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Inequality

Inequality has been a news theme for a few years now. It is certain to be an enduring topic, a bit on the order of the environment or race relations. The President has given it his imprimatur, calling it the ‘defining challenge of our time’. The Federal Reserve chairwoman has graced it with sonorous fedspeak, ‘I think it is appropriate to ask whether growing inequality is compatible with values rooted in our nation’s history’, which is punchier prose than her ‘greater income inequality is associated with diminished intergenerational mobility’. For the foreseeable future, whenever there is a slow news cycle, we can be sure that inequality will be hauled out for comment and hand wringing. Who after all wishes ill upon the less fortunate?

On the surface it appears undeniable that there is increasing economic inequality. Between 1979 and 2012 American worker productivity and gross domestic product both increased 75% while real, that is inflation adjusted, wages grew on average just 5%. From 1979 to 2013 real after tax income of the top one-fifth of households rose by 44% while that for the bottom 60% was virtually flat. The difference between median and average incomes tells a similar story. Median means in the middle, in other words one-half of all households made more and one-half made less, while average means all of the income divided by all of the households. The higher the average, the higher the incomes of those on the top end. In 1989 the median real family income was $47,000 while the average was $72,000. In 2013 the median was still $47,000 but the average had gone up to $88,000.

Differences in wealth are another illustration of the same story. In 1989 the top 3% of wealth holders owned 45% of all American assets while the bottom 90% had 33%. By 2013 those shares had become 54% and 25%, and the bottom 80% had just 11% of all assets. In other words the top 20% of holders owned 89% of the wealth.

The fact of growing inequality leaves us with several questions. Why is it happening, what is its’ impact and should we care?

Globalization is the answer to the first question. It has knocked down national trade barriers, created an enormous market and expanded the number of players in that world market. The American worker now has to compete with labor in the developing world. Manufacturing used to provide the kind of relatively unskilled jobs that kept millions of workers in the middle class. It may be hard to imagine now but there was a time, up until a few decades ago, when a man could work in a factory, support a family, pay a mortgage and see his kids off to college. In the 1950s about 40% of the workforce was engaged in the actual production of material things. By 1990 that number was down to 14% and has continued to fall.

While this process may be increasing inequality domestically the other side of that is the diminishing inequality between the U.S. and the developing world. Since 1980 China's gross domestic product has risen over 1,700% and the industrial worker's average annual wage has gone from $342 to $7,465. In 1980 there were under 60 million manufacturing jobs in China, by 2009 that number had more than doubled.

Another facet of globalization is that it has increased competition among producers. There is definitely a premium on the better organized, the higher skilled and more creative. This is clear in the difference between the rewards going to different educational levels. In 1965 the average high school graduate made an inflation adjusted income of slightly over

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$30,000. By 2013 that income was down to $27,000. In the same period the college graduate's average income went from just below $40,000 to about $45,000. These changes may seem small but seen in percentage terms they are much more meaningful. In 1965 the average college graduate made one-third more than the average high school grad. By 2013 that premium had doubled, going to two-thirds.

We should be cautious when we hear that the bulk of the population has received no benefit from the American economy's great growth. When skeptics rejigger the numbers they take into account a number of things that are not included in most discussions of incomes, which are based on tax return data. Tax returns just tell us about wages and investment income. A more comprehensive approach includes all forms of transfer payments, with social security, welfare and disability being the major cash transfers. Non-cash items are principally employer provided medical insurance, medicare and medicaid, scholarship assistance, food stamps, surplus food distribution and rent subsidies. When all of this is taken into account the distribution of increased income is much more level. Since 1979 real income for the bottom 40% of the American population has risen 25%, for the next 40% the increase is over 35% and even the top fifth have done better on average than the raw dollar income figures indicate. This may explain why Americans in general don't believe inequality is any greater now than it has been in recent decades.

The serious growth in inequality has been between the top 1% and the rest of us. It's the one percenters again. From 1963 through 1983 the ratio of wealth owned by the top 1% of households to that held by the median was around 125 to 1. By 2010 that ratio had gone up to 288. In 1965 the average CEO made about 18 times what the average worker earned. By 2012 that ratio had become 354. Between 1979 and 2007 one percenters' real income rose 275%. Estimates vary but where we noted above that the top 3% owns 54% of all assets, it seems that the top 1% have the lion's share at 35% of total wealth, much higher than in the past.

Does the one percent deserve this vast fortune? Of course there are plenty of one percenters whose wealth does not derive from any especially valuable social contribution. Still it is worth noting that most of the top American fortunes are held by the person who created it; it is not inherited wealth. The American rich are by and large the working rich. Of the top 90-95% of income recipients in 1929, 79% worked as employees or business owners. In 1998, the latest year for such figures, that share had gone to 96%. In 1929 among the top one-tenth of one percent in income only 36% actually worked. In 1998 that share was 86%.

And what of the new industries that have been created? The last few decades have seen the growth of computer, software and web based business from almost nothing to a $1.7 trillion per year enterprise. That is just one among many new industries. Do we not benefit from computers, from biomedicine, from the myriad new ways to produce and deliver goods and services?

Are we damaged by the fact that some have created great wealth?

If we benefit from the new products that have been invented and if we enjoy at least some of the benefit from a rising level of income then the issue of growing inequality really becomes philosophical. Is it “fair” that some have so much more than others? Is it “fair” that the developing world gets richer at the expense of our workers?

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