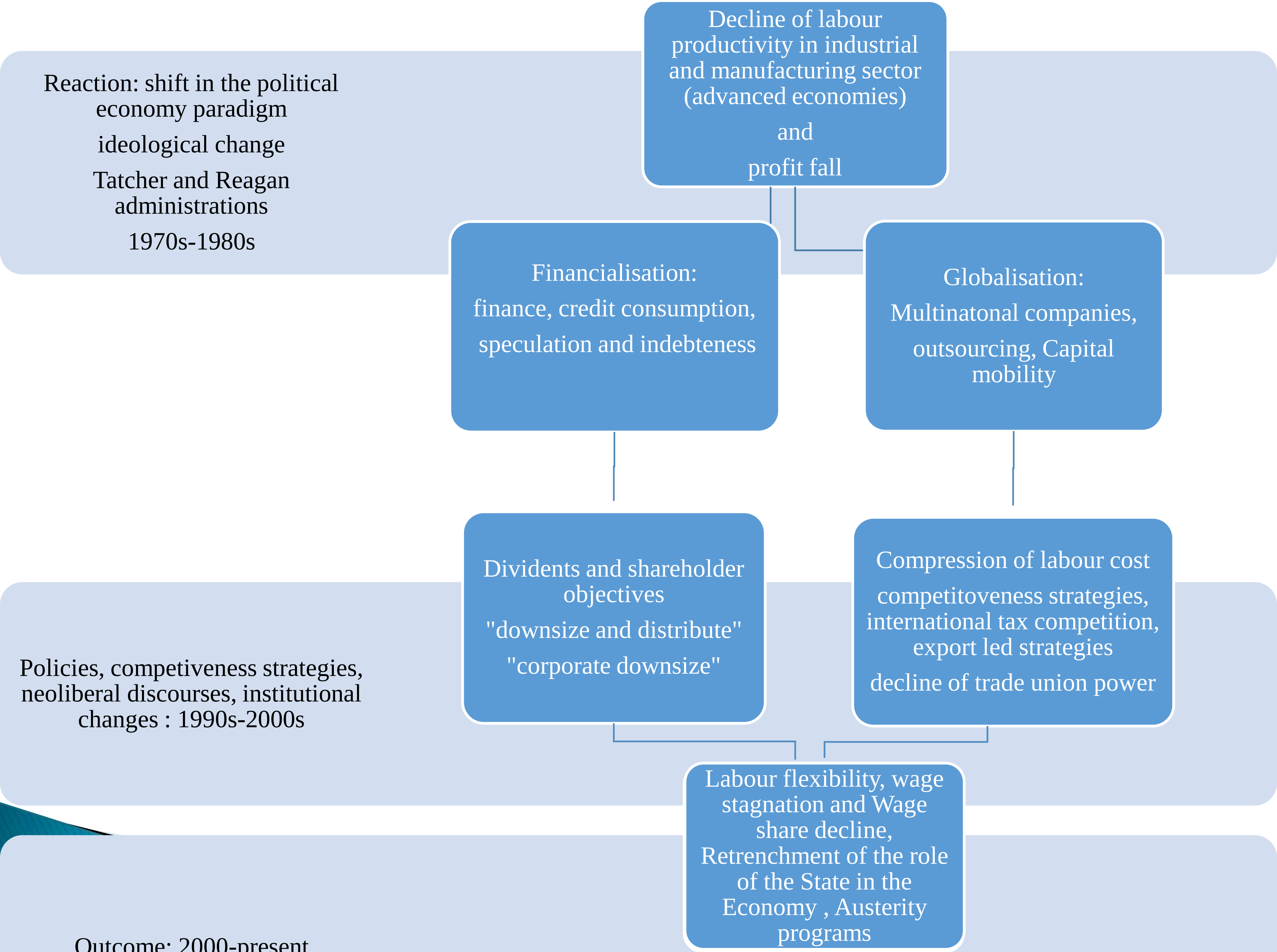




"The good way": recent distribution of labour productivity in advanced economies.



Source: ILO 2015, online database.


Reaction: shift in the political economy paradigm
ideological change
Tatcher and Reagan administrations
1970s-1980s
Decline of labour productivity in industrial and manufacturing sector (advanced economies)
and
profit fall
Financialisation:
finance, credit consumption,
speculation and indebteness
Globalisation:
Multinatonal companies,
outsourcing, Capital mobility
Dividents and shareholder objectives
"downsize and distribute"
"corporate downsize"
Compression of labour cost
competitoveness strategies, international tax competition, export led strategies
decline of trade union power
Policies, competiveness strategies, neoliberal discourses, institutional changes : 1990s-2000s
Labour flexibility, wage stagnation and Wage share decline, Retrenchment of the role of the State in the Economy , Austerity programs
Outcome: 2000-present

Financial capitalism

- The globalisation of the economy increased the power of capital in relation to labour, and trade unions lost power, contributing to the deterioration of labour market institutions.
- During the process of financialisation and globalisation of economies, which identifies the shift towards what I called financial capitalism, labour markets were affected by radical changes too, involving above all an increase in labour flexibility.

Thatcher and Reagan for finance

- Since 1980, and in particular since the Thatcher and Reagan administrations in the UK and the US, financial capitalism was shaped
- a set of neoliberal policies boosting financialisation and globalisation were implemented, such as deregulation of the financial sector, liberalization of trade, capital mobility, wage flexibility, privatization, structural adjustments, retrenchment of welfare states, the creation of a second pillar in the pension system – i.e. the pension funds with the clear aim to collect easy savings.

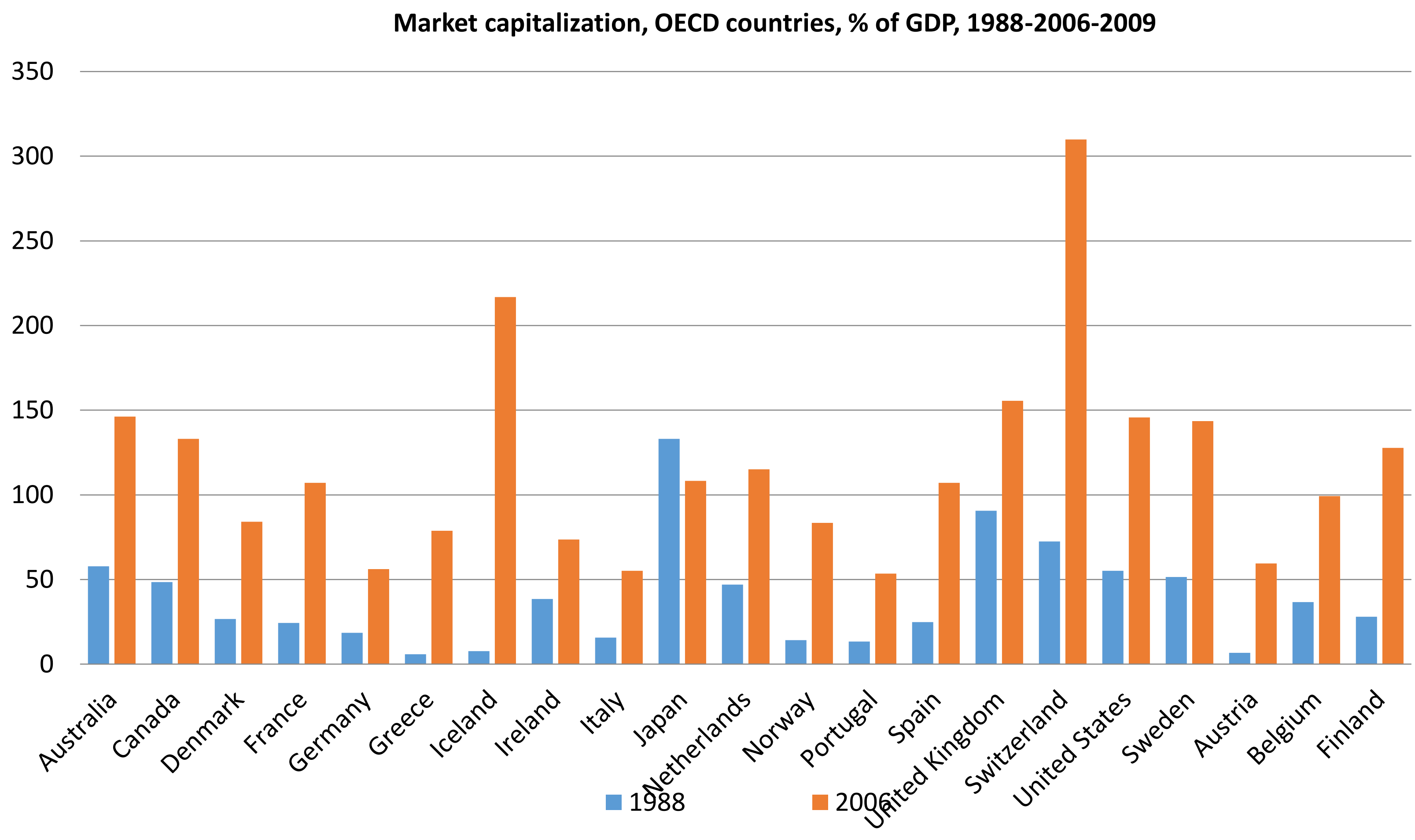
The return of a “patrimonial society

- CEO salaries, in financial capitalism, depend on the increase of value shares, and on the short-term results performance in the stock exchange.
- In 1950, the average American chief executive was paid about 20x as much as the typical employee of his firm.
- Today, ratio is +500 to 1.
- In 2011, Apple’s Tim Cook received $378 million (6,258X the wage of an average Apple employee ($60,000). A typical worker at Walmart earns less than $25,000 a year; Michael Duke, the retailer’s former chief executive, was paid more than $23 million in 2012.
- This represents the return of a “patrimonial society”as Piketty (2014) stated: the patrimonial society today is the financial class.

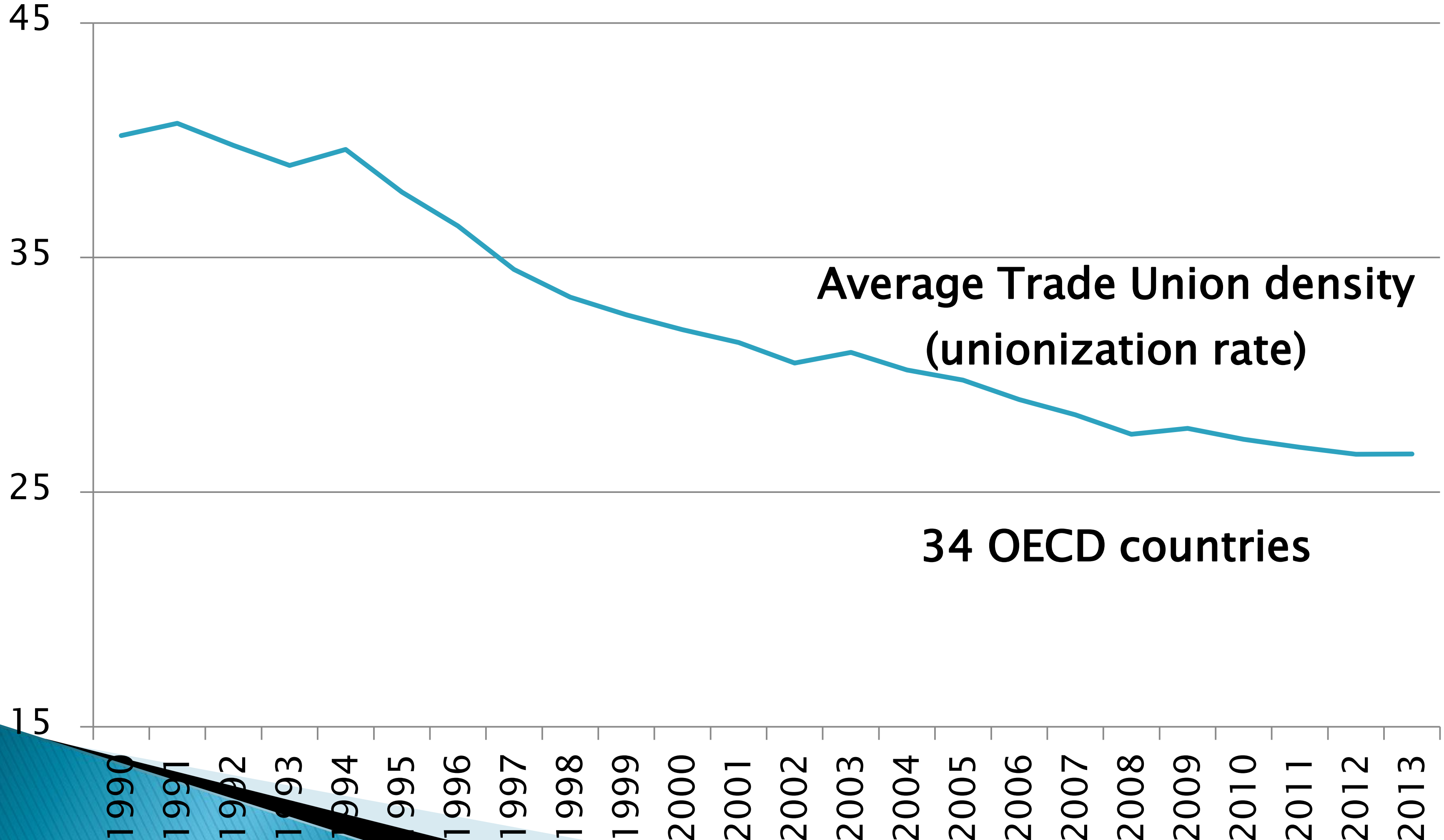
Generous monetary policies and QE in FC

- Before 2007→ generous monetary policies. This increased opportunity in the financial sector, speculation, value shares, asset prices, dividends → financial bubble; boom in the housing sector and the emerging of the huge insurance business.
- After 2007 even more → QE by the Fed, BoE, BoJ, and ..ECB
- QE favoured speculations more than real investments and did not allow, for the "Keynes effect"
- financial and labour compensation gap increased even more, and income inequality worsened also after the crisis.
- in CF, investment behaviour is not driven by macroeconomic policies (such as the Keynes effect) but by discourses and stories able to convince speculators, hedge funds owner and managers, feeling and perverse "animal spirits" (Erturk *et al.*, 2008).

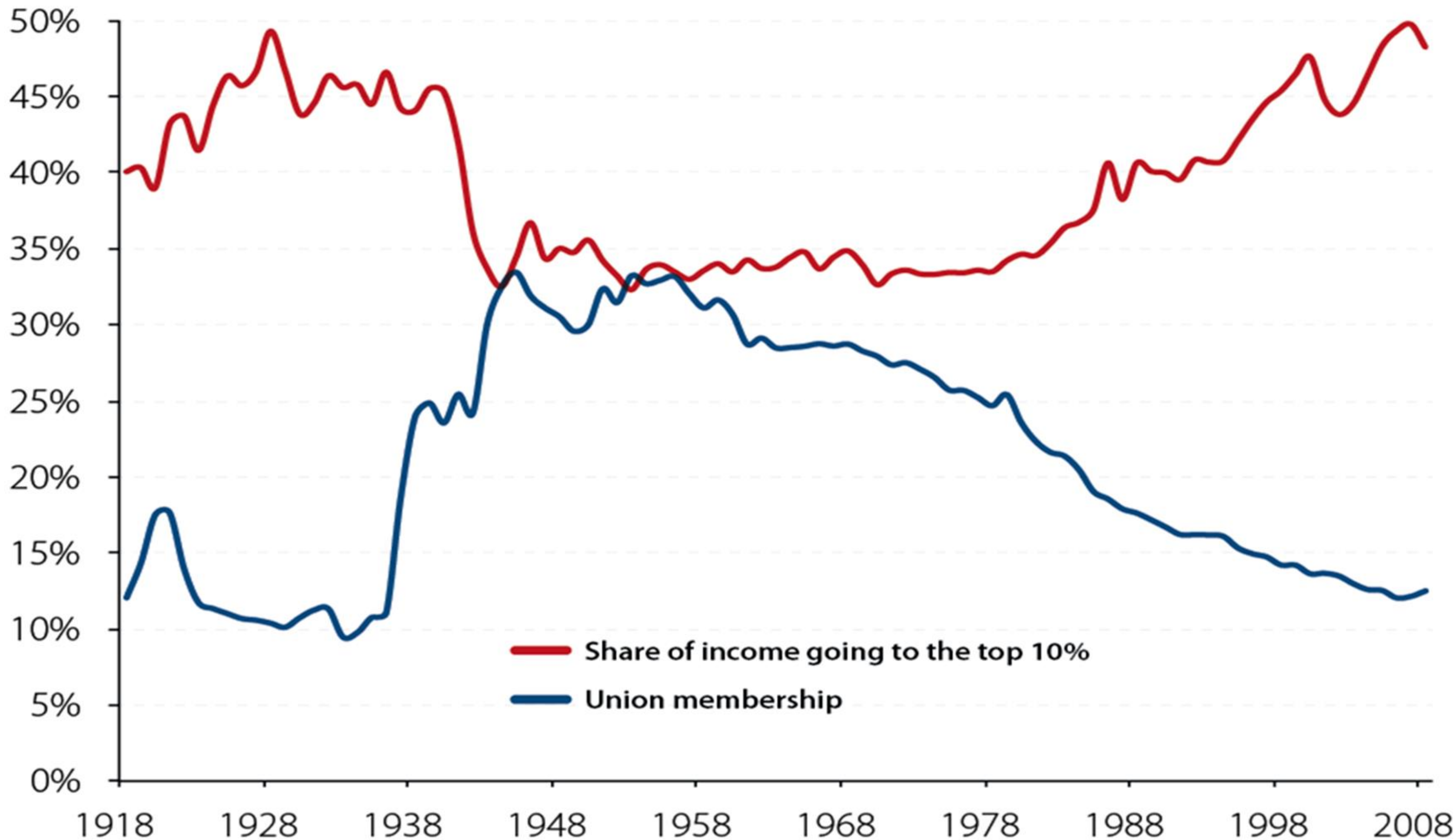
Financialisation during neoliberalism



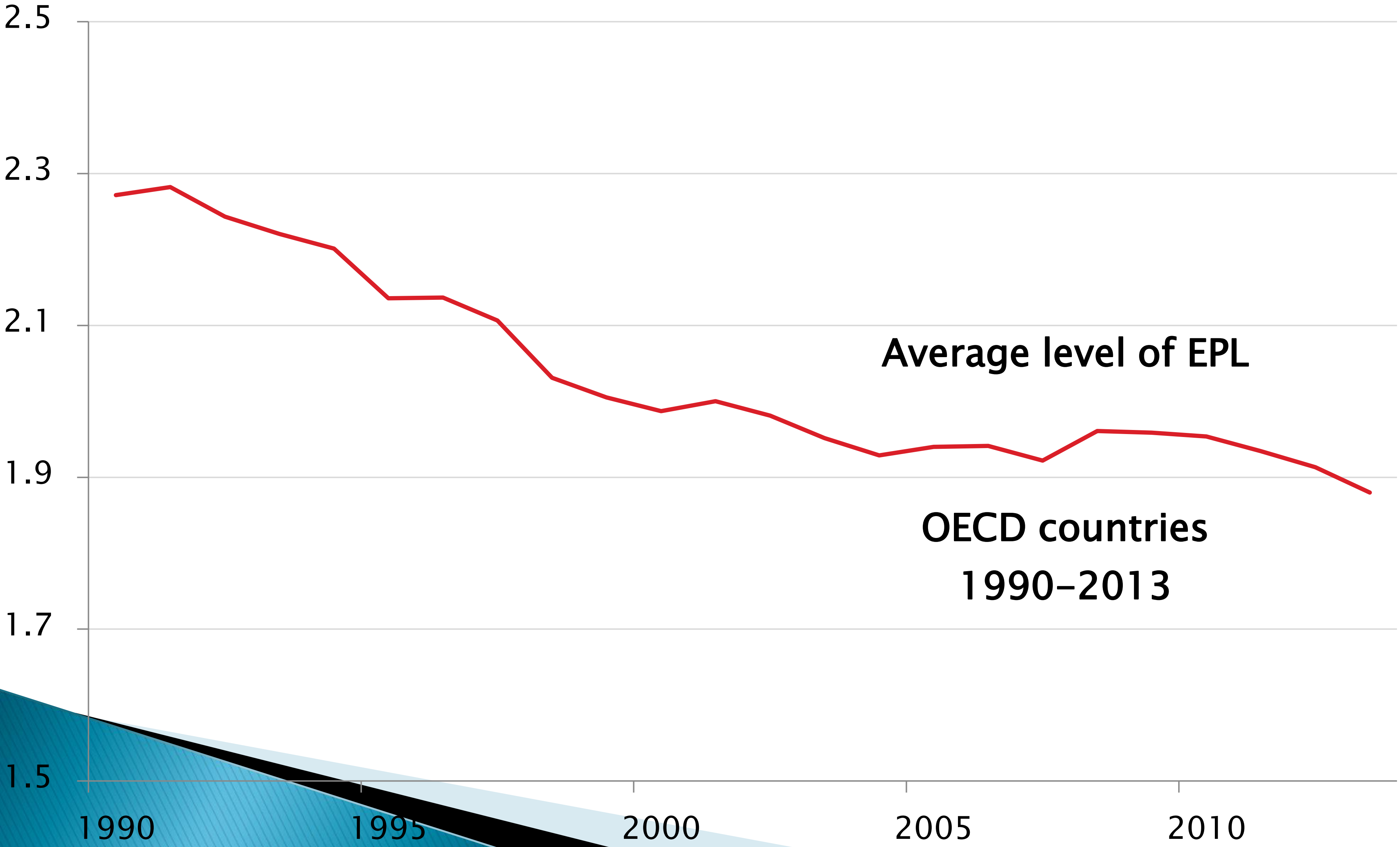
The decline of Trade Unions density



Unionisation and share of income to the top 10% (USA)



Labour flexibility during neoliberalism



Labour flexibility and finance

- A flexible labour market with compressed and low wages needs to be supplemented by credit consumption and developed financial tools to sustain consumption.
- Hence, a strong correlation between financialisation and labour flexibility was identified in our empirical analysis, suggesting complementarities between these two phenomena.

Figure - Correlation scatter between financialisation and labour flexibility (EPL) in 2013

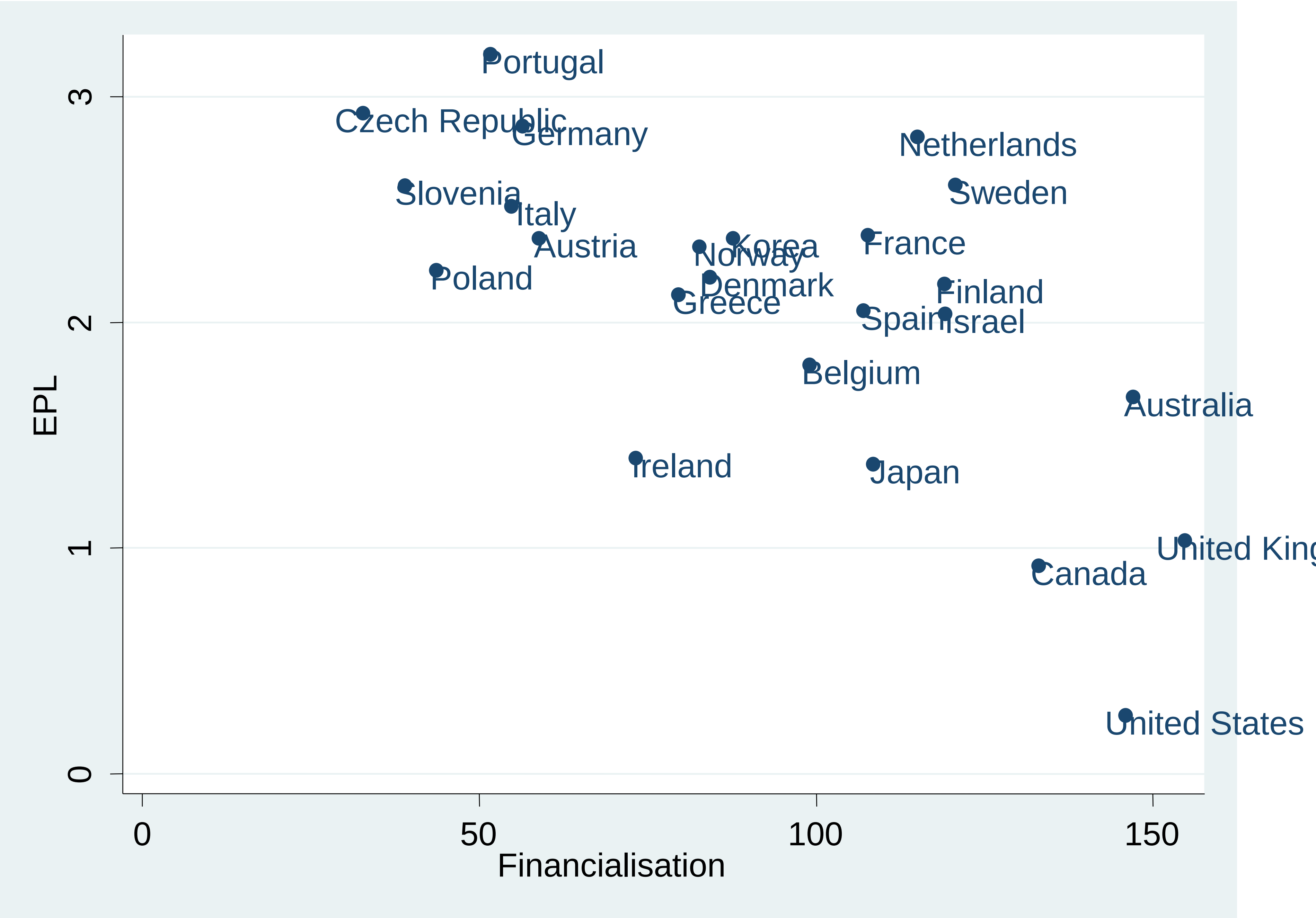
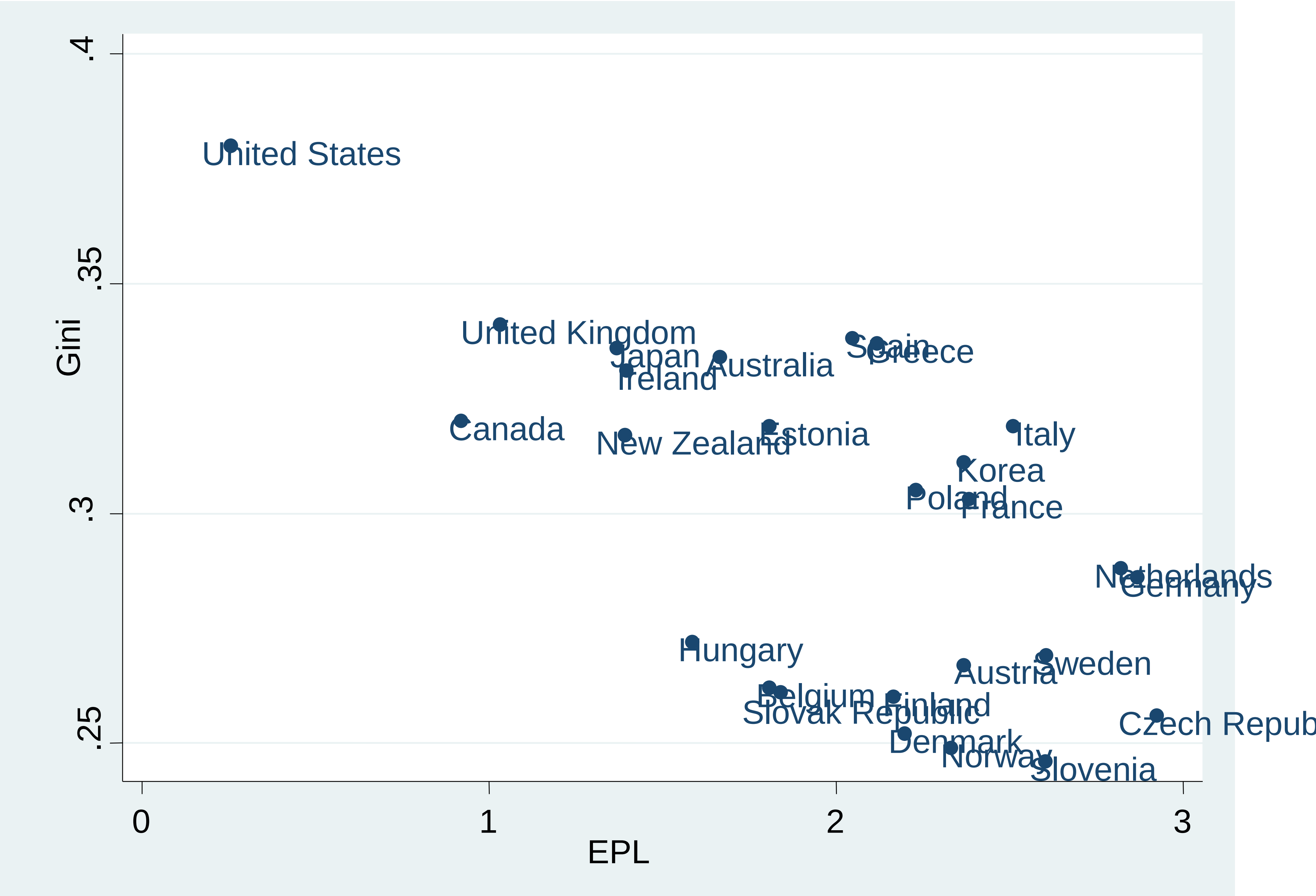


Figure - Correlation scatter between inequality and EPL in 2013



Inequality and Labour Market indicators

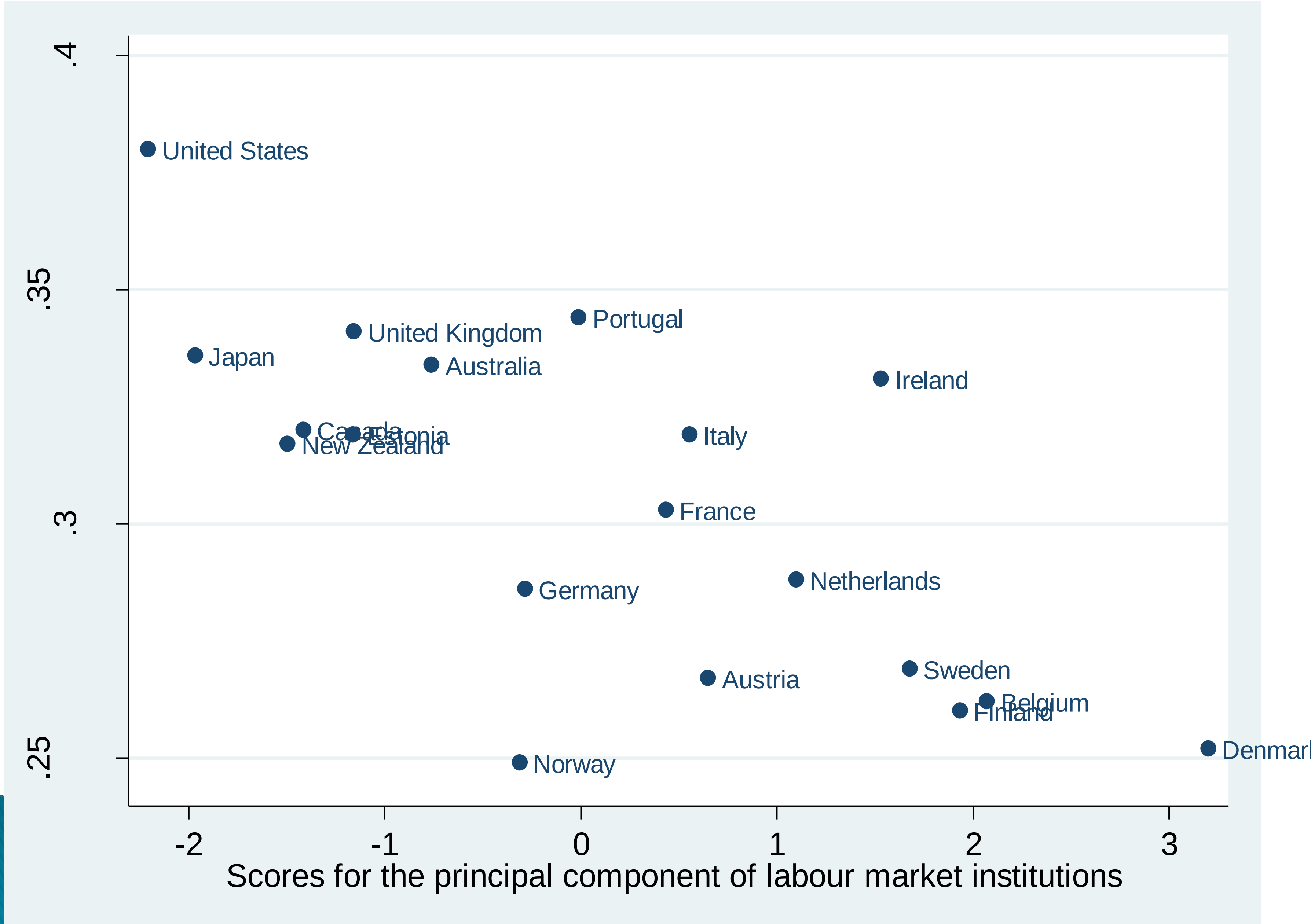
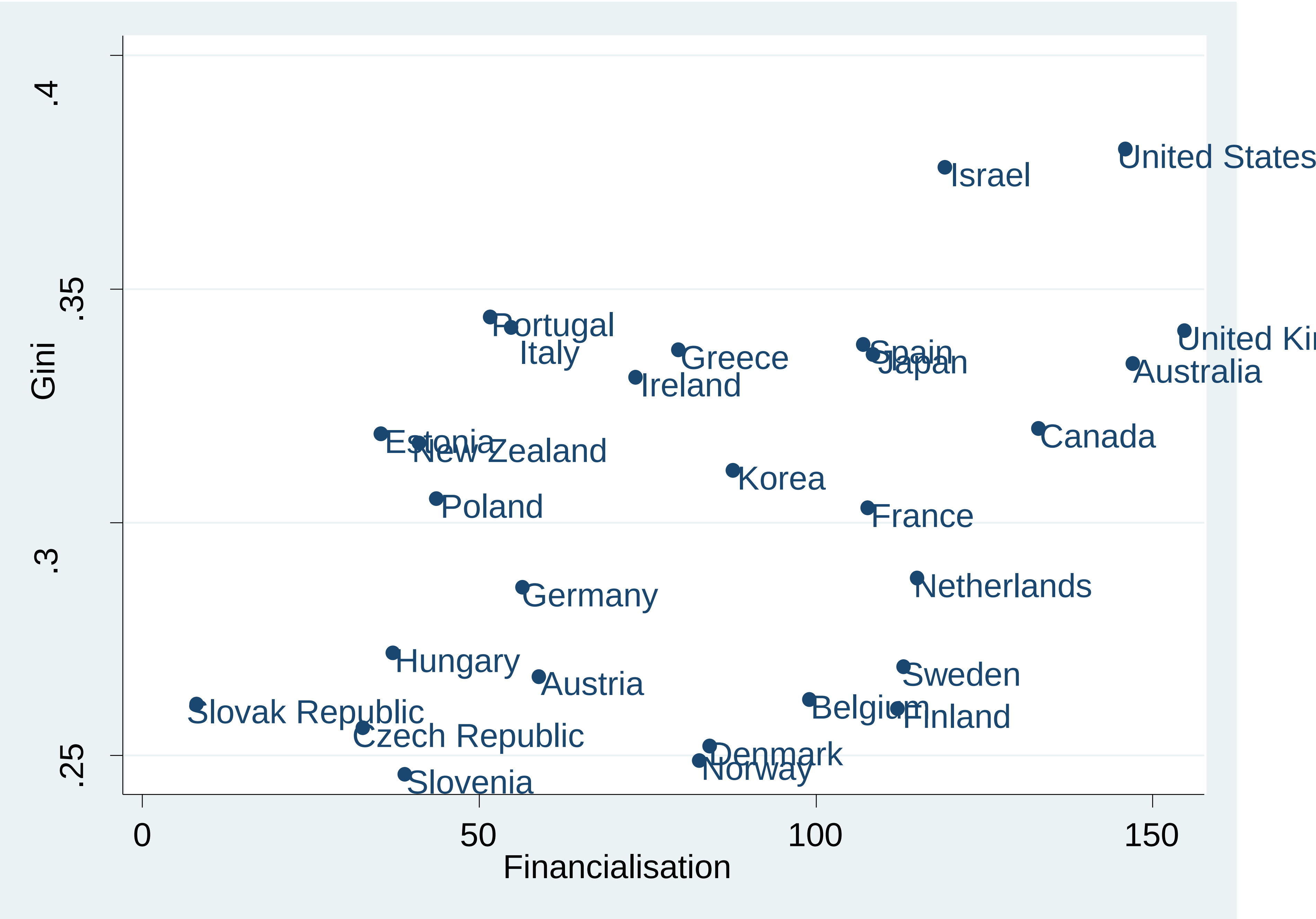


Figure - Correlation scatter between financialisation and inequality in 2013



Neoliberalism

Financialization

+

labour flexibility

↓

Neoliberalism => Inequality

The root of the crisis since the end of 1970s

- Profit soar (rents and financial compensation)
- Wages stagnated
- Inequality increased
- Consumption kept up thanks to financialization

→ private debt (financial innovation)

→ public debt (bonds China–US)

Stiglitz (2010); Brancaccio and Fontana (2011); Fitoussi and Saraceno (2010); Barba and Pivetti (2009); Tridico (2012)…

Interactions and bubbles within the Finance-led Growth Model

LABOR

↓ w/p
Instable wages
Precarious job

FINANCE

Financialization
↑ Demand for finance
↑ Price shares
(financial) BUBBLE

↑Finance for consumption
↑ Credits, loans, mortgages
(credit) BUBBLE
(Prices in the commodity market increase too)

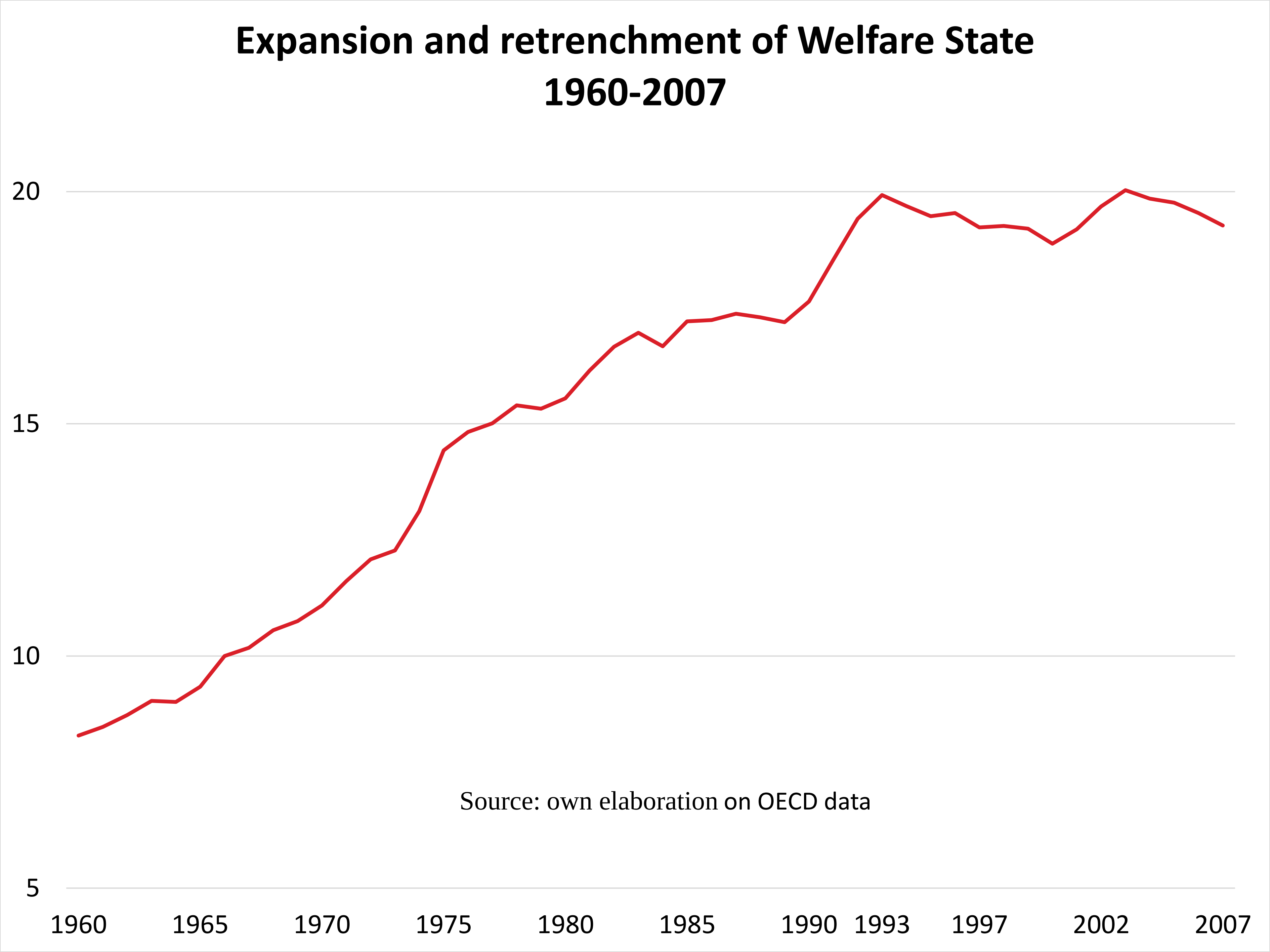
CONSUMPTION

↑ Movement of Portfolio
↑ Financial investments
(speculative) BUBBLE
↓ Productive investments

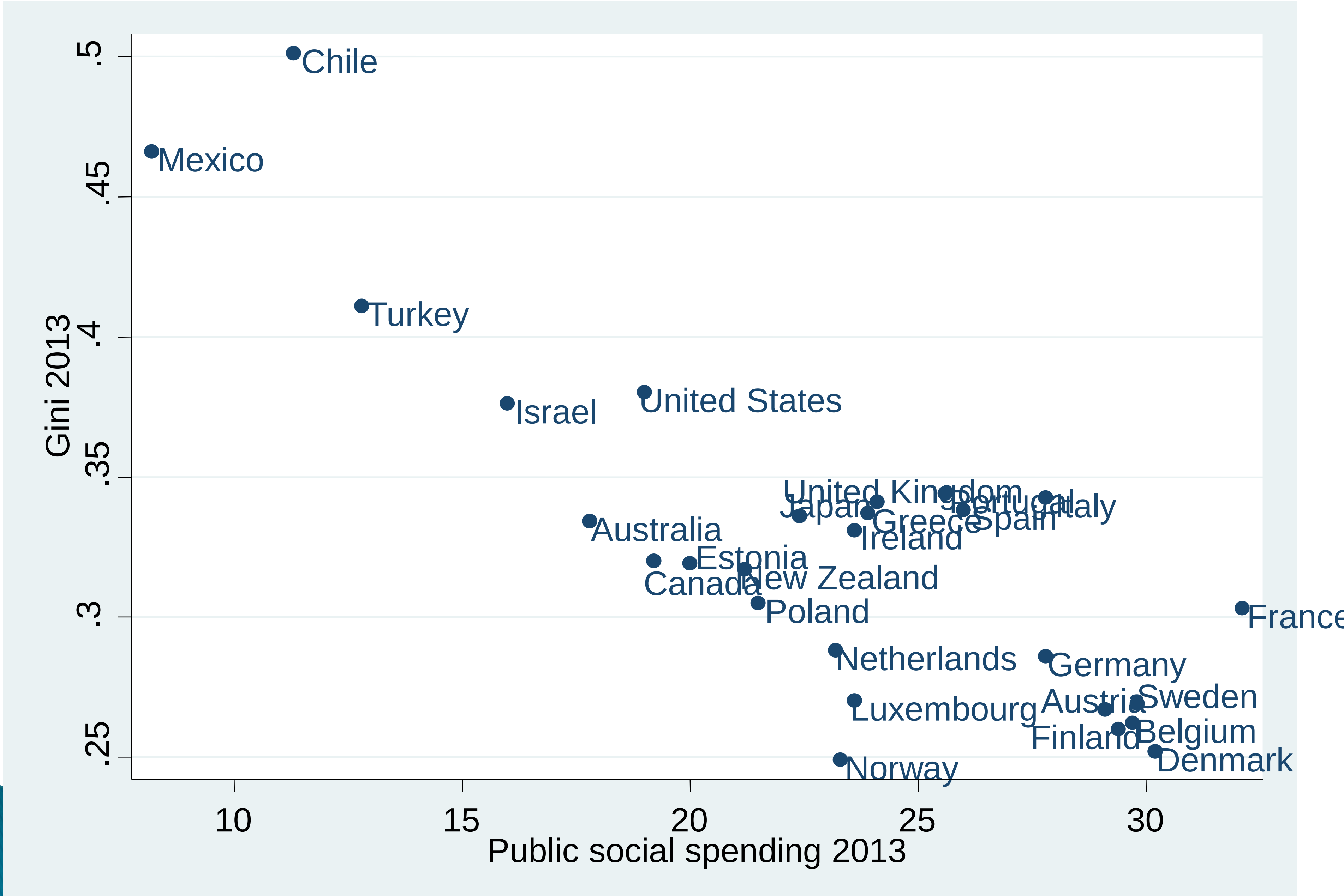
INVESTMENTS

Inequality and welfare

- Finally, income distribution was worsened by the retrenchment of the welfare state : with the justification that firms would be more competitive, and economies could attract more capitals as the so-called "efficiency thesis" would suggest.


Expansion and retrenchment of Welfare State
1960-2007
20
15
10
5
1960
1965
1970
1975
1980
1985
1990
1993
1997
2002
2007
Source: own elaboration on OECD data

Figure– Inequality (Gini) and Public Social Expenditure (% GDP)



The model:

$$Ineq = \alpha + \beta_1 F - \beta_2 EPL - \beta_3 TU - \beta_4 S + \varepsilon$$

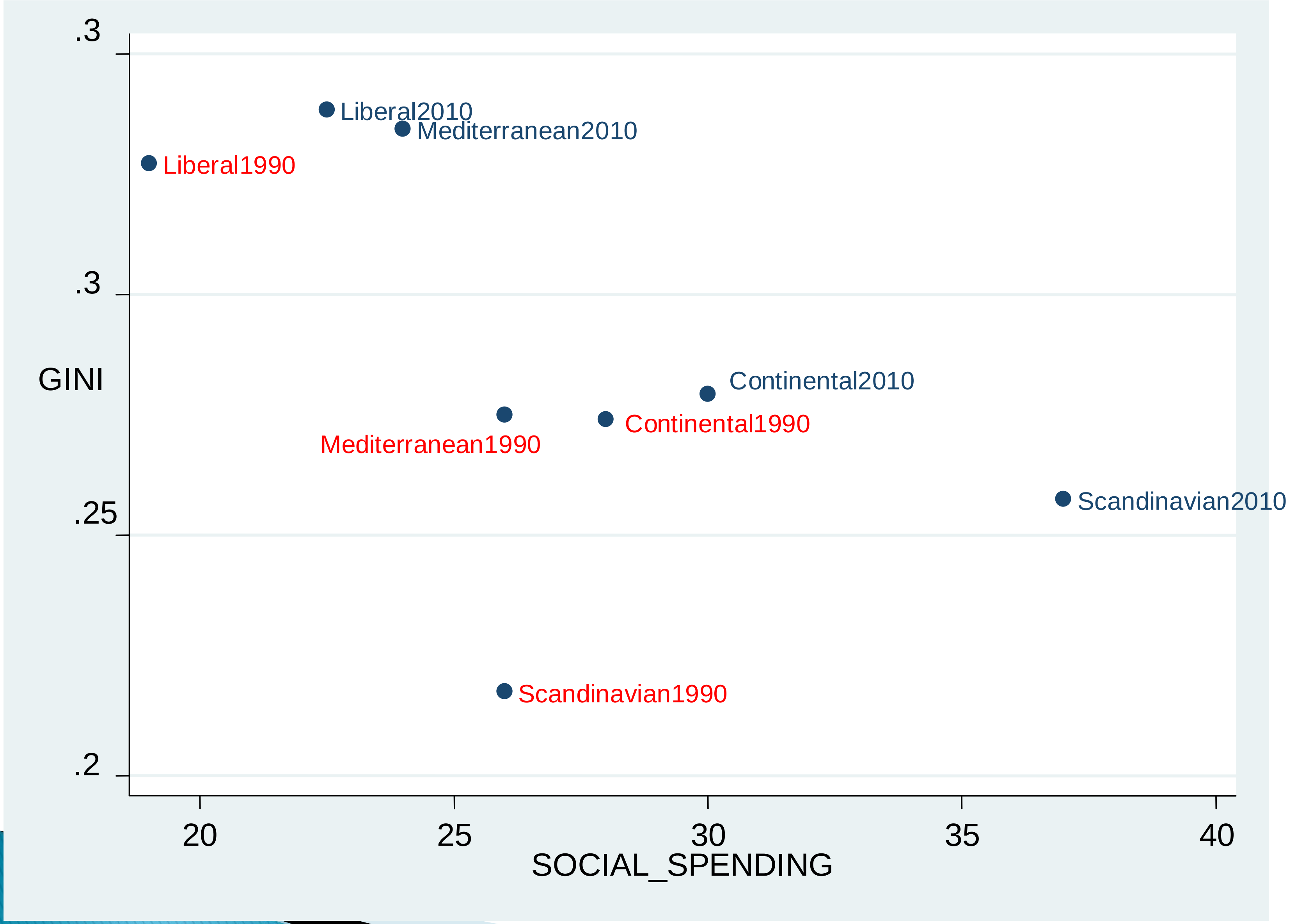
Dep.var. is: inequality (Ineq)

Indep. Var. are:

financialisation (F),
labour flexibility (EPL Employment Protection Legislation),
trade union density (TU)
public social spending (S).
I use panel data for 34 OECD countries from 1990 to 2013,
for a total of 816 observations.

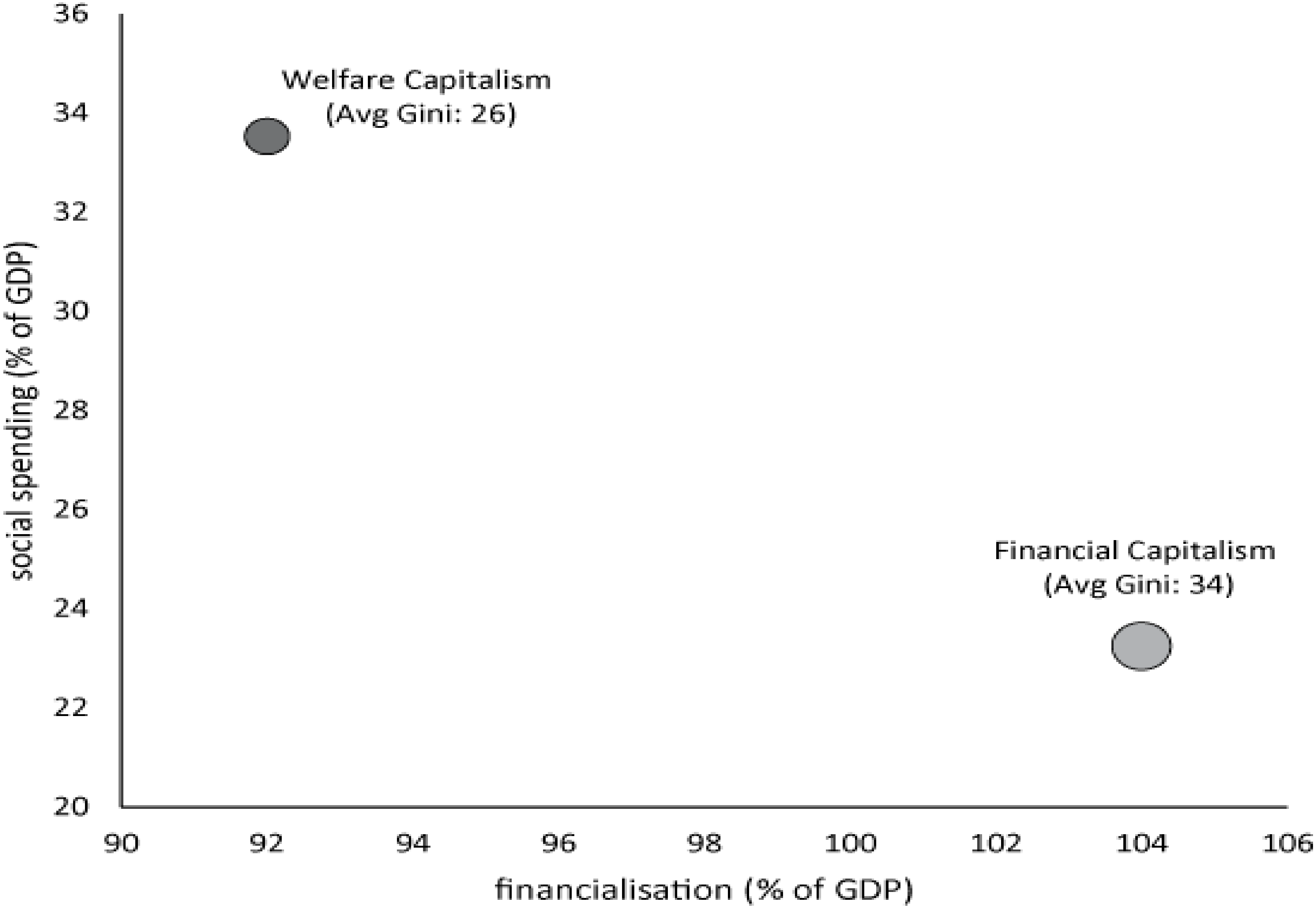
	Random-effects GLS regression		Fixed-effect Regression
	Number of obs = 816; Number of groups = 34; anel = 1990-2013		
	Model I	**Model II (with control var)**	**Model III**
Var	Coeff (St. er. in brackets)	Coeff (St. er. in brackets)	
Financialisation (F)	.0000502** (.000019)	.0000459** (.0000214)	.0000451** (.000021)
EPL (LF)	-.0040886** (.0021277)	-.0051814** (.0024638)	-.0061798** (.0025251)
TU density (TU)	-.0005735* (.0001389)	-.0005768* (.0001975)	-.0004044*** (.0002232)
Social Spending (S)	-.000829* (.0002327)	-.0010213* (.0003015)	-.0007598** (.000301)
Unemployment		.0000153 (.0002661)	-.0000472 (.0002632)
FDI in		.0000543 (.0000604)	.0000384 (.000059)
Import		-.0001758 (.0001385)	2.92e-06 (.0001501)
Econ. Growth		.0001935 (.0002315)	.0001312 (.0002276)
Tertiary Education lev		-.0001815 (.0003467)	.0001228 (.000372)
Time dummies (years 1990-2013)	YES	YES	YES
Constant	.3530048 (.0124588)	-.2291932 (.4890413)	.2456811 (.5126353)
	R-sq = 0.2437	R-sq = 0.3167	R-sq = 0.1447

welfare evolution



Welfare Capitalism vs Financial Capitalism

Welfare Capitalism and Financial Capitalism



Some Conclusion

- the increase in inequality, which has been very marked over the last two decades, is due to a radical change to the main features of the socio-economic model of advanced economies.
- This change involves
  - a shift towards financialisation,
  - a pressure on labour through increased labour flexibility,
  - the decline of trade unions' power and
  - the retrenchment of public social spending.
- Our sample was composed of data for 34 OECD countries during the period between 1990 and 2013. The econometric analysis produced very interesting results and the regression confirmed our hypothesis