RS: We'll start out with your book on inequality. And what we see right at the beginning is the house of cards on the cover, which implies that something's not really as it should be, that it's an unstable system.

JG: One of the basic findings of my work is that measures of inequality are very good indicators of instability, which is what is conveyed by the house of cards on the front cover.

RS: Do you see inequality as being the cause of instability, or just as accompanying it?

JG: The book is a work of applied statistics, it's a work of measurement, a work of pattern-finding in the data, it's very hard to make a definitive statement of causality from that kind of evidence, so I'll rest on what I said, which is that inequality, which is something that one can measure directly is a very good indicator of instability.

RS: One thing that stood out and sort of surprised me was that inequality seems to follow the stock market.

JG: In the United States it certainly does, and there's a very straightforward reason for that, which is that we measure inequality from tax records. Tax records are records of taxable income. Taxable income at the top of the scale is very closely correlated, it's essentially determined by capital gains and stock options realizations and salary payments that come out of venture capital initial public offerings, things of that nature, and are very closely correlated to the level of asset prices in the stock market.

RS: How does this type of inequality really affect the well-being of people in general, given that pay inequality hasn't changed much?

JG: Well, generally, it improves their well-being in the short run, because a stock boom is associated with higher rates of investment, job creation and more overtime pay throughout the workforce, and so if you separate out incomes of working people from the capital incomes, that sort of inequality actually goes down in the stock boom. A prime example of this is in the late 1990's when overall income inequality goes up enormously as the result of a NASDAQ information technology boom, but inequality in the working population declines, the poverty levels decline because of the effect of that on economic activity. So this is not mysterious. It is why I think the emphasis should not be on the welfare effects of inequality, but on the instability.

RS: Do you suspect a causal relationship?

JG: Again, what I find in the data is that very rapidly rising inequality, which is something that one can measure, is associated with credit booms, and credit booms are followed by credit busts. This is part of a dialog that, well I'll leave it at that and come back to how it fits into the discussion in economics. There's a reason for stressing this particular point.

RS: Did the credit boom transfer wealth from the bottom to the top?

JG: In a credit boom, the incomes of people at the top, which again, are measured from their tax reports, go up enormously, because they are experiencing great capital gains.

JB: Where does the money flow? If you have incomes from the tax [sic] markets for the top earners, where does the money come from? We see that, on the other hand, the bottom, they pay the money for the one at the top to...

JG: The money associated with a credit boom is largely created in the process of credit extension, it's not something that comes out of the pockets of poorer people, there's not a fixed sum of money, this is the mechanism of an unstable credit economy.

RS: The fact that the money is essentially, well it's not really virtual, either, or is it?

JG: Money is a spreadsheet operation, all of it is virtual in that sense. Your bank does not maintain a large stack of notes with your name on it.

RS: What's the link between inequality and poverty? Is there a link between inequality and poverty, or are these just two very different things? We think about poverty when we think about inequality. But is that really the same thing? Do they go together?

JG: I think one has to be careful about cases. In the U.S. case, where, as I say, we have been for thirty years, our moments of prosperity were of this highly unstable credit-driven type. The poverty rates went down in the booms and go up in the slumps, so they're really quite different from the inequality numbers as measured in the tax records. On the other hand, they do reflect the strength of demand for labor in the bottom half of the wage structure because the numbers which one can measure separately for wage inequality are very closely correlated to the hours worked by people in low-paid jobs. The number of jobs they hold, the number of hours they work in each of them, all of that translates very directly into their weekly earnings, and in the booms, of course, that goes up.

JB: How do you measure poverty? Is it just a statistical quantity?

JG: We have many ways of measuring poverty, but there's no question that in the booms, poverty rates fell. No question about that. By the end of the 1990's, poverty rates for minorities in the United States were at all-time lows. That's a direct consequence of the fact that you had three years of unemployment rates that were below four percent. The problem with that time – one can argue about the allocation of resources, could you have done better than spending all those hundreds of billions of dollars on internet start-ups that were going to go bust – but the problem of that time was not a poverty question, the problem of that time was that prosperity was built on a very unstable foundation.

RS: So essentially it's the credit that makes the whole thing unstable, that credit is excessive...

JG: Yes, yes, yes, that's exactly the point.

RS: ...and the fact that the financial system has gotten so large. What's the percentage of the GDP that's financial?

JG: Well, ten percent of incomes or about forty percent of profits.

RS: Is that excessive?

JG: I think it's excessive, yeah, sure.

RS: What do you think would be a reasonable amount? Where can you tell that it's excessive?

JG: Well, we were doing quite well on numbers far lower than that twenty, twenty-five years ago. So there's very little reason to believe that the economy has changed in such a way as to make the financial sector that much more necessary. What actually has happened is that the sector has found a way to assert itself in a much larger share of economic transactions than was previously the case.

JB: What can politics do to lower inequality?

JG: I think there are many different things that one can do that will lower inequality. You could regulate the wage structure, you can foster higher rates and more stable rates of employment, the whole structure of social insurances and services is inequality-reducing, and one can reduce the scale and activities of the financial sector. All of those things would work to reduce inequality in different parts of the distribution.

JB: What income tax for the top earnings?

JG: I'm referring to inequality before tax. Of course, the tax system is going to have a further effect on things, sure.

JB: And what do... for example, France...

JG: This has always been an interesting debate amongst economists for whom the professional credo has been that you should allow whatever distribution emerges before tax, and then redistribute through the tax system, and I've never thought that was very persuasive. I think what actually happens is that the distribution before tax is substantially a regulatory outcome, it's an artifact of *ex ante* social decisions. It has to do with, among other things, minimum wages and the structure of trade unions and a great many other things in society, and that having am accepted pretax distribution that is fair is much more stable than trying to change things through the tax code, because you get an enormously powerful political resistance to doing that once you've allowed people to have the attribution of income to them pretax.

RS: Of course, if we look at the postwar period, there we had some very high upper tax brackets, over 90 percent.

JG: Applied to very small numbers of people.

RS: But even now it would probably be applied to a very small – the upper one percent or one tenth of one percent.

JG: In the U.S. In the 1980's, the progressive reform which was developed by Bill Bradley and Dick Gephardt in Congress was to reduce the top tax rates by extending the base, because the system of very high marginal rates was so riddled with loopholes and exemptions that top earners by and large didn't pay it unless they were of a very peculiar type, for example a celebrity athlete like Bill Bradley himself or Jack Kemp, who was also in the Congress at the time. They paid very high rates on that sort of straight salary income that they had. But if you were in any kind of business activity, you had a depletion allowance or timber allowance or some other damn thing that got you out of that.

RS: That seems to kind of be the way that things always run, though, that wages and salaries end up getting taxed higher than anything else. It seems to happen in every country.

JG: That may very well be, but the point of the '86 act was to reduce the rates at the top, but to expand the base such as to be revenue-neutral, which it largely was. I think the long-term implications of the '86 act are only now being recognized in the economics profession. A major thing that it did was to – and that's true also of the earlier Reagan cuts – was to create a strong incentive for corporations to shift income directly to their chief executives. I think the CEO boom was partly an artifact of the reduction of marginal tax rates, and that had very pernicious effects on corporate governance in the United States. I wrote about this in a previous book, in *The Predator State*, and I'm now beginning to see some commentary. I know that Thomas Piketty has come to the same conclusion.

RS: How did that happen? I don't quite understand.

JG: Well, if you have a high marginal rate, then you have an incentive to retain earnings in the corporation and pay the corporate tax rate and then to use the retained earnings in ways that add indirectly to the consumption of your top executives. You build a skyscraper with lovely penthouses in it, you have corporate aircraft, you have the whole aspect of this that characterized the way the big corporations presented themselves in the 50's and 60's in the United States. And they stopped building skyscrapers – when was the last time one was built? Probably the World Trade Center in 1970. There was very, very little after that, and corporations started building basically campuses, which are much cheaper, and instead funneling the money directly into the pockets of their chief executives.

RS: Okay, that makes sense.

JG: That's what happened. I don't know that that was entirely anticipated by the authors of the tax cuts in the 80's.

RS: It's not something that one thinks about, it isn't obvious.

JG: It isn't entirely obvious, and obviously, there may well have been people in the industry who had this objective in view. But it certainly developed afterwards and seems to be pretty clear in retrospect.

RS: What do you think the effect is of the CEO boom on the economy? Does it set the wrong incentives?

JG: The main thing is that it creates a kind of very small class of, let's say, of "personally-empowered corporate executives" who are detached from the technical operations of their own enterprises by and large – that is to say, they are primarily financial people – and I think that has had a very significant effect on the way in which large American corporations operate. It has made them much more vulnerable to being downsized, having their physical operations manipulated for the sake of financial results.

RS: To put a value on that, that's a pretty negative result.

JG: Yes, I think that's a pernicious result, for sure.

RS: Do you think that there's any possibility of changing that, I mean there's certainly resistance to it.

JG: Well there's always a possibility of changing things.

RS: Realistic possibility...

JG: I'm not in the business of judging realistic possibilities. I think my role as an economist is to try to describe what the political decisions have led to and to let people make informed judgments about what they would like to see in the way of changes.

RS: Currently, there's difficulties even discussing the idea of wanting to change the tax rate back to what it was before 2002 – it was 2002, wasn't it?

JG: 2001.

RS: 2001. One of the more obvious changes that would seem like could be made would be to start taxing hedge-funds managers as if they were getting real income and not just capital gains, not even capital gains, dividends, they're taxing them as dividends. That isn't even politically possible.

JG: And your point?

RS: The point is...

JG: ...rich people are influential? Yes, okay, we all know that. (Laughs)

RS: …which is why I question the realism of being able to change anything.

JB: I have a question about the top earnings of the CEO's. If you ask German mainstream economists, they say that's a totally normal market effect. They even link it to the labor market. What do you think about this theory?

JG: One would have to ask, how was it that the chief executive officers suddenly acquired all sorts of skills that they didn't happen to have thirty years ago when their companies were in fact more powerful and more stable and more prominent forces in the economy than they are today. It's pretty hard to argue with a completely closed circle of reasoning such as you've just described.