

Money, Real Estate, and Inequality

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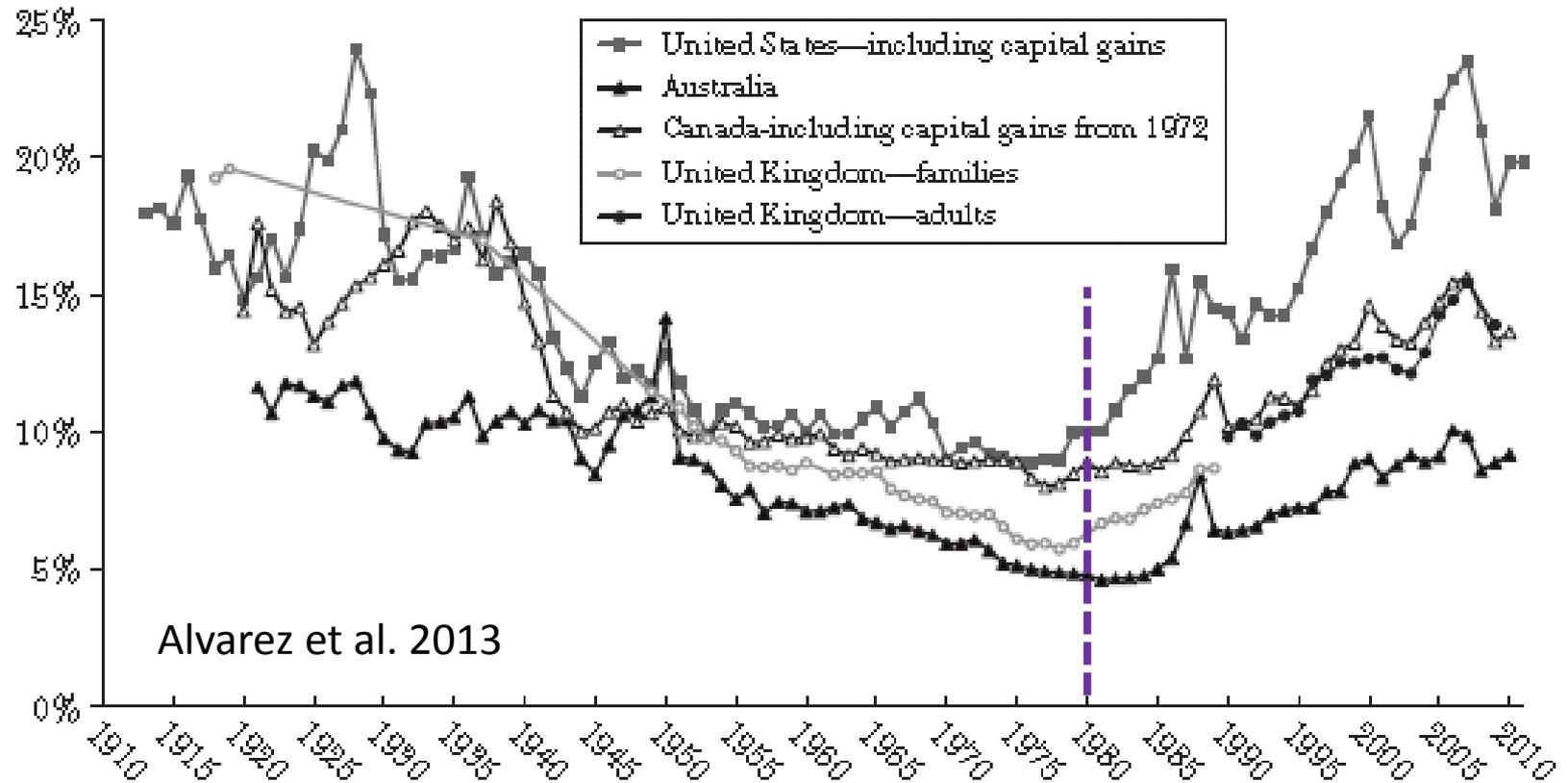
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Piketty model of inequality: $r > g$

Piketty wrong 70 percent of the time

The Evolution of the Shares of the Top 1 Percent in Different Countries

A: Top 1 Percent Income Shares in English-speaking Countries (U-Shape)



- If not for last forty years, he would be wrong all the time
 - What happened in last forty years?

Two Stories: Money and Housing

(1) THE MONEY STORY

- Up to 1970s, credit repression.
 - Fixed exchange rates: Bretton Woods, Gold Standard
- 1970s: floating exchange rates.
- Justified by faith in markets.
- Credit de-regulated.
- Where does money come from? Not from depositors.
- Originated by commercial banks. Does not require 'intermediation' or prior deposits.
- Evidence: Bank balance sheets (assets, loans) grow tenfold as percentage of GDP. In UK, from 0.5 of GDP to five times GDP.
- No other plausible source of liquidity for such an increase in deposits.
- Banks create money by lending it.

(2) THE HOUSING STORY

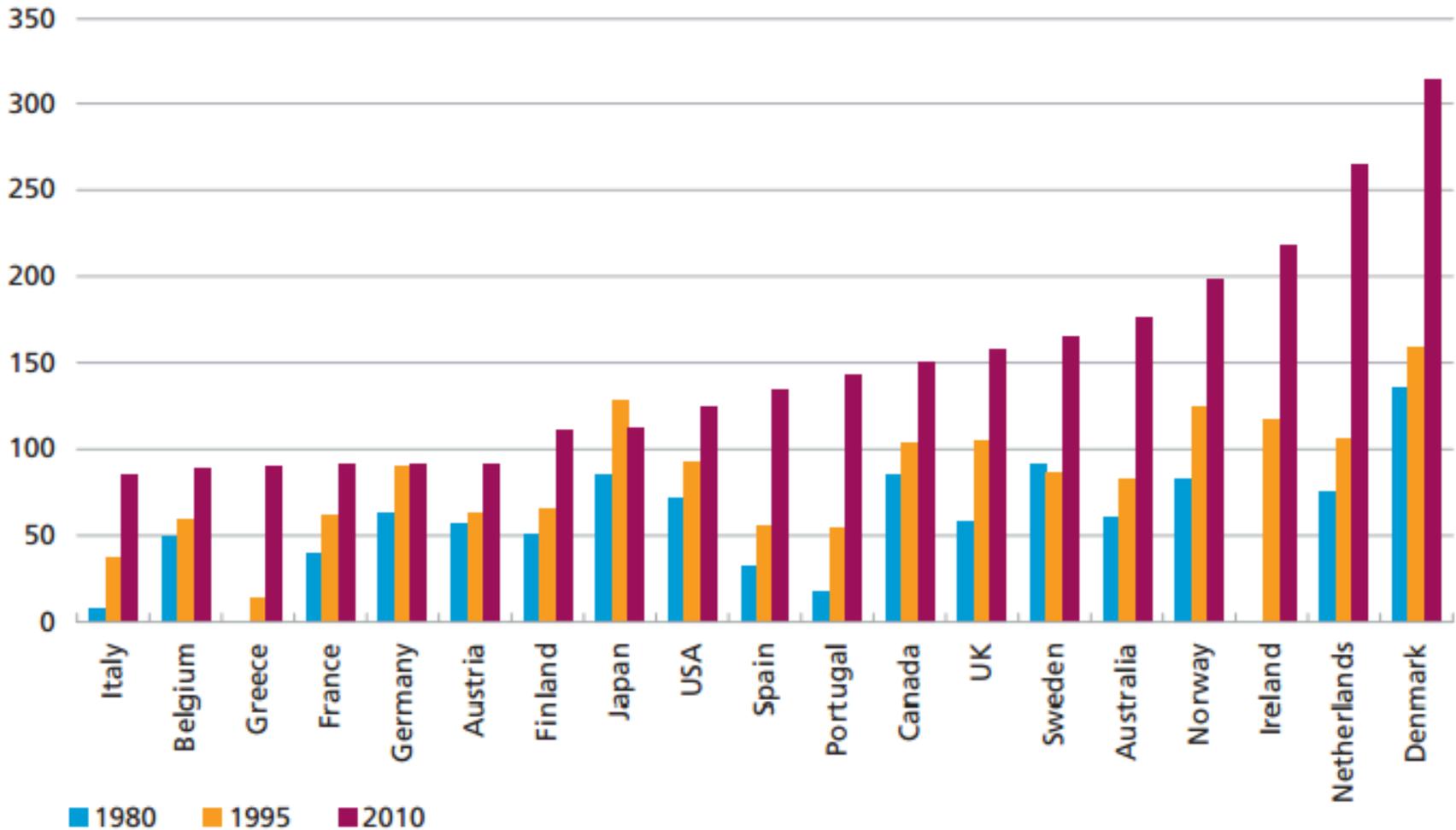
- But money not easy to lend.
- De-industrialisation: shortage of productive investments.
- International trade imbalances adds pressure to lend.
- Housing - ideal asset: built-in collateral. Demand insatiable: rises with income. Subsistence and status good. Largest consumer expenditure.
- House prices driven by credit. Credit used for price-bidding competition. Competition cannot be avoided.
- Pays off. Wealth grows faster than debt. Also of paid-off housing.
Housing windfall economy. Everyone seems to benefit.
- Two-thirds of population. Social and political support from wealthy.
- **Tax relief:** tax-free investment, capital gains, interest payments untaxed in some places.
- Releases income for more borrowing and higher house prices.
- **WINDFALL NEEDS CREDIT TO CONTINUE.**

Household debt rises much faster than income

HOUSEHOLD GROSS DEBT

Chart 3

Per cent of disposable income

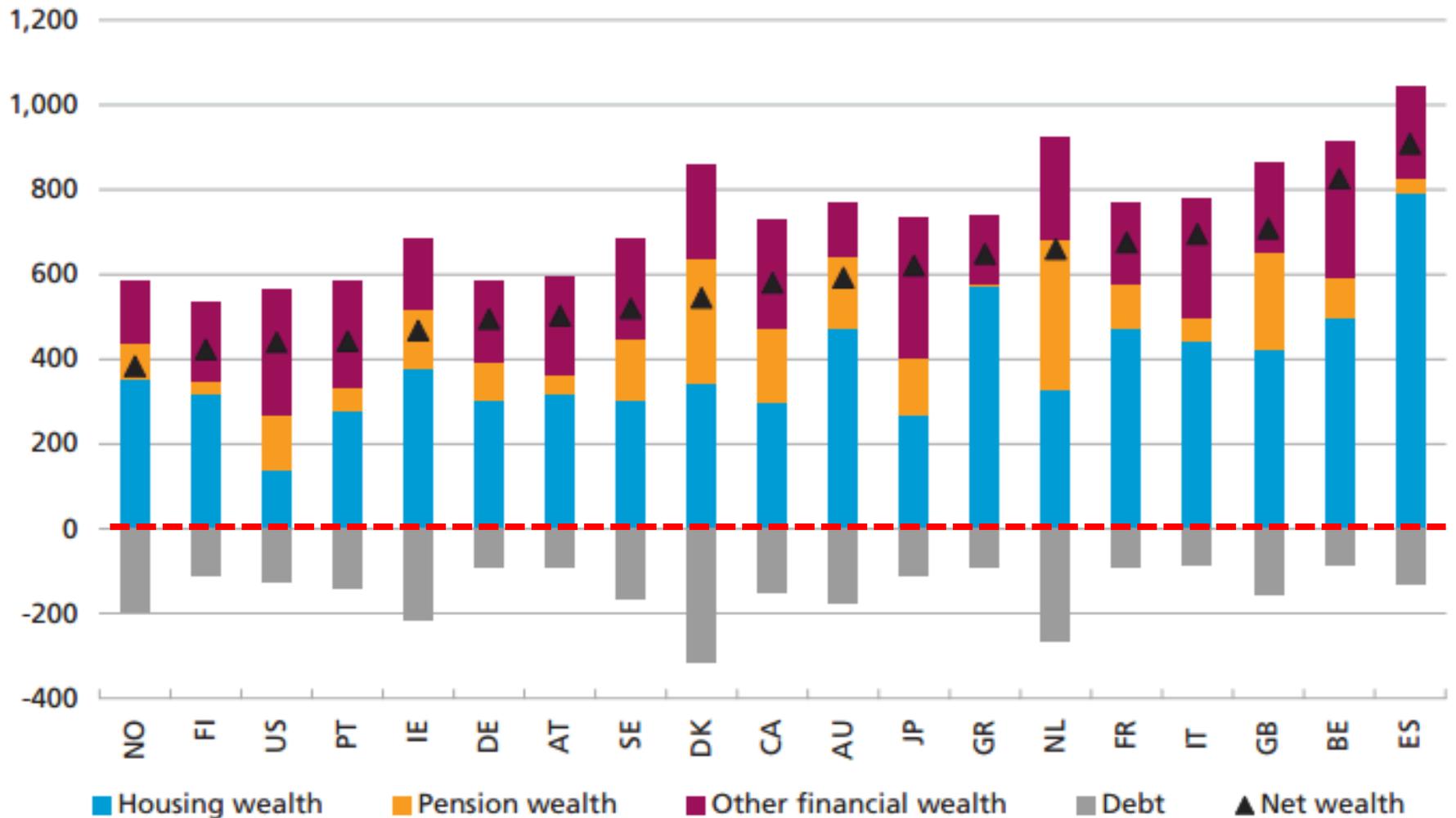


Wealth grows faster than debt

HOUSEHOLD WEALTH AND GROSS DEBT

Chart 2

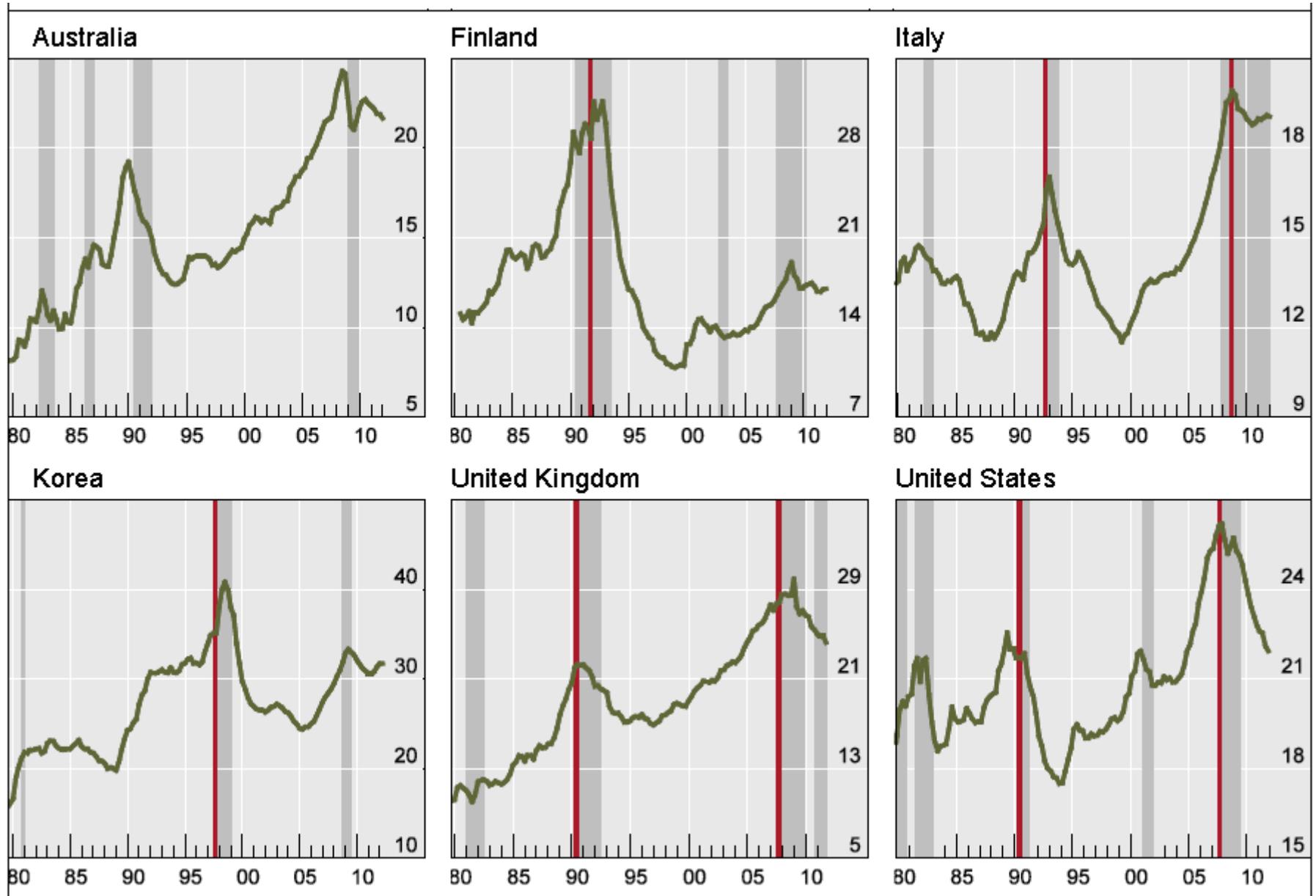
Per cent of disposable income, 2010



Loose credit drives inequality and instability

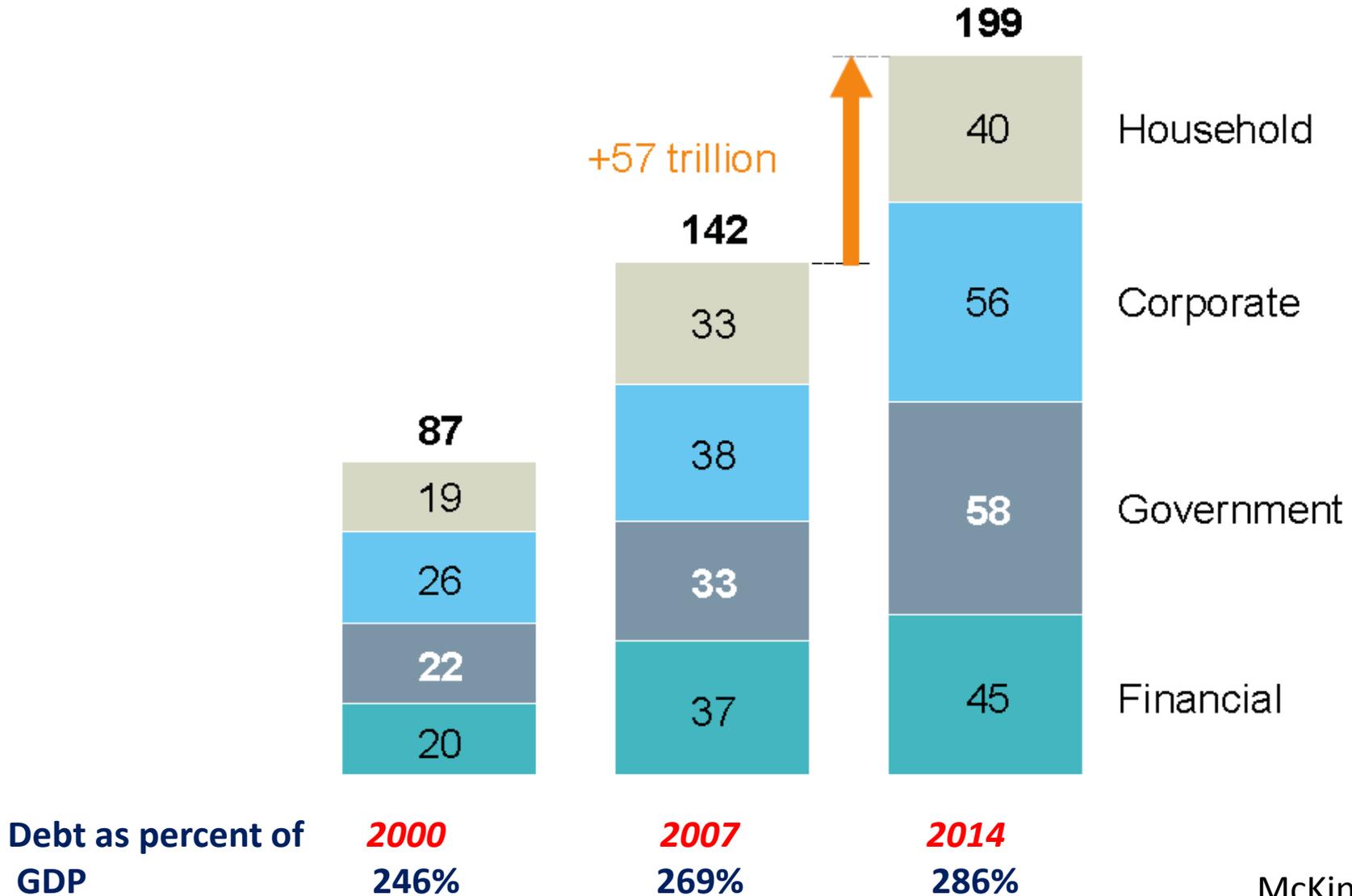
- Debt service takes rising share of labour income. Falling labour share of GDP.
- Young and low-earners unable to buy. Housing shortage and inequality. Housing/social crisis. 'Lost generation' of renters.
- Intermediaries (FIRE) take a big cut. Sector 14-35% of GDP in UK.
- Debt service withdrawn from consumption of goods and services
- Transfers from spenders to hoarders.
- From public goods (taxation) to rentiers/lenders.
- Depresses demand, economic activity, and public services.
- Borrowers unable to service loans. Financial crisis.
- Collapse of wealth effects, and of construction outlays and employment as well.
- Creditors bailed out by taxpayers paid by means of austerity.
- Quantitative Easing inflates asset values. Increase debt overhang.
- Economic stagnation, slow/no recovery.

Debt Service Ratios percent of GDP and Crisis Dates



Global Stock of debt outstanding, 2000-2014

\$ trillion, constant 2013 exchange rates



What to do?

- Just now Piketty is right: Since 1980s $r > g$ (financial return higher than economic growth).
- Unstable equilibrium drives rising inequality. Heading for a crash.
- Thirty years of life-cycle spent paying for housing.
- Privatisation of education, pensions/care extends rent-seeking further over the life-cycle.
- Policy Principle: Regulate private credit. Quantitative controls.
- Restrict credit growth to productive economy. Both efficient and equitable.
- Won't solve existing debt overhang. What to do about that?
- Drastic proposals: inflation, write-offs, sovereign money.
- The choice: drastic action now or a drastic crisis later?
- Current policy preference is for a drastic crisis later.

References

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