

# What the Developing World can Learn from the Economic History of the United States – and Vice Versa

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Using History to Inform Development Policy: The Role of Archives  
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# Acemoglu and Robinson (2012)

- Criticize focus on geography or disease environment as well as assertions about culture in explaining why some countries are rich and some poor
- Stress the independent influence of political institutions on a country's income level and rate of growth
- Extractive political institutions retard growth
- Extractive political institutions allow an elite to enforce a preference for a larger absolute slice, and thus smaller slices for everyone else, and possibly a smaller overall pie
- Is the US developing such institutions?

# The Washington Consensus and the Dangers of American Triumphalism

- “Most informed observers today would agree that the United States has just about the best financial system in the world. Its problems are newsworthy mostly because they arose in the context of a well functioning financial order, not one that is disorderly” (Richard Sylla, 2007, p. 115)
- The crisis that ensued shortly thereafter had as its epicenter the US financial system, was associated with a seizing up of most credit markets, and could easily have plunged the world economy into a depression as serious as the one that marked the 1930s.

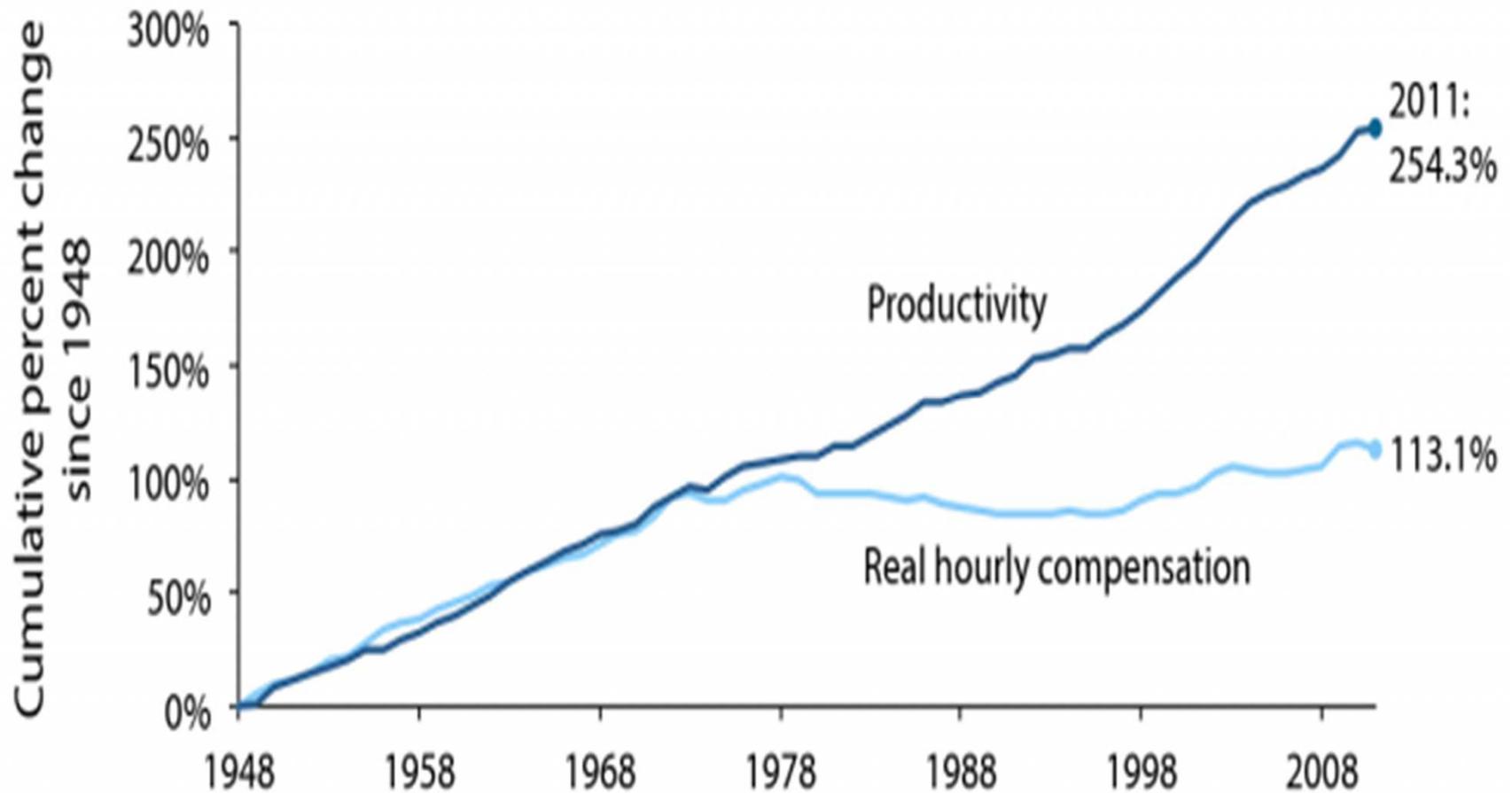
# Troubling Trends in the US

- Substantial increase in pre-tax income inequality, exacerbated by tax policy
- Even larger increases in wealth inequality
- political contributions from the wealthy play a growing role in the democratic process
- Reduced social mobility
- Declines in life expectancy among the less well educated
- Loss of US leadership in educational attainment

# Income and Productivity Gains

- 1948-73 – relatively rapid gains in output per hour, with gains on the income side shared relatively equally among all quintiles of the income distribution, with some bias toward the bottom
- 1973-2012 – slower gains in output per hour with all of the gains on the income side going to the very top
- In 2008, the top 400 individual returns (.00028 percent, or about 3 millionths of a total of ~143 million), booked ~1.6 percent of total income, including 4.04 percent of all taxable interest, 4.14 percent of all taxable dividends, and 10 percent of all net capital gains (this rose to 16 percent in 2009, the latest year for which we have data)

# Output per Hour (Total Economy) and Real Hourly Compensation, 1948-2011



# Extractive Policies: Why Tax Cuts?

- Full employment effects of tax cuts are “pro-growth” because of their argued effects on labor supply and on saving. In both cases the effects are assumed to be positive.
- Lower rates on high incomes and income from capital will yield more capital accumulation, more labor supply, and more entrepreneurial initiative, ensuring higher economic growth, with benefits to all.
- “When you tax something you get less of it, and when you reward something you get more of it.” -- Jack Kemp
- *Not necessarily.* We can have income as well as substitution effects.

# Income and Substitution Effects

- Before and after tax real wages for the bottom 80 percent have stagnated since 1973
- Before and after tax real wages of the top 5 percent have increased dramatically
- Yet labor supply among the bottom 80 percent has increased substantially, as households sent more workers into the labor force and increased debt to try and sustain rising consumption. In contrast, household labor supply (annual hours) of top 5 percent of households has declined slightly.
- This suggests the possibility that income effects may not just counterbalance but may actually dominate substitution effects when considering the effects of tax rate changes on labor supply
- Similarly, the downward trend in capital gains rates has corresponded with a decline in personal saving rates. If you cut tax rates on high incomes and capital incomes, those aspiring to a “nut” of a certain size can reach it earlier.

# Stimulus, Multipliers, and Job creators

- “Governments can’t create jobs.” *Of course they can,* provided that there is an output gap. When we’re at full employment, such spending can change the balance between the private and public sector, but, on net, because of crowding out, can only reallocate employment, not increase it.
- *The same is true for the private sector.* It makes little sense for us to talk about how entrepreneurs create jobs, unless we are also comfortable with the idea that deficiencies in aggregate demand can allow an economy to stabilize below its potential.
- If we view the economy through market clearing lenses then the only people who can truly “create jobs” (at least on net) are individuals who wish to occupy them.
- Thus, remarkably, if you want to talk about the private sector’s job creating capability, you must also endorse the key insight of Keynesian economics.
- *When the economy is below capacity, the most powerful and indeed the only job creation machine in the short run is aggregate demand.*

# Social Mobility, Education, Life Expectancy

- In the United States, high scoring students on a 1998 eighth grade math test who were in the bottom quartile of households ranked by SES were less likely to complete college than low scoring students in the top quartile.
- The US, which used to rank first in college attainment, now ranks 16th among OECD countries in the percentage of 25-34 year olds with a tertiary degree.
- In the US in 1990 the gap in life expectancy between those with a college degree or more and those without a high school degree was 2 years for women and 5 years for men
- In 2008 that gap was 10 years for women and 13 years for men
- Difference in differences: 8 years

# Conclusion

- If a powerful segment of the US polity continues to advocate and successfully implement policies that depress both pre- and post-fisc income for the bottom while increasing it at the top, there is a danger the United States could evolve into something approaching a kleptocracy.
- Worsening inequality arguably retards innovation and economic growth by creating an environment in which capable individuals are not able to realize their true potential.
- We in the developed world stand to benefit from material in World Bank archives documenting the degree to which inequality and/or extractive political practices have or have not hindered the economic growth and development of individual countries.
- At this historical juncture it is no longer simply a question of what the history of the United States can teach the rest of the world, but what the economic history of the rest of the world can teach us.