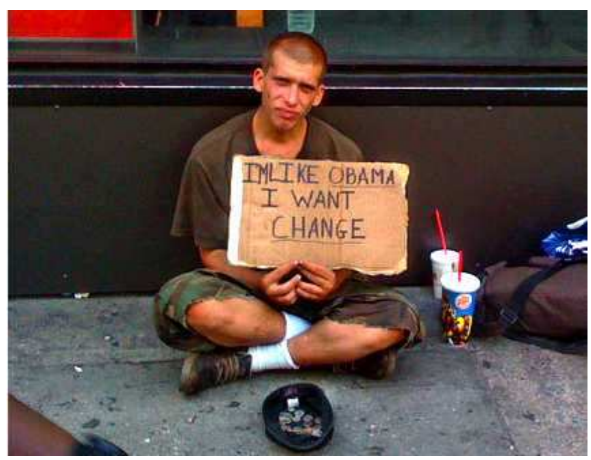
THE BUSINESS INSIDER

Economic Inequality: The Wall Street Journal Is Just Wrong

Bruce Judson | **Sep. 15, 2009, 11:57 AM** | **17**

Tags: Economy, Financial Crisis, U.S. Government, Earnings



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 per cent. 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?

Bruce Judson is a Senior Faculty Fellow at the Yale School of Management, and the author of the forthcoming book, *It Could Happen Here: America on the Brink*, which will be released by HarperCollins on Oct 6, 2009. He blogs at It Could Happen Here.

Embed This Post

What's This?

See Also:

Income Inequality Has Fallen... Let's Hope It Rises Again

Bruce Judson is Senior Faculty Fellow of Yale School Of Management.

17 Comments

Brilliant Trader said: Sep 15, 11:59 AM

That guy looks like a former AIG trader I know!

GAZA said: Sep 15, 12:10 PM

we know already
you heard from the Masters that the Slaves have it good

Wealth is relative - everyone can not be rich or poor

all of America lives off the Slave Labor of the rest of the world

even our poorest

GlassHammer said: Sep 15, 12:13 PM

The argument over economic inewquality always boils down to:

Those who don't think economic inequality is an issue simply want to die with the most stuff and could care less about a healthy society.

Let's Get Real said: Sep 15, 12:18 PM

What happens then?

I've said in the past that we are three meals from a revolution. It won't matter what the "aristocracy" does, if people can't feed themselves or their families, then all hell will break loose.

Jimbo said: Sep 15, 12:21 PM

Did your figures take into account the unrealized losses in stocks and real estate that the rich incurred over the past few years? I don't see how that you show up in IRS data. What about transfer payments (welfare, ADC, food stamps, etc.)? They wouldn't show up in tax returns yet they are certainly income to some people. You use household data without taking into account the fact that households are smaller. Using per capita information would give even less support to your theories.

What about all those figures that show middle income and poor households possessing more things like cars, computers, TVs, air conditioning, etc.? Wouldn't that indicate that things are improving more than most people think? Have you looked at other factors such as longevity and leisure activities? If all people are living longer, have more stuff and are spending more money and time on leisure activities then what's the problem???

Mike said: Sep 15, 12:38 PM

"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."

Hopefully, with their gains in Congress in 2010, Republicans will make it so that the top 1% receives 100% of the entire income gains in the nation !

Joe said: Sep 15, 12:40 PM

@ Jimbo

Exactly!

I've got workers that are on state assistance who's husbands don't work and yet they've got two cars, one is buying their second 42" LCD/Plasma TV, eating at restaurants more frequently than me, taking their kids out to disneyland and eager to take days off. And that's off of 30 hours a week @ $10/hr - classified by the state/fed as poor. Look, if our poor are living like that, then it doesn't matter whether I'm making $100k a year or $100M a year. And heck, they are twice the size of me -they aren't starving for food. The bottom line is that the poor have never had it so good. And, because of this screwed up high welfare system, many of "the poor" may be living better and easier lives than our traditional middle class (especially the last few years as the home prices have fallen and really put some stress on the middle class). If we want to lessen the actual wage disparity between the poor and rich, then we need to eliminate welfare and give "the poor" an incentive to work -otherwise, any disparity argument is pretty much moot.

Terry said: Sep 15, 12:49 PM

That is a very clever sign the man in the photo is holding.

He should try and get into marketing.

Rich said: Sep 15, 12:50 PM

Nixon was right, Yale faculty are commies. He even links to his book calling for the proletariat to throw off their chains and start a revolution haha. I'm sorry sir but this line of thinking lost its ideological verve at Kronstadt and never regained it. Equality of opportunity has proven to be the winning model and no amount of hope and change or downturns in the business cycle will ever change that. Garbage men can become millionaire CEO's, college drop outs can become billionaire entrepreneurs, it happens ever day.

Ex-Fortune 500 CEO said: Sep 15, 12:50 PM

"The bottom line is that the poor have never had it so good."

Well said.

I recently quit my job, lost all my money in Las Vegas' casino, and I never had it better.

Sleeping under a bridge and eating what I can find from the garbage can is actually quite quite an enjoyable lifestyle.

So Joe, are you thinking about becoming poor soon too?

Cafe Hayekan said:"...Those who don't think economic inequality is an issue simply want to die with the most stuff and could care less about a healthy society. " Sep 15, 12:52 PM

So true.

Ever notice that Austrian Economics tend to attract high-functioning sociopaths who, addicted to the adrenaline of chronic narcissistic rage, and impaired by the lack of any empathy, scream on and on about how their personal desires should not be tailored in any way by concerns for the general welfare, or the common good?

Justin said: Sep 15, 12:52 PM

It's debt you idiots. All the tvs and electronics are all due to increased credit available to people who will never pay it back. Incomes are stagnant for the middle class and the poor, and they are fat because the cheap food is horrible for you. Even non organic veggies and fruits are way more expensive than processed crap.

This is the fault of the fed. The wealthy elite get the money first and by the time it trickles down the purchasing power is gone. And now we've got a bunch of poor and almostpoor people who have been living off credit cards and "home equity" and they are fucked

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Paul said: Sep 15, 12:57 PM

While we are at it, how about all the tax attorney and CPA shenanigans, not to mention the Swiss bank accounts that never show up in the IRS data. As for the welfare, etc. A lot of these folks probably dont even file tax returns, so if you included them it would probably pull the median numbers down.

GlasssHammer said: Sep 15, 1:06 PM

Joe,

Welfare is the reason you didn't see the obvious signs of a depression in this recession. I also don't often go visit friends who are on welfare and say "You have many nice things in this house" in fact its the opposite of that. The other thing you tend to notice from those on welfare (the poor in general) is nice TVs, cars, etc.. only hang out for roughly 4 missed payments.

GeorgeIII said: Sep 15, 1:22 PM

"...Equality of opportunity has proven to be the winning model and no amount of hope and change or downturns in the business cycle will ever change that."

I agree. And so because it would be insane to think that Ivanka Trump and the child born to the crack-addicted mother in the projects have had equal opportunity, the govt should intervene to assist the poor child. Glad we're both on board.

"...Garbage men can become millionaire CEO's, college drop outs can become billionaire entrepreneurs, it happens ever day. "

Name one. Should be easy. Happens every day.

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john grandits said: Sep 15, 1:31 PM

'It's debt you idiots. All the tvs and electronics are all due to increased credit available to people who will never pay it back. Incomes are stagnant for the middle class and the poor, and they are fat because the cheap food is horrible for you.'

eating well, healthy is not expensive at all. lean meats, pastas, potatoes, veggies, legumes, eggs, bread, etc can be the staple of very good diet, easy to prepare, and expensive, esp if you buy in bulk. problem is that people are lazy about eating well, exercising, and leading overall healthy lifestyles. this is why we have such a huge problem with diseases such as diabetes, heart disease, etc. sure some stuff is genetic, but there's a lot we can control through personal intake and expenditure, ie caloric burn

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adrian said: Sep 15, 1:33 PM

blah blah blah redistribute the wealth blah blah blah

another professor who doesn't understand the CAPITAL part of CAPITALISM. If you want more competition and better markets, and faster growth (for all involved) get the government out of the picture. For reference, see most of american history.
