INCOME INEQUALITY:
THE ROOT OF AMERICA'S PROBLEMS

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Read all of Gier's columns on the "Third Way" between unfettered capitalism and communism at www.home.roadrunner.com/~nickgier/ThirdWay.htm

Among the new objects that attracted my attention during my stay in America, none struck me with greater force than the equality of conditions. I easily perceived the enormous influence that this primary fact exercises on the workings of the society.

—Alexis de Tocqueville, *Democracy in America*

Growing income inequality in the United States and the policy responses it has spawned have done tremendous damage to our economy.

— Raghuram Rajan, University of Chicago Professor of Finance

If you want to know why one country does better or worse than another, the first thing to look at is the extent of economic inequality.

—Richard Wilkinson and Kate Pickett

The Spirit Level: Why Greater Equality Makes Societies Stronger

At least one conservative economist is now joining liberals in identifying income inequality as the number one problem in America. His name is Raghuram Rajan, professor of finance at the University of Chicago. This is the home of the Milton Friedman school of free market economics. Rajan has had long-running debates with liberal economist Paul Krugman. Krugman believes that more stimulus is required, but Rajan believes that this is the wrong way to solve our economic problems.

Geoff Colvin, senior editor at *Fortune* magazine, recently published the following data: "In 2008 the top one percent of taxpayers accounted for 20 percent of total pretax income; in 1986, by contrast, they accounted for only 11 percent. Over that same period, the share of income going to the bottom 50 percent of taxpayers fell from 17 to 13 percent." In 2008 the top one percent made on average $1,137,684 per year while the bottom 90 percent made $31,244. Inflation adjusted median salaries for this group—the most productive workers in the world—have remained stagnant for 35 years.

European countries and post-war America bridged the income gap with progressive taxation. In 1945 U.S. top rates were 66 percent, dropping to 48 percent under Reagan, and then to 32 percent under Bush 43. Americans at all levels have not paid such low taxes since the Great Depression, but neither have they had such high budget deficits.

A standard measure of income equality is the Gini Scale, where 0 is the most equal and 100 is the least equal. The 27 members of the European Union have an average score of 31, but the U.S. figure has risen from 40 in 1967 to 47 in 2005. World-wide the most equal nation is Denmark at 25 versus 74 for Namibia, where most of the wealth is concentrated in a small white minority.

Writing for *The New Republic* (8/27/10) Rajan states: "Growing income inequality in the United States and the policy responses it has spawned have done tremendous damage to our economy." Rajan blames both Democrats and Republicans for making the same basic mistake. Presidents Clinton and Bush 43 pushed home ownership as the way for average Americans to increase their wealth. After buying their homes at subprime rates, these new owners joined millions of others in taking out equity loans (a whopping $5 trillion from 2001-2005) for new cars, boats, etc. Nearly 45 percent Americans with home equity loans now owe more on their houses than when they bought them.

While the bottom 60 percent of Americans had 65 percent of their net worth tied up in their homes in 2007, only 10 percent of the net worth of the top one percent was. As a sign of decreasing wealth for most Americans, home equity has dropped to 38 percent of home value, down from 61 percent in 2001. While consumption equality went up with easy credit, income inequality is now worse than ever. Instead of creating wealth, a free-wheeling financial industry and an enabling Bush administration were responsible for the loss of 10 million jobs and a loss of $10 trillion to the American economy.

Economist William Black, who oversaw the litigation of the Savings and Loan debacle of the late 1980s, estimates that there were 1 million financial fraud cases that the Bush Administration refused to prosecute. Instead, the Bush Justice Department transferred 500 white collar crime specialists to the War on Terror. The threat of terrorism pales in comparison to the possibility that American and European banks could have pushed us into a world-wide economic depression.

Some libertarians believe that income equality and inadequate social safety nets are actually an advantage. These conditions serve as incentives for people to work harder and improve their station in life. They will not just sit around living on welfare and unemployment benefits.

The facts, however, indicate something every different. There is simply no evidence that a strong safety net makes people lazy or causes social and health problems. Egalitarian countries score very high on all indicators of general well being. The exhaustive research in *The Spirit Level* demonstrates that these countries have less mental illness, longer life expectancy, lower infant mortality, higher educational achievement, fewer teen births and abortions, far fewer homicides, better child well being, lower rates of preventable deaths, and very low incarceration rates. For more see www.NickGier.com/SpiritLevel.pdf.

Social mobility in egalitarian countries is also much higher than unequal countries. While only 25 percent of Americans born in the lowest economic 20 percent move out of the bottom, a full 40 percent of Danes do. There are fewer and fewer Andrew Carnegies: only 7 percent of Americans now make it from the bottom to the top 20 percent. Libertarians say that inequality inspires poor kids to aspire to greatness, but without opportunities (most always created by government) they rarely make it.

Prof. Rajan believes that better education and job training are the keys to turning the economy around and putting more wealth in the hands of average Americans. People cannot advance themselves without educational and job training opportunities. Rajan praises the Europeans for their worker training and retention programs, but he does not appear willing to raise the revenues to fund them.

In the early 1990s a Social Democratic government in Denmark established an employee training program that has kept the unemployment rate steady at 3-4 percent for 20 years even through the Great Recession. A German program, also started by Social Democrats 10 years ago, retrains workers and pays businesses to keep workers on the job (sometimes at reduced hours). This program allowed Germany to increase employment during the down-turn of 2007-2008 and its economic growth has now exploded.

The Danish and German programs cost a lot of money: the Danes spend 20 times more per capita for job training than the U.S. does. U.S. investment in human capital at the state and national level is falling dramatically, so the job training and better education that we require to become more equal citizens will simply not happen.

Even before the Great Recession the number of American high school and post-secondary graduates was falling, and now 25-30 year-olds in 9 countries hold more college degrees than their American counterparts. Those Asian and European graduates will have better jobs and earn more money. American companies will be inclined either to hire them on visas outsource these good jobs to their own countries. The result will be even greater income inequality in the U.S.

Rajan observes that "inequality will likely also cause U.S. politics to become even more fractured and polarized than it already is, making it harder for our politicians to make the right kinds of legislative decisions." Even though most Americans would be proud if their children got into Harvard or Princeton, far too many reject as "elitist" or "leftist" the well-trained people who offer their expertise from these institutions of higher learning. The skepticism embodied in good science is a virtue but ignorant or self-serving denial is a vice.

Studies have shown that general distrust rises in populations of greatest income disparities. In 1960 60 percent of Americans agreed with the statement "most people can be trusted," but now only 38 percent do. Egalitarian Scandinavians and the Dutch are still just as trustful as more equal Americans were 50 years ago.

Conservatives are saying that Rajan has betrayed the Chicago school of free market economics, but he says that he is simply a pragmatist who is trying to "soften the rough edges of capitalism." Rajan's pragmatism sounds just like Social Democracy: "Markets don't work independently of regulatory support. We need to find a balance that works." The "social" market theory of conservative German chancellor Angela Merkel and other European countries is one that obviously works, while poorly regulated markets in Iceland and Ireland have crashed.

A typical profile of Third World countries is high infant mortality rates, high incarceration rates, low tax rates but high tax evasion (legal or otherwise), and high military expenditures. In a list of 136 countries compiled by the CIA, we find 38 unequal nations at the top. The U.S. stands between Jamaica (38th) and Cameron (40th), while Portugal is 70th and Sweden is at the bottom. This is a national disgrace and an international embarrassment. It also does not bode well for the U.S. in the 21st Century.

Nick Gier taught philosophy at the University of Idaho for 31 years.