

War and famine. Peace and milk. — Somali proverb

## The Inequality Issue

“While economists have advanced many explanations for rising inequality in America and around the world, including technology, trade and changing institutions, Joe Stiglitz and [James Galbraith] converge in assigning an important role to the financial sector. We think that the banks did it, first and foremost.”

*James Galbraith, page 9*

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## America's prosperity requires a level playing field

Joseph E. Stiglitz

*This article first appeared in the Los Angeles Times on July 22, 2012.*

To fix the economy, we must boost demand. To do that, we have to address inequality. Despite what the debt and deficit hawks would have you believe, we can't cut our way back to prosperity. No large economy has ever recovered from serious recession through austerity, but there is another factor holding our economy back: inequality.

Any solution to today's problems requires addressing the economy's underlying weakness: a deficiency in aggregate demand. Firms won't invest if there is no demand for their products, and one of the key reasons for lack of demand is America's level of inequality, the highest in the advanced countries.

Because those at the top spend a much smaller portion of their income than those in the bottom and middle, when money moves from the bottom and middle to the top (as has been happening in America in the last dozen years), demand drops. The best way to promote employment today and sustained economic growth for the future, therefore, is to focus on the underlying problem of inequality. In turn, this better economic performance will generate more tax revenue, improving the country's fiscal position.

Even supply-side economists, who emphasize the importance of increasing productivity, should understand the benefits of attacking inequality. America's inequality does not come solely from market forces; those are at play in all advanced countries. Rather, much of the growth of income and wealth at the top in recent decades has come from

what economists call rent-seeking: activities directed more at increasing the share of the pie they get rather than increasing the size of the pie itself.

Some examples: Corporate executives in the US take advantage of deficiencies in our corporate governance laws to seize an increasing share of corporate revenue, enriching themselves at the expense of other stakeholders. Pharmaceutical companies successfully lobbied to prohibit the federal government—the largest buyer of drugs—from bargaining over drug prices, resulting in taxpayers' overpaying by an estimated half a trillion dollars in about a decade. Mineral companies get resources at below competitive prices. Oil companies and other corporations get "gifts" in the hundreds of billions of dollars a year in corporate welfare, through special benefits hidden in the tax code. Some of this rent-seeking is very subtle; our bankruptcy laws give priority to derivatives (such as those risky products that led to the \$150-billion AIG bailout), but dictate that student debt can't be discharged even in bankruptcy.

Rent-seeking distorts the economy and makes it less efficient. When, for instance, speculation gains get taxed at a lower rate than true innovation, resources that could support productivity-enhancing activities get diverted to gambling in the stock market and other financial markets. So too, much of the income in the financial sector (including that derived from predatory lending and abusive credit card practices) derives not from making our economy more efficient, but from rent-seeking.

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## From The Director

Johan Galtung says that defining peace as the absence of war is too negative, in the same way that health is more than the absence of disease. His definition of “positive peace” includes harmony, cooperation, and integration. I wonder whether we can think of economic opportunity in the same way. We have structures that guarantee each person equal opportunity under the law. This would be negative opportunity; there is “officially” nothing standing in your way. Perhaps we can have a system that actually encourages cooperation and integration.

Bill Clinton recently said, “It turns out that advancing equal opportunity and economic empowerment is both morally right and good economics. Why? Because poverty, discrimination and ignorance restrict growth. When you stifle human potential, when you don’t invest in new ideas, it doesn’t just cut off the people who are affected; it hurts us all.”

The issue of inequality is a central one in this year’s US presidential race. Should we be taxing the very rich more, or giving them tax breaks? Whom should we tax and how much, in order to create jobs — the point of job creation being (presumably) to lower inequality? Some even ask whether a very rich president-elect can truly understand the needs of the middle class and the poor.

To look at these issues we bring you articles by two of the leading thinkers on inequality. Joseph Stiglitz, whose latest book is *The Price of Inequality: How Today’s Divided Society Endangers Our Future*, writes, “To fix the economy, we must boost demand. To do that, we have to address inequality.” James Galbraith’s latest book is *Inequality and Instability: A Study of the World Economy Just Before the Great Crisis*. In this issue of EPS Quarterly, he brings us “A few comments from the front lines.”

In addition to these political and policy-oriented questions, I thought we should ask whether there is a relationship between inequality and conflict or violence. Many members of Economists for Peace and Security have looked at the effects of war and violence on the economy and social stability, but can we

see a correlation or even a causal connection in the other direction? Does inequality contribute to the conditions that lead to conflict?

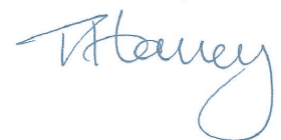
Research from the Institute for Economics and Peace shows that America’s high income inequality strongly correlates with high rates of violence. Frances Stewart, recently awarded Tufts University’s Global Development And Environment Institute 2013 Leontief Prize for Advancing the Frontiers of Economic Thought, writes about inequality between groups rather than individuals, and demonstrates how “horizontal inequalities...galvanize group action to address actual or perceived inequalities.”

Recently, Robert Reich commented on NPR,

“For 30 years, median real wages have barely increased, and over the last decade they’ve dropped—even though the productive capacity of the economy has soared... [Business leaders and entrepreneurs] won’t create more jobs without more customers... We’re caught in a trap of our own making that defies the standard remedies. Neither Keynesian stimulus nor supply-side tax cuts...will restore buoyant job growth...”

“The fact is that unless we can get the economy back to the balance it achieved 30 years ago, when the middle class and those aspiring to join it received a much larger share of the economy’s gain, we simply can’t get back on track.”

I like Dr. Reich’s explanation of why neither the Democratic nor the Republican solution has been terribly successful. While I certainly don’t have the magic answer, we can see why inequality is such a very important issue to address.



# The Complex Ties among Poverty, Development, and Security

Terra Lawson-Remer

Over the past decade, a new conventional wisdom has emerged that security and development are mutually reinforcing, and that long-term security is not possible without reducing poverty and promoting economic development. This implies that economic development in unstable regions that pose potential threats to US security should be a key pillar of US foreign policy, a viewpoint embraced by top officials in the Obama Administration. Global poverty and economic crises pose risks on four fronts.

First, sudden drops in income, so-called “negative growth shocks,” generate political instability and violence. When people living on the brink lose their livelihoods, they are more likely to turn to arms—because either they are angry at perceived injustice, or they see few other options and feel they have little to lose. One highly regarded study of African conflicts, led by UC Berkeley economist Edward Miguel and NYU political scientists Shanker Satyanath and Ernest Sergenti, found that a negative growth shock of five percent increases by 50 percent the likelihood that a country will be engulfed in conflict. Economic crisis, accompanied by public perception that some benefited unfairly from prosperity while the burdens of austerity fall most heavily on those who were left out, creates a dangerous search for scapegoats. The violent mob attacks and forced out-migration of ethnic Chinese in Indonesia in 1998 were caused in large part by a belief that Chinese shopkeepers were benefiting from the sharp price increases of rice and cooking oil, which were caused by the Asian financial crisis. The turn towards virulent anti-Semitism in Weimar Germany can in part be attributed to the runaway inflation and crushing economic contraction that gripped Germany after World War I. Economic collapse generated despair, outrage, and hopelessness, and made ordinary Germans receptive to the xenophobic racism that eventually produced a terrible genocide and spawned Germany’s imperial aggression.

**Foreign aid can undermine democratic accountability, generate corruption, and reduce the incentive of rulers to meet the needs of the broader public... [and] can even exacerbate violence...**

Second, low per capita income weakens states: poor states have severely limited financial, administrative, legal, and military capabilities. A number of well-known studies—by Stanford political scientists James Fearon and David Laitin, Oxford economists Paul Collier and Anke Hoeffler, and others—have found a strong relationship between poverty and civil war. Political rebellion and quasi-political criminal activity are more feasible when central governments are weak and incapable of mounting effective counterinsurgency efforts. Poverty also makes civil war more likely because a weak state lacks the resources to provide critical social services like health and education, creating an opening for fundamentalists and would-be rebel groups to win hearts and minds by stepping into the gap. In Lebanon, for example, Hezbollah has built strong support beyond its Shi’a base—throughout a broader population of Sunni, Druze, and Christians—by operating schools and hospitals for thousands of Lebanese. Paradoxically, poverty increases the public’s need for government help while reducing a state’s capacity to meet these demands, creating fertile ground for rebel and terrorist groups.

Third, when ordinary people are left with no viable economic opportunities other than traffic in drugs and other illicit commodities, they are likely to sympathize with the rebel groups who make those kinds of livelihoods possible.

Guerrilla organizations in Afghanistan, for example, sustain themselves through drug trafficking. They buy raw crops from poor farmers and, in turn, protect growers from government prosecution and eradication efforts. Afghanistan’s economic decimation has left poor farmers with no real choice other than opium. An Afghan farmer can gross significantly more from poppy than from wheat—\$254.28 per kg from dry opium, compared to only \$0.40 per kg for wheat. At the same time, the cost of opium production and distribution is low, as poppy is drought resistant and easy to transport and store. Limited irrigation, poor transport infrastructure, lack of access to markets, and the unenforceability of business contracts due to weak court systems make opium the most lucrative crop by a wide margin. Drug-related exports currently account for roughly 15 percent of Afghanistan’s Gross National Product. However, it would be cavalier to conclude that the risks of conflict and instability posed by economic crises and poverty require the substitution of military adventurism with a package of coercive economic aid policies.

Finally, history has important lessons to teach about the perverse unintended consequences of American economic intervention in developing countries. Foreign aid can undermine democratic accountability, generate corruption, and reduce the incentive of rulers to meet the needs of the broader public. When developing country governments receive large amounts of financing from abroad, rulers often dance to the tune set by donors instead of responding to the needs of local citizens. Lack of democracy has been shown to make famine more likely: when the poor have no voice in determining spending priorities, politicians do not prioritize delivering on programs and policies that help the most vulnerable. This lack of accountability also breeds corruption on the part of recipient country government bureaucrats, since they ultimately must answer neither to domestic voters nor foreign donors. Historically, aid dollars often

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## The Complex Ties among Poverty, Development, and Security (continued)

have been misspent supporting large-scale extractive industries, like the World Bank-financed oil pipeline in Chad and Cameroon. However, in the absence of good governance, economic dependence on natural resource extraction reduces economic growth, weakens democracy, fosters corruption, and increases the likelihood of conflict.

Done wrong, well-intended development aid can even exacerbate violence directly. Political scientist Peter Uvin's detailed analysis of conflicts from Rwanda to Afghanistan to Sierra Leone reveals that prior to the conflicts, development and humanitarian aid reinforced tensions and repression by favoring some factions over others, and increasing the disparities between ethnic groups. Warring factions were then incentivized to fight to capture aid resources. Aid, when funneled into the hands of local actors, strengthens certain groups at the expense of others.

This reinforces unjust local power structures, increases inequality, and exacerbates grievances.

In sum, the connections between economic development, foreign assistance, and security are complex. Failure to grapple with these complexities can actually increase instability, conflict, and terrorism, while leading the US further down the rabbit hole of long-term entanglement without an exit strategy.

That's the bad news. There are no simple answers, and no clear strategies to generate long-term economic growth. Now the good news: we do know what can be done to reduce poverty and improve basic levels of human development, especially in the areas of health, education, and agriculture. Foreign aid can achieve significant concrete improvements in the lives of the poor, if attention is paid from the outset to inequality and distributional challenges, and if the power to shape development

policies is placed in the hands of the intended beneficiaries themselves. Stay tuned as the Development Channel continues to explore what works (and does not work) in fostering equity and opportunity in the global economy and improving the lives of the global poor.

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*This article was originally posted on the Council on Foreign Relations blog, "The Development Channel."*

### PEACE ECONOMICS

#### A MACROECONOMIC PRIMER FOR VIOLENCE-AFFLICTED STATES

Jurgen Brauer and J. Paul Dunne, USIP Press, September 2012

"Essential reading for any person interested in understanding and assessing the costs of war and how to create real incentives to secure stable peace. The twelve design principles for building peaceful institutions and the four policy lessons brilliantly provide policymakers and concerned citizens with economic and social tools to rebuild trust, social capital, and cooperative harmonious social and political relationships."

— Kevin Clements, professor and director, National Centre for Peace and Conflict Studies, University of Otago, Dunedin, New Zealand

Creating sound economic policy and a stable macroeconomic framework is essential to societies recovering from violent conflict, yet few practitioners have the background needed to apply economic concepts effectively. To provide practitioners with a concise but broad overview of macroeconomic fundamentals as they touch on violence-afflicted states, Brauer and Dunne have created *Peace Economics*. Filling a gap in the literature on peace design from an economic perspective, *Peace Economics* extends beyond economic principles into the wider realm of social reconstitution, social contract, and social capital in the hopes of helping practitioners build a more stable peace.

CONTENTS • Violence and Economic Development • Long-Term Economic Goals: Investment, Productivity, and Growth • Macroeconomic Stabilization and Dealing with Turbulence • The Global Economy: International Trade and Finance • Designing and Promoting Peace

*Peace Economics* is the first volume of the US Institute of Peace Academy Guides, a series developed by the Institute's Academy for International Conflict Management and Peacebuilding, a professional education and training center offering practitioner courses on conflict prevention, management, and resolution. Future volumes will address governance and democratic practices in war-to-peace transitions and engaging in identity-based differences, among other topics.

# Group Inequality and Conflict: Some Insights for Peacebuilding

Michelle Swearingen

*This brief reflects the discussion at the United States Institute of Peace (USIP) public event “Will Decreasing Horizontal Inequalities Reduce the Likelihood of Political Violence?” held on February 22, 2010. It featured leading experts on horizontal inequalities: Frances Stewart of Oxford University, S. Tjip Walker and Robert Aten of the United States Agency for International Development (USAID), and Raymond Gilpin, associate vice president of USIP’s Center for Sustainable Economies. Details of this event, including the audio and Stewart’s PowerPoint presentation, are available online: <http://www.usip.org/events/will-addressing-horizontal-inequalities-reduce-the-likelihood-political-violence>.*

## INTRODUCTION

Political, socioeconomic, or cultural inequalities among defined groups could potentially motivate political violence in societies when groups have strong identities, and grievances mobilize both the group leaders and followers. These differences, which have been termed “horizontal inequalities,” galvanize group action to address actual or perceived inequalities. These dynamics should influence peacebuilding efforts as they reveal underlying motivations for grievance and mobilization, require specific policy action to address the differences among groups, and finally inform sequencing of policy implementation.

Vertical inequality, which measures differences between individuals, often gets more attention; but it is the differences between groups that have been more concretely linked to conflict. The three broad areas of group differences include: political, demonstrated by participation in government and the security sector; socioeconomic, including access to land, private capital and government infrastructure, and levels of income and employment in the private and public sector; and cultural, nationally recognized languages, holidays and cultural or religious sites. Research has shown that political inequalities between groups are most likely to motivate leaders, while

socioeconomic inequalities motivate followers. Empirical data suggest that when a strong combination of political and socioeconomic inequalities is present, leaders emerge and disaffected groups choose political violence to address injustice. By more fully incorporating group dynamics into conflict management and peacebuilding strategies, we can more efficiently target the immediate drivers of conflict and defuse threatening situations.

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## GROUP DYNAMICS AND CONFLICT Group Identities

A strong group identity is a vital component of mobilization. Whether group identities are based on ethnicity, religion, race, caste, class, or region, they must have defined and relatively impermeable boundaries. If group’s identities are fluid, they will be less easily mobilized for violence, as group members will maximize their opportunities by switching to the better-off group. This is one explanation for the lack of race riots in Brazil where blacks have been severely disadvantaged compared to their white and “mixed” or “brown” peers. The “mixed” or “brown” category made up 43 percent of the population in 1993, while only 5 percent of the population considered themselves black. The racial categories were fluid, diluting the threat of group mobilization. Black South Africans under apartheid, however, were evaluated and

assigned a race by the Race Classification Board, leaving no opportunity for fluidity between groups. Their organized and widespread rebellion brought down the apartheid regime in the early 1990s.

## Mobilizing Factors

The work of Frances Stewart, leading expert on horizontal inequalities, has shown that there are different mobilizing triggers for leaders and followers in rebellion movements. While it is often political inequalities that spur leaders to accentuate and rouse group identities to foster rebellion, it is more often the economic and social inequalities that lead group members to follow. For this reason, mobilization of violent groups is most likely to occur when there is a confluence of political exclusion and economic and social marginalization imposed by one group on another.

Although inequalities in cultural recognition are important, they are not a critical part of the analytical framework for group inequalities and conflict. The conflict in Northern Ireland, which was fought between Catholics and Protestants along religious lines, was laid over serious and long-lasting political and socioeconomic inequalities between the two groups. The policies most effective in ending the conflict were those targeted at reducing political and socioeconomic inequalities between the disadvantaged Catholics and the Protestants, such as strengthening the Fair Employment Act of 1989 and improving equality in housing and education.

## Scenarios and Outcomes

Just as groups vary, the results of group dynamics vary and may produce either peaceful or violent outcomes. In some situations the violence manifests in a coup, while in other cases there is rebellion, political violence, riots or increased crime. Most often, group inequalities fit into one of two scenarios. Either one group is both politically and socioeconomically privileged over another group,

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## Group Inequality and Conflict: Some Insights for Peacebuilding (continued)

or one group is politically dominant while the other is socioeconomically advantaged.

One-sided deprivation or simultaneous political and socioeconomic deprivation of one group has been found in Mexico's Chiapas state, South Africa under apartheid, the United States, Brazil, Northern Ireland, and Sudan. Under apartheid, black South Africans were disadvantaged both politically and socioeconomically. They had one-tenth the per capita income of whites and even less representation in managerial civil service jobs. Their life expectancy and literacy rates were also considerably lower than those of white South Africans. After peaceful protests failed to bring about change, an armed rebellion began in 1976 that persisted until 1990, when changing international dynamics, economic sanctions and the black resistance contributed to the end of the apartheid regime. While blacks continue to be socioeconomically disadvantaged, the conflict ended with political compromise and the South African government continues to work to reduce the socioeconomic inequalities peacefully.

Sudan presents another example of one-sided deprivation. The United Nations Development Program, the agency responsible for measuring the progress of the Millennium Development Goals (MDGs), reports that Southern Sudan is drastically worse off than the North. After nearly a decade of working toward attaining the MDGs, 90 percent of the Southern population is categorized as living in poverty, compared to 50 percent in the North. Twenty percent of children in the South are enrolled in primary education, compared with 62 percent in the North, and rates of maternal mortality in Southern Sudan are more than three times as high as in the North. Only after decades of civil war has the government in Khartoum made any steps toward including Southerners in the political institutions of the country.

Shared deprivation with one group that is politically powerful yet socioeconomically deprived has been found in

**To minimize the likelihood of conflict, policies should first address the monopoly on political power and resulting political exclusion that most often mobilizes the leadership of a conflict.**

Malaysia, South Africa after apartheid, Uganda, Sri Lanka, and Rwanda. In the case of Malaysia, drastic group inequalities at independence left the majority Bumiputera population with a severely low level of education, economic assets, and opportunities relative to the minority ethnic Chinese population. Yet, the country was able to implement successful policies to reduce violence along with the pervasive inequalities. The position of the Bumiputera as the majority in a country with "broadly democratic institutions" enabled the implementation of policies such as "quotas, target and affirmative action with respect to land ownership, public service employment and ownership of quoted companies." During this time, Malaysia experienced record growth, allowing the Chinese to succeed as well. The balance of inequalities between the two groups encouraged a cooperative approach to resolving the issue nonviolently.

### **STRATEGIC APPROACHES TO REDUCE INEQUALITIES BETWEEN GROUPS AND BUILD PEACE** **Policy Categories**

If addressed conscientiously, group inequalities as well as the conflict they trigger can be mitigated. Stewart proposes three types of policy interventions to reduce group inequalities: direct, indirect, and integrationist. Direct policies include affirmative action and quotas. These policies are attractive, as they immediately target the disadvantaged

population. They are most effective in the short term but, if incorporated into long-term strategy, can serve to calcify group identities, leading to further conflict in the future. Indirect policies include progressive taxation and antidiscrimination legislation. They work well over the long term and ultimately are more likely to reduce a strong sense of identity differences. However, these policies are less precise. Finally, integrationist policies that work to dissolve group boundaries are theoretically attractive, but often lead to suppression of information about groups and group identities without actually reducing inequalities. Integrationist policies include bans on political parties defined solely by ethnicity or religion and requirements for multiculturalism in schools or other institutions. As each category of policies has different strengths, weaknesses and timelines, it is critical that peacebuilding approaches seeking to reduce group inequalities include a combination of direct, indirect, and integrationist policies that address the specific political and socioeconomic inequalities that underlie the conflict and could trigger violence.

### **Strategic Sequencing**

To minimize the likelihood of conflict, policies should first address the monopoly on political power and resulting political exclusion that most often mobilizes the leadership of a conflict. This could be done by addressing the monopoly on political power through reservations for under-represented groups in all levels of government and the security sector, citizenship expansion, enactment of human rights legislation, and other measures. This would reduce the immediacy of conflict and allow for work on the next step: addressing socioeconomic inequalities between groups. Socioeconomic inequalities can be addressed through any of the approaches outlined above, and include policy measures such as employment and education quotas, antidiscrimination legislation, progressive taxation, incentives for inter-group economic activities, and other steps.

## Group Inequality and Conflict: Some Insights for Peacebuilding

### Potential Applications

Sudan and Rwanda, two previously conflict-affected states, are once again facing increasing tensions between groups. Sudan's longstanding civil war between the politically and socioeconomically advantaged North and the poor, yet resource-rich South ended in a peace agreement in 2005. The Comprehensive Peace Agreement (CPA) addressed political inequalities and bought the country time to address the socioeconomic disparities. However, many of the initial grievances have not been addressed, and now that the CPA is expiring the country faces the threat of renewed conflict.

The 1994 genocide in Rwanda, responsible for the death of more than 500,000 people in less than 100 days, arguably resulted from decades of group inequalities. Following the genocide, the regime of Paul Kagame instituted integrationist policies, forcing the suppression of group—in this case, ethnic—identities. Sixteen years later, tensions run high in Rwanda as ethnic violence has increased, along with state suppression. It is not the group identities, or even religious identities (such as the greatly publicized Muslim North and

Christian South in Sudan) alone that drive these conflicts. It is the combination of political and socioeconomic exclusion, and the failure to adequately address the group inequalities that led these two countries into conflict initially and threatens to do so again. In order to diffuse these situations effectively, our approaches to development and peacebuilding in countries like Sudan and Rwanda must reflect the power of group inequalities to cause conflict.

### POLICY RECOMMENDATIONS

**1. Increase research into group dynamics:** there is a need for increased data and research regarding group dynamics and conflict to complement current work on individuals and conflict.

**2. Coordinate international assistance to ensure optimal policy sequencing:** the many bilateral, multi-lateral, and nongovernmental organization actors in a conflict-affected country should coordinate their policies to diffuse the conflict by first targeting the immediate problem of political exclusion and then implementing policies to attack socioeconomic inequality.

**3. Integrate equality into foreign assistance programs:** equality should

be a strong factor in development and humanitarian programs, promoting stronger, more stable and more just societies.

**4. Conduct training and sensitization programs on reducing group inequalities:** increasing education and awareness about the value of correcting group inequalities will improve policies in and toward conflict-affected countries.

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*This article is available in its entirety, with all endnotes and references, at [http://www.humansecuritygateway.com/documents/USIP\\_GroupInequalityConflict\\_InsightsPeacebuilding.pdf](http://www.humansecuritygateway.com/documents/USIP_GroupInequalityConflict_InsightsPeacebuilding.pdf)*

*The web address for the event is <http://www.usip.org/events/will-addressing-horizontal-inequalities-reduce-the-likelihood-political-violence>.*

## Inequality: A few comments from the front lines

James K. Galbraith

The publication this year of *The Price of Inequality* by EPS Trustee Joseph Stiglitz and of my own *Inequality and Instability* has helped to deepen our understanding of this issue, and perhaps also to raise its profile as a policy question.

Stiglitz's new book is a work of art and passion, a cry from the head and the heart that America confront inequality as its greatest economic challenge. Joe wastes no time and few words in stating the nub of his case. He writes, "The simple story of America, is this: the rich are getting richer, the richest of the rich are getting still richer, the poor are becoming poorer and more numerous, and the

middle class is being hollowed out" (page 7). Further, as if this were not bad enough, Stiglitz argues that the Great Crisis has made matters even worse, especially by reducing the buffers protecting the middle class from distress and penury later on.

Meanwhile, as a political matter, inequality empowers the rich, disenfranchises the poor and weakens the middle class. Unemployment insurance is reduced, health and education deteriorate, people are forced to withdraw from community life. One consequence ultimately is the erosion of democracy itself, as the political classes come to depend on the very wealthy—alone—for their campaign fund-

ing as well as for their future employment. Accordingly, they align with those interests as surely as the sunflower follows the sun.

Joe also writes with great conviction that inequality is damaging to the economy, and therefore unnecessary. In some ways, his core argument restates the case made long ago by Adam Smith: inequality arises from monopoly, which arises from the abuse and manipulation of government power (a case I also made a few years back in *The Predator State*). Inequality that arises from rent-seeking and from abusive financial practices cannot be defended as necessary for economic dynamism

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## Inequality: A few comments from the front lines (continued)

and progress. On the contrary, the economy would work better, and maybe even grow faster, if such inequality were controlled.

*Inequality and Instability* is a different sort of book. Where Joe Stiglitz is concerned mainly with making the case that inequality in America must be reduced, my chief purpose is more prosaic. I'm mainly concerned with working out what the facts actually are, and in checking whether certain economic relationships — such as between inequality and income, or between inequality and growth — actually exist. My focus is as much on the world at large as it is on the United States.

I have been working with measurements of inequality around the world since the mid-1990s, and supervising research students in the field. One great constant of that experience is the weakness of the previously available data. It's an odd situation, where practically every data point — every measure of inequality that we have for every country since the 1950s — has been assembled at great expense and with the best procedures known at the time. It's impossible not to admire this work, and also the effort that has gone into bringing them all together. However, the resulting compilations, the data sets that researchers try to mine, are still not up to the job. The observations are too few, and are often too different in what they attempt to measure (sometimes income, sometimes expenditure...) to be consistently comparable. As a result, the numbers are sparse in some places, comparisons are implausible in others, and the whole business is very, very noisy.

We did find that although there exist many collections of data that can be used to compute measurements of inequality, they had never been used for this purpose. Geographic statistics, industrial statistics, sectoral statistics, and international comparative data sets of income and population or payrolls and employment by country and year can be employed, so long as some fairly simple conditions are met. The resulting inequality measures aren't perfect, but they are dense, consistent, and fairly

closely related to existing income inequality measures, taken from surveys. The advantage is that there are so many more of them; and as they are far less noisy, one can develop a much clearer statistical picture.

**I take the view that economics is economics, that the world economy is in many ways a single unit, and that the distinction between “advanced” and “developing” economies is a throwback...**

Examination of that picture makes me a bit cautious about the claim that the United States is a uniquely unequal society, even now. First, as Joe Stiglitz also notes, inequality is much higher out in the wide world than we realize because we consider “developing countries” as separate from our own. I take the view that economics is economics, that the world economy is in many ways a single unit, and that the distinction between “advanced” and “developing” economies is a throwback — and perhaps also a way for economists to duck the hard work of incorporating the wide world into their analyses. I think we can learn a lot by studying all the countries together — including the common movement of inequality in the global economy taken as a whole — and that it's useful to compare inequality in the US with inequality in China or Brazil.

Still, the main comparisons are with other rich countries. By my measures, while inequality in the US is fairly high compared to other wealthy countries, it's not out of line with some of them: Italy, for instance, or Spain. There is the further point that many of the low-inequality countries to which the US is frequently compared — for example, Finland or

Denmark — are very small and homogeneous. It is much easier to achieve low inequality across 5.5 million people (the population of Denmark) than across a country with some 311 million.

Here's another complication. In the past, comparisons of inequality between the US and Europe have always been made between a measure for the US and a measure for some individual country in Europe — France, or Germany, or Sweden. However, Europe today isn't a loose collection of separated countries. It's a single unified continent, with a (troubled) common currency, many common regulations, and no internal barriers to trade or capital movement. The relevant concept of inequality is not that within any particular country, but that for Europe taken as a whole. This must include inequality measured within countries, as well as the differences between the average level of income or pay in the different countries of Europe. These differences — say between Germany and Poland, or Sweden and Portugal — can be very large. Unfortunately, no such measure has existed.

A nice feature of the techniques used in *Inequality and Instability* is that they permit us to add together inequality within and between countries. When we do that, we find that inequalities of pay within Europe, taken as a whole — at least for manufacturing, a critical sector for trade and technology — are larger than they are in the United States. Inequalities of income, overall, probably remain larger in the United States, mainly because the US has so much taxable private capital income, concentrated in so few hands; but even here one can't be sure. Part of the difference may lie in different standards about what is required to be reported, and in different degrees of tax compliance. Of course, tax avoidance and evasion are big problems on both continents; but because the US has a single unified tax law, it may do a better job of measuring top-level incomes than the European countries do.

That said, the finding that manufacturing pay inequalities are actually larger in Europe strongly supports Joe Stiglitz's point that equality and efficiency are



## Inequality: A few comments from the front lines

complements, not substitutes. Before the crisis, it used to be said that Europe's chronic high unemployment was due to too much equality, the fault of strong unions and big welfare states. In that telling, the US enjoyed near-full employment because it paid low wages and had "flexibility." However, the story had many problems, among them the inconvenient fact that countries with the most compressed wages and the strongest unions and welfare systems (in Northern Europe) usually had less unemployment than their more unequal counterparts in the South. Some economists would gloss over this by referring to the "Scandinavian model" as something special and unexplained, a very ad hoc evasion. There was also the problem that before the 1970s, several highly egalitarian countries — such as post-war Germany and Britain — had hardly any unemployment at all.

Our findings work to resolve these puzzles. They show that greater equality is systematically associated with more jobs and less unemployment. Europe's problem before the crisis was not too much equality. It was, rather, that capital and (to a lesser degree) labor markets had become integrated, and as they did, the amount of inequality that was relevant went up — along with European joblessness. Europe's problem was that it had not experienced the measures of continental integration and development that the United States initiated under the New Deal and Great Society, which

(notwithstanding the modern, free-market world-view) have continued to shape and unify the American economy ever since.

It is true that income inequality in the US has risen sharply. In my data it rises to a peak in 2000, with a saw-tooth pattern after that. While economists have advanced many explanations for rising inequality in America and around the world, including technology, trade and changing institutions, Joe Stiglitz and I converge in assigning an important role to the financial sector. We think that the banks did it, first and foremost.

Specifically, we pinpoint our growing dependence, after the mid-1970s, on economic growth generated by unsustainable credit booms. My data show the force of the information-technology boom in the late 1990s ending with the NASDAQ crash. More recent numbers show a similar effect of the mortgage-fueled real estate boom and debacle in the mid-2000s. Looking at a map of the contributions to income inequality by county in the United States in 2007 (see below), it is easy to pick out the housing hot-spots of Southern California and Florida, and a few others — as well as the financial epicenter in New York, New York.

This leads to a metaphor that isn't in my book, but only because I didn't think of it in time. Income inequality in an economy seems to be a measure with a number of useful parallels to blood pressure in human beings. To begin with,

there is a normal range. Within that range, lower readings are better, the sign of a healthier, more resilient organism. Certainly, it is possible for the readings to be too low, as they were in the communist states, and the result is sluggish performance. Zero inequality, like zero blood pressure, is achieved only in the morgue. However, when inequality rises sharply, past the upper bound of a normal and healthy range, then like rising blood pressure that's a sign of a coming crisis. That is how inequality and instability are linked.

Of course we had the crisis — a massive economic heart attack — in late 2008. We are still coping with the aftermath, but that's not surprising either. After such an event, core institutions are deeply damaged, and cannot be expected to recover quickly. Stimulus is not going to be sufficient when a heart transplant — make that a bank transplant — is required. Inequality may even be down a bit compared to the peak; but in these conditions, that isn't necessarily a good sign.

*James K. Galbraith holds degrees from Harvard (BA magna cum laude, 1974) and Yale (PhD in economics, 1981). He teaches economics and a variety of other subjects at the LBJ School at the University of Texas at Austin, where he directed the School's PhD Program in Public Policy from 1995 to 1997. He directs the University of Texas Inequality Project, and serves as Chair of the Board of Economists for Peace and Security.*

### Contributions to income inequality by county in the United States, 2007



## America's prosperity requires a level playing field (continued from page 1)

If we curbed these abuses by the financial sector, more resources—especially the scarce talent of some of our brightest young people—might well be devoted to making a stronger economy rather than to exploiting the financially unsophisticated. The banks might actually go back to the boring business of lending rather than high-risk and often opaque speculation.

Curbing rent-seeking is not that complicated, aside from the politics. It would

require better financial regulations; fairer and better-designed bankruptcy laws; stronger and better-enforced antitrust laws; corporate governance laws that limit the power of CEOs to effectively set their own pay; and, in all of these areas, more transparency. Because so much of the income at the top is from rent-seeking, more progressive taxation (of capital gains, in particular) is necessary to discourage it. If the additional revenue is used by the government for high-return

public investments, there are double benefits.

*Joseph E. Stiglitz is University Professor at Columbia University; Co-Chair of the Committee on Global Thought; and co-founder and Co-President of the Initiative for Policy Dialogue. In 2001, he was awarded the Nobel Prize in economics for his analyses of markets with asymmetric information. He has written textbooks that have been translated into more than a dozen languages, and is a Trustee of EPS.*

**Jurgen Brauer and Raul Caruso have put up the first-ever article on peace economics on Wikipedia.**

They write: "Apologies to colleagues in the field if your work is not (yet) mentioned. We had two objectives: (1) to put up something simply to get the topic on the wiki record and (2) to conform to wiki standards in terms of wiki structure, style, and content. We passed the wiki editors' test, and the page was made 'live' on 17 August 2012."

See [http://en.wikipedia.org/wiki/Peace\\_economics](http://en.wikipedia.org/wiki/Peace_economics).

For the story behind the wiki entry, visit <http://stonegardeneconomics.com/blog/?p=2043>.

## With Income Inequality Comes Violence

US News Staff

*On July 16, 2012, US News ran a review of the recently-published OECD book, Divided We Stand: Why Inequality Keeps Rising. The author contends, "while the OECD finds there are some factors that contribute to inequality and other factors that equalize wages, they failed to explain the shift in incomes toward the top." His own analysis, he continues, suggests that "increased financial sector compensation has been an important driver of inequality." Michael Shank, US Vice President of the Institute for Economics and Peace, responded to that article with the following letter, published in US News on July 18, 2012 (<http://www.usnews.com/opinion/blogs/letters-to-the-editor/2012/07/18/with-income-inequality-comes-violence>).*

David Rosnick is spot on in "Breaking Down the Causes of Income Inequality," but what about the effects of income inequality? Our research at the Institute for Economics and Peace shows that

America's high income inequality—at its highest level since the early 1900s—also strongly correlates with high rates of violence, which costs our economies even more money in terms of lost economic productivity. But don't just take our word for it. The research of economists Richard Wilkinson and Kate Pickett at the Equality Trust, authors of *The Spirit Level: Why Great Equality Makes Societies Stronger*, supports this thinking.

In fact, the economic impact of violence on the world's global domestic product neared \$9 trillion this year, according to the Global Peace Index, which, now in its sixth year, measures 23 indicators of violence from ongoing violent conflict, to safety and security in society, to militarization. That's money lost from the direct act of violence (e.g. a homicide's medical, police, and court costs), and money lost from the fact that the person killed is permanently removed from the workforce and from constructively contributing to a society's economic growth.

Nine trillion dollars is a lot of money lost to violence. A mere 25 percent reduction in worldwide violence would garner well over \$2 trillion, a meaningful sum in an age of austerity budgets and rising debts and deficits.

For America alone, a 25 percent reduction would garner an additional \$500 billion. This is no small change considering Washington's conversation on defense cuts of a similar figure.

Reducing income inequality, then, brings additional benefits. If policymakers are willing to tackle inequality and poverty—through, among other measures, improved educational, health and economic opportunity—they will undoubtedly see savings in reduced costs associated with violence. Convincing them to do so, however, is the key.

*Read the original article to which this letter refers at <http://www.usnews.com/opinion/blogs/economic-intelligence/2012/07/16/breaking-down-the-causes-of-income-inequality>.*

## UPCOMING EVENTS

•**October 19—20, 2012** Conflict Studies Conference: The New Generation of Ideas, Ninth Biennial Graduate Student Conference organized by the UMass Boston Graduate Programs in Conflict Resolution, Conflict Studies. The New Generation of Ideas brings together graduate students from a variety of fields to present their work and share ideas.

Further details on the event are available here:

[http://www.umb.edu/academics/mgs/crhsgg/conflict\\_studies\\_conference/](http://www.umb.edu/academics/mgs/crhsgg/conflict_studies_conference/).

•**October 26—27, 2012** Twenty-Third BREAD Conference on Development Economics, sponsored by University of Michigan, Ann Arbor (Department of Business Economics and Public Policy, Ross School of Business; Department of Economics; Ford School of Public Policy; International Policy Center, Ford School; Population Studies Center, Institute for Social Research; and William Davidson Institute), Bureau for Research and Economic Analysis of Development (BREAD), and Hewlett Foundation. Conference location: University of Michigan, Ann Arbor.

View the full program at

<http://ipl.econ.duke.edu/bread/conferences/cf23/cfAnnouncement.php?w=1680&h=920>.

•**December 3—4, 2012** The 8th Annual Households in Conflict Network Workshop and 2nd AMSE Economic Development Conference, jointly organized by the Aix-Marseille School of Economics and the Households in Conflict Network, will take place in Aix-en-Provence France. This year's workshop will have a focus on the relationship between violent conflict and socio-economic development. Submissions that address key issues in conflict and economic development analysis are invited, as well as submissions from other disciplines on the usual HiCN topics around the empirical analysis of violent conflict from a micro-level perspective. Theoretical papers about violent conflict issues are also welcome. Submissions should be in English, and be completed but unpublished papers. Submissions by early stage researchers are encouraged.

Workshop information and calls for papers can be found at either of these sites:

[http://www.hicn.org/wordpress/?page\\_id=24](http://www.hicn.org/wordpress/?page_id=24)

<http://www.thehivefcv.org/Pages/BuzzIndi.aspx?bid=16>

•**December 18—19, 2012** Fourth Conference on Conflict Management Peace Economics and Peace Science hosted in cooperation with Mahatma Gandhi Center for Conflict Prevention and Management - Department of Sociology, Mahatma Gandhi Kashi Vidyapith, Varanasi (UP), India Binghamton University, State University of New York at Binghamton at Mahatma Gandhi Kashi Vidyapith, Varanasi (UP), India.

For more material about the conference, contact Ravi Prakash Pandey, Mahatma Gandhi Kashi Vidyapith, Varanasi (UP), India: [ravisociology@rediffmail.com](mailto:ravisociology@rediffmail.com).

•**January 4—6, 2013** The ASSA/AEA Annual Meetings will be held in San Diego, CA. EPS will host two sessions during the Annual Meetings, and a dinner in honor of EPS Vice-Chair Michael Intriligator. Details about the EPS sessions are on the back of this issue.

To find out more, contact EPS Director Thea Harvey: [theaharvey@epsusa.org](mailto:theaharvey@epsusa.org).

## EPS Quarterly

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## Annual meetings of the Allied Social Sciences Association and American Economics Association

January 4–6, 2013 in San Diego, CA

EPS will host two sessions, and a dinner  
in honor of EPS Vice-Chair Michael Intriligator.

Friday, January 4, 2013 at 10:15am

**Up from Here? Challenges and Barriers  
to Recovery from the Crisis**  
Manchester Grand Hyatt, Randle B

Panel Moderator:

James Galbraith (University of Texas-Austin)

- Kenneth Arrow (Stanford University)
- Robert Gordon (Northwestern University)
- Eric Laursen (Independent Journalist)
- Yanis Varoufakis (University of Athens)

Friday, January 4, 2013 at 2:30pm

**Is War Over? The Economics of National  
Security after Iraq and Afghanistan**  
Manchester Grand Hyatt, Ford B

Panel Moderator:

Michael Lind (New America Foundation)

- Linda Bilmes (Harvard University)
- Richard Kaufman (Bethesda Research Institute)
- Lloyd J. Dumas (University of Texas-Dallas)
- J. Paul Dunne (University of Cape Town)

Saturday, January 5, 2013 at 6:30pm

**Dinner honoring EPS Vice-Chair Michael Intriligator**  
Co-chaired by James K. Galbraith and Richard Kaufman

Contact Thea Harvey for more information: [theaharvey@epsusa.org](mailto:theaharvey@epsusa.org)

Summaries of EPS involvement at past ASSA/AEA Annual Meetings  
can be found at <http://www.epsusa.org/events/aea.htm>