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:

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

• 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)

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

- 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

Adjusted Consumption
Household Investment
Adjusted Transfers and Interest
Motivating Fact: Stagnant Household Demand

Real Adjusted Household Demand

Billions of 2009 Dollars

Real Household Demand Profiles

Years Since Pre-Recession Peak

- 1973-1980
- 1979-1986
- 1990-1997
- 2000-2007
- 2006-2013
Effect on Balance Sheets
Debt-Income Ratios by Income Group

- Bottom 95%
- Top 5%

Graph showing the trend of debt-income ratios from 1983 to 2010.
Who Cut Back?

![Graph showing consumption and outlay rates from 1989 to 2012. The graph indicates a decline in both consumption and outlay rates, with consumption rates stabilizing at around 95% and outlay rates at around 5%. The years 1989 to 2012 are marked on the x-axis, while the y-axis ranges from 70% to 100%.

Legend:
- Red line with dots: Consumption Rate 95%
- Black line with dots: Consumption Rate 5%
- Red line with dots: Outlay Rate 95%
- Black line with dots: Outlay Rate 5%]
Bigger Collapse: Cash Flow Measure

Demand Rates: NIPA Definition and Adjusted

NIPA PCE / NIPA DPI
Adj HH Dem / Adj DPI
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)

- Bottom 95%
- Top 5%
Challenge to Economic Democracy

Personal Consumption Shares of Total

- Black line: Bottom 80% (Right)
- Red line: Top 5% (Left)