Grounded by an Income Gap

By ALEXANDER STILLE

For 30 years the gap between the richest Americans and everyone else has been growing so much that the level of inequality is higher than in any other industrialized nation.

What no one can quite figure out, though, is why, or even whether anything should be done about it.

"Why there has been increasing inequality in this country has been one of the big puzzles in our field and has absorbed a lot of intellectual effort," said Martin Feldstein, a professor of economics at Harvard University and the chairman of President Ronald Reagan's Council of Economic Advisers. "But if you ask me whether we should worry about the fact that some people on Wall Street and basketball players are making a lot of money, I say no."

With inequality growing throughout the industrialized world, Mr. Feldstein, like many economists, has come to see inequality as a basic feature of the new high-tech economic scene, the natural consequence of an economy that has begun to reward talent, skills, education and entrepreneurial risk with increasing efficiency.

"There is no doubt that market forces have spoken in favor of more inequality," said Richard Freeman, a professor of economics at Harvard. Just look at the figures. Most of the incredible wealth generated during the 1990's boom went to the richest of the rich. "Forty-seven percent of the total real income gain between 1983 and 1998 accrued to the top 1 percent of income recipients, 42 percent went to the next 19 percent, and 12 percent accrued to the bottom 80 percent," writes Edward Wolff, an economics professor at New York University in a new edition of his book "Top Heavy" (New Press), about growing economic inequality.

In the 90's only the people at the very top and very bottom made any real improvement. Wages for full-time male workers, for example, have grown only 1.3 percent since 1989. The richest 10 percent of American households, economists point out, have 34.5 percent more financial wealth than the average family. These changes have persisted through Democratic and Republican administrations and began at the same time in Britain, even before Margaret Thatcher's market-oriented policies, Mr. Wolff said, indicating that they are not simply the product of economic policy but reflect deep structural changes in the economy. The leading hypotheses are technological advances, increases in trade and imports, growing immigration and declining union membership.

But where economists split is whether anything should be done about the divide. "The question is whether you lean against the wind of the market to try to preserve decent living standards for working and poor people," Mr. Freeman said. "Europe and Japan are leaning against the wind."

Many liberal economists say the United States should, too.

Levels of equality and inequality play a large role in people's sense of satisfaction or dissatisfaction with their lot in life, said Ronald Inglehart, a sociology professor at the University of Michigan, who for 30 years has been conducting something called the World Values Survey. "Interestingly the levels of dissatisfaction are highest in both the most equal countries in the world, the Communist countries or those that have just emerged from Communism, and also those with very high levels of inequality," he said.
The only way you can achieve total equality is through coercion, he said, which makes people feel they have no control over their lives and no way to benefit from their labor. But highly unequal, extremely stratified societies, where people feel crushed by the economic power of others, breed similar dissatisfaction.

Conservative economists insist that the problem with the new economy is not that some people make a lot of money but a series of noneconomic factors that are holding others back. "The problem is not inequality but poverty," Mr. Feldstein said. Poor education, the breakdown of the family and what he terms "low cognitive ability," together, may be responsible for holding back many of those mired in persistent poverty. He added that some poor people may choose not to work as hard as investment bankers working 70 hours a week, or to skip school, and so earn less.

James Heckman, a professor of economics at the University of Chicago, argued: "We have to look at some of the basic structural reasons why we have so many unskilled, poorly educated, poorly motivated people in our society. One of the most amazing phenomena of recent years is why so many people, especially minorities, have not responded to the opportunities out there. There has been a big increase in demand for skills, educated blacks have done very well, but college completion rates have leveled off."

Perhaps never before, economists say, has education been such an important factor in predicting future earnings. Marvin Kosters, a senior economist with the American Enterprise Institute, a conservative think tank in Washington, said the earning advantage for those who attend college over those who do not has doubled to about 60 percent from 30 percent in the early 1970's.

"Even finishing high school improves your income by about 30 percent," Mr. Heckman said.

One of the biggest reasons people fail to finish school is teenage pregnancy and the strains of running a household as a single parent. "More than 40 percent of all female-headed families with children had incomes below the poverty line," Prof. Marc L. Miringoff of Fordham University writes in his recent book, "The Social Health of the Nation" (Oxford University Press).

Meanwhile the high school dropout rate for Hispanics -- the fastest-growing ethnic group in the country -- remains more than 30 percent, more than twice that of blacks and nearly three times that of non-Latino whites.

David Ellwood, a liberal economist who does worry about inequality, said this may be just the beginning of a trend toward greater inequality. "We are in the midst of two huge demographic changes," he said. "In the last 20 years our prime labor force -- people between 25 and 54 -- grew by 20 million people, 16 million of them native born. In the next 20 years the growth of that labor force will be zero, all growth will be by immigrants and by older workers." Immigrants generally do not have the same education and language skills as native-born workers, he said, meaning that there will be fewer skilled laborers and more unskilled, accentuating the income gap.

"The other thing that is happening is a slowdown in the upgrading of the work force," Mr. Ellwood added. "Baby boomers got a lot more education than their parents. There was a lot of upgrading in skills. But the children of baby boomers are not more educated than their parents. This would mean that wage inequality could increase rapidly."

Economists like Mr. Feldstein consider the level of inequality -- measured by something economists call the Gini quotient -- irrelevant. "If the stock market goes up, which we generally regard as a good thing, the Gini quotient may well go up, too, as stockholders get richer," he said. "If the stock market collapses and everyone gets poorer, the Gini quotient would go down. So I think that's the wrong way to focus the question." If one person's good fortune does not harm others, why should we worry?

The problem, said Alan Krueger, an economist at Princeton University, is that Mr. Feldstein's analysis looks at money in the abstract. "There is a relationship between economic power and political power," he
said, noting that as the income gap has increased, political participation among those at the bottom of the economic ladder has dropped precipitously. Poorer people may be dropping out of the process because they feel they have no voice.

To Mr. Ellwood a host of social ills come with growing inequality. Problems like drug use, teenage pregnancy, crime and lowered life expectancy all have gotten worse with widening income inequality, while these improved somewhat when the poverty rate went down and real wages went up in the late 90's.

"If you are born to a woman in the bottom quarter of the income scale or grow up in the a single-parent household, the odds that you will go on to college, even if you have the same grades and the same test scores, are much lower," Mr. Ellwood said.

Curiously, this is a point on which the views of conservatives like Mr. Heckman converge with those of liberal economists.

"Never has the accident of birth mattered more," Mr. Heckman said. "If I am born to educated, supportive parents, my chances of doing well are totally different than if I were born to a single parent or abusive parents. I am a University of Chicago libertarian, but this is a case of market failure: children don't get to 'buy' their parents, and so there has to be some kind of intervention to make up for these environmental differences."

Even Adam Smith, the prophet of laissez-faire economics, had a strong concern for equity if not equality. "No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable," he wrote. "It is but equity, besides, that they who feed, clothe and lodge the whole body of the people should have such a share of the produce of their own labor as to be themselves tolerably well fed, clothed and lodged."