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THE BIG PICTURE ON INEQUALITY TRENDS?

Review of *Inequality and Instability: A Study of the World Economy Just Before the Great Crisis*, by James K. Galbraith (Oxford University Press, Oxford, 2012)

Detail or Big Picture, focusing on the forest or on the trees, writing books or articles: what's the best strategy for understanding economic inequality? The incentives of tenure and promotion imply that most of the academic researchers writing on economic inequality are doing so primarily in the format of academic journal articles. With multiple referees to satisfy and strict page limits, the authors of articles are necessarily constrained in how much they can talk about and what they can say. Even if big social issues (like inequality) are nuanced, interrelated, and multidimensional, the journal article medium primarily rewards those who can provide rigorously tested answers to clearly defined (and often quite narrow) questions. Precision, focus, and carefully qualified conclusions are better predictors of the probability of journal acceptance (and all the good things that come with it—like continued employment) than holistic vision, range of ideas, or even social importance.

But although articles can typically only be marginal additions to ongoing specialist debates, books can offer a larger perspective to a wider audience. And it is in this sense that I think James Galbraith's new book makes its major contribution. Throughout the book, Galbraith emphasizes The Big Picture. Although he presents many regression results, he always emphasizes that the micro-economic determinants of individual pay and household incomes necessarily operate within a macro-economic context. At any moment in time, in Galbraith's perspective, the long-run structural changes of economic development and the immediate impact of macro-economic policy decisions and the business cycle combine to determine the structure and level of aggregate demand—and both Supply and Demand should be considered in the analysis of economic inequality. Specifically, Galbraith's long-run perspective owes a great deal to the Kuznet's vision of structural changes of capitalist development which change economic inequality over time by changing the relative incomes and relative population importance of different economic sectors. He combines this with a Keynesian emphasis on the many impacts of deficient aggregate demand for labor and the importance for unemployment, wages, and pay inequality of high interest rate monetary policy and contractionary fiscal policy.

The explicitness of his big picture perspective sets Galbraith apart—most journal articles try to avoid mentioning the possibility that uneven development or market disequilibrium might ever exist—and as one might expect, Galbraith also has lots to say about the evolution of economic thought. As he notes, when economists were fewer in number and less specialized in focus, inequality in factor income shares was seen as a central issue in macro-economics—but inequality disappears in macro-economic theories based on representative agents. Coincidentally with the emergence of representative agent macro, he notes the explosion of micro-data based analyses of individual income determination. However, largely because household surveys can only gather reliable data on household characteristics, that literature has become dominated by "supply-side" explanations. Hence, the demand side of labor markets largely disappeared from both macro and micro economic analyses of economic inequality. Today, micro and macro economists also tend to read different journals and go to different conferences—theoretical perspectives have become increasingly fragmented.

Galbraith, however, is not shy about connecting the dots—both between micro and macro and between economic theory and ideology. Chapter 8, for example, debunks the idea that higher European unemployment (prior to 2007) was due to some sort of "excessive solidarity in the European wage structure," and Chapter 9 challenges the notion of wage inflexibility within Europe. Throughout the book, one can sense that the author takes a positive pleasure in deflating any available balloon of empirical support for simplistic bromides of neo-liberal political economy.

The first four chapters of the book present and justify the core methodology, which rests on "a simple insight: the major contours of inequality between people could be captured, substantially, by measures of inequality between *groups* to which those persons belong" (p. 8). In practice, this idea is operationalized by calculation of the *between-group* component of the Theil Index. The key dataset is UNIDO statistics on the average earnings and employment, by industrial sector, of manufacturing workers, which are available for almost all countries, for many years. Chapters focusing on the U.S. use BLS data, while the China, Brazil/Argentina, and Cuban chapters use similar data from administrative social security records. However, throughout the book the inequality concept used to summarize these differences between employment sectors is a Theil Index of the inequality of average rates of pay between manufacturing industries, weighted by size of industrial sector.

"Economic Inequality" is certainly a multi-faceted social issue, so many readers will ask: why should one take this particular corner of the problem so seriously? In Chapter 4, a cross-country OLS regression takes the Gini Index of Household Inequality calculated from the Deninger–Squires database as the dependent variable and uses, as right-hand side variables, the between-group Theil (as calculated above), the percentage of workers in manufacturing, and dummies for data type (Income/Expenditure) or (Household/Personal) or (Gross/Net of Tax). An R^2 of 0.59 is obtained and Galbraith draws the conclusion that "there is a predictable relationship between inequality measures based on manufacturing pay and those based on surveys of income or expenditure" (p. 85). In examining the residuals from this regression, he does note that there are some countries (e.g., in sub-Saharan Africa) in which "manufacturing pay dispersions may be barely relevant to economic structure". However, such qualifications are rare—mostly Galbraith runs wholeheartedly with the idea that "changing inequality within manufacturing is likely to be a good proxy for changing inequality within the larger structures of pay" (p. 55).

Quite a few readers will quibble about this argument. For example, Atkinson and Piketty (2007) have shown that "Anglo" nations have experienced a rapid increase in the income share of the very top end, an increase not seen elsewhere. Twenty years ago, Levy and Murnane (1992) called attention to the long run increase in the U.S. in earnings inequality *within* groups (defined by education, age/experience, and gender). The roles of changing income sources and household demographics and the distinction between individual earnings inequality and household income inequality have recently been emphasized by Brewer and Liam Wren-Lewis (2012) in the U.K. context. They argue that these factors explain why, despite a fairly steady ongoing trend to increasing earnings inequality, the rapid rise in household income inequality of the 1980s in the U.K. came to a stop in 1991.[1] Around the world, the extent of increasing household income inequality driven by "power couples"—i.e., marital sorting and family labor supply decisions—has also been much examined (in the German context, see Pestel, 2012). These issues—the rising income shares of the very affluent, greater within-group pay dispersion, changing tax/transfer patterns of redistribution, changing income sources, changing patterns of family formation, and labor supply within households, etc.—are examples of just some of the rich bodies of research on economic inequality trends which lie outside the reach of Galbraith's methodology.

Nevertheless, Chapter 5 reports cross-country OLS results in which the level of inequality (in average pay across manufacturing industries) is regressed on the type of political regime—a strength of this chapter is its nuanced discussion of the differences between dictatorships, Islamic republics, communist regimes, and the social, pseudo, and recent varieties of democracies. Chapter 6 looks at the geographic dimensions of inequality within the U.S., combining Bureau of Economic Analysis (BEA) data across sectors and states and tax data on average income differences among the 3,150 counties that make up the U.S. In Chapter 7, voter choice in the 2000 Bush/Gore election, and from 1969 to 2004, is examined using BEA calculations of the Gini Index of household income inequality at the state level as the primary explanatory variable of interest and per capita income, urbanization, and percentage white and non-Hispanic as controls. Chapters 8 and 9 take up the relationship between inequality and unemployment, and between wage flexibility and unemployment, in Europe.

Chapter 10 then discusses globalization and the impact of trade and capital flows on industry/state sector inequality within China over the 1998 to 2007 period, during which China signed onto the World Trade Organization, exports boomed and inequality soared. Over roughly the same period, as Chapter 11 documents, Argentina and Brazil have seen declines in inequality as both countries "retreated—to a degree—from neoliberal globalization" (p. 265). From the early 1990s to 2004, the Cuban economy also had to adjust to the sudden withdrawal of trade subsidies and market access following the collapse of the USSR. Chapter 12 examines the impacts of this "Special Period" on average incomes, inequality across sectors, and economic policy—Galbraith argues that strong social security networks and centralized controls limited the extent of the rise in Cuban inequality. Can these nations reasonably be seen as paradigmatic cases for their regions? Even if they can, the Middle East, Africa, and India are still missing—but Chapter 13 then tries, in only five pages, to wrap all these disparate pieces up together and draw out the connections between Economic Inequality and the World Crisis.

[1]They ascribe this to a fall in inequality of investment and pension income and a decrease in the inequality between those with and without employment.

To some extent, the differing demands, as a medium of expression, of the book and the article are illustrated within this book. Articles demand a clear focus, which can be achieved by invoking "ceteris paribus" and ignoring inconvenient complications. Books have the space for discussion of many linked issues, but they need an over-arching narrative to tie them together. In this book, footnotes to Chapters 3, 4, 7, 8, 10, 11, and 12 identify their earlier origins as journal articles. For this reader, these initially "stand-alone" pieces are each interesting in themselves, but they do not seem to link into a natural narrative line. As well, none of them directly address the analysis of "Instability" which the book's title promises. Furthermore, in the many cross-sectional OLS regressions results reported in the book, those readers who insist on a strict distinction between causality and correlation may occasionally find themselves dissatisfied with Galbraith's interpretation of coefficients.

Some readers may agree with some of Galbraith's big picture conclusions without really being convinced that this book has actually proven the case. Galbraith, for example, argues that financial factors are crucial to financial trends, that these were driven by high interest rates and that "the simplest, clearest and most compelling explanation" for high interest rates after 1980 is aggressive monetary policy (p. 290)—but this book does not contain any direct examination of monetary policy. Other readers may wonder about the sweeping nature of some conclusions—although Galbraith argues that "the ability or willingness of political systems to affect the movement of inequality is very limited in the world today" (p. 290), his phrasing obscures the crucial difference between "ability" and "willingness." And it is just not clear to me how that conclusion can possibly fit with his recognition (in the very next paragraph) that the stable social democracies of Northern Europe have delivered persistently low inequality—or with his earlier insistence on the importance of discretionary monetary policy.

But such quibbles and qualifications should not obscure the main point. Galbraith has written a very wide-ranging and stimulating book which deserves to be widely read. Unlike many other authors, he has a Big Picture, and a vision of the whole forest, as well as much useful detail on individual trees. I look forward to reading his next book.

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