

READING 13

The Rich, the Poor, and the Growing Gap between Them—Inequality in America

The Economist

Americans do not go in for envy. The gap between rich and poor is bigger than in any other advanced country, but most people are unconcerned. Whereas Europeans fret about the way the economic pie is divided, Americans want to join the rich, not soak them. Eight out of ten, more than anywhere else, believe that though you may start poor, if you work hard, you can make pots of money. It is a central part of the American Dream.

The political consensus, therefore, has sought to pursue economic growth rather than the redistribution of income, in keeping with John Kennedy's adage that "a rising tide lifts all boats." The tide has been rising fast recently. Thanks to a jump in productivity growth after 1995, America's economy has outpaced other rich countries' for a decade. Its workers now produce over 30% more each hour they work than ten years ago. In the late 1990s everybody shared in this boom. Though incomes were rising fastest at the top, all workers' wages far outpaced inflation.

But after 2000 something changed. The pace of productivity growth has been rising again, but now it seems to be lifting fewer boats. After you adjust for inflation, the wages of the typical American worker—the one at the very middle of the income distribution—have risen less than 1% since 2000. In the previous five years, they rose over 6%. If you take into account the value of employee benefits, such as health care, the contrast is a little less stark. But, whatever the measure, it seems clear that only the most skilled workers have seen their pay packets swell much in the current economic expansion. The fruits of productivity gains have been skewed towards the highest earners, and towards companies, whose profits have reached record levels as a share of GDP. . . .

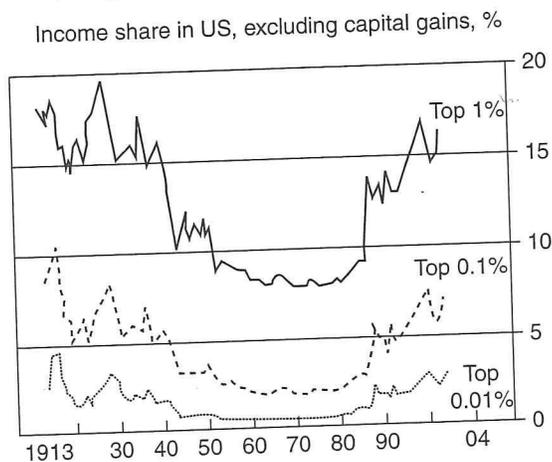
. . . The statistics suggest that the economic boom may fade. Americans still head to the shops with gusto, but it is falling savings rates and rising debts (made possible by high house prices), not real income growth, that keep their wallets open. A bust of some kind could lead to widespread political disaffection. Eventually, the country's social fabric could stretch. "If things carry on like this for long enough," muses one insider, "we are going to end up like Brazil"—a country notorious for the concentration of its income and wealth.

America is nowhere near Brazil yet. Despite a quarter century during which incomes have drifted ever farther apart, the distribution of wealth has remained remarkably stable. The richest Americans now earn as big a share of overall income as they did a century ago (see chart 1), but their share of overall wealth is much lower. Indeed, it has barely budged in the few past decades.

The elites in the early years of the 20th century were living off the income generated by their accumulated fortunes. Today's rich, by and large, are earning their money. In 1916 the richest 1% got only a fifth of their income from paid work, whereas the figure in 2004 was over 60%.

CHART 1

Rich pickings. Source: Emmanuel Saez et al.



THE NOT-SO-IDLE RICH

The rise of the working rich reinforces America's self-image as the land of opportunity. But, by some measures, that image is an illusion. Several new studies,* show parental income to be a better predictor of whether someone will be rich or poor in America than in Canada or much of Europe. In America about half of the income disparities in one generation are reflected in the next. In Canada and the Nordic countries that proportion is about a fifth.

It is not clear whether this sclerosis is increasing: the evidence is mixed. Many studies suggest that mobility between generations has stayed roughly the same in recent decades, and some suggest it is decreasing. Even so, ordinary Americans seem to believe that theirs is still a land of opportunity. The proportion who think you can start poor and end up rich has risen 20 percentage points since 1980.

That helps explain why voters who grumble about the economy have nonetheless failed to respond to class politics. John Edwards, the Democrats' vice-presidential candidate in 2004, made little headway with his tale of "Two Americas," one for the rich and one for the rest. Over 70% of Americans support the abolition of the estate tax (inheritance tax), even though only one household in 100 pays it.

Americans tend to blame their woes not on rich compatriots but on poor foreigners. More than six out of ten are sceptical of free trade. A new poll in *Foreign Affairs* suggests that almost nine out of ten worry about their jobs going offshore. Congressmen reflect their concerns. Though the economy grows, many have become vociferous protectionists.

Other rich countries are watching America's experience closely. For many Europeans, America's brand of capitalism is already far too unequal. Such sceptics will be sure to make much of any sign that the broad middle-class reaps scant benefit from the current productivity boom, setting back the course of European reform even further.

*The papers mentioned in this article can be found at www.economist.com/inequality.

The conventional tale is that the changes of the past few years are simply more steps along paths that began to diverge for rich and poor in the Reagan era. During the 1950s and 1960s, the halcyon days for America's middle class, productivity boomed and its benefits were broadly shared. The gap between the lowest and highest earners narrowed. After the 1973 oil shocks, productivity growth suddenly slowed. A few years later, at the start of the 1980s, the gap between rich and poor began to widen.

The exact size of that gap depends on how you measure it. Look at wages, the main source of income of most people, and you understate the importance of health care and other benefits. Look at household income and you need to take into account that the typical household has fallen in size in recent decades, thanks to the growth in single-parent families. Look at statistics on spending and you find that the gaps between top and bottom have widened less than for income. But every measure shows that, over the past quarter century, those at the top have done better than those in the middle, who in turn have outpaced those at the bottom. The gains of productivity growth have become increasingly skewed.

If all Americans were set on a ladder with ten rungs, the gap between the wages of those on the ninth rung and those on the first has risen by a third since 1980. Put another way, the typical worker earns only 10% more in real terms than his counterpart 25 years ago, even though overall productivity has risen much faster. Economists have long debated why America's income disparities suddenly widened after 1980. The consensus is that the main cause was technology, which increased the demand for skilled workers relative to their supply, with freer trade reinforcing the effect. Some evidence suggests that institutional changes, particularly the weakening of unions, made the going harder for people at the bottom.

Whether these shifts were good or bad depends on your political persuasion. Those on the left lament the gaps, often forgetting that the greater income disparities have created bigger incentives to get an education, which has led to a better trained, more productive workforce. The share of American workers with a college degree, 20% in 1980, is over 30% today.

THE EXCLUDED MIDDLE

In their haste to applaud or lament this tale, both sides of the debate tend to overlook some nuances. First, America's rising inequality has not, in fact, been continuous. The gap between the bottom and the middle—whether in terms of skills, age, job experience or income—did widen sharply in the 1980s. High-school dropouts earned 12% less in an average week in 1990 than in 1980; those with only a high-school education earned 6% less. But during the 1990s, particularly towards the end of the decade, that gap stabilised and, by some measures, even narrowed. Real wages rose faster for the bottom quarter of workers than for those in the middle.

After 2000 most people lost ground, but, by many measures, those in the middle of the skills and education ladder have been hit relatively harder than those at the bottom. People who had some college experience, but no degree, fared worse than high-school dropouts. Some statistics suggest that the annual income of Americans with a college degree has fallen relative to that of high-school graduates for the first time in decades. So, whereas the 1980s were hardest on the lowest skilled, the 1990s and this decade have squeezed people in the middle.

The one truly continuous trend over the past 25 years has been towards greater concentration of income at the very top. The scale of this shift is not visible from most popular measures of income or wages, as they do not break the distribution down finely enough. But several recent studies have dissected tax records to investigate what goes on at the very top.

The figures are startling. According to Emmanuel Saez of the University of California, Berkeley, and Thomas Piketty of the Ecole Normale Supérieure in Paris, the share of aggregate income going to the highest-earning 1% of Americans has doubled from 8% in 1980 to over 16% in 2004. That going to the top tenth of 1% has tripled from 2% in 1980 to 7% today. And that going to the top one-hundredth of 1%—the 14,000 taxpayers at the very top of the income ladder—has quadrupled from 0.65% in 1980 to 2.87% in 2004.

Put these pieces together and you do not have a picture of ever-widening inequality but of what

Lawrence Katz of Harvard University, David Autor of the Massachusetts Institute of Technology and Melissa Kearney of the Brookings Institution call a polarisation of the labour market. The bottom is no longer falling behind, the top is soaring ahead and the middle is under pressure.

SUPERSTARS AND SUPER-SQUEEZED

Can changes in technology explain this revised picture? Up to a point. Computers and the internet have reduced the demand for routine jobs that demand only moderate skills, such as the work of bank clerks, while increasing the productivity of the highest-skilled. Studies in Britain and Germany as well as America show that the pace of job growth since the early 1990s has been slower in occupations that are easy to computerise.

For the most talented and skilled, technology has increased the potential market and thus their productivity. Top entertainers or sportsmen, for instance, now perform for a global audience. Some economists believe that technology also explains the soaring pay of chief executives. One argument is that information technology has made top managers more mobile, since it no longer takes years to master the intricacies of any one industry. As a result, the market for chief executives is bigger and their pay is bid up. Global firms plainly do compete globally for talent: Alcoa's boss is a Brazilian; Sony's chief executive is American (and Welsh).

But the scale of America's income concentration at the top, and the fact that no other country has seen such extreme shifts, has sent people searching for other causes. The typical American chief executive now earns 300 times the average wage, up tenfold from the 1970s. Continental Europe's bosses have seen nothing similar. This discrepancy has fostered the "fat cat" theory of inequality: greedy businessmen sanction huge salaries for each other at the expense of shareholders.

Whichever explanation you choose for the signs of growing inequality, none of the changes seems transitory. The middle rungs of America's labour

market are likely to become ever more squeezed. And that squeeze feels worse thanks to another change that has hit the middle class most: greater fluctuations in people's incomes.

The overall economy has become more stable over the past quarter century. America has had only two recessions in the past 20 years, in 1990–91 and 2001, both of which were mild by historical standards. But life has become more turbulent for firms and people's income now fluctuates much more from one year to the next than it did a generation ago. Some evidence suggests that the trends in short-term income volatility mirror the underlying wage shifts and may now be hitting the middle class most.

What of the future? It is possible that the benign pattern of the late 1990s will return. The disappointing performance of the Bush era may simply reflect a job market that is weaker than it appears. Although unemployment is low, at 4.6%, other signals, such as the proportion of people working, seem inconsistent with a booming economy.

More likely, the structural changes in America's job market that began in the 1990s are now being reinforced by big changes in the global economy. The integration of China's low-skilled millions and the increased offshoring of services to India and other countries has expanded the global supply of workers. This has reduced the relative price of labour and raised the returns to capital. That reinforces the income concentration at the top, since most stocks and shares are held by richer people. More important, globalisation may further fracture the traditional link between skills and wages.

As Frank Levy of MIT points out, offshoring and technology work in tandem, since both dampen the demand for jobs that can be reduced to a set of rules or scripts, whether those jobs are for bookkeepers or call-centre workers. Alan Blinder of Princeton, by contrast, says that the demand for skills depends on whether they must be used in person: X-rays taken in Boston may be read by Indians in Bangalore, but offices cannot be cleaned at long distance. So who will be squeezed and who will not is hard to predict.

The number of American service jobs that have shifted offshore is small, some 1 [million] at the most.

And most of those demand few skills, such as operating telephones. Mr Levy points out that only 15 radiologists in India are now reading American X-rays. But nine out of ten Americans worry about offshoring. That fear may be enough to hold down the wages of college graduates in service industries.

All in all, American's income distribution is likely to continue the trends of the recent past. While those at the top will go on drawing huge salaries, those in the broad middle of the middle class will see their incomes churned. The political consequences will depend on the pace of change and the economy's general health. With luck, the offshoring of services will happen gradually, allowing time for workers to adapt their skills while strong growth will keep employment high. But if the economy slows, Americans' scepticism of globalisation is sure to rise. And even their famous tolerance of inequality may reach a limit.

DISCUSSION QUESTIONS

1. Why don't Americans complain about the rich?
2. Is technology the main cause of the widening income inequality?
3. Why will those in the middle class continue to get squeezed?

READING 14

Framing Class: Media Representations of Wealth and Poverty in America

Diana Kendall

"The Simple Life 2"—the second season of the reality show, on which the celebante Paris Hilton and her Best Friend Forever, the professional pop-star-daughter Nicole Richie, are set on a cross-country road trip—*once again takes the heaviest of topics and makes them as weightless as a social X-ray.*¹

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