

Finance and Inequality

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Interest rates and inequality

- Conventional argument that high interest rates increase top wealth inequality.
- Wold and Whittle (1957)
- Fortunes grow relative to the economy
 - Piketty and Zucman (2015)
- Arguments as to why low interest rates should increase inequality at top.
- Literature ignores the role of financing in investments.
- Sources
 - Gomez and Guin-Bonenfant (unpublished 2020)
 - Entrepreneurs
 - Bolton-Santos-S (*RFS* 2020)
 - Financiers
- SPACs
 - Illustrates my general skepticism concerning the role of financial innovations in lowering inequality.

Entrepreneurs

- Firms produce homogeneous good with aK technology. TFP evolves over time according to a Markov chain with S states .
- To grow capital stock at rate g firm must invest $i(g)K$ units of the consumption good
 - $i(g)$ strongly convex.
- Assume firms are financed by debt at a rate r .
 - Entrepreneurial demand for capital does not affect r .
 - Gomez and Gouin-Bonenfant allow for any fixed debt to equity ratio. Use actual leverage in estimation.
- Lower rate of interest increases rate of accumulation by entrepreneurs relative to others.
- Inequality measured by inverse of Pareto exponent.
- Estimate that 2/3 of increase in inequality in 1985-2015 is accounted by decline in interest rates.

Capital and Knowledge

- Three types of agents
 - ① Originators of projects that payoff in period 2 but want to consume in period 1.
 - Fraction e of good projects that pay x_h , bad projects pay 0.
 - ② Investors that possess capital K per capita in period 1 but want to consume in period 2
 - ③ Financiers that possess capital μK in period 1, want to consume in period 2 and also possess knowledge - can distinguish good from bad projects.
 - Financiers are few.
- 3 Markets
 - ① Stock market where investors buy projects that they regard as homogeneous at an equilibrium price p .
 - ② An OTC market where financiers cream-skim good projects and pay originators

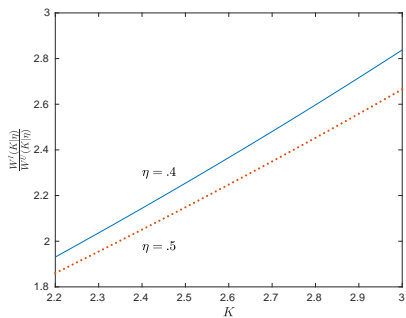
$$p^d := \lambda x_h + (1 - \lambda)p \quad (1)$$

- ③ A secure loan market where financiers borrow from investors subject to haircut $0 < \eta < 1$, at an equilibrium gross rate r .

Equilibrium and comparative statics

- An equilibrium consists of a triple p^d , p and r such that all three markets clear.
- CIMP (Allen-Gale) allows one to combine risk-neutrality with prices that respond to supply of funds and projects in the stock market.
- Equilibrium determines p , leverage of financiers ℓ and fraction of projects m cream-skimmed by financiers.
- $R := \frac{x_h}{p^d}$ and $r = \frac{\mathbb{E}x}{p} = \frac{e(1-m)x_h}{(1-em)p}$
- K increases $\Rightarrow r$ decreases, ℓ and m increase and $\frac{R}{r}$ increases.
- Increase in ℓ increases further the wealth of financiers relative to uninformed investors.
- Decrease in η increases wealth of financiers while decreasing wealth of uninformed.

Effect of hair-cut on inequality



- Michael Cembalist (JPM)
- Return analysis of 90 SPAC companies brought public or liquidated between 1/1/2019 and 1/22/2021.
- Median return to SPAC sponsor 418%, after considering concessions, vesting etc...
- Advantages to companies: Faster speed-to-market some evidence of leaving less money on the table; during SPAC marketing process to institutional and retail investors, management can use its own financial projections (compare with IPO restrictions).
- Median return for buy and hold investors (upfront SPAC buyers, PIPE investors, post-merger buy-and-hold investors) much worse and does not beat Russel 2000 Growth.
- One more example of innovation in finance that benefits principally the holders of specialized human capital.