

Economic Inequality, Debt Crises and Human Rights

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I. INTRODUCTION

Severe economic inequality frequently affects the effective enjoyment of particular human rights, both civil and political rights, as well as social, economic and cultural ones. It may also lead to forms of discrimination that are prohibited under international human rights law. Human rights law therefore imposes certain legal obligations on States to address economic inequalities affecting the enjoyment of human rights and bestows effectual guidance for reducing inequalities, including the prioritization of policy responses in this

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field. Recognizing these interdependencies, human rights protection mechanisms have recently increased their attention for economic inequality.¹

This is also the result of a better understanding of the negative effects of increased economic inequality on social development that has emerged recently among scholars and civil society organizations. In a testament to this new sensitivity, a commitment to reduce inequality within and among countries is now enshrined in Goal 10 of the Sustainable Development Goals. Accordingly, the international community strives not only to promote the social, economic, and political inclusion of all, but also the adoption of fiscal, wage, and social policies to progressively achieve greater equality and better regulation of global financial markets and institutions.

Yet there is one particular facet of inequality that has been frequently neglected: the linkages among economic inequality, sovereign debt crises, and human rights. There is widespread acknowledgement that debt crises and adjustment programs adopted to respond to them not only impair a country's general economic performance, but also frequently increase inequality and have a negative impact on socioeconomic outcomes and particularly on vulnerable populations. However, inequality may also be an important contributing factor to the emergence of debt crises. This article offers reflections on both dimensions, exploring answers to the following questions: Does inequality matter from a human rights perspective? Does inequality impair debt sustainability? Does lower debt sustainability lead to higher levels of inequality? And, finally, what guidance does human rights law provide for addressing inequality?

In so doing, this Article will be exclusively devoted to the relationship between human rights and economic inequality, and specifically income and wealth inequality. Hence, the term "inequality" employed in this Article, unless otherwise qualified, should be understood as referring to these types of inequality.²

As explained by Bohoslavsky and Goldmann,³ the incremental approach to sovereign debt restructuring, the focus of this special issue, requires legal principles, whether principles of public international law, general principles of law, or of another legal status, reflecting progressive trends in current debt restructuring practice. The contribution of this Article lies not so much in the establishment of new principles, as human rights and nondiscrimination are well entrenched in international law.⁴ Rather, its contribution lies in an analysis

1. See, e.g., Report of the Special Rapporteur on Extreme Poverty and Human rights, U.N. Doc. A/HRC/29/31 (2015).

2. Moreover, while both income and wealth inequality relate to economic disparities, there are important differences between the two aspects. Inequality in wealth appears to be more pronounced in many countries and in the world generally. Policy responses designed to address wealth inequality on the one hand and income inequality on the other hand may differ. Therefore, the article clearly distinguishes between those two forms of inequality where necessary. However, if such distinction is not expressly made, then the term "inequality" encompasses both forms of economic inequality.

3. Juan Pablo Bohoslavsky & Matthias Goldmann, *An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of Public International Law*, in this issue.

4. On the question of whether human rights are customary rules or general principles, see Bruno Simma & Philip Alston, *The Sources of Human Rights Law: Custom, Jus Cogens, General*

of the potential of such established principles to further sustainable sovereign debt levels. The following considerations thus show how the debt restructuring principles turn attention to hitherto underdeveloped aspects of the meaning of certain human rights. This is particularly compelling because human rights have emerged as a constituent part of the principle of debt sustainability in the Basic Principles on Sovereign Debt Restructuring Processes adopted by the U.N. General Assembly.⁵ Likewise, the Sustainable Development Goals establish a connection between sovereign debt sustainability and human development, which comprises the progressive realization of economic, social, and cultural rights.⁶

II. THE IMPORTANCE OF CONSIDERING ECONOMIC INEQUALITY FROM A HUMAN RIGHTS PERSPECTIVE

The financial crisis has brought the growth of income and wealth inequalities back onto the global agenda.

Global inequality currently stands at extremely high levels and is further increasing. The United Nations Development Program (UNDP) has reported that the richest eight per cent of the world's population earns half of the world's total income, leaving the other half for the remaining ninety-two per cent.⁷ Over the past two decades, income inequality has increased by nine per cent in developed countries and eleven per cent in developing countries.⁸ Top incomes dramatically increased from the 1980s, mostly in developed countries but also in emerging economies, such as India and China.⁹ In addition to wealth transmitted through inheritance, top wages have increased dramatically, outpacing increases in average wages many times and resulting in an unprecedented accumulation of wealth by a small but powerful elite.¹⁰ In 2015, the richest one per cent of people in the world owned more than fifty per cent of global wealth, up from forty-four per cent in 2010.¹¹ Furthermore, the eighty richest individuals currently own as much wealth as the bottom fifty per cent of the entire global population.¹²

International human rights law addresses inequality on many levels. First, the recognition of economic and social rights imposes upon States the duty to address and/or prevent inequality inasmuch as it constitutes a threat to human rights realization. These rights include fundamental workers' rights—in particular the right to form and join trade unions and the right to fair remuneration—and social rights—in particular the rights to education, health,

Principles, 12 AUSTRALIAN YEARBOOK OF INTERNATIONAL LAW 82-108 (1989).

5. G.A. Res. 69/319, U.N. Doc. A/RES/69/319 (Sept. 29, 2015).

6. G.A. Res. 70/1, U.N. Doc. A/RES/70/1, ¶ 54 (Oct. 21, 2015).

7. See U.N. Development Program (UNDP), *Humanity Divided: Confronting Inequality in Developing Countries* (2013).

8. *Id.* at 7, using the Gini coefficient.

9. See Anothony B. Atkinson, Thomas Piketty & Emmanuel Saez, *Top Income in the Long Run of History*, 49 J. ECON. LIT. 3 (2011).

10. See THOMAS PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY* (2014).

11. See *Global Wealth Report*, CREDIT SUISSE RES. INST. 19, 21 (2015).

12. See WEALTH: HAVING IT ALL AND WANTING MORE, OXFAM INT'L 2, 3 (2015).

and social security.¹³

Moreover, guarantees of nondiscrimination and equality might be infringed by socioeconomic disadvantages. All international and regional human rights treaties include a broadly constructed principle of nondiscrimination¹⁴ that covers formal discrimination on prohibited grounds in law or official policy documents as well as substantive discrimination, i.e. discrimination in practice and in outcomes. For example, States have certain obligations to ensure equal access to health services, adequate housing, and water and sanitation.¹⁵ The prohibition of discrimination extends not only to the grounds explicitly enumerated in article 2(2) of the International Covenant on Economic, Social and Cultural Rights, such as race, color, sex, or religion, but also to grounds based exclusively on economic and social status.¹⁶

While human rights law does not necessarily imply a perfectly equal distribution of income and wealth, it does require conditions in which rights can be fully exercised. As a consequence, a certain level of distribution of resources is expected to guarantee individuals an equal enjoyment of the realization of their basic rights without resulting in discriminatory outcomes.¹⁷ When income inequality creates discriminatory outcomes, it becomes a human rights issue. States can make an important contribution to overcoming discrimination by ensuring equal opportunity for all members of society. However, the notion of equal opportunity resembles a myth in many countries and situations, and many people in the world do not have reasonable means for overcoming socioeconomic handicaps.¹⁸

Inequality implies a violation of the rights enshrined in the Covenant when a significant number of individuals within a society cannot enjoy minimum essential levels of each of the rights enumerated in the Covenant, while other individuals within the society have more than sufficient resources available to guarantee a basic enjoyment of those rights. The violation in such cases appears to be twofold: States may fail to meet their minimum core obligations and to mobilize maximum available resources for the progressive realization of rights, as explained below.

According to the views of the Committee on Social, Economic and Cultural Rights, when a significant number of individuals living in a State party

13. See U.N. Committee on Economic, Social and Cultural Rights, General Comment No. 13, U.N. Doc. E/C.12/1999/10, at ¶ 6(b)(iii) (1999); U.N. Committee on Economic, Social and Cultural Rights, General Comment No. 14, U.N. Doc. E/C.12/2000/4, at ¶ 19 (2000); U.N. Committee on Economic, Social and Cultural Rights, General Comment No. 19, U.N. Doc. E/C.12/GC/19, at ¶¶ 16, 25 (2008).

14. See, e.g., article 2(1) of the International Covenant on Civil and Political Rights *or* article 2(2) of the International Covenant on Economic, Social and Cultural Rights; article 14 of the European Convention for the Protection of Human Rights and Fundamental Freedoms; article 1(1) of the American Convention on Human Rights.

15. See Committee on Economic, Social and Cultural Rights, General Comment No. 20, U.N. Doc. E/C.12/GC/20 (2009) for commentary on nondiscrimination in economic, social, and cultural rights, among other general comments.

16. *Id.* at ¶ 35.

17. See Radhika Balakrishnan, James Heintz & Diane Elson, *What does inequality have to do with human rights?* POL. ECON. RES. INST., Working Paper Series No. 392, at 16 (2015).

18. JOSEPH E. STIGLITZ, *THE PRICE OF INEQUALITY: HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE* 18 (2012).

are deprived of critical foodstuffs, essential primary health care, basic shelter and housing, or the most indispensable forms of education, there is a prima facie case of failure to discharge obligations under the Covenant.¹⁹ It should be noted that the minimum income necessary for the enjoyment of such essential levels of economic, social, and cultural rights may differ from one individual to the other—an aged and sick person may potentially need more resources to enjoy effective access to adequate health care and medication than a healthy young person—and from one country to the other. In essence, international human rights norms require States to ensure that all persons residing in their territory live in conditions of dignity.

States are furthermore obliged to use maximum available resources for the progressive realization of economic, social, and cultural rights. Progressive realization implies that States have to ensure the enjoyment of minimum essential levels of rights on a non-discriminatory basis first and without retrogression. States may also fail to use their maximum available resources if they neglect to undertake reasonable efforts to ensure domestic revenue generation and redistribution to address income inequality that violates human rights—for example, if a State fails to address inequality through appropriate taxation or social policies.²⁰

To reduce the concept of “maximum available resources” to only those resources on the balance sheet of the treasury would be contrary to the purpose of the Covenant and the Universal Declaration of Human Rights, which guarantees to every person a life with dignity and freedom from fear and want. The term “maximum available resources” also encompasses those resources that a State can reasonably generate through adequate, appropriate, and fair taxation of individuals and corporations or through the levying of tariffs.

In addition, it should be noted that article 2(1) of the Covenant explicitly refers to those resources that can be made available through international assistance and cooperation, in particular economic and technical assistance. It also extends to an obligation to create an international enabling environment conducive to the universal fulfillment of human rights. This international terrain includes bilateral and multilateral trade, investment, taxation, finance, environmental protection, and development cooperation. In other words, human rights law requires a certain degree of redistribution of resources and support based on available capacities within and among nations. This encompasses an organization of the local and global economies that prevents and eradicates extreme poverty.²¹ Violations of this principle are pervasive: With 795 million people worldwide being undernourished, at least one out of nine persons on Earth is currently excluded from enjoying essential minimum levels of the right to food.²² The United Nations Human Settlements Program has estimated that

19. See Committee on Economic, Social and Cultural Rights, General Comment No. 3, U.N. Doc. E/1991/23, at ¶ 10 (1990), for an explanation of the nature of States parties' obligations.

20. See ASOCIACION CIVIL POR LA IGUALDAD Y LA JUSTICIA ET AL., *POLÍTICA FISCAL Y DERECHOS HUMANOS EN LAS AMÉRICAS: MOVILIZAR LOS RECURSOS PARA GARANTIZAR LOS DERECHOS* (2015), available at www.cesr.org/downloads/cidh_fiscalidad_ddhh_oct2015.pdf.

21. See ETO, *Maastricht Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights*, principle 29 (2013).

22. See U.N. FOOD AND AGRICULTURE ORGANIZATION (FAO), *THE STATE OF FOOD*

close to one billion people currently do not have adequate housing but instead often live in informal settlements in developing countries.²³ Inequalities within and among nations are an important contributing factor to these unsettling outcomes. Inequality is both a cause and a symptom of massive violations of economic, social, and cultural rights.

Economic inequality also matters from a human rights perspective when it translates into other types of inequalities. The enjoyment of human rights does not depend only on access to goods and services reflecting the minimum needed for survival; an individual's access to resources relative to others is also of crucial importance. Data suggests that high levels of relative inequality may have substantial negative effects on the practice of human rights. It has been observed that low-income households in a very unequal society may do worse than households with the identical income in a more equal society.²⁴ This pattern is obvious in numerous areas, including legal representation, education, political influence, health, housing, and social discrimination that can escalate into conflict.

To illustrate, a poor domestic worker may not be able to sue his or her employer to challenge an unfair unilaterally imposed pay cut, both because labor rights may not be institutionalized in the State and because legal representation is not affordable. Continuing to work in unfair conditions or quitting the job may be the only viable options, which is a choice that can beget oppression, particularly when market conditions of high unemployment make replacing employees rather easy.

Likewise, people in poverty may not be able to afford higher education because of prohibitively high tuition fees, the need to work for immediate income, and the inability to move themselves out of unskilled positions. These circumstances can become a multigenerational trap, as generation after generation is not able to break this chain.²⁵

It is also common for poorer segments of the population to be marginalized or even effectively excluded from the political process. As noted by the Special Rapporteur on extreme poverty and human rights, Philip Alston, economic and social inequalities often reinforce one another “when individuals with higher incomes or their family members have more political power or access to better education than those with lower incomes.”²⁶ In failing to recognize the connection between social and economic inequalities, there is a risk of political capture of the political system by economic elites, effectively undermining the right to vote and the principle of democracy.

INSECURITY IN THE WORLD, MEETING THE 2015 INTERNATIONAL HUNGER TARGETS: TAKING STOCK OF UNEVEN PROGRESS 8 (2015). FAO employs a narrow definition of undernourishment, which has faced heavy criticism for masking the magnitude of the hunger problem, see Frances M. Lappé et al., *How We Count Hunger Matters*, 27 ETHICS & INT'L AFF. 251 (2013).

23. See U.N. Habitat, *UN-Habitat and POST-2015*, <http://mirror.unhabitat.org/content.asp?cid=11848&catid=746&typeid=24&subMenuId=0>.

24. See Balakrishnan, Heintz & Elson, *supra* note 17; see also RICHARD WILKINSON & KATE PICKETT, *THE SPIRIT LEVEL: WHY MORE EQUAL SOCIETIES ALMOST ALWAYS DO BETTER* (2009).

25. For more information on the negative effect of income inequality on the right to education, see the Report of the Special Rapporteur on Extreme Poverty and Human Rights, *supra* note 1, at ¶ 30.

26. *Id.* at ¶ 6.

Equally significant is that those on the high end of the income and wealth divide become less dependent on public goods and services because they have the means to purchase private alternatives. At the same time, the poor are getting more dependent on public services, as private alternatives become less affordable for them. As soon as the more affluent and powerful groups in society cease to depend on public goods and services, the State is less likely investing in public, collective goods, leading to a vicious circle of their degeneration.

Moreover, countries suffering from high levels of inequality have worse health outcomes compared to other countries with a similar gross domestic product (GDP).²⁷ For example, there is a strong positive correlation between rates of child mortality and inequality among countries at similar levels of development. Also, inequality may impair the availability of adequate housing for low-income households.²⁸

Inequality often contributes to social exclusion and marginalization of certain groups and individuals. In addition, if inequality entrenches social cleavages along regional, religious, racial, or ethnic lines, social instability and violent internal conflict are more frequent.²⁹ It has recently been noted that “[w]hen the poor are from one race, ethnicity, religion or region and the rich are from another, a lethal, destabilizing dynamic often emerges.”³⁰ Inequality not only increases the risk of economic and social rights violations, it also augments the likelihood of severe violations of civil and political rights.³¹

III. THE RELATIONSHIP BETWEEN INEQUALITY AND SOVEREIGN DEBT CRISES

A. *Inequality as a Source of Sovereign Debt Increase and Crisis*

Inequality may affect sovereign debt both directly and indirectly.³² In short, the direct impact proceeds from the “corrosive” influence of inequality on the tax base, as well as from its enhancing effect on demand for redistribution through debt default. As for the indirect impact, it is mainly private debt that acts as an interface between inequality and sovereign debt. Increasing inequality may lead to private over-borrowing and over-lending. The resulting excessive private leverage can accumulate over many years, destabilize the financial system³³ and even become so volatile for the economy that the debt can trigger a banking crisis, leading to both output losses and

27. See Wilkinson & Pickett, *supra* note 24.

28. See Janna L. Matlack & Jacob L. Vigdor, *Do Rising Tides Lift All Prices? Income Inequality and Housing Affordability*, 17 J. HOUSING ECON., 212 (2008).

29. See Lars-Erik Cederman et al., *Horizontal Inequalities and Ethnonationalist Civil War: a Global Comparison*, 105 AM. POL. SCI. REV. 478, 487-89 (2011).

30. See Michael W. Doyle & Joseph E. Stiglitz, *Eliminating Extreme Inequality: a Sustainable Development Goal, 2015-2030*, 28 ETHICS & INT’L AFF. (2014).

31. See Todd Landman & Marco Larizza, *Inequality and Human Rights: Who Controls What, When, and How*, 53 INT’L STUD. Q., 715 (2009).

32. For a detailed overview of the interrelationships between inequality and financial crises, see Rémi Bazillier & Jérôme Héricourt in *The Circulare Relationship Between Inequality, Leverage and Financial Crisis*, LABORATOIRE D’ÉCONOMIE D’ORLÉANS, (2015).

33. See Michael Kumhof, Roman Rancière & Pablo Winant, *Inequality, Leverage and Crises*, 105 AM. ECON. REV. 1217 (2015).

massive bailout costs for State governments. In addition, both the direct and the indirect channel may simultaneously prompt a currency crisis if external debt is involved.

1. *Inequality as a Direct Cause of Sovereign Debt Increase and Crisis*

Inequality may exert a considerable direct influence on the structure and the level of government revenues and spending. Increased levels of inequality also mean that the income tax base of the State concerned is rather small, at least if income taxation is not progressive. This diminishes sovereign revenues and consequently makes the State more dependent on borrowing. Thus inequality contributes in many cases to sovereign debt, which may eventually result in sovereign default and financial crises. There is a growing body of evidence for this mechanism.

Empirical studies point to a clear nexus between inequality, income tax base, and sovereign debt. One study, using data from fifty countries in 2007, 2009, and 2011, found a negative correlation between income inequality and the tax base and a positive correlation with sovereign debt.³⁴ An analysis of a panel of seventeen countries of the Organization for Economic Cooperation and Development (OECD) covering the period 1974-2005 found a positive correlation between the top one per cent income share, a widely used indicator of income inequality, and fiscal deficit.³⁵ The erosion of the income tax base following an increase in inequality is also likely to affect the structure of tax revenue. The alternative to experiencing a fiscal deficit would be to increase other types of taxes, such as import or export duties and indirect or corporate taxes. This would, however, lead to higher revenue volatility, consequently increasing the risk of sovereign debt crisis.

Increased inequality is also found to contribute to the degeneration of sovereign debt into sovereign debt crises. A number of studies show that high inequality increases the probability of default significantly.³⁶ In one research paper, it was emphasized that sudden, rapid rises in inequality, in particular, can considerably increase the sovereign default risk. The authors specify that such “inequality shocks” generate a far higher probability of default than collapses of domestic production of the same scale.³⁷ Several authors have also established that progressive income taxes, which decrease income inequality, can decrease the default risk.³⁸

34. See Joshua Aizenman & Yothin Jinjark, *Income Inequality, Tax Base and Sovereign Spreads*, 68 FINANZARCHIV: PUBLIC FINANCE ANALYSIS 431 (2012).

35. See Santo Milasi, *Top Income Shares and Budget Deficits*, 10 CTR. ECON. & INT’L STUD. (2013).

36. See Andrew Berg & Jeffrey Sachs, *The Debt Crisis Structural Explanations of Country Performance*, 29 J. DEV. ECON. 271 (1988); Jeffrey Sachs, *The Debt Overhang of Developing Countries* in DEBT, STABILIZATION AND DEVELOPMENT: ESSAYS IN MEMORY OF CARLOS DIAZ ALEJANDRO (1989) and the papers referred to in footnotes 37-40.

37. See K. Jeon & Z. Kabukcuoglu, *Income Inequality and Sovereign Default*, working paper (University of Pittsburgh, 2015).

38. *Id.*; see also A. Ferriere, *Sovereign Default, Inequality and Progressive Taxation*, job market paper (New York University, 2014).

One explanation for these links focuses on the incentives of the government to reap the short-term gains of a default. By defaulting, the government may obtain new fiscal freedom—even if this freedom might be short-lived—permitting tax cuts or spending increases to the benefit of the poorer. These benefits are considered greater in more unequal societies with a larger number of low-income households.³⁹ At the same time, owing to the higher probability that a government in highly unequal States may decide to default, lenders may accept only lower levels of aggregate debt before they sharply raise interest rates or even refuse to issue further credit.⁴⁰

Yet in the long run, default normally implies future costs owing to a (temporary) exclusion from financial markets. As the government cannot incur additional debt to smooth taxes, it is forced to adjust its tax revenues to any short-term fluctuation. The resulting volatile taxation harms poorer households in particular. The more numerous they are, the larger the future costs of default therefore become. However, the incentives to default tend to dominate the second long-term effects in very unequal societies; hence, economies with more progressive taxation have less incentive to default.⁴¹

2. *Inequality as an Indirect Cause of Sovereign Debt Increase and Crisis*

Inequality can also indirectly contribute to increased sovereign debt and consequently to sovereign debt crises. There are at least two avenues to such outcomes: (a) high levels of inequality contribute significantly to the generation and increase of private debt, with strong interrelationships between excessive private debt, sovereign debt, and financial crises; and (b) inequality adversely affects social and political stability, thereby hampering growth and eventually affecting both government revenue and spending.

39. *See id.*; *see also* Y.K. Kim, *Inequality and Sovereign Default Under Democracy*, 6 EUR. J. ECON. & POL. STUD. 5 (2013). It is important to note that a default does not imply per se negative consequences for the population. It is mainly the fiscal retrenchment following the default—because the government cannot anymore borrow on financial markets—which impacts negatively the people's human rights.

40. *See* Alessandro Dovis, Mikhail Golosov & Ali Shourideh, *Political Economy of Sovereign Debt: Cycles of Debt Crisis and Inequality Overhang*, Working Paper (2015), available at <https://economics.sas.upenn.edu/sites/economics.sas.upenn.edu/files/u21/Dovis-et-al.pdf>.

41. Ferriere, *supra* note 38.

a. Interrelationships between Private Debt, Sovereign Debt and Financial Crises

A boom in private debt is usually considered a more accurate predictor of financial instability than the level or development of sovereign debt.⁴² However, sovereign debt may be, depending on the circumstances, a major factor for triggering or worsening financial crisis. For example, excessive sovereign debt in some countries has been a prominent contributor to the recent global financial crisis. Public and private debts are linked in many ways, often reinforcing the other's negative effects, which may be described as a diabolical loop between both.⁴³ Even when financial crises are not necessarily driven by public debt, such debt has an impact on the aftermath of crises, leading to more prolonged periods of economic depression.⁴⁴

The consequences of a financial crisis on public finances are immense. Nationalization of private debts along with bailout and recapitalizing costs for the banking system has contributed to an explosion of sovereign debt. Further important factors to the aggregation of sovereign debt are decreases in production, consecutive contractions in the tax base, and countercyclical policies set to fight the downturn resulting in higher government spending. If the country instead uses consolidation policies to reduce its debt, this often turns out counterproductive because reduced government spending has a negative impact on economic growth and employment, as the International Monetary Fund (IMF) has recently acknowledged.⁴⁵

There are several channels through which inequality affects private debt and financial crises. As a starting point, it is noteworthy that household debt and top income share—a standard indicator of inequality—are strongly correlated: in many countries, household debt and top income share have grown simultaneously and at a similar pace over many years.⁴⁶ Recent research has focused on credit demand and supply channels for explaining the nexus between private debt and inequality.

According to the credit-demand line of reasoning, private debt increases as households try to maintain certain absolute or relative levels of consumption, while facing growing inequality.⁴⁷ In other words, people borrow more extensively to maintain their absolute or relative standard of living. Data collected for the United States of America confirm this interpretation: a study

42. See Moritz Schularik & Alan M. Taylor, *Credit Booms Gone Bust: Monetary Policy, Leverage Cycles and Financial Crises, 1870-2008*, 102 AM. ECON. REV. 1029 (2012).

43. See Markus K. Brunnermeier et al., *European Safe Bonds* (Euro-nomics group 2011).

44. See Oscar Jordà, Moritz Schularick & Alan M. Taylor, *Sovereigns Versus Banks: Credit, Crises and Consequences*, (National Bureau of Economic Research, working paper No. 19506, 2013).

45. See IMF, *World Economic Outlook 2012: Coping with High Debt and Sluggish Growth*, (World Economic and Financial Surveys, 2012); N. Batini, L. Eyraud, L. Forni & A. Weber, *Fiscal Multipliers: Size, Determinants and Use in Macroeconomic Projections*, IMF technical notes and manuals No. 14 (2014).

46. See Bazillier & Hericourt, *supra* note 32.

47. See James K. Galbraith, *INEQUALITY AND INSTABILITY. A STUDY OF THE WORLD ECONOMY JUST BEFORE THE GREAT CRISIS* (2012).

from 2006 revealed that, over the previous twenty-five years, income inequalities in the United States had increased without being followed by an increase in consumption inequalities.⁴⁸ Some explain this as a result of a higher dispersion of transitory income, but it appears likely that massive permanent income shifts play a more prominent role here.⁴⁹ In particular, the observation that the debt-to-income ratio of the top five per cent and bottom ninety-five per cent households has undergone a dramatic reversion between 1983 and 2007 supports the latter view.³³ Also, a negative link between income inequality and social mobility was found by analyzing a sample of sixteen countries.⁵⁰ For numerous developing and developed countries, it has also been shown that the increase in inequality was mainly due to an increase in between-group inequality, reflecting permanent income shocks.⁵¹ Explanations for persistent borrowing by low- and middle-income households despite growing income inequality can be found in several variants of the relative income hypothesis, according to which household consumption is a function of the household's position in the income distribution and its past levels of consumption.⁵²

Another theory connects inequality, credit demand, and monetary policy. It holds that highly unequal income distribution leads to overreliance on investment and luxury consumption. This may not be sufficient for a sustainable level of economic output, prompting low interest rates that itself allows private debt to increase beyond sustainable levels.⁵³

In turn, the rise in the incomes of the richest will also increase their savings, leading to a huge accumulation of private wealth. This rising supply of capital requires more investment opportunities and consequently boosts the credit supply, even for riskier borrowers.⁵⁴ Moreover, a possible consequence of this accumulation of private wealth is creditor-led lobbying to favor policies that may lead banks to issue risky loans and eventually to a massive distribution of subprime loans to low-income individuals. It has been argued that “growing income inequality in the United States . . . led to political pressure for more housing credit,” which eventually “distorted lending in the

48. See Dirk Krueger & Fabrizio Peri, *Does Income Inequality Lead to Consumption Inequality? Evidence and Theory*, 73 REV. ECON. STUD. 163 (2006).

49. See Robert A. Moffitt & Peter Gottschalk, *Trends in the Transitory Variance of Male Earnings in the United States, 1970-2004*, (National Bureau of Economic Research, working paper No. 16833, 2011); Matteo Iacoviello, *Household Debt and Income Inequality, 1963-2003*, 40 J. MONEY, CREDIT AND BANKING, 929 (2008).

50. See D. Andrews & A. Leigh, *More Inequality, Less Social Mobility*, 16 APPLIED ECON. LETTERS 1489 (2009).

51. *Id.*; see also R. Kanbur, C. Rhee & J. Zhuang, *Rising Inequality in Asia and Policy Implications* (East Asian Bureau of Economic Research, macroeconomics working paper No. 23973, 2014).

52. See T. van Treeck, *Did Inequality Cause the United States Financial Crisis?*, 28 J. ECON. SURVEY 421 (2014); R.H. Frank, Adam S. Levine & Oege Dijk, *Expenditure Cascades*, 1 REV. BEHAVIORAL ECON. 55 (2014).

53. See J.-P. Fitouso & F. Saraceno, *How Deep is a Crisis? Policy Responses and Structural Factors Behind Diverging Performances*, (Observatoire français des conjonctures économiques, working document No. 2009-31, 2009); A.B. Atkinson & S. Morelli, *Economic Crises & Inequality*, (United Nations Development Program, Human Development Research Paper No. 2011/06, 2011).

54. See P. Lysandrou, *Global Inequality, Wealth Concentration and the Subprime Crisis: a Marxian Commodity Theory Analysis*, 42 DEVELOPMENT & CHANGE 183 (2011). See also M. Kumhof et al., *supra* note 33.

financial sector.”⁵⁵

It seems likely that the credit demand and credit supply channel are activated simultaneously. Other factors also play an important role.⁵⁶ A general shift towards a radical free-market stance,⁵⁷ the prevalent finance-led model of growth and the accompanying deregulation of the financial sector even seem to be main factors explaining the global financial and economic crises that began in 2007, which is often labelled the “Great Recession.”⁵⁸ The decline of workers’ bargaining power owing to labor market flexibility and wage moderation has possibly contributed to the demand side of the crisis described above. Financial liberalization and deregulation explain, besides the growing wealth at the top, increased credit supply.⁵⁹

Based on the theoretical considerations above, it is not surprising that an examination of eighteen OECD countries over the period 1970-2007 revealed a positive link between income inequality and credit growth.⁶⁰ Moreover, over the period 1980-2010, a large majority of banking crises were preceded by persistently high levels of income inequality.⁶¹ Concerning the United States specifically, one study that investigated the period 1980-2003 found a “strong positive effect of income inequality in household debt relative to disposable income as well as the components of the household debt (mortgage debt, revolving debt, e.g. credit cards, and non-revolving debts, e.g. car loans)”.⁶² Although these results seem to confirm the theoretical ideas above, it should be noted that more empirical research is needed.

b. Impact of Inequalities on Social and Political Stability and Growth

Inequality may also reduce social and political stability. This creates disincentives for investment, disruptions in business activity, disunity,⁶³ threats

55. See R.G. RAJAN, *FAULT LINES: HOW HIDDEN FRACTURES STILL THREATEN THE WORLD ECONOMY* (2010); see also Galbraith, *supra* note 47.

56. See Bazillier & Hericourt, *supra* note 32.

57. See P. Krugman, *Inequality and Crises*, NYTIMESBLOG (June 2010), <http://krugman.blogs.nytimes.com/2010/06/28/inequality-and-crises>.

58. See Galbraith, *supra* note 47. He also identifies mainly financial forces as the source of growing inequality.

59. See P. Tridico, *Financial Crisis and Global Imbalances: Its Labor Market Origins and the Aftermath*, 36 CAMBRIDGE J. ECON. 17 (2012).

60. See C. Perugini, J. Hölscher & S. Collie, *Inequality, credit and financial crises*, 40 CAMBRIDGE JOURNAL OF ECONOMICS 227 (2016).

61. See G. Bellettini & F. Delbono, *Persistence of high income inequality and banking crises: 1980-2010*, (University of Bologna, Department of Economics, working paper No. 885, 2013). By contrast, works by A.B. Atkinson and S. Morelli come to inconclusive results, both for increases and levels of inequalities; see id., *Income inequality and banking crisis: a first look, report prepared for the Global Labor Forum 2011* (International Labour Organization (ILO), Turin, 2010) and *Inequality and crises revisited* (Centre for Studies in Economics and Finance, University of Naples, working paper No. 387, 2015). They also provide for possible explanations for their outcomes, in particular the choice of inequality measures and contagion between national economies due to globalization.

62. See M. Christen & R. Morgan, *Keeping up with the Joneses: analyzing the effect of income inequality on consumer borrowing*, 3 QUANTITATIVE MARKETING AND ECONOMICS 145, at 148 (2005).

63. See K.H. Park, *Income inequality and economic progress: an empirical test of the institutional approach*, 55 AMERICAN JOURNAL OF ECONOMICS AND SOCIOLOGY 87 (1996).

to property, and policy uncertainty and may even raise the probability of coups and mass violence. The result is a lower level of growth, which consequently provokes higher levels of debt. The link between inequality, political instability, and investment has been confirmed by an empirical study made on seventy countries over the period 1960-1985.⁶⁴

Recent cross-country evidence supports the notion that inequality reduces economic growth. Based on vast data for both OECD and emerging countries, an IMF study from 2014 provides a solid case that lower inequality is robustly correlated with faster and more durable growth.⁶⁵ A further IMF study supports these conclusions using a sample of 159 advanced, emerging, and developing economies. The authors conclude that the income distribution itself matters for growth. Specifically, if the income share of the top twenty per cent increases, then GDP growth actually declines over the medium term, suggesting that the benefits do not trickle down. In contrast, an increase in the income share of the bottom twenty per cent is associated with higher GDP growth.⁶⁶

B. Impact of Sovereign Debt Crises on Inequality

Sovereign debt crises, like financial crises generally, have enormous distributional consequences, originating in several factors.

1. Decline in Economic Output

To start with, financial crises may massively hamper economic growth, principally because of decline in investment in production, as a result of credit contraction. Banking crises usually lead to a significant output drop. On average, the real per capita GDP drop amounts to over nine per cent, with a recovery time of two years.⁶⁷ An analysis of financial crises, taking into account both banking and currency crises, has revealed that the average output loss is twenty per cent of GDP, with a recovery time of three to four years.⁶⁸ However, isolated currency crises as such may have mixed effects: they usually increase the price of imported goods and may lead to a contraction of available credit, considerably encumbering growth. At the same time, currency crises may also benefit the exporting sector of a country.

The consequences of sovereign debt crisis on economic growth are difficult to isolate, as they are generally preceded by, or coincide with, banking crises. However, there is a strong negative correlation between extreme levels of sovereign debt or sovereign default on the one hand and growth on the other.

64. See A. Alesina & R. Perotti, *Income distribution, political instability, and investment*, 40 EUROPEAN ECONOMIC REVIEW 1203 (1996).

65. See J. Ostry, J. Berg & C.G. Tsangarides, *Redistribution, inequality and growth*, (IMF staff discussion note No. 14/02, 2014).

66. See E. Dabla-Norris et al., *Causes and consequences of income inequality: a global perspective*, (IMF staff discussion note No. 15/13, 2015).

67. See C.M. Reinhart & K.S. Rogoff, *The aftermath of financial crises*, 99 AMERICAN ECONOMIC REVIEW 466 (2009).

68. See M.D. Bordo et al., *Is the crisis problem growing more severe?*, 16 ECONOMIC POLICY 51 (2001). The authors also demonstrate that banking and currency crises have become more frequent in the last quarter of the twentieth century.

One study, for example, has found that debt crises lead to significant and long-lasting output losses, reducing output by about ten per cent after eight years.⁶⁹

2. *Inflation, Unemployment and Labour Share*

In addition to this slowdown in economic activity, there are several other channels through which financial crises affect income and wealth distribution. Currency crises exert their influence by leading to relative price changes, fiscal retrenchment, and changes in assets.⁷⁰ Devaluation leads to the aforementioned fall in earnings of those employed in the non-tradable sector, while it increases the demand for exports and therefore may benefit employment and earnings in this sector. The poor may also be affected by the price increase of imported goods, especially food prices. Fiscal retrenchment and public spending cuts may affect social assistance outlays, amplifying the consequences of the crisis on the poor. Lastly, changes in the value of assets have an impact on income distribution because variations in interest rates, assets, and real estate prices are more likely to affect the wealth of the better off.

In the aftermath of banking crises, the associated unemployment rate rises on average by about seven percentage points for a period of over four years.⁷¹ Currency crises also affect the labor share of income.⁷² The labor share is a key indicator for the distribution of income in a country: it shows how much of national income is distributed to labor and how much to capital. Currency crises are associated with a strong fall of the labor share, which is only partially compensated in the following years. Even the long-term trend of declining labor share that has been observed for decades may at least partly be explained by financial crises. This implies consistently growing income inequality, as a falling labor share means that an ever-larger share of the benefits of growth accrues to owners of capital. This development may be even more significant in developing countries, where a large share of the capital is held by foreigners.⁷³

3. *Increase in Poverty*

Financial crises might have a magnifying impact on both the spread of poverty and inequality. For example, based on the Gini coefficient, one

69. See D. Furceri & A. Zdzienicka, *How costly are debt crises?*, 31 JOURNAL OF INTERNATIONAL MONEY AND FINANCE 726 (2012); see also F. Sturzenegger, *Toolkit for the analysis of debt problems*, 1 JOURNAL OF RESTRUCTURING FINANCE 201 (2004); and B. De Paoli & G. Hoggarth, *Costs of sovereign default*, BANK OF ENGLAND QUARTERLY BULLETIN (Q3, 2006), finding negative correlations between sovereign default and growth. Although some researchers interpret sovereign default as the beginning of economic recovery, for example, E. Levy Yeyati & U. Panizza, *The elusive costs of sovereign defaults*, 94 JOURNAL OF DEVELOPMENT ECONOMICS 95 (2011), this does not contradict the finding that high increasing levels of sovereign debt may hamper economic growth, as “the anticipation of a default causes low growth”, *ibid.*

70. See E. Baldacci, L. de Mello & G. Inchauste, *Financial crises, poverty and income distribution*, (IMF working paper No. 02/4, 2002).

71. See C.M. Reinhart & K.S. Rogoff, *supra* note 67.

72. See R. Bazillier & B. Najman, *Labour and Financial Crises: Is Labour Paying the Price of the Crisis?* (LEO Working Paper, 2012), available at http://remi.bazillier.free.fr/bazillier_najman_v2.pdf.

73. See I. Diwan, *Debt as Sweat: Labor, Financial Crises, and the Globalization of Capital* (World Bank Working Paper, Washington, D.C., 2001); and P. Maarek & E. Orgiazzi, *Currency crises and the labor share*, 80 ECONOMICA 566 (2013).

particular study found a significant increase in inequality during a currency crisis relative to the pre-crisis year. Moreover, the correlation between crises and income distribution was stronger when crises were followed by average income losses. This fall of income accounted for fifteen to thirty per cent of the variations in the poverty and inequality indicators. The study also found a more-than-proportional fall in the income share of the lowest income quintiles and an increase in the income share of the highest quintile.⁷⁴ Another study concluded that on the average inequality rises by 16.2 per cent in the two-year period immediately following a currency crisis as opposed to 3.2 per cent in years without crises.⁷⁵ The Great Recession, best described as a systemic banking crisis, which has been followed by a debt crisis, especially in the European Union, has led to massive inequality jumps. Using the ratio between the share of income available to ninety per cent of the population and the richest 10 per cent as a proxy of inequality, United States income inequalities have risen by 11 per cent between 2007 and 2011.⁷⁶

When assessing the impact of financial crises on inequality, it is necessary to keep two aspects in mind that may lead to distortions of the outcomes. First, poverty rates may only be a limited indicator of the scope of the problem, as the number of people falling into poverty and escaping poverty over the same period may surge, increasing the depth of poverty, while the poverty rate remains stable. Second, top income earners may experience a decrease of their revenues in the short run owing to a crisis because of their higher dependence on capital income. This may explain why the distributional effect of crises is not always clear in the very short run.

4. *Structural Factors Mitigating Social Impacts, Labour Regulations and Safety Nets*

Some other factors have significant influence on the effects of financial crises on inequality. For example, it appears that crises exacerbate inequalities more in the most deregulated labor markets. Financial crises have had worse effects on Latin American workers than on Asians, and stronger adverse impacts on Asians than on the organized workers of Northern economies.⁷⁷ This finding suggests that there is a crucial interaction between labor market institutions and the specific effects of financial crises.

One should also note that the impact of crises on inequality depends on the existing social protection system in the country, as well as the level of public spending, which serves as an automatic stabilizer during a recession. Experiences in the OECD support this notion: during the period 2007-2009, in the OECD, the household sector in the aggregate appears to have been well

74. See Baldacci et al., *supra* note 70.

75. See J.K. Galbraith & L. Jiaqing, *Inequality and financial crises: some early findings* (University of Texas working paper No. 9, 1999), using the Theil Index, another inequality indicator.

76. See B.D. Meyer & J.X. Sullivan, *Consumption and income inequality and the great recession*, 103 *AMERICAN ECONOMIC REVIEW* 178 (2013).

77. “[...] it is the rich, advanced, and successful economies that have the bestpaid workers, the most stable wage structures, and the strongest forms of insulation from economic shocks, including financial shocks” Galbraith & Jiaqing, *supra* note 75, at 7.

protected from the impact of the downturn. This was possible because of government intervention through tax and benefit systems in most countries.⁷⁸ However, consolidation policies implemented after 2010 are likely to have a greater effect on income distribution.⁷⁹

5. *Impacts of Government Responses to Crises: Fiscal Consolidation*

In most countries, financial crisis is followed by fiscal consolidation, which may also have a strong distributional impact. Several studies on OECD countries and other emerging and advanced economies have demonstrated that fiscal consolidation is usually associated with a rise of inequality, a fall of the labor share, and a rise of long-term unemployment.⁸⁰ One study came to the conclusion that fifteen to twenty per cent of the increase in inequality following a fiscal consolidation is explained by the rise of unemployment.⁸¹ Social spending cuts are another substantial contributor to rising inequalities. A one per cent decrease in social spending is associated with a rise of 0.2-0.7 per cent in inequality measured by the Gini coefficient.⁸² Crises usually have strong effects on social spending, with lowest income countries being more likely to cut social spending during crises.⁸³ The Great Recession, for example, has led to broad and deep cuts in social security spending.⁸⁴

With sovereign debt crises, it is challenging to disentangle the specific effects of default from those of the stabilization policies, such as those that tend to follow IMF interventions in developing countries. What seems clear is that IMF programs are associated with a worsening of income distribution and a reduction in the incomes of the poorest citizens when external imbalances were high prior to the program. These programs may only decrease income inequality when external imbalances are less severe.⁸⁵

The dynamics of inequality in Latin America in the 1980s offer good insights into the potential distributive impact of debt crises. A study on this region during that decade provided strong evidence confirming that income inequality “mirrors the economic cycle, rising during recessions.”⁸⁶ The costs of the crises have not been borne equally⁸⁷ and most adjustment programs

78. See S.P. JENKINS ET AL., *THE GREAT RECESSION AND THE DISTRIBUTION OF HOUSEHOLD INCOME* (Oxford, Oxford University Press, 2013).

79. *Ibid.*

80. See L. Ball et al., *The distributional effects of fiscal consolidation*, (IMF working paper No. 13/151, 2013); J. Woo et al., *Distributional effects of fiscal consolidation and the role of fiscal policy: what do the data say?* (IMF working paper 13/195, 2013).

81. J. Woo et al., *supra* note 80.

82. *Ibid.*

83. See M. Lewis & M. Verhoeven, “*inancial crises and social spending: the impact of the 2008-2009 crisis*,” (World Bank, Other Operational Studies No. 12965, 2010).

84. See F. Bonnet, E. Ehmke & K. Hagemejer, *Social security in times of crisis*, 63 *INTERNATIONAL SOCIAL SECURITY REVIEW* 47, 48 (2010).

85. See M. Pastor, *The effects of IMF programs in the third world: debate and evidence from Latin America*, 15 *WORLD DEVELOPMENT* 249 (1987); and G. Garuda, *The distributional effects of IMF programs: a cross-country analysis*, 28 *WORLD DEVELOPMENT*, 1031 (2000).

86. See G. Psacharopoulos et al., *Poverty and income inequality in Latin America during the 1980s*, 41 *REVIEW OF INCOME AND WEALTH* 245 (1995).

87. See N. Lustig, *The 1982 debt crisis, Chiapas, NAFTA, and Mexico's poor*, 38

resulted in “overkill” leading to increases in poverty and inequality beyond what was necessary (and legal).⁸⁸

6. *Social Impact of Financial Crises*

Financial crises and the austerity measures adopted in response also have a robust negative social impact that, in turn, perpetuates or exacerbates inequality. The organization Caritas has summarized that the situation of many households in Europe “remains serious, as poverty and social exclusion are rising in most member States, affecting particularly the working age population and, consequently, children. Young people are seriously affected by labor market exclusion: nearly a quarter of economically active young people in the European Union are unemployed.”⁸⁹ In one study, OECD notes that “the numbers living in households without any income from work have doubled in Greece, Ireland and Spain. Low-income groups have been hit hardest, as have young people and families with children.”⁹⁰ The study also points out the adverse long-term impact of the Great Recession on families, fertility, and health. Drops in fertility rates have already been observed. Families have cut back on essential spending, compromising their current and future well-being. Furthermore, although it is too early to assess the overall impact on health, unemployment and connected economic difficulties are known to increase health problems, including mental illness. Cutbacks in social protection are also likely to increase health problems. As an illustration, Oxfam reports that twenty per cent of pharmacy clients in Lisbon did not complete their whole prescriptions owing to rising costs.⁹¹ In a case study on Greece, Oxfam reports a strong impact of increased poverty and inequality on crime and suicide rates.⁹² In Spain, meanwhile, a harsh set of austerity measures has driven a dramatic uptick in unmet health needs among the poor, wage precariousness, income inequality, and poverty, especially among children.⁹³

Similarly, several United Nations bodies have identified the social impact of debt crises and related structural adjustment programs.⁹⁴ Studies by the United Nations Children’s Fund (UNICEF) have demonstrated that debt-servicing obligations diverted cash from social welfare programs with adverse

CHALLENGE, 45 (1995).

88. See L. Gasparini & A. L. Lustig, *The Rise and Fall of Income Inequality in Latin America* (Center for Distributive, Labor and Social Studies, Working Paper, 2011).

89. CARITAS CRISIS MONITORING REPORT, POVERTY AND INEQUALITY ON THE RISE 29 (2015).

90. See OECD, SOCIETY AT A GLANCE 2014: OECD SOCIAL INDICATORS (Paris, 2014), available at http://dx.doi.org/10.1787/soc_glance-2014-en.

91. See T. Caverro & K. Poinsasamy, *A Cautionary Tale: The True Cost of Austerity and Inequality in Europe*, (Oxfam, Briefing Paper 2013).

92. See G. Caverro, *The True Cost of Austerity and Inequality in Europe – Greek Case Study*, (Oxfam, Case Study 2013).

93. See *Visualizing Rights: A Snapshot of Relevant Statistics on Spain*, (Centre for Economic and Social Rights, Fact Sheet No. 14 2015).

94. See E/C.12/ESP/CO/5; E/C.12/GRC/CO/2; E/C.12/PRT/CO/4; A/HRC/25/Add.1; UNICEF, Austerity measures threaten children and poor households, working paper (September 2011); UNICEF, CHILDREN OF THE RECESSION: THE IMPACT OF THE ECONOMIC CRISIS ON CHILD WELL-BEING IN RICH COUNTRIES (New York, 2014); and ILO, WORLD SOCIAL PROTECTION REPORT 2014-15 (Geneva, 2014).

consequences on human development.⁹⁵ Austerity measures have exacerbated the negative social impact for disadvantaged groups such as women, children, person with disabilities, older persons, people with HIV/AIDS, indigenous peoples, ethnic minorities, migrants, refugees, and the unemployed, as documented in a report by the Office of the United Nations High Commissioner for Human Rights in 2013.⁹⁶ Overall, adjustment plans without substantial sovereign debt relief have proven to be detrimental to human development and human rights, at least in the short term. Alternatively, substantial sovereign debt relief has allowed targeted countries to scale up “poverty-reducing” expenditures.⁹⁷

IV. CONCLUSIONS AND RECOMMENDATIONS

A. *Conclusions*

This article has demonstrated that linkages between inequality, private and sovereign debt, and the occurrence of financial crises are manifold. Although economic research only recently has turned to this field and many aspects still need to be examined, a number of important outcomes appear to be established at this stage. First, there are strong indications that inequality may substantially contribute to and exacerbate the emergence and the course of financial crises, even if other factors, in particular financial deregulation, obviously also play a crucial role. Inequality erodes States’ tax base, thereby depleting revenue. Inequality also appears to prompt increased levels of private credit, which in turn may adversely affect sovereign debt and the stability of financial markets. This phenomenon is mainly explained by rising credit demand and credit supply. Aggregate under-consumption in conjunction with corresponding low interest monetary policy may be a contributing factor to an increased credit supply.

Second, according to most studies, financial crises and the subsequent policy measures commonly implemented to alleviate their consequences—e.g., fiscal retrenchment and stabilization policies—enhance inequalities, with devastating social consequences. A debt crisis may have a massive depressive impact on output, which may in turn affect the level of inequality. Most studies also concur that financial crises result in an increase in income inequality. Fiscal consolidation following a sovereign debt overhang may also have strong distributional consequences, both directly and indirectly, for example, through the increase in the unemployment rate and social spending cuts. The social effects of crises are often catastrophic, particularly for the most vulnerable in society. Widespread poverty, the emergence of health issues, and rising unemployment are only a few common problems.

This Article has traced the numerous social and human rights dimensions of inequality and outlined corresponding human rights obligations of States.

95. See G.A. CORDIA, R. JOLLY & F. STEWART, *ADJUSTMENT WITH A HUMAN FACE*, VOL. II, (Clarendon Press, Oxford, 1988).

96. UN Doc. E/2013/82.

97. See UN Doc. A/HRC/23/37.

The finding that inequality may contribute to the occurrence of financial crises, which in turn exacerbate inequality and adversely affect human rights, has far reaching policy and legal implications. It underscores that human rights, social and economic aspects are inseparably intertwined, calling for a holistic approach to preventing and confronting financial crises. This Article suggests that financial crises may not be prevented without addressing the contributing human rights shortcomings, including those connected to inequality. The same is true for crisis-response measures: any reaction to a financial crisis that neglects the effects on human rights and inequality does not only run afoul of human rights duties and responsibilities but also risks creating the same problems again and again, preventing any economically sustainable future.⁹⁸ This lends additional urgency to the international community's commitment to reducing inequality reflected in Goal 10 of the Sustainable Development Goals.

Enhancing our knowledge and understanding of the interlinkages among inequality, debt crises, and human rights leads us to raise questions about the way we deal with sovereign debt restructurings. The incremental approach lends a normative framework to improve present practice. As shown in the following recommendations, debt restructuring practice reflects the way we understand how inequality affects debt sustainability and human rights. By improving our understanding of these interlinkages, it is possible to foster human rights through existing mechanisms, strategies, contracts, rules, and principles currently used to prevent and deal with debt crises. Human rights law has, then, a great transformative potential in modern financial markets.

B. Recommendations

Preventing and responding to financial crises and combating inequalities must thus go hand in hand. Hence, policymakers must ensure that they tackle dangerous destabilizing developments in the financial sphere while addressing inequality directly. While financial regulation, labor and education policies, access to justice, the financing of political parties, ensuring pluralism in the media, and consumer protection should be all on the agenda when discussing recommendations to tackle inequality and debt sustainability,⁹⁹ this article focuses on fiscal policies and crisis response as they are more directly related to debt restructurings.

1. Fiscal Policies

Tax justice is a legal issue,¹⁰⁰ and as such, it might suggest that inequalities be reduced through taxation and transfers, the latter including in cash and in kind.¹⁰¹ In the field of taxation, there are numerous ways for

98. See Bohoslavsky & Goldmann, *supra* note 3.

99. See recommendations on these aspects in the report on illicit financial flows of the Independent Expert on Foreign Debt and Human Rights, UN Doc. A/HRC/28/5.9.

100. See THOMAS POGGE & KRISHEN MEHTA (EDS.), *GLOBAL TAX FAIRNESS* (2016), and Asociación Civil por la Igualdad y la Justicia et al., *supra* note 20.

101. On this topic, see the report of the Secretary-General on the role of the United Nations in promoting a new global human order and an assessment of the implications of inequality for development, UN Doc. A/67/394, para. 56, in which he exhorts that governments "may wish to consider

addressing inequalities.²⁰ To start with, it is crucial to rely more on direct than indirect taxes, as the latter tend to be regressive or proportional to incomes.¹⁰² This is particularly true for excise duties and taxes.¹⁰³

Income taxation needs to be aligned with a number of principles. First and foremost, tax progressivity is an important factor in fostering increased equality and should therefore be a prominent guiding principle of income taxation. Trends in the most recent decades of decreasing progressivity have massively contributed to the widening of the wealth and income gap. Moreover, tax progressivity decreases the probability of financial crises and default. The top marginal income tax rate should thus be considerably higher than what is currently common.¹⁰⁴ The minimum taxable income must always be above the poverty line.

In general, States should take care that capital income does not receive privileged treatment compared to income from labor, as is currently prevalent in many States. Obviously, this may call for amendments to applicable tax laws, but changes in other parts of the States' legal systems may also contribute to ending the special status of capital income, as described below.

Another important step towards increased equality should be to phase out certain tax deductions and excessive and unjustified tax privileges applicable to certain sources of income and sectors. Such privileges usually benefit the high earners disproportionately and thus foil progressive taxation.

Introducing a wealth tax is another measure States should consider. Against the backdrop of increasing inequality, wealth taxes have recently drawn new attention¹⁰⁵ and may provide another way for increasing tax revenues while also fostering equality. States should also reassess other forms of taxation of property, including the transfer of assets. Broadening the tax base this way, and by closing loopholes in the tax code, has the benefit of improving both efficiency and equity.¹⁰⁶

Furthermore, States should put an emphasis on fighting tax evasion and avoidance.¹⁰⁷ Tax loopholes used by wealthy individuals and multinational companies must be closed. Corporate tax minimizing strategies need to be addressed urgently. For this to be sufficiently effective, and in order to avoid detrimental outcomes for States advancing with such efforts, the work in this

a combination of progressive income taxes and highly redistributive transfers to decrease income inequality and its impact on social development.”

102. See *Fiscal policy and income*, IMF policy paper 18 (January 2014); C. O’Donoghue, M. Baldini, & D. Mantovani, *Modelling the redistributive impact of indirect taxes in Europe: an application of EUROMOD*, (Euromod working paper No. EM7/01, University of Essex, 2004); and S. CNOSSSEN, *THEORY AND PRACTICE OF EXCISE TAXATION: SMOKING, DRINKING, GAMBLING, POLLUTING, AND DRIVING* (Oxford, Oxford University Press, 2005).

103. See IMF, *supra* note 102.

104. In JOSEPH STIGLITZ, *THE PRICE OF INEQUALITY: HOW TODAY’S DIVIDED SOCIETY ENDANGERS OUR FUTURE* 273 (2012), the author suggests that the top marginal tax rate should be well in excess of 50 percent and plausibly in excess of 70 percent; in A.B. ATKINSON, *INEQUALITY: WHAT CAN BE DONE?* 179 (2015), the author promotes a top marginal tax rate of 65 percent.

105. See PIKETTY, *supra* note 10.

106. See F. Cingano, *Trends in Income Inequality and its Impact on Economic Growth*, at para. 58 (OECD Social, Employment and Migration Working Papers No. 163 2014).

107. See the report of the Independent Expert on Foreign Debt and Human Rights, UN Doc. A/HRC/31/61.

field, as in others discussed before, needs to be international in its scope.

Simultaneously, the findings of this article call for consistent public spending policies that ensure full compliance with the human rights obligations of the States. Such policies must first and foremost ensure that the human rights of the poorest and most vulnerable be respected, protected, and fulfilled. They also must include decisive steps towards reversing the trend towards increasing inequality within and among States.

It is of utmost importance that States provide and progressively extend social protection floors, in accordance with the Social Protection Floor Initiative, the ILO Social Protection Floors Recommendation, 2012 (No. 202), and Goal 1.3 of the Sustainable Development Goals.¹⁰⁸ This entails at a minimum that “all in need have access to essential health care and to basic income security,”¹⁰⁹ in particular for socially disadvantaged groups. However, States are under the obligation to work progressively towards the full realization of economic, social, and cultural rights, using the maximum of the available resources. Consequently, States must continue further developing and extending their social systems, if resources permit. Cuts in social spending, and particularly social security and unemployment benefits, may only be made in cases of absolute necessity, after the most careful consideration of all alternatives, which may include tax reforms,²⁰ and only if they are duly justified by reference to the totality of the rights provided for in the Covenant in the context of the full use of the State party’s maximum available resources (obligation to realize progressively economic, social, and cultural rights).¹¹⁰

Public spending must be structured in a way that it benefits mostly persons and groups in need. Despite great efforts of many States and the international community, redistributive policies all too often favor the haves rather than the have-nots, widening the income and wealth gap and making highly inefficient use of financial resources. For example, redistributions in the pension sector may increase inequality if they do not tackle the limited coverage of the system and/or benefit workers and pensioners with high income.¹¹¹

2. *Crisis Response*

It cannot be stressed too often that any response to financial crises, in particular sovereign debt crises, must fully comply with human rights law. In her report, the former Independent Expert on human rights and extreme poverty, Magdalena Sepúlveda Carmona, has provided very detailed recommendations for such human rights compliant crises responses.¹¹² This

108. See the report of the Special Rapporteur on extreme poverty and human rights, Philip Alston, in which a thorough analysis of the linkages between social protection and human rights is provided, UN Doc. A/69/297; and Human Rights Council resolution 25/11.

109. Sec. 4, ILO Social Protection Floors Recommendation, 2012 (No. 202).

110. See Committee on Economic, Social and Cultural Rights, General Comment No. 3, 1990.

111. See A. NIETO RAMOS, *EL EFECTO DE LAS PENSIONES SOBRE LA DESIGUADAD DE INGRESOS EN COLOMBIA* (Bogotá, Universidad de los Andes, 2014). See also Asociación Civil por la Igualdad y la Justicia et al., *supra* note 20, at n. 16.

112. See UN Doc. A/HRC/17/34.

Article therefore focuses on highlighting only very few important aspects of relevance in the context of inequalities and financial crises.

Fiscal stability and GDP may not be the sole targets of adjustment, and adjustment may not overrule, suspend, or dilute existing human rights obligations and responsibilities. Preserving economic, social, and cultural rights—including the right to work and the rights to social security, health, housing, and education—must be a critical priority.¹¹³ Socioeconomic inequalities must be fully taken into account when implementing crises response measures.

While certain spending cuts may be temporarily necessary, debtor and creditor (“*implementing*”) States must always provide evidence of the following:

(1) the existence of a compelling State interest; (2) the necessity, reasonableness, temporariness and proportionality of the austerity measures; (3) the exhaustion of alternative and less restrictive measures; (4) the non-discriminatory nature of the proposed measures; (5) protection of a minimum core content of the rights; and (6) genuine participation of affected groups and individuals in decision-making processes.¹¹⁴

In light of the evidence provided in this article, avoidance of exacerbating inequality should also be a limiting factor.

Austerity policies must ensure, to the extent possible, that social spending is the last and the least to be affected. To the extent possible, States should strongly focus on finding and creating progressive ways of increasing revenues. The protection of vulnerable groups must have the highest priority, which may call for exemptions from cuts or even the implementation of new social protection programs. The recent experiences of Iceland evidence that this approach is realistic and can yield fruitful results.

More specifically,¹¹⁵ Iceland’s adjustment program emphasized increasing revenue generation through taxation, while focusing to a lesser extent on public expenditure cuts. The reintroduction of a progressive income tax system helped to shelter the most vulnerable groups from the effects of the crisis. In addition, the flat tax on capital income was increased and a wealth tax was temporarily introduced to generate revenue. The only regressive tax measure was a one per cent increase in the value added tax from 24.5 to

113. See the end-of-mission statement of the Independent Expert on Foreign Debt and Human Rights of his mission to Greece (December 8, 2015), available at www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=16852&LangID=E.

114. See the Report of the United Nations High Commissioner for Human Rights, UN Doc. E/2013/82 (May 7, 2013), para 15, laying out the criteria States should apply when considering the adoption of austerity measures, available at http://www.un.org/ga/search/view_doc.asp?symbol=E/2013/82; the Letter of the Chair of the Committee on Economic, Social and Cultural Rights addressed to States parties to the International Covenant on Economic, Social and Cultural Rights dated 16 May 2012; and a more comprehensive statement issued by the same Committee on Public debt, austerity measures and the International Covenant on Economic, Social and Cultural Rights, UN Doc. E/C.12/2016/1 (June 24, 2016), available at http://tbinternet.ohchr.org/_layouts/treatybodyexternal/Download.aspx?symbolno=E/C.12/2016/1&Lang=en, outlining obligations relating to borrowing and lending for States and international financial institutions and organizations.

115. See the report of the Independent Expert on Foreign Debt and Human Rights on his mission to Iceland, UN Doc. A/HRC/28/59/Add.1.

25.5 per cent. On the whole, social benefits were directed to lower-income households, mainly by cutting maternal and parental leave entitlements. Disposable income fell across the entire society. The poorest 20 per cent of the population in Iceland lost around 9 per cent of their disposable income between 2008 and 2010. In contrast, 10 per cent of the wealthiest households that had accumulated assets during the boom years of the bubble economy lost 38 per cent of their income. Social transfers and taxation policies reduced inequality in Iceland significantly. They also helped to stabilize internal demand, as the citizens with lower incomes spent a much higher percentage of their funds on goods and services.¹¹⁶

Crises responses, including any agreements between creditors and debtor States, should comply with the principles of transparency, accountability, and participation. Structural adjustment measures should be subjected to robust human rights impact assessments, both before the implementation and at regular intervals after. Both creditors and debtors must honor their human rights obligations and responsibilities in their response to debt crises. This may include agreeing on sufficient debt relief in order to avert human rights violations the growth of severe economic inequality.¹¹⁷

The principles referred to in the previous paragraph are considered to be building blocks of an emerging set of principles to frame debt restructurings,¹¹⁸ and debt sustainability is intrinsically linked to minimum levels of equality. Therefore, inequality should be given the utmost consideration in debt workout negotiations and judicial decisions relating thereto, not only to prevent further human rights violations in the context of ongoing debt crises but also to avert their recurrence.

116. See Stefán Ólafsson, *The Icelandic Way Out of the Crisis: Welfarism, Redistribution and Austerity* (Social Research Centre, University of Iceland, Working Paper No. 1, 2012); and Bruno Martorano, *Is it possible to adjust 'with a human face'? Differences in fiscal consolidation strategies between Hungary and Iceland* (UNICEF Office of Research Working Paper, WP-2014-No. 03, 2014).

117. See the report of the Independent Expert on Foreign Debt and Human Rights submitted to the General Assembly in 2015, UN Doc. A/70/275.

118. See The UN the Guiding Principles on Business and Human Rights (2011); UN Guiding Principles on Foreign Debt and Human Rights (2012); UNCTAD Principles on Responsible Sovereign Lending and Borrowing (2012); the UNCTAD Roadmap and Guide on Sovereign Debt Workouts (2015); and the UN Basic Principles on Sovereign Debt Restructuring Processes (2015).