James K. Galbraith, *Inequality and instability*, Oxford University Press, 2012

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James K. Galbraith's *Inequality and instability* (Oxford University Press, 2012) is a must-read for anyone who wishes to investigate the hidden relationship between the increasing inequalities and the financial crises which marked the world economy since the first 1970s. It leads to a radical reversal of the conventional (i.e. mainstream) wisdom concerning the roots of this income inequality and the methodology to be employed to detect it. It does so by combining a simple, but innovative, statistical analysis with a simple language which makes the book accessible to the interested not necessarily specialised reader.

The text is ideally subdivided in two parts. The first part deals with the 'physics' of inequality measurement (i.e. with the search for a new analytical measure of inequality based on Theil (1972)'s pioneering formulation) and presents the new datasets employed by the author. On this basis, Galbraith tests the core argument of Kuznets (1955), which has been re-interpreted and generalized as the idea that there is a 'downward-sloping relationship between inequality and national income' (p. 73). He finds that, with the exception of China, the relationship still holds, although there seems to be a reversal for the richest countries. In addition, the downward-sloping relationship has 'shifted relentlessly outward in the years between 1982 and 2000 for developing and developed countries alike' (*ibidem*). The reason is that changes in the distribution of income are a *global* phenomenon, largely independent from national institutions and policies.

Still in the first part, the author turns to examine the relationship between political regimes and economic inequality. In doing so, he reverses the conventional idea that the more a country follows the Western democracy model the higher is its economic equality. Ironically, Galbraith's study clearly shows that 'communist states, social democracies and Islamic republics have lower inequality than other regimes type, in that order of effect' (p. 108).

After a detailed analysis of several case studies (US, EU and some developing countries), in the second part of the book the author also provides an original interpretation of the cause of the recent financial turmoil and the current economic recession. In contrast to mainstream authors, who locate the financial crisis in a global saving glut (or even in 'loose' monetary policies applied by Fed), he argues that the current crisis is 'the consequence of a deliberate effort to sustain [via credit extension and financial innovation] a model of economic growth based on inequality that had, in the year 2000, already ended' (*ibidem*). As such, he also disagrees with the most part of non-mainstream scholars (and some dissenters among mainstream economists) who consider the crisis just as 'the natural outgrowth of rising inequality as a further phase' (p. 293).

Finally, particular mention must go to chapters 8 and 9 of the book, where Galbraith turns his attention to Europe and the process of economic and monetary integration. He does so by dropping the usual 'unstated assumption' of every study on the mass unemployment that, from the first 1970s to the present day, has haunted Europe, 'which is that the national borders within Europe are also economic borders' (p. 166). The results could sound once again surprising. First, even though the introduction of the euro in 1999 improved unemployment initially, the Maastricht

Treaty implementation has been, in general, associated with an increase in the unemployment rate (and in the inequality). In fact, a great part of European excess unemployment ‘reflects the influence on policy conducted *at the European level* since the Union’ (p. 178). Second, although inequalities within-countries in Europe were usually lower than the United States, ‘the verdict is reversed once one takes account of between-country differentials”. (p. 180). Inter-country inequality in Europe comes out about 30% higher than in the United States’. Third, national institutions ‘do no matter much’. What really matters ‘are regional differences on one side ... and the forces affecting European economic conditions as a whole on the other’ (p. 181). Finally, data suggest that, contrary to the usual thesis that European employment is due to rigid and sclerotic labour markets, ‘wages in Europe tend to rise and fall with, and not against, movements of employment’ (p. 213).

To sum up, one of the greatest merits of Galbraith’s work is to quieten the too many clichés which mark the current economic debate and affect policy decisions. Notice that another important corollary of Galbraith’s analysis is that the current austerity programmes imposed on European ‘peripheral’ countries will end up to increase the divergence of incomes and the relative unemployment rates within Europe. Thus, if it is true that ‘economics of inequality is, in large measure, an economics of instability’ (p. 18), austerity measures are doomed to amplify the instability on the financial markets and to lengthen the current economic recession. Unfortunately, it is this a lesson that a still relevant, though decreasing, part of mainstream economists’ community still refuses to understand.

References

Kuznets, S. (1955), ‘Economic growth and income inequality’, *American Economic Review*, 45(1): 1-28.

Theil, H. (1972), *Statistical decomposition analysis: with applications in the social and administrative sciences,* Amsterdam-London: North Holland.