

# Why Income Inequality Matters for Macroeconomics

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# Acknowledgment

- Co-authored work: Barry Cynamon and Steven Fazzari
  - Opinions belong to the authors and not the institutions with which they're affiliated
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# The Plan

- This session: “Macroeconomic Causes of Inequality”
- Our work: effects of inequality on macro, but the links go both ways
  - Key issue is how inequality has affected consumption demand
- Barry: some tricky measurement issues
- Steve: perspectives from our new data on rising inequality and slow U.S. growth

# Motivation – Part 1

- Demand effects of household sector
- Consumption drives much of the economy
- PCE vs. what households actually spend
- Prime example: residential construction vs. imputed rent on owner-occupied housing

# Motivation – Part 2

- Disaggregation of household flows using household micro data
  - Example: recent work on rising inequality and consumption
  - Need disaggregated data
- Inconsistency between representative surveys and macro measures
  - Not just sampling error; important conceptual differences

# Objectives: Measure Actual Cash Flows

- Eliminate imputed value of services in consumption
  - Spending versus some concept of “utility”
- Eliminate spending not controlled by households
  - Example: Medicare
- Cash flow concept of disposable income
  - Flow of funds under household control
- Concept likely to correspond better with flows households report on surveys
  - Household financial flows the way households actually see these flows

# Key Identity

- Accounting identity maintained before and after adjustments:

$$\text{Disposable Income} = \text{Household Consumption} + \text{Household Investment} + \text{Transfers \& Interest} + \text{Financial Saving}$$

- Identity holds in NIPA
  - Household investment not distinguished from financial saving
- Adjustments to consumption or income require balancing change elsewhere
- HH Demand = Consumption + HH Investment

# Housing Example (2013 \$billions)

	Disp. Income	Cons.	HH Invest.	Trans. & Int.	Fin. Saving
Implicit Rent	- 1326	- 1326			
Intermediate Inputs	+ 152	+ 152			
Mortgage Interest	+ 334			+ 334	
Depreciation	+ 312				+ 312
New Construction Single-Family Homes			+ 426		- 426
Broker commissions		+ 105	- 105		
<b>Total</b>	<b>- 528</b>	<b>- 1068</b>	<b>+ 321</b>	<b>+ 334</b>	<b>- 115</b>

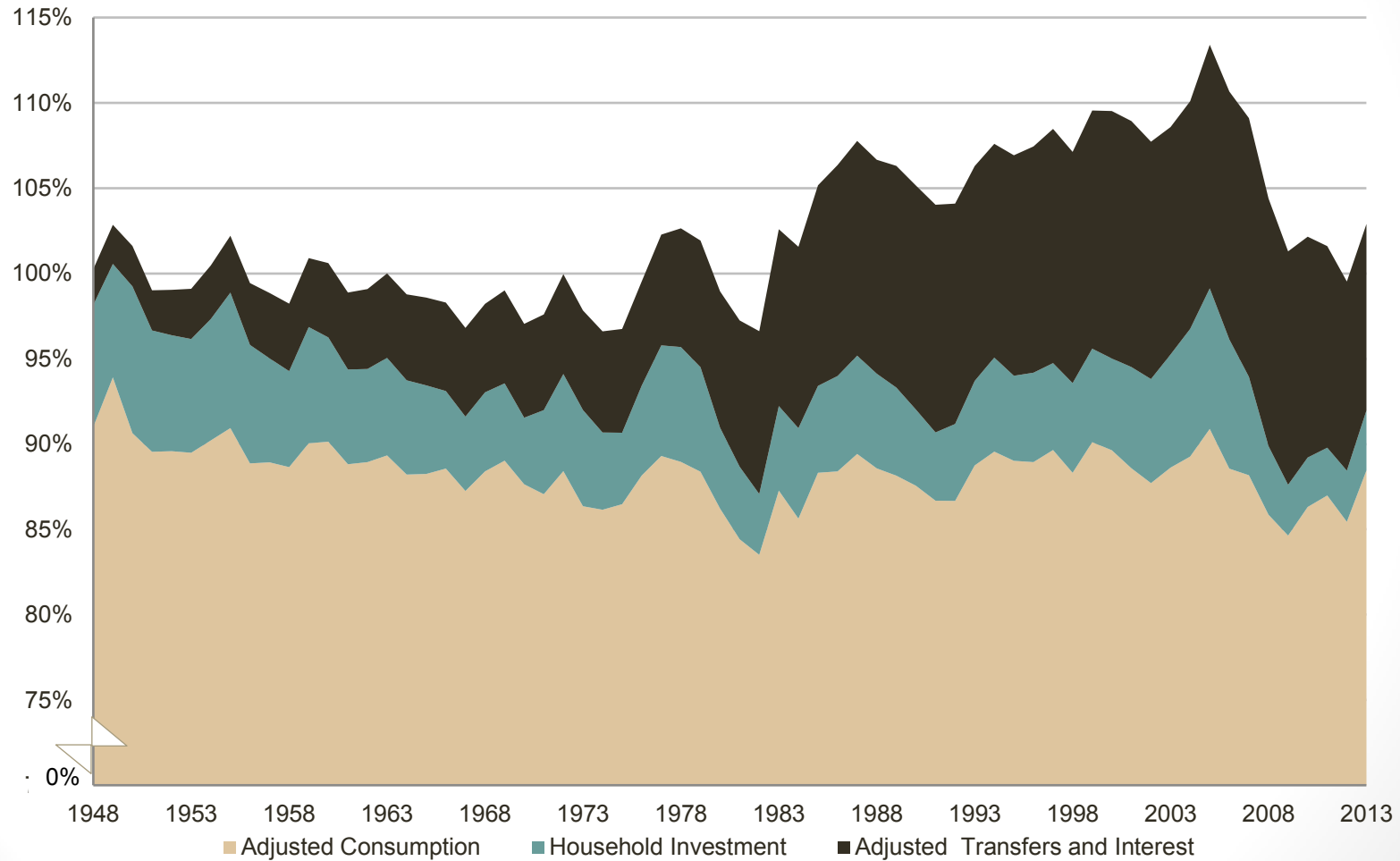
- Eliminate “rent home to yourself” business
  - Effect on Household Demand = -747
  - Effect on Household Income = -528



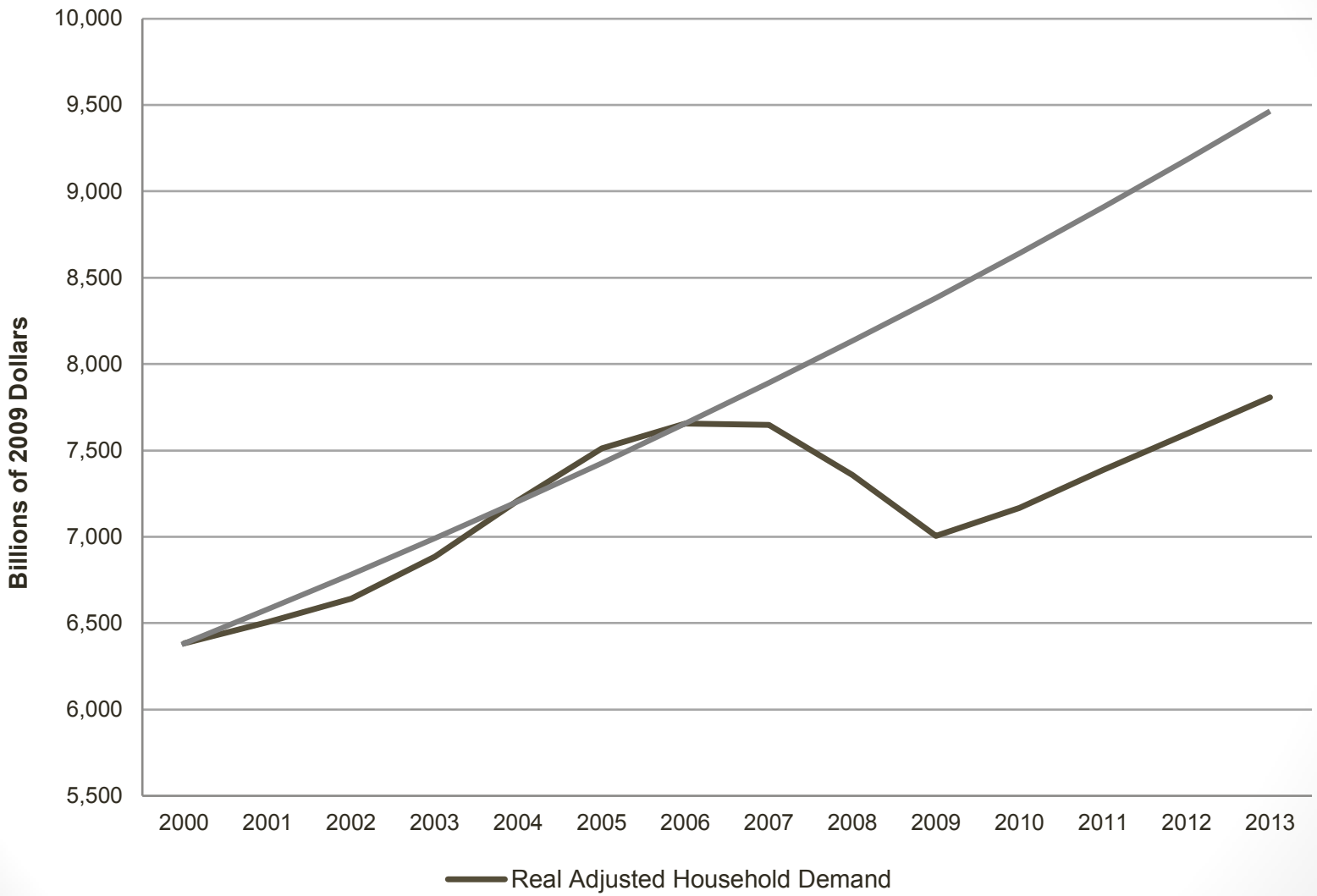
# Other Important Categories

- About 40 (!) separate adjustments
- Remove “NPISH” sector
- Free financial services
- Medical care
  - Employer and government, not households
- Retirement accounting
  - Exclude contributions by employers and government to defined benefit plans
  - Include benefits from DB plans

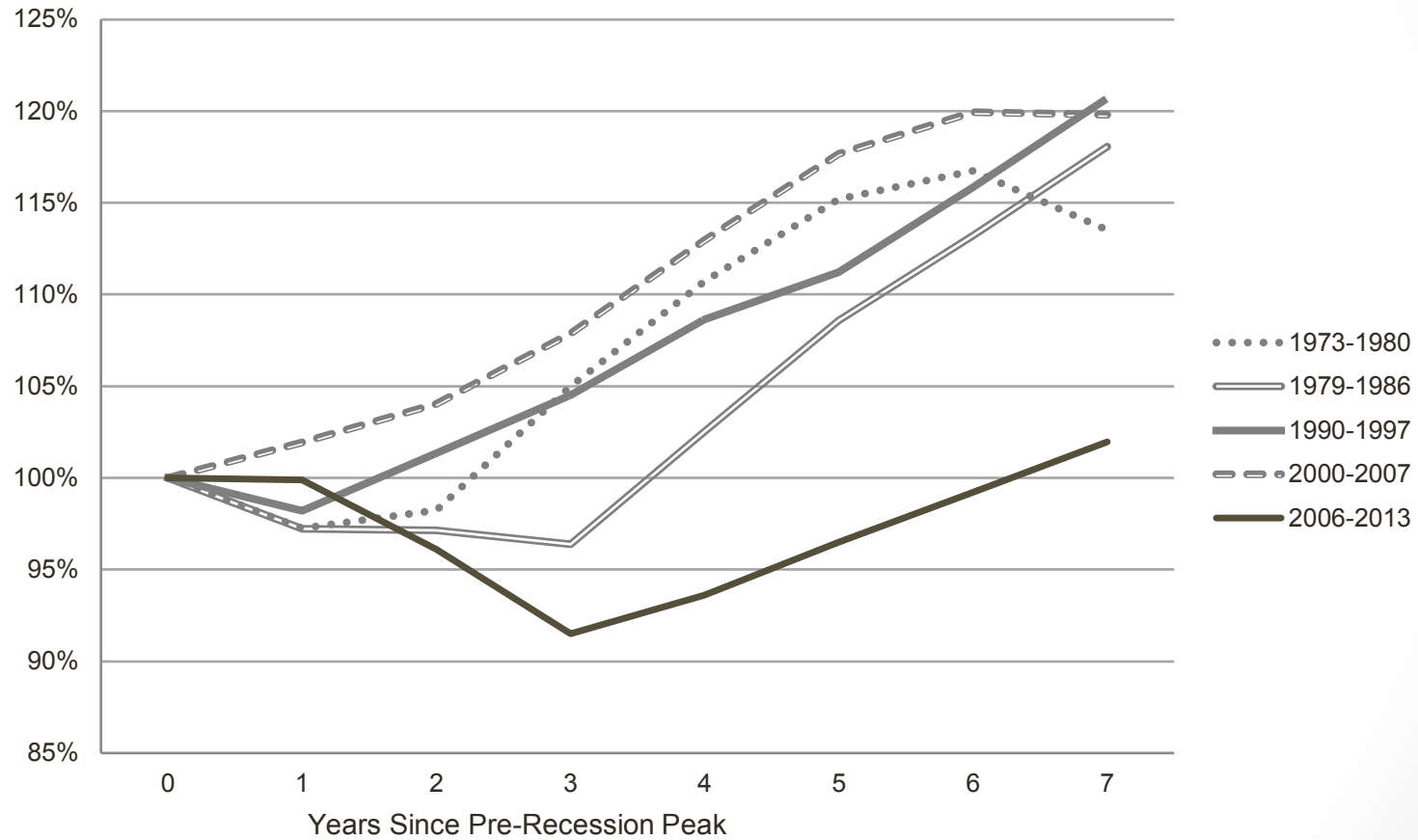
# Expenditure Shares of Income



# Motivating Fact: Stagnant Household Demand

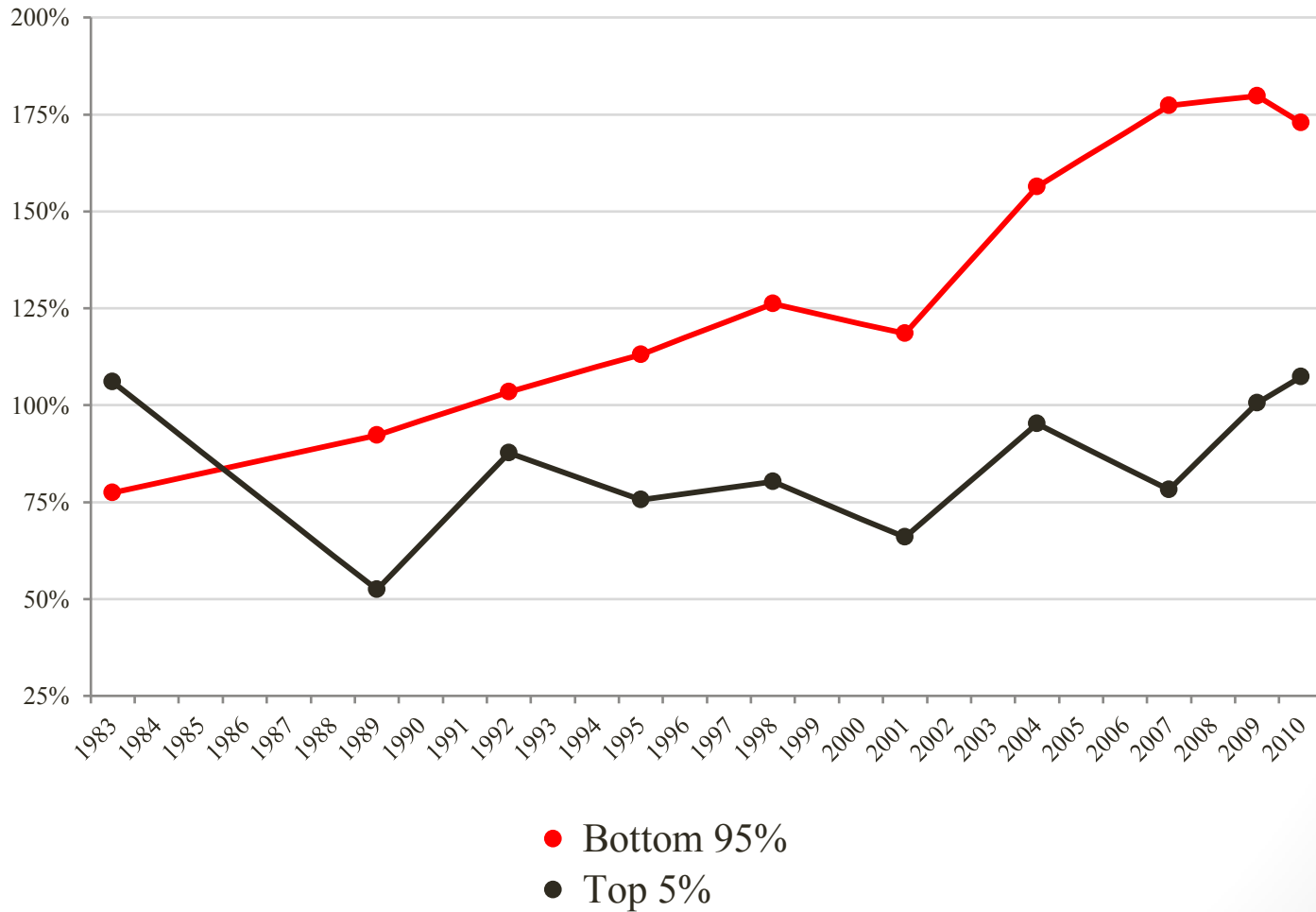


# Real Household Demand Profiles

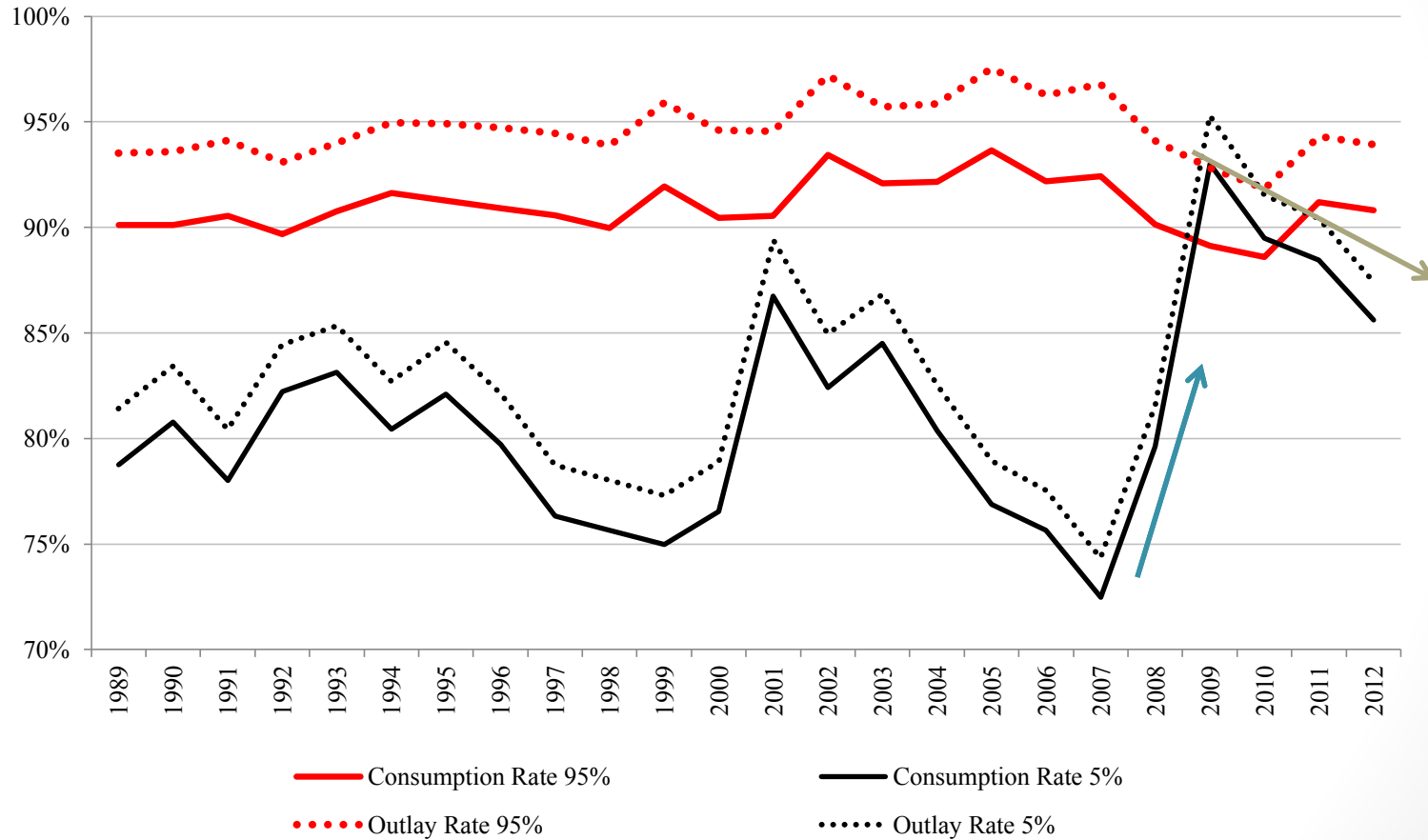


# Effect on Balance Sheets

## Debt-Income Ratios by Income Group

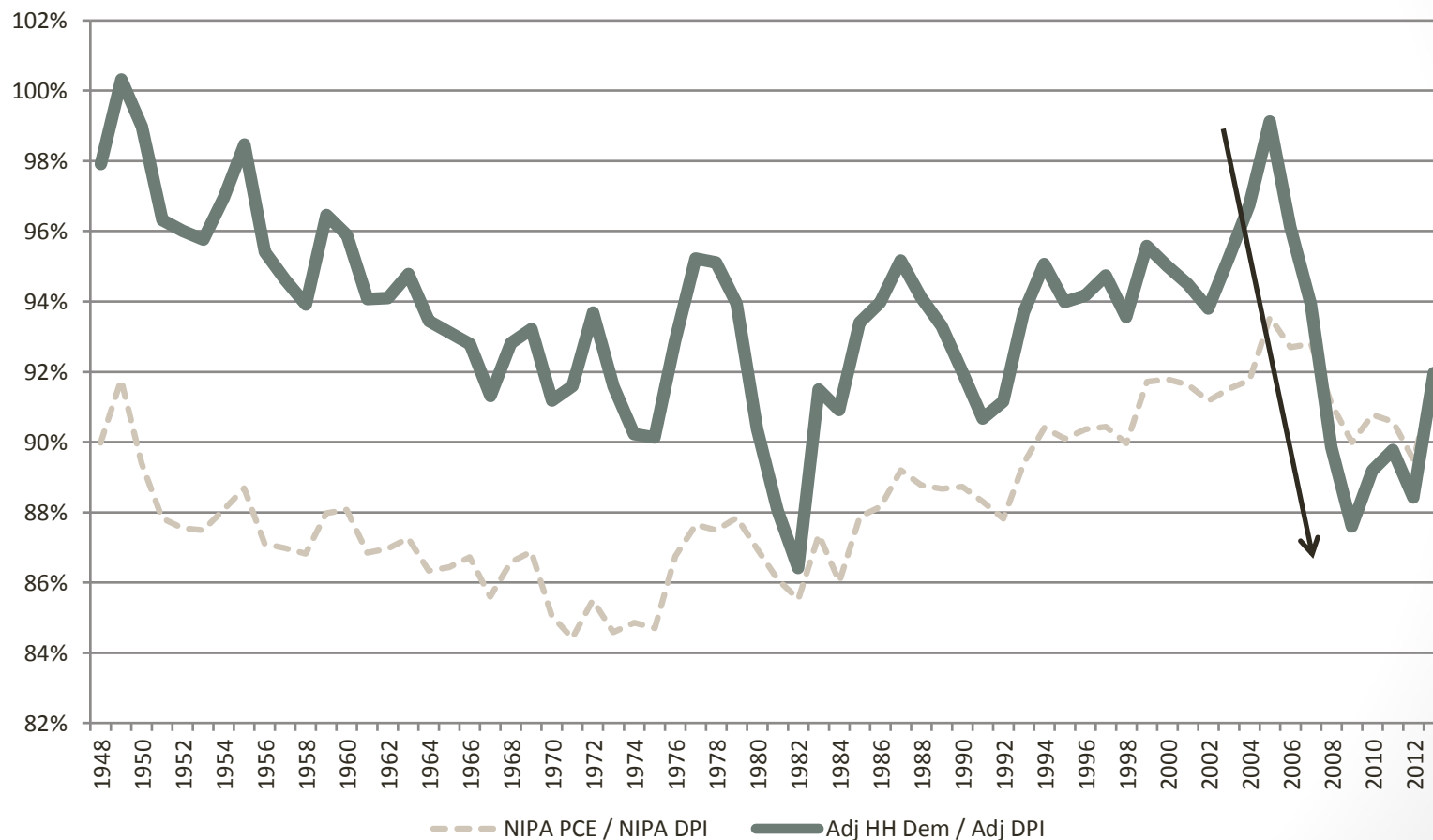


# Who Cut Back?



# Bigger Collapse: Cash Flow Measure

Demand Rates: NIPA Definition and Adjusted



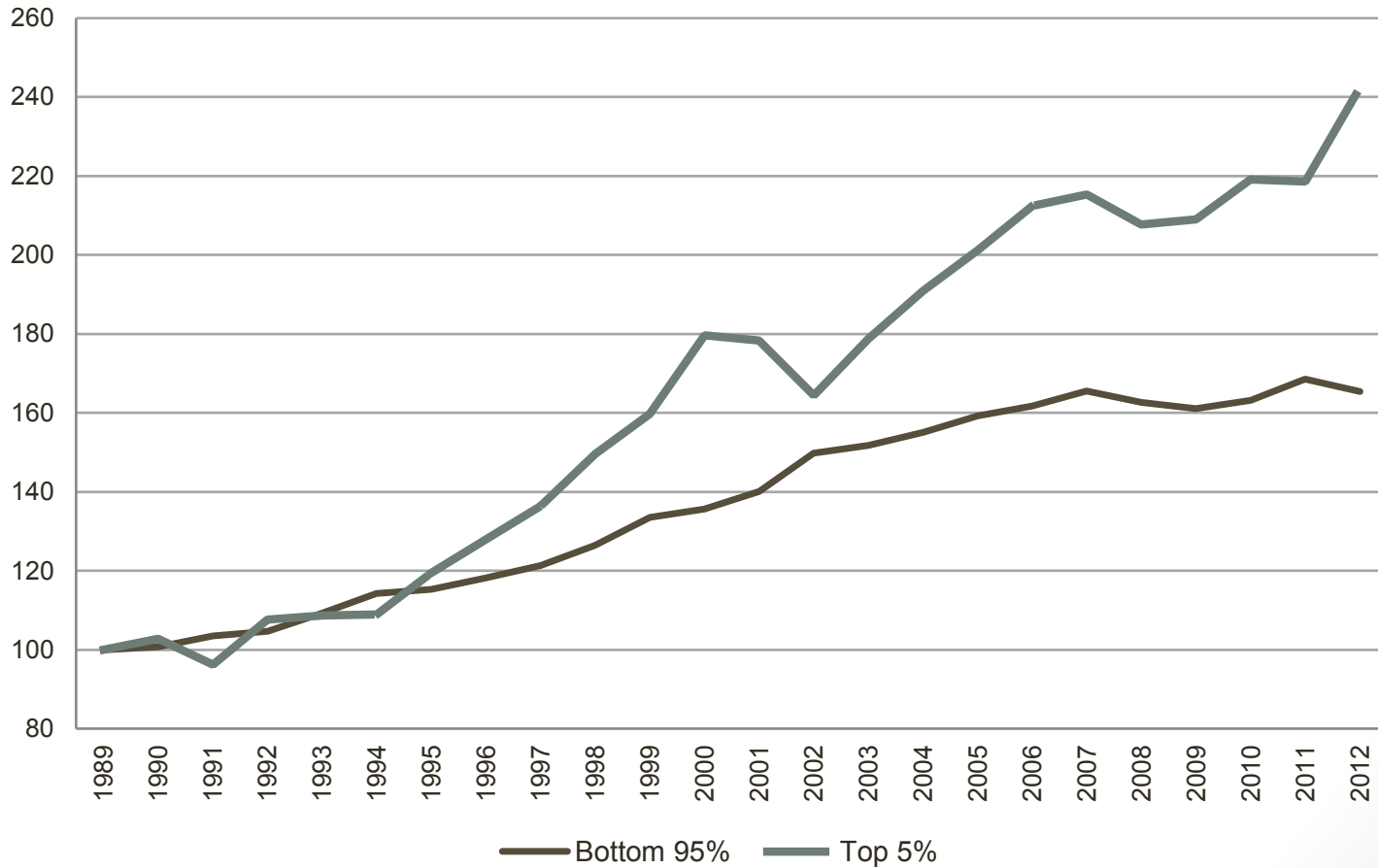
# Simple Multiplier Model

- Experiment: Shift the top 5% income share: 23% to 37%
- Assumptions
  - Tax rates: 0.4 (top 5%); 0.2 (others)
  - MPC (after-tax): 0.82 (top 5%); 0.92 (others)
- Distribution shift implies 9.5% drop in GDP
- Income distribution shift can explain substantial “secular stagnation”



# The Affluent as Growth Engine

Index of Real Consumption, Bottom 95% and Top 5% (1989=100)



# Challenge to Economic Democracy

## Personal Consumption Shares of Total

