CQ Researcher

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Income Inequality

Is the gap between rich and poor getting wider?

A recent Census Bureau report brought a flurry of press attention to the widening gap between rich and poor. The gap in New York City is widening — and is now bigger than in India, noted the *New York Daily News.* Indeed, most analysts agree incomes of the very rich have been pulling away from all others in recent decades. The average pretax income for the bottom 90 percent of households is almost $900 below what it was in 1979, while the average pretax income for the top 1 percent is $700,000 higher. Having a wealthy class with very large amounts of disposable money is valuable — not harmful — to society, some argue. But others say the recent winner-take-all economy helped trigger the massive recession, leaving most people with stagnant incomes. Meanwhile, Republicans argue that Bush-era tax cuts on top earnings should be extended to stimulate the economy, while many Democrats back extensions only for lower earners.

A homeless woman asks for money amid the affluence of New York City, where the gap between rich and poor is said to be greater than in India.

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Income Inequality

By Marcia Clemmitt

The Issues

A Census Bureau report released in September brought a brief flurry of press attention to rising income inequality in America.

"The gap between rich and poor in New York is getting worse," noted the *New York Daily News*. In 2009, 18.7 percent of New York City's population lived in poverty, and the median household income fell to $50,033, from $51,116 in 2008, even as the combined worth of the city's 58 richest residents rose by $19 billion. As a result, the earnings gap among New Yorkers "is now larger than the gap in India and the African nation of Burkina Faso," Joel Berg, executive director of the New York City Coalition Against Hunger, told the paper. [1]

The finding that income inequality is increasing is generally accepted by analysts across the political spectrum, with the exception of libertarian commentators, who argue that no existing data set accurately depicts how money is distributed. What provokes debate in all quarters, however, is whether steep income inequality in an industrialized nation is something to worry about and, if it is, what policies would address it effectively.

The main story is that the very rich have been pulling away from all others in income over the past three decades, most analysts agree.

"The average pretax income for the bottom 90 percent of households is almost $900 below what it was in 1979, while the average pretax income for the top 1 percent is over $700,000 above its 1979 level," according to the Center on Budget and Policy Priorities (CBPP) a liberal-leaning think tank. [2]

After-tax incomes also have risen more for the highest earners, says CBPP. From 1979 to 2007, the average after-tax income of the top 1 percent of earners "nearly quadrupled, from $347,000 to over $1.3 million," a 281-percent increase, based on data from the nonpartisan Congressional Budget Office. Over the same period, the after-tax income of the middle fifth of the population rose from $44,100 to $55,300, or 25 percent, while the bottom fifth saw its average after-tax income grow from $15,300 to $17,600, or 16 percent. [3]

Getty Images/David McNew

A Ferrari complements the conspicuous consumption on display along Rodeo Drive in Beverly Hills, Calif. Experts agree the rich are pulling away from other Americans, but not all think it's a problem. Some say investments by the wealthy stimulate the economy by building businesses and driving demand for labor, but others say the result has been a severe recession and stagnant incomes for most Americans.

Citigroup, the financial-services conglomerate, concurs. As of 2006, "the richest 10 percent of Americans account for 43 percent of income, and 57 percent of net worth," based on Federal Reserve data, says a Citigroup analysis. The United States, Canada, Australia and the United Kingdom "have seen the rich take an increasing share of income and wealth over the last 20 years, to the extent that the rich now dominate income, wealth and spending." The distribution of wealth — the value of one's assets such as real estate and stocks, minus one's debts — "continues to be even more aggressively skewed" than income, it said. [4]

But having an economic class with very large amounts of disposable money is valuable — not harmful — to society, some argue. That's because only the very richest can make the investments vital to building businesses and driving demand for labor, wrote George Reisman, a professor emeritus of economics at Pepperdine University, in Malibu, Calif. "In a market economy, the wealth of the rich . . . is overwhelmingly invested in means of production, that is, in factories, machinery and equipment, farms, mines, stores, and the like." [5]

Other analysts question that proposition. "We've had a natural experiment recently with what can happen to the economy" when the richest people make extraordinary gains compared to others, says Yale University political scientist Jacob S. Hacker. "We've had a winner-takes-all economy for a while, and it's provided limited benefits," leaving the country with a severe recession and virtually stagnant incomes for most people.

Richest Americans Have Biggest Share of Income

The top 1 percent of income earners in the United States control nearly 18 percent of Americans' total income, the world's highest such concentration. In 1949, however, the top American earners lagged behind those of several other countries, including Indonesia, Germany and the United Kingdom.

Share of Earnings of Top 1% Income Earners in Select Countries, 1949 and 2005

Source: Anthony B. Atkinson, et al., *"Top Incomes in the Long Run of History," National Bureau of Economic Research, January 2010*

Simmering debates over rising income inequality in America — not to mention the solvency of Social Security and the growing federal deficit — lie behind many of this year's policy and political battles.

At the heart of the debates is the system of taxing income: In the United States each additional increment of an individual's income is taxed at a different rate in a so-called "marginal" tax scheme; marginal income tax rates on higher earnings are generally higher — known as a "progressive" taxation scheme. And while many liberals this year have called for raising the marginal tax rate on the highest earners, that's a bad idea, said Sen. Joseph Lieberman of Connecticut, a former Democrat who became an independent during a tough reelection campaign a few years ago. "To me, these are the people we need to be protecting — their income to spend and invest to spur growth and job creation. The fact is that the top 3 percent of . . . earners account for 25 percent of the consumption in our economy." [6]

But history casts doubt on whether holding down taxes on the highest earnings boosts the economy, said Cenk Uygur, a journalist and political commentator on the Internet and the Sirius Satellite Radio show "The Young Turks." "From 1925 to 1931, the highest marginal tax rate was as low as it has almost ever been — between 24-25 percent. And between 2003-2010, the highest marginal tax rate was also at one of its lowest points — 35 percent," he said. "So what happened . . . ? The Great Depression and the Great Recession." [7]

The current high-profile debate over whether Social Security benefits must be cut to keep future federal budgets in balance is skewed by lack of attention to growing income inequality, argued Robert Kuttner, founder and co-editor of the liberal magazine *The American Prospect*. Social Security is funded by payroll taxes on earnings beneath a certain cap — around $107,000 in 2010. In other words, people who earn above $107,000 only pay Social Security tax on that $107,000. Thus, lower-earning people pay a much higher percentage of their income to sustain the system than high earners, he said. "If you want to get Social Security well into the black for the indefinite future, the easiest way is to restore wage growth" among low earners, which would boost Social Security's take. Instead, recent earnings growth has gone almost entirely to people whose incomes are high above the cap and

thus hasn't helped at all to shore up Social Security, he wrote. [8]

As economists, lawmakers and the public debate whether economic inequality should be an important public-policy agenda item, here are some questions being asked:

Tax Rates Drop for Highest Earners

The average income of the top 400 American households increased from $71 million in 1992 to $357 million in 2007 — a 403 percent rise — while the effective tax rate dropped from 26 percent to 17 percent. By comparison, the bottom 90 percent of earners saw their income rise from about $29,000 to about $33,000 — a modest 14 percent increase.

Income and Tax Rates of 400 Highest-Income American Households, 1992-2007

	Average income in 2009 dollars (in millions)	Effective tax rate
1992	$71.5	26.4%
1995	$71.6	29.9
1998	$125.0	22.0
2001	$158.8	22.8
2004	$196.2	18.2
2007	$356.7	16.6

Source: David Cay Johnston, "Tax Rates for Top 400 Earners Fall as Income Soars, IRS Data," Tax.com, February 2010

Is income inequality growing in the United States?

In recent years, many analysts have come to agree that income inequality is rising, mostly because incomes of the top earners have skyrocketed. However, some say that studies that find very high inequality are based on incomplete or misleading data.

In comparisons that include people's spending, for example, the effective income gap between the rich and poor is narrower, say some economists. Contrary to what some other studies find, "poor households systematically pay less than richer households for identical goods . . . in part because they shop in cheaper stores and in part because they pay less for the same goods even in the same store," most likely by buying things on sale, wrote University of Chicago professor of economics and business Christian Broda, U.S. Department of Agriculture economist Ephraim Leibtag and Columbia University professor of Japanese economy David E. Weinstein. As a result, poorer people effectively have higher-value incomes, something that most research fails to acknowledge, they argue. When the differential spending is taken into account, poverty rates turn out to be "less than half of the official numbers." [9]

Income studies generally examine "households," not individuals, and changes in household size over the years mean that supposed inequality problems are much lower than many estimate, wrote Stephen J. Rose, a research professor at the Georgetown University Center on Education and the Workforce. "Americans today are more likely to live in single-adult households than they were 30 years ago," so actual per-person earnings growth for middle-class people is considerably higher than other studies suggest, he said. [10]

The most recent statistics that indicate poverty is rising don't depict long-term poverty but recession-related job loss, argued Atlanta-based, nationally syndicated libertarian radio host and commentator Neal Boortz. "If you're out of work, you have no income. Snap! You're living in poverty. It doesn't matter what your net worth actually is" or if you "own $3 million homes free and clear." [11]

"The evidence is incontrovertible that American income inequality has increased . . . since the 1970s," said Robert J. Gordon, a professor of economics at Northwestern University. Nevertheless, its rise "has been exaggerated" since the most recent increase consists entirely of a tiny group of very high earners pulling far ahead of everyone else. Analysis of census and tax data reveals that "there was no increase in inequality after 1993 in the bottom 99 percent of the population, and the remaining increase . . . can be entirely explained by the behavior of incomes in the top 1 percent." [12]

Many other commentators, however, including some conservatives, stress that the income gap that opened between 1980 and 2000 is indeed very wide.

"Income inequality is real; it's been rising for more than 25 years," said President George W. Bush in 2007. Furthermore, the gap is serious enough to warrant careful watching, said Bush. [13]

This "growth in wage inequality is one of the most spectacular and consequential developments of our time," partly because most people have expected that economic development and modernization would create more economically equitable societies, said David B. Grusky, director of Stanford University's Center for the Study of Poverty and Inequality, and Kim A. Weeden, an associate professor of sociology at Cornell University. [14]

"Data from both . . . income tax returns and . . . W-2 records tell a simple and similar story" to the tale of inequality told by analysis of census figures, which is often criticized — to some extent correctly — for including data on too few people, said Gary Burtless, a senior fellow at the center-left Brookings Institution think tank. "The relative incomes and the relative wages of top income recipients have been increasing much faster than the incomes and wages of people further down in the distribution." W-2 records show that an earner in the top .01 percent of the income distribution made 46 times as much as the country's median wage earner in 1990, but 81 times as much in 2005, for example. [15]

Does increasing economic inequality harm society?

Most analysts agree that a certain amount of income inequality is valuable because it gives people incentives to work hard and try out new business ideas, in hopes of reaping big rewards. However, many are skeptical that current U.S. inequality levels are risk free or contribute much to building the economy.

Some international data suggest that countries with more extreme income inequality experience faster economic growth overall, said Brookings' Burtless. From 1990 to 2000, economic growth in the G-7 countries — Canada, France, Germany, Italy, Japan, the United Kingdom and the United States, whose top finance officials have met regularly since 1976 — was fastest in the United States and the United Kingdom, the countries that also "experienced the fastest growth in inequality," he said. While not constituting conclusive evidence, this fact is at least "consistent with the view that the rapid rise in U.S. inequality has contributed to the relatively good performance of American output and employment since the late 1970s." [16]

While "it's true that the share of national income going to the richest 20 percent of households" has risen, and "families in the lowest fifth saw their piece of the pie fall," income statistics don't tell the whole story of Americans' living standards, which provide evidence that rising income inequality is highly compatible with a system that produces a better life for all, wrote W. Michael Cox, director of the O'Neil Center for Global Markets and Freedom at Southern Methodist University and senior fellow at the Federal Reserve Bank of Dallas, and Richard Alm, an economics writer. Today, large majorities of Americans enjoy the convenience of once-unheard-of consumer goods like cars and clothes dryers while most are employed in "clean, well-lit, and air-conditioned environment[s]," unlike in the past, they said. [17]

Furthermore, "a far more direct measure of American families' economic status [rather than tax or census data] — household consumption — indicates that the gap between rich and poor is far less than most assume, and that the abstract, income-based way in which we measure the so-called poverty rate no longer applies to our society," they said. In 2006, while the income ratio between the highest- and lowest-earning quintiles was 15 to one, the spending ratio was only four to one, demonstrating the similarity in living standards. Lower-income families can spend more than many believe because they "have access to various sources of spending money that doesn't fall under taxable income," including "sales of property like homes and cars and securities that are not subject to capital gains taxes, insurance policies redeemed," and "the drawing down of bank accounts," they pointed out. [18]

But markets that produce income inequalities at the present scale are in fact failed markets, inefficient because they provide unreasonably high levels of return — what economists dub "rents" — to some people who don't deserve so much, argues Grusky, at Stanford's Center for the Study of Poverty and Inequality. For example, some top executives win extremely high paydays not because they lead their companies to prosper beyond expectations but due to various "sweetheart deals" and the machinations of corporate governing boards who approve outsize CEO payments because they're personally beholden to the executives, he argues.

International studies conducted over the past decade by the Organization for Economic Co-operation and Development have "found no evidence that inequality may be conducive to growth in OECD countries, as some had suggested," said OECD Secretary-General Angel Gurria. "On the contrary, our work shows that greater inequality stifles upward mobility between generations, making it harder for talented and hard-working people to get the rewards they deserve. And the resulting inequality of opportunities . . . inevitably impacts economic performance as a whole." [19]

Some fear that having too much income concentrated at the top compromises the ability of a democracy to give equal political voice to all citizens.

In international studies, nations with wider income inequality often have political structures in which fewer people have an equal voice and there is less government accountability, said Nancy Bermeo, a professor of comparative politics at Oxford University, in England. [20]

"The ability of citizens to influence public policy is the 'bottom line' of democratic government," but in recent decades in the United States the ability to influence policy has skewed toward the most affluent people, whose priorities often don't coincide with those of people who earn less, said Martin Gilens, an associate professor of politics at Princeton University. [21]

Based on survey data from 1981 to 2002, on issues where "Americans

with different income levels differ in their policy preferences, actual policy outcomes strongly reflect the preferences of the most affluent but bear virtually no relationship to the preferences of poor or middle-income Americans." So stark is this finding that it may "call into question the very democratic character of our society," according to Gilens. [22]

With money concentrated at the top, "there may be a demand for private jets and yachts, but you need a healthy middle-income group" to drive the massive consumption that promotes real economic growth, said Kemal Dervis, director of the global economy and development division at the Brookings Institution. [23]

Furthermore, "when we see income inequality rising, we ought to start looking for bubbles" — fast-rising prices in some investment sector like the Internet stock bubble of the 1990s and the housing bubble of the 2000s, said Mark Thoma, a professor of economics at the University of Oregon. Such investment bubbles aren't sustainable because they ultimately price things beyond their value and out of reach of too many buyers, and their collapse leads to heavy losses and, often, economic recessions. [24]

Rising inequality also played another role in sparking the financial-market crash and recession, according to University of Chicago professor of finance Raghuram Rajan. Because policy makers have few tools available for directly raising incomes, Washington took the dangerous step of subsidizing large numbers of high-risk mortgage loans — such as no-down-payment loans — to people who may have had limited ability to pay, out of concern that the "American dream" might be slipping away from many people as inequality increased, he said. Those actions helped create the swelling bubble of mortgage debt that exploded when some people began defaulting on their risky loans, said Rajan. [25]

Should the government act to limit inequality?

Not surprisingly, those who argue that income inequality boosts the economy strongly oppose government actions intended to limit its growth or redistribute incomes. Meanwhile, analysts who argue that inequality is risky don't necessarily agree about policies to address it.

"Democrats are right about one thing: I can afford to pay more in taxes," said Harvard economics professor N. Gregory Mankiw. "My income is not in the same league as superstar actors and hedge fund managers, but I have been very lucky. . . . I don't have trouble making ends meet," and "indeed, I could go so far as to say I am almost completely sated. . . . Nonetheless," neither high earnings nor large inherited estates should be subject to higher taxes because such taxes would sap the incentive of top professionals to work hard, Mankiw said. [26]

Mankiw noted that he is "regularly offered opportunities to earn extra money," but if Bush-era tax rates were raised, the resulting gains for him and for his children — who will inherit the money down the line — would be too small to provide an incentive for him to take those extra jobs, he wrote. The same would hold true for other "high-income taxpayers whose services you enjoy," like movie actors, pop singers, blockbuster novelists, top surgeons, and orthodontists, Mankiw argued. "As they face higher tax rates, their services will be in shorter supply. . . . Don't let anyone fool you into thinking that when the government taxes the rich, only the rich bear the burden." [27]

Attempts to put a floor under the lowest income, such as a minimum wage, also harm society, said Art Carden, an assistant professor of economics and business at Rhodes College in Memphis. A higher minimum wage is "likely to exacerbate rather than mitigate social inequalities" because when potential hires aren't permitted to compete intensely for jobs by offering to work for very low wages, then "firms can discriminate on the basis of something other than productivity," he argued. [28]

With no minimum wage set, a "historically disadvantaged" jobseeker, such as "Crackhead Carl, a middle-aged African-American male who was just released from jail," could win a job over "Tad Vanderbilt Rockefeller, a flaxen-haired white teenager from an affluent suburb" — even from a racially biased employer — simply by accepting a rock-bottom wage, said Carden But with a minimum wage in place, Carl could offer a racially biased employer no incentive to hire him rather than Tad, he explained. [29]

Many scholars say that if greater economic equity is the goal, it's hard to imagine it coming about without government action.

"What are the pathways to create a more equal society? Taxation, education and health care," says Dan Ariely, a professor of behavioral economics at Duke University.

"There's nothing anti-capitalist about saying that the sharp edges of capitalism should be softened by government," says Yale's Hacker. A quick look around the globe "shows that capitalism is consistent with a lot of different ways of organizing the economy," including some with high taxes and strict regulations. The wide variation in income-inequality ratios in countries with market economies show that high U.S. ratios aren't simply the inevitable product of a market economy, he says.

In 2008, the ratio between the pay of the average CEO and the average worker was 319 to one in the United States but only 11 to one in Japan, 12 to one in Germany, and 47 to one in Mexico, suggesting that the U.S. distribution is out of line with those in other market economies, including some that are doing fairly well economically, such as Germany, according to the progressive Institute for Policy Studies. [30]

Rich Got Richer While Poor Lagged

The top 1 percent of American earners took in an average of $1.3 million after taxes in 2007, nearly a 300 percent increase over 1979. By contrast, income for the bottom 20 percent of earners rose only 16 percent over the same period.

Average After-tax Income, 1979 and 2007
(in 2007 dollars)

Income category	1979	2007	% change	$ change
Lowest fifth	$15,300	$17,700	16%	$2,400
Second fifth	$31,000	$38,000	23%	$7,000
Middle fifth	$44,100	$55,300	25%	$11,200
Fourth fifth	$57,700	$77,700	35%	$20,000
Top fifth	$101,700	$198,300	95%	$96,600
Top 1 percent	$346,600	$1,319,700	281%	$973,100

Source: Arloc Sherman and Chad Stone, "Income Gaps Between Very Rich and Everyone Else More Than Tripled in Last Three Decades, New Data Show," Center on Budget and Policy Priorities, June 2010

In the past, strong economic growth has proven to be compatible with high tax rates on top earnings, argued Clinton administration Secretary of Labor Robert Reich, a professor of economics at the University of California, Berkeley. "Under President Dwight Eisenhower (whom no one would have accused of being a radical) it was 91 percent. Now it's 36 percent," the "lowest it's been in more than 80 years." [31]

The highest earners have benefited disproportionately from recent workplace productivity gains, so taxing top earnings higher would seem only fair, suggested Northwestern's Gordon and Ian Dew-Becker, a doctoral candidate at Harvard University. Between 2001 and 2004, for example, the U.S. labor force produced an "explosion" in productivity — over 3 percent a year — higher productivity gains than at any other period since World War II, they wrote. Nevertheless, median family income actually fell by 3.18 percent from 1999 and 2004, and — for the whole period of rising productivity between 1995 and 2004, — increased annually by only 0.9 percent, compared to an annual rate of productivity gains in non-farm businesses of 2.9 percent, they said. [32]

During this period of skyrocketing productivity, "only the top 10 percent of the income distribution enjoyed a growth rate of total real income . . . equal to or above the average rate of economywide productivity growth." Thus, the "no-brainer solution to central social objectives" including the budget deficit, Social Security and health care is to "raise taxes on the top 1 percent by a major amount, say from 33 to 50 percent," Gordon and Dew-Becker recommended. [33]

"I know many well-educated professionals convinced that nobody works as hard as they do," wrote Jonathan Cohn, senior editor of *The New Republic*. . . . But I've met many people at the bottom of the income ladder who work just as hard, for far less reward. Between 1980 and 2005, the richest 1 percent of Americans got more than four-fifths of the country's income gains. Does anybody seriously believe that the other 99 percent didn't deserve to take home a much larger share?" [34]

An investment in postsecondary skills training and education for people who can't find jobs in an increasingly technology-based job market would ease income inequality by holding wages for high-skill jobs down a bit as the supply of skilled workers came closer to meeting the full demand, says Anthony P. Carnevale, a research professor at the Georgetown University Center on Education and the Workforce. The 11 million or so "low-income, dislocated or imprisoned adults with an immediate ability to benefit" from new training programs "are the low-hanging fruit," he wrote. [35]

Government policy should focus on education rather than any direct means of redistributing income such as through tax policy, wrote University of Chicago economists Kevin M. Murphy and Gary S. Becker, winner of the 1992 Nobel Prize for economics. Taxing higher incomes is tantamount to taxing college tuition while giving subsidies "for dropping out of high school," a strategy no one would recommend, Murphy and Becker write. Instead, "the public should focus attention on how to raise the fraction of American youth who complete high school." [36]

Not everyone is sure that education funding will help ease inequalities.

"The last 15 years" have actually "seen significantly slower job growth in high-earnings growth sectors than in the economy at large," wrote James K. Galbraith, a professor of government, and J. Travis Hale, a graduate student, at the University of Texas, Austin. "So even if large numbers of young people 'acquire the skills needed to advance,' there is no evidence that the economy will provide them with suitable employment. Moreover, investments in education presuppose that we know, in advance, what education should be for." For example, "students who studied information technology in the mid-1990s were lucky; those completing similar degrees in 2000 faced unemployment." [37] ■

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Bleak Futures Await Those with Limited Education

"You need to target kids who are coming out of prison for the first time."

"People up to age 30 who only have a high school diploma or less are in trouble," potentially facing a lifetime of incomes sagging farther and farther behind those of people with a college education or technical training, says Timothy M. Smeeding, a professor of public affairs and economics at the University of Wisconsin, Madison.

They face a bleak future because most of the "traditional roads" to a middle-class income for people with that level of education, such as manufacturing, have dried up. The resulting large oversupply of workers must fight for jobs with low skill requirements, driving down the wages for those positions even further and increasing the nation's income inequality, Smeeding says.

When the recession ends, "it will become clear that there is no work for these people," except jobs like waiting table or mowing lawns. "We have to get more people employed or we'll lose a whole generation. We need to get the less-skilled people to work before they all turn to crime," Smeeding says. Worse, among young men with a high school education or less, 73 percent are fathers by age 30. Furthermore, a high school dropout is likely to have 2.7 children, compared to the 1.9-child average for college graduates, creating a huge additional economic disadvantage for children of low-skilled parents.

If after 1983 the country had continued to produce bachelor's and associate's degree holders at the same rate of increase as it did in earlier years, there would be 10 million more such degree holders competing for high-skill jobs, and "the income distribution would look like it did in 1979," according to Anthony P. Carnevale, director of the Georgetown University Center on Education and the Workforce. Instead, high school graduation rates stalled beginning in the mid-1970s and even dropped in some years, curtailing the number of people eligible for post-secondary training, even as the rates of high school graduates who went to college rose.

The workplace income gap between high-skilled and low-skilled employees relates more to specific occupations, such as engineering, than to education itself, says Carnevale. For example, "you can get a 13-month certificate in engineering and earn more" than a significant chunk of people with B.A.s, he says. "It's access to an occupation that makes the difference, and education gets you that access."

The country needs to produce more people with post-secondary education, especially in technical fields, Carnevale says. "Are we going to be able to do that? It's doubtful." Unlike with K-12 education, "we tend to see higher education as something families do, not as a public good," and the result is that it's tough to expand higher-education opportunities and especially tough to bridge a spending gap between institutions — "we have huge differentials in spending," he says.

The Obama administration is taking a different and somewhat more promising tack than previous administrations, understanding that "community colleges and public universities are where the students and the voters are,' says Carnevale.

Meanwhile, the "premium" salaries that go to college-educated people increase income inequality, representing a "market failure" in the education system, says David B. Grusky, director of Stanford University's Center for the Study of Poverty and Inequality.

In a rational market, schools "would see rising demand" for post-secondary education and open up more spots, says Grusky. "Any rational market will do that." If a car manufacturer sees more demand, the company increases production of cars. But universities, especially high-status schools like Stanford, are likely to continue to limit their spots, despite increasing demand, because by doing so the degrees and certificates their graduates obtain will be worth higher salaries in a marketplace where demand for the degrees outstrips supply, he explains.

As a result, the salary "return for a college degree is too high today," and "the college-educated people are getting a free ride," Grusky says. "We haven't had substantial investments" in public higher education for a long time, but making them could help, he says.

Young people coming out of jail and prison, who are overwhelmingly urban teenagers, face the worst lifetime income gap, says Smeeding. "I told our governor that you need to target kids who are coming out of prison for the first time, help them get jobs. Because if they don't get a job quickly, within a few weeks they'll be career criminals," and since three of four are fathers, helping them is a twofer.

The widespread incarceration of young men — mostly African-American but also Latino and white men — who have a high school education or less is driving increased social and economic inequality in our society that is "sizable . . . enduring" and "intergenerational," said sociologists Bruce Western at Harvard and Becky Pettit at the University of Washington, Seattle. "The social and economic penalties that flow from incarceration are accrued by those who already have the weakest economic opportunities," and their prison records impose additional "significant declines in earnings and employment" that affect them and their children. [1]

Ironically public-spending trends over the past several decades have reinforced these inequality-creating trends, especially at the state level. For example, 30 years ago, 10 percent of California's general fund went to higher education and 3 percent to prisons. Today, higher education's share has dropped to 8 percent, and nearly 11 percent goes to prisons, so that the state spends more on inequality-increasing incarcerations than on inequality-reducing education. [2]

— Marcia Clemmitt

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[1] Bruce Western and Becky Pettit, "Incarceration and Social Inequality," *Daedalus*, summer 2010, p. 8.

[2] "Rising Above the Gathering Storm, Revisited: Rapidly Approaching Category 5," Members of 2005 Rising Above the Gathering Storm Committee, National Academies of Sciences and Engineering and Institute of Medicine, 2010, www.nap.edu/catalog/12999.html.

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BACKGROUND

All That Glitters

At the end of the 18th century, the young United States was known as the "best poor man's country" in the world, with fertile farmland plentiful enough for most people to earn a decent living and little of either extreme poverty or extreme wealth to be found. [38]

A century later, however, with the industrial age booming, the United States experienced the first of three eras of very high income inequality.

The first stretched from around 1870 through the early 1900s and was characterized by ostentatious spending by industrial titans, even as poverty deepened. Humorist and social critic Mark Twain and essayist and novelist Charles Dudley Warner dubbed the period "the Gilded Age" in their 1873 novel satirizing the corruption in Washington that accompanied what the authors depicted as a mad national scramble after wealth, at the expense of other values. [39]

Gradually, unease grew about economic inequality that might threaten the country's cherished reputation as a land where all residents had the chance to rise.

In hopes of demonstrating that Americans at all income levels were enjoying the fruits of booming industry, University of Wisconsin statistician Willford I. King launched the first major study of U.S. wealth and income distribution, publishing two books on the subject. King unhappily reported, however, that economic inequality was steeper than he had expected, with the richest 1 percent of the population taking home about 15 percent of the national income in 1910, giving the wealthiest Americans an income hundreds or even thousands of times greater than that of a working-class citizen. [40]

"It is easy to find a man in almost any line of employment who is twice as efficient as another employee, but it is very rare to find one who is ten times as efficient," mused King. "It is common, however, to see one man possessing not ten times but a thousand times the wealth of his neighbor," largely due to some people's "greater facility of taking advantage of . . . laws and circumstances to acquire property rights" and the fact that "wealth tends to breed wealth," he wrote. "Is the middle class doomed to extinction, and shall we soon find the handful of plutocrats, the modern barons of wealth, lined up squarely in opposition to the property-less masses?" [41]

The vast sums of heritable wealth amassed by industrialists also posed a danger to society if they were simply passed on to the next generation, opined steel magnate Andrew Carnegie in his 1889 essay "The Gospel of Wealth." "In many cases the bequests are so used to become only monuments of . . . folly." Far better to establish a charitable institution that pursues a public good that's in accordance with the wealth earners' own ideas, said Carnegie, whose own fortune established universities, libraries, museums, research institutions, a pension fund for his former employees and the think tank Carnegie Endowment for International Peace. [42]

Leeriness about the rising concentration of income and the political corruption it might spawn built support among the middle and upper classes for a so-called Progressive Era in politics, which brought new regulations for business and the modern-day progressive federal income tax, which taxes higher earners at a higher percentage, among other changes.

Congress had levied an income tax in 1861, to help pay for the Civil War. The tax withstood a court challenge but was eventually repealed when military needs lessened. In 1894, Congress enacted a second income tax, in the form of a 2 percent levy on all incomes over $4,000 (the equivalent of around $100,000 today), aimed at harnessing some of the income of the richest Americans for public purposes. [43]

But this time a Supreme Court divided 5-4 struck down the tax a year later. The Constitution barred Congress from enacting any so-called "direct" federal tax — a tax based on ownership, such as the ownership of property — unless it would be paid proportionately by the states according to their population, said the court. Unlike the earlier court, the 1895 Supreme Court deemed the income tax such an "ownership" tax. [44]

Proponents were not long deterred, however. In 1909, President William Howard Taft proposed the 16th Amendment to the Constitution to allow Congress to enact a tax on income — from any source, such as property or wages — without apportioning the tax among states based on population. By February 1913 the amendment had been ratified by the required 36 out of the 48 states.

The fortunes of the Gilded Age had largely deflated by 1920, mainly because of capital losses related to catastrophic events like World War I rather than Progressive Era reforms, according to Thomas Piketty, a professor at the Paris School of Economics, in France, and Emmanuel Saez, a professor of economics at the University of California, Berkeley. [45]

In the 1920s, however, both the stock market and the nation's top incomes began soaring again, and income inequality reached another peak in 1929. The crash of financial markets late in that year, and the Great Depression that followed, cut this second period of inequality very short, however. A number of factors kept economic inequalities from rising steeply again until around 1980, including the loss of capital by the wealthy during the Depression, World War II, and government actions to bolster lower earners and tax the wealthy more.

"The stability in income equality, where wages rose with national productivity for a generation after the Second World War, was the result of policies that

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Chronology

1860s-1910s

Income and wealth inequality increase to unprecedented levels in the Gilded Age.

1868
Massachusetts-born writer Horatio Alger publishes *Ragged Dick*, the first of dozens of popular Alger novels depicting the American dream of poor boys rising to wealth through talent and hard work.

1889
In "The Gospel of Wealth," industrialist Andrew Carnegie urges rich people to endow charities rather than passing their money on to their children.

1894
Congress passes a 2 percent tax on incomes over $4,000 (about $100,000 today); the Supreme Court deems it unconstitutional a year later.

1913
The Constitution's 16th Amendment, permitting Congress to enact a federal income tax, is ratified by the required 36 out of 48 states.

1915
In the largest such study to date, University of Wisconsin statistician Willford I. King reports that the richest 1 percent of Americans get at least 15 percent of the income.

1920s

Income inequality rises again. The top marginal income tax rate is at an all-time low 25 percent.

1929
Driven by a growing economic bubble at the top, the stock market booms, and then crashes.

1930s-1960s

During the Depression, government safety-net programs support low earners; in World War II the top income tax rate rises to over 90 percent.

1932
President Herbert Hoover raises top income tax rate to 63 percent.

1935
Supreme Court strikes down a minimum-wage law.

1938
Fair Labor Standards Act sets federal minimum wage at 25 cents an hour and survives a court challenge.

1959
Since 1950, the percentage of Americans in poverty has dropped from 32 to 22 percent, and median family income has risen 43 percent.

1970s-1980s

Inequality rises as top incomes soar, high school graduation rates stagnate and computers and automation squeeze out middle-earning manufacturing and other jobs.

1973
High school graduation rates peak.

1979
U.S. manufacturing employment peaks at 21.4 million workers.

1981
President Ronald Reagan fires 11,000 striking members of the air traffic controllers union, helping to weaken the power of organized labor. . . . Reagan persuades Congress to pass the largest tax cuts in U.S. history.

2000s

U.S. productivity continues to increase, but gains go mostly to highest earners. During the economy's expansion from 2002-2007, the top 1 percent of earners capture two-thirds of income gains.

2003
Top marginal tax rate is cut to 35 percent.

2006
Richest 10 percent of Americans account for 57 percent of the nation's net worth.

2007
Since 1979, the average after-tax income for the top 1 percent of earners nearly quadruples, rising from $347,000 to more than $1.3 million; after-tax income for the bottom fifth averages $17,600, up 16 percent from 1979.

2008
Ratio between the pay of the average CEO and the average worker is 319 to one in the United States, 11 to one in Japan, 12 to one in Germany and 47 to one in Mexico.

2010
Since 1979, the average pretax income has dropped $900 for the bottom 90 percent of households but risen $700,000 for the top 1 percent. . . . The nation's growing income gap since 1993 is entirely accounted for by soaring incomes for the top 1 percent of earners. . . . Large majorities of Americans support raising the minimum wage and taxing the wealthy more and creating a more equal income structure, such as that in Sweden; Republicans, who oppose these actions, nevertheless regain control of the House of Representatives in the midterm elections.

Is Upward Mobility Still Possible?

Research suggests it's becoming more difficult.

The gap between rich and poor may be wider than ever in the United States, but the U.S. remains, in the dreams of many, a land of equal opportunity — where talent and hard work are the tickets to a better future for anyone. Current data suggest, however, that the dream may have faded a bit.

"The U.S. today has a lower rate of intergenerational mobility than Europe, and that would be a surprise to most Americans," says Richard J. Murnane, a professor of education and society at the Harvard Graduate School of Education. "The key reason for this is the difficulty the poor face trying to get the education they need" to get into occupations that would allow them to move ahead, according to Murnane.

"Americans have an optimistic faith in the ability of individuals to get ahead within a lifetime or from one generation to the next," believing this much more strongly than people in other countries, wrote Julia B. Isaacs, a policy fellow at the Brookings Institution, a center-left think tank. In a survey of people from 27 countries, for example, only 19 percent of Americans thought that coming from a rich family was essential or very important to getting ahead, compared to a median of 28 percent in all the other countries. [1]

In reality, however, Americans are much less likely to move from one economic level to another than people in many other countries, said Isaacs. In a study of eight of the most highly industrialized countries, the link between parents' earnings and children's economic attainment was strongest in the United States and the United Kingdom, where it takes an average of six generations for wealthy families' economic advantage to stop influencing the economic status of their children, she reported. In Canada, Norway, Finland and Denmark, by contrast, it takes only three generations "to cancel out the effects of being born into a wealthy family." [2]

Being born at the top or the bottom of the income distribution affects people much more in the United States than in Canada, said Miles Corak, a professor of economics at Canada's University of Ottawa. For example, in the United States, 22 percent of sons born to fathers in the bottom tenth of the income distribution remain in the bottom tenth as adults, while 18 percent move up only into the next decile; in Canada only 16 percent of those born into the bottom decile stay there and 14 percent move up to the next decile. A similar "stickiness" holds for the top-earning decile, Corak said. [3]

Race plays a major role in trapping people at the bottom of the ladder, according to a 2009 report from the Pew Charitable Trusts Economic Mobility Project. About 47 percent of black children born to families in the middle fifth of the income distribution fall into the bottom fifth as adults, "compared to only 16 percent of middle-income white children." [4]

Some analysts further argue that society has built-in mechanisms to keep people from high-earning families from falling out of their spots. For example, in a recent analysis of so-called "legacy" college admissions, Richard D. Kahlenberg, a senior fellow at the Century Foundation, a liberal think tank, reports that at selective colleges alumni children generally make up 10 to 25 percent

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began in the Great Depression with the New Deal and were amplified by both public and private actions after the war," wrote Massachusetts Institute of Technology professor of urban economics Frank Levy and professor of economics Peter Temin. [46]

For example, in the early days of the Depression President Herbert Hoover raised marginal tax rates for the highest earnings from 25 to 63 percent. Then, in 1936, President Franklin D. Roosevelt, architect of the New Deal, raised the top rate to 79 percent, with the goal of narrowing the income distribution. [47]

The first federal minimum wage was enacted in 1933, but the Supreme Court struck it down in the 1935 case *Schechter Poultry Corp. v. United States.* [48] In 1938, Congress passed another minimum-wage law, which has survived legal challenge. Meanwhile, the National Labor Relations Act of 1935 — often called the "Wagner Act," for its sponsor Sen. Robert F. Wagner, D-N.Y. — endorsed the right of workers to unionize, strike and engage in collective bargaining with management while limiting the means employers could use to fight unions. [49]

Inequality Rises

When the most recent new era of rising inequality began, around 1980, many were surprised.

As Galbraith at the University of Texas explained, "the very essence" of being a "developed" nation lies in industrialization, long believed to foster both democracy and "the emergence of a stable, middle-class working population, paid at rates which vary only by the range of skills in the workforce." By contrast, "the very essence of underdevelopment is not poverty per se" but a skewed income and wealth distribution with a few very wealthy people at the top and the vast majority of people struggling below. [50]

Nevertheless, in the past three decades the United States and to a lesser extent other industrialized countries, especially Canada and the United Kingdom, have seen a rise of economic inequality whose cause analysts struggle to understand.

Initially, suspicion focused on supply-and-demand trends in the workforce stemming from increased immigration

of the student body. Since the proportion of alumni children each college accepts varies little from year to year, that suggests "an informal quota system," he says. Statistical analysis suggests, he says, that being a legacy boosts a student's chance of admission to a selective school by about 20 percentage points — say, from a 40-percent to a 60-percent chance — over a non-legacy student with a similar transcript and scores. [5]

The existence of such a strong tradition of legacy admissions by the most selective colleges — whose graduates also may have a leg up in many job markets — is especially damaging to African-American and Hispanic students, for example, who have been underrepresented at America's most prestigious colleges in the past and thus will continue to get no legacy boost for several generations to come, Kahlenberg said. [6]

Many conservative and libertarian analysts, however, argue that, as with many purported measures of economic inequality, researchers who find low economic mobility in the United States look at the wrong studies and interpret them too narrowly.

Some studies show high mobility, said Jagadeesh Gokhale, a senior fellow at the libertarian Cato Institute, and Pamela Villarreal, a graduate student fellow at the conservative National Center for Policy Analysis. For example, a study has shown that between 1984 and 1994 almost two-thirds of families in the lowest tenth of the income ladder in 1984 had reached a higher rung 10 years later, they pointed out. Meanwhile, 47 percent of the families in the top tenth of earners in 1984 had fallen to a lower decile 10 years later. [7]

Furthermore, "wealth is highly mobile in the United States," where "most fortunes are earned, rather than inherited," write Gokhale and Villarreal. On *Forbes* magazine's annual list of the 400 richest Americans, for example, the vast majority of the 2,218 people listed from 1995 to 2003 — 87 percent — made the cut for only one or two years during the period, they note, indicating that most of the very top earners don't hold onto their top incomes long, as others climb to take their place. [8]

— Marcia Clemmitt

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[1] Julia B. Isaacs, "International Comparisons of Economic Mobility," Economic Mobility Project, Pew Charitable Trusts, February 2008, www.economicmobility.org/assets/pdfs/EMP_InternationalComparisons_ChapterIII.pdf.

[2] *Ibid*.

[3] Miles Corak, "Chasing the Same Dreams, Climbing Different Ladders," Economic Mobility Project, Pew Charitable Trusts, January 2009, www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Economic_Mobility/EMP_Chasing%20the%20Same%20Dream_Full%20Report_2010-1-07.pdf.

[4] "Renewing the American Dream: A Road Map to Enhancing Economic Mobility in America," Economic Mobility Project, Pew Charitable Trusts, November 2009, www.economicmobility.org.

[5] Richard D. Kahlenberg, "10 Myths About Legacy Preferences in College Admissions," *The Chronicle of Higher Education*, Sept. 22, 2010, http://chronicle.com.

[6] *Ibid*.

[7] Jagadeesh Gokhale and Pamela Villarreal, "Wealth, Inheritance and the Estate Tax," NCPA Policy Report No. 289, September 2006, www.ncpa.org/pub/st/st289.

[8] *Ibid*.

and more women workers. Recent analyses find that these suspect trends don't tell the whole story, however.

For example, since women first began entering the workplace in large numbers, beginning in the 1970s, studies show that they've actually outperformed men on average when it comes to "moving out of moderately skilled jobs" and into higher-level, better-paid occupations, said journalist Timothy Noah in a recent series of articles in the online magazine *Slate*. That statistic means that women's employment isn't holding workers' wages down substantially. [51]

Immigration, meanwhile, has had some effect in holding down wages for low-skilled workers, but its overall contribution to inequality is less than expected.

In 2000, the average income of a native-born high school dropout was about 7.4 percent lower than it would have been that year had the immigration that occurred between 1980 and 2000 never occurred, concluded George J. Borjas, a professor of economics and social policy at Harvard. Immigration depressed the incomes of high school graduates by only 2.1 percent over the two-decade period, however, Borjas said. [52] It appears that only about 5 percent of the overall increase in income inequality observed over the past three decades is due to immigration, according to Noah. [53]

A bigger culprit may be what scholars call skill-based technological change (SBTC) — technology-driven changes in the skills workers need to get good jobs, especially as many medium-skill jobs, such as manufacturing, move overseas in a globalized economy where companies can pay people less to do the same work in less-developed economies.

"The American economy grew rapidly and its people 'grew together'" from World War II to about 1973, wrote Harvard economists Claudia Goldin and Lawrence F. Katz. "Each generation of Americans achieved a level of education that greatly exceeded that of the previous one," and this situation allowed businesses based on new technologies to find enough high-skilled workers. At the same time, the emergence of new, larger cohorts of skilled Americans generally created a demand and supply balance in the workforce that kept skilled workers' salaries from rising too high — and

Courts Open Door to Big-Money Political Donors

Do the rich wield more political power than the poor?

In the 2010 campaign season, a single political action committee (PAC) poured $600,000 into the Nevada Senate race on behalf of the Republican challenger, Sharron Angle, who came close to unseating Senate Democratic Majority Leader Harry Reid on Nov. 2. Big spending by PACs is nothing new in political campaigns, but the Ending Spending Fund that operated in Nevada represents a new wrinkle — a PAC funded by a single big donor. [1]

Two 2010 court rulings — the Supreme Court's controversial January decision in the so-called *Citizens United* case and a March ruling by the U.S. Court of Appeals for the District of Columbia Circuit in *Speechnow.org vs. the Federal Election Commission* — cleared the way for outside donors to pour unlimited funds into elections, as long as they don't coordinate with political candidates or party committees. [2] Outside donors can now sponsor election advertising, for example, without abiding by older campaign rules, such as individual-donor spending limits. That opens the door for a PAC like the Ending Spending Fund, bankrolled by J. Joseph Ricketts, the Omaha-based founder of the discount online stock brokerage Ameritrade. [3]

This new avenue for wielding political clout is part of a historical trend over the past several decades that is consolidating disproportionate political power in the hands of the richest citizens, some scholars argue.

"The Founding Fathers believed in political equality, meaning that whether one is rich or poor would determine a person's market power but not their power in the democracy," says Jacob S. Hacker, a professor of political science at Yale University. "I believe we're falling quite dramatically short of this," as wealthier people have gradually developed institutional means like PACs and lobbies to see their favored policies enacted into law and regulation, and the government has become more friendly to these efforts, he says.

"There may exist mechanisms or pathways of influence by which a very small set of oligarchs" — rich people who wield political power — "could, to a far greater extent than their numbers alone would suggest, have a major impact on policy outcomes," wrote Northwestern University political scientists Benjamin I. Page and Jeffrey A. Winters. They point to the many "highly professionalized and extremely expensive" lobbying organizations that have sprung up in Washington since the mid-20th century, mostly representing business and professional groups. Meanwhile, once-powerful labor unions now represent only about 15 percent of the U.S. workforce, mostly government workers. "The pluralist dream of balance among competing interest groups" is thus "largely discredited," while "those who are able and willing to invest large sums of money" in increasingly professional and expensive lobbying efforts have "a big advantage," they argue. [4]

Politicians' increasing need for fundraising has helped lobbies to increase the power of big-money business interests, wrote Hacker and Paul Pierson, a professor of political science at the University of California, Berkeley. For example, beginning in the 1970s, television advertising and modern public-opinion polling allowed candidates to reach unheard of numbers of people with messages shrewdly crafted to tap into voters' prime desires. The ads and the "pricey political consultants" whom candidates hired to poll and develop campaign strategies greatly increased politicians' reliance on big-money donors, Hacker and Pierson argue. [5]

Based on decades of detailed polling data on different income groups, it's clear that "when the opinions of the poor diverged from those of the well-off, the opinions of the poor ceased to have any apparent influence: If 90 percent of poor Americans supported a policy change, it was no more likely to happen than if 10 percent did," according to political scientist Martin Gilens at Princeton University. [6]

By contrast, when well-off people supported a policy change, it was three times more likely to occur than if they opposed it. Furthermore, the middle class did not fare much better than the poor when their opinions departed from those of the well-off. When median-income people strongly supported a policy change, it had hardly any more chance of occurring than a change that they strongly opposed, Gilens said. [7]

The policy preferences of wealthy people tend to diverge from those of other citizens on various issues, according to Page, who has begun an extensive study of this question. His preliminary work finds that 58.8 percent of the richest Americans — in the top 4 percent of income — identify as Republicans, for

thus driving income inequality compared to low-skilled workers — because many people could compete for high-skilled occupations, Katz and Goldin wrote. [54]

"Historically, education has been the primary pathway of upward mobility in the United States," says Richard J. Murnane, a professor of education and society at the Harvard Graduate School of Education. In 1973, the United States had the highest high school graduation rate among OECD [Organization for Economic Co-operation and Development] countries, but the education engine "stopped in the mid-1970s" as high school graduation rates stalled, he says.

Levels of income inequality "depend very strongly on the supply and demand for skills," at least among people between the 10th and the 90th percentile of the income distribution, says David Autor, an economist at the Massachusetts Institute of Technology. For example, in the early 1970s, when the huge Baby Boom generation saw a rising proportion of its members go to college, wages for higher-skilled

example, compared to 36.1 percent of others. Very high-income Americans are more likely than others to be liberal or libertarian on social issues — favoring abortion rights and the right of atheists to teach, for example. But they are more likely than others to be conservative on economic issues, not favoring government efforts to reduce economic inequalities. [8]

In the 2010 midterm elections, high earners showed a strong preference for Republican candidates and, presumably, policies, while 58 percent of those earning $30,000 or less and 52 percent of those earning between $30,000 and $50,000 voted for Democratic candidates, according to a *Wall Street Journal* analysis. The Republican preference strengthened all the way up the income ladder, with 52 percent of those earning between $50,000 and $75,000 voting GOP; 56 percent of the $75,000 to $200,000 earners; and a whopping 62 percent of those earning over $200,000. [9]

Conservative and libertarian analysts remain skeptical that economic clout helps some gain undue political influence.

While highly educated people wield greater influence, "it is very difficult to see how income in excess of the threshold necessary to receive a high-quality education adds much to most people's pool of political resources," said Will Wilkinson, a research fellow at the libertarian Cato Institute. "Ideologically motivated wealthy Americans are limited by the menu of preexisting organizations, prevailing ideas and the supply of ideologically congenial labor," he argued. "No amount of money can buy you a think tank with your politics if there is no one with your politics to work in it." [10]

"Capitalism might indeed preclude democracy if capitalism meant that rich people really were a permanent class," wrote Council on Foreign Relations Senior Fellow Amity Shlaes. But "one capitalist idea (the railroad, say) brutally supplants another (the shipping canal)," and "within a few generations . . . this supplanting knocks some parties out of the top tier and elevates others to it." [11]

A focus on the dangers of wealth concentration simply "provides a political justification for encouraging envy," a state that leads to neglect of "family and friends, community involvement" and "charitable work" and "bolsters an empty materialism," wrote Jeffrey M. Jones, assistant director of Stanford University's Hoover Institution, a conservative public-policy research organization, and Daniel Heil, a graduate student at Pepperdine University. [12]

Ironically, when Americans become aware that income inequality is on the rise, that knowledge actually sways the voting public away from liberal policies aimed at decreasing inequality, according to Nathan J. Kelly, an assistant professor of political science at the University of Tennessee, Knoxville, and Peter K. Enns, an assistant professor of government at Cornell University, in Ithaca, N.Y. In the United States, "public opinion moves in a conservative direction in response to income inequality," among both rich and poor Americans, potentially making income inequality a "self-reinforcing" phenomenon, they wrote. [13]

— Marcia Clemmitt

[1] Amanda Terkel, "The One-Person Funded Super PAC," *Huffington Post blog*, Oct. 22, 2010, www.huffingtonpost.com.

[2] The cases are *Citizens United v. Federal Election Commission*, 130 S.Ct. 876 (2010), www.law.cornell.edu/supct/html/08-205.ZS.html and *Speechnow.org, et al. v. Federal Election Commission*, No. 08-5223, http://pacer.cadc.uscourts.gov/common/opinions/201003/08-5223-1236837.pdf. For background, see Kenneth Jost, "Campaign Finance Debates," *CQ Researcher*, May 28, 2010, pp. 457-480.

[3] Terkel, *op. cit.*

[4] Jeffrey A. Winters and Benjamin I. Page, "Oligarchy in the United States?" *Perspectives on Politics*, December 2009, p. 731.

[5] Jacob S. Hacker and Paul Pierson, *Winner-Take-All Politics: How Washington Made the Rich Richer — and Turned Its Back on the Middle Class* (2010), p. 171.

[6] Quoted in *ibid.*, p. 111.

[7] *Ibid.*

[8] Benjamin I. Page and Cari Lynn Hennessy, "What Affluent Americans Want From Politics," paper delivered to the American Political Science Association, annual meeting, Washington, D.C., Sept. 2-5, 2010, www.russellsage.org/sites/all/files/u4/Page%20%26%20Hennessy%2C%20What%20Affluent%20Americans%20Want%20from%20Politics.pdf.

[9] "Democratic Coalition Crumbles, Exit Polls Say," *The Wall Street Journal online*, Nov. 3, 2010, http://online.wsj.com/article/SB10001424052748703778304575590860891293580.html?KEYWORDS=voters+election+2010#project%3DEXITPOLL101102%26articleTabs%3Dinteractive.

[10] Will Wilkinson, "Thinking Clearly About Economic Inequality," *Policy Analysis No. 640*, Cato Institute July 14, 2009, www.cato.org.

[11] Amity Shlaes, "An Age of Creative Destruction," *The Wall Street Journal online*, Oct. 29, 2010, http://online.wsj.com.

[12] Jeffrey M. Jones and Daniel Heil, "The Politics of Envy," tech-archives.net website, Aug. 21, 2009, http://sci.tech-archive.net.

[13] Nathan J. Kelly and Peter K. Enns, "Inequality and the Dynamics of Public Opinion: The Self-Reinforcing Link Between Economic Inequality and Mass Preferences," *American Journal of Political Science*, October 2010, p. 855.

workers temporarily fell somewhat.

In the mid-1970s, as high school graduation rates stalled and smaller generational cohorts attained adulthood behind the Baby Boomers, the supply of high-skill workers began to shrink compared to the growing demand for them in technology-based industries, Autor says. At that point, "we began to get a [wage] premium for college grads," and their rising incomes helped increase income inequality.

At the same time, the advent of the computer age allowed automation of virtually any repetitive task so that middle-skill jobs — like bookkeeping, many manufacturing jobs and even many computer programming and sales positions — gradually evaporated from the workplace or shifted overseas, explains Carnevale, at Georgetown's Center on Education and the Workforce. With high school graduation rates stagnant, a growing pool of U.S. workers are left to compete for low-skilled jobs like security guards and home-health workers, where the large supply of available workers drives

down wages further, Carnevale says.

In 1973 the majority of people with a high school education or less were in the middle 40 percent of the income distribution — solidly middle class, says Carnevale. "Now that number is below 30 percent." People with B.A.s, by contrast, have remained in the middle class, and about a third have moved into the top 30 percent of incomes, he says.

This workforce "polarization" that drives income inequality is evident in European Union and OECD countries, too, says Autor.

Winners Take All

Other scholars point to a different trend as the key driver of income inequality — a "winner-take-all" economy in which a few high earners rack up income gains that far outstrip those of everyone else.

"There was no increase in inequality after 1993 in the bottom 99 percent of the population, and the remaining increase . . . can be entirely explained by the behavior of incomes in the top 1 percent," said Northwestern's Gordon. [55]

Unlike in the Gilded Age, it wasn't investment income but high-rising salaries for people like top executives and Hollywood stars that fueled the outsized gains at the top, according to Piketty and Saez. [56]

Some argue that superstar salaries simply represent a new, globalized market rationally presenting very high rewards to people whose wares sell to tens of millions of people worldwide. "I think there are people, including myself at certain times in my career, who because of their uniqueness warrant whatever the market will bear," said Leo J. Hindery, a managing partner of the New York City-based private equity fund InterMedia Partners. [57]

But others say that government structures and policies — not just market forces — have played a large role in the U.S. shift of income toward the very top earners.

For one thing, financial-industry executives make up nearly 20 percent of the people with salaries in the top 1 percent of the U.S. income distribution, and "it strains credulity to say they are . . . the talented tamers of technological change" who've benefited from skill-based technological workplace change, write Yale's Hacker and University of California, Berkeley, political scientist Paul Pierson. The financial crisis demonstrated that "plenty of the so-called financial innovations that their complex computer models helped spawn proved to be just fancier (and riskier) ways of . . . benefiting from short-term market swings," not the true innovation that markets presumably reward. [58]

Over the past several decades, wealthy business interests have organized into lobbies, political action committees (PACs) and think tanks, at the same time as the main organizations that once represented the working class — labor unions — have shrunk, leaving some business sectors like finance with enormous power to influence government policies, Hacker and Pierson argue. Furthermore, beginning in the 1970s, TV ads and pricey opinion-poll surveying became a necessity for political campaigns, greatly increasing politicians' need for high-dollar contributors and increasing those contributors' influence in Washington, they contend. As a result, "government policy has grown much more generous toward the fortunate."

"Financial deregulation didn't just happen, nor did tax policy" that saw corporate and inheritance taxes as well as marginal taxes on high incomes drop significantly, says Hacker. "The government has made and remade markets" by law and regulation, and the much smaller income differentials that prevail in every other market-based industrialized economy make clear that U.S. income inequalities result from policy choices, he says.

For example, not market forces alone but deliberate government policies drove the "precipitous" decline in U.S. union membership that began just after World War II — when more than one in three workers was a union member — and continues today, when about one in nine is, and most union members are government, not private-sector, workers, Hacker says. While unions aren't blameless in their own demise, and globalization has realigned markets, over the past few decades Congress, state legislatures and successive White Houses dragged their feet on measure after measure that would have strengthened unions' bargaining power, he says.

The result is the loss of a key political force that was "broadly representative of the middle class" in a way that no other large, politically influential organization has been —"a key source of voter turnout" and "a counterweight in boardrooms" to represent the interests of middle- and low-wage workers, Hacker says.

Economic troubles fueled lawmakers' increasingly business- and wealth-friendly policies beginning in the late 1970s, said University of Arizona professor of sociology and political science Lane Kenworthy. "Stagflation" — slow economic growth combined with rising prices and high unemployment — "and a surge in imports had turned [Americans' long-held] optimism [about the economy] to worry," and the "underlying pessimism" persisted through the late 1990s, making policy makers "more willing to entertain the pleas of business interests," whatever they might be. [59] ■

CURRENT SITUATION

Policies Debated

Although few members of Congress or candidates in the hotly

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At Issue:

Should tax cuts on high earnings be extended?

ALAN REYNOLDS
SENIOR FELLOW, CATO INSTITUTE

WRITTEN FOR *CQ RESEARCHER*, NOVEMBER 2010

yes

In 2001, Congress assembled a time bomb with a 10-year fuse. Unless the lame duck Congress acts with atypical urgency, all tax cuts enacted in 2001-2003 will vanish on Dec. 31.

If lawmakers fail to defuse the tax time bomb by the end of the year, withholding taxes will increase dramatically. Moreover, if lawmakers and the president can't agree on a solution by year's end, the top tax on dividends would jump from 15 percent to 39.6 percent, ensuring a stock market crash. The estate tax would jump to 55 percent with only a $1 million exemption. Marginal tax rates would rise by 3-5 percentage points across the board.

President Obama has appeared eager to hurl himself on top of this bomb. He threatened economic homicide and political suicide by threatening to veto any solution that did not impose much higher taxes on two-earner couples and small businesses earning more than $250,000. Yet the president has had eight months to enact the tax hikes in his 2011 budget. If he couldn't do it then, he certainly can't now. Everyone knows this is playing with fire. The targets of Obama's planned tax increases account for a fourth of all consumer spending, and a greater fraction of entrepreneurship and investment.

Christina Romer, formerly Obama's top economic adviser, found that a U.S. tax increase amounting to 1 percent of gross domestic product (GDP) reduces real GDP by nearly 3 percent within three years, with employment falling 1.1 percent. Harvard economists Alberto Alesina and Silvia Ardagna found that "fiscal adjustments, those based upon spending cuts and no tax increases, are more likely to reduce deficits . . . [and] less likely to create recessions."

Under the fanciful assumption that Obama's tax hikes on "the rich" did no damage to the economy, his plan is estimated to raise $35 billion next year. That would cover the budget deficit for just nine days. This is all risk and no reward.

The White House is now rumored to be willing to compromise on legislation that postpones the president's planned tax hikes on upper-income families while supposedly making "permanent" all other Bush tax cuts. That may not be the ideal solution, but it buys time for the new Congress to tackle the budget in an economy that is rising slowly rather than falling fast.

CHUCK MARR
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WRITTEN FOR *CQ RESEARCHER*, NOVEMBER 2010

no

Letting President Bush's tax cuts for incomes over $250,000 expire on schedule at the end of December is the right move from the standpoint of both equity and economic efficiency.

Recent decades have witnessed a stunning shift in incomes from the middle class to those few at the top. Between 1980 and 2005, about 80 percent of the country's total income gains went to the top 1 percent of the population, according to a report by MIT researchers Frank Levy and Peter Temin. Moreover, while incomes stagnated for middle-class Americans in recent decades, they surged for the wealthy — in stark contrast to the decades between the mid-1940s and mid-1970s, when income growth was widely shared. The average middle-income American family had $13,000 less after-tax income in 2007 than it would have had if incomes of all groups had grown at the same average rate since 1979.

Tax policy is one of the best tools we have to help offset the troubling trend of growing inequality. Unfortunately, President Bush's tax cuts have had the opposite effect, providing much larger benefits — both in dollar terms and as a percentage of income — to people at the very top than to middle- and lower-income people.

In fact, people making more than $1 million a year get an average of about $129,000 each year from the Bush tax cuts, according to the Urban Institute-Brookings Institution Tax Policy Center. The main reason, of course, is the large tax cuts targeted specifically at high-income households. Extending the tax cuts for high-income people would only make inequality worse. (High-income people would still benefit from an extension of the so-called "middle-class" Bush tax cuts, since the first $250,000 of their income would be taxed at the lower marginal tax rates.)

Extending the high-end tax cuts doesn't make sense from an economic perspective, either. The Congressional Budget Office (CBO) rated it the least cost-effective of 11 options for boosting economic growth and job creation. A far better alternative would be to extend President Obama's Making Work Pay tax credit, which is targeted to people who live paycheck-to-paycheck but is also scheduled to expire at the end of December. This would generate two to three times the economic growth and job creation as extending the high-end Bush tax cuts, according to CBO.

The right course, then, would be to let the high-end Bush tax cuts expire, locking in significant long-term budgetary savings, while temporarily extending the Making Work Pay credit while the economy remains weak.

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contested 2010 elections have specifically addressed the question of whether growing economic inequality is bad or good, the issue simmers beneath many of the hottest election-year debates, including taxes, the minimum wage and the power of unions.

In light of the country's fiscal problems, many Democrats in Congress, along with President Obama, have called for the wealthiest to take on a greater share of the public burden. In a heated debate that remained unresolved when Congress adjourned its main session in the fall to campaign, the White House and most Democrats backed the idea of extending Bush-era tax cuts for family earnings under $250,000 and letting the cuts expire for dollars earned above that level. [60]

"In order to save our children from a future of debt, we will . . . end the tax breaks for the wealthiest 2 percent of Americans," said Obama. [61]

But Republicans and some conservative Democrats argue that high-earners' money is the key driver of the whole economy. "History shows and good economic theory shows, if you reduce taxes, you're going to have more economic activity," said Republican Minnesota Gov. Tim Pawlenty, on CBS News' "Face the Nation" on Oct. 31. "If you don't extend those Bush tax cuts — all of them — it's going to send a very negative signal," said Pawlenty, who is reportedly mulling a run for the White House in 2012. [62]

Most recently, the White House reportedly favors a plan to temporarily extend the cuts for earnings over $250,000 while extending the cuts permanently for earnings under that amount. With Congress in upheaval following the elections, it's not clear whether lawmakers will tackle the issue in the final days of the 2010 "lame duck" session, when most newly elected members won't yet be seated.

Conservative candidates campaigning around the country this fall spoke out against government mechanisms intended to push the income distribution more in favor of lower earners.

John Raese, West Virginia's Republican nominee for the Senate, and Joe Miller, the Republican nominee for Senate in Alaska, for example, argued that the Constitution does not give Congress the power to set a minimum wage for the nation but reserves that power for states. [63] (Similar arguments were made on the two occasions when Congress enacted federal minimum-wage laws, in 1933 and 1938. The Supreme Court struck down the first law as unconstitutional in 1935, [64] but upheld the 1938 Fair Labor Standards Act in a unanimous 1941 decision, *U.S. v. Darby.* [65])

Linda McMahon, the Republican nominee for Senate in Connecticut, opposed increasing the minimum wage, and Rand Paul, Republican nominee for the Senate in Kentucky, suggested a very cautious approach to minimum-wage increases. [66]

How big a role candidates' views on income redistribution played in election results isn't clear, but for these Senate hopefuls the results were mixed: Paul won his race; Raese, McMahon and Miller lost, but Miller is contesting his narrow defeat to write-in candidate Republican Sen. Lisa Murkowski, the incumbent.

Meanwhile, four states voted on ballot measures in November that would slow the growth of unions, and all the measures were approved. Voters in Arizona, South Carolina, South Dakota and Utah approved making a secret vote by workers the sole allowable means of determining whether an authorized workplace union has been formed, outlawing an alternative practice that requires an employer to recognize that a union has been formed any time a majority of workers have signed cards authorizing union formation. [67]

Ambivalent Public?

The public, meanwhile, remains both confused and ambivalent about the underlying question of whether economic inequalities are worrisome.

"It is usually only left-leaning rich people that care about inequality in the U.S.," said Carol Graham, a senior fellow at the Brookings Institution think tank. [68]

Nevertheless, some polling suggests that the public may be fairly supportive of government policies to prop up lower incomes, in particular. For example, an October poll found 67 percent of respondents favoring an increase in the minimum wage from its current $7.50 an hour to $10 an hour, even including a majority — 51 percent — of Republicans. Among people who identified themselves as belonging to the Tea Party, however, 50 percent opposed the increase and 47 percent supported it. [69]

Underlying the ambivalence is the fact that few Americans accurately gauge the level of income inequality, some researchers say.

The public tends to guess right about lower- and middle-income wages, but few seem aware of how high the highest salaries actually are, reports Benjamin I. Page, a professor of decision making in Northwestern University's political science department, and Lawrence R. Jacobs, a professor of political studies at the University of Minnesota. The average person surveyed estimated $250,000 to be the annual income for a heart surgeon and $500,000 for the CEO of a large corporation. The guesses were well off the mark, especially for CEOs. The average heart surgeon earns over $400,000, while the CEOs of Standard & Poor's 500 companies average over $14 million in annual income. [70]

"Even professional economists" generally underestimate current levels of inequality, says Duke's Ariely.

This finding isn't surprising, says Michael I. Norton, an associate professor of business administration at Harvard Business School. "As an average person, we don't really see the very rich or their wealth. It's in trusts"

and other financial forms "that make it mostly invisible. People don't see very poor people in their lives, either."

At the same time, the public generally believes that society would be more just if incomes varied a bit less widely, says Norton, who, along with Ariely, conducted a recent study asking people how they would like to see income distributed in a hypothetical society, if they knew that they would be placed into that society at some random spot.

"When you ask people a specific question about a tax cut or some other proposal, you tend to have a very hostile debate. So we stepped back and looked at a very broad level" of what kind of society people actually desire, "and when we did that, people agreed a lot," Norton says.

When shown unlabeled diagrams that actually depicted the income distributions of the United States and Sweden — where inequality is much lower than in the United States — fully 92 percent of Americans surveyed preferred to live in the unlabeled country with the Swedish distribution, says Ariely. Furthermore, "when you look at the apparently differing ideology of Republicans and Democrats, the differences" in how members of the two parties answered the question "are very, very small," with 90 percent of Republicans opting for the Swedish distribution, compared to 93 percent of Democrats.

A desire for overall fairness seems to be the key motivation for most, says Norton. "When people are asked about how they'd redistribute" society's wealth, "they don't just give it to poor, they give it to everybody," and the main sentiment people express is "the rich just have somewhat too much."

When it comes to "taking that broad vision and boiling it down to policy, though, that's very hard to do," Norton acknowledges. "At both the macro and the micro level, people have certain ideas about what they want their lives to be, but very often our decisions go the other way." ■

OUTLOOK

Progressive Era Redux?

Whether the American economy will continue the trend toward greater inequality or adopt policies to rein in the widening gap is unclear, and lawmakers and the public vary widely in their views of which course is preferable and what policies might change things for the better.

"If you look back at the 1890s — ultimately there was a reaction to it, there was a cycle" that saw an era of progressive taxation and other measures to limit the income inequalities that marked the Gilded Age, says Northwestern's Page. "A lot of these reforms were undertaken by the upper middle class" and even some wealthier people, he says. "And there does now seem to be something in the air" that could portend a similar shift to progressive policies, as billionaires like Microsoft founder Bill Gates and investor Warren Buffett suggest that the wealthy should devote large portions of their estates to charitable and public purposes, he says. [71]

Indeed, in the Progressive Era, "the economic problems dwarfed those we have today," but the nation still came together to shape national policies to overcome them and to rein in rampant inequality, says Yale's Hacker. The same thing could happen today, Hacker says. "Whatever pessimism I have is not over the scope of the problem but over the lack of a widespread recognition" that a problem of inequality exists, he says. "We have really only begun to have this debate. We are where we were on climate change a few decades ago."

Hacker focuses on government policies related to unions, taxation and business regulation as keys to keeping economic inequalities at a reasonable level, but MIT's Autor worries that such a focus might leave Americans "thinking that the whole thing is out of our hands."

The best cure for extreme inequality is education because it creates economic opportunity, he says. "We haven't been keeping pace with the demand for skilled labor," and bolstering technical education and skills training for more young people could go a long way toward rebuilding the American workforce and the businesses that support it, he says. This issue "may not matter much to businesses," most of which can locate anywhere in the world that a skilled workforce exists, "but it matters greatly to our prosperity."

The stagnant buying power of middle- and lower-earning Americans is a severe, growing problem for the wealthiest Americans, whether they realize it or not, says Max Fraad Wolff, an economics writer and commentator who teaches at the New School University Graduate Program in International Affairs. Business leaders may bank on the emergence of global markets to replace U.S. buying power, but that's not a winning strategy, he says.

"What we know is that Americans can sell to Americans," Wolff says. "In this early phase of modernization [in emerging economies like China and India] what it means to be modern is to be Americanized," but "in the early history of the United States being modern meant being Europeanized, too," he says. "Eventually American pride overtook that, and that will happen" to currently modernizing countries like China, too. That makes bolstering the average American's earning power a critical issue for U.S. businesses, he says. ■

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FOR MORE INFORMATION

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