

Social Capital and Crises

With an Application to Iceland



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Overview

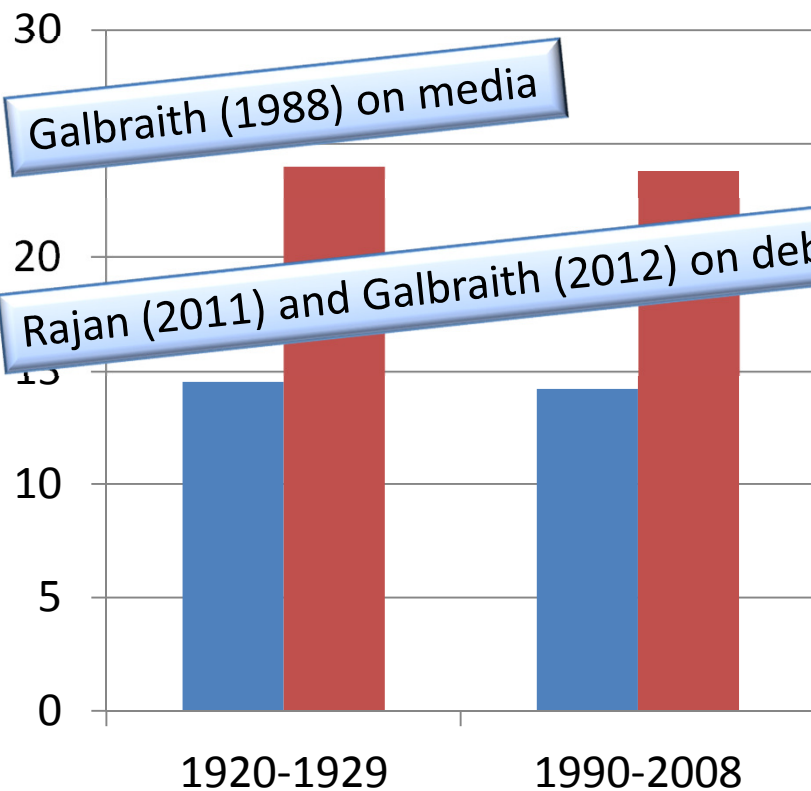
- Social capital as a source of growth
 - Frayed social capital as a precursor as well as consequence of slow growth and of economic crises
 - From inequality *via* crises to broken trust
 - Social and economic indicators side by side (Deaton, 2013)
- Inequality and crises, 1920-1929 and 1990-2008
 - Inequality and trust in Sweden vs. US and Iceland
 - Nordic countries: Big divergence since 2000
- Iceland: Gathering clouds
 - Broken trust undermines economic performance
 - Uncertain prospects for reform and restoration of trust, prosperity, and growth

From inequality to instability

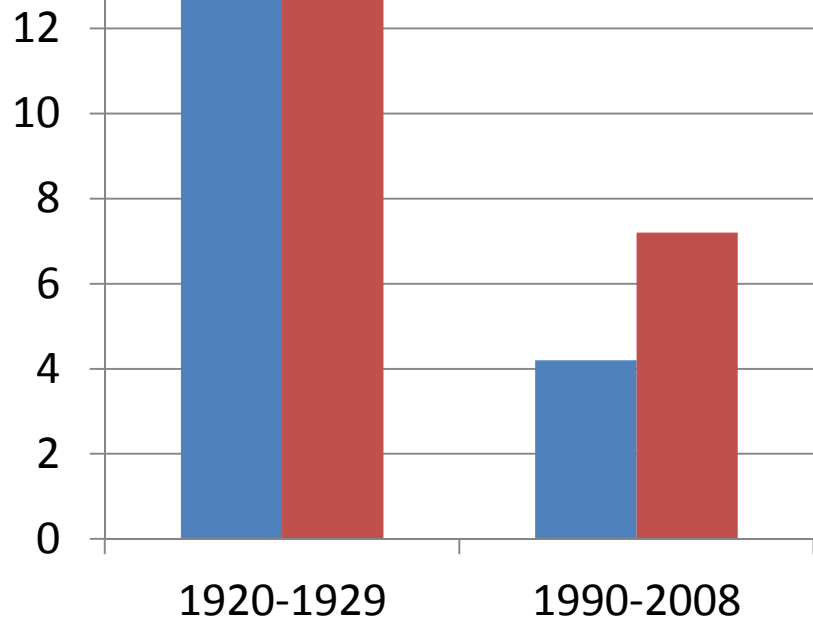
- Increased inequality appears to breed, or at least precede, financial crises
 - Roaring 1920s preceded Great Depression
 - Galbraith's *The Great Crash 1929* (1988)
 - Financial deregulation with attendant rise of the 1% (and 0.1%) preceded fall of Lehman Brothers
 - Galbraith's *Inequality and Instability* (2012)
 - Ratio of US executive salaries to ordinary salaries rose from 30 in 1960s to 270 in 2008 (Economic Policy Institute, 2011)
 - Piketty's *Capital* (2014) covers both episodes, and more
 - Share of top 10% in US national income rose from 40% to 50% from 1920 to 1929 and again from 1990 to 2008 compared with 20% in Scandinavia and 25% in rest of Europe

Share of top 1% in total income (%)

United States



“American enterprise in the twenties had opened its hospitable arms to an exceptional numbers of promoters, grafters, swindlers, impostors, and frauds.”
Galbraith (1988)

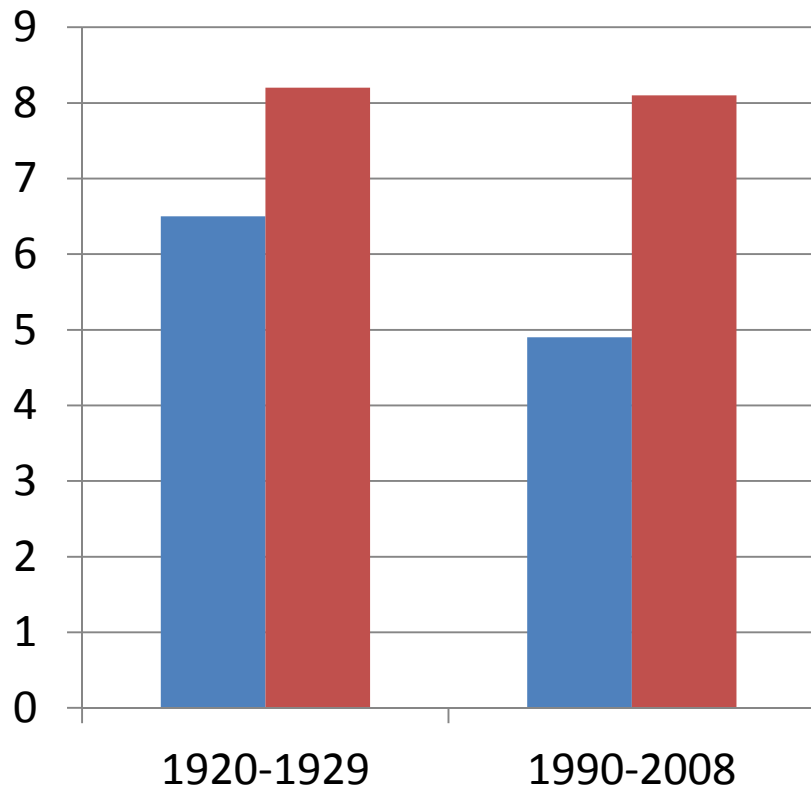


Did increased inequality cause financial crash or were both consequences of recklessness?

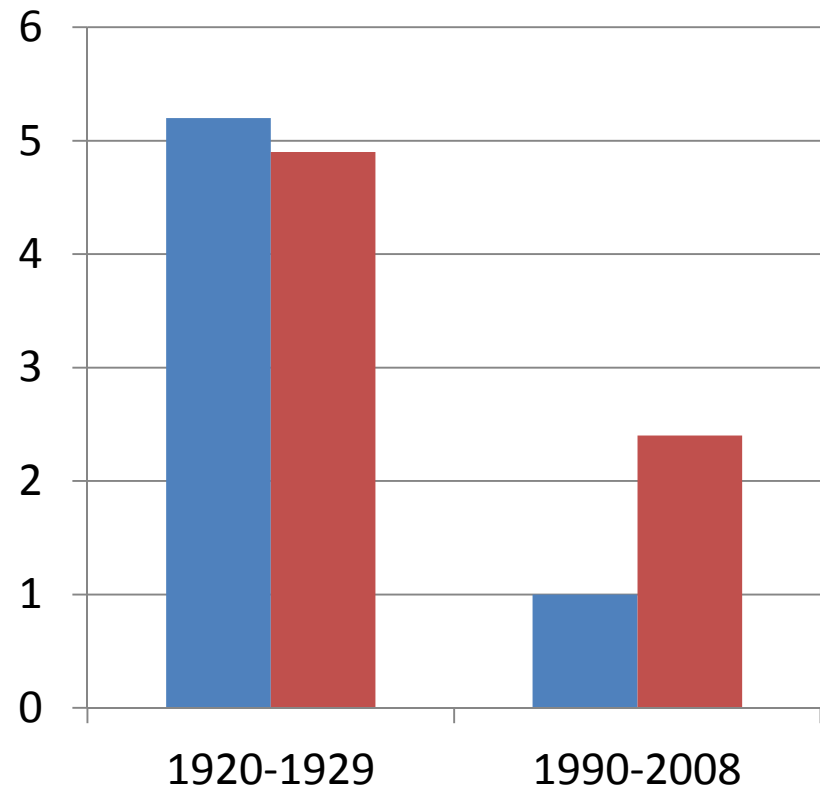
Source: Piketty (2014).

Share of top 0.1% in total income (%)

United States



Sweden

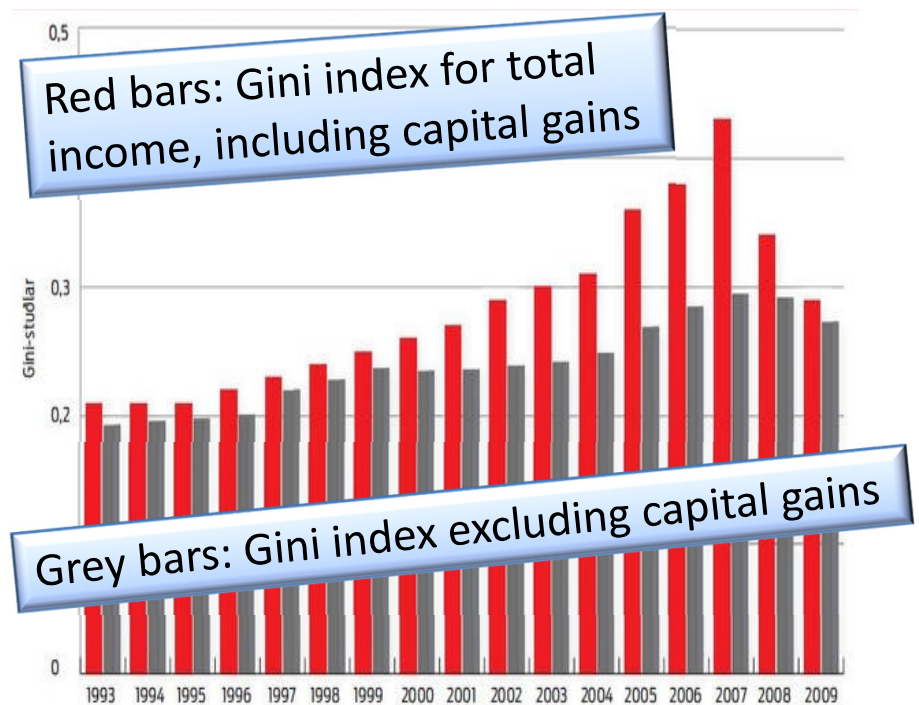


Source: Piketty (2014).

Iceland fits the pattern

- Deregulation without markedly increased inequality preceded Nordic financial crisis of 1989-1994 (Jonung *et al.*, 2009)
 - Denmark escaped crisis
 - Like Finland, Norway, and Sweden, Iceland also had its financial crisis, but it was covered up, paving the way to the cliff in 2008
 - Increased inequality after 1995 was also covered up

Iceland: Inequality of disposable income 1993-2009

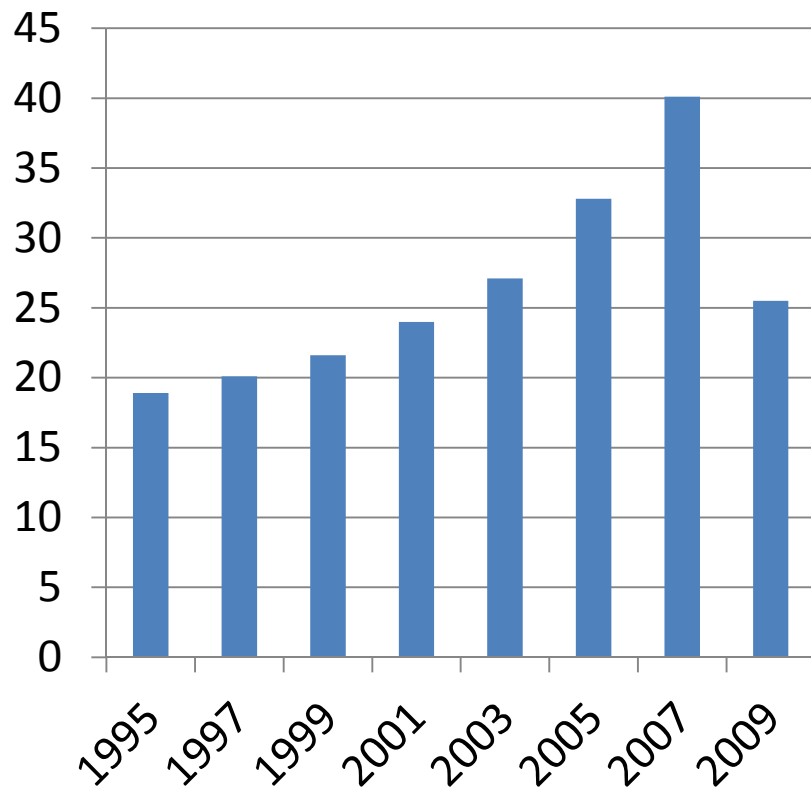


Unprecedented increase in inequality

Source: Internal Revenue Directorate, <http://www.rsk.is/>.

Iceland: Share of top 10% and top 1% in total disposable income (%)

Top 10%



Top 1%

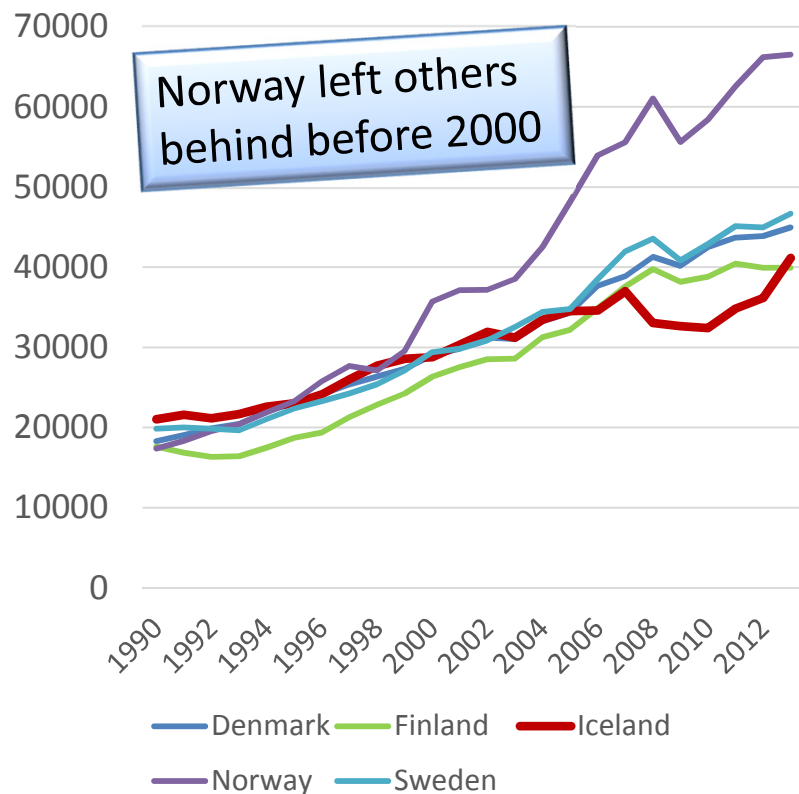


Source: Internal Revenue Directorate, <http://www.rsk.is/>.

Income per person and per hour

(Current international \$, ppp)

GNI per capita 1990-2013



GNI per hour worked 1990-2013

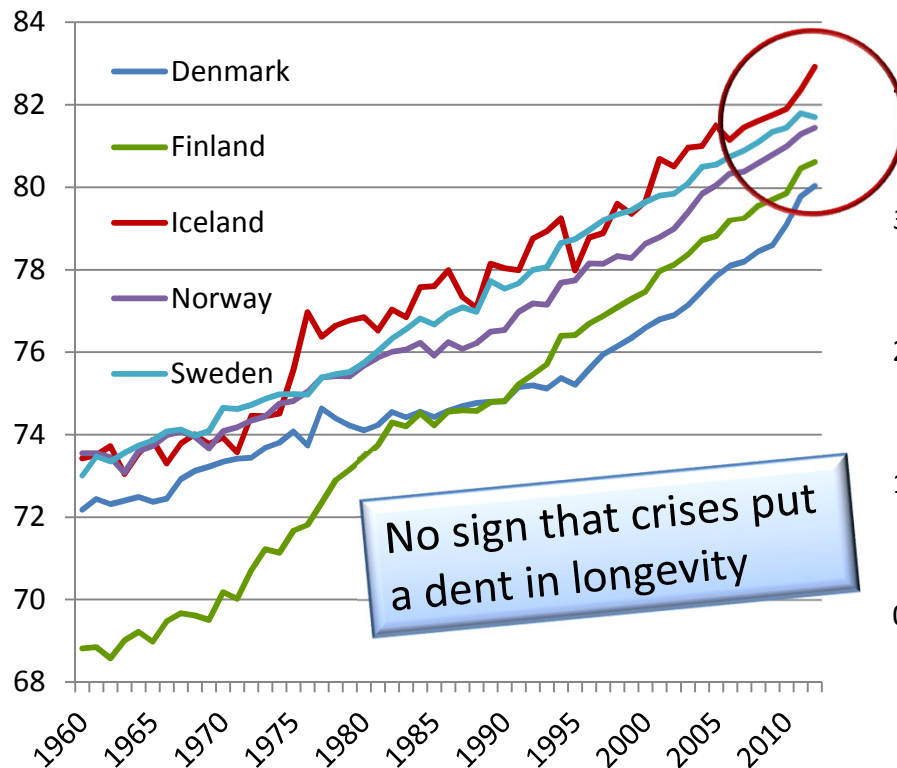


Source: World Bank *World Development Indicators* and The Conference Board *Total Economy Database™*, January 2013, <http://www.conference-board.org/data/economydatabase/>.

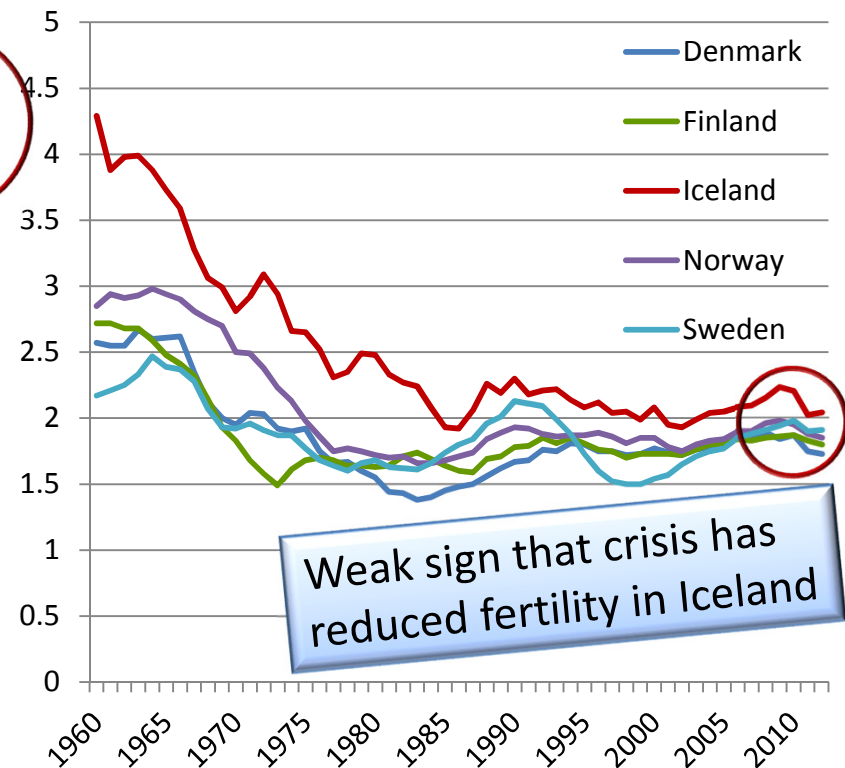
Longevity and fertility

(1960-2012)

Life expectancy (years)



Fertility (births per woman)



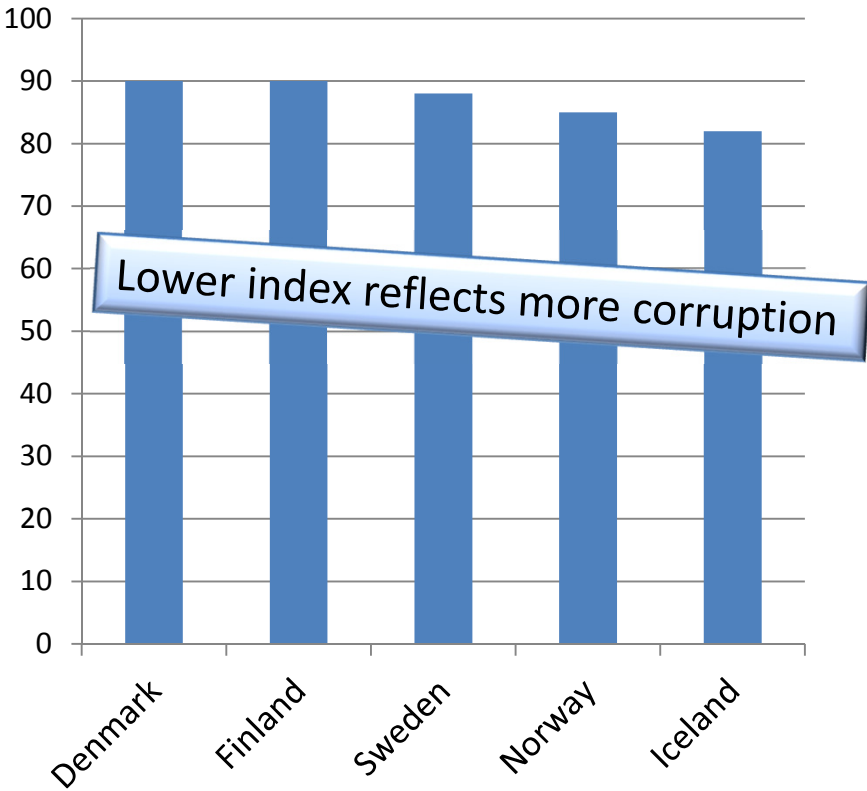
Source: World Bank World Development Indicators.

More on social capital

- Cement that keep our societies reasonably cohesive and cooperative
 - Coagulative properties
 - Relational goods
- Three aspects of decaying social capital
 - Inequality
 - Corruption
 - Lack of trust

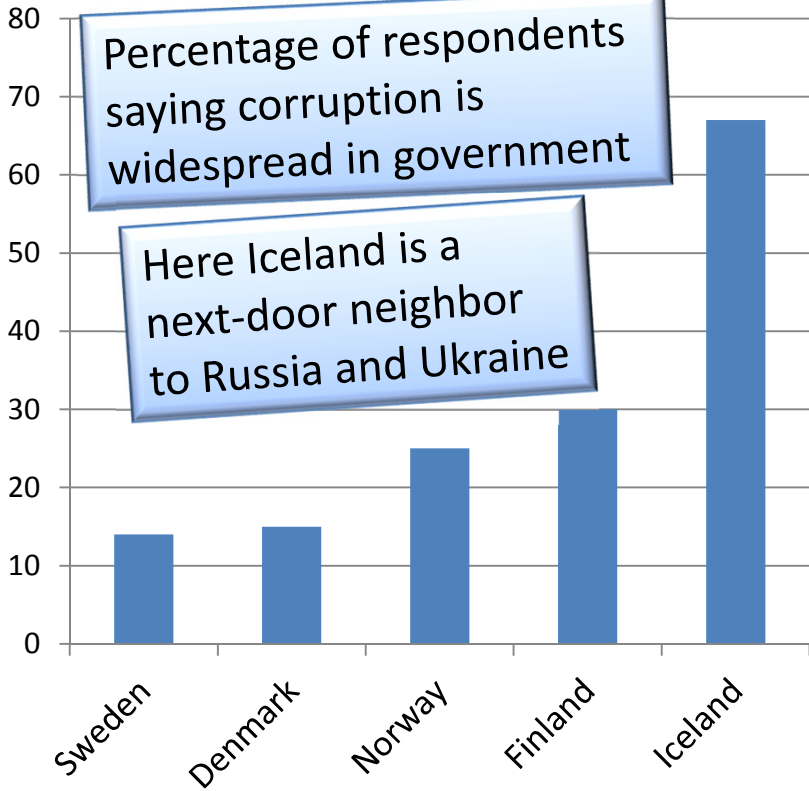
Corruption 2012

Business corruption



Source: Transparency International.

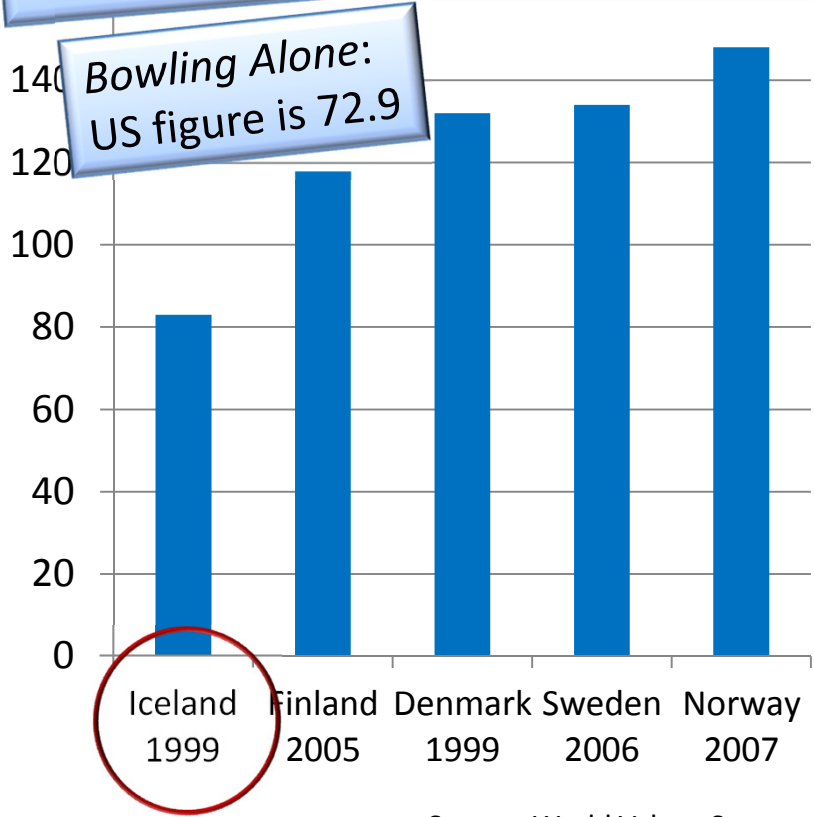
Political corruption



Source: Gallup,
<http://www.gallup.com/poll/165476/government-corruption-viewed-pervasive-worldwide.aspx>.

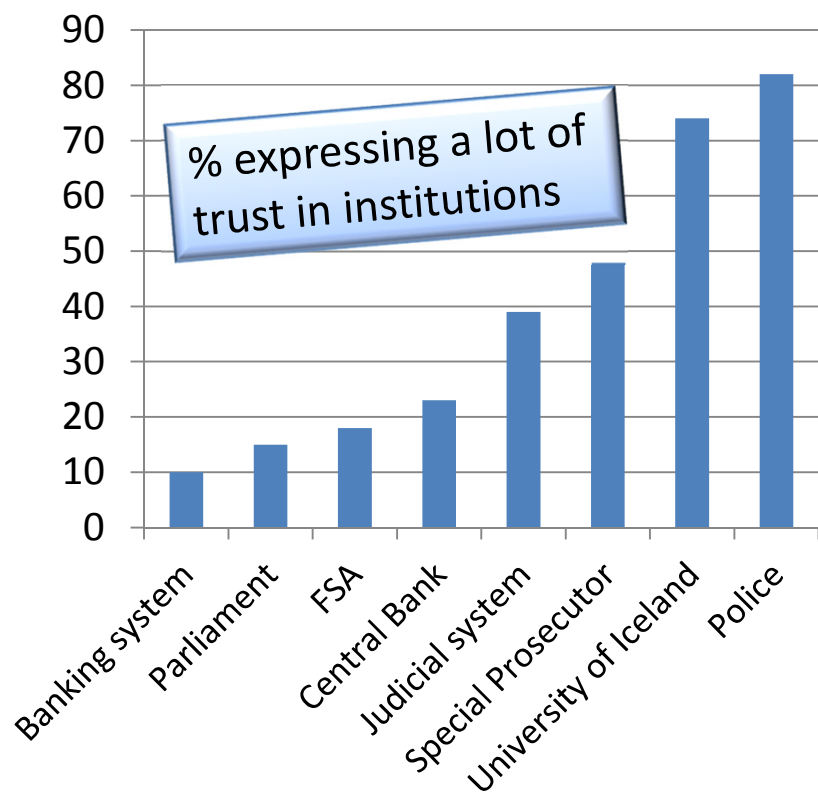
Interpersonal trust and trust in institutions

TRUST INDEX = 100 + (% Most people can be trusted) - (% Can't be too careful)



Source: World Values Survey.

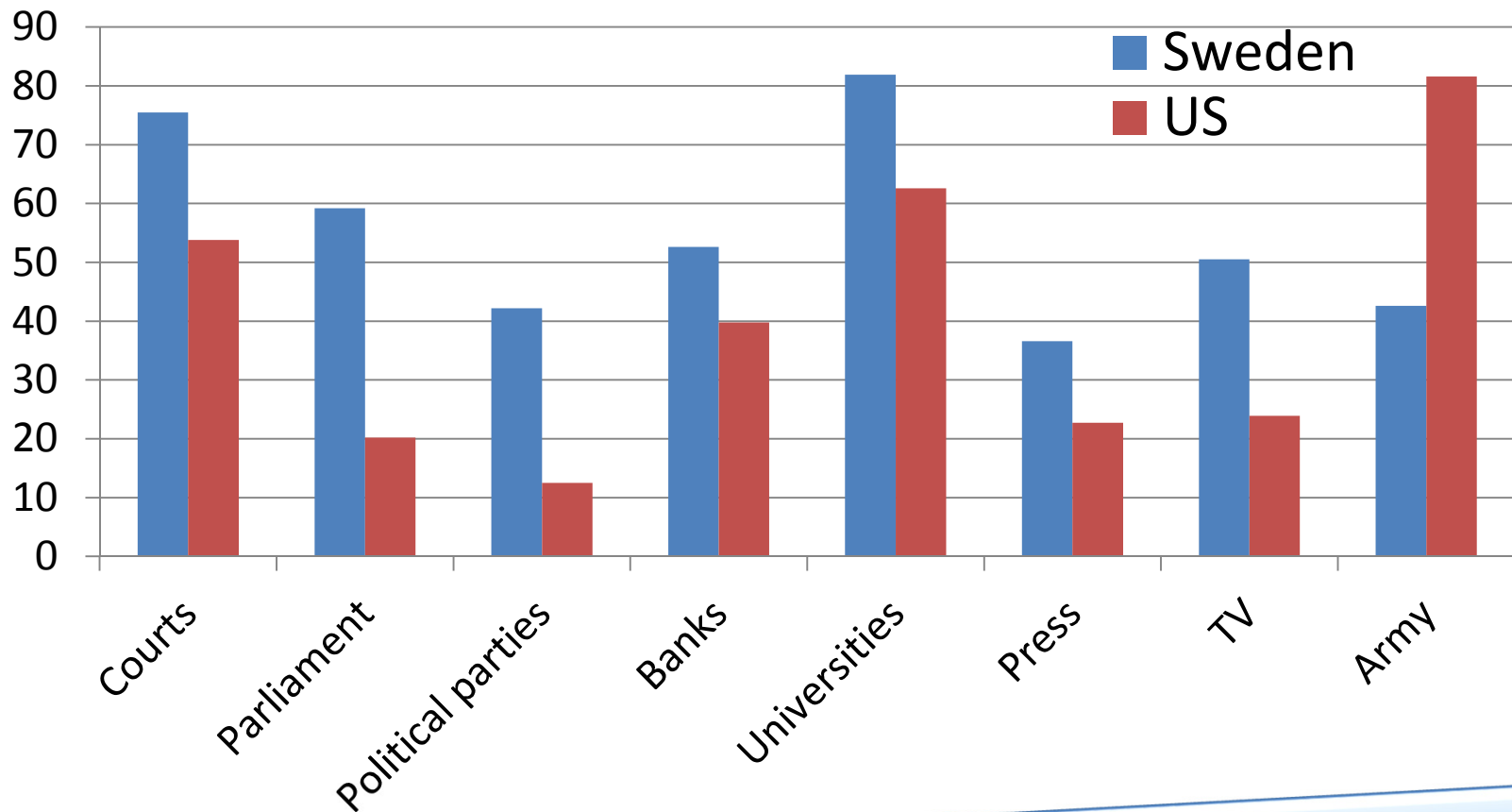
Iceland: Trust in institutions 2013



Source: Capacent.

Sweden and US: Trust in institutions

(% answering Yes to “Do you have a great deal or quite a lot of confidence in the courts, etc.”?)



Sweden beats the US every time, with one exception

Source: World Values Survey.

Discussion

- Financial crises can, in part, be traced to weaker social cohesion, with long-lasting economic effects threatening to further weaken social capital by undermining trust, etc.
 - No prosecutions of bank CEOs in US, not yet
 - James Galbraith and Bill Black are severely critical of this
 - Citing FBI, Black insists that all major US banks broke laws
 - Some banks have paid fines, their CEOs have gone unpunished
 - Practical equivalent of fining Route 66 for speeding
 - Iceland prosecutions of bankers: 30 prison years so far
 - Equivalent to 30,000 prison years in US

Discussion

- James Galbraith before US Senate Judiciary Committee 2010
 - “the country faces an existential threat. Either the legal system must do its work. Or the market system cannot be restored. There must be a thorough, transparent, effective, radical cleaning of the financial sector and also of those public officials who failed the public trust. The financiers must be made to feel, in their bones, the power of the law. And the public, which lives by the law, must see very clearly and unambiguously that this is the case.”
- If so, economic recovery is not enough

Discussion

- How do we respond?
- By investing in social capital
 - Education
 - Public policies to narrow income and wealth inequalities to rebuild trust
 - Moral instruction (Sachs, 2015)
 - Professional codes of conduct
 - Public censure of violators of the public trust
 - Banks do not break laws, bankers do

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