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Social Inequality Causes Economic Crashes

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John Kenneth Galbraith and Marriner Eccles Explained 50 Years Ago that Inequality Causes Crashes

In his definitive study of the Great Depression, The Great Crash, 1929, John Kenneth Galbraith wrote:

> There seems little question that in 1929, modifying a famous cliche, the economy was fundamentally unsound. This is a circumstance of first-rate importance. Many things were wrong, but five weaknesses seem to have had an especially intimate bearing on the ensuing disaster. They are:
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> (1) The bad distribution of income. In 1929 the rich were indubitable rich. The figures are not entirely satisfactory, but it seems certain that the five per cent of the population with the highest incomes in that year received approximately one-third of all income. The proportion of personal income received in the form of interest, dividends, and rent – the income, broadly speaking, of the well-to-do – was about twice as great as in the years following the Second World War.
>
> This highly unequal income distribution meant that the economy was dependent on a high level of investment or a high level of luxury consumer spending or both. The rich cannot buy great quantities of bread. If they are to dispose of what they receive it must be on luxuries or by way of investment in new plants and new projects. Both investment and luxury spending are subject, inevitably, to more erratic influences and to wider fluctuations than the bread and rent outlays of the $25-week workman. This high bracket spending and investment was especially susceptible, one may assume, to the crushing news from the stock market in October 1929.

Galbraith wrote that in 1954.

Marriner S. Eccles – Federal Reserve chairman from 1934 to 1948 – made a similar point in his 1951 book *Beckoning Frontiers*:

> As mass production has to be accompanied by mass consumption, mass consumption, in turn, implies a distribution of wealth — not of existing wealth, but of wealth as it is currently produced — to provide men with buying power equal to the amount of goods and services offered by the nation's economic machinery. Instead of achieving that kind of distribution, a giant suction pump had by 1929-30 drawn into a few hands an increasing portion of currently produced wealth. This served them as capital accumulations. But by taking

> purchasing power out of the hands of mass consumers, the savers denied to themselves the kind of effective demand for their products that would justify a reinvestment of their capital accumulations in new plants. In consequence, as in a poker game where the chips were concentrated in fewer and fewer hands, the other fellows could stay in the game only by borrowing. When their credit ran out, the game stopped.

Numerous prominent economists in government and academia have since agreed that large inequalities can cause – or at least contribute to – financial crises, including:

- Robert Shiller
- Raghuram Rajan
- Robert Reich
- Mark Thoma
- Emmanuel Saez
- Thomas Piketty
- David Moss
- Kemal Dervi
- Michael Kumhof
- Romain Rancière
- Robert Wade
- David Ruccio

Paul Krugman and Simon Johnson are also open to the possibility..

In addition, a large and healthy middle class has long been understood to lead to political stability. But America's middle class is being decimated.

Given that revolts are partly being waged in a number of Arabic countries because of inequality, and that inequality in America is worse than in Tunisia, Egypt or Yemen, this is a cause for concern. (As NPR notes, inequality in America is now also worse than in many Latin America banana republics.)

As Robert Shiller said recently:

> I think inequality is a huge emerging problem, and that our society has to think about dealing with it in a constructive and real way – not through 'Let them eat credit,' [a reference to the "let them eat cake" statement of the soon-to-be-

> deposed French aristocracy] not through wishful thinking. We have to understand how we get inequality and what we can do about it.

Shiller said in 2009:

> To me, I would hope that this would spur public discussion about the structural problem that inequality, economic inequality, has been worsening in the United States and in other countries for 30 years. And it's gotten really — especially at the high end — it's gotten really off.
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> And it's not like we want to level income. I'm not saying spread the wealth around, which got Obama in trouble. But I think, I would hope that this would be a time for a national consideration about policies that would focus on restraining any possible further increases in inequality.
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> This, I think, is potentially the big problem which is bigger than this whole financial crisis.
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> If these trends that we've seen for 30 years now in inequality continue for another 30 years, we're going to look like — it's going to create resentment and hostility. It's not a country that — we could turn into a country that even the rich would rather not be in.