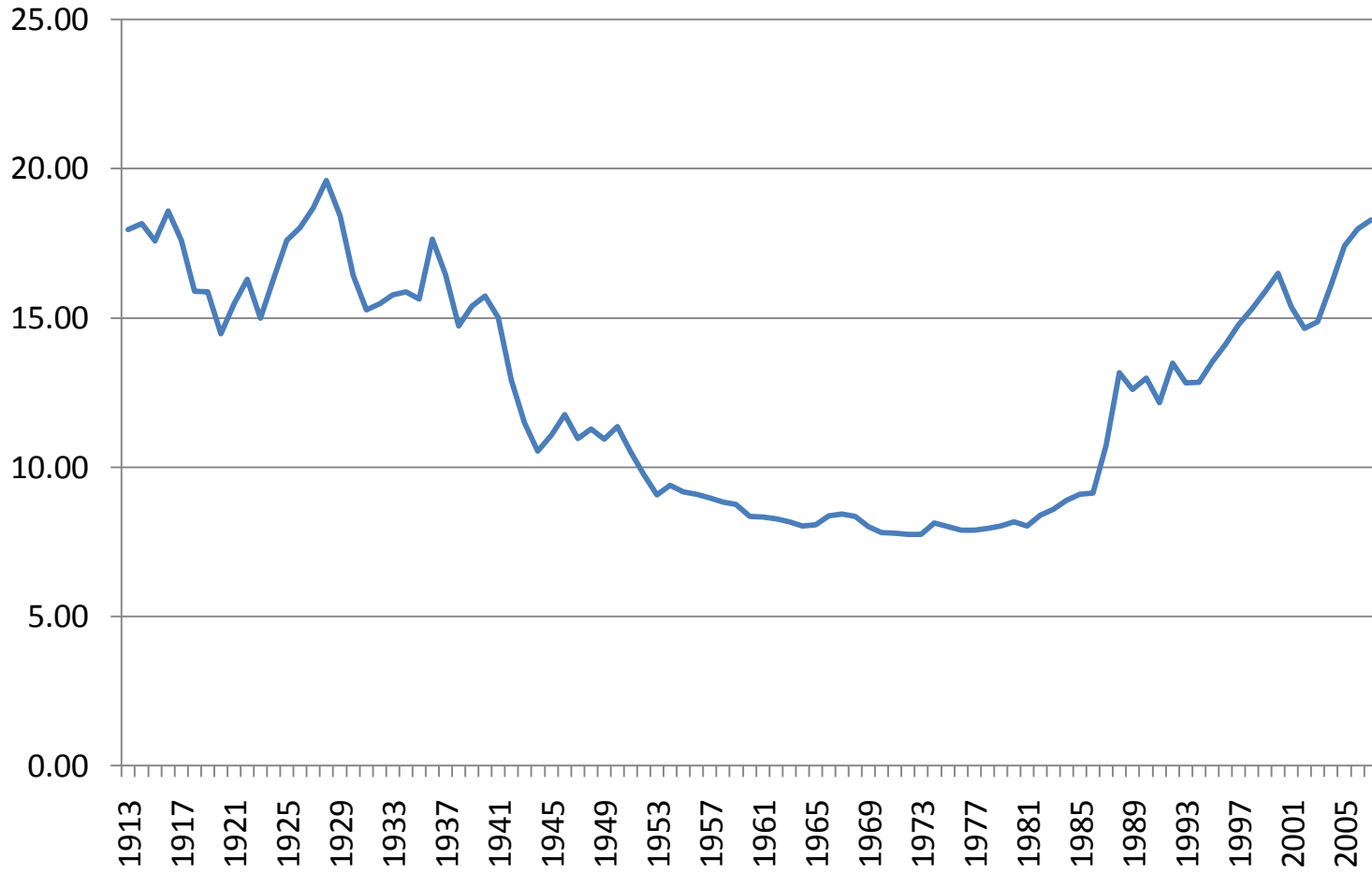


# Inequality and crises: coincidence or causation?

Paul Krugman

## Top 1% share



Source: Piketty and Saez

Pre-2008: When I would talk to lay audiences about inequality, I would mention that we were reaching levels not seen since 1929 – and that would inevitably lead to questions about whether we would soon have another Depression. No, I'd say – there really isn't a clear reason why high inequality should lead to macroeconomic crisis.

And then ....



Sources: Eichengreen and O'Rourke, World Trade Monitor

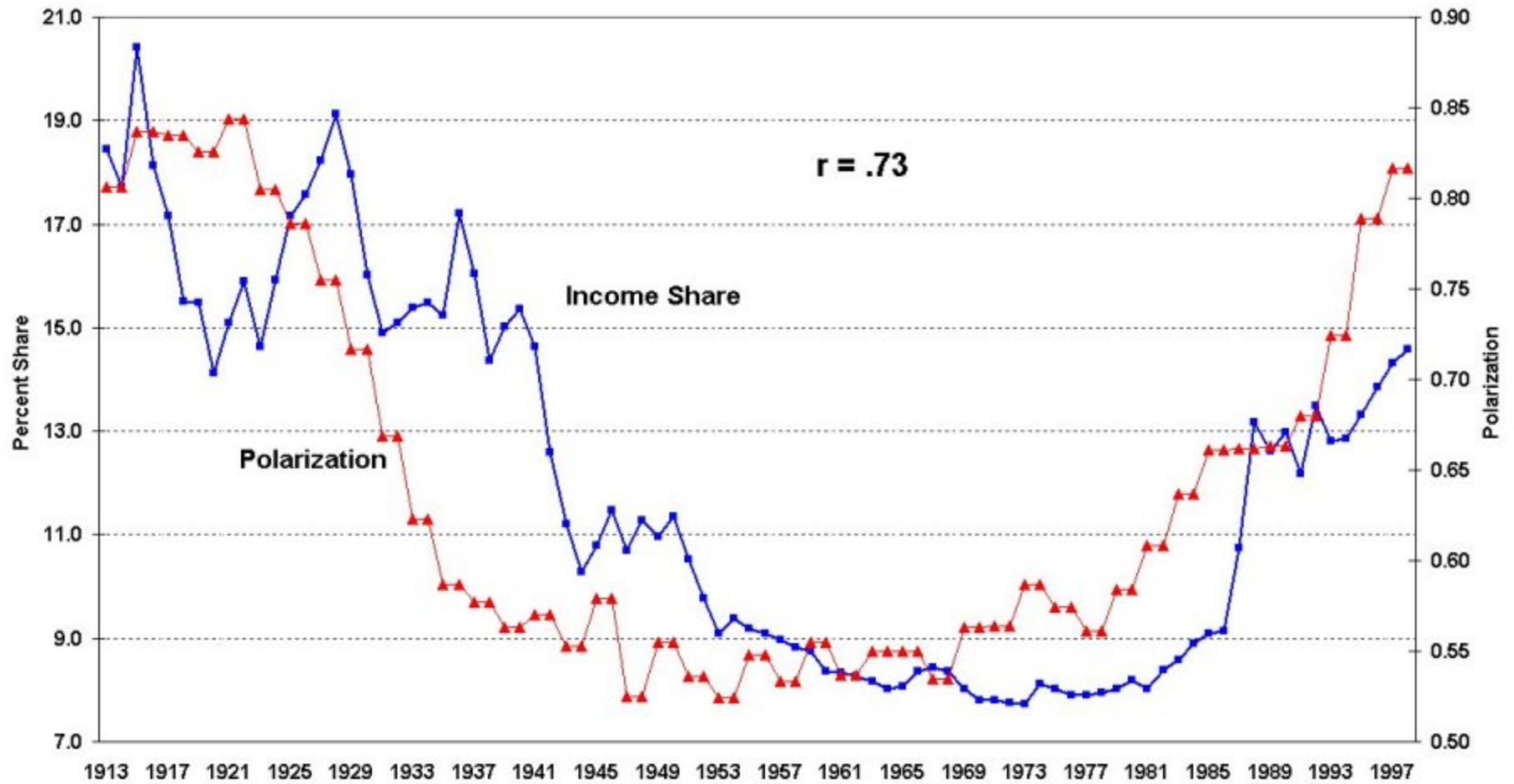
So a return of inequality to 1920s levels was followed by a financial crisis similar to the onset of the Great Depression. Why? Three possibilities:

1. Coincidence
2. Common causation – e.g., neoliberal ideology
3. Actual causation: inequality somehow creates macroeconomic vulnerability

Sharp rightward shift in politics in US and to lesser extent UK circa 1980. Reflected in polarization, and also in policies – including financial deregulation.

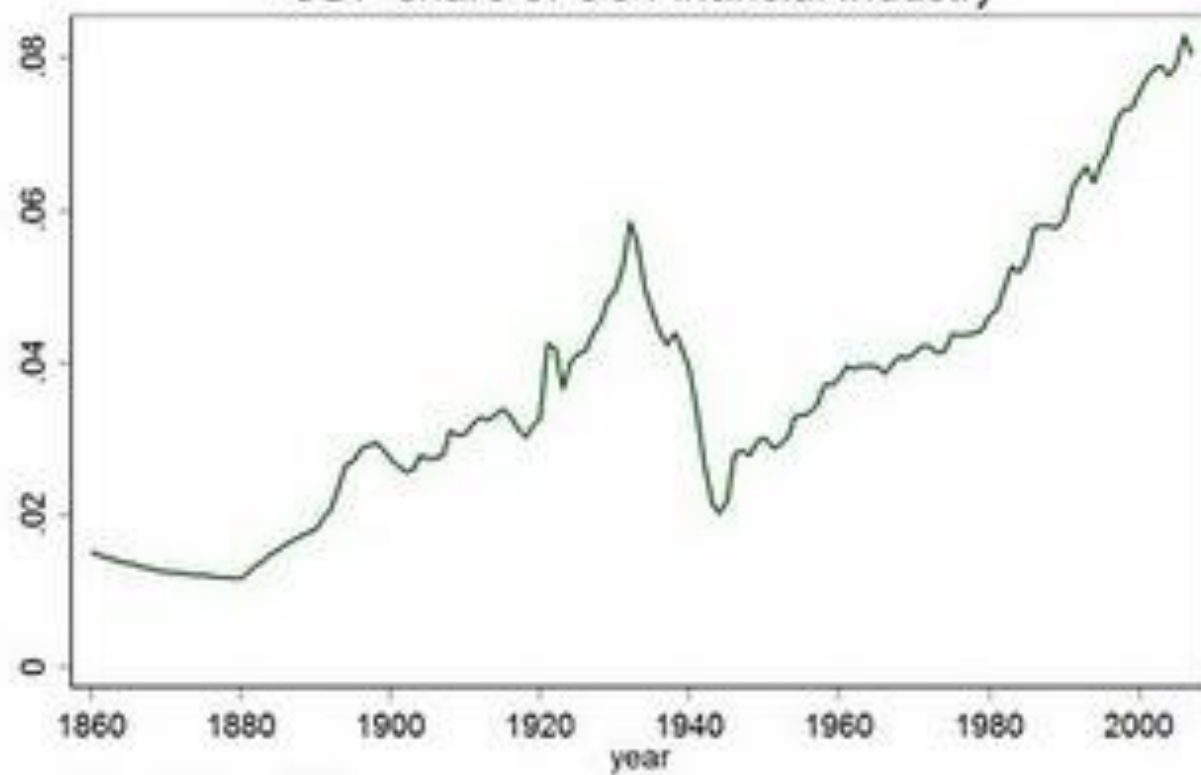
Also, strong correlation between political shifts and inequality.

## Top 1% Income Share and House Polarization 1913 - 1998



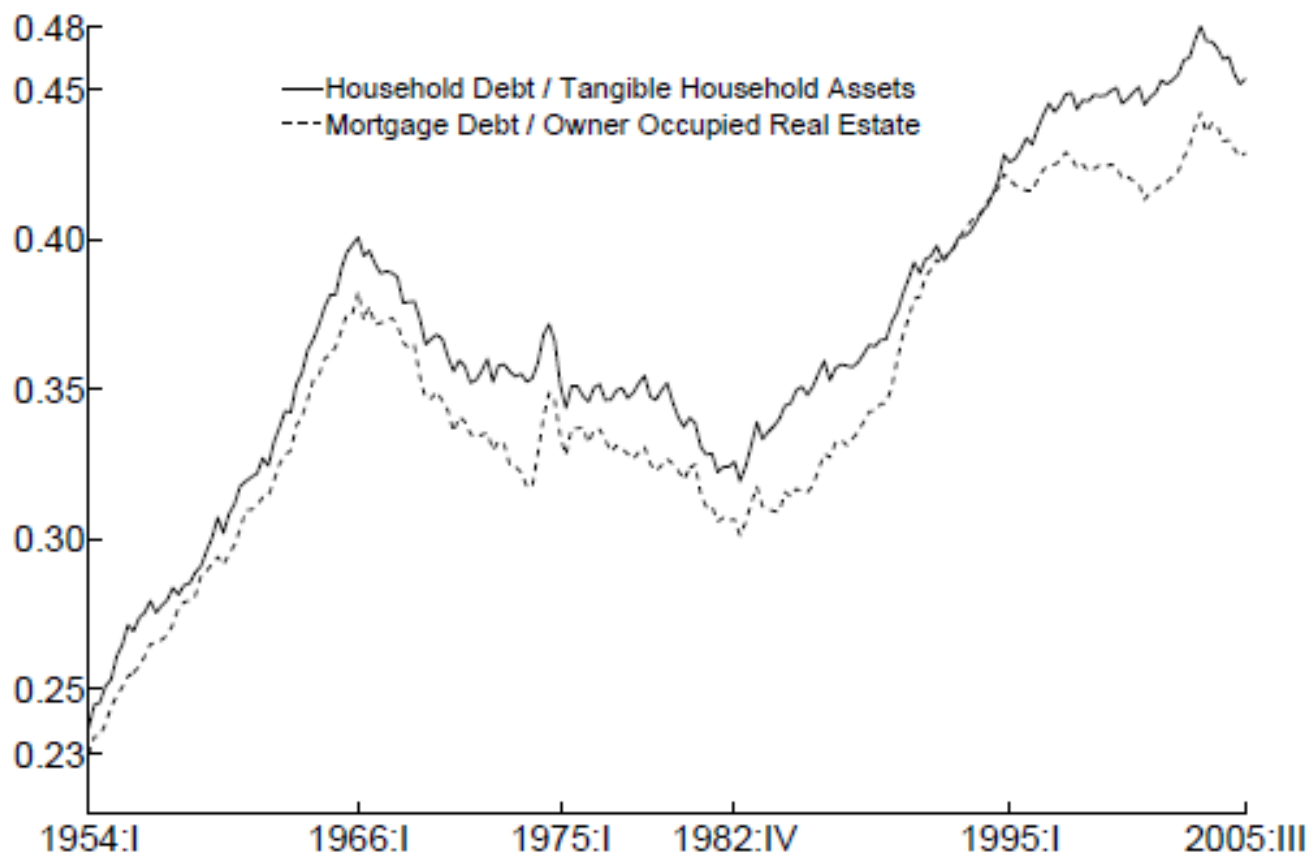
Source: Poole and Rosenthal

GDP share of US Financial Industry



Source: Philippon, 2008





Source: Campbell and Hercowitz

So political shifts may have led both to rising inequality and to a more vulnerable financial system

But might there be a direct causal link from inequality to macro crisis?

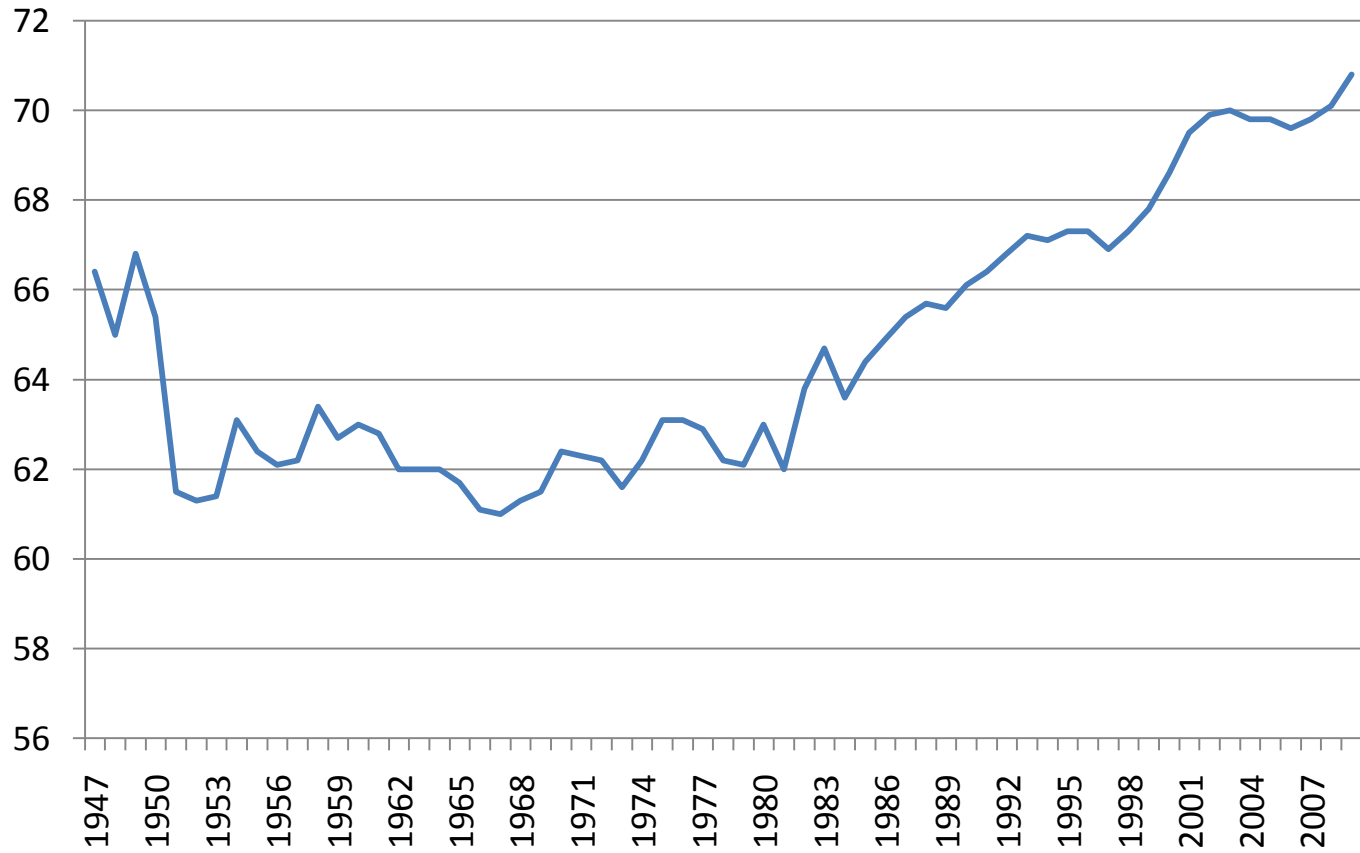
Hobson's choice: underconsumption theory

Robert Reich: “The problem wasn't that consumers lived beyond their means. It was that their means didn't keep up with what the growing economy was capable of producing at or near full-employment. A larger and larger share of total income went to people at the top.

“So in the longer term, it's hard to see where the buying power will come from unless America's vast middle class has more take-home pay.”

But underconsumption has both conceptual problems and empirical troubles.

## Consumption share of GDP

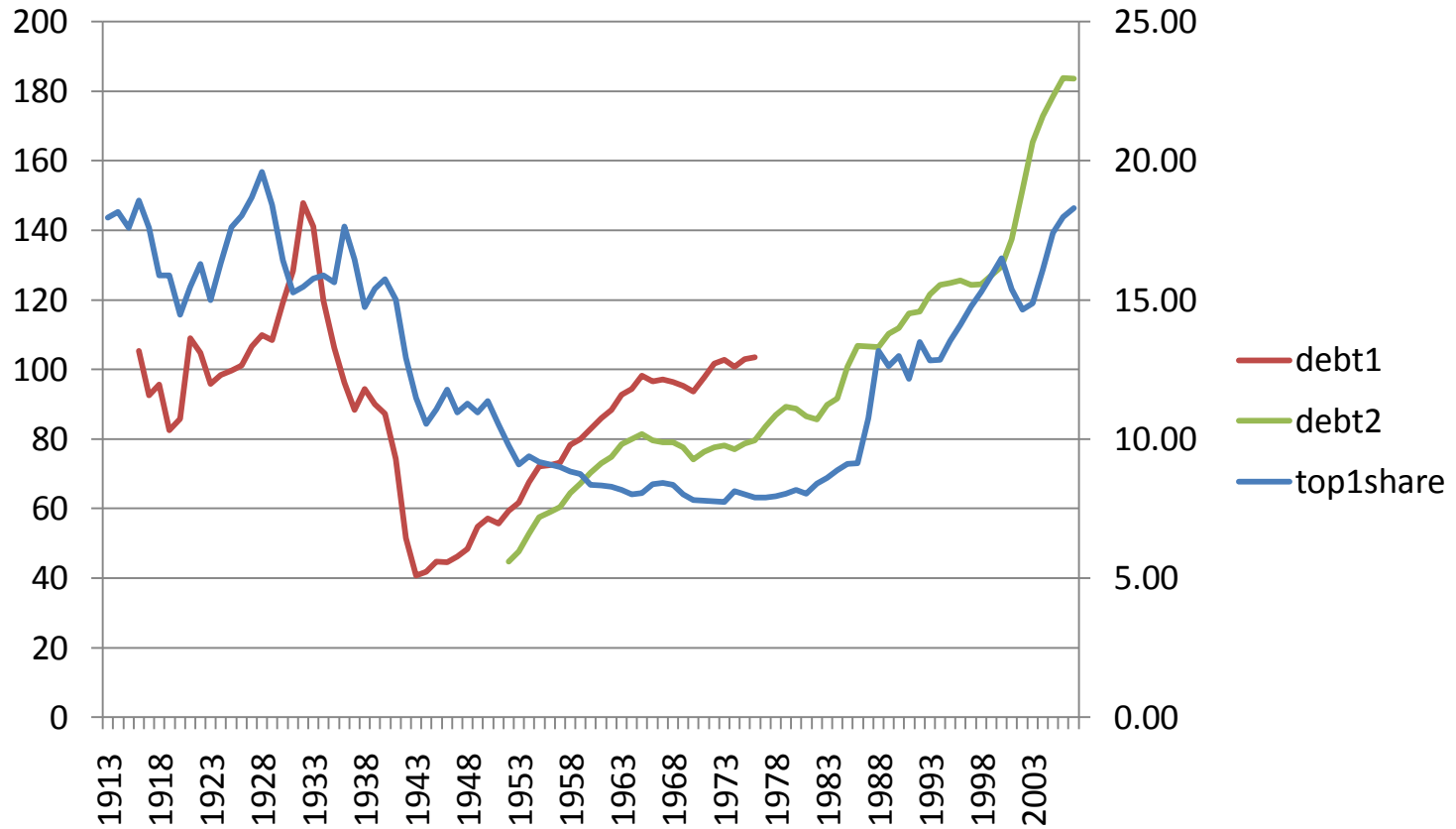


Modern ideas: overconsumption (and over-indebtedness), not underconsumption

Frank: “The wealthy are spending more now simply because they have more money. But their spending has led others to spend more as well, including middle-income families. If the real incomes of middle-class families have grown only slightly, how have they financed this additional consumption? In part by working longer hours, but mainly by saving less and borrowing more.”

Also see Warren-Tyagi on bankruptcies.

## Inequality and household debt



Sources: Piketty-Saez, Historical Statistics, Federal Reserve

