Inequality Reduces GDP: S&P

By Editorial Staff *Wed, Aug 6, 2014*

"At extreme levels, income inequality can harm sustained economic growth over long periods. The U.S. is approaching that threshold," said the Standard & Poor's report.

Only months after the inequality debate sparked by Thomas Piketty's book, "Capital," the chief economist at Standard & Poor's has weighed in with a new, much briefer critique of inequality called, "How Increasing Income Inequality is Dampening U.S. Economic Growth, and Possible Ways to Change the Tide."

The report suggests that an extra year of education, on average, for the American workforce would boost productivity enough to add significantly to GDP.

According to the report:

- At extreme levels, income inequality can harm sustained economic growth over long periods. The U.S. is approaching that threshold.
- Standard & Poor's sees extreme income inequality as a drag on long-run economic growth. We've reduced our 10-year U.S. growth forecast to 2.5% from 2.8% five years ago.
- With wages of a college graduate double that of a high school graduate, increasing educational attainment is an effective way to bring income inequality back to healthy levels.
- It also helps the U.S economy. Over the next five years, if the American workforce completed just one more year of school, the resulting productivity gains could add about $525 billion, or 2.4%, to the level of GDP, relative to the baseline.
- A cautious approach to reducing inequality would benefit the economy, but extreme policy measures could backfire.

"Aside from the extreme economic swings, … income imbalances tend to dampen social mobility and produce a less-educated workforce that can't compete in a changing global economy. This diminishes future income prospects and potential long-term growth, becoming entrenched as political repercussions extend the problems," the report said.

"Alternatively, if we added another year of education to the American workforce from 2014 to 2019, in line with education levels increasing at the rate of educational achievement seen from 1960 to 1965, U.S. potential GDP would likely be $525 billion, or 2.4% higher in five years, than in the baseline. If education levels were increasing at the rate they were 15 years ago, the level of potential GDP would be 1%, or $185 billion higher in five years.

"Our review of the data, [and] a wealth of research on this matter, leads us to conclude that the current level of income inequality in the U.S. is dampening GDP growth, at a time when the world's biggest economy is struggling to recover from the Great Recession and the government is in need of funds to support an aging population."