Preface

The United States approached the precipice of the current economic crisis with the most unequal distribution of wealth since the eve of the Great Depression. This sorry fact forms the kernel for The Wealth Inequality Reader. The authors here analyze the issue of wealth inequality from the multiple points of view informed by sociology, economics, and social activism.

Most discussions of economic inequality focus on income, not wealth, for the simple reason that data on income are more readily available. But wealth has its own dynamic, and its distribution has unique causes and consequences. More than income, wealth both tells us about the past and foretells the future. A family’s wealth today reflects the asset-building opportunities open not only to this generation, but also to parents, grandparents, and great-grandparents. Likewise, parents use their wealth to position their children for future economic success in countless ways—moving into an excellent school district or giving an adult son or daughter money for a down payment on a house, for example—that are out of reach for those who may earn a middle-class income but have few assets.

Given the country’s severe wealth gap, proposals for asset-building as a solution to poverty have recently come into vogue (although the chief policy incarnation of this idea, a matched savings plan known as an Individual Development Account (IDA), has yet to become more than a minor pilot program). This approach is in line with the individualist ethos that dominates U.S. politics. This volume describes IDAs and a range of other policies that can help individuals accumulate assets. But more important, several of the authors here argue that the wealth gap cannot be addressed unless our commonwealth of shared public assets, which form the foundation of individual wealth, are expanded and more equitably distributed.

The Introduction documents the worsening landscape of wealth inequality. Here are just a few items:

- Between 2004 and 2007, the median net worth of the poorest 25% of U.S. households fell by 37%, while for the richest 10% of households, median net worth rose by 20%.

- The racial wealth divide persists: In 2007, the median net worth of families of color was $27,800, just 16% of the median white family net worth of $170,400.

- In just 15 years, from 1992 to 2007, the average net worth of the wealthiest 400 Americans more than tripled in real terms, from $937 million to $3.85 billion.

Although systematic data are scarce for many other parts of the world, the trend in the United States is clear: over the last 30 years wealth has become more and more concentrated. Recent fluctuations in the stock market have pushed the share of total wealth owned by the top 1% of U.S. households up and down at different times. But the sub-prime mortgage meltdown is putting the wealth of many average Americans—whose home is their single largest asset—at risk. There is every reason to believe that wealth concentration will continue to grow, given the current direction of so many of the political-economic vectors that shape wealth distribution.

Since the first edition of this book was published in 2004, the U.S. and global economy have gone from a boom that greatly benefited the few to a bust that has pushed billions of people to the breaking point. Section I looks at the forces that led us to this point. The authors not only
ask how we got here, but who benefited along the way, and who the losers are now. Although it will take some time to assess the full measure of the devastating impact this crisis has had on wealth inequality, the authors have begun to highlight the damage, and call for urgent actions to turn the crisis into an opportunity to level the playing field in favor of those currently on the bottom.

Why is the wealth gap in the United States widening now? Section II tackles the causes of growing wealth inequality. For nearly 30 years following World War II, both government and organized labor acted as counterweights to the power of corporations. Building on the legacy of the New Deal years, a range of government policies and a relatively stable business-labor compact moderated the excesses of the market, and as a result, a broad swath of Americans shared, at least to a degree, in the prosperity of the time.

But since the mid-1970s, determined efforts by conservatives and corporations have succeeded in dismantling parts of the New Deal legacy and crushing the labor movement. These efforts have both contributed to and benefited from the country's history of race and discrimination. Playing "the race card" has been a key piece of the GOP's strategy for enlisting low- and moderate-income white voters against their own economic interests; meanwhile, conservative economic policies worsen the racial wealth gap, an artifact of centuries of slavery and post-slavery discrimination. The consequences of the growing wealth gap are dissected in Section III. As we noted, people usually think about inequality in terms of income. But wealth inequality matters at least as much as, if not more than, income inequality. For one thing, incomes are volatile, subject to the domestic business cycle and deepening global competition. In contrast, assets like a home, land, or savings offer a more stable form of security and allow families to survive financial setbacks without seeing their standard of living permanently undermined. Ownership and control of assets may be particularly important to members of historically disadvantaged groups; for example, a study in India has shown that women who own land or a house in their own names are, other things equal, far less likely to be victims of domestic violence.

Furthermore, wealth inequality is self-reinforcing and worsens over time in the absence of proactive efforts at redistribution. Wealth allows parents to give their children a wide range of advantages that position them to build even greater wealth as adults. Extreme concentrations of wealth do not only hurt those far down the economic ladder. Concentrated wealth distorts democracy by giving a small elite both the motive and the means to buy the policies they want from contribution-hungry politicians. Concentrated wealth bites the hand that feeds it, too: evidence suggests that extreme inequality actually undermines economic growth. And concentrated wealth spawns a culture of excessive consumption that subverts all of the nonmaterial values people find difficult enough to sustain in a modern capitalist economy.

While the picture up to this point may seem dismal, we need only look back to find the cause for optimism. Throughout U.S. history, periods of excessive wealth polarization have been followed by mass movements for economic reform. The Gilded Age was followed by populism and progressivism; the 1929 crash was followed by poor people's movements and the New Deal. These movements for change succeeded, however unevenly, in getting working people and the middle class a larger piece of the ownership pie (although, to be clear, wealth has never been divided near equitably, even in the country's most egalitarian eras).

Likewise, today, a movement is beginning to grow to restructure the economy and reorient government policies so that wealth will be more widely shared. The plural—movements—might be more appropriate: countless activists, scholars, unions, and a few politicians and business leaders are engaging this issue from many angles. Section IV sketches out some of these potential solutions, from the nuts and bolts of specific asset-building programs to visionary proposals for institutionalizing an overall more equitable distribution of wealth—for example, by collecting rents and fees from private interests who use common assets like the sky and the airwaves, then paying those revenues out to all.
For those who believe that human beings can vary so widely in merit—however merit is defined—that one may deserve to possess billions of dollars and a surfeit of mansions and jets while another deserves to sleep on a sewer grate, the authors here will have little to say. But for anyone who is convinced that inherent in any definition of a healthy and just society are some limits to the unequal distribution of wealth, this volume provides a roadmap through—and, we hope, beyond—the current political economy of wealth inequality.

Not since the Gilded Age has this country seen such a yawning gap between the very rich and those with little wealth. Global wealth disparities are even larger. The following pages capture this polarization with facts and figures on the distribution of wealth in the United States and, to the extent possible, worldwide.

The Wealth Pie

The wealthiest 1% of households owns more than a third of the nation's household wealth. The next tier, those in the 95th through 98th percentiles, claims another 27%. While the top 5% holds well over half of the wealth pie, the bottom three-fifths make do with the crumbs—holding a meager 4.2% of total net worth.

What is Wealth?

A family's wealth, or net worth, is defined as the sum of its assets minus its debts. In other words, wealth is "what you own" minus "what you owe." Assets are all resources that a household holds in store—the bank of reserves a family has available to invest in its members and their futures. Many assets grow in value and generate income. Just as important, asset wealth provides a cushion, protecting families from the vicissitudes of the business cycle, as wealth assets may be drawn down during periods of crisis (a job loss, for example). Financial assets include savings, bonds, certificates of deposit, stocks, mutual fund investments, retirement pensions, and the like. Nonfinancial assets may include homes, other real estate, vehicles, ownership in a privately held business, and all sorts of other property—from rare baseball card collections to jewelry or hobby equipment. Debts are liabilities—credit card balances, mortgages, and other loans—that are owed.

One way to think about wealth, as distinct from income, is to picture it as a pool of resources—much like a pond. Income, by contrast, is more like a river. Most adults receive an income stream of paychecks, entitlement payments like Social Security, child support, or pensions that pays for housing, health care, food, clothing, consumer goods, and miscellaneous expenses. If any trickle of income remains, it is set aside as savings—becoming wealth. People with large "ponds" of wealth typically receive streams of income in the form of interest, dividends, or rent from those assets. The very wealthy have "lakes" of assets that spring substantial rivers of income.

Looking at information about wealth can tell us a lot about people's lives, and it can tell us things that income statistics fail to reveal. The bottom quartile of U.S. families has a mean net worth of negative $2,300—an average family in the bottom quartile carries a debt burden greater than all of its assets combined. From this, we can surmise that such a family most likely does not own a home, or if they do, all of its value has been mortgaged or its market value has declined. If such a family owns any asset, it is probably a car that they had to borrow money to purchase. By contrast, a family in the second or third wealth quartile is likely to own a home as its largest asset. Families in the top quartile probably own not just one or more homes, but also stocks and other financial assets.

While private wealth is an important source of security in our society, social wealth can reduce the need for substantial individual wealth. For instance, an adequate social safety net that includes income support and health care would reduce the need for individual savings to ensure basic economic security.

Different researchers use slightly different definitions of wealth. For example, some exclude those retirement pensions that an individual cannot currently access, while others include the estimated present value of pensions. And some scholars consider automobiles a form of wealth, whereas others exclude the value of automobiles from their calculations.

Data on wealth is far scarcer than data on income. The primary source of information on private wealth in the United States is the Federal Reserve's triennial Survey of Consumer Finances, which collects household-level data on assets, liabilities, income, use of financial services, and other household financial behavior.

The Super Rich

Over a 30-year period beginning in 1970, the richest 1% (as ranked by income) accrued a mounting share of the nation's private wealth. Throughout the 1990s, the top percent-tile held a larger concentration of total household wealth than at any time since the 1920s. Its wealth share declined somewhat during the 2001 recession, thanks to falling corporate share prices, but then resumed its climb, reaching 34.6% in 2007 (since 2007 the fall-off in stock prices have no doubt pushed the figure down somewhat).
The past two decades have been kind to the super-rich. From 1992 to 2007, the average wealth held by the nation's wealthiest 400 people more than quadrupled, rising from $937 million to a whopping $3.85 billion in inflation-adjusted dollars. Within the top 400, the highest ranked saw the largest gains.

### THE WEALTHIEST 400 PEOPLE IN THE UNITED STATES

Wealth by Rank and Average Wealth (in millions of 2004 dollars), 1992-2007

<table>
<thead>
<tr>
<th>Year</th>
<th>1st</th>
<th>10th</th>
<th>50th</th>
<th>100th</th>
<th>400th</th>
<th>Avg.</th>
<th>Num of</th>
</tr>
</thead>
<tbody>
<tr>
<td>992</td>
<td>73.4</td>
<td>44.7</td>
<td>3,631</td>
<td>2,178</td>
<td>809</td>
<td>7,148</td>
<td>2</td>
</tr>
<tr>
<td>1995</td>
<td>33.3</td>
<td>22.8</td>
<td>2,178</td>
<td>1,346</td>
<td>518</td>
<td>3,631</td>
<td>7</td>
</tr>
<tr>
<td>1999</td>
<td>27.2</td>
<td>21.8</td>
<td>2,178</td>
<td>1,346</td>
<td>518</td>
<td>3,631</td>
<td>7</td>
</tr>
<tr>
<td>2000</td>
<td>29.7</td>
<td>21.8</td>
<td>2,178</td>
<td>1,346</td>
<td>518</td>
<td>3,631</td>
<td>7</td>
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<td>1,346</td>
<td>518</td>
<td>3,631</td>
<td>7</td>
</tr>
<tr>
<td>2002</td>
<td>36.5</td>
<td>21.8</td>
<td>2,178</td>
<td>1,346</td>
<td>518</td>
<td>3,631</td>
<td>7</td>
</tr>
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<td>3,631</td>
<td>7</td>
</tr>
<tr>
<td>2007</td>
<td>38.5</td>
<td>21.8</td>
<td>2,178</td>
<td>1,346</td>
<td>518</td>
<td>3,631</td>
<td>7</td>
</tr>
</tbody>
</table>


Source: Calculated from Forbes 400.
HOUSEHOLDS WITH NET WORTH EQUAL TO OR EXCEEDING $10 MILLION

The number of households with $10 million or more (in constant 1995 dollars) has grown nearly sevenfold since 1983, from 66,500 to 464,200.

The Wealthless

The 1990s were supposed to be economic good times, and the brief 2001 recession was followed by six full years of economic expansion. Yet the share of Americans with no wealth at all was larger in 2007 than it had been in 1989, and the poorest quarter of U.S. households saw a 36.8% drop in median net worth between 2004 and 2007. Moreover, data from 2007 are too early to reflect much of the fall in housing prices and other asset values in the current crisis. Federal Reserve Board economists estimate the median net worth of all U.S. households to be nearly 18% lower today, in 2009, than it was in 2007.

HOUSEHOLDS WITH LITTLE OR NO NET WORTH, 1983-2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage of Households with Zero or Negative Net Worth</th>
<th>Percentage of Households with Net Worth Less Than $5,000*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>15.5%</td>
<td>25.4%</td>
</tr>
<tr>
<td>1989</td>
<td>17.9%</td>
<td>27.6%</td>
</tr>
<tr>
<td>1992</td>
<td>18.0%</td>
<td>27.2%</td>
</tr>
<tr>
<td>1995</td>
<td>18.5%</td>
<td>27.8%</td>
</tr>
<tr>
<td>1998</td>
<td>18.0%</td>
<td>27.2%</td>
</tr>
<tr>
<td>2001</td>
<td>17.6%</td>
<td>26.6%</td>
</tr>
<tr>
<td>2004</td>
<td>17.0%</td>
<td>26.8%</td>
</tr>
<tr>
<td>2007</td>
<td>18.6%</td>
<td>26.6%</td>
</tr>
</tbody>
</table>

* Constant 1995 Dollars
In the United States, a pretty sure way to secure a high income is to be born to parents with high incomes. Only 7.3% of children born to parents with incomes in the top 20% grow up to have incomes in the bottom 20%. Likewise, just 6.3% of children with parents in the bottom income quintile earn incomes in the top 20% as adults. So much for the myth of meritocracy.

If anything, these figures actually overstate the degree of income mobility in the United States. This is because it takes much larger increases in income to enter the top quintile from the others than it takes to move up one, two, or even three quintiles from the bottom. In 2006, for example, the mean household income of the lowest quintile was $11,352 (2006 dollars), compared to $28,777 for the second quintile (a difference of $17,425). By contrast, the mean household income of the top quintile was $111,536, compared to $58,163 for the next highest quintile (a difference of $53,373—a much larger distance to travel). Although a large percentage of children born to parents in the bottom 20% move up a few quintiles as adults, their mobility is less striking than the lack of mobility into the top quintile.

Figures on mobility by wealth don't exist, but if they did, they'd probably paint an even bleaker picture.
### Table: Child's Income Quintile as Adult

<table>
<thead>
<tr>
<th>Parents' Income</th>
<th>Top 20%</th>
<th>Middle</th>
<th>Bottom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 20%</td>
<td>37.3%</td>
<td>18.4%</td>
<td>7.3%</td>
</tr>
<tr>
<td>Middle 20%</td>
<td>17.3%</td>
<td>25.0%</td>
<td>15.3%</td>
</tr>
<tr>
<td>Bottom 20%</td>
<td>6.3%</td>
<td>16.5%</td>
<td>42.3%</td>
</tr>
</tbody>
</table>

**Chance of Child Attaining Income Level As Adult, by Parental Income**


Note: These figures are based on total family income for black and white participants in the Panel Study of Income Dynamics who were born between 1942 and 1972, observed as children in their households of origin, and later as adults (26 or older) in their own households.

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**The Owning Class**

While upwards of 90% of people in the United States make their living by working for a wage or salary, a small number gain their incomes from the ownership of property. These large-scale property owners may have jobs (usually, high-paying ones), but they do not have to work for a living. They own businesses, which yield profits; stocks, which yield dividends; real estate, which yields rent; and money, which yields interest. Unlike the houses and cars that are most Americans’ primary assets, these forms of wealth typically yield income and, when their value increases, capital gains as well. They also give their owners, in varying ways and degrees, some control over the nation’s economy.

Some of the 90% also own these kinds of property: a triple-decker or a small stock portfolio, perhaps. But ownership of income-accumulating property is even more highly concentrated than ownership of wealth overall. The income from such property is considerable—nearly $3 trillion in the United States in 2003, or over one-quarter of gross national income (even by the most conservative estimate). This is the tribute the owning class extracts each year from society’s total production.

Profits and other private property income have ranged between one-fourth and one-third of U.S. national income over the last 45 years. This variation may not seem like much, but when the private-property share of national income declined sharply in the mid-1960s, as a result of high employment and rising worker militancy, U.S. capitalism went into crisis. The “recovery” beginning in the early 1980s coincided with property ownership garnering an increasing share of national income, as attacks on unions and social welfare programs eroded workers’ bargaining power. In short, capitalism “functions” as long as the owning class can take a satisfactory cut of the national income.

**The Stock Ownership Pie**

If the distribution of wealth overall in the United States is very skewed, the distribution of financial assets such as stocks and bonds is far more so. A home is the single largest asset for most American families who have any wealth at all; most other kinds of assets are heavily concentrated in the hands of the wealthiest few percent of families. The chart shows the distribution of the nation’s publicly traded stock that is directly held—in other words, outside of a managed account such as a mutual fund. The richest 1% of families owns over half of all directly held stock; the bottom 50% owns one-half of one percent. Assets not directly held, such
as those in IRAs, are more equally distributed—but only among the wealthier half of the population. The bottom 50% owns almost none of those assets either: only 0.7% of the value of mutual funds and 3.4% of the value of retirement accounts such as 401(k)s.

**PRIVATE PROPERTY INCOME (PROFITS, INTEREST, RENT, ETC., BEFORE TAXES) AS A PERCENTAGE OF NATIONAL INCOME, 1959-2006**

![Graph of Private Property Income as a Percentage of National Income](chart)

*Source: U.S. Dept. of Commerce, Bureau of Economic Analysis, National Income and Product Accounts, Table 1.10 Gross Domestic Income by Type of Income. Percentages equal "Net operating surplus, private enterprises" divided by the sum of itself and "Compensation of employees, paid."

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**The Racial Wealth Gap**

The United States has a racial wealth gap that far exceeds its racial income gap. This wealth gap persists even during periods of economic growth. In the 1990s boom, the median wealth of families of color (nonwhite and Latino) actually fell, although this drop was reversed in the 2000s. This intransigent wealth gap is the product of a long history of discrimination in the United States, and is perpetuated by family inheritance patterns that pass accumulated advantages and disadvantages from one generation to the next. The median net worth of families of color is just a fraction of white families'. The racial wealth gap is far larger than the racial gap in income and, as the table below shows, the wealth gap between families of color and white families has grown wider over the past decade even as the income gap has narrowed somewhat.

Racial disparities are found across all categories of asset ownership. For nearly every kind of asset, whether financial or nonfinancial, white families are more likely to own the asset in any amount and have larger holdings in the asset, as the following table shows.
### WEALTH VS. INCOME BY RACE, 1998-2007

(Thousands of 2007 dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Median Net Worth</th>
<th>Median Income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Families of color</td>
<td>White families</td>
</tr>
<tr>
<td>1998</td>
<td>21.2</td>
<td>121.9</td>
</tr>
<tr>
<td>2001</td>
<td>21.0</td>
<td>143.0</td>
</tr>
<tr>
<td>2004</td>
<td>27.2</td>
<td>154.5</td>
</tr>
<tr>
<td>2007</td>
<td>27.8</td>
<td>170.4</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>5.75 to 1</td>
</tr>
<tr>
<td>2001</td>
<td>6.81 to 1</td>
</tr>
<tr>
<td>2004</td>
<td>5.68 to 1</td>
</tr>
<tr>
<td>2007</td>
<td>6.13 to 1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Median Net Worth</th>
<th>Median Income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Families of color</td>
<td>White families</td>
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<tr>
<td>1998</td>
<td>29.7</td>
<td>48.6</td>
</tr>
<tr>
<td>2001</td>
<td>30.1</td>
<td>52.9</td>
</tr>
<tr>
<td>2004</td>
<td>32.7</td>
<td>54.3</td>
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<td>2007</td>
<td>36.8</td>
<td>51.8</td>
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<table>
<thead>
<tr>
<th>Year</th>
<th>Ratio</th>
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</thead>
<tbody>
<tr>
<td>1998</td>
<td>1.64 to 1</td>
</tr>
<tr>
<td>2001</td>
<td>1.76 to 1</td>
</tr>
<tr>
<td>2004</td>
<td>1.66 to 1</td>
</tr>
<tr>
<td>2007</td>
<td>1.41 to 1</td>
</tr>
</tbody>
</table>


### FAMILY HOLDINGS OF SELECTED ASSETS BY RACE, 2007

<table>
<thead>
<tr>
<th>Percent of families holding asset</th>
<th>Certificates of deposit</th>
<th>Savings bonds</th>
<th>Stocks</th>
<th>Pooled investment funds</th>
<th>Retirement accounts</th>
<th>Primary residence</th>
<th>Privately-held businesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Families of color</td>
<td>8.2</td>
<td>7.8</td>
<td>9.4</td>
<td>5.8</td>
<td>38.1</td>
<td>51.9</td>
<td>7.4</td>
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<tr>
<td>White families</td>
<td>19.4</td>
<td>17.3</td>
<td>21.4</td>
<td>13.7</td>
<td>58.2</td>
<td>7.5</td>
<td>13.9</td>
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</table>

<table>
<thead>
<tr>
<th>Median value of holdings for families holding asset (thousands of 2007 dollars)</th>
<th>Families of color</th>
<th>White families</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>10.0</td>
<td>20.0</td>
</tr>
<tr>
<td>2001</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>2004</td>
<td>8.0</td>
<td>19.0</td>
</tr>
<tr>
<td>2007</td>
<td>30.0</td>
<td>64.0</td>
</tr>
<tr>
<td>2008</td>
<td>25.4</td>
<td>52.7</td>
</tr>
<tr>
<td>2009</td>
<td>180.0</td>
<td>200.0</td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td>112.5</td>
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</tbody>
</table>

Women’s Wealth
Women and Wealth in the United States

Women own less wealth than men, but the gender wealth gap may be shrinking. So suggest the most recent data on wealth ownership in the United States. Virtually all data on asset ownership is by household and does not distinguish among people living in the household. So, the only gender comparison that typically can be made is between single women and single men.

Data from the 2001 Survey of Consumer Finances show a dramatic gap between the net worth of households headed by single females and those headed by single males: the median net worth of the latter is 69% higher. Data on young baby boomers —those born between 1957 and 1964—from the National Longitudinal Survey of Youth, however, show a much smaller gap between these two groups; this snapshot of the young boomers does suggest a promising trend.

Median Net Worth and Financial Assets of All Households (2001)

World Wide Wealth

Data on wealth ownership and its distribution are scarce compared to data on income. This is particularly true on an international scale: only a handful of countries systematically collect information on individual or household wealth holdings. In the absence of such data, two World Bank economists have estimated the per capita wealth in different world regions using national-level data. They derive total wealth by adding the monetary values of a nation's natural resources (for example, oil, timber, and cropland), its produced assets (for example, goods and factories), and its "human resources" (the wealth inhering in people's projected lifetime productivity, computed as a function of GNP with some adjustments). The authors acknowledge that these are rough, preliminary estimates.

Poor countries tend to have lower per-capita natural resource wealth than rich countries. But it's notable that the natural resource gap is much smaller than the gap in the other components of wealth (the Middle East excepted). This suggests that a country's natural endowments are less important than how it deploys them and how the international rules governing trade and financial transactions shape its economy.
## GLOBAL WEALTH DISTRIBUTION (2000)

<table>
<thead>
<tr>
<th>Region</th>
<th>Population Share</th>
<th>Wealth Per Adult</th>
<th>Wealth Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America: Canada and U.S. only</td>
<td>6.1%</td>
<td>$190,653</td>
<td>34.3%</td>
</tr>
<tr>
<td>Latin America &amp;</td>
<td>8.2%</td>
<td>$18,163</td>
<td>4.4%</td>
</tr>
<tr>
<td>Europe</td>
<td>14.9%</td>
<td>$67,232</td>
<td>29.5%</td>
</tr>
<tr>
<td>Asia: China</td>
<td>22.8%</td>
<td>$3,885</td>
<td>2.6%</td>
</tr>
<tr>
<td>Asia: India</td>
<td>15.4%</td>
<td>$1,989</td>
<td>0.9%</td>
</tr>
<tr>
<td>Asia: High Income</td>
<td>4.5%</td>
<td>$172,414</td>
<td>22.9%</td>
</tr>
<tr>
<td>Asia: Other</td>
<td>18.0%</td>
<td>$5,952</td>
<td>4.3%</td>
</tr>
<tr>
<td>Africa</td>
<td>10.2%</td>
<td>$3,558</td>
<td>1.1%</td>
</tr>
</tbody>
</table>


Note: "Asia: High Income "includes Australia, Japan, New Zealand, South Korea, and Taiwan.
MacEwan, A. (March / April 2009). Inequality, power, and ideology: Getting it right about the causes of the current economic crisis. Dollars and Sense.

It is hard to solve a problem without an understanding of what caused it. For example, in medicine, until we gained an understanding of the way bacteria and viruses cause various infectious diseases, it was virtually impossible to develop effective cures. Of course, dealing with many diseases is complicated by the fact that germs, genes, diet and the environment establish a nexus of causes.

The same is true in economics. Without an understanding of the causes of the current crisis, we are unlikely to develop a solution; certainly we are not going to get a solution that has a lasting impact. And determining the causes is complicated because several intertwined factors have been involved.

The current economic crisis was brought about by a nexus of factors that involved: a growing concentration of political and social power in the hands of the wealthy; the ascendance of a perverse leave-it-to-the-market ideology which was an instrument of that power; and rising income inequality, which both resulted from and enhanced that power. These various factors formed a vicious circle, reinforcing one another and together shaping the economic conditions that led us to the present situation. Several other factors were also involved—the growing role of credit, the puffing up of the housing bubble, and the increasing deregulation of financial markets have been very important. However, these are best understood as transmitters of our economic problems, arising from the nexus that formed the vicious circle.

What does this tell us about a solution? Economic stimulus, repair of the housing market, and new regulation are all well and good, but they do not deal with the underlying causes of the crisis. Instead, progressive groups need to work to shift each of the factors I have noted—power, ideology, and income distribution—in the other direction. In doing so, we can create a virtuous circle, with each change reinforcing the other changes. If successful, we not only establish a more stable economy, but we lay the foundation for a more democratic, equitable, and sustainable economic order. A crisis by its very nature creates opportunities for change. One good place to begin change and intervene in this "circle"—and transform it from vicious to virtuous—is through pushing for the expansion and reform of social programs, programs that directly serve social needs of the great majority of the population (for example: single-payer health care, education programs, and environmental protection and repair). By establishing changes in social programs, we will have impacts on income distribution and ideology, and, perhaps most important, we set in motion a power shift that improves our position for preserving the changes. While I emphasize social programs as a means to initiate social and economic change, there are other ways to intervene in the circle. Efforts to re-strengthen unions would be especially important; and there are other options as well.

**CAUSES OF THE CRISIS: A LONG TIME COMING**

Sometime around the early 1970s, there were some dramatic changes in the U.S. economy. The twenty-five years following World War II had been an era of relatively stable economic growth; the benefits of growth had been widely shared, with wages rising along with productivity gains, and income distribution became slightly less unequal (a good deal less unequal as compared to the pre-Great Depression era). There were severe economic problems in the United States, not the least of which were the continued exclusion of African Americans, large gender inequalities, and the woeful inadequacy of social welfare programs. Nonetheless, relatively stable growth, rising wages, and then the advent of the civil rights movement and the War on Poverty gave some important, positive social and economic character to the era—
especially in hindsight! In part, this comparatively favorable experience for the United States had depended on the very dominant position that U.S. firms held in the world economy, a position in which they were relatively unchallenged by international competition. The firms and their owners were not the only beneficiaries of this situation. With less competitive pressure on them from foreign companies, many U.S. firms accepted unionization and did not find it worthwhile to focus on keeping wages down and obstructing the implementation of social supports for the low-income population. Also, having had the recent experience of the Great Depression, many wealthy people and business executives were probably not so averse to a substantial role for government in regulating the economy.

**A Power Grab**

By about 1970, the situation was changing. Firms in Europe and Japan had long recovered from World War II, OPEC was taking shape, and weaknesses were emerging in the U.S. economy. The weaknesses were in part a consequence of heavy spending for the Vietnam War combined with the government's reluctance to tax for the war because of its unpopularity. The pressures on U.S. firms arising from these changes had two sets of consequences: slower growth and greater instability; and concerted efforts—a power grab, if you will—by firms and the wealthy to shift the costs of economic deterioration onto U.S. workers and the low-income population.

These "concerted efforts" took many forms: greater resistance to unions and unionization, battles to reduce taxes, stronger opposition to social welfare programs, and, above all, a push to reduce or eliminate government regulation of economic activity through a powerful political campaign to gain control of the various branches and levels of government. The 1980s, with Reagan and Bush Sr. in the White House, were the years in which all these efforts were solidified. Unions were greatly weakened, a phenomenon both demonstrated and exacerbated by Reagan's firing of the air traffic controllers in response to their strike in 1981. The tax cuts of the period were also important markers of the change. But the change had begun earlier; the 1978 passage of the tax-cutting Proposition 13 in California was perhaps the first major success of the movement. And the changes continued well after the 1980s, with welfare reform and deregulation of finance during the Clinton era, to say nothing of the tax cuts and other actions during Bush Jr.

**Ideology Shift**

The changes that began in the 1970s, however, were not simply these sorts of concrete alterations in the structure of power affecting the economy and, especially, government's role in the economy. There was a major shift in ideology, the dominant set of ideas that organize an understanding of our social relations and both guide and rationalize policy decisions.

Following the Great Depression and World War II, there was a wide acceptance of the idea that government had a major role to play in economic life. Less than in many other countries but nonetheless to a substantial degree, at all levels of society, it was generally believed that there should be a substantial government safety net and that government should both regulate the economy in various ways and, through fiscal as well as monetary policy, should maintain aggregate demand. This large economic role for government came to be called Keynesianism, after the British economist John Maynard Keynes, who had set out the arguments for an active fiscal policy in time of economic weakness. In the early 1970s, as economic troubles developed, even Richard Nixon declared: "We are all Keynesians now."

The election of Ronald Reagan, however, marked a sharp change in ideology, at least at the top. Actions of the government were blamed for all economic ills: government spending, Keynesianism, was alleged to be the cause of the inflation of the 1970s; government regulation
was supposedly crippling industry; high taxes were, it was argued, undermining incentives for workers to work and for businesses to invest; social welfare spending was blamed for making people dependent on the government and was charged with fraud and corruption (the "welfare queens"); and so on and so on.

On economic matters, Reagan championed supply-side economics, the principal idea of which was that tax cuts yield an increase in government revenue because the cuts lead to more rapid economic growth through encouraging more work and more investment. Thus, so the argument went, tax cuts would reduce the government deficit. Reagan, with the cooperation of Democrats, got the tax cuts—and, as the loss of revenue combined with a large increase in military spending, the federal budget deficit grew by leaps and bounds, almost doubling as a share of GDP over the course of the 1980s. It was all summed up in the idea of keeping the government out of the economy; let the free market work its magic.

Growing Inequality

The shifts of power and ideology were very much bound up with a major redistribution upwards of income and wealth. The weakening of unions, the increasing access of firms to low-wage foreign (and immigrant) labor, the refusal of government to maintain the buying power of the minimum wage, favorable tax treatment of the wealthy and their corporations, deregulation in a wide range of industries and lack of enforcement of existing regulation (e.g., the authorities turning a blind eye to off-shore tax shelters) all contributed to these shifts.

Many economists, however, explain the rising income inequality as a result of technological change that favored more highly skilled workers; and changing technology has probably been a factor. Yet the most dramatic aspect of the rising inequality has been the rapidly rising share of income obtained by those at the very top (see figures below), who get their incomes from the ownership and control of business, not from their skilled labor. For these people the role of new technologies was most important through its impact on providing more options (e.g., international options) for the managers of firms, more thorough means to control labor, and more effective ways—in the absence of regulation—to manipulate finance. All of these gains that might be associated with new technology were also gains brought by the way the government handled, or didn't handle (failed to regulate), economic affairs.

ALAN GREENSPAN, SYMBOL OF AN ERA

One significant symbol of the full rise of the conservative ideology that became so dominant in the latter part of the 20th century was Alan Greenspan, who served from 1974 through 1976 as chairman of the President's Council of Economic Advisers under Gerald Ford and in 1987 became chairman of the Federal Reserve Board, a position he held until 2006. While his predecessors had hardly been critics of U.S. capitalism, Greenspan was a close associate of the philosopher Ayn Rand and an adherent of her extreme ideas supporting individualism and *laissez-faire* (keep-the-government-out) capitalism.

When chairman of the Fed, Greenspan was widely credited with maintaining an era of stable economic growth. As things fell apart in 2008, however, Greenspan was seen as having a large share of responsibility for the non-regulation and excessively easy credit (see article) that led into the crisis.

Called before Congress in October of 2008, Greenspan was chastised by Rep. Henry Waxman (D-Calif), who asked him: "Do you feel that your ideology pushed you to make decisions that you wish you had not made?" To which Greenspan replied: "Yes, I've found a flaw. I don't know how significant or permanent it is. But I've been very distressed by that fact."
And Greenspan told Congress: "Those of us who have looked to the self-interest of lending institutions to protect shareholders' equity, myself included, are in a state of shocked disbelief."

Greenspan's "shock" was reminiscent of the scene in the film "Casablanca," where Captain Renault (Claude Rains) declares: "I'm shocked, shocked to find that gambling is going on in here!" At which point, a croupier hands Renault a pile of money and says, "Your winnings, sir." Renault replies, sotto voce, "Thank you very much."

PERCENTAGE CHANGE IN REAL FAMILY INCOME BY QUINTILE AND TOP 5%, 1949-1979

Several sets of data demonstrate the sharp changes in the distribution of income that have taken place in the last several decades. Most striking is the changing position of the very highest income segment of the population. In the mid-1920s, the share of all pre-tax income going to the top 1% of households peaked at 23.9%. This elite group's share of income fell dramatically during the Great Depression and World War II to about 12% at the end of the war and then slowly fell further during the next thirty years, reaching a low of 8.9% in the mid-1970s. Since then, the top 1% has regained its exalted position of the earlier era, with 21.8% of income in 2005. Since 1993, more than one-half of all income gains have accrued to this highest 1% of the population.

Figures 1 and 2 show the gains (or losses) of various groups in the 1947 to 1979 period and in the 1979 to 2005 period. The difference is dramatic. For example, in the earlier era, the bottom 20% saw its income in real (inflation-adjusted) terms rise by 116%, and real income of the top 5% grew by only 86%. But in the latter era, the bottom 20% saw a 1% decline in its income, while the top 5% obtained a 81% increase.

THE EMERGENCE OF CRISIS

These changes, especially these dramatic shifts in the distribution of income, set the stage for the increasingly large reliance on credit, especially consumer and mortgage credit, that played a major role in the emergence of the current economic crisis. Other factors were involved, but rising inequality was especially important in effecting the increase in both the demand and supply of credit.

PERCENTAGE CHANGE IN REAL FAMILY INCOME BY QUINTILE AND TOP 5%, 1979-2005

<table>
<thead>
<tr>
<th>Quintile</th>
<th>1979-2005 Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bottom 20% Less than $24,616</td>
<td>-1%</td>
</tr>
<tr>
<td>Second 20% $24,616-$45,021</td>
<td>9%</td>
</tr>
<tr>
<td>Middle 20% $45,021-$68,304</td>
<td>15%</td>
</tr>
<tr>
<td>Fourth 20% $68,304-$103,100</td>
<td>25%</td>
</tr>
<tr>
<td>Top 20% $103,100 and up</td>
<td>53%</td>
</tr>
<tr>
<td>Top 5% $184,500 and up</td>
<td>81%</td>
</tr>
</tbody>
</table>

Source: U.S. Census Bureau, Historical Income Tables, Table F-3.

Credit Expansion

On the demand side, rising inequality translated into a growing gap between the of most members of society and their needs. For the 2000 to 2007 period, average weekly earnings in the private sector were 12% below their average for the 1970s (in inflation-adjusted terms). From 1980 to 2005 the share of income going to the bottom 60% of families fell from 35% to 29%. Under these circumstances, more and more people relied more and more heavily on credit to meet their needs—everything from food to fuel, from education to entertainment, and especially housing.
While the increasing reliance of consumers on credit has been going on for a long time, it has been especially marked in recent decades. Consumer debt as a share of after-tax personal income averaged 20% in the 1990s, and then jumped up to an average of 25% in the first seven years of the new millennium. But the debt expansion was most marked in housing, where mortgage debt as a percent of after-tax personal income rose from 89% to 94% over the 1990s, and then ballooned to 140% by 2006 as housing prices skyrocketed.

On the supply side, especially in the last few years, the government seems to have relied on making credit readily available as a means to bolster aggregate demand and maintain at least a modicum of economic growth. During the 1990s, the federal funds interest rate averaged 5.1%, but fell to an average of 3.4% in the 2000 to 2007 period—and averaged only 1.4% in 2002 to 2004 period. (The federal funds interest rate is the rate that banks charge one another for overnight loans and is a rate directly affected by the Federal Reserve.) Corresponding to the low interest rates, the money supply grew twice as fast in the new millennium as it had in the 1990s.

The increasing reliance of U.S. consumers on credit has often been presented as a moral weakness, as an infatuation with consumerism, and as a failure to look beyond the present. Whatever moral judgments one may make, however, the expansion of the credit economy has been a response to real economic forces—inequality and government policies, in particular.

The Failure to Regulate

The credit expansion by itself, however, did not precipitate the current crisis. Deregulation—or, more generally, the failure to regulate—is also an important part of the story. The government's role in regulation of financial markets has been a central feature in the development of this crisis, but the situation in financial markets has been part of a more general process—affecting airlines and trucking, telecommunications, food processing, broadcasting, and of course international trade and investment. The process has been driven by a combination of power (of large firms and wealthy individuals) and ideology (leave it to the market, get the government out).

The failure to regulate financial markets that transformed the credit expansion into a financial crisis shows up well in three examples:

The 1999 repeal of the Glass-Steagall Act. Glass-Steagall had been enacted in the midst of the Great Depression, as a response to the financial implosion following the stock market crash of 1929. Among other things, it required that different kinds of financial firms—commercial banks, investment banks, insurance companies—be separate. This separation both limited the spread of financial problems and reduced conflicts of interest that could arise were the different functions of these firms combined into a single firm. As perhaps the most important legislation regulating the financial sector, the repeal of Glass-Steagall was not only a substantive change but was an important symbol of the whole process of deregulation.

The failure to regulate mortgage lending. Existing laws and regulations require lending institutions to follow prudent practices in making loans, assuring that borrowers have the capacity to be able to pay back the loans. And of course fraud—lying about the provisions of loans—is prohibited. Yet in an atmosphere where regulation was "out," regulators were simply not doing their jobs. The consequences are illustrated in a December 28, 2008, New York Times story on the failed Washington Mutual Bank. The article describes a supervisor at a mortgage processing center as having been "accustomed to seeing babysitters claiming salaries worthy of college presidents, and schoolteachers with incomes rivaling stockbrokers'. He rarely questioned them. A real estate frenzy was under way and WaMu, as his bank was known, was all about saying yes."
One may wonder why banks—or other lending institutions, mortgage firms, in particular—would make loans to people who were unlikely to be able to pay them back. The reason is that the lending institutions quickly combined such loans into packages (i.e., a security made up of several borrowers' obligations to pay) and sold them to other investors in a practice called "securitization."

**Credit-default swaps.** Perhaps the most egregious failure to regulate in recent years has been the emergence of credit-default swaps, which are connected to securitization. Because they were made up of obligations by a diverse set of borrowers, the packages of loans were supposedly low-risk investments. Yet those who purchased them still sought insurance against default. Insurance sellers, however, are regulated—required, for example, to keep a certain amount of capital on hand to cover possible claims. So the sellers of these insurance policies on packages of loans called the policies "credit-default swaps" and thus were allowed to avoid regulation. Further, these credit-default swaps, these insurance policies, themselves were bought and sold again and again in unregulated markets in a continuing process of speculation. The credit-default swaps are a form of derivative, a financial asset the value of which is derived from some other asset—in this case the value of packages of mortgages on which they were the insurance policies. When the housing bubble began to collapse and people started to default on their mortgages, the value of credit-default swaps plummeted and their future value was impossible to determine. No one would buy them, and several banks that had speculated in these derivatives were left holding huge amounts of these "toxic assets."

**Bubble and Bust**

The combination of easy credit and the failure to regulate together fueled the housing bubble. People could buy expensive houses but make relatively low monthly payments. Without effective regulation of mortgage lending, they could get the loans even when they were unlikely to be able to make payments over the long run. Moreover, as these pressures pushed up housing prices, many people bought houses simply to resell them quickly at a higher price, in a process called "flipping." And such speculation pushed the prices up further. Between 2000 and 2006, housing prices rose by 90% (as consumer prices generally rose by only 17%).

While the housing boom was in full swing, both successful housing speculators and lots of people involved in the shenanigans of credit markets made a lot of money. However, as the housing bubble burst—as all bubbles do—things fell apart. The packages of loans lost value, and the insurance policies on them, the credit-default swaps, lost value. These then became "toxic" assets for those who held them, assets not only with reduced value but with unknown value. Not only did large financial firms—for example, Lehman Brothers and AIG—have billions of dollars in losses, but no one knew the worth of their remaining assets. The assets were called "toxic" because they poisoned the operations of the financial system. Under these circumstances, financial institutions stopped lending to one another—that is, the credit markets "froze up." The financial crisis was here.

The financial crisis, not surprisingly, very quickly shifted to a general economic crisis. Firms in the "real" economy rely heavily on a well-functioning financial system to supply them with the funds they need for their regular operations—loans to car buyers, loans to finance inventory, loans for construction of new facilities, loans for new equipment, and, of course, mortgage loans. Without those loans (or with the loans much more difficult to obtain), there has been a general cut-back in economic activity, what is becoming a serious and probably prolonged recession.
WHAT IS TO BE DONE?

So here we are. The shifts in power, ideology, and income distribution have placed us in a rather nasty situation. There are some steps that will be taken that have a reasonable probability of yielding short-run improvement. In particular, a large increase in government spending—deficit spending—will probably reduce the depth and shorten the length of the recession. And the actions of the Federal Reserve and Treasury to inject funds into the financial system are likely, along with the deficit spending, to "un-freeze" credit markets (the mismanagement and, it seems, outright corruption of the bailout notwithstanding). Also, there is likely to be some re-regulation of the financial industry. These steps, however, at best will restore things to where they were before the crisis. They do not treat the underlying causes of the crisis—the vicious circle of power, ideology, and inequality.

Opportunity for Change

Fortunately, the crisis itself has weakened some aspects of this circle. The cry of "leave it to the market" is still heard, but is now more a basis for derision than a guide to policy. The ideology and, to a degree, the power behind the ideology, have been severely weakened as the role of "keeping the government out" has shown to be a major cause of the financial mess and our current hardships. There is now widespread support among the general populace and some support in Washington for greater regulation of the financial industry.

Whether or not the coming period will see this support translated into effective policy is of course an open question. Also an open question is how much the turn away from "leaving it to the market" can be extended to other sectors of the economy. With regard to the environment, there is already general acceptance of the principle that the government (indeed, many governments) must take an active role in regulating economic activity. Similar principles need to be recognized with regard to health care, education, housing, child care, and other support programs for low-income families.

The discrediting of "keep the government out" ideology provides an opening to develop new programs in these areas and to expand old programs. Furthermore, as the federal government revs up its "stimulus" program in the coming months, opportunities will exist for expanding support for these sorts of programs. This support is important, first of all, because these programs serve real, pressing needs—needs that have long existed and are becoming acute and more extensive in the current crisis.

Breaking the Circle

Support for these social programs, however, may also serve to break into the vicious power-ideology-inequality circle and begin transforming it into a virtuous circle. Social programs are inherently equalizing in two ways: they provide their benefits to low-income people and they provide some options for those people in their efforts to demand better work and higher pay. Also, the further these programs develop, the more they establish the legitimacy of a larger role for social control of—government involvement in—the economy; they tend to bring about an ideological shift. By affecting a positive distributional shift and by shifting ideology, the emergence of stronger social programs can have a wider impact on power. In other words, efforts to promote social programs are one place to start, an entry point to shift the vicious circle to a virtuous circle.

There are other entry points. Perhaps the most obvious ones are actions to strengthen the role of unions. The Employee Free Choice Act may be a useful first step, and it will be helpful to establish a more union-friendly Department of Labor and National Labor Relations Board. Raising the minimum wage—ideally indexing it to inflation—would also be highly desirable.
While conditions have changed since the heyday of unions in the middle of the 20th century, and we cannot expect to restore the conditions of that era, a greater role for unions would seem essential in righting the structural conditions at the foundation of the current crisis.

Shifting Class Power

None of this is assured, of course. Simply starting social programs will not necessarily mean that they have the wider impacts that I am suggesting are possible. No one should think that by setting up some new programs and strengthening some existing ones we will be on a smooth road to economic and social change. Likewise, rebuilding the strength of unions will involve extensive struggle and will not be accomplished by a few legislative or executive actions.

Also, all efforts to involve the government in economic activity—whether in finance or environmental affairs, in health care or education, in work support or job training programs—will be met with the worn-out claims that government involvement generates bureaucracy, stifles initiative, and places an excessive burden on private firms and individuals. We are already hearing warnings that in dealing with the financial crisis the government must avoid "over-regulation." Likewise, efforts to strengthen unions will suffer the traditional attacks, as unions are portrayed as corrupt and their members privileged. The unfolding situation with regard to the auto firms' troubles has demonstrated the attack, as conservatives have blamed the United Auto Workers for the industry's woes and have demanded extensive concessions by the union.

Certainly not all regulation is good regulation. Aside from excessive bureaucratic controls, there is the phenomenon by which regulating agencies are often captives of the industries that they are supposed to regulate. And there are corrupt unions. These are real issues, but they should not be allowed to derail change.

The current economic crisis emerged in large part as a shift in the balance of class power in the United States, a shift that began in the early 1970s and continued into the new millennium. Perhaps the present moment offers an opportunity to shift things back in the other direction. Recognition of the complex nexus of causes of the current economic crisis provides some guidance where people might start. Rebuilding and extending social programs, strengthening unions, and other actions that contribute to a more egalitarian power shift will not solve all the problems of U.S. capitalism. They can, however, begin to move us in the right direction.
Dear Dr. Dollar,

As housing prices have fallen, it seems that people have lost a huge amount in terms of the value of their homes. We are told that, over the whole country, trillions of dollars in home equity have been lost. ~Who gets those trillions? And, likewise, what about the trillions lost in the stock market?

— Carlos Rafael Alicea Negron, Bronx, N.Y.

Dear Carlos:
The simple answer to your question is that no one gets the lost trillions; they are simply gone. But, like all simple answers, this one doesn't explain very much.

Suppose that seven years ago, you bought your house for $200,000. Housing prices continued to rise, and at the beginning of 2007 you saw that other people in your neighborhood were selling houses similar to yours for $400,000. So you, quite reasonably, figured that your house was worth $400,000.

But now the housing bubble has burst. Similar houses in your neighborhood are selling for "only" $300,000 and thus it is now quite reasonable to figure that the value of your house has dropped by $100,000 as compared to the beginning of 2007. (Multiply this $100,000 by roughly 75 million homes across the country, and you have losses of $7.5 trillion.)

Your house, however, was not involved in any actual transaction at this lower value. So no one has gained the value you lost. If, for example, last year one of your neighbors had sold an equivalent house for $400,000 and now buys your house for $300,000 this neighbor would have gained what you lost. But most houses are not bought and sold in any given year. Their value is determined by those equivalent (or similar) houses that are actually bought and sold.

Moreover, even if someone bought your house at $300,000, that person would gain the value you lost only in the special case of the example above, where the person was lucky enough to have sold an equivalent house at $400,000. If instead that person was a new entrant to the housing market or a person who had just sold a similar house elsewhere for $300,000, then no one would be gaining what you lost.

Thus in the great majority of cases, the $100,000 value would simply be gone, and no one would have gotten it.

The situation on the stock market is similar. The values of stocks are determined by the sales that actually take place. When we hear that today the value of Mega Corporation's stock fell from $100 a share to $75 dollars a share, this means that the price of shares that were traded today were selling at $75 while those that were traded yesterday were selling for $100. But most shares of Mega Corporation were not actually traded either day. Their value fell—just like the value of your house fell when neighbors sold their houses—but no one gained this lost value. As in the housing market, the values of stocks have declined by trillions, but the trillions are simply gone.

Of course as with the situation in the housing market, some actual gains of value can take place when stock prices fall. If someone sold a share of Mega Corporation yesterday for $100 and bought it today for $75, this person obtained a gain. But with most of the declines in stock values, no one gets a gain.

To understand what has happened recently, it is useful to keep in mind that the high housing values of recent years were the result of a speculative bubble. The values increased not because there was some real change in the houses themselves. The houses were not providing more living services to the degree that their prices rose. The prices of housing rose because
people expected them to rise more. The situation was a speculative bubble, and housing prices rose far above their historical trend.

And just as, in general, the loss of value when prices fell was not balanced by a gain, the gains that people saw when the bubbles expanded were not balanced by losses. As the bubble grew and the value of your house rose from $200,000 to $400,000, no one experienced an equivalent loss. Virtually all home buyers and owners were winners.

But speculative bubbles do not last.


Let me begin by saying what I think this crisis is not. It is not a financial crisis. It is a systemic crisis whose first serious symptom happened to be finance. But this crisis has its economic roots and its effects in manufacturing, services, and, to be sure, finance. It grows out of the relation of wages to profits across the economy. It has profound social roots in America's households and families and political roots in government policies. The current crisis did not start with finance, and it won't end with finance.

From 1820 to around 1970, 150 years, the average productivity of American workers went up each year. Average workers produced more stuff every year than they had the year before. They were trained better, they had more machines, and they had better machines. So productivity went up every year.

And, over this period of time, the wages of American workers rose every decade. Every decade, real wages—the amount of money you get in relation to the prices you pay for the things you use your money for—were higher than the decade before. Profits also went up.

The American working class enjoyed 150 years of rising consumption, so it's not surprising that it would choose to define its own self-worth, measure its own success in life, according to the standard of consumption. Americans began to think of themselves as successful if they lived in the right neighborhood, drove the right car, wore the right outfit, went on the right vacation.

But in the 1970s, the world changed for the American working class in ways that it hasn't come to terms with—at all. Real wages stopped going up. As U.S. corporations moved operations abroad to take advantage of lower wages and higher profits and as they replaced workers with machines (and especially computers), those who lost their jobs were soon willing to work even if their wages stopped rising. So real wages trended down a little bit. The real hourly wage of a worker in the 1970s was higher than what it is today. What you get for an hour of work, in goods and services, is less now that what your parents got.

Meanwhile, productivity kept going up. If what the employer gets from each worker keeps going up, but what you give to each worker does not, then the difference becomes bigger, and bigger, and bigger. Employers’ profits have gone wild, and all the people who get their fingers on employers profits—the professionals who sing the songs they like to hear, the shareholders who get a piece of the action on each company's profits—have enjoyed a bonanza over the last thirty years.

The only thing more profitable than simply making the money off the worker is handling this exploding bundle of profits—packaging and repackaging it, lending it and borrowing it, and inventing new mechanisms for doing all that. That's called the finance industry, and they have stumbled all over themselves to get a hold of a piece of this immense pot of profit.

What did the working class do? What happens to a population committed to measuring people’s success by the amount of consumption they could afford when the means they had always had to achieve it, rising wages, stop? They can go through a trauma right then and there: "We can't anymore—it's over." Most people didn't do that. They found other ways.
Americans undertook more work. People took a second or third job. The number of hours per year worked by the average American worker has risen by about 20 percent since the 1970s. By comparison, in Germany, France, and Italy, the number of hours worked per year per worker has dropped 20%. American workers began to work to a level of exhaustion. They sent more family members—and especially women—out to work. This enlarged supply of workers meant that employers could find plenty of employees without having to offer higher pay. Yet, with more family members out working, new kinds of costs and problems hit American families. The woman who goes out to work needs new outfits. In our society, she probably needs another car. With women exhausted from jobs outside and continued work demands inside households, with families stressed by exhaustion and mounting bills, interpersonal tensions mounted and brought new costs: child care, psychotherapy, drugs. Such extra costs neutralized the extra income, so it did not solve the problem.

The American working class had to do a second thing to keep its consumption levels rising. It went on the greatest binge of borrowing in the history of any working class in any country at any time. Members of the business community began to realize that they had a fantastic double opportunity. They could get the profits from flat wages and rising productivity, and then they could turn to the working class traumatized by the inability to have rising consumption, and give them the means to consume more. So instead of paying your workers a wage, you're going to lend them the money—so they have to pay it back to you! With interest!

That solved the problem. For a while, employers could pay the workers the same or less, and instead of creating the usual problems for capitalism—workers without enough income to buy all the output their increased productivity yields—rising worker debt seemed magical. Workers could consume ever more; profits exploding in every category. Underneath the magic, however, there were workers who were completely exhausted, whose families were falling apart, and who were now ridden with anxiety because their rising debts were unsustainable. This was a system built to fail, to reach its end when the combination of physical exhaustion and emotional anxiety from the debt made people unable to continue. Those people are, by the millions, walking away from those obligations, and the house of cards comes down.

If you put together (a) the desperation of the American working class and (b) the efforts of the finance industry to scrounge out every conceivable borrower, the idea that the banks would end up lending money to people who couldn't pay it back is not a tough call. The system, however, was premised on the idea that that would not happen, and when it happened nobody was prepared.

The conservatives these days are in a tough spot. The story about how markets and private enterprise interact to produce wonderful outcomes is, even for them these days, a cause for gagging. Of course, ever resourceful, there are conservatives who will rise to the occasion, sort of like dead fish. They rattle off twenty things the government did over the last twenty years, which indeed it did, and draw a line from those things the government did to this disaster now, to reach the conclusion that the reason we have this problem now is too much government intervention. These days they get nowhere. Even the mainstream press has a hard time with this stuff.

What about the liberals and many leftists too? They seem to favor regulation. They think the problem was that the banks weren't regulated, that credit-rating companies weren't regulated, that the Federal Reserve didn't regulate better, or differently, or more, or something. Salaries should be regulated to not be so high. Greed should be regulated. I find this astonishing and depressing.

In the 1930s, the last time we had capitalism hitting the fan in this way, we produced a lot of regulation. Social Security didn't exist before then. Unemployment insurance didn't exist before then. Banks were told: you can do this, but you can't do that. Insurance companies were told: you can do that, but you can't do this. They limited what the board of directors of a corporation could do ten ways to Sunday. They taxed them. They did all sorts of things that annoyed,
bothered, and troubled boards of directors because the regulations impeded the boards’ efforts
to grow their companies and make money for the shareholders who elected them.

You don’t need to be a great genius to understand that the boards of directors encumbered
by all these regulations would have a very strong incentive to evade them, to undermine them,
and, if possible, to get rid of them. Indeed, the boards went to work on that project as soon as
the regulations were passed. The crucial fact about the regulations imposed on business in the
1930s is that they did not take away from the boards of directors the freedom or the incentives
or the opportunities to undo all the regulations and reforms. The regulations left in place an
institution devoted to their undoing. But that wasn’t the worst of it. They also left in place boards
of directors who, as the first appropriators of all the profits, had the resources to undo the
regulations. This peculiar system of regulation had a built-in self-destruct button.

Over the last thirty years, the boards of directors of the United States’ larger corporations
have used their profits to buy the president and the Congress, to buy the public media, and to
wage a systematic campaign, from 1945 to 1975, to evade the regulations, and, after 1975, to
get rid of them. And it worked. That’s why we’re here now. And if you impose another set of
regulations along the lines liberals propose, not only are you going to have the same history, but
you’re going to have the same history faster. The right wing in America, the business
community, has spent the last fifty years perfecting every technique that is known to turn the
population against regulation. And they’re going to go right to work to do it again, and they’ll do it
better, and they’ll do it faster.

So what do we do? Let’s regulate, by all means. Let’s try to make a reasonable economic
system that doesn’t allow the grotesque abuses we’ve seen in recent decades. But let’s not
reproduce the self-destruct button. This time the change has to include the following: The
people in every enterprise who do the work of that enterprise, will become collectively their own
board of directors. For the first time in American history, the people who depend on the survival
of those regulations will be in the position of receiving the profits of their own work and using
them to make the regulations succeed rather than sabotaging them.

This proposal for workers to collectively become their own board of directors also
democratizes the enterprise. The people who work in an enterprise, the front line of those who
have to live with what it does, where it goes, how it uses its wealth, they should be the people
who have influence over the decisions it makes. That’s democracy.

Maybe we could even extend this argument to democracy in our political life, which leaves a
little to be desired—some people call it a “formal” democracy, that isn’t real. Maybe the problem
all along has been that you can’t have a real democracy politically if you don’t have a real
democracy underpinning it economically. If the workers are not in charge of their work
situations, five days a week, 9 to 5, the major time of their adult lives, then how much aptitude
and how much appetite are they going to have to control their political life? Maybe we need the
democracy of economics, not just to prevent the regulations from being undone, but also to
realize the political objectives of democracy.
Wicks-Lim, J. (March / April 2009). Should we be talking about living wages now? Dollars & Sense.

The Department of Labor announced in January that the U.S. economy shed 2.8 million jobs in 2008, bringing the national unemployment rate to 7.2%—its highest level in 16 years. In today’s economic climate, the worst since the Great Depression, are the raises demanded by living-wage campaigns a luxury? Should living-wage campaigns take a back seat to pulling the economy out of recession?

For many, the answer is no. Campaigns across the country continue to build on the widespread success of a movement that has put into place more than 140 living-wage laws since the mid-1990s. Take the Hartford Living Wage Task Force in Connecticut, which is trying to expand the number of workers guaranteed a living wage under its original 1997 law. Or Santa Fe’s Living Wage Network, which fought for, and won, a cost-of-living increase to its living wage rate for 2009. Or the Nashville Movement in Tennessee, a group laying the groundwork for a campaign to establish a brand new ordinance.

They are right. Today's economic turmoil challenges us to create practical policies to meet the heightened imperative of living wages, not to abandon them.

Why do we need living-wage campaigns? Let's consider first the current legal wage floor. At $7.25 per hour, the federal minimum wage as of July 2009, a full-time year-round worker will bring home $15,080—less than the official poverty threshold of $17,330 for a family of three. Moreover, poverty experts roundly criticize that official poverty line as too severe. According to the National Survey of American Families, nearly two-thirds of people in households with incomes above the poverty line but below twice that level reported serious economic hardships—failing to pay their rent, having their phone disconnected, worrying about running out of food, or relying on the emergency room for routine medical care.

Consider a more realistic poverty line: the "basic budget" thresholds developed by the Economic Policy Institute as a measure of the income required for "a safe and decent standard of living." These range between two and three times the official poverty line depending on local living costs such as housing. For a family of three, a full-time year-round worker would need to earn between $16 and $24 an hour to reach these basic budget thresholds. Two workers would each need to earn between $8 and $12 per hour. The living-wage ordinances enacted in recent years have typically required rates in this range—on average $10.80, or about 50% above the federal minimum wage.

These basic budgets, however, leave out not only extras such as restaurant meals, but also essential, if not immediate, items such as savings for education, retirement, or even emergencies. Any cut in hours or spell of unemployment can immediately compromise these families’ ability to meet their basic needs. Unfortunately, these will be all-too-common occurrences in today’s economic climate, which will expose the lowest-paid workers to increasingly severe hardships. This is because businesses tend to let the wages of the lowest-paid workers stagnate or fall unless prodded by a minimum-wage hike or a near-full-employment economy. In the 1980s, for instance, the federal minimum wage remained the same for ten years. Over this period, the lowest-paid workers saw their real (i.e., inflation-adjusted) wages fall by 15%.

In other words, to put living-wage campaigns on hold would not simply mean that conditions for low-wage workers and their families would not improve. Instead, these families would face worsening economic hardships.

But perhaps that's inevitable during a recession. Today, with economic indicators falling by the day, can businesses afford to pay a living wage without slashing jobs?
We can learn from the experience of New Jersey's state minimum-wage hikes in the early 1990s: from $3.35 to $3.80 in 1990, then to $4.25 in 1991, and finally to $5.05 in 1992. These three raises, about 10% to 20% each, amounted to a 40% overall rise in the wage floor once adjusted for inflation. The first hike took place in April 1990 when the economy was nearing a business cycle peak. The second and third hikes, however, took place on the heels of the 1990 recession. Economists studied their effects extensively among the businesses likely to be hit hardest—fast-food restaurants—and found no significant negative impact on employment.

One reason businesses can absorb these costs is that for most, minimum-wage hikes require only modest adjustments. For example, in 2003 Santa Fe passed an $8.50 citywide minimum wage. The average low-wage worker, who earned $6.91, received about a 23% raise. The resulting cost increases for restaurants—the most heavily affected businesses—equalled 3% of their sales revenue. In other words, a typical restaurant could offset the entire expense of the minimum-wage hike with a 3% price increase, say, 60 cents on a $20 meal. Unsurprisingly, the city's new wage floor appears to have had no negative impact on jobs.

Even in today's sharp downturn, businesses can likely absorb similar minimum-wage hikes. To see this, consider that U.S. restaurant sales rose by 2.8% between November 2007 and November 2008, almost two percentage points faster than inflation. This is despite a 5% rise in restaurant prices over the same period. In other words, overall sales in this sector grew, albeit sluggishly, even as restaurants raised their prices and the recession deepened.

Based on the Santa Fe experience, and using extremely pessimistic assumptions about future sales trends, I estimate that a 20% minimum-wage hike would require, as before, just a 3% price increase to cover these businesses' higher costs.

What can living-wage campaigns draw from these experiences, given that transforming a minimum wage into a living wage requires more dramatic raises on the order of 50%? An obvious possibility is to structure a living-wage ordinance as a series of raises, 10% to 20% each, which gradually achieve an adequate living-wage rate. An added precaution may be in order since we simply do not have extensive data on the impact of minimum-wage hikes during similar economic conditions: each raise could be followed by a year of evaluation, used in turn to adjust future raises up or down. This, by the way, is another lesson Santa Fe's experience offers: the city required exactly such an evaluation before raising its initial $8.50 minimum to $9.50 in 2006.

To turn the economy around we need a significant boost in economic activity—an increase in the demand for businesses' goods and services, not minor adjustments to business costs. This is the logic behind President Obama's stimulus package.

Widespread public support for raising minimum-wage rates (in 2006, more than 60% of voters in six states passed state minimum-wage hikes) suggests, however, that we want not only decent schools, decent medical care, decent roads, and a decent environment, but also decent-paying jobs. To create such jobs, living-wage requirements must be tied to the stimulus plan's funding. Without such mandates, private sector businesses that are the main focus for job creation are unlikely to pass some of that stimulus money along in the form of raises for their lowest-paid workers. Current living-wage laws provide a model: these laws impose living-wage requirements on businesses that contract with, or receive subsidies from, local governments.

Today's economic crisis highlights the vulnerability of the lowest-paid workers and virtually ensures that their living standards will worsen. These facts compel us to pursue living-wage policies with even greater force. Two policy prescriptions are especially important. First, the economic recovery plan, with its extensive government subsidies, provides a tool to impose living-wage requirements. Second, a broader, longer term living-wage policy of multi-step raises guided by interim economic impact studies will allow us to sensibly wean our economy off of poverty wages. Past experience tells us that our economy, even today, can adjust to such a policy.
Collins, C. (August 2004). The visible hand: Seven government actions that have worsened inequality. Dollars & Sense.

A primary reason that U.S. wealth inequality has accelerated in the last two decades is that power has shifted in our democracy. Corporations, investors, and campaign donors have gained power while main street business, wage earners, and voters have lost power. As political influence has shifted, the rules governing the economy have changed to benefit asset-owners and large corporations at the expense of wage-earners.

These rule changes—the visible hand of government—have worsened the wealth and income divide, putting a heavy thumb on the scale in favor of the rich and powerful. Rules governing taxes, trade, wages, spending priorities, and monetary policy have all changed, and in each case, the government has acted on behalf of corporations and the rich to rig who wins and who loses in the economy.

Of course, the U.S. economy has always been governed by rules that created inequality, from regulations protecting private property, to labor laws stacked against workers, to state taxes that fall disproportionately on the poor. Government actions can either mitigate or exacerbate inequality, and in recent years, hundreds of deliberate public policy choices have made it much worse. Here are seven nominations for the public policy hall of shame.

1. THE PLUMMETING MINIMUM WAGE

Decent wages are a prerequisite for individual wealth accumulation: workers cannot save money when their wages barely pay for basic necessities. Today, even when they earn a decent wage, most Americans are not able to save much of anything. And its much worse for those at the bottom. The U.S. minimum wage has plummeted in value over the last 35 years, and today leaves families below the federal poverty line.

Over 2.1 million workers earn today’s minimum-wage of $5.15 per hour. In 1968, the minimum wage of $1.60—or $7.07 in today’s dollars—was 86% of the amount needed to bring a family of four to the federal poverty line. But today the minimum wage is only 61% of that benchmark. A full-time worker earning today’s minimum wage has an annual income of just $10,712. And Congress has not raised the minimum wage since 1996.

It didn’t have to be this way. While the minimum wage has been falling, worker productivity has skyrocketed, reducing costs for employers and increasing their profits. If worker wages overall had shared in the productivity gains since the late 1970s, they would be 33% higher in real terms than they are today.

2. TAXING WAGES, NOT WEALTH

Over the last 30 years, the federal government has shifted the tax burden off wealth and onto wages. Since 1980, the payroll tax rate—the main tax on work income—has jumped 25%. In the same period, top tax rates on investment income fell by 31% and taxes on large inheritances have been cut by 79%. This shift means that a person who derives millions of dollars solely in dividend income from investments now pays a marginal tax rate of just 15%, down from 28% in 1997. Compare that with a schoolteacher earning an adjusted gross income of $28,400. The teacher pays a payroll tax rate of 15.3% plus a marginal income tax rate of 28% for a total marginal rate of over 43%!

One policy exacerbating this shift was the 1997 Tax Reform Act, signed into law by President Clinton, which reduced capital gains tax rates from 28% to 20%. The 1997 capital gains provision was wrapped in pretty packaging, including expanded child and education
credits for the middle class, and it didn't get much attention. But it was a centerpiece of the right-wing tax program. The 2003 Bush tax cut further reduced the capital gains rate to 15% and cut taxes on dividend income, delivering windfalls for the wealthy.

At the same time that the tax burden has been shifted from wealth to wages, the sheer size of recent tax cuts threatens the social programs many wage-earners depend on. The 2001 and 2003 federal tax cuts, which the Bush administration's 2005 budget proposes to make permanent, guarantee further cuts to social spending. The 2001 tax cut was the largest income tax rollback in two decades, and the 2003 cut reduced dividend and capital gains taxes while accelerating the 2001 rate cut for the top income brackets. These tax cuts, which mainly benefit the rich, will cost at least $824.1 billion between 2001 and 2010; if extended, they will cost $5.9 trillion over the next 75 years, according to William G. Gale and Peter R. Orszag of the Brookings Institution. Revenue losses of this magnitude can be sustained only by cutting social programs.

3. STACKING LABOR LAWS AGAINST WORKERS

Collective action is the most effective means that workers have to win a larger share of the economic pie. But U.S. workers face repressive labor laws that make many forms of collective action difficult or even illegal.

Workers who want to organize a union in the United States must overcome obstacles unheard of in Canada and Western Europe. Canadian workers simply need to present signatures showing that a majority of workers wish to form a union. But in the United States, the 1935 National Labor Relations Act, which governs union organizing in most sectors of the economy, requires workers to complete a lengthy election process during which employers can run intimidating anti-union campaigns. Employers force workers to attend meetings, individually and in groups, in which supervisors spread misinformation about unions. They routinely challenge election bids on frivolous grounds, delaying elections and vote-counting for months and years. And employers illegally fire worker organizers in 25% of unionization drives. Workers who seek reinstatement after being illegally fired face years of hearings before the National Labor Relations Board.

Workers who win union representation face other legal obstacles. When protesting their employer, for instance, they cannot conduct "secondary boycotts," or protests targeting firms that do business with their employer. Moreover, U.S. labor law makes it very difficult for workers to strike. Employers can permanently replace workers who strike for "economic" reasons — like wanting higher wages. The 1947 Taff-Hartley Act banned "sympathy strikes" in which workers striking at one employer could be joined by those at other companies and in other sectors of the economy. Taft-Hartley also gave the president the right to end strikes by executive order.

Unions and legal scholars have proposed labor law reforms for decades, but have been thwarted by both Democrats and Republicans in Congress. Union certification procedures have not changed even as employers' anti-union campaigns have grown more virulent. Congress has taken no action on proposals to ban strikebreakers and permanent replacements, or to lift restrictions on secondary boycotts. The legislative record on workers' substantive demands has also been dismal. Congress and state legislatures could have passed laws to raise workplace standards, require minimum benefits, and limit the use of contract or temporary labor. Instead, Congress has passed laws to reclassify jobs in ways that disqualify workers from receiving overtime pay, reducing the paychecks and clout of millions of workers.

4. SHREDDING THE SAFETY NET

The U.S. safety net has historically been much thinner than those in other industrialized nations. Yet, over the last 20 years, state and federal governments have slashed public
programs that historically worked to narrow economic inequalities. Cuts in social spending increase Americans' reliance on unequal personal income and savings, and guarantee a growing divide between rich and poor.

In 1996, President Clinton and a Republican Congress ended "welfare as we knew it" by abolishing Aid to Families with Dependent Children (AFDC) and replacing it with Temporary Assistance to Needy Families (TANF). Unlike AFDC, a federal entitlement that provided a guaranteed minimum benefit, TANF includes strict work requirements, a five-year lifetime limit on assistance, and sanctions that can push people off the rolls. TANF is administered by the states with little federal oversight, allowing for inequities in benefit provisions.

Federal Pell grants, created in 1972 to provide aid to working-class college students, are much less generous than they used to be. Whereas the maximum Pell grant in 1975-76 covered 84% of the average cost of attending a four-year public institution, today it covers just 39% of that cost.

In 2004, the Department of Housing and Urban Development (HUD) changed the formulas it uses to finance the Section 8 housing voucher program. Section 8 vouchers help 2 million poor, elderly, and disabled Americans pay their rent and were originally lauded by conservatives as a market-based alternative to public housing. The new HUD formulas mean that the state housing authorities that administer the vouchers received $183 million less than they expected, even though Congress had already appropriated the funds. The new policy wasn't announced until April 23, 2004, but HUD made it effective retroactive to January 1, meaning that local housing authorities have to make up for funds they had already spent. In order to fill the budget gap, housing agencies across the country are being forced to take harmful steps including prohibiting eligible new families from receiving vouchers, reducing the maximum rent that a voucher will cover, and withdrawing newly issued vouchers from families that are still looking for an apartment. The Bush administration's proposed 2005 budget includes $1 billion in cuts for Section 8 housing vouchers, or 5.5% of the program's total funding.

5. LETTING EXECUTIVE PAY SKYROCKET

In 1992, President Clinton was elected calling for reform of executive compensation laws. At the time, corporations deducted the entire value of their bloated CEO pay packages as a tax-reducing business expense. Some salary expense is obviously a business expense, but corporations were using these excessive pay packages to shrink their tax liabilities on paper while bestowing largess on a privileged few. Clinton proposed limiting the "tax deductibility of excessive compensation" to $1 million. This still would have allowed corporations to take tremendous tax deductions, but it would have been a step in the right direction.

However, the final bill that passed was amended to exempt pay packages where compensation was judged to be "performance based." As a result, corporate boards today simply pass resolutions stating that their executive compensation pay packages are "performance based," and circumvent the law's intent. Apparently, it doesn't matter if that performance was abysmal. Safeway CEO Steven Burd cashed out $13 million in stock options in 2003 even as the company lost $169.8 million in net revenue. Imagine if a law with teeth had been in place during the late 1990s, when average executive compensation grew to more than 500 times average worker pay.

6. CHANGING THE RULES ON INVESTMENT AND TRADING

The recent stock market and accounting scandals have had a crushing effect on small stockholders and pension plans but put billions into the pockets of insider investors in America's largest corporations. The scandals were made possible by rule changes and "reforms" that took the few remaining teeth out of the regulatory process. In 1999, Congress repealed the 1933
Glass-Steagall Act, a banking law that prohibited mergers between banks, insurance companies, and securities trading firms. The New Deal-era law was designed to guard against the conflicts of interest that had led to a series of corporate abuses in the 1920s. The finance, insurance, and real estate sectors spent $200 million in campaign contributions, according to the Center for Responsive Politics, to remove this reform. Glass-Steagall was replaced by the Financial Modernization Act, which created a new kind of corporation—the financial holding company—that could bring together any number of these formerly separate financial institutions in a single corporation.

By removing the barriers between banks and securities firms, Congress ushered in a new wave of speculative mega-mergers. Firms such as Citigroup, J.P. Morgan Chase and others took advantage of the new rules by forming mega-conglomerates that financed Enron and other disasters.

Repealing Glass-Steagall also exposed small investors to new risks. Glass-Steagall had required banks to maintain a firewall between investment bankers (who facilitate deals between banks and corporations) and brokers (who buy and sell securities for investors). Eliminating this firewall gave brokers incentives to lie to investors about the quality of securities in order to promote deals that the bankers were pushing. In one case uncovered by New York State Attorney General Eliot Spitzer, Citigroup CEO Sandy Weill was on AT&T's board of directors when he sent an e-mail to Citigroup analyst Jack Grubman asking him to upgrade AT&T's investment rating as a personal favor. Grubman upped the company's rating just before Citigroup secured a deal to manage the AT&T wireless division's initial public offering. Soon after the IPO, Grubman downgraded AT&T's stock, and the price plummeted. Citigroup reaped over $40 million in fees from managing the IPO, while investors were duped out of millions more.

In 2000, Congress passed the Commodity Futures Modernization Act to deregulate derivative investments, which are highly speculative investment vehicles. Sen. Phil Gramm (R-Texas) attached the act to an omnibus bill immediately after the 2000 Supreme Court decision in favor of Bush's selection. The bill included the infamous "Enron exclusion" that exempted Enron's online energy-trading floor from public oversight, creating the conditions in which Enron was able to manipulate California's electricity market. This law also exempted over-the-counter derivatives from regulation, helping to pave the way for the 2001 Wall Street fiascos. It specifically included an exception for the trading of energy derivatives, a provision strongly supported by Gramm, whose wife Wendy had deregulated energy swaps in 1993 as chairman of the Commodity Futures Trading Commission and then joined Enron's board of directors. These changes helped produce the corporate meltdowns that looted employees and investors alike, fueling wealth inequality.

Finally, thanks to a little-known 1995 rule change, shareholders and pensioners who saw their wealth vanish in the post-1990s corporate debacles found that they had little recourse against corporate malfeasance. This was because the 1995 Private Securities Litigation Reform Act had raised hurdles for investors attempting to file securities-fraud lawsuits in federal court. Investors fleeced by companies like WorldCom have been thwarted in their efforts to recoup their loses.

7. LETTING CORPORATE ACCOUNTING GO WILD

For years, shady corporate accounting left workers' savings and pensions dangerously exposed. The SEC and Congress failed to enact meaningful safeguards, and small investors were left holding the bag when disaster finally struck. Throughout the 1990s, the Financial Accounting Standards Board (FASB) and Securities and Exchange (SEC) Chairman Arthur Leavitt considered a number of reforms to make accounting more transparent and reduce opportunities for corporate manipulation. Leavitt proposed several reforms, including one which
would have required companies to treat stock options as expenses. The SEC also proposed a rule requiring auditors to be independent of the companies they audited, as many were not. For instance, a number of accounting firms conducting corporate audits also maintained lucrative consulting contracts with the same firms. Knowing that they might lose consulting revenue if their audits weren't rosy enough, accounting firms had strong incentives to cook the books.

These proposals weathered an onslaught of industry and political attacks during the 1990s. Legislators led by Sen. Joseph Leiberman (D-Conn.), representing Connecticut's insurance industry, intervened to stop the SEC from implementing rules requiring auditor independence. When President Bush came into office, he appointed Harvey Pitt, the former chief lobbyist for the accounting industry, to replace Leavitt—a way of preventing further reforms. Rule changes were thwarted until corporate fraud scandals created a tremendous public backlash. Even then, Congress enacted only modest reforms such as the Sarbanes-Oxley Public Company Accounting and Investor Protection Act of 2002. While this law mandated some restrictions on certain non-auditing services that auditors can provide for their clients, it left in place the cozy auditor-client relationships that encouraged auditors to approve the shady accounting practices of Enron and WorldCom. In the end, even these weak reforms came too late to protect the millions of working Americans who saw their pensions and savings vanish, nor did it insure that similar scandals would be prevented from happening in the future.

Today, economic inequality in the United States is more extreme than at any time since the 1920s. Left to its own devices, the underlying tendency of the U.S. private sector is toward ever-increasing levels of inequality. This tendency must be counteracted by the visible hand of progressive government policies. But the rule changes and policy choices described here have taken the country in exactly the wrong direction. It doesn't have to be that way. We could have public policy that restores the lost purchasing power of the minimum wage; insists that the rich pay their fair share in taxes by blocking the repeal of the estate tax and reinstating the lost progressivity of the income tax; patches the holes in the social safety net by returning non-defense discretionary spending to its level at the beginning of the Reagan administration (5.2% of GDP); enforces labor laws that oversee an orderly process of helping workers gain a voice in their work life; and reregulates financial markets and large corporations as opposed to celebrating corporate recklessness. These measures would go a long way toward counteracting the two-decade trend of widening inequality of the U.S. economy.
Miller, J. (September / October 2008). One-quarter of large U.S. corporations don’t pay profit taxes – why should the rest? Dollars & Sense.

America the Uncompetitive

Our political class has managed to maintain America’s rank with the second highest corporate tax rate in the world at 39.3% (average combined federal and state). Only Japan is slightly higher overall.

In Washington, meanwhile, Senator Byron Dorgan of North Dakota waved around a new politically generated study by the Government Accountability Office (GAO) finding that 28% of large U.S. corporations paid no income tax in 2005. “It’s time for big corporations to pay their fair share,” Mr. Dorgan roared.

Among the large companies that paid no taxes, 85% of them also made no profits that year. American Airlines and General Motors escaped income tax for 2005 through the clever tax dodge of losing $862 million and $10.5 billion, respectively.

The GAO data only add to the case for cutting U.S. corporate rates. America now has the worst of all worlds: high corporate tax rates, but also lots of loopholes passed by Congress at the behest of favored businesses to avoid the confiscatory rate.

The average European nation has tax rates on corporate income 10 percentage points lower than the U.S., but those countries on average raise 50% more as a share of GDP in corporate taxes than does the U.S.

John McCain has proposed cutting the 35% federal corporate tax rate to 25%. That’s a good start, but even that would leave the U.S. with a combined state and federal rate nearly five percentage points above the global average. With corporate tax rates falling around the world, and with its damage to investment increasingly obvious, abolishing the U.S. corporate income tax should be on the table.

—Wall Street Journal editorial, August 15, 2008

You have to hand it to the Wall Street Journal editors: They don't embarrass easily. The Government Accountability Office (GAO) reports that one-quarter of large U.S. corporations paid no income taxes in 2005, and the editors whine that high corporate taxes have rendered the United States uncompetitive and call once again for abolishing the corporate income tax.

Let's start with the title. The editors surely know that U.S. competitiveness has been improving, not worsening, due to the decline in the value of dollar (something they regularly lament). According to KPMG, the international accounting and consulting firm, the cost of doing business in the United States dropped from 2006 to 2008 and is now lower than that in much of Europe, including Germany, Italy, France, and the U.K., as well as in Japan.

Such inaccuracy is a problem. But it pales next to the profound illogic the Journal editors are trying to purvey here. The editorial acknowledges that U.S. corporations pay less in corporate income taxes than the average across industrialized countries—despite the higher U.S. "nominal" tax rate. It recognizes that European countries collect 50% more in corporate income taxes as a share of GDP than does the United States. Nonetheless, the editors still want to argue that high U.S. corporate income taxes are driving investment away to other countries.

But they can't have it both ways. The editors are right that it is myriad tax loopholes that account for the difference between the nominal and effective tax rates on U.S. corporations. If they find loopholes objectionable, then they should propose simplifying the corporate tax code in a revenue-neutral way, with a lower rate and fewer loopholes. But that's entirely different from what they actually propose here: that U.S. corporations should pay less in corporate income taxes altogether. And that is an awfully hard case to make when you have already admitted that U.S. corporations pay less than their counterparts in other industrialized countries.
LOOPHOLES OR LOSSES?

The GAO report does need to be read carefully. It never said that profitable corporations typically avoid federal corporate income taxes, nominally 35% of all taxable income or profits above $10 million. Nonetheless, the report did offer some deservedly headline-grabbing news: 55% of large U.S. corporations reported no tax liability for at least one of the eight years from 1998 to 2005, and 25% paid no corporate income taxes in 2005 alone. That last figure was actually down from its peak of 38% in 2001. But that shift must be viewed in context: corporate profits more than doubled from 2001 to 2005, so it's not surprising that the share of corporations managing to avoid income tax liability entirely declined somewhat over the period.

Why did so many large U.S. corporations pay no corporate income taxes? Was it because they suffered massive losses, as the editors maintain? Or was it because they took advantage of loopholes in the tax code to eliminate on paper any taxable income or profits?

The GAO report is silent on that question, but other studies point to the key role that loopholes played in allowing these corporations to escape taxation. For instance, Citizens for Tax Justice (CTJ) conducted a detailed study of the tax liability of 275 of the largest U.S. corporations from 2001 to 2003. Eighty-two of those 275 major corporations, or nearly one-third, paid no corporate income taxes in at least one of those three years. Far from losing money, these 82 corporations made a total of $102 billion in pre-tax U.S. profits in the years for which they paid no taxes. But thanks to tax breaks, these corporations actually—$12.6 billion back from the U.S. Treasury. In other words, as a group their effective tax rate—the share of their pretax profit they paid in corporate income taxes—was -12.6% (yes, that's a minus sign). Among the rebate recipients were Pepco Holdings, Prudential Financial, ITT Industries, Boeing, Unisys, Fluor, and CSX.

Taken together, all 275 corporations in the CTJ study paid from 21.4% (in 2001) to 17.4% (in 2003) of their pre-tax profits in corporate income taxes, not much more than half the nominal rate of 35%. Other measures also peg the effective tax rate on U.S. corporate profits far below 35%. For instance, using Treasury Department data, tax analyst Martin Sullivan found that the effective tax rate on U.S. corporate profits reached a ten-year low of 22.2% in 2006.

HOW TO AVOID CORPORATE TAXES

What accounts for the stark difference between the effective rates of taxation paid by U.S. corporations and the 35% rate specified in the tax code?

Corporate income taxes are levied against reported corporate profits. Corporations use a variety of mechanisms to inflate their reported costs and thereby reduce their taxable profits, including:

- **Accelerated Depreciation.** This provision allows corporations to write off machinery and equipment or other assets more quickly than those assets actually deteriorate. Enacted in the 1980s and expanded by the Bush administration and Congress, it dramatically lowered the effective tax rate on U.S. corporations. Accelerated depreciation generated $70.9 billion of tax savings from 2001 to 2003 for the 275 corporations in the CTJ study. Fully two-thirds of those savings went to just 25 corporations, including Verizon, Exxon-Mobil, and Wachovia. In fiscal year 2006, accelerated depreciation of machinery and equipment cost the federal government $36.5 billion in lost tax revenues.

- **Stock Options.** Most big corporations give their executives the option to buy the company's stock at a favorable price. Corporations can then take a tax deduction for the difference between what the employee pays for the stock and its market price. Of the 275
corporations in the CTJ study, 269 received stock-option benefits between 2001 and 2003 worth a total of $32 billion in reduced taxes over the period.

- **Debt Financing.** When corporations finance new investment by issuing stock, the dividends they pay to stockholders are not counted as costs, and so do not reduce their taxable profits. But when corporations borrow capital to invest (typically by issuing bonds), the interest payments on that debt do count as costs. This tax advantage that the U.S. tax code grants to debt financing is unusually generous: other countries typically treat debt financing less favorably. Interest deductions accounted for 15% of the total deductions taken by corporations in the GAO study.

The result of these and other corporate tax loopholes is that effective corporate tax rates in the United States are no higher, and in some cases lower, than rates across the Organization for Economic Cooperation and Development (OECD), the group of the world's most industrialized countries. For instance, a Congressional Budget Office study found that effective U.S. corporate income tax rates in 2003 were close to the OECD average for profits derived from equity-financed investments and substantially below the average for profits derived from debt-financed investments. The U.S. rates, in other words, are hardly prohibitive or non-competitive.

**WHAT TO DO WITH $166 BILLION?**

Closing loopholes could boost U.S. corporate income tax revenues to the OECD average of 3.4% of GDP. In 2007, that would have added $166 billion to federal government revenues—enough to just restore U.S. infrastructure spending to its level four decades ago, and a large down payment toward the $1.6 trillion of investments over the next five years called for by the American Society of Civil Engineers to repair levees, bridges, schools, and power grids, as well as to build high speed transit and modern sewerage systems and to make many other desperately needed infrastructure investments.

That would do far more to improve U.S. economic competitiveness than the editors' proposal to let the other three-quarters of large U.S. corporations go tax-free. At the same time it would satisfy the demand—not just from Senator Dorgan, but from many Americans—that "big corporations pay their fair share."


Lani Guinier became a household name in 1993 when Bill Clinton appointed her to head the Civil Rights Division of the Justice Department and then, under pressure from conservatives, withdrew her nomination without a confirmation hearing. Guinier is currently the Bennett Boskey Professor of Law at Harvard University where, in 1998, she became the first black woman to be tenured at the law school.


Guinier's forthcoming book is *Meritocracy Inc.: How Wealth Became Merit, Class Became Race, and College Education Became a Gift from the Poor to the Rich* (Harvard University Press); she offered a glimpse of its analysis in this interview with D&S intern Rebecca Parrish.

Rebecca Parrish: What is meritocracy? What is the difference between the conventional understanding and the way you are using the term in Meritocracy, Inc.?

Lani Guinier: The conventional understanding of meritocracy is that it is a system for awarding or allocating scarce resources to those who most deserve them. The idea behind meritocracy is that people should achieve status or realize the promise of upward mobility based on their individual talent or individual effort. It is conceived as a repudiation of systems like aristocracy where individuals inherit their social status.

I am arguing that many of the criteria we associate with individual talent and effort do not measure the individual in isolation but rather parallel the phenomena associated with aristocracy; what we're calling individual talent is actually a function of that individual's social position or opportunities gained by virtue of family and ancestry. So, although the system we call "meritocracy" is presumed to be more democratic and egalitarian than aristocracy, it is in fact reproducing that which it was intended to dislodge.

Michael Young, a British sociologist, created the term in 1958 when he wrote a science fiction novel called *The Rise of Meritocracy.* The book was a satire in which he depicted a society where people in power could legitimate their status using "merit" as the justificatory terminology and in which others could be determined not simply to have been poor or left out but to be deservedly disenfranchised.

RP: How did you become interested in studying meritocracy in the first place?

LG: I became interested in the 1990s as a result of looking at the performance of women in law school. A student and I became interested in the disparity between the grades that men and women at an Ivy League law school were receiving. Working with Michelle Fein and Jean Belan, we found that male and female students were coming in with basically the same credentials. The minor difference was that the women tended to have entered with slightly higher undergraduate grades and the men with higher LSATs.

The assumption at that time was that incoming credentials predicted how you would perform. Relying on things like the LSAT allowed law school officials to say they were determining admission based on merit. So several colleagues told me to look at the LSAT scores because they were confident that I might find something to explain the significant differences in performance. But we found that, surprisingly, the LSAT was actually a very poor
predictor of performance for both men and women, that this "objective" marker which determined who could even gain access was actually not accomplishing its ostensible mandate.

I then became interested in studying meritocracy because of the attacks poor and working class whites were waging against Affirmative Action. People were arguing that they were rejected from positions because less qualified people of color were taking their spots. I began to question what determines who is qualified. Then, the more research I did, the more I discovered that these so-called markers of merit did not actually correlate with future performance in college but rather correlated more with an applicant's parents' and even grandparents' wealth. Schools were substituting markers of wealth for merit.

**RP:** As a theorist of democracy, how do you approach issues of educational equity and achievement differently from other scholars? Are current educational institutions democratic?

**LG:** My approach builds on and borrows from work of many other scholars. It perhaps expands on it or shifts emphasis. For example, many people defend Affirmative Action on grounds that there are multiple measures of merit and that bringing diverse students to the school would benefit the learning environment. The problem with this argument is that it pits diversity as a counterpoint to merit. And, the argument is not strong enough to counter the belief in "merit" as an egalitarian and democratic way to allocate scarce resources. I am arguing that there are fundamental flaws in the over-reliance on these supposedly objective indicators of merit. This approach positions poor people and people of color as the problem rather than problematizing the ways we measure merit in the first place.

**RP:** Can you talk about the Harvard and Michigan studies?

**LG:** Harvard University did a study based on thirty Harvard graduates over a thirty-year period. They wanted to know which students were most likely to exemplify the things that Harvard values most: doing well financially, having a satisfying career and contributing to society (especially in the form of donating to Harvard). The two variables that most predicted which students would achieve these criteria were low SAT scores and a blue-collar background.

That study was followed by one at the University of Michigan Law School that found that those most likely to do well financially, maintain a satisfying career, and contribute to society, were black and Latino students who were admitted pursuant to Affirmative Action. Conversely, those with the highest LSAT scores were the least likely to mentor younger attorneys, do pro-bono work, sit on community boards, etc.

So, the use of these so called "measures of merit" like standardized tests is backfiring on our institutions of higher learning and blocking the road to a more democratic society.

**RP:** You refer to college education as a gift from poor to rich.

**LG:** Anthony Carnevaly made that statement when he was the vice president of the Educational Testing Service. He did a study of 146 of the most selective colleges and universities and found that 74% of students came from the top 25% of the socio-economic spectrum. Only 3% came from the lowest quartile and 10% (which is 3% plus 7%) came from the bottom half. So that means that 50% of people in the country are providing substantial state and federal taxes to both public and private institutions even though they are among those least well off and are being excluded from the opportunity.

**RP:** In *Meritocracy Inc.*, you'll be exploring the relationship between class and race in structuring US society. What insights can you offer into their relationship? How can we think about class and race in our efforts to democratize higher education?
**LG:** The argument I'm making is that in many ways race is being used as a stand in for class. I am not saying that race and class are coterminous but that people look at race and see race because it is highly visible but they don't see class.

**RP:** Can you give some examples?

**LG:** In Arkansas in 1957 whites rioted as Central High School in Little Rock was desegregated by nine carefully-chosen middle-class black students. The rage and hate on people's faces was broadcast on national television and President Eisenhower had to send in the National Guard to ensure that blacks could get an education. What most people don't know is that at same time as the leaders of city of Little Rock planned the desegregation of Central High, they built and opened a new high school located in an area where the sons and daughters of the doctors and lawyers lived.

Blacks were coming in at the same time that upper-class whites were exiting and this was part of what provoked the intense backlash; there was the sense among the working-class whites who remained that their chances for upward mobility were lost because they could no longer fraternize with the middle and upper class. Previously, there were only two high schools in Little Rock, one white and one black. So Central High was segregated by race and integrated by class. Now Central was integrated by race and segregated by class.

Beth Roy did interviews with white graduates of Central High thirty years later [for her book *Bitters in the Honey*] and determined that many of them still blame blacks for the failure of themselves and their children to gain a secure toehold in a middle class lifestyle. They think that the American Dream owed them individual opportunity through its promise that if you work hard and play by the rules you will succeed. The problem with the American Dream is that it offers no explanation for failure other than that you deserve your lot in life and that if you fail there must be something wrong with you. Many people are perfectly willing to believe that success is individual but don't want to think about failure as individual and no one wants to believe that they deserve to fail. So they find a scapegoat and blacks were an easy scapegoat in this case. Even thirty years later, the white graduates of Central High claimed that blacks stole the American Dream.

While the integration of Central was hyper-visible, the building of Hall High was kept under wraps—most people still don't know about it. Wealthier whites were able to get away with building Hall High because blacks were used as a scapegoat.

**RP:** You and Gerald Torres wrote about the Texas Ten Percent Plan in *The Miner's Canary.* How does that relate to this?

**LG:** Sheryl Hopwood was a white working-class woman who applied to the University of Texas Law School and was denied admission. In 1996, she sued the university for racial discrimination, arguing that less qualified blacks and Latinos had taken her spot. Thirty-nine years after Central, she sued in the district court and then in the Fifth Circuit and won, but the problem with the court's analysis was that they did not look behind the school's claim that all slots, except for those bestowed through Affirmative Action, were distributed based on merit.

It actually turns out mat the school's own formula for determining merit disadvantaged Sheryl Hopwood. She went to a community college and the University of Texas Law weighted her LSAT scores with those of other applicants from her school and graduating year. Because her community college drew from a working class population, Hopwood's own LSAT score was negatively weighted. So Hopwood's chance of attending the University of Texas was diminished because of class status not because of her race.
After the ruling in Hopwood's favor, a group of legislators and concerned citizens determined that the University of Texas would not return to its segregationist roots. They started investigating the population of the University of Texas graduate school and found that 75% students admitted according to "merit" were coming from only 10% of high schools in the state. These schools tended to be suburban, white, and middle or upper class. Their logic was that if the University of Texas is supposed to be a flagship school and a place from which the state's leaders would be drawn, then 10% of students from each high school in the state should be automatically eligible for access. So the Texas Ten Percent Plan was passed by the legislature and Governor Bush signed it into law.

It all started with concern about racial diversity but it was discovered that class was also at the core. The law ultimately passed because a conservative republican legislator voted for the law when he learned that not one of his constituents, who were white and poor or working class, had been admitted in the previous cycle. So, "meritocratic" standards were keeping out poor and working class whites, especially the rural poor. Many people worried that if SAT scores were eliminated as marker, then grades would go down. However, those who've come in based on the Ten Percent plan have had higher freshman year grades.

**RP:** You've said before that race is being used as a decoy.

**LG:** Race was being used as a decoy for class, leading working-class and poor whites to challenge Affirmative Action, and to challenge the integration of Central High School. In fact, meritocratic standards, which favor the wealthy, have kept them out. Too often, poor and working class whites are willing to throw their lot in with upper class and middle class whites because class is obscured while race is quite visible. People think that if anyone can succeed, if these other whites can succeed, then they can too because merit claims to be about the individual operating without regard to background conditions.

**RP:** So what are the background conditions of students of color attending elite universities?

**LG:** Many students admitted through Affirmative Action are not that different from those admitted through conventional standards of merit because schools are so committed to the annual issue of *U.S. News and World Report* that ranks educational institutions according to the their students' standardized test scores.

In Ivy League schools, a large percentage of Latinos and blacks are foreign-born and don't identify with communities of color who are born in the United States. I'm not arguing that international students should not have access to U.S. institutions. It is significant, however, that in the '70s and '80s, blacks and Latinos entering through Affirmative Action were coming in from poor U.S. communities and were passionate about returning to those communities and lifting as they climbed. Currently, schools are more concerned about admitting people that have high SAT scores who will boost their status than recruiting leaders. Education is changing from an opportunity for students to explore and grow to institutions that are consumed with rankings. Education is becoming about providing credentials to obtain high-paying jobs rather than training people for a thriving democracy.
In 1948, siblings Joseph and Agnes Waschak purchased a home in Taylor, Pennsylvania, in the midst of coal mining country. Within a few years, hydrogen sulfide fumes and other gases from the nearby mines and mine waste turned the Waschaks' white house black and stained all the internal fixtures yellowish-brown or black. The Waschaks filed suit for damages. According to evidence presented in the subsequent court case, the Waschaks and other area residents who were forced to breathe the gases "suffered from headaches, throat irritation, inability to sleep, coughing, light-headedness, nausea and stomach ailments."

Eric Freyfogle describes the *Waschak v. Moffat* case in his book *The Land We Share: Private Property and the Common Good* as an illustration of how changing concepts of property relate to the preservation of the natural environment. Eventually, the case worked its way up to the Pennsylvania Supreme Court. *Waschak v. Moffat* was not simply an instance of citizens challenging property owners, but of one set of property owners positioned against another. On one side were the Waschaks and others who claimed that the actions of the coal companies constituted a nuisance that prevented them from fully using their property; on the other side were the coal companies who wanted to use their mines as they saw fit. The court had to decide not whether property rights would prevail, but which set of property rights had priority.

In 1954, the court ruled that a nuisance existed only when the actions involved were intentional or the result of negligence. The coal companies, the court maintained, intended no harm and were not negligent because they were following standard practices in the mining industry. The Waschaks lost.

Four decades later, concepts of property rights and priorities had changed, as illustrated by a 1998 case in Iowa, *Barman v. Board of Supervisors*, also described by Freyfogle. In this case, the landowning plaintiffs wanted to prevent another landowner from developing a "Confined Animal Feeding Operation" (CAFO) that would involve thousands of animals generating large amounts of waste, odors, and other damage to the surrounding properties. Again, the dispute was between the conflicting rights of two sets of property owners.

The Iowa Supreme Court ruled in favor of the plaintiffs, agreeing that the nuisance that would be created by the CAFO would be an illegitimate interference with their property rights. The court did not deny that its ruling limited the property rights of the CAFO planners, but it gave priority to the rights of the plaintiffs. Moreover, the court ruled that the CAFO planners were not due any compensation, by the state, even though it was preventing them from using their land as they chose and thereby reducing the value of that property.

What changed between 1954 and 1998? Many things were different, of course, including the fact that the earlier case was in one state and the later case in another. But the most important difference was that society's views on environmental issues had changed, evolving along with the development of a broad social movement to protect the environment. As a result, concepts regarding property rights changed. What had earlier been seen as legitimate action by a property owner was, by the end of century, viewed as an illegitimate degradation of the environment.

Property rights, it turns out, are not fixed. They change. They are a product of society and of social decisions. As society changes, so too do property rights. And the changes in property rights are contested, subject to political power and social struggle.
WHY DO WE PROTECT PRIVATE PROPERTY?

Although we often take property rights for granted, as though they are based on some absolute standard, in reality they are both changing and ambiguous. Moreover, many widely accepted ideas about property rights start to fall apart when we ask: Why do we protect private property?

For example, suppose a family has a deed on a particular field. Why do we as a society say that another family cannot come along, take part of that field, and sow and reap their own crops? Does it make any difference if the family with the deed has never used the field for any productive purpose, but has simply let it sit idle?

Or, for another example, suppose a pharmaceutical company develops a new antibiotic. Why do we allow that company the right to take out a patent and then prevent other firms or individuals from producing and selling that same antibiotic? Does it make any difference if the antibiotic is one that would save the lives of many people were it more readily available—that is, available at a lower price than the company charges?

Or, for still another example, what if a man owns a large house in the suburbs, an extensive apartment in the city, a ski lodge in the mountains, a beach house at the shore, two or three other homes at convenient sites, three yachts, a jet plane, and seven cars? Why do we prevent a poor man who has nothing—no home, no car, and certainly no yacht or jet plane—from occupying one of these many homes?

Perhaps the most common argument in favor of our protection of private property is the claim: We protect private property because it works to do so. That is, secure property rights are viewed as a basis for a stable and prosperous society. If people do not know that their accumulated wealth—held in the form of cash, land, houses, or factories—will be protected by society, they will see little point in trying to accumulate. According to the argument, if the pharmaceutical company cannot be assured of the profit from its patent, it will have no incentive to finance the research that leads to the drug's development. And if the state did not protect people's wealth, society could be in a continual state of instability and conflict.

As a defense of private property rights, however, this it-works-to-do-so argument is incomplete, as the Waschak and Barman cases illustrate, because it does not tell us what to do when property rights come into conflict with one another. This defense of property rights is also flawed because it is too vague, failing to provide a sufficiently clear statement of what things can legitimately be held as private property. Can air or water or people be held as private property? Can a patent be held forever?

What's more, the argument puts defenders of property rights in a precarious position because it implicitly concedes that private property rights exist in order to serve the larger good of society. If we determine that the larger good of society dictates a change in property rights—new restrictions on the use of property, for example—then the it-works-to-do-so argument provides no defense.

In many instances, property owners have claimed that environmental regulations infringe on their property rights. Property owners who are prevented from establishing a CAFO as in the Borman case, from filling wetlands, from building along fragile coast lines, or from destroying the habitat of an endangered species argue that government regulation is, in effect, taking away their property because it is reducing the value of that property. And they demand payment for this "taking." Such a claim loses its ideological and legal force, however, in a world where property rights change, where they are a creation of society, and where the larger good of society is the ultimate justification for protecting private property.

While questions about property rights are surrounded by ideology, legal complications, and arguments about the larger good of society, at the core of these questions lie fundamental disputes about the distribution of wealth. Who gets to use a field, the extent of a pharmaceutical company's patent rights, the preservation of a rich man's houses—each of these examples
illustrates a conflict over the distribution of wealth as much as it illustrates a complication of how we define and protect property rights. Property rights are the rules of the game by which society's wealth gets divided up, and how we shape those rules is very much connected to how we define the larger good of society.

**PATENTS VERSUS LIFE**

The relationship between property rights and the larger good of society has come to a head in recent years in the dispute over patent rights and AIDS drugs. It has become increasingly apparent that, when it comes to protecting the property rights of the pharmaceutical companies that hold patents on these life-saving drugs, it doesn't work to do so.

In low-income countries, multinational pharmaceutical companies have attempted to enforce their patents on life-saving AIDS drugs and prevent the provision of these drugs at affordable prices. The matter has been especially important in several African countries where governments, ignoring the companies' patents, have taken steps to allow local production or importation of low-cost generic forms of the drugs. Large pharmaceutical corporations such as Glaxo, Merck, and Roche have fought back, and their resistance has received extensive support from the U.S. government. In 1998, for example, the South African government of Nelson Mandela passed a law allowing local firms to produce low-cost versions of the AIDS drugs on which U.S. pharmaceutical firms hold patents. The Clinton administration responded on behalf of the firms, accusing the South Africans of "unfair trade practices" and threatening the country with trade sanctions if it implemented the law. The drug companies have since backed off, seeking compromises that would allow access to the drugs in particular cases but that would avoid precedents undermining their property rights in the patents.

The conflict between patent rights and the availability of AIDS drugs, however, has continued and spread. In Thailand, for example, the Government Pharmaceutical Organization (GPO) sought permission from the country's Commerce Department to produce a drug, didanosine, for which Bristol-Myers Squibb holds the patent. In spite of the fact that the locally produced drug would allow treatment of close to a million HIV-positive people in Thailand who would otherwise be unable to afford the didanosine, the permission was rejected because the Thai Commerce Department feared trade retaliation from the United States. Instead, the GPO was only allowed to produce a form of the drug that has greater side effects. Early in 2004, however, Bristol-Myers Squibb ceded the issue. Fearing public outcry and damaging precedents in the courts, the company surrendered in Thailand its exclusive patent rights to manufacture and sell the drug.

These conflicts have not been confined to the particular case of AIDS drugs, but have also been major issues in World Trade Organization (WTO) negotiations on the international extension of patent rights in general. Popular pressure and government actions in several low-income regions of the world have forced compromises from the companies and at the WTO.

But the dispute is far from over, and it is not just about formal issues of property rights and patents. At its core, it is a dispute over whether medical advances will be directed toward the larger good of society or toward greater profits for the pharmaceutical companies and their shareholders. It is a dispute over the distribution of wealth and income.

"FREETHE MOUSE!"

Patents and, similarly, copyrights are a form of property (known as "intellectual property") that is quite clearly a creation of society, and the way society handles patents and copyrights does a great deal to shape the distribution of wealth and income. Acting through the state (the Department of Commerce in the United States), society gives the creator of a new product exclusive rights—in effect, monopoly control—to make, use, or sell the item, based on the
general rationale that doing so will encourage the creation of more products (machines, books, music, pharmaceuticals, etc.).

The general rationale for these property rights, however, does not tell us very much about their nature. How long should patents and copyrights last? What can and what cannot be patented? What, exactly, constitutes an infringement of the copyright holder's property rights? And what if the rationale is wrong in the first place? What if patent and copyright protections are not necessary to promote creative activity? The answer to each of these questions is contested terrain, changing time and again as a consequence of larger political and social changes.

Beyond the issue of AIDS drugs, there are several other patent or copyright-related conflicts that illustrate how these rights change through conflict and the exercise of political power. One case is the Napster phenomenon, where people have shared music files over the Internet and generated outcry and lawsuits from music companies. This battle over property rights, inconceivable a generation ago, is now the subject of intense conflict in the courts.

An especially interesting case where rights have been altered by the effective use of political power has been the Mickey Mouse matter. In 1998, Congress passed the Sonny Bono Copyright Term Extension Act, extending copyright protection 20 years beyond what existing regulations provided for. One of the prime beneficiaries of—and one of the strongest lobbyists for—this act was the Disney company; the act assures Disney's control over Mickey Mouse until 2023—and Pluto, Goofy, and Donald Duck until 2025, 2027, and 2029, respectively.

Not surprisingly, the Copyright Extension Act aroused opposition, campaigning under the banner "Free the Mouse!" Along with popular efforts, the act was challenged in the courts. While the challenge had particular legal nuances, it was based on the seemingly reasonable argument that the Copyright Extension Act, which protects creative activity retroactively, could have no impact now on the efforts of authors and composers who created their works in the first half of the 20th century. The Supreme Court, apparently deciding that its view of the law trumped this reasonable argument, upheld the act. Congress and the Court provided a valuable handout to Disney and other firms, but it is hard to see how a 20-year extension of copyright protection will have any significant impact on creative efforts now or in the future.

"COULD YOU PATENT THE SUN?"

Indeed, in a recent paper issued by the Federal Reserve Bank of Minneapolis, economists Michele Boldrin and David K. Levine suggest that the governments granting of protection through patents and copyrights may not be necessary to encourage innovation. When government does grant these protections, it is granting a form of monopoly. Boldrin and Levine argue that when "new ideas are built on old ideas," the monopoly position embodied in patents and copyrights may stifle rather than encourage creativity. Microsoft, a firm that has prospered by building new ideas on old ideas and then protecting itself with patents and copyrights, provides a good example, for it is also a firm that has attempted to control new innovations and limit the options of competitors who might bring further advances. (Microsoft, dependent as it is on microprocessors developed in federal research programs and on the government-sponsored emergence of the Internet, is also a good example of the way property is often brought into being by public, government actions and then appropriated by private interests. But that is another story.)

Boldrin and Levine also point out that historically there have been many periods of thriving innovation in the absence of patents and copyrights. The economic historian David Landes relates how medieval Europe was "one of the most inventive societies that history has known." Landes describes, as examples, the development of the water wheel (by the early 11th century), eyeglasses (by the early 14th century), and the mechanical clock (by the late 13th century). Also, first invented by the Chinese in the ninth century, printing rapidly developed in Europe by the middle of the 15th century with the important addition of movable type. Yet the first patent statute
was not enacted until 1474, in Venice, and the system of patents spread widely only with the rise of the Industrial Revolution. (There had been earlier ad hoc patents granted by state authorities, but these had limited force.)

Even in the current era, experience calls into question the necessity of patents and copyrights to spur innovations. The tremendous expansion of creativity on the Internet and the associated advances of open-access software, in spite of Microsoft's best efforts to limit potential competitors, illustrate the point.

The most famous inventor in U.S. history, Benjamin Franklin, declined to obtain patents for his various devices, offering the following principle in his autobiography: "That as we enjoy great Advantages from the Inventions of Others, we should be glad of an Opportunity to serve others by any Invention of ours, and this we should do freely and generously." Probably the most outstanding example of successful research and scientific advance without the motivation of patents and consequent financial rewards is the development of the polio vaccine. Jonas Salk, the principal creator of the polio vaccine, like Franklin, did not seek patents for his invention, one that has saved and improved countless lives around the world. Salk was once asked who would control the new drug. He replied: "Well, the people, I would say. There is no patent. Could you patent the sun?"

It turns out, then, that there is no simple answer to the question: "Why do we protect private property?" because the meaning of private property rights is not fixed but is a continually changing product of social transformation, social conflict, and political power. The courts are often the venue in which property rights are defined, but, as illustrated by the Pennsylvania and Iowa cases, the definitions provided by the courts change along with society.

The scourge of AIDS combined with the advent of the current wave of globalization have established a new arena for conflict over patent laws governing pharmaceuticals, and an international social movement has arisen to contest property laws in this area. The advances of information technology have likewise generated a new round of legal changes, and the interests, demands, and actions of a vast array of music listeners will be a major factor affecting those changes. With the emergence of the environmental movement and widespread concern for the protection of the natural environment, traditional views of how owners can use their land are coming into question. When society begins to question property rights, it is also questioning the distribution of wealth and income, and it is questioning the distribution of power.

Few realms of property rights can be taken for granted for very long. Whether we are talking about property in the most tangible form as land or property in the intangible form of patents and copyrights, the substance of property rights—who has a right to what and why—is continually changing.

Do soaring corporate profits (higher as a share of national income than at any time since 1950) and a green Christmas on Wall Street (green as in record-setting multimillion dollar bonuses for investment bankers) have you worried about economic inequality? How about real wages that are lower and poverty rates higher than when the current economic expansion began five years ago? If that is not enough to make you worry, try this. The editors of the Wall Street Journal me spilling a whole lot of ink these days to convince their readers that today's inequality is just not a problem. Besides that, there is not much to be done about inequality, say the editors, since taxes are already soaking the rich.

Not even Ben Bernanke, the new head of the Fed, is prepared to swallow the editors' line this time. Inequality in the U.S. economy "is increasing beyond what is healthy," Bernanke told Congress, although like the editors he finds it a "big challenge to think about what to do about it."

There is real reason to worry. By nearly every measure, inequality today is at a level not seen since the Great Depression. And by historical standards, the rich have hardly overpaid in taxes for their decades-long economic banquet.

Once you remove the Journal editors' spin, the "actual evidence" from the Congressional Budget Office (CBO) makes clear that the charge of worsening inequality and a declining tax burden on the rich is anything but "trumped up." The CBO's latest numbers document a lopsided economic growth that has done little to improve the lot of most households while it has paid off handsomely for those at the top. From 1979 to 2004, the poorest quintile saw their average real (i.e., inflation-adjusted) income barely budge, increasing just 2.0% over the entire period. The middle-income quintile enjoyed a larger but still modest real-income gain of 14.6% over the 25-year span, while the best-off fifth enjoyed a 63.0% gain. But the 153.9% jump in the real income of the richest 1% far outdistanced even the gains of the neat-rich. (See figure.)

The Journal's editors are right about one thing: a widening income gap is a long-term trend that has persisted regardless of the party in power. The well-to-do made out like bandits during the Clinton years as well as the Bush years. In fact, postwar inequality, after peaking in 2000, did retreat somewhat in the first four Bush years as the stock market bubble burst, cutting into the income share of the most well-off, who hold the vast majority of corporate stock. (In 2004, the wealthiest 1% of U.S. households held 36.9% of common stock by value; the wealthiest 10% held 78.7%.)

The increase in the gulf between the haves and the have-nots during the Bush years, however, has hardly been modest. In 2004, as in 1999 and in 2000, the share of pre-tax income going to the richest 1% is greater than the share they received in any year since 1929, according to the ground-breaking historical study of inequality by economists Thomas Piketty and Emmanuel Saez. Barron's magazine, the Dow Jones business and financial weekly, put it succinctly in their recent cover story, "Rich America, Poor America": "never in history have the haves had so much."

FEAST AND FAMINE

The editors' banquet scenario is unconvincing, to say the least. First off, before we examine the bill for the banquet, we ought to look at what the 100 guests were served. Not everyone got the same meal; in fact, the economic banquet of the last two and a half decades was a feast for some and a famine for others. Most people got modest portions indeed. The income, or serving size if you will, of the average guest was just one sixteenth of the economic feast lavished on
the richest 1%. Surely even Wall Street Journal editors wouldn't expect the average taxpayer to subsidize the culinary indulgences of the rich.

Second, the well-to-do picked up much less of the tab for their banquet than the Journal's editorials suggest. True enough, the richest 1% of taxpayers now pay more than one-third of all income taxes. But the federal tax bill is not confined to income taxes alone. It also includes payroll taxes (like PICA, the Social Security tax) and excise taxes (for example, on cars) that fall more heavily on low-income households than the income tax does, making up much of their tax bill. Taking those taxes into account does make a substantial difference in the share of the total federal tax bill shouldered by the rich. In 2004, the richest 1% paid just over one-quarter (25.3%), not one-third, of all federal taxes. (See table.) No working American ate for free.

Beyond federal tax liabilities, the banquet tab also includes state and local taxes. Those taxes, especially state sales taxes, fall most heavily on those who were served the smallest portions: low-income earners. Once state and local taxes are included, the tax share of the richest 1% falls to just over one-fifth, not much more than their share of national income as calculated by the IRS. According to these estimates, provided by the Washington-based think tank Citizens for Tax Justice, the U.S. tax code taken in its entirety does little to redistribute income. By any definition, our tax system is at best mildly progressive, and surely not "highly progressive" as the Journal claims.

On top of all that, when the bill for today's economic banquet came due, the Bush administration somehow decided that the guests as a group had overpaid. The purported excess over the amount of the bill should, at least according to the Bush administration's reasoning, go back to each member of the group in tax cuts, in proportion with what they contributed toward paying the bill. Those who contributed the most should get the most back; those who contributed less should get less back. And those whom the rest are treating to dinner, of course, should get nothing back.

But the Bush tax cuts don't manage to conform to even this version of fairness, at least not when it comes to the share of the cuts going to the super-rich. The richest 1% of taxpayers, with average household income well over $1 million, get a whopping 35.9% of the benefits of the Bush tax cuts, or an annual tax cut of $48,311 during this decade, well in excess of their one-quarter (25.3% to be exact) share of the federal tax burden.

All told, the U.S. tax system does not soak the rich, especially after the Bush tax cuts. In 2004, the effective federal tax rate—that is, the share of total income anyone hands over to the government in federal taxes—for the richest 1% was 24.6%, according to Citizens for Tax Justice, far lower than it was in the 1970s. By historical standards, or by any reasonable definition, taxes on the rich have not reached the saturation point.

On top of that, the effective tax rate for all federal, state, and local taxes combined for the poorest fifth of households is 19.7%—well over half the effective tax rate of 32.8% that the richest 1% pay—and that's after taking into account the Earned Income Tax Credit that some low-income households receive. With an average income of $1,259,700, as opposed to $15,400, that rate falls far short of exhausting the ability of the superrich to pay. It hardly represents a contribution to the bill for the economic banquet of the last two and a half decades that is in proportion to the large and lavish meal they've enjoyed.
## SHARE OF TOTAL TAX LIABILITIES AND EFFECTIVE TAX RATES PAID BY DIFFERENT INCOME GROUPS, 2004

<table>
<thead>
<tr>
<th>Income Category</th>
<th>Share of Total Tax Liabilities</th>
<th>Effective Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Federal</td>
<td>Federal, State, and Local</td>
</tr>
<tr>
<td>Lowest Quintile</td>
<td>0.9%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Second Quintile</td>
<td>4.5%</td>
<td>5.5%</td>
</tr>
<tr>
<td>Middle Quintile</td>
<td>9.7%</td>
<td>10.5%</td>
</tr>
<tr>
<td>Fourth Quintile</td>
<td>17.6%</td>
<td>19.0%</td>
</tr>
<tr>
<td>Highest Quintile</td>
<td>67.1%</td>
<td>62.6%</td>
</tr>
<tr>
<td>Top 1%</td>
<td>25.3%</td>
<td>20.8%</td>
</tr>
</tbody>
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### WHAT WOULD ADAM SMITH SAY?

There is no reason to be flummoxed about how to address worsening inequality, even in the short run. *Wall Street Journal* columnist David Wessel, in a November 2006 article on how Democrats might tackle the wealth gap, had no problem enumerating several measures that would lessen inequality. Those included raising the minimum wage, restraining CEO pay, expanding the earned-income tax credit, and rolling back President Bush's upper-income tax cuts.

Just the thought that Congress might actually pass some of these measures was enough for the Journal's editors to minimize the reality of rising inequality and to extol the supposed tax generosity of the rich.

Too bad. Unlike the *Wall Street Journal*'s editors, even Adam Smith, the patron saint of capitalism, recognized the corrupting effect of inequality in a market economy. As Smith put it in *The Theory of Moral Sentiments*, his often overlooked lectures on ethics, the "disposition to admire, and almost to worship, the rich and the powerful, and to despise, or, at least, to neglect persons of poor and mean condition is the great and most universal cause of the corruption of our moral sentiments."

A fitting description of the attitude the *Wall Street Journal* editors seem to have toward the rich and the poor. Business executives and policymakers would do well to skip the *Journal* and go back to Smith.
Dollars and Sense Collective. (March / April 2005). Rich and poor in the

global economy: An interview with Bob Sutcliffe. Dollars & Sense.

Dollars & Sense: If someone asked you whether global inequality has grown over the past
25 years, I assume you'd say, "It depends—on how inequality is defined, on what data is used,
on how that data is analyzed." Is that fair?

Bob Sutcliffe: Yes, it's fair, but it's not enough. First, the most basic fact about world
inequality is that it is monstrously large; that result is inescapable, whatever the method or
definition. As to its direction of change in the last 25 years, to some extent there are different
answers. But also there are different questions. Inequality is not a simple one-dimensional
concept that can be reduced to a single number. Single overall measures of world inequality
(where all incomes are taken into account) give a different result from measures of the relation
of the extremes (the richest compared with the poorest). Over the last 25 years, you find that the
bottom half of world income earners seems to have gained something in relation to the top half
(so, in this sense, there is less inequality), but the bottom 10% have lost seriously in comparison
with the top -10% (thus, more inequality), and the bottom 1% have lost enormously in relation to
the top 1% (much more inequality). None of these measures is a single true measure of
inequality; they are all part of a complex structure of inequalities, some of which can lessen as
part of the same overall process in which others increase.

We do have to be clear about one data-related question that has caused huge confusion. To
look at the distribution of income in the world, you have to reduce incomes of different countries
to one standard. Traditionally it has been done by using exchange rates; this makes inequality
appear to change when exchange rates change, which is misleading. But now we have data
based on "purchasing power parity" (the comparative buying power, or real equivalence, of
currencies). Using PPP values achieves for comparisons over space what inflation-adjusted
index numbers have achieved for comparisons over time. Although many problems remain with
PPP values, they are the only way to make coherent comparisons of incomes between
countries. But they produce estimates that are astonishingly different from exchange rate-based
calculations. For instance, U.S. income per head is 34 times Chinese income per head using
exchange rates, but only 8 times as great using PPP values. (And, incidentally, on PPP
estimates the total size of the U.S. economy is now only 1.7 times that of China, and is likely to
be overtaken by it by 2011.) So when you make this apparently technical choice between two
methods of converting one currency to another, you come up not only with different figures on
income distribution but also with two totally different world economic, and thus political,
perspectives.

D&S: So even if some consensus were reached on the choices of definition, data, and
method, you're urging a complex, nuanced portrait of what is happening to global inequality,
rather than a yes or no answer. Could you give a brief outline of what you think that portrait
looks like?

BS: Most integral measures—integral meaning including the entire population rather than
comparing the extremes—that use PPP figures suggest that overall income distribution at the
global level during the last 25 years has shown a slight decline in inequality, though there is
some dissent on this. In any event this conclusion is tremendously affected by China, a country
with a fifth of world population which has been growing economically at an unprecedented rate.
Second, there seems to me little room for debate over the fact that the relative difference
between the very rich and the very poor has gotten worse. And the smaller the extreme
proportions you compare, the greater the gap. So the immensely rich have done especially well in the last 25 years, while the extremely poor have done very badly. The top one-tenth of U.S. citizens now receive a total income equal to that of the poorest 2.2 billion people in the rest of the world.

There have also been clear trends within some countries. Some of the fastest growing countries have become considerably more unequal. China is an example, along with some other industrializing countries like Thailand. The most economically liberal of the developed countries have also become much more unequal—for instance, the United States, the United Kingdom, and Australia—and so have the post-communist countries. The most extreme figures for inequality are found in a group of poor countries including Namibia and Botswana in southern Africa and Paraguay and Panama in Latin America.

Finally, the overall index of world inequality (measured by the Gini coefficient, a measure of income distribution) is about the same as that for two infamously unequal countries, South Africa and Brazil. And in the last few years it has shown no signs of improvement whatsoever.

**D&S:** People use the terms "unimodal" and "bimodal" to describe the global distribution of income. Can you explain what these mean? Also, you have referred elsewhere to a possible trimodal distribution—what does that refer to?

**BS:** The mode of a distribution is its most common value. In many countries there is one level of income around which a large proportion of the population clusters; at higher or lower levels of income there are progressively fewer people, so the distribution curve rises to a peak and then falls off. That is a unimodal distribution. But in South Africa, for example, due to the continued existence of entrenched ethnic division and economic inequality, the curve of distribution has two peaks—a low one, the most common income received by black citizens, and another, higher one, the most common received by whites. This is a bimodal distribution because there are two values that are relatively more common than those above or below them. Because of its origins you could call it the "Apartheid distribution." The world distribution is in many respects uncannily like that of South Africa. It could be becoming trimodal in the sense that the frequency distribution of income has three peaks—one including those in very poor countries which have not been growing economically (e.g., parts of Africa), one in those developing countries which really have been developing (e.g., in South and East Asia), and one in the high-income industrialized countries. It's a kind of "apartheid plus" form of distribution.

**D&S:** In 2002, you wrote that many institutions, like the United Nations and the World Bank, were not being exactly honest in this debate—for example, emphasizing results based on data or methods that they elsewhere acknowledged to be poor. Has this changed over the past few years? Has the quality of the debate over trends in global income inequality improved?

**BS:** The most egregious pieces of statistical opportunism have declined. But I think there is a strong tendency in general for institutions to seize on optimistic conclusions regarding distribution in order to placate critics of the present world order. This increasingly takes the form of putting too much weight on measures of welfare other than income, for instance, life expectancy, for which there has been more international convergence than in the case of income. But there has been very little discussion of the philosophical basis for using life expectancy instead of or combined with income to measure inequality. If poor people live longer but in income terms remain as relatively poor as ever, has the world become less unequal?

The problem of statistical opportunism is not confined to those who are defending the world economic order; it also exists on the left. So, on the question of inequality, there is a tendency to accept whatever numerical estimate shows greatest inequality on the false assumption that this confirms the wickedness of capitalism. But capitalist inequality is so great that the willful
exaggeration of it is not needed as the basis of anti-capitalist propaganda. It is more important for the left to look at the best indicators of the changing state of capitalism, including indicators of inequality, in order to intervene more effectively.

Finally, the quality of the debate, regardless of the intentions of the participants, is still greatly restricted by the shortage of available statistics about inequalities. That has improved somewhat in recent years although there are many things about past and present inequalities which we shall probably never know.

**D&S:** Do you see any contexts in which it's more important to focus on absolute poverty levels and trends in those levels rather than on inequality?

**BS:** The short answer is no, I do not. Plans for minimum income guarantees or for reducing the number of people lacking basic necessities can be important. But poverty always has a relative as well as an absolute component. It is a major weakness of the Millenium Development Goals, for example, that they talk about halving the number of people in absolute extreme poverty without a single mention of inequality. [The Millenium Development Goals is a U.N. program aimed at eliminating extreme poverty and achieving certain other development goals worldwide by 2015. — Eds.] And there is now a very active campaign on the part of anti-egalitarian, pro-capitalist ideologues in favor of the complete separation of the two. That is wrong not only because inequality is what partly defines poverty but more importantly because inequality and poverty reduction are inseparable. To separate them is to say that redistribution should not form part of the solution to poverty. Everyone is prepared in some sense to regard poverty as undesirable. But egalitarians see riches as pathological too. The objective of reducing poverty is integrally linked to the objective of greater equality and social justice.

**D&S:** Can you explain the paradox that China's economic liberalization since the late 1970s has increased inequality within China and at the same time reduced global inequality? Some researchers and policymakers interpret China's experience over this period as teaching us that it may be necessary for poor countries to sacrifice some equality in order to fight poverty. Do you agree with this—if not, how would you respond?

**BS:** When you measure *global* inequality, you are not just totalling the levels of inequality in individual countries. In theory all individual countries could become more unequal and yet the world as a whole become more equal, or vice versa. In China, a very poor country in 1980, average incomes have risen much faster than the world average and this has reduced world inequality. But different sections of the population have done much better than others so that inequality within China has grown. If and when China becomes on average a richer country than it is now, further unequal growth there may contribute to increasing rather than decreasing world inequality.

China's growth has been very inegalitarian, but it has been very fast. And the proportion of the population in poverty seems to have been reduced. But it is possible to envisage a more egalitarian growth path which would have been slower in aggregate but which would have reduced the number of poor people at least as much if not more than China's actual record. So I do not think it is right to say that higher inequality is the cause of reduced poverty, though it may for a time be a feature of the rapid growth which in turn creates employment and reduces poverty.

This does not mean that all increases in inequality are necessarily pathological. The famous Kuznets curve sees inequality first rising and then falling during economic growth as an initially poor population moves by stages from low-income, low-productivity work into high-income, high-productivity work, until at the end of the process 100% of the population is in the second group. If you measure inequality during such a process, it does in fact rise and then fall again to its
original level—in this example at the start everyone is equally poor, at the end everyone is equally richer. That might be called transitional inequality; many growth processes may include an element of it. In that case equality is not really being "sacrificed" to reduce poverty—poverty is reduced by a process which increases inequality and then eliminates it again. But at the same time inequality may be growing for many other reasons which are not, like the Kuznets effect, self-eliminating, but rather cumulative. When inequality grows, this malign variety tends to be more important than the self-eliminating variety. But many economists are far too ready to see growing inequality as the more benign, self-eliminating variety.

**D&S:** Where do you think the question of what is happening to global income inequality fits into the broader debate over neoliberalism and globalization?

**BS:** Many people say that since some measures of inequality started to improve in about 1980 and that is also when neoliberalism and globalization accelerated, it is those processes which have produced greater equality. There are many problems with this argument, among them the fact that at least on some measures global inequality has grown since 1980. In any case, measures which show global inequality falling in this period are, as we have seen, very strongly influenced by China. China's extraordinary growth has, of course, in part been expressed in and permitted by greater globalization (its internationalization has grown faster than its production), and it is also clear that liberalization of economic policy has played a role, though China hardly has a neoliberal economy. But to permit is not to cause. The real cause is surely to be found not so much in economic policy as in a profound social movement in which a new and highly dynamic capitalist class (combined with a supportive authoritarian state) has once again become an agent of massive capitalist accumulation, as seen before in Japan, the United States, and Western Europe. So, an important part of what we are observing in figures which show declining world inequality is not any growth of egalitarianism, but the dynamic ascent of Chinese and other Asian capitalisms.

This interview also appears on the website of the Political Economy Research Institute at the University of Massachusetts-Amherst, along with Bob Sutcliffe's working paper "A More or Less Unequal World? World Income Distribution in the 20th Century." See <www.umass.edu/peri>.
Economic inequality has been on the rise in the United States for 30-odd years. Not since the Gilded Age of the late 19th century—during what Mark Twain referred to as "the Great Barbeque"—has the country witnessed such a rapid shift in the distribution of economic resources.

Still, most mainstream economists do not pay too much attention to the distribution of income and wealth—that is, how the value of current production (income) and past accumulated assets (wealth) is divided up among U.S. households. Some economists focus their attention on theory for theory's sake and do not work much with empirical data of any kind. Others who are interested in these on-the-ground data simply assume that each individual or group gets what it deserves from a capitalist economy. In their view, if the share of income going to wage earners goes up, that must mean that wage earners are more productive and thus deserve a larger slice of the nation's total income—and vice versa if that share goes down.

Heterodox economists, however, frequently look upon the distribution of income and wealth as among the most important shorthand guides to the overall state of a society and its economy. Some are interested in economic justice; others may or may not be, but nonetheless are convinced that changes in income distribution signal underlying societal trends and perhaps important points of political tension. And the general public appears to be paying increasing attention to income and wealth inequality. Consider the strong support voters have given to recent ballot questions raising state minimum wages and the extensive coverage of economic inequality that has suddenly begun to appear in mainstream news outlets like the New York Times, the Los Angeles Times, and the Wall Street Journal, all of which published lengthy article series on the topic in the past few years. Just last month, news outlets around the country spotlighted the extravagant bonuses paid out by investment firm Goldman Sachs, including a $53.4 million bonus to the firm's CEO.

By now, economists and others who do pay attention to the issue are aware that income and wealth inequality in the United States rose steadily during the last three decades of the 20th century. But now that we are several years into the 21st, what do we know about income and wealth distribution today? Has the trend toward greater inequality continued, or are there signs of a reversal? And what can an understanding of the entire post-World War II era tell us about how to move again toward greater economic equality?

The short answers are: (1) Income distribution is even more unequal that we thought; (2) The newest data suggest the trend toward greater inequality continues, with no signs of a reversal; (3) We all do better when we all do better. During the 30 or so years after World War II the economy boomed and every stratum of society did better—pretty much at the same rate. When the era of shared growth ended, so too did much of the growth: the U.S. economy slowed down and recessions were deeper, more frequent, and harder to overcome. Growth spurts that did occur left most people out: the bottom 60% of U.S. households earned only 95 cents in 2004 for every dollar they made in 1979. A quarter century of falling incomes for the vast majority, even though average household income rose by 27% in real terms. Whew!

THE CLASSLESS SOCIETY?

Throughout the 1950s, 1960s, and 1970s, sociologists preached that the United States was an essentially "classless" society in which everyone belonged to the middle class. A new "mass market" society with an essentially affluent, economically homogeneous population, they claimed, had emerged. Exaggerated as these claims were in the 1950s, there was some reason
for their popular acceptance. Union membership reached its peak share of the private-sector labor force in the early 1950s; unions were able to force corporations of the day to share the benefits of strong economic growth. The union wage created a target for non-union workers as well, pulling up all but the lowest of wages as workers sought to match the union wage and employers often granted it as a tactic for keeping unions out. Under these circumstances, millions of families entered the lower middle class and saw their standard of living rise markedly. All of this made the distribution of income more equal for decades until the late 1970s. Of course there were outliers—some millions of poor, disproportionately blacks, and the rich family here and there.

Something serious must have happened in the 1970s as the trend toward greater economic equality rapidly reversed. Here are the numbers. The share of income received by the bottom 90% of the population was a modest 67% in 1970, but by 2000 this had shrunk to a mere 52%, according to a detailed study of U.S. income distribution conducted by Thomas Piketty and Emmanuel Saez, published by the prestigious National Bureau of Economic Research in 2002. Put another way, the top 10% increased their overall share of the nation's total income by 15 percentage points from 1970 to 2000. This is a rather astonishing jump—the gain of the top 10% in these years was equivalent to more than the total income received annually by the bottom 40% of households.

To get on the bottom rung of the top 10% of households in 2000, it would have been necessary to have an adjusted gross income of $104,000 a year. The real money, though, starts on the 99th rung of the income ladder—the top 1% received an unbelievable 21.7% of all income in 2000. To get a handhold on the very bottom of this top rung took more than $384,000.

The Piketty-Saez study (and subsequent updates), which included in its measure of annual household income some data, such as income from capital gains, that generally are not factored in, verified a rising trend in income inequality which had been widely noted by others, and a degree of inequality which was far beyond most current estimates.

The Internal Revenue Service has essentially duplicated the Piketty-Saez study. They find that in 2003, the share of total income going to the "bottom" four-fifths of households (that's 80% of the population!) was only slightly above 40%. (See Figure 1.) Both of these studies show much higher levels of inequality than were previously thought to exist based on widely referenced Census Bureau studies. The Census studies still attribute 50% of total income to the top fifth for 2003, but this number appears to understate what the top fifth now receives—nearly 60%, according to the IRS.

**A BRAVE NEW (GLOBALIZED) WORLD FOR WORKERS**

Why the big change from 1970 to 2000? That is too long a story to tell here in full. But briefly, we can say that beginning in the early 1970s, U.S. corporations and the wealthy individuals who largely own them had the means, the motive, and the opportunity to garner a larger share of the nation's income—and they did so.

Let’s start with the motive. The 1970s saw a significant slowdown in U.S. economic growth, which made corporations and stockholders anxious to stop sharing the benefits of growth to the degree they had in the immediate postwar era.

Opportunity appeared in the form of an accelerating globalization of economic activity. Beginning in the 1970s, more and more U.S.-based corporations began to set up production operations overseas. The trend has only accelerated since, in part because international communication and transportation costs have fallen dramatically. Until the 1970s, it was very difficult—essentially unprofitable—for giants like General Electric or General Motors to operate plants offshore and then import their foreign-made products into the United States. So from the 1940s to the 1970s, U.S. workers had a geographic lever, one they have now almost entirely lost. This erosion in workers’ bargaining power has undermined the middle class and decimated
the unions that once managed to assure the working class a generally comfortable economic existence. And today, of course, the tendency to send jobs offshore is affecting many highly trained professionals such as engineers. So this process of gutting the middle class has not run its course.

Given the opportunity presented by globalization, companies took a two-pronged approach to strengthening their hand vis-a-vis workers: (1) a frontal assault on unions, with decertification elections and get-tough tactics during unionization attempts, and (2) a debilitating war of nerves whereby corporations threatened to move offshore unless workers scaled back their demands or agreed to givebacks of prior gains in wage and benefit levels or working conditions.

A succession of U.S. governments that pursued conservative—or pro-corporate—economic policies provided the means. Since the 1970s, both Republican and Democratic administrations have tailored their economic policies to benefit corporations and shareholders over workers. The laundry list of such policies includes:

* new trade agreements, such as NAFTA, that allow companies to cement favorable deals to move offshore to host nations such as Mexico;
* tax cuts for corporations and for the wealthiest households, along with hikes in the payroll taxes that represent the largest share of the tax burden on the working and middle classes;
* lax enforcement of labor laws that are supposed to protect the right to organize unions and bargain collectively.

**EXPLODING MILLIONAIRISM**

Given these shifts in the political economy of the United States, it is not surprising that economic inequality in 2000 was higher than in 1970. But at this point, careful readers may well ask whether it is misleading to use data for the year 2000, as the studies reported above do, to demonstrate rising inequality. After all, wasn't 2000 the year the NASDAQ peaked, the year the dot-corn bubble reached its maximum volume? So if the wealthiest households received an especially large slice of the nation's total income that year, doesn't that just reflect a bubble about to burst rather than an underlying trend?

To begin to answer this question, we need to look at the trends in income and wealth distribution since 2000. And it turns out that after a slight pause in 2000-2001, inequality has continued to rise. Look at household income, for example. According to the standard indicators, the U.S. economy saw a brief recession in 2000-2001 and has been in a recovery ever since. But the median household income has failed to recover. In 2000 the median household had an annual income of $49,133; by 2005, after adjusting for inflation, the figure stood at $46,242. This 6% drop in median household income occurred while the inflation-adjusted Gross Domestic Product expanded by 14.4%.

When the Census Bureau released these data, it noted that median household income had gone up slightly between 2004 and 2005. This point was seized upon by Bush administration officials to bolster their claim that times are good for American workers. A closer look at the data, however, revealed a rather astounding fact: Only 23 million households moved ahead in 2005, most headed by someone aged 65 or above. In other words, subtracting out the cost-of-living increase in Social Security benefits and increases in investment income (such as profits, dividends, interest, capital gains, and rents) to the over-65 group, workers again suffered a decline in income in 2005.

Another bit of evidence is the number of millionaire households—those with net worth of $1 million or more excluding the value of a primary residence and any IRAs. In 1999, just before the bubbles burst, there were 7.1 million millionaire households in the United States. In 2005,
there were 8.9 million, a record number. Ordinary workers may not have recovered from the 2000-2001 rough patch yet, but evidently the wealthiest households have!

Many economists pay scant attention to income distribution patterns on the assumption that those shifts merely reflect trends in the productivity of labor or the return to risk-taking. But worker productivity rose in the 2000-2005 period, by 27.1% (see Figure 2). At the same time, from 2003 to 2005 average hourly pay fell by 1.2%. (Total compensation, including all forms of benefits, rose by 7.2% between 2000 and 2005. Most of the higher compensation spending merely reflects rapid increases in the health insurance premiums that employers have to pay just to maintain the same levels of coverage. But even if benefits are counted as part of workers' pay—a common and questionable practice—productivity growth outpaced this elastic definition of "pay" by 50% between 1972 and 2005.)

And at the macro level, recent data released by the Commerce Department demonstrate that the share of the country's GDP going to wages and salaries sank to its lowest postwar level, 45.4%, in the third quarter of 2006 (see Figure 3). And this figure actually overstates how well ordinary workers are doing. The "Wage & Salary" share includes all income of this type, not just production workers' pay. Corporate executives' increasingly munificent salaries are included as well. Workers got roughly 65% of total wage and salary income in 2005, according to survey data from the U.S. Department of Labor; the other 35% went to salaried professionals—medical doctors and technicians, managers, and lawyers—who comprised only 15.6% of the sample.

Moreover, the "Wage & Salary" share shown in the National Income and Product Accounts includes bonuses, overtime, and other forms of payment not included in the Labor Department survey. If this income were factored in, the share going to nonprofessional, nonmanagerial workers would be even smaller. Bonuses and other forms of income to top employees can be many times base pay in important areas such as law and banking. Goldman Sachs's notorious 2006 bonuses are a case in point; the typical managing director on Wall Street garnered a bonus ranging between $1 and $3 million.

So, labor's share of the nation's income is falling, as Figure 3 shows, but it is actually falling much faster than these data suggest. Profits, meanwhile, are at their highest level as a share of GDP since the booming 1960s.

These numbers should come as no surprise to anyone who reads the paper: story after story illustrates how corporations are continuing to squeeze workers. For instance, workers at the giant auto parts manufacturer Delphi have been told to prepare for a drop in wages from $27.50 an hour in 2006 to $16.50 an hour in 2007. In order to keep some of Caterpillar's manufacturing work in the United States, the union was cornered into accepting a contract in 2006 that limits new workers to a maximum salary of $27,000 a year — no matter how long they work there—compared to the $38,000 or more that long-time Caterpillar workers make today. More generally, for young women with a high school diploma, average entry-level pay fell to only $9.08 an hour in 2005, down by 4.9% just since 2001. For male college graduates, starter-job pay fell by 7.3% over the same period.

AIDING AND ABETTING

And the federal government is continuing to play its part, facilitating the transfer of an ever-larger share of the nation's income to its wealthiest households. George W. Bush once joked that his constituency was "the haves and the have-mores" — this may have been one of the few instances in which he was actually leveling with his audience. Consider aspects of the four tax cuts for individuals that Bush has implemented since taking office. The first two cut the top nominal tax rate from 39.6% to 35%. Then, in 2003, the third cut benefited solely those who hold wealth, reducing taxes on dividends from 39.6% to 15% and on capital gains from 20% to 15%. (Bush's fourth tax cut — in 2006 — is expected to drop taxes by 4.8% percent for the top
one tenth of one percent of all households, while the median household will luxuriate with an extra nickel per day.)

So, if you make your money by the sweat of your brow and you earned $200,000 in 2003, you paid an effective tax rate of 21%. If you earned a bit more, say another $60,500, you paid an effective tax rate of 35% on the additional income. But if, with a flick of the wrist on your laptop, you flipped some stock you had held for six months and cleared $60,500 on the transaction, you paid the IRS an effective tax rate of only 15%. What difference does it make? Well, in 2003 the 6,126 households with incomes over $10 million saw their taxes go down by an average of $521,905 from this one tax cut alone.

These tax cuts represent only one of the many Bush administration policies that have abetted the ongoing shift of income away from most households and toward the wealthiest ones. And what do these top-tier households do with all this newfound money? For one thing, they save. This is in sharp contrast to most households. While the top fifth of households by income has a savings rate of 23%, the bottom 80% as a group dissave — in other words, they go into debt, spending more than they earn. Households headed by a person under 35 currently show a negative savings rate of 16% of income. Today overall savings — the savings of the top fifth minus the dis-savings of the bottom four-fifths—are slightly negative, for the first time since the Great Depression.

Here we find the crucial link between income and wealth accumulation. Able to save nearly a quarter of their income, the rich search out financial assets (and sometimes real assets such as houses and businesses) to pour their vast funds into. In many instances, sometimes with inside information, they are able to generate considerable future income from their invested savings. Like a snowball rolling downhill, savings for the rich can have a turbo effect—more savings generates more income, which then accumulates as wealth.

**LIFESTYLES OF THE RICH**

Make the rich even richer and the creative forces of market capitalism will be unleashed, resulting in more savings and consequently more capital investment, raising productivity and creating abundance for all. At any rate, that’s the supply-side/neoliberal theory. However—and reminiscent of the false boom that defined the Japanese economy in the late 1980s—the big money has not gone into productive investments in the United States. Stripping out the money pumped into the residential real estate bubble, inflation-adjusted investment in machinery, equipment, technology, and structures increased only 1.4% from 1999 through 2005—an average of 0.23% per year. Essentially, productive investment has stagnated since the close of the dot-corn boom.

Instead, the money has poured into high-risk hedge funds. These are vast pools of unregulated funds that are now generating 40% to 50% of the trades in the New York Stock Exchange and account for very large portions of trading in many U.S. and foreign credit and debt markets.

And where is the income from these investments going? Last fall media mogul David Geffen sold two paintings at record prices, a Jasper Johns ($80 million) and a Willem de Kooning ($63.5 million), to two of "today's crop of hedge-fund billionaires" whose cash is making the art market "red-hot," according to the *New York Times*.

Other forms of conspicuous consumption have their allure as well. Boeing and Lufthansa are expecting brisk business for the newly introduced 787 airplane. The commercial version of the new Boeing jet will seat 330, but the VIP version offered by Lufthansa Technik (for a mere $240 million) will have seating for 35 or fewer, leaving room for master bedrooms, a bar, and the transport of racehorses or Rolls Royces. And if you lose your auto assembly job? It should be easy to find work as a dog walker: High-end pet care services are booming, with sales more than doubling between 2000 and 2004. Opened in 2001, Just Dogs Gourmet expects to have 45
franchises in place by the end of 2006 selling hand-decorated doggie treats. And then there is Camp Bow Wow, which offers piped-in classical music for the dogs (oops, "guests") and a live Camper Cam for their owners. Started only three years ago, the company already has 140 franchises up and running.

According to David Butler, the manager of a premiere auto dealership outside of Detroit, sales of Bentleys, at $180,000 a pop, are brisk. But not many $300,000 Rolls Royces are selling. "It's not that they can't afford it," Butler told the New York Times, "it's because of the image it would give." Just what is the image problem in Detroit? Well, maybe it has something to do with those Delphi workers facing a 40% pay cut. Michigan's economy is one of the hardest-hit in the nation. GM, long a symbol of U.S. manufacturing prowess, is staggering, with rumors of possible bankruptcy rife. The best union in terms of delivering the goods for the U.S. working class, the United Auto Workers, is facing an implosion. Thousands of Michigan workers at Delphi, GM, and Ford will be out on the streets very soon. (The top three domestic car makers are determined to permanently lay off three-quarters of their U.S. assembly-line workers—nearly 200,000 hourly employees. If they do, then the number of autoworkers employed by the Big Three—Ford, Chrysler, and GM—will have shrunk by a staggering 900,000 since 1978.) So, this might not be the time to buy a Rolls. But a mere $180,000 Bentley—why not?

HAD ENOUGH OF THE "HAVES"?

In the era Twain decried as the "great barbeque," the outrageous concentration of income and wealth eventually sparked a reaction and a vast reform movement. But it was not until the onset of the Great Depression, decades later, that massive labor/social unrest and economic collapse forced the country's political elite to check the growing concentration of income and wealth.

Today, it does not appear that there are, as yet, any viable forces at work to put the brakes on the current runaway process of rising inequality. Nor does it appear that this era's power elite is ready to accept any new social compact. In a recent report on the "new king of Wall Street" (a co-founder of the hedge fund/private-equity buyout corporation Blackstone Group) that seemed to typify elite perspectives on today's inequality, the New York Times gushed that "a crashing wave of capital is minting new billionaires each year." Naturally, the Times was too discreet to mention is that those same "crashing waves" have flattened the middle class. And their backwash has turned the working class every-which-way while pulling it down, down, down.

But perhaps those who decry the trend can find at least symbolic hope in the new boom in yet another luxury good. Private mausoleums, in vogue during that earlier Gilded Age, are back. For $650,000, one was recently constructed at Daytona Memorial Park in Florida—with matching $4,000 Medjool date palms for shade. Another, complete with granite patio, meditation room, and doors of hand cast bronze, went up in the same cemetery. Business is booming, apparently, with 2,000 private mausoleums sold in 2005, up from a single-year peak of 65 in the 1980s. Some cost "well into the millions," according to one the nation's largest makers of cemetery monuments. Who knows: maybe the mausoleum boom portends the ultimate (dead) end for the neo-Gilded Age.


Whenever progressives propose ways to redistribute wealth from the rich to those with low and moderate incomes, conservative politicians and economists accuse them of trying to kill the goose that lays the golden egg. The advocates of unfettered capitalism proclaim that inequality is good for the economy because it promotes economic growth. Unequal incomes, they say, provide the incentives necessary to guide productive economic decisions by businesses and individuals. Try to reduce inequality, and you'll sap growth. Furthermore, the conservatives argue, growth actually promotes equality by boosting the have-nots more than the haves. So instead of fiddling with who gets how much, the best way to help those at the bottom is to pump up growth.

But these conservative prescriptions are absolutely, dangerously wrong. Instead of the goose-killer, equality turns out to be the goose. Inequality stifles growth; equality gooses it up. Moreover, economic expansion does not necessarily promote equality—instead, it is the types of jobs and the rules of the economic game that matter most.

**INEQUALITY: GOOSE OR GOOSE-KILLER?**

The conservative argument may be wrong, but it's straightforward. Inequality is good for the economy, conservatives say, because it provides the right incentives for innovation and economic growth. First of all, people will only have the motivation to work hard, innovate, and invest wisely if the economic system rewards them for good economic choices and penalizes bad ones. Robin Hood-style policies that collect from the wealthy and help those who are worse off violate this principle. They reduce the payoff to smart decisions and lessen the sting of dumb ones. The result: people and companies are bound to make less efficient decisions. "We must allow [individuals] to fail, as well as succeed, and we must replace the nanny state with a regime of self-reliance and self-respect," writes conservative lawyer Stephen Kinsella in *The Freeman: Ideas on Liberty* (not clear how the free woman fits in). To prove their point, conservatives point to the former state socialist countries, whose economies had become stagnant and inefficient by the time they fell at the end of the 1980s.

If you don't buy this incentive story, there's always the well-worn trickle-down theory. To grow, the economy needs productive investments: new offices, factories, computers, and machines. To finance such investments takes a pool of savings. The 'rich save a larger fraction of their incomes than those less well-off. So to spur growth, give more to the well-heeled (or at least take less away from them in the form of taxes), and give less to the down-and-out. The rich will save their money and then invest it, promoting growth that's good for everyone.

Unfortunately for trickle-down, the brilliant economist John Maynard Keynes debunked the theory in his *General Theory of Employment, Interest, and Money* in 1936. Keynes, whose precepts guided liberal U.S. economic policy from the 1940s through the 1970s, agreed that investments must be financed out of savings. But he showed that most often it's changes in investment that drive savings, rather than the other way around. When businesses are optimistic about the future and invest in building and retooling, the economy booms, all of us make more money, and we put some of it in banks, 401 (k)s, stocks, and so on. That is, saving grows to match investment. When companies are glum, the process runs in reverse, and savings shrink to equal investment. This leads to the "paradox of thrift": if people try to save too much, businesses will see less consumer spending, will invest less, and total savings will end up diminishing rather than growing as the economy spirals downward. A number of Keynes's
followers added the next logical step: shifting money from the high-saving rich to the high-
spending rest of us, and not the other way around, will spur investment and growth.

Of the two conservative arguments in favor of inequality, the incentive argument is a little
weightier. Keynes himself agreed that people needed financial consequences to steer their
actions, but questioned whether the differences in payoffs needed to be so huge. Certainly state
socialist countries' attempts to replace material incentives with moral exhortation have often
fallen short. In 1970, the Cuban government launched the Gran Zafra (Great Harvest), an
attempt to reap 10 million tons of sugar cane with (strongly encouraged) volunteer labor.
Originally inspired by Che Guevara's ideal of the New Socialist Man (not clear how the New
Socialist Woman fit in), the effort ended with Fidel Castro tearfully apologizing to the Cuban
people in a nationally broadcast speech for letting wishful thinking guide economic policy.

But before conceding this point to the conservatives, let's look at the evidence about the
connection between equality and growth. Economists William Easterly of New York University
and Gary Fields of Cornell University have recently summarized this evidence:

- Countries, and regions within countries, with more equal incomes grow faster. (These
growth figures do not include environmental destruction or improvement. If they knocked off
points for environmental destruction and added points for environmental improvement, the
correlation between equality and growth would be even stronger, since desperation drives poor
people to adopt environmentally destructive practices such as rapid deforestation.)
- Countries with more equally distributed land grow faster.
- Somewhat disturbingly, more ethnically homogeneous countries and regions grow
faster—presumably because there are fewer ethnically based inequalities.

In addition, more worker rights are associated with higher rates of economic growth,
according to Josh Bivens and Christian Weller, economists at two Washington think tanks, the
Economic Policy Institute and the Center for American Progress.

These patterns recommend a second look at the incentive question. In fact, more equality
can actually strengthen incentives and opportunities to produce.

EQUALITY AS THE GOOSE

Equality can boost growth in several ways. Perhaps the simplest is that study after study
has shown that farmland is more productive when cultivated in small plots. So organizations
promoting more equal distribution of land, like Brazil's Landless Workers' Movement, are not
just helping the landless poor—they're contributing to agricultural productivity!

Another reason for the link between equality and growth is what Easterly calls "match
effects," which have been highlighted in research by Stanford's Paul Roemer and others in
recent years. One example of a match effect is the fact that well-educated people are most
productive when working with others who have lots of schooling. Likewise, people working with
computers are more productive when many others have computers (so that, for example, e-mail
communication is widespread, and know-how about computer repair and software is easy to
come by). In very unequal societies, highly educated, computer-using elites are surrounded by
majorsities with little education and no computer access, dragging down their productivity. This
decreases young people's incentive to get more education and businesses' incentive to invest in
computers, since the payoff will be smaller.

Match effects can even matter at the level of a metropolitan area. Urban economist Larry
Lebedur looked at income and employment growth in 85 U.S. cities and their neighboring
suburbs. He found that where the income gap between those in the suburbs and those in the
city was largest, income and job growth was slower for everyone.
"Pressure effects" also help explain why equality sparks growth. Policies that close off the low-road strategy of exploiting poor and working people create pressure effects, driving economic elites to search for investment opportunities that pay off by boosting productivity rather than squeezing the have-nots harder. For example, where workers have more rights, they will place greater demands on businesses. Business owners will respond by trying to increase productivity, both to remain profitable even after paying higher wages, and to find ways to produce with fewer workers. The CIO union drives in U.S. mass production industries in the 1930s and 1940s provide much of the explanation for the superb productivity growth of the 1950s and 1960s. (The absence of pressure effects may help explain why many past and present state socialist countries have seen slow growth, since they tend to offer numerous protections for workers but no right to organize independent unions.) Similarly, if a government buys out large landholdings in order to break them up, wealthy families who simply kept their fortunes tied up in land for generations will look for new, productive investments. Industrialization in Asian "tigers" South Korea and Taiwan took off in the 1950s on the wings of funds freed up in exactly this way.

**INEQUALITY, CONFLICT, AND GROWTH**

Inequality hinders growth in another important way: it fuels social conflict. Stark inequality in countries such as Bolivia and Haiti has led to chronic conflict that hobbles economic growth. Moreover, inequality ties up resources in unproductive uses such as paying for large numbers of police and security guards—attempts to prevent individuals from redistributing resources through theft.

Ethnic variety is connected to slower growth because, on the average, more ethnically diverse countries are also more likely to be ethnically divided. In other words, the problem isn't ethnic variety itself, but racism and ethnic conflict that can exist among diverse populations. In nations like Guatemala, Congo, and Nigeria, ethnic strife has crippled growth—a problem alien to ethnically uniform Japan and South Korea. The reasons are similar to some of the reasons that large class divides hurt growth. Where ethnic divisions (which can take tribal, language, religious, racial, or regional forms) loom large, dominant ethnic groups seek to use government power to better themselves at the expense of other groups, rather than making broad-based investments in education and infrastructure. This can involve keeping down the underdogs—slower growth in the U.S. South for much of the country's history was linked to the Southern system of white supremacy. Or it can involve seizing the surplus of ethnic groups perceived as better off—in the extreme, Nazi Germany's expropriation and genocide of the Jews, who often held professional and commercial jobs.

Of course, the solution to such divisions is not "ethnic cleansing" so that each country has only one ethnic group—in addition to being morally abhorrent, this is simply impossible in a world with 191 countries and 5,000 ethnic groups. Rather, the solution is to diminish ethnic inequalities. Once the 1964 Civil Rights Act forced the South to drop racist laws, the New Souths economic growth spurt began. Easterly reports that in countries with strong rule of law, professional bureaucracies, protection of contracts, and freedom from expropriation—all rules that make it harder for one ethnic group to economically oppress another—ethnic diversity has no negative impact on growth.

If more equality leads to faster growth so everybody benefits, why do the rich typically resist redistribution? Looking at the ways that equity seeds growth helps us understand why. The importance of pressure effects tells us that the wealthy often don't think about more productive ways to invest or reorganize their businesses until they are forced to. But also, if a country becomes very unequal, it can get stuck in an "inequality trap." Any redistribution involves a tradeoff for the rich. They lose by giving up part of their wealth, but they gain a share in increased economic growth. The bigger the disparity between the rich and the rest, the more the
"rich have to lose, and the less likely that the equal share of boosted growth they'll get will make up for their loss. Once the gap goes beyond a certain point, the wealthy have a strong incentive to restrict democracy, and to block spending on education which might lead the poor to challenge economic injustice—making reform that much harder.

DOES ECONOMIC GROWTH REDUCE INEQUALITY?

If inequality isn't actually good for the economy, what about the second part of the conservatives' argument—that growth itself promotes equality? According to the conservatives, those who care about equality should simply pursue growth and wait for equality to follow.

"A rising tide lifts all boats," President John E Kennedy famously declared. But he said nothing about which boats will rise fastest when the economic tide comes in. Growth does typically reduce poverty, according to studies reviewed by economist Gary Fields, though some "boats"—especially families with strong barriers to participating in the labor force—stay "stuck in the mud." But inequality can increase at the same time that poverty falls, if the rich gain even faster than the poor do. True, sustained periods of low unemployment, like that in the late 1990s United States, do tend to raise wages at the bottom even faster than salaries at the top. But growth after the recessions of 1991 and 2001 began with years of "jobless recoveries"—growth with inequality.

For decades the prevailing view about growth and inequality within countries was that expressed by Simon Kuznets in his 1955 presidential address to the American Economic Association. Kuznets argued that as countries grew, inequality would first increase, then decrease. The reason is that people will gradually move from the low-income agricultural sector to higher-income industrial jobs—with inequality peaking when the workforce is equally divided between low- and high-income sectors. For mature industrial economies, Kuznets's proposition counsels focusing on growth, assuming that it will bring equity. In developing countries, it calls for enduring current inequality for the sake of future equity and prosperity.

But economic growth doesn't automatically fuel equality. In 1998, economists Klaus Deininger and Lyn Squire traced inequality and growth over time in 48 countries. Five followed the Kuznets pattern, four followed the reverse pattern (decreasing inequality followed by an increase), and the rest showed no systematic pattern. In the United States, for example:

- incomes became more equal during the 1930s through 1940s New Deal period (a time that included economic decline followed by growth)
- from the 1950s through the 1970s, income gaps lessened during booms and expanded during slumps
- from the late 1970s forward, income inequality worsened fairly consistently, whether the economy was stagnating or growing.

The reasons are not hard to guess. The New Deal introduced widespread unionization, a minimum wage, social security, unemployment insurance, and welfare. Since the late 1970s, unions have declined, the inflation-adjusted value of the minimum wage has fallen, and the social safety net has been shredded. In the United States, as elsewhere, growth only promotes equality if policies and institutions to support equity are in place.

TRAPPED?

Let's revisit the idea of an inequality trap. The notion is that as the gap between the rich and everybody else grows wider, the wealthy become more willing to give up overall growth in return for the larger share they're getting for themselves. The "haves" back policies to control the
"have-nots," instead of devoting social resources to educating the poor so they'll be more productive.

Sound familiar? It should. After two decades of widening inequality, the last few years have brought us massive tax cuts that primarily benefit the wealthiest, at the expense of investment in infrastructure and the education, child care, and income supports that would help raise less well-off kids to be productive adults. Federal and state governments have cranked up expenditures on prisons, police, and "homeland security," and Republican campaign organizations have devoted major resources to keeping blacks and the poor away from the polls. If the economic patterns of the past are any indication, we're going to pay for these policies in slower growth and stagnation unless we can find our way out of this inequality trap.


A few years ago, I appeared regularly on talk radio as part of a campaign to block the repeal of the estate tax. As an economist, my job was to correct the distortions and outright hucksterism that the Heritage Foundation and other right-wing think tanks used to demonize the estate tax. In their hands, this modest tax on the inheritance of the richest 2% of U.S. taxpayers became a "death tax" that double-taxed assets in family estates, destroyed family farms and small businesses, and put a brake on economic growth.

Once that was done, assuming anyone was still listening, I was supposed to make the affirmative case for taxing wealth. But before I got very far, whichever conservative expert I was debating would inevitably interrupt and ask, "Isn't what you advocate straight out of Marx's Communist Manifesto?" After my first stammering reply, I got pretty good at saying, "Perhaps, but calls for taxing wealth are also straight out of The Gospel of Wealth by Andrew Carnegie. Do you think he was anti-capitalist?" Then it was the conservative's turn to stammer.

In fact, Marx, the philosopher of socialism, and Carnegie, the predatory capitalist turned philanthropist, weren't the only ones to call for heavy taxation of estates. Over the 19th and 20th centuries, they were joined by great political economists who, unlike Marx, were more concerned with saving capitalism from its excesses than replacing it. Let's take a look at what all these writers had to say.

KARL MARX

Sure enough, the manifesto of the Communist League, penned by Karl Marx and Fredrick Engels in 1848, called for the heavy taxation and even confiscation of inherited wealth. In the Communist Manifesto, Marx and Engels developed a transitional program intended to lead Europe away from the horrors of industrial capitalism—a system guided by "naked self interest"—and toward a socialist society. The ten-step program that Marx and Engels laid out for the most advanced countries began with these demands:
1. Abolition of property in land and application of all rents of land to public purposes.

2. A heavy or progressive graduated income tax.

3. Abolition of all rights of inheritance.

These clauses need to be understood in context of the socialist debate of the day and Marx's other writings. The first clause did not target the capitalist who directed production on the farm or in the mine, but the landowner or rentier who collected a return merely by owning the land or mine. It was their rents, not the capitalist's profits, that Marx and Engels argued should go to the state to be used for public purposes.

A heavy or progressive graduated income tax, the second clause, hardly seems radical. The U.S. federal income tax had a top tax bracket of 90% in the early post-World War II period (prior to 1962), although effective income tax rates were far lower than that.

Abolishing rights of inheritance, on the other hand, would be a radical change. The third clause targeted large estates; despite its wording, it was not intended to apply to small holders of property. "The distinguishing feature of Communism," as Marx and Engels made clear, "is not the abolition of property generally, but the abolition of bourgeois property." Marx and Engels were concerned with the social relation of capital based on the private ownership of the means of production. They saw this as the root of capitalist class power and the basis of class antagonisms that involved "the exploitation of the many by the few." The abolition of capitalist private property was surely the backbone of the *Communist Manifesto,* the most influential economic pamphlet ever written.

JOHN STUART MILL

Writing in the middle of the 19th century as well, the far more respectable John Stuart Mill also called for limitations on inheritance. Mill was a radical, but also a member of the English parliament and the author of the *Principles of Political Economy,* the undisputed bible of economists of his day. Mill regarded the laws of distribution of capitalism (who got paid what) to be a matter of social custom and quite malleable, unlike the inalterable market laws that governed production (how commodities were made). Indeed, he devoted long sections of the later editions of *Principles* to then-novel experiments with workers' cooperatives and Utopian communities which he thought could distribute resources more equitably.

Mill openly attacked the institution of inheritance and entered a plea for progressive death duties. Observing the gaping inequalities that the industrial system had produced in England, he wrote that there existed "an immense majority" who were condemned from their birth to a life of "never-ending toil" eking out a "precarious subsistence." At the same time, "a small minority" were born with "all the external advantages of life without earning them by any merit or acquiring them by any exertion of their own." To curtail this "unearned advantage," Mill called for the "limitation of the sum which any one person may acquire by gift or inheritance to the amount
sufficient to constitute a moderate independence.” He argued for a "system of legislation that favors equality of fortunes" to allow individuals to realize "the just claim of the individual to the fruits, whether great or small, of his or her own industry." Otherwise, as he famously observed, all the mechanical inventions of the industrial revolution would only enable "a greater population to live the same life of drudgery and imprisonment and an increased number of manufacturers and others to make fortunes."

HENRY GEORGE

Henry George, a journalist who taught himself economics, burst onto the American scene in 1879 with the publication of *Progress and Poverty*. This instant bestseller launched a crusade for a "single tax" on land that would put an end to the speculation that George saw as the root cause of the country's unjust distribution of wealth. Although rejected by the economics profession, *Progress and Poverty* sold more copies than all the economic texts previously published in the United States. It is easy to see why. In epic prose, George laid out the problem plaguing U.S. society at the close of the 19th century:

"The association of poverty with progress is the greatest enigma of our times. It is the central fact from which spring industrial, social, and political difficulties that perplex the world... It is the riddle which the Sphinx of Fate puts to our civilization and which not to answer is to be destroyed. So long as all the increased wealth which modern progress brings goes but to build up great fortunes, to increase luxury, and make sharper the contrast between the House of Have and the House of Want, progress is not real and cannot be permanent." George traced the maldistribution of wealth to the institution of private property in land. To end the association of poverty with progress, he argued that "we must make land common property." But, he argued, "it is not necessary to confiscate land; it is only necessary to confiscate rent." Taxation was his means for appropriating rent, and George proposed "to abolish all taxation save that upon land values."

Henry George's single tax on land (excluding improvements) was meant to lift the burden of taxation from labor and all productive effort and place it on the rising of value of land. That rising value, he wrote, was the product of social advancement, and should be socialized. It was unjust for such gains to remain in the hands of an individual land owner—"someone whose grandfather owned a pasture on which two generations later, society saw fit to erect a skyscraper," as Robert Heilbroner, the historian of economic ideas, put it.

*Progress and Poverty* spawned an impressive grassroots movement dedicated to undoing the wealth gap. Georigist Land and Labor clubs sprang up across the nation, and despite a concerted counter-attack by the economics profession, Georgists exerted considerable influence on U.S. tax policy. Most recently, Alaska adopted a George-like proposition. The state created the Alaska Permanent Fund and in its constitution vested the ownership of the state's oil and natural resources in the people as a whole. The Permanent Fund distributes substantial oil revenues as citizen dividends to state residents.
JOHN MAYNARD KEYNES

During the Great Depression of the 1930s, John Maynard Keynes, the pre-eminent economist of the 20th century, warned that a worsening maldistribution of wealth threatened to bring capitalism to its knees. Keynes was no radical. Instead, he was concerned with rescuing capitalism from its own excesses. Keynes’s analysis of the instabilities of capitalist economies, and his prescriptions for taming them, guided U.S. economic policy from the 1940s through the 1970s and are still tremendously influential today.

"The outstanding faults of the economic society in which we live," he wrote in The General Theory of Employment, Interest, and Money in 1936, "are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes." Keynes argued that income inequality and financial instability made for unstable demand among consumers. Without stable demand for goods and services, corporations invested less and cut jobs. Indeed, during the worst years of the Great Depression, this chain of economic events cost more than one-quarter of U.S. workers their jobs.

By 1936, Keynes wrote, British death duties, along with other forms of direct taxation, had made "significant progress toward the removal of very great disparities of wealth and income" of the 19th century. Still, he thought that much more was needed. In the last chapter of the General Theory, Keynes went so far as to propose what he called the "euthanasia of the rentier." By this he meant the gradual elimination of "the functionless investor," who made money not by working but by investing accumulated wealth. Keynes imagined a capitalist economy in which public policy kept interest rates so low that they eroded the income of the functionless investor and at the same time lowered the cost of capital (or borrowing funds) so that it was abundant enough to provide jobs for everyone. This was Keynes’s plan to support continuous full employment.

Neither the United States nor Britain ever instituted such a policy, but Keynes provided the theoretical bulwark for the "mixed economy" in which public and private investment complemented one another. He showed how government spending could compensate for the instability of private investment, with government investment rising when private investment fell. The mixed economy, which moderated capitalist instability during the post-war period, remains, in the words of economist Dani Rodrik, "the most valuable heritage the 20th century bequeaths to the 21st century in the realm of economic policy."

Today, just a few years into the 21st century, a conservative movement is trying to rob us of that bequest. The repeal of the estate tax, all but accomplished in 2001, is the sharp end of the axe its adherents are using to cut government down to size. That move is sure to fuel the very excesses that Keynes worried were likely to undo capitalism during the 1930s. It will starve the public sector of revenue, compromising its ability to stabilize the private economy. By showering tax cuts on the richest of our society, it will also exacerbate inequality at a time when the richest 1% already receive their largest share of the nation's income (before taxes) since 1936, the very year that Keynes published the General Theory. Finally, repealing the estate tax is unlikely to improve the management of our economic affairs: as Keynes caustically wrote, "the hereditary
principle in the transmission of wealth and the control of business is the reason why the leadership of the capitalist cause is weak and stupid."

ANDREW CARNEGIE

It is not easy for me to invoke Andrew Carnegie's defense of the estate tax. For over a decade, I lived in Pittsburgh, where Andrew Carnegie is remembered as the ruthless capitalist who built his public libraries up and down the Monongahela River valley with the money he sweated out of his immigrant workforce, and only after he had busted the union in the local steel mill. Carnegie actually applauded the maldistribution of wealth that Marx, Mill, George, and even Keynes railed against. As he argued, concentrated wealth "is not to be deplored, but welcomed as highly beneficial. Much better this great irregularity than universal squalor."

But despite these apologetics, Carnegie was deeply troubled by large inheritances. "Why should men leave great fortunes to their children?" he asked in his 1889 book, The Gospel of Wealth. "If this is done from affection, is it not misguided affection? Observation teaches that, generally speaking, it is not well for the children that they should be so burdened."

Carnegie was also an unabashed supporter of the estate tax. "The growing disposition to tax more and more heavily large estates left at death," Carnegie declared, "is a cheering indication of the growth of a salutary change in public opinion." He added that "of all forms of taxation, this seems the wisest. ... By taxing estates heavily at death, the state marks its condemnation of the selfish millionaire's unworthy life." Finally, Carnegie warned that "the more society is organized around the preservation of wealth for those who already have it, rather than building new wealth, the more impoverished we will all be."

FROM HERE TO THERE

Today, whether one is out to save capitalism from its excesses or to bring capitalist exploitation to a halt, taxing accumulated wealth and especially large estates is essential. On that point, Marx, Mill, George, Keynes, and even Carnegie all agreed. But to subject wealth to fair taxation, we will need to do more than resurrect the ideas of these thinkers. We will need a spate of grassroots organizing—from workers' organizations to organizations of the socially-conscious well-to-do—dedicated to the demand that those who have benefited most from our collective efforts give back the most.

This can be done. A hundred years ago, populists concerned about the concentration of wealth forced Congress to enact the original estate tax. They also pushed through a constitutional amendment allowing a progressive income tax that raised revenue for public services. These kinds of advances can happen again.

It will be no easy task. Politics at the beginning of the 21st century are far less progressive than they were at the beginning of the 20th century. But with the greatest of political economists and even a predatory capitalist on our side, perhaps we have a chance.