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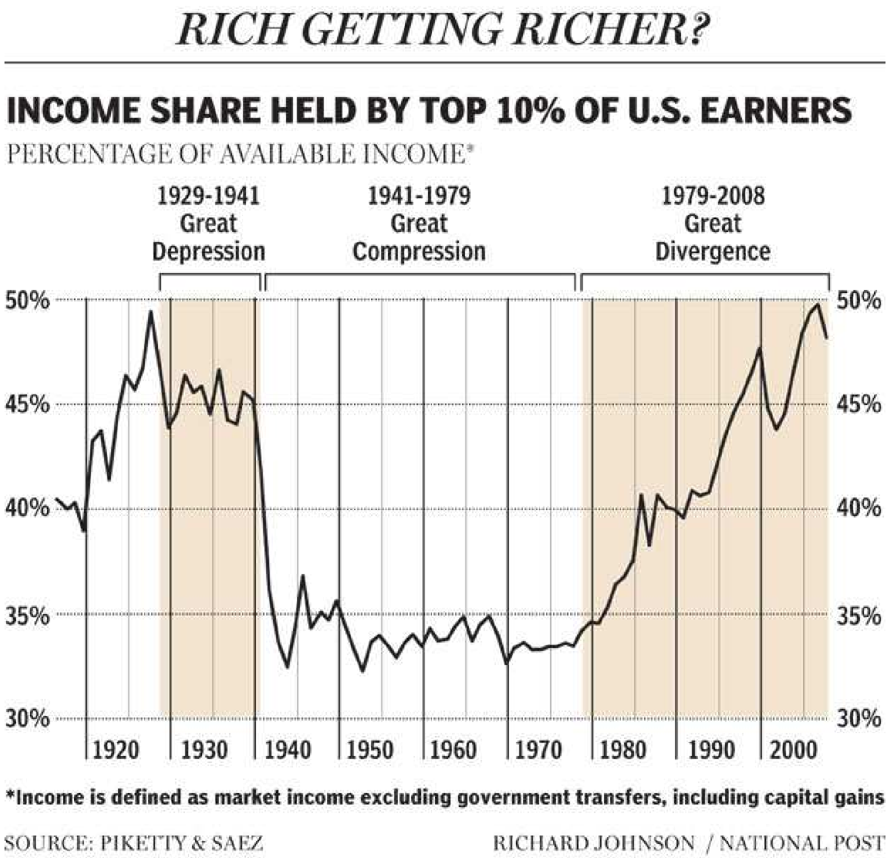
The great inequality debate, part 1: Linda McQuaig and Neil Brooks



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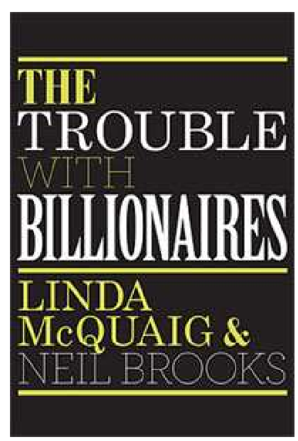
Extreme inequality is on the rise. Is Alex Rodriguez really 30 times better than Hank Aaron?

By Linda McQuaig and Neil Brooks



Billionaires are on the rise. While workers' wages have stagnated over the past 30 years, the rich have gotten richer, and the very rich have gotten wildly richer.

We're no longer amazed to hear that Tiger Woods is making US$100-million a year, or that Oprah Winfrey ranks among the billionaires. Thirty years ago, CEOs of large corporations were content to make 20 or 30 times the average income; now they feel hard done by if they only make 200 to 300 times as much. Things are even more out of whack in the financial world. In 2009, the 25 highest-paid hedge fund managers earned an average over US$1-billion each — about 24,000 times the average income.

These anecdotal reports of rising inequality have been confirmed in countless empirical studies. Perhaps the most widely cited have been a series of studies led by University of California economist

Emmanuel Saez and Thomas Piketty of the Paris School of Economics. Using income tax data, the Saez-Piketty studies show that the share of market income captured by the top 1% in the United States rose dramatically from 8.9% in 1978 to a staggering 23.5% in 2007. But even that understates the windfall at the very top. Those in the top 0.01%, for instance, increased their share more than sevenfold, from 0.86% in 1978 to 6.04% in 2007. This is the largest share of national income this very top group has received since the introduction of the U.S. income tax in 1913.

There has been no serious academic dispute over these findings. The American Economic Association awarded Emmanuel Saez the John Bates Clark Medal, given to "that American economist under the age of 40 who is adjudged to have made a significant contribution to economic thought and knowledge," largely for his work on income distribution.

This data is the basis of our recently released book, *The Trouble with Billionaires*, which documents the negative consequences of the rise of extreme inequality in Canada, the United States and Britain.

So we were surprised to discover Terence Corcoran's article in the *Post* purporting to expose the "myth" of rising inequality (Sept. 16).

Corcoran asserts that "the economic literature is full of debate, most of it in rejection of the basic premise that inequality has been dramatically on the rise." While there is some dispute over the size of the increase in income inequality among the bottom 90%, there's been no dispute that inequality has risen, and risen particularly dramatically at the very top.

Corcoran supports his case by referring to a working paper by Northwestern University economist Robert Gordon entitled "Has the Rise in American Inequality Been Exaggerated?" The paper suggests that some analysts may have overstated the increase in inequality, and notes that it has not been a "steady, ongoing process."

But Gordon doesn't take issue at all with the finding that there's been a dramatic increase in income share going to the top earners, as noted by Saez and Piketty. In the very first sentence of the paper Corcoran cites, Gordon states: "The evidence is incontrovertible that income inequality has increased in the United States since the 1960s." In fact, Gordon has documented this trend in his own studies, speculated about its causes, and even shown serious concern about its consequences. As he wrote in a published version of his working paper:

There is a simple solution to growing inequality at the top.... Let the top 1% earn its millions, but then let the government substantially boost the taxation of those rewards, not just in the form of much higher (not just 39%, how about 50%?) top-bracket tax rates, but also a reversal of all the reductions in tax rates on dividends and capital gains of the past 30 years.

So not only does Gordon clearly acknowledge the rise in inequality, he considers it a significant problem that should be addressed through major tax increases at the upper end — a position we heartily endorse. Gordon even goes on to say that "the policy proposals of the Obama administration are, at least so far, meek in contrast to the more radical needed increases in top-income tax rates."

Corcoran also refers to a critique of the Saaez-Piketty studies by Alan Reynolds of the libertarian Cato Institute. A key assertion by Reynolds is that Saez and Piketty use pretax numbers, and that, once taxes and transfers are added in, there's been no increase in inequality. This suggests that government redistribution is adequately compensating for increasing market inequality, effectively cancelling its impact. Sadly, however, this simply is not true.

Virtually every study on after-tax income in the United States shows there is little redistribution done by government, and that rising inequality is clearly evident in after-tax income, as well as in pretax income. For example, the Congressional Budget Office reports that from 1979 to 2006, the average after-tax income of the lowest fifth of tax-filers increased only 11%, while for the top 1%, it increased 256%. So much for redistribution.

Similarly, the 2008 OECD report "Growing Unequal?" notes that: "Redistribution of income by government plays a relatively minor role in the United States. Only in Korea is the effect smaller.... The effectiveness of taxes and transfers in reducing inequality has fallen still further in the past 10 years."

There's room for serious debate around the issue of extreme inequality. For instance, some commentators justify today's huge pay packages at the top on the grounds that enormous incentives are necessary to encourage top performances. But this does little to explain why Alex Rodriguez, today's top-earning baseball player, earns 30 times more (in inflation-adjusted dollars) than Hank Aaron, the top-earning player in the early 1970s, whose performance on the field was as good or better (without the benefit of steroids).

Even more dramatic examples of the disconnect between today's pay packages and performance are found throughout the world of business and finance. Let's not forget that Merrill Lynch paid its "top people" some US$4-billion in bonuses in 2009 — right after that same group of overachievers had steered the company to a US$27-billion loss, and in the process helped trigger the global economic meltdown.

Many commentators will object that higher taxes on the rich would lead to stunted economic growth. But as Gordon himself notes, "rapid economic growth from 1947 to 1973 took place in an era of top-bracket tax rates ranging from 78% to 90%. High top-bracket tax rates are not incompatible with healthy growth."

There are fascinating questions about income inequality that cry out for serious public debate, and we look forward to debating them with Corcoran and others. But let's not get caught up in a sideshow dispute over whether billionaires are just figments of our imaginations.

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Linda McQuaig is a journalist and Neil Brooks is a professor of tax law at Osgoode Hall Law School. Their book, The Trouble with Billionaires, is published this month by Penguin Books Canada. A Toronto launch event is scheduled for Tuesday at the Ryerson Student Centre and on Sunday in Calgary at the Plaza Theatre.

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