INCOME INEQUALITY AND ECONOMIC GROWTH

BARRY Z. CYNAMON

Federal Reserve Bank of St. Louis
Center for Household Financial Stability

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- Opinions are mine and not those of the Fed
BACKGROUND

- Income Shares
  - Share of top 5% stable from 1960 – 1980
  - Increases steadily between 1980 and 2007

- Consumption
  - Consumption share of GDP stable from 1960 - 1980
  - Increases steadily between 1980 and 2007

- Debt
  - Debt to income ratio stable from 1960 – 1980
  - Doubles between 1980 and 2007

- Great Moderation
  - Decline of GDP volatility starting in mid 1980s
RICH GOT RICHER

Income share of the top 5% of US households

Source: The World Top Incomes Database
CONSUMPTION DROVE ECONOMIC GROWTH

Consumption share of GDP

Source: BEA National Income and Product Accounts
HOUSEHOLDS DOUBLED THEIR LEVERAGE

Debt to income ratio of US households

Source: FRB Flow of Funds
GREAT MODERATION OF MACRO VOLATILITY

Twelve quarter rolling S.D. of GDP growth (index = 100 in 1985)

Source: BEA National Income and Product Accounts
In 2007, should we bet on Lucas or Minsky?

“[The] central problem of depression-prevention [has] been solved, for all practical purposes.”


“A fundamental characteristic of our economy is that the financial system swings between robustness and fragility...”

-Minsky (1974)
MOTIVATION II

Team Lucas
GDP growth volatility down
Steady economic growth

Team Minsky
Rising household leverage

Rising income inequality??

Need to look at disaggregated data.
DISAGGREGATED VIEW: INCOME

- Source of rising inequality?

  Acceleration at the top vs. stagnation at the bottom

Real annualized growth rates

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<tr>
<td>Top 5%</td>
<td>4.0%</td>
<td>5.0%</td>
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<tr>
<td>Bottom 95%</td>
<td>3.9%</td>
<td>2.6%</td>
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DISAGGREGATED VIEW: CONSUMPTION

Consumption to income ratio of US households

Source: FRB Flow of Funds, Survey of Consumer Finances, Calculations by Mark Zandi and authors
DISAGGREGATED VIEW: DEBT

Debt to income ratio of US households

Source: FRB Flow of Funds, Survey of Consumer Finances, authors’ calculations
Financial net worth to income ratio of US households

Source: FRB Flow of Funds, Survey of Consumer Finances, authors’ calculations
SUMMARY OF EVIDENCE IN 2007

**Top 5%**
- Income share rising
- Evidence of consumption smoothing
- Rising leverage
- Rising financial net worth

**Bottom 95%**
- Income growing slowly
- Rapidly rising leverage
- Shrinking financial net worth

What happens when the leverage ratio of the bottom 95% stops rising?
Consumption to income ratio of US households

Source: FRB Flow of Funds, Survey of Consumer Finances, Calculations by Mark Zandi and authors
DISAGGREGATED VIEW: CONSUMPTION LEVELS

Real consumption of US households

Billions of (2005) Dollars


Source: FRB Flow of Funds, Survey of Consumer Finances, Calculations by Mark Zandi and authors
GDP AFTER THE CONSUMER AGE

Real Gross Domestic Product, Chained Dollars (exponential trend)

Source: BEA National Product Accounts
CONCLUSION: A NEW ERA?

- Short history of U.S. demand generation
  - Postwar shared prosperity
  - Rising inequality and unsustainable Consumer Age
  - Recession and secular stagnation

- Link between income distribution dynamics and macro dynamics: **not a coincidence**