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Economic Inequality: The *Wall Street Journal* Is Just Wrong

For anyone with even a passing familiarity with issues associated with economic inequality, *The Wall Street Journal* front page story last week was shocking. It's use of bad data was a misuse of this important forum.

In effect, the article says that economic inequality was never really a problem, and even if it is we no longer have to worry about it. These conclusions are just plain wrong.

The *Journal* article effectively leads the reader to two conclusions: First, any issues that may exist around economic inequality are disappearing, because of the likely decline in the outsize incomes of the top 1% of Americans, those with a minimum income of $400,000. Second, the problem was never really that bad in the first place. Using Census Bureau data, which has been widely discredited for this type of analysis, the article asserts that growth at the top of our society was only slightly higher than for the nation as a whole, saying

The gains at the top didn't necessarily come at the expense of others, because the economy expanded greatly after 1980, letting incomes grow across the spectrum. But those at the top end rose more rapidly. In 1980, for instance, the income of the top 5% of households was 2.86 times median incomes; by 2007, it was 3.52 times the median. In other words, the gap widened by 23%, Census data show.

Unfortunately, few conclusions could be further off the mark.

In some eras, when America did well everyone did well. However, this has been far from true for the past thirty years. Moreover, as a result of the Great Recession we may have to worry more about economic inequality rather than less.

First, let's start with what we know about economic inequality. Scholars have, with few exceptions, reached a consensus that Census Data is not appropriate for measuring high incomes. To ensure the privacy of individuals, the census assumes a maximum individual income of $999,000 or less. So, it does not capture the true income of oil traders or anyone else earning $100 million, $50 million or five million per year. Second, the Census data does not include capital gains, a central source of the wealth created in private equity and hedge funds. Finally, the Census is based on samples, and the small proportion of wealthy Americans, as compared to the total proportion, further limits the accuracy of its projections.

In response to these limitations, two economists, Professor Emanuel Saez at Berkeley and Professor Thomas Pickety at the Paris School of Economic developed a highly regarded technique for measuring the distribution of income, including capital gains, by using IRS data. So, the Saez-Pickety data goes back to 1913, when the modern income tax was introduced. Saez updates the data each year, and the analysis of the most recent data, for 2007, was released in early August of this year.

The validity of Census Data for measuring economic inequality was the subject of intense discussion several years ago, when Alan Reynolds. of the Cato Institute, wrote an article in The *Wall Street Journal*, titled "The Top 1%... of What?" in December, 2006 similarly asserting that economic inequality had been overstated. In response, Saez posted a detailed open letter on his Web site, explaining why Census Data was entirely inadequate for measuring income inequality and refuting Reynold's claims. In the open from Saez and Pickety, they state:

> The ... Census Bureau estimates are based on survey data which are not suitable to study high incomes... In contrast, tax return data provide a very accurate picture... Our key contribution was precisely to use those tax data to construct better inequality estimates.

> In sum, our work has shown the top 1% income share has increased dramatically in recent decades... [C]onservatives like Alan Reynolds ... prefer to dismiss the facts about growing income inequality rather than face the debate on income tax progressivity at a time of growing economic disparity.

Before joining the Obama administration, an independent study by Larry Summers based on Congressional Budget Office data, similarly concluded that economic inequality had increased massively in past decades. In a June 2007 article in the *Financial Times* Summers wrote:

> Indeed, in a recent paper on tax policy prepared for the Hamilton project, my collaborators and I concluded from Congressional Budget Office data that, since 1979, changes in income distribution had raised the pre-tax incomes of the top 1 per cent of the population by $664bn or $600,000 per family - an increase of 43 per cent.By definition what one group gains from changes in the distribution of income another group must lose. The lower 80 per cent of families are $664bn poorer than they would be with a static income distribution, which works out to $7,000 less in income per family or a 14 per cent loss.

To put this in some perspective, the total gain in median family incomes adjusted for inflation between 1979 and 2004 was only 14 percent. If middle income families had shared fully in the economy's income growth over the past generation their incomes would have risen twice as rapidly!

With few exceptions, scholars have concluded the Saez-Pickety data is correct. The basic conclusion of this data, that the nation suffers from extreme and growing income inequality is essentially irrefutable. Moreover, when the latest data was released a few weeks ago, Paul Krugman called the findings of growing income inequality "truly amazing" in a blog post titled Even More Guilded.

So, the *Journal* based it's claims on data that is, with very few exceptions, considered essentially worthless for measuring income inequality.

Now, where do we really stand: The data released in August showed that, by some measures, the nation was at its highest level of income inequality in its history.

In 2007, the percent of total income received by the top 10% of families was 49.74%, or effectively one-half of the nation's total. This compares to 1980, when the top 10% received 34.63%, or about one-third of all income.

By looking at Census data, the *Journal* article finds that "the gap" in median income between the top 5% of households and all U.S. households "widened by 23%" since 1980. Such a finding may not be good, but it does not seem so extreme. This supports the unconscionable conclusion that "The gains at the top didn't necessarily come at the expense of others, because the economy expanded greatly after 1980, letting incomes grow across the spectrum." Of course, as already noted, the Census Data is completely unreliable for measuring these types of changes.

The Pickety-Saez data paints a very different picture. It shows that the average income in 2007 dollars (which adjusts for inflation) for the top 5% of households grew from $134,800 in 1980 to $220,100 in 2007; an increase of 63%. In contrast, over this 27 year period, the average real household income of the bottom 90% of families increased from $29,800 to $32,400; less than 9%.

So, real income among the top 5% grew at seven times the rate of income of the bottom 90% (63% as compared to less than 9%), an extraordinary difference of 600%. Second, these percentage increases reflect much higher absolute numbers. The average income growth of the top 5% in a single year between 1980 and 2007 was almost $3,200, which is more than the $2,600 average income growth of the bottom 90% *for the entire 27 years*. As others such as Joseph Stiglitz have noted, the vast majority of Americans have been waiting three decades for a decent raise.

It is also impossible to understand how the *Journal* could seriously assert that the income gains at the top occurred because of a widely shared growing pie, as opposed to one group taking a far larger piece of the growth.

Once again this is at odds with the Saez-Pickety data, whose conclusions are far more consistent with the real life experience of today's struggling middle income households. The data released by Saez in August shows that between 1993 and 2007, the top 1% of Americans received 50% of the entire income gains in the nation. In the shorter period between 2002 and 2007, *the top 1% received an even more concentrated 65% of the entire income gains in the nation*. In fact, on September 9th, the day before the *Wall Street Journal* article ran, the Council on Budget Priorities and Policies, released a detailed analysis of this data, titled, "Top 1 Percent of Americans Reaped Two-Thirds of Income Gains in Last Economic Expansion." This analysis, or its implications, was nowhere to be found in the *Journal* story.

In addition, I am forced to wonder about what interviews the reporters conducted before releasing the story. The central argument in the article, that the percentage of total income received by the top 1% will decline, gains enormous legitimacy by stating near the start of the piece that "Mr. Saez and other economists expect income going to the top 1% of taxpayers...will drop..by 2010." I cannot speak for Professor Saez, and I don't know whether he was interviewed for the *Journal* article, but any reading of his work suggests that the article provides a skewed representation of his views.

In a short paper accompanying the updated August data, Professor Saez concludes that "the most likely outcome is that income concentration will fall in 2008 and 2009." But, he follows this conclusion by stating that in the absence of significant policy actions such declines will be temporary:

> Based on the US historical record, falls in income concentration due to recessions are temporary unless drastic policy changes, such as financial regulation or significantly more progressive taxation, are implemented and prevent income concentration from bouncing back. Such policy changes took place after the Great Depression during the New Deal and permanently reduced income concentration till the 1970s. In contrast, recent downturns, such as the 2001 recession, lead to only very temporary drops in income concentration. (references to charts omitted).

My intense study of past history, which will soon be released in *It Could Happen Here* is in line with Professor Saez's conclusion. Once income concentration becomes a reinforcing cycle of the kind we are witnessing, it is never stopped by pure market forces. Only extensive government intervention, of the kind that will inevitably create high controversy, reverses this trend. Indeed, the policies of the New Deal, which led to the rapid decline of inequality, reflected bitter and hard fights. *Time* magazine reported in April 1936, that:

Certainly no President in recent times has so bitterly aroused the enmity of a whole class as Franklin Roosevelt has aroused the economically substantial element of the U.S. Regardless of party and regardless of region, today, with few exceptions, members of the so-called Upper Class frankly hate Franklin Roosevelt.

It's possible that the growth in income concentration may take a brief respite, but without substantial intervention the long-term trend toward ever greater concentration will march forward.

When the historians Will and Ariel Durant completed their massive multi-volume study of history, encompassing the broad sweep of time from ancient Greece to the modern United States, they subsequently wrote a short book of 102 pages titled *The Lessons of History*, in which they sought to identify the broad trends that are common to civilizations. The chapter economics and history is all of six pages, and the bulk of it addresses the inevitable concentration of income that occurs in societies over time. The Durant's bluntly conclude that such concentration ultimately leads to redistribution of some type, by "violent or peaceable" means.

We conclude that the concentration of wealth is natural and inevitable and is periodically alleviated by violent or peacable partial redistribution. In this view, all economic history is the slow heartbeat of the social organism, a vast systolic and diastole of concentrating wealth and compulsive recirculation.

The *Journal* article give us the false impression that, counter to all historical evidence, we no longer need to worry about economic inequality. It will take care of itself.

Finally, it is not even clear that the central point of the article is correct. Yes, the rich are suffering relative to the past. However, the middle class and underclass are suffering as well. Jobs continue to disappear and housing could still decline substantially. With each job loss or foreclosure, another family joins the ranks of *the former middle class*. Simon Johnston, in a *New York Times* blog post, "The Two-Track Economy: Inequality Emerging From Today's Recession", among others, has pointed out that the Great Recession may be creating an even less economically equal society:

The overall numbers on outcomes by groups can get complicated (here's a partial guide), but the simple version is: The top 10 percent of people are going to do fine, those in the middle of the income distribution have been hard hit by overborrowing, and poorer people will continue to struggle with unstable jobs and low wages.

Can the richest people spend enough to power a recovery in overall G.D.P.? Perhaps, but is that really the kind of economy you want to live in?

The United States has, over the past two decades, started to take on characteristics more traditionally associated with Latin America: extreme income inequality, rising poverty levels and worsening health conditions for many. The elite live well and seem not to mind repeated cycles of economic-financial crisis. In fact, if you want to be cynical, you might start to think that the most powerful of the well-to-do actually don't lose much from a banking sector run amok -- providing the government can afford to provide repeated bailouts (paid for presumably through various impositions on people outside the uppermost elite strata).

All of this suggests that we have a lot to worry about. On its front page, The *Wall Street Journal* may say that it never happened, and even if it did it is fixing itself. Everything we know suggest that this reading of the past is wrong, and such a future -- without determined government action -- is unlikely. The larger worry is that we will emerge from the Great Recession as a society sharply divided between a small privileged upper class, and an underclass that lacks basic economic security. What happens then?

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