

## The Great Divergence

By Timothy Noah

### ***Part One: Introducing the Great Divergence***

In 1915, a statistician at the University of Wisconsin named Willford I. King published *The Wealth and Income of the People of the United States*, the most comprehensive study of its kind to date. The United States was displacing Great Britain as the world's wealthiest nation, but detailed information about its economy was not yet readily available; the federal government wouldn't start collecting such data in any systematic way until the 1930s. One of King's purposes was to reassure the public that all Americans were sharing in the country's newfound wealth.

King was somewhat troubled to find that the richest 1 percent possessed about 15 percent of the nation's income. (A more authoritative subsequent calculation puts the figure slightly higher, at about 18 percent.<sup>1</sup>)

This was the era in which the accumulated wealth of America's richest families—the Rockefellers, the Vanderbilts, the Carnegies—helped prompt creation of the modern income tax, lest disparities in wealth turn the United States into a European-style aristocracy. The socialist movement was at its historic peak, a wave of anarchist bombings was terrorizing the nation's industrialists, and President Woodrow Wilson's attorney general, Alexander Palmer, would soon stage brutal raids on radicals of every stripe. In American history, there has never been a time when class warfare seemed more imminent.

That was when the richest 1 percent accounted for 18 percent of the nation's income. Today, the richest 1 percent account for 24 percent of the nation's income. What caused this to happen? Over the next two weeks, I'll try to answer that question by looking at all potential explanations—race, gender, the computer revolution, immigration, trade, government policies, the decline of labor, compensation policies on Wall Street and in executive suites, and education. Then I'll explain why people who say we don't need to worry about income inequality (there aren't many of them) are wrong.

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<sup>1</sup> Sticklers will note that King was looking at the year 1910, whereas the later calculation, by economists Emmanuel Saez and Thomas Piketty, looks at 1913. The point is that King, who is almost entirely forgotten by today's leading economists, pretty much nailed it.

Income inequality in the United States has not worsened steadily since 1915. It dropped a bit in the late teens, then started climbing again in the 1920s, reaching its peak just before the 1929 crash. The trend then reversed itself. Incomes started to become more equal in the 1930s and then became dramatically more equal in the 1940s.<sup>2</sup> Income distribution remained roughly stable through the postwar economic boom of the 1950s and 1960s. Economic historians Claudia Goldin and Robert Margo have termed this midcentury era the "Great Compression." The deep nostalgia for that period felt by the World War II generation—the era of *Life* magazine and the bowling league—reflects something more than mere sentimentality. Assuming you were white, not of draft age, and Christian, there probably was no better time to belong to America's middle class.

The Great Compression ended in the 1970s. Wages stagnated, inflation raged, and by the decade's end, income inequality had started to rise. Income inequality grew through the 1980s, slackened briefly at the end of the 1990s, and then resumed with a vengeance in the aughts. In his 2007 book *The Conscience of a Liberal*, the Nobel laureate, Princeton economist and *New York Times* columnist Paul Krugman labeled the post-1979 epoch the "Great Divergence."

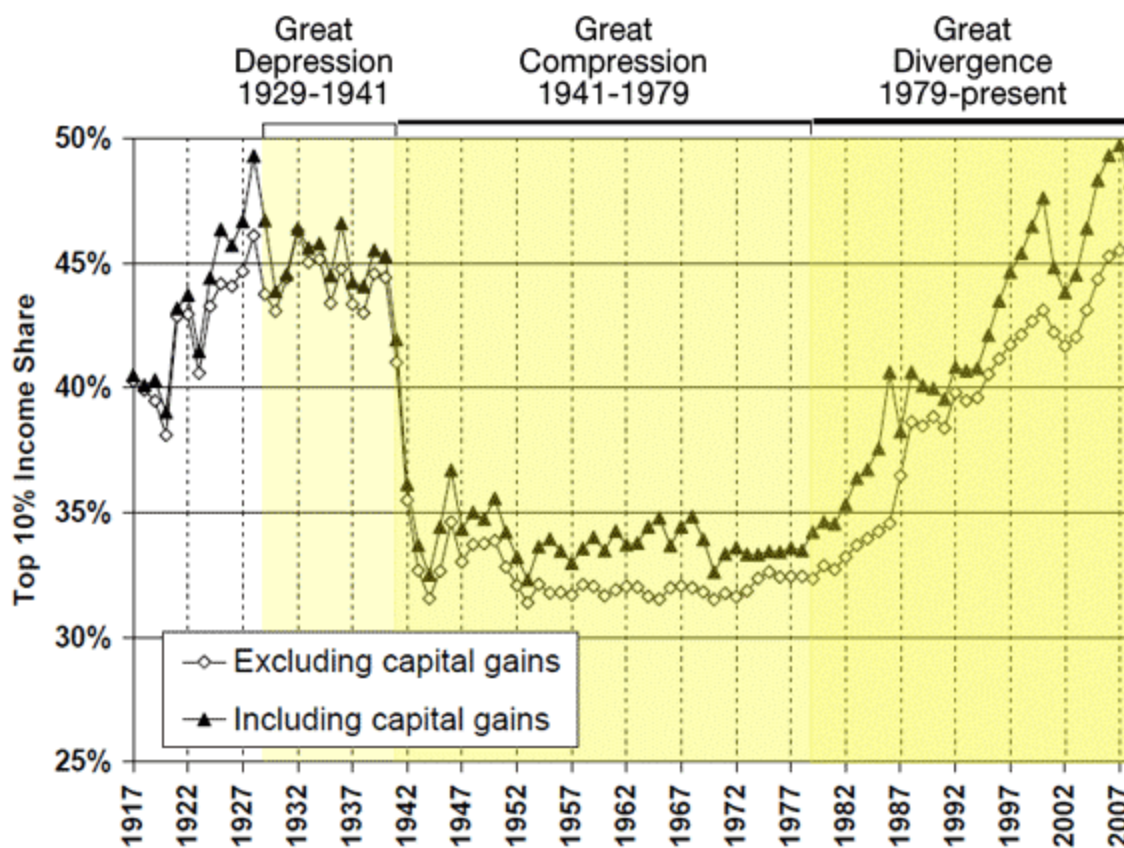
It's generally understood that we live in a time of growing income inequality, but "the ordinary person is not really aware of how big it is," Krugman told me. During the late 1980s and the late 1990s, the United States experienced two unprecedentedly long periods of sustained economic growth—the "seven fat years" and the "long boom." Yet from 1980 to 2005, more than 80 percent of total increase in Americans' income went to the top 1 percent. Economic growth was more sluggish in the aughts, but the decade saw productivity increase by about 20 percent. Yet virtually none of the increase translated into wage growth at middle and lower incomes, an outcome that left many economists scratching their heads.

Here is a snapshot of income distribution during the past 100 years:

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<sup>2</sup> During the 1930s the richest 1 percent's share of the nation's income dropped. Overall, the income-equality trend of the Great Depression was somewhat equivocal. On the one hand, the rich lost income. On the other hand, middle-class incomes stagnated and a high level of unemployment (which peaked at 25 percent) hit those at the bottom of the income scale especially hard. I note all this to emphasize that it is neither necessary nor desirable to achieve equality through economic catastrophe.

## The Top Ten Percent Income Share, 1917 - 2008



Income is defined as market income (and excludes government transfers).  
 In 2008, top decile includes all families with annual income above \$109,000.

Source: Thomas Piketty and Emmanuel Saez.

Why don't Americans pay more attention to growing income disparity? One reason may be our enduring belief in social mobility. Economic inequality is less troubling if you live in a country where any child, no matter how humble his or her origins, can grow up to be president. In a survey of 27 nations conducted from 1998 to 2001, the country where the highest proportion agreed with the statement "people are rewarded for intelligence and skill" was, of course, the United States (69 percent). But when it comes to real as opposed to imagined social mobility, surveys find less in the United States than in much of (what we consider) the class-bound Old World. France, Germany, Sweden, Denmark, Spain—not to mention some newer nations like Canada and Australia—are all places where your chances of rising from the bottom are better than they are in the land of Horatio Alger's *Ragged Dick*.

All my life I've heard Latin America described as a failed society (or collection of failed societies) because of its grotesque maldistribution of wealth. Peasants in rags beg for food outside the high walls of opulent villas, and so on. But according to the Central Intelligence Agency (whose patriotism I hesitate to question), income distribution in the United States is

more unequal than in Guyana, Nicaragua, and Venezuela, and roughly on par with Uruguay, Argentina, and Ecuador. Income inequality is actually declining in Latin America even as it continues to increase in the United States. Economically speaking, the richest nation on earth is starting to resemble a banana republic. The main difference is that the United States is big enough to maintain geographic distance between the villa-dweller and the beggar. As Ralston Thorpe tells his St. Paul's classmate, the investment banker Sherman McCoy, in Tom Wolfe's 1987 novel *The Bonfire of the Vanities*: "You've got to insulate, insulate, insulate."

In 1915, King wrote, "It is easy to find a man in almost any line of employment who is twice as efficient as another employee,"

but it is very rare to find one who is **ten times** as efficient. It is common, however, to see one man possessing not **ten times** but **a thousand** times the wealth of his neighbor. ... Is the middle class doomed to extinction and shall we soon find the handful of plutocrats, the modern barons of wealth, lined up squarely in opposition to the propertyless masses with no buffer between to lessen the chances of open battle? With the middle class gone and the laborer condemned to remain a lifelong wage-earner with no hope of attaining wealth or even a competence in his old age, all the conditions are ripe for a crowning class-conflict equaling in intensity and bitterness anything pictured by the most radical follower of Karl Marx. Is this condition soon coming to pass? [emphasis his]

In the end, King concluded it wasn't. Income distribution in the United States, he found, was more equal than in Prussia, France, and the United Kingdom. King was no socialist. Redistributing income to the poor, he wrote, "would merely mean more rapid multiplication of the lowest and least desirable classes," who remained, "from the reproductive standpoint, on the low point of their four-footed ancestors." A Malthusian, he believed in population control. Income inequality in the United States could be addressed by limiting immigration (King deplored "low-standard alien invaders") and by discouraging excessive breeding among the poor ("eugenicists are just beginning to impress upon us the absurd folly of breeding great troops of paupers, defectives and criminals to be a burden upon organized society").

Today, incomes in the U.S. are more unequal than in Germany, France, and the United Kingdom, not less so. Eugenics (thankfully) has fallen out of fashion, and the immigration debate has become (somewhat) more polite. As for income inequality, it's barely entered the national political debate. Indeed, the evidence from the 2000 and 2004 presidential elections suggests that even mild economic populism was a loser for Democrats.

But income inequality is a topic of huge importance to American society and therefore a subject of large and growing interest to a host of economists, political scientists, and other wonky types. Except for a few Libertarian outliers (whose views we'll examine later), these experts agree that the country's growing income inequality is deeply worrying. Even Alan Greenspan, the former

Federal Reserve Board chairman and onetime Ayn Rand acolyte, has registered concern. "This is not the type of thing which a democratic society—a capitalist democratic society—can really accept without addressing," Greenspan said in 2005. Greenspan's Republican-appointed successor, Ben Bernanke, has also fretted about income inequality.

Yet few of these experts have much idea how to reverse the trend. That's because almost no one can agree about what's causing it. This week and next, I will detail and weigh the strengths and weaknesses of various prominent theories as to what has brought about the income inequality boom of the last three decades. At the same time, I'll try to convey the magnitude of its effects on American life. The Great Divergence may represent the most significant change in American society in your lifetime—and it's not a change for the better. Let's see if we can figure out what got us here.

### ***Part Two: The usual suspects are innocent***

Most discussion about inequality in the United States focuses on race and gender. That makes sense, because our society has a conspicuous history of treating blacks differently from whites and women differently from men. Black/white and male/female inequality persist to this day. The median annual income for women working full time is 23 percent lower than for their male counterparts. The median annual income for black families is 38 percent lower than for their white counterparts. The extent to which these imbalances involve lingering racism and sexism or more complex matters of sociology and biology is a topic of much anguished and heated debate.

But we need not delve into that debate, because the Great Divergence can't be blamed on either race or gender. To contribute to the growth in income inequality over the past three decades, the income gaps between women and men, and between blacks and whites, would have to have grown. They didn't.

The black/white gap in median family income has stagnated; it's a mere three percentage points smaller today than it was in 1979.<sup>3</sup> This lack of progress is dismaying. So is the apparent trend that, during the current economic downturn, the black/white income gap widened somewhat. But the black/white income gap can't be a contributing factor to the Great Divergence if it hasn't grown over the past three decades. And even if it had grown, there would be a limit to how much

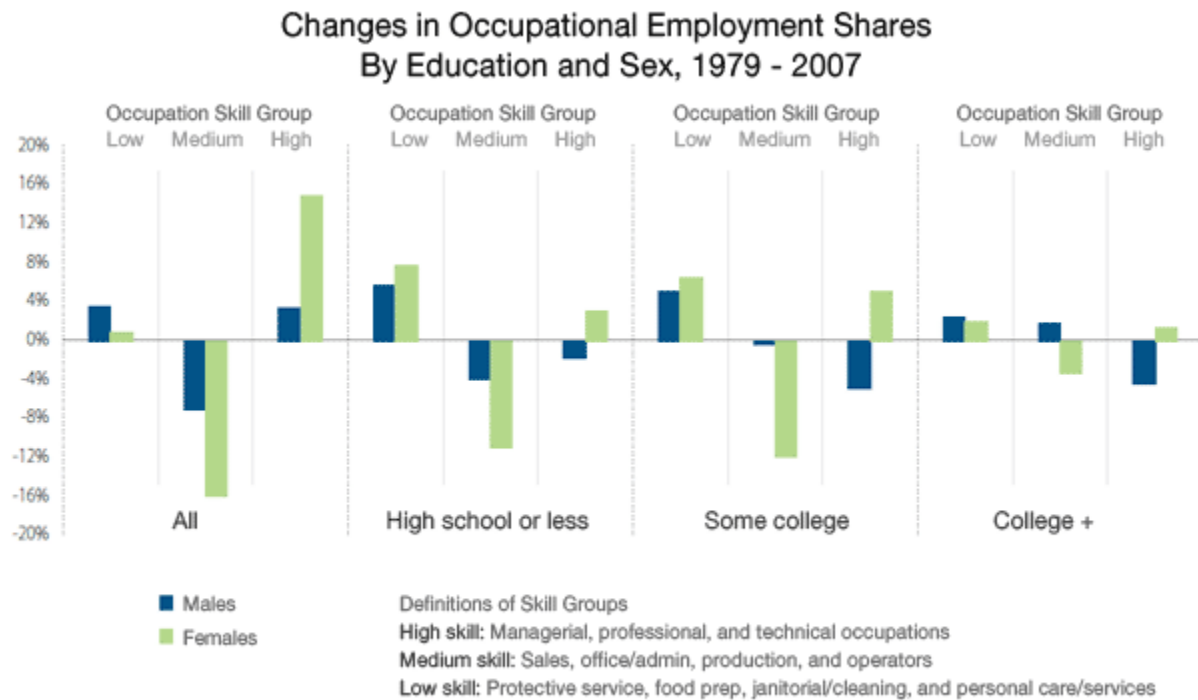
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<sup>3</sup> It is possible to argue that the black/white wage gap grew worse during the past three decades, for instance by factoring in blacks' higher incarceration rate and lower participation in the job market. It has also been shown that, within income groups, blacks enjoyed less upward mobility during this period than whites. But the Great Divergence is a phenomenon that's measured according to family ("household") income, so in examining whether black/white income inequality contributed to it, I'll consider only the 30-year change in black family income relative to white family income. And that change is nonexistent.

impact it could have on the national income-inequality trend, because African-Americans constitute only 13 percent of the U.S. population.

Women constitute half the U.S. population, but they can't be causing the Great Divergence because the male-female wage gap has shrunk by nearly half. Thirty years ago the median annual income for women working full-time was not 23 percent less than men's, but 40 percent less.<sup>4</sup> Most of these gains occurred in the 1980s and early 1990s; during the past five years they halted. But there's every reason to believe the male-female income gap will continue to narrow in the future, if only because in the U.S. women are now better educated than men. Ever since the late 1990s female students have outnumbered male students at colleges and universities. The female-male ratio is currently 57 to 43, and the U.S. Department of Education expects that disparity to increase over the next decade.

Far from contributing to the Great Divergence, women have, to a remarkable degree, absented themselves from it. Take a look at this bar graph by David Autor, an MIT labor economist:



Source: David Autor and Center For American Progress.

The graph demonstrates that during the past three decades, women have outperformed men at all education levels in the workforce. Both men and women have (in the aggregate) been moving out of moderately skilled jobs—secretary, retail sales representative, steelworker, etc.—women

<sup>4</sup> Some people prefer to compare median *weekly* incomes because women are more likely to take time off over the course of the year, but weekly incomes followed a near-identical trend. Among *part-time* workers, women now enjoy a *higher* median weekly income than men. This is mainly because female part-time workers tend to be older than male part-time workers.

more rapidly than men. But women have been much more likely than men to shift upward into higher skilled jobs—from information technology engineer and personnel manager on up through various high-paying professions that require graduate degrees (doctor, lawyer, etc.).

These findings suggest that women's relative gains in the workplace are not solely a You've-Come-a-Long-Way-Baby triumph of the feminist movement and individual pluck. They also reflect downward mobility among men. My Slate colleague Hanna Rosin, writing in the *Atlantic*, recently looked at these and other data and asked, "What if the modern, postindustrial economy is simply more congenial to women than to men?"

She might have asked the same about the modern, postindustrial family. The declining economic value of men as Ward Cleaver-style breadwinners is a significant reason for the rise in single parenthood, which most of the time means children being raised by an unmarried or divorced mother. The percentage of children living with one parent has doubled since 1970, from 12 percent to more than 26 percent in 2004. Conservatives often decry this trend, and they rightly point out that children who grow up in single-parent homes are much likelier to be poor. "Single mothers seldom command high wages," confirmed David Ellwood and Christopher Jencks, both of Harvard's Kennedy School of Government, in a 2004 paper. "They also find it unusually difficult to work long hours." But it would be difficult to attribute much of the Great Divergence to single parenthood, because it increased mostly before 1980, when the Great Divergence was just getting under way.<sup>5</sup> By the early 1990s, the growth trend halted altogether, and though it resumed in the aughts the rate of growth was significantly slower.<sup>6</sup>

Also, single parenthood isn't as damaging economically as it was at the start of the Great Divergence. "That's mostly because the percentage of women who are actually working who are single parents went up," Jencks told me. In a January 2008 paper, three Harvard sociologists concluded that the two-thirds rise in income inequality among families with children from 1975 to 2005 could not be attributed to divorce and out-of-wedlock births. "Single parenthood increased inequality," they conceded, "but the income gap was closed by mothers who entered the labor force." One trend canceled the effects of another (at least in the aggregate).

While we're on the topic of single versus two-parent households, perhaps we ought to consider what a "household" is.

Stephen J. Rose is a labor economist at Georgetown best-known for publishing, since the 1970s, successive editions of *Social Stratification in the United States*, a pamphlet and poster much revered by the left that depicts economic inequality in the United States. In his recent book *Rebound*, Rose made an apparent 180-degree turn and argued that worries about rising income inequality and a disappearing middle class were overblown. Rose built his case largely on the

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<sup>5</sup> By 1980 the proportion of children living with one parent was already 20 percent.

<sup>6</sup> The especially worrisome trend of *teenage* births peaked in the early 1990s.

notion that the Census Bureau's preferred metric—"median household income"—was misleading.

The trouble, Rose wrote, was that households varied greatly in composition and size. A household might consist of a single young man just starting out on his own or an elderly widow in retirement. Neither would likely enjoy a high income, but that would be a function of mere circumstance (the young man was just beginning his climb up the greasy pole; the retired widow no longer worked at all) and need (neither was likely to be responsible for any children). Another problem, Rose suggested, was that some households were bigger than others. Couples tended to have larger household incomes than single people, but that was because they likely collected two paychecks rather than one. The proportion of Americans living alone had for various reasons increased over time; that needed to be taken into account, too. Correcting for all these factors, Rose calculated that median household income was 30 percent higher than the Census' official figure (about \$50,000 in 2007).

That was the good news. The bad news was that even with these new calculations, Rose couldn't deny the existence of a Great Divergence. "Under all circumstances," he wrote, "inequality has risen considerably, and this is a bad thing for America. Those at the bottom of the income ladder have benefited only minimally from the significant gains in overall production over the past three decades."

Back, then, to the drawing board. Conventional liberal and conservative explanations about what ails society can neither explain the Great Divergence nor make it go away.

### ***Part Three: Did immigration create the Great Divergence?***

In June 1970, when I was 12, my family moved from New York to California. We didn't know it at the time, but our migration came at the tail end of a historic trend that predated California's entry into the union. Starting with the 1849 Gold Rush (which prompted Congress to grant statehood), California had been a place whose population grew mainly because people from other parts of the United States picked up and moved there. In the 1870s, Hoosiers tired of the cold and settled Pasadena. In the 1930s, Okies fled the Dust Bowl and followed Route 66 to the Central Valley. In the 1940s and 1950s, engineers descended on South Bay to create an aerospace industry. My family's migration came about because television production had been relocating from New York City to Los Angeles for about a decade. (My dad was a TV producer.)

After 1970, people kept coming to California, and new industries continued to sprout there (most notably in Northern California's Silicon Valley). But the engine of population growth ceased to be native-born Americans leaving one part of the United States for another. Instead, California's population grew mainly because foreign-born people moved there. The catalyst was the Immigration and Nationality Act of 1965, which eased up on immigration restrictions generally



and on restrictions affecting non-Europeans in particular. Since 1970, the foreign-born share of the U.S. population (legal and illegal) has risen from 4.8 percent to 11 percent. More than half of U.S. immigrants now come from Mexico, Central and South America, and the Caribbean. Although a substantial minority of immigrants are highly skilled, for most immigrants incomes and educational attainment are significantly lower than for the native-born.

Did the post-1965 immigration surge cause the Great Divergence?

The timing is hard to ignore. During the Great Compression, the long and prosperous mid-20th-century idyll when income inequality shrank or held steady, immigration was held in check by quotas first imposed during the 1920s. The Nobel-prizewinning economist Paul Samuelson saw a connection. "By keeping labor supply down," he wrote in his best-selling economics textbook, a restrictive immigration policy "tends to keep wages high." After the 1965 immigration law reopened the spigot, the income trend reversed itself and income inequality grew.

But when economists look at actual labor markets, most find little evidence that immigration harms the economic interests of native-born Americans, and much evidence that it stimulates the economy. Even the 1980 Mariel boatlift, when Fidel Castro sent 125,000 Cubans to Miami—abruptly expanding the city's labor force by 7 percent—had virtually no measurable effect on Miami's wages or unemployment.

George Borjas, an economics professor at Harvard's Kennedy School, rejects this reasoning. Looking at individual cities or regions, he argues, is the wrong way to measure immigration's impact. Immigrants, he observes, are drawn to areas with booming economies. That creates a "spurious positive correlation between immigration and wages," he wrote in a 2003 paper. Immigration looks like it is creating opportunity, but what's really happening is that immigrants are moving to places where opportunity is already plentiful. Once a place starts to become saturated with cheap immigrant labor, Borjas wrote, the unskilled American workers who compete with immigrants for jobs no longer move there. (Or if they already live there, they move away to seek better pay.)

Instead of looking at the effects of immigration in isolated labor markets like New York or Los Angeles, Borjas gathered data at the national level and sorted workers according to their skill levels and their experience. He found that from 1980 to 2000, immigration had reduced the average annual income of native-born high-school dropouts ("who roughly correspond to the poorest tenth of the workforce") by 7.4 percent. In a subsequent 2006 study with Harvard economist Lawrence Katz, this one focusing solely on immigration from Mexico, Borjas calculated that from 1980 to 2000, Mexican immigrants reduced annual income for native-born high-school dropouts by 8.2 percent. Illegal immigration has a disproportionate effect on the labor pool for high-school dropouts because the native-born portion of that pool is relatively small. A Congressional Budget Office study released a year after Borjas' study reported that

among U.S. workers who lacked a high-school diploma, nearly half were immigrants, most of them from Mexico and Central America.

Immigration clearly imposes hardships on the poorest U.S. workers, but its impact on the moderately-skilled middle class—the group whose vanishing job opportunities largely define the Great Divergence—is much smaller. For native-born high-school graduates, Borjas calculated that from 1980 to 2000, immigration drove annual income down 2.1 percent. For native-born workers with "some college," immigration drove annual income down 2.3 percent. Comparable figures for Mexican immigration were 2.2 percent and 2.7 percent. (For all workers, annual income went down 3.7 percent due to all immigration and down 3.4 percent due to Mexican immigration.) To put these numbers in perspective, the difference between the rate at which the middle fifth of the income distribution grew in after-tax income and the rate at which the top fifth of the income distribution grew during this period was 70 percent. The difference between the middle fifth growth rate and the top 1 percent growth rate was 256 percent.

Another obstacle to blaming the Great Divergence on immigration is that one of Borjas' findings runs in the wrong direction. From 1980 to 2000, immigration depressed wages for college graduates by 3.6 percent. That's because some of those immigrants were highly skilled. But the Great Divergence sent college graduates' wages up, not down. To reverse that trend would require importing a lot more highly skilled workers. That's the solution favored by Alan Greenspan. In his 2007 book *The Age of Turbulence*, the former Federal Reserve chairman proposed not that we step up patrols along the Rio Grande but that we "allow open migration of skilled workers." The United States has, Greenspan complained, created "a privileged, native-born elite of skilled workers whose incomes are being supported at noncompetitively high levels by immigration quotas." Eliminating these "would, at the stroke of a pen, reduce much income inequality."

Gary Burtless, an economist at the Brookings Institution in Washington, proposes a different way to think about immigration. Noting that immigrants "accounted for one-third of the U.S. population growth between 1980 and 2007," Burtless argued in a 2009 paper that even if they failed to exert heavy downward pressure on the incomes of most native-born Americans, the roughly 900,000 immigrants who arrive in the United States each year were sufficient in number to skew the national income distribution by their mere presence. But while Burtless' methodology was more expansive than Borjas', his calculation of immigration's effect was more modest. Had there been no immigration after 1979, he calculated, average annual wages for all workers "may have risen by an additional 2.3 percent" (compared to Borjas's 3.7 percent).

The conclusion here is as overwhelming as it is unsatisfying. Immigration has probably helped create income inequality. But it isn't the star of the show. "If you were to list the five or six main

things" that caused the Great Divergence, Borjas told me, "what I would say is [immigration is] a contributor. Is it the most important contributor? No."<sup>7</sup>

#### ***Part Four: Did computers create inequality?***

"What you earn," Bill Clinton said more than once when he was president, "is a function of what you can learn." That had always been true, but Clinton's point was that at the close of the 20th century it was becoming more true, because computers were transforming the marketplace. A manufacturing-based economy was giving way to a knowledge-based economy that had an upper class and a lower class but not much of a middle class.

The top was occupied by a group that Clinton's first labor secretary, Robert Reich, labeled "symbolic analysts."<sup>8</sup> These were people who "simplify reality into abstract images that can be rearranged, juggled, or experimented with" using "mathematical algorithms, legal arguments, financial gimmicks, scientific principles, psychological insights," and other tools seldom acquired without a college or graduate degree. At the bottom were providers of "in-person services" like waitressing, home health care, and security. The middle, once occupied by factory workers, stenographers, and other moderately skilled laborers, was disappearing fast.

Did computerization create the Great Divergence?

Our story begins in the 1950s, at the dawn of the computer age, when homo sapiens first began to worry that automation would bring about mass unemployment. Economic theory dating back to the 19th century said this couldn't happen, because the number of jobs isn't fixed; a new machine might eliminate jobs in one part of the economy, but it would also create jobs in another

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<sup>7</sup> A caveat is in order. Economists work from available data, which at the national level is often five to 10 years old. It's possible that immigration is currently having a greater impact on the wages of the native-born than past data indicate. For example, illegal immigrants are currently believed to constitute 20 percent to 36 percent of construction workers in low-skill trades. But a [recent survey](#) conducted by the engineering department at the University of Maryland found that in the Washington metropolitan area, illegal immigrants actually constitute 55 percent of construction workers in low-skill trades. Is that finding accurate? If so, does it reflect a local anomaly? A recession blip? Or are the national numbers too low? It could be years before we know. A D.C.-based labor lawyer of my acquaintance, who blogs under the pseudonym of "Sir Charles," recently estimated that in the D.C. metropolitan area the construction industry typically pays undocumented workers about \$13 an hour to avoid paying native-born and legal-immigrant workers about \$30 an hour. "In the past year," [he wrote](#), "I have negotiated wages cuts of \$2, \$4, and \$12--yes, \$12--n hour for various groups with whom I work."

<sup>8</sup> Reich's January 2008 Berkeley lecture, "How Unequal Can America Get Before We Snap?," an excellent introduction to the topic at hand, [is available on You Tube](#).

part. For example, someone had to be employed to make these new machines. But as the economists Frank Levy of MIT and Richard J. Murnane of Harvard have noted, computers represented an entirely different sort of new machine. Previously, technology had performed physical tasks. (Think of John Henry's nemesis, the steam-powered hammer.) Computers were designed to perform cognitive tasks. (Think of Garry Kasparov's nemesis, IBM's Deep Blue.) Theoretically, there was no limit to the kinds of work computers might eventually perform. In 1964 several eminent Americans, including past and future Nobel laureates Linus Pauling and Gunnar Myrdal, wrote President Lyndon Johnson to warn him about "a system of almost unlimited productive capacity which requires progressively less human labor."

Such a dystopia may yet one day emerge. But thus far traditional economic theory is holding up reasonably well. Computers are eliminating jobs, but they're also creating jobs. The trouble, Levy and Murnane argue, is that the kinds of jobs computers tend to eliminate are those that require some thinking but not a lot—precisely the niche previously occupied by moderately skilled middle-class laborers.

Consider the sad tale of the bank teller. When is the last time you saw one? In the 1970s, the number of bank tellers grew by more than 85 percent. It was one of the nation's fastest-growing occupations, and it required only a high school degree. In 1970, bank tellers averaged about \$90 a week, which in 2010 dollars translates into an annual wage of about \$26,000. But over the last 30 years, people pretty much stopped ever stepping into the lobby of their bank; instead, they started using the automatic teller machine outside and eventually learned to manage their accounts from their personal computers or mobile phones.

Today, the job category "bank teller" is one of the nation's slowest-growing occupations. The Bureau of Labor Statistics projects a paltry 6 percent growth rate during the next decade. The job now pays slightly less than it did in 1970, averaging about \$25,000 a year.

As this story plays out in similar occupations—cashiers, typists, welders, farmers, appliance repairmen (this last already so obsolete that no one bothers to substitute a plausible ungendered noun)—the moderately skilled workforce is hollowing out. This trend isn't unique to the United States. The Japanese have a word for it: *kudoka*. David Autor, an MIT economist, calls it "job polarization," and he has demonstrated that it's happening to roughly the same extent within the European Union as it is in the United States. But Autor readily concedes that computer-driven job polarization can't possibly explain the entire trend toward income inequality in the United States, because income inequality is much greater in the United States than it is in Europe.

Another problem that arises when you try to attribute the income-inequality trend to computers is that the Great Divergence began in the late 1970s, well before most people had ever seen a personal computer. By the late 1990s, as businesses stampeded to the Internet, inequality slackened a bit. If computers were the only factor driving inequality, or even the main factor, the

opposite should have happened.<sup>9</sup> A final problem is that the income premium for college or graduate-level education gradually slackens off at higher incomes, even as income inequality intensifies. If computers required ever-higher levels of education to manipulate ever-growing quantities of information in ever-more rococo ways, then we'd expect the very richest people to be the biggest nerds. They aren't.

Here, then, is a dilemma. We know that computers put a premium on more highly educated workers, but we can't really demonstrate that computers caused the Great Divergence. What is it that's so special about computers? Harvard economists Claudia Goldin and Lawrence Katz offer an interesting answer: Nothing!

Yes, Goldin and Katz argue, computer technology had a big impact on the economy. But that impact was no larger than that of other technologies introduced throughout the 20th century, starting in 1900 with the dynamo that Henry Adams famously swooned over at the Paris Exposition. Between 1909 and 1929, Katz and Goldin report in their 2008 book, *The Race Between Education and Technology*, the percentage of manufacturing horsepower acquired through the purchase of electricity rose sixfold. From 1917 to 1930, the proportion of U.S. homes with electricity increased from 24 percent to 80 percent. By contrast, from 1984 to 2003, the proportion of U.S. workers using computers increased from 25 percent to 57 percent. Computer use has spread quickly, but not as quickly as electric power did during the early part of the 20th century. "Skill-biased technological change is not new," Katz and Goldin wrote in a 2009 paper, "and it did not greatly accelerate toward the end of the twentieth century."

Contemporary culture is so fixated on the computer revolution that the very word "technology" has become an informal synonym for "computers." But before computers we witnessed technological revolutions brought on by the advent of the automobile, the airplane, radio, television, the washing machine, the Xerox machine, and too many other devices to name. Most of these earlier inventions had much the same effect as the computer—that is, they increased demand for progressively higher-skilled workers. But (with the possible exception of radio) none of these consumer innovations coincided with an increase in inequality. Why not? Katz and Goldin have a persuasive answer that we'll consider later in this series.

*Correction, Sept. 9, 2010: An earlier version of this story misstated Kasparov's first name as "Boris."*

### **Part Five: Can we blame income inequality on Republicans?**

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<sup>9</sup> The percentage of the labor force that used computers increased at a **faster rate** in the 1980s than in the 1990s, but it wasn't until the mid-to-late late '90s that a majority of workers used computers.

Liberal politicians and activists have long argued that the federal government caused the Great Divergence. And by "federal government," they generally mean Republicans, who have controlled the White House for 20 of the past 30 years, after all. A few outliers even argue that for Republicans, creating income inequality was a conscious and deliberate policy goal.

Until recently, the consensus among academics—even most liberal ones—was quite different. Economists argued that the Great Divergence was the result not of Washington policymaking but of larger "exogenous" (external) and "secular" (long-term) forces. In June, the Congressional Budget Office calculated that spending by the federal government made up 23 percent of U.S. gross domestic product, after averaging 18.5 percent during the previous four decades. But even with federal spending at this unusually high level (necessitated by a severe recession), Washington's nut remains less than one-quarter the size of the economy. Most of that nut is automatic "entitlement" spending over which Washington policymakers seldom exert much control. Brad DeLong, a liberal economist at Berkeley, expressed the prevailing view in 2006: "[T]he shifts in income inequality seem to me to be too big to be associated with anything the government does or did."

My Slate colleague Mickey Kaus took this argument one step further in his 1992 book *The End of Equality*, positing that income inequality was the inevitable outgrowth of ever-more-ruthlessly efficient markets, and that government attempts to reverse it were certain to fail. "[Y]ou cannot decide to keep all the nice parts of capitalism," he wrote, "and get rid of all the nasty ones." Instead, Kaus urged liberals to combat social inequality by nurturing egalitarian civic institutions (parks, schools, libraries, museums) and by creating some new ones (national health care, national service, a revived WPA) that remove many of life's most important activities from the "money sphere" altogether.

Finding ways to increase social equality is an important goal, and Kaus's book remains a smart and provocative read. But the academic consensus that underlay Kaus's argument (and Long's more modest one) has lately started to crumble.

Economists and political scientists previously resisted blaming the Great Divergence on government mainly because it didn't show up when you looked at the changing distribution of federal income taxes. Taxation is the most logical government activity to focus on, because it is literally redistribution: taking money from one group of people (through taxes) and handing it over to another group (through government benefits and appropriations).

Another compelling reason to focus on taxation is that income-tax policy has changed very dramatically during the last 30 years. Before Ronald Reagan's election in 1980, the top income tax bracket stood at or above 70 percent, where it had been since the Great Depression. (In the 1950s and the *Mad Men* early 1960s, the top bracket exceeded 90 percent!) Throughout the Great Compression, as the economy boomed and income inequality dwindled, the top bracket resided at a level that even most Democrats would today call confiscatory. Reagan dropped the top

bracket from 70 percent to 50 percent, and eventually pushed it all the way down to 28 percent. Since then, it has hovered between 30 percent and 40 percent. If President Obama lets George W. Bush's 2001 tax cut expire for families earning more than \$250,000, as he's expected to do, Tea Partiers will call him a Bolshevik. But at a whisker under 40 percent (up from 35), the top bracket would remain 30 to 50 percentage points below what it was under Presidents Eisenhower, Nixon, and Ford. That's how much Reagan changed the debate.

But tax brackets, including the top one, tell you only the marginal tax rate, i.e., the rate on the last dollar earned. The percentage of total income that you actually pay in taxes is known as the effective tax rate. That calculation looks at income taxed at various rates as you move from one bracket to the next; it figures in taxes on capital gains and pensions; it figures in "imputed taxes" such as corporate and payroll taxes paid by your employer (on the theory that if your boss didn't give this money to Uncle Sam he'd give it to you); and it removes from the total any money the federal government paid you in Social Security, welfare, unemployment benefits, or some other benefit. Reagan lowered top marginal tax rates a lot, but he lowered top effective tax rates much less—and certainly not enough to make income-tax policy a major cause of the Great Divergence.

In 1979, the effective tax rate on the top 0.01 percent (i.e., rich people) was 42.9 percent, according to the Congressional Budget Office. By Reagan's last year in office it was 32.2 percent. From 1989 to 2005 (the last year for which data are available), as income inequality continued to climb, the effective tax rate on the top 0.01 percent largely held steady; in most years it remained in the low 30s, surging to 41 during Clinton's first term but falling back during his second, where it remained. The change in the effective tax rate on the bottom 20 percent (i.e., poor and lower-middle-class people) was much more dramatic, but not in a direction that would increase income inequality. Under Clinton, it dropped from 8 percent (about where it had stood since 1979) to 6.4 percent. Under George W. Bush, it fell to 4.3 percent.

Measuring tax impacts is not an exact science. There are many ways to define rich, poor, and middle class, and many variables to consider. Some experts have looked at the same data and concluded that effective tax rates have gone up slightly for people at high incomes. Others concluded they've gone down. The larger point is that you can't really demonstrate that U.S. tax policy had a large impact on the three-decade income inequality trend one way or the other. The inequality trend for pre-tax income during this period was much more dramatic. That's why academics concluded that government policy didn't affect U.S. income distribution very much.

But in recent years a few prominent economists and political scientists have suggested looking at the question somewhat differently. Rather than consider only effective tax rates, they recommend that we look at what MIT economists Frank Levy and Peter Temin call "institutions and norms." It's somewhat vague phrase, but in practice what it mostly means is "stuff the government did, or didn't do, in more ways than we can count." In his 2007 book, *The Conscience of a Liberal*, Princeton economist and *New York Times* columnist Paul Krugman concludes that there is "a

strong circumstantial case for believing that institutions and norms ... are the big sources of rising inequality in the United States." Krugman elaborated in his *New York Times* blog:

[T]he great reduction of inequality that created middle-class America between 1935 and 1945 was driven by political change; I believe that politics has also played an important role in rising inequality since the 1970s. It's important to know that no other advanced economy has seen a comparable surge in inequality.

Proponents of this theory tend to make their case not by measuring the precise impact of each thing government has done but rather by charting strong correlations between economic trends and political ones. In his 2008 book *Unequal Democracy*, Larry Bartels, a Princeton political scientist, writes:

[T]he narrowly economic focus of most previous studies of inequality has caused them to miss what may be the most important single influence on the changing U.S. income distribution over the past half-century—the contrasting policy choices of Democratic and Republican presidents. Under Republican administrations, real income growth for the lower- and middle-classes has consistently lagged well behind the income growth rate for the rich—and well behind the income growth rate for the lower and middle classes themselves under Democratic administrations.

Bartels came to this conclusion by looking at average annual pre-tax income growth (corrected for inflation) for the years 1948 to 2005, a period encompassing much of the egalitarian Great Compression and all of the inegalitarian Great Divergence (up until the time he did his research). Bartels broke down the data according to income percentile and whether the president was a Democrat or a Republican. Figuring the effects of White House policies were best measured on a one-year lag, Bartels eliminated each president's first year in office and substituted the year following departure. Here is what he found:

Real Income Growth Rates by Income Level and  
Presidential Partisanship, 1948 - 2005

	<i>All Presidents</i>	<i>Democratic Presidents</i>	<i>Republican Presidents</i>	<i>Partisan Difference</i>
20th percentile	1.42 (.50)	2.64 (.77)	.43 (.61)	2.21 (.97)
40th percentile	1.54 (.39)	2.46 (.58)	.80 (.49)	1.67 (.75)
60th percentile	1.73 (.34)	2.47 (.52)	1.13 (.43)	1.33 (.67)
80th percentile	1.84 (.33)	2.38 (.50)	1.39 (.42)	.99 (.65)
95th percentile	2.00 (.38)	2.12 (.65)	1.90 (.46)	.22 (.77)
N	58	26	32	58

Source: Calculations based on data from Census Bureau Historical Income Tables.



Overall, pre-tax income increased 1.42 percent annually for the 20th percentile (poor and lower-middle-class people) and 2 percent annually for the 95th percentile (upper-middle-class and rich people). The White House during this period was occupied by five Democrats (Truman, Kennedy, Johnson, Carter, Clinton) and six Republicans (Eisenhower, Nixon, Ford, Reagan, Bush I, Bush II). Bartels plotted out what the inequality trend would have been had only Democrats been president. He also plotted out what the trend would be had only Republicans been president.

In Democrat-world, pre-tax income increased 2.64 percent annually for the poor and lower-middle-class and 2.12 percent annually for the upper-middle-class and rich. There was no Great Divergence. Instead, the Great Compression—the egalitarian income trend that prevailed through the 1940s, 1950s, and 1960s—continued to the present, albeit with incomes converging less rapidly than before. In Republican-world, meanwhile, pre-tax income increased 0.43 percent annually for the poor and lower-middle-class and 1.90 percent for the upper-middle-class and rich. Not only did the Great Divergence occur; it was more greatly divergent. Also of note: In Democrat-world pre-tax income increased faster than in the real world not just for the 20th percentile but also for the 40th, 60th, and 80th. We were all richer and more equal! But in Republican-world, pre-tax income increased slower than in the real world not just for the 20th percentile but also for the 40th, 60th, and 80th. We were all poorer and less equal! Democrats also produced marginally faster income growth than Republicans at the 95th percentile, but the difference wasn't statistically significant. (More on that in a future installment.)

What did Democrats do right? What did Republicans do wrong? Bartels doesn't know; in *Unequal Democracy* he writes that it would take "a small army of economists" to find out. But since these are pre-tax numbers, the difference would appear to be in macroeconomic policies. (One clue, Bartels suggests, is that Republicans always worry more than Democrats about inflation.) Bartels' evidence is circumstantial rather than direct. But so is the evidence that smoking is a leading cause of lung cancer. We don't know exactly how tobacco causes the cells inside your lungs to turn cancerous, but the correlation is strong enough to convince virtually every public health official in the world.

Jacob Hacker and Paul Pierson, political scientists at Yale and Berkeley, respectively, take a slightly different tack. Like Bartels and Krugman, they believe that government action (and inaction) at the federal level played a leading role in creating the Great Divergence. But the culprit, they say, is not so much partisan politics (i.e., Republicans) as institutional changes in the way Washington does business (i.e., lobbyists). "Of the billions of dollars now spent every year on politics," Hacker and Pierson point out in their new book, *Winner-Take-All Politics*, "only a fairly small fraction is directly connected to electoral contests. The bulk of it goes to lobbying...." Corporations now spend more than \$3 billion annually on lobbying, according to

official records cited by Hacker and Pierson (which, they note, understate true expenditures). That's nearly twice what corporations spent a decade ago.

According to Hacker and Pierson, industry began to mobilize in the early 1970s in response to liberalism's political ascendancy (which didn't end when Richard Nixon entered the White House in 1969):

The number of corporations with public affairs offices in Washington grew from 100 in 1968 to over 500 in 1978. In 1971, only 175 firms had registered lobbyists in Washington, but by 1982, 2,500 did. The number of corporate [political action committees] increased from under 300 in 1976 to over 1,200 by the middle of 1980. [...] The Chamber [of Commerce] doubled in membership between 1974 and 1980. Its budget tripled. The National Federation of Independent Business (NFIB) doubled its membership between 1970 and 1979.

The resultant power shift, they argue, affects Democrats and Republicans alike.

Academics who believe that government policies are largely responsible for the Great Divergence don't breeze past the relevant mechanisms. Bartels writes at length about repeal of the estate tax, and the decline of the minimum wage; Hacker and Pierson about financial deregulation. But their approach to them is more impressionistic than comprehensive. They offer examples and make arguments that are a little more speculative. We'll look at one such example in the next installment.

### ***Part Six: The Great Divergence and the death of organized labor.***

The Great Divergence coincided with a dramatic decline in the power of organized labor. Union members now account for **about 12 percent** of the workforce, down from about 20 percent in 1983. When you exclude public-employee unions (whose membership has been *growing*), union membership has dropped to a mere 7.5 percent of the private-sector workforce. Did the decline of labor create the income-inequality binge?

The chief purpose of a union is to maximize the income of its members. Since union workers usually earn more than nonunion workers, and since union members in higher-paying occupations tend to exercise more clout than union members in lower-paying ones, you might think higher union membership would *increase* income inequality. That was, in fact, the **consensus among economists** before the Great Divergence. But the Harvard economist Richard Freeman demonstrated in a **1980 paper** that at the national level, unions' ability to reduce income disparities among members outweighed other factors, and therefore their net effect was to *reduce* income inequality. That remains true, though perhaps not as true as it was 30 years ago, because

union membership has been declining more precipitously for workers at lower incomes. Berkeley economist David Card calculated in a 2001 paper that the decline in union membership among men explained about 15 percent to 20 percent of the Great Divergence among men. (Among women—whose incomes, as noted in an earlier installment, were largely unaffected by the Great Divergence—union membership remained relatively stable during the past three decades.)

It's possible, however, that labor's decline had a larger impact on the Great Divergence than Card's estimate suggests. To consider how, let's return to the "institutions and norms" framework introduced by MIT's Frank Levy and Peter Temin\* and further elaborated by Princeton's Paul Krugman and Larry Bartels.

In their influential 2007 paper, "[Inequality and Institutions in 20<sup>th</sup> Century America](#)," Levy and Temin regard unions not merely as organizations that struck wage bargains for a specific number of workers but rather as institutions that, prior to the Great Divergence, played a significant role in the workings of government. "If our interpretation is correct," they wrote, "no rebalancing of the labor force can restore a more equal distribution of productivity gains without government intervention and changes in private sector behavior."

According to Levy and Temin, labor's influential role in the egalitarian and booming post-World War II economy was epitomized by a November 1945 summit convened in Detroit by President Harry Truman. The war had ended a mere three months earlier, and Truman knew the labor peace that had prevailed during the war was about to come to an abrupt end. To minimize the inevitable disruptions, Truman promised labor continued government support. Truman even coaxed Chamber of Commerce President Eric Johnson into making the following statement: "Labor unions are woven into our economic pattern of American life, and collective bargaining is part of the democratic process. I say recognize this fact not only with our lips but with our hearts."<sup>10</sup>

An eventual result of Truman's 1945 summit was a five-year contract between United Auto Workers President Walter Reuther and the big three automakers that included cost-of-living adjustments, productivity-based wage increases, health insurance, and guaranteed-benefit pensions. Daniel Bell (then a writer for *Fortune* magazine) named the agreement, versions of which would be adopted by Big Steel and other industries, the [Treaty of Detroit](#). Even non-union

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<sup>10</sup> The Chamber's current position on unions, laid out in a 2008 [white paper](#), is ... um ... somewhat different: "[U]nions are not the answer to increasing prosperity for Americans workers or the economy."

companies mimicked the Reuther pact. The federal government's ongoing collaborative role in the process was demonstrated in April 1962 when President John F. Kennedy, having talked the United Steel Workers into accepting a moderate wage increase, **publicly attacked** U.S. Steel over a price hike he deemed excessive ("a wholly unjustifiable and irresponsible defiance of the public interest"), forcing the steel giant to back down. According to Levy and Temin, this display of muscle "helps to explain why the reduced top tax rate" enacted two years later (it dropped to 70 percent) "produced no surge in either executive compensation or high incomes per se." Fear of attracting comparable attention from President Lyndon Johnson kept corporations from showering the bosses with obscene pay hikes.

The Treaty of Detroit didn't last. One reason was that, even as Truman was romancing Big Labor, the Republican Party won majorities in the House and Senate and passed the **Taft-Hartley Act** over Truman's **veto** in 1947. Levy and Temin don't dwell on this, but in his 1991 book *Which Side Are You On?: Trying To Be For Labor When It's Flat On Its Back*, Thomas Geoghegan, a Chicago-based labor lawyer, argues that Taft-Hartley was the principal cause of the American labor movement's eventual steep decline:

First, it ended organizing on the grand, 1930s scale. It outlawed mass picketing, secondary strikes of neutral employers, sit downs: in short, everything [Congress of Industrial Organizations founder John L.] Lewis did in the 1930s.

[...]

The second effect of Taft-Hartley was subtler and slower-working. It was to hold up *any* new organizing at all, even on a quiet, low-key scale. For example, Taft-Hartley ended "**card checks**" .... Taft-Hartley required hearings, campaign periods, secret-ballot elections, and sometimes more hearings, before a union could be officially recognized.

It also allowed and even encouraged employers to threaten workers who want to organize. Employers could hold "captive meetings," bring workers into the office and chew them out for thinking about the Union.

And Taft-Hartley led to the "union-busting" that started in the late 1960s and continues today. It started when a new "profession" of labor consultants began to convince employers that they could violate the [pro-labor 1935] Wagner Act, fire workers at will,

fire them deliberately for exercising their legal rights, and *nothing would happen*. The Wagner Act had never had any real sanctions.

[...]

So why hadn't employers been violating the Wagner Act all along? Well, at first, in the 1930s and 1940s, they tried, and they got riots in the streets: mass picketing, secondary strikes, etc. But after Taft-Hartley, unions couldn't retaliate like this, or they would end up with penalty fines and jail sentences.

To summarize: Taft-Hartley halted labor's growth and then, over many decades, enabled management to roll back its previous gains. Big manufacturing's desire to do so grew more urgent in the 1970s as inflation spun out of control, **productivity fell**, and the steel and auto industries faced stiffer competition from abroad. Even before Ronald Reagan's election, Levin and Temin write, the Senate signaled the federal government was rapidly losing interest in enforcing Truman's 1945 pact when it killed off, by filibuster, a **pro-labor reform bill** aimed at easing union organizing in the South.

President Reagan's 1981 decision to break the air-traffic controllers' union and to slash top income-tax rates killed off Truman's 1945 pact entirely. Although Reagan was a onetime **union president**, he showed little concern when the **1982 recession** rapidly eliminated so many Rust Belt manufacturing jobs that the proportion of private-sector workers who belonged to unions dropped to 16 percent in 1985, down from 23 percent as recently as 1979. Reagan's hostility to unions was further reflected in his choice of **Donald Dotson** to chair the National Labor Relations Board. Dotson had previously worked as a management-side labor adversary for Wheeling-Pittsburgh Steel, and (presumably with both lips and heart) believed **collective bargaining** led to "the destruction of individual freedom." Under Reagan's two terms, the **federal minimum wage**, which previously had been adjusted upward every year or two, would remain stuck at \$3.35 an hour for close to a full decade. Similarly, President George W. Bush, another two-term Republican, later let the minimum wage remain at \$5.15 (to which it had risen during the presidencies of his father and Bill Clinton) for two months shy of 10 years, by which time its buying power had reached a **51-year low**.

Academics may argue about the significance of any one of these decisions. Raising the minimum wage, for instance, reduces income inequality to a degree that some experts judge **negligible** and

others judge **substantial**.<sup>11</sup> Where Levy and Temain (who lean toward the “negligible” characterization) and Princeton’s Bartels (who leans toward the “substantial” one) agree is that policies like setting the minimum wage don’t occur in a vacuum; they are linked to a host of other government policies likely to have similar effects. Bartels emphasizes partisan differences and Levy and Temain emphasize ideological ones that occur over time, but both constitute changes in the way Washington governs. Levy and Temain concede that the ideological shift was influenced by changing circumstance (inflation *did* rise; productivity *did* fall; Rust Belt manufacturers *did* face increased foreign competition). But they argue that the policies embraced, and the increased income inequality that resulted, were not inevitable. The proof, they argue, lies in the fact that other industrialized nations faced similar pressures but often embraced different policies, resulting in far less income inequality.

Geoghegan’s latest book, *Were You Born On The Wrong Continent?*, makes this point largely by looking at Germany. German firms, Geoghegan writes,

don’t have the illusion that they can bust the unions, in the U.S. manner, as the prime way of competing with China and other countries. It’s no accident that the social democracies, Sweden, France, and Germany, which kept on paying high wages, now have more industry than the U.S. or the UK. ... [T]hat’s what the U.S. and the UK did: they smashed the unions, in the belief that they had to compete on cost. The result? They quickly ended up wrecking their industrial base.

Geoghegan’s book went to press too soon to report that Germany is now experiencing a **recovery that’s leaving the United States in the dust**. *New York Times* columnist David Brooks **took away the lesson** that the Germans succeeded by spending less government money than the United States to stimulate its economy (a conclusion that Krugman, his fellow *Times* columnist, **had already labelled “foolish”**). Brooks mentioned only in passing (and somewhat elliptically) that government policy in Germany is much more supportive of labor; for example, during the recession it paid businesses to keep workers employed (something the United States was willing to do only for state government workers). The idea that pro-labor policies can produce an economy that’s both more egalitarian *and* more robust—as occurred under the Treaty of Detroit—has, regrettably, become unfashionable.

\*An earlier version of this installment misidentified MIT’s Peter Temin as “Peter Temlin.” The error resulted from a typo on the cover of Levy and Temin’s paper as it appears on an MIT Web site.

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<sup>11</sup> The traditional economic argument against raising the minimum wage—that it increases low-wage unemployment—has lately been **called into question**.

### ***Part Seven: Trade didn't create inequality, and then it did.***

I typed this article on a laptop that was made in China. Everything I own was made in China. Everything you own was made in China, too. In 1979, when the Great Divergence began, you and I didn't own anything made in China. With Mao only three years in the grave, China still had a sluggish centrally planned economy. In that year, Mao's successor, Deng Xiaoping, decided enough was enough and inaugurated various **market reforms**. "Black cat, white cat," the Communist leader famously said. "What does it matter what color the cat is as long as it catches mice?"

Since 1979, China has caught a stunning quantity of mice, raising the annual value of its exports a hundredfold. In 2007, China displaced the U.S. as the world's second-biggest exporter, and in 2009 it displaced Germany as the **world's biggest exporter**. That year, China's **per capita gross national income** was \$6,710—compared to \$47,240 in the U.S.—and the U.S.'s trade deficit with China stood at **\$227 billion**. Given China's aggressively mercantilist trade policy and its preposterously huge pool of cheap labor, it's logical to wonder whether the common timeline of China's manufacturing boom and the U.S.'s inequality boom is more than mere coincidence.<sup>12</sup> Did China—and growing trade competition from other low-wage nations—cause the Great Divergence?

Two decades ago, Adrian Wood, a British economist, started arguing that trade with low-wage countries lowered wages for unskilled workers in developed countries. "There is a clear inverse association," Wood **wrote** in a 1995 paper. "Countries with larger increases in import penetration experienced larger falls in manufacturing employment." But in the United States, Wood had to concede, imports of manufactured goods from low-wage countries still totaled less than 3 percent of gross domestic product. By itself, that wasn't enough to displace many workers. Wood answered by arguing the effects were subtle and indirect. For example, he wrote that imports from low-wage countries required more labor than other goods, and therefore displaced more U.S. workers than imports from high-wage countries.

Most leading economists in the U.S. didn't buy it. Paul Krugman (then at MIT, now at Princeton) and Robert Z. Lawrence (then at the Brookings Institution, now at Harvard), **argued** that international trade had played a much smaller role in U.S. manufacturing's decline than had domestic considerations. Among these, ironically, was the U.S. manufacturing sector's own efficiency, which had lowered prices on consumer products and therefore on the proportion of U.S. spending on goods (TVs, refrigerators, groceries) as opposed to services (CT scans, legal advice, college tuition). Between 1970 and 1990, the prices of U.S. goods relative to services had fallen by nearly one-quarter. "Although the effect of foreign competition is measurable,"

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<sup>12</sup> This logic was laid out in a **1941 paper** by economists Paul Samuelson and Wolfgang Stolper.

Krugman and Lawrence concluded, “it can by no means account for the stagnation of U.S. earnings.”<sup>13</sup>

Two decades later, Krugman decided his earlier analysis no longer held up. “My argument was always yes, *in principle*” imports from low-wage countries could affect income inequality, Krugman told me. But in the 1990s there simply weren’t enough of them. That changed in the aughts. In a [December 2007 \*New York Times\* column](#) and a [2008 paper](#) for the Brookings Institution, Krugman observed that the United States had in 2006 crossed “an important watershed: we now import more manufactured goods from the third world than from other advanced economies.” Imports of manufactured goods that came from less-developed nations had more than doubled as a percentage of gross domestic product, from 2.5 percent in 1990 to 6 percent in 2006. Moreover, the wage levels in the countries ramping up U.S. trade the fastest—Mexico and China—were considerably lower than the wage levels in the countries whose increased U.S. trade had created worry in the 1990s—South Korea, Taiwan, Hong Kong, Singapore. The Southeast Asian nations had, in 1990, paid workers about 25 percent of what U.S. workers received. By 1995 they paid 39 percent—demonstrating, reassuringly, that low-wage developing countries that undergo rapid economic growth don’t stay low-wage for long. But as of 2005, Mexico and China paid 11 percent and 3 percent, respectively. “It’s likely,” Krugman concluded, “that the rapid growth of trade since the early 1990s has had significant distributional effects.”

Lawrence, [looking at the same new data](#), continued to believe that trade did not affect U.S. income inequality to any great extent. Lawrence focused on the fact that China was increasingly exporting computers and other sophisticated electronics. To depress the wages of lower-skilled workers in the United States, Lawrence reasoned, China would have to compete with American firms that employed lower-skilled workers. But the U.S. tech sector doesn’t, for the most part, employ lower-skilled workers. It employs higher-skilled workers. If trade with China were throwing anybody out of work, Lawrence concluded, “it is likely to be ... workers with relatively high wages.” And in fact, Lawrence wrote, during the first decade of the 21<sup>st</sup> century there was very little measured increase in income inequality “by skill, education, unionization or occupation.” Income inequality did increase through the aughts, but that was because incomes soared at the tippy top of the income-distribution scale, where just about everybody had a college degree, and often a graduate degree, too. It didn’t increase because less-skilled workers got squeezed—or rather, it didn’t increase because less-skilled workers got squeezed any more than they did during the previous two decades. At the very bottom, incomes actually edged up slightly.

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<sup>13</sup> Krugman also argued, in his 1994 book *Peddling Prosperity*, that if trade were creating greater income inequality in the U.S., one would expect to see it creating greater income equality in, say, Mexico, which “ships low-skill goods to the United States and imports high-skill goods in return.” But income inequality, Krugman wrote, was increasing in Mexico. That was true at the time, but the trend has since reversed itself. For the past decade and a half income inequality has been *decreasing* in Mexico.



Krugman wasn't convinced by his former collaborator's argument. "There is good reason to believe that the apparent sophistication of developing country exports is, in reality, largely a statistical illusion," he answered in his Brookings paper. Unskilled laborers paid a pittance in China weren't really doing high-tech work, Krugman wrote. They were grabbing sophisticated components manufactured in more advanced and higher-paid economies like Japan, Ireland, and—yes—the United States, and they were slapping them together on an assembly line. That couldn't be good news for less-skilled workers in the United States, though Krugman said he couldn't quantify the effect without "a much better understanding of the increasingly fine-grained nature of international specialization and trade."

Where does that leave us? Trade does not appear to have contributed much to the Great Divergence through the mid-1990s. Since then, it may have contributed to it more significantly, though we don't yet have the data to quantify it. With trade more than with most topics, the economics profession is struggling to interpret **a reality that may not fit the familiar models**.

### ***Part Eight: The Stinking Rich and the Great Divergence***

The American Economic Association's **John Bates Clark medal** is to the Nobel what the Golden Globes are to the Oscars. Whoever wins the Clark medal (given to an economist who makes a significant contribution before the age of 40) automatically becomes a future favorite to win the Nobel prize in economics. Last year the Clark medal **went to** Emmanuel Saez, a Berkeley economist. He's French, he **looks like a movie star**, and he's the single most influential theoretician of the Great Divergence, which began when Saez was *un très petit écolier*. What Saez (in collaboration with another Frenchman, Thomas Piketty) brought to the discussion was a deeper and more complex understanding of high-income subcultures.

Prior to the publication of Saez and Piketty's 2003 ground-breaking paper, "**Income Inequality in the United States, 1913-1998**," analysis of U.S. income distribution typically derived from Census records. Census data is useful if you want to track income trends for households as divided into quintiles (five groups, richest to poorest) or deciles (10). But Census data is not particularly useful if you want to break down the population into much smaller groups, especially at the top end of the income scale. The rich are different—from you and me, as F. Scott Fitzgerald **famously wrote**, but also (and more to the point) *from one another*. There's the Sort of Rich. That's everybody in the top 10 percent, who today earn about \$100,000 or more. There's the Rich. That's everybody in the top 1 percent, who today earn about \$368,000 or more.

And there's the Stinking Rich. That's everybody in the top 0.1 percent, who today earn about \$1 million or more. (The blunt terminology is mine, not Saez and Piketty's.)

Saez and Piketty replaced income data from the Census with income data from the Internal Revenue Service. They then broke that down more precisely than anyone had before. This yielded three discoveries.

-- The American aristocracy is less different from you and me than it was in Fitzgerald's day. "Before World War II," they wrote, "the richest Americans were overwhelmingly *rentiers* deriving most of their income from wealth holdings (mainly in the form of dividends)." But today, they found, the top of the heap are overwhelmingly job-holders *deriving most of their income from their wages*. Did it become posh to have a job? Not exactly. Having a job—the right job, anyway—became the way to get posh. That's encouraging in one sense: To roll in the dough you now have to work for a living. But it's discouraging in another sense: You can't blame enormous income disparities on coupon-clippers who exist outside the wage structure (and reality as most of us understand it). The wage structure itself is grossly misshapen.

-- The share of national income going to the top 1 percent (the Rich) *more than doubled* during the Great Divergence, and now stands at about *21 percent*. The chart showing this found its way into President Obama's first budget, prompting *Wall Street Journal* columnist Daniel Henninger to *call it* "the most politically potent squiggle along an axis since Arthur Laffer drew his famous curve on a napkin in the mid-1970s." But where Laffer's squiggle was an argument to *lower* taxes, Piketty and Saez's (the conservative Henninger noted with some dismay) was to *raise* them on the Rich.

-- The share of national income going to the top 0.1 percent (the Stinking Rich) had increased *nearly fourfold* during the Great Divergence. "The [inequality] phenomenon is more extreme the further you go up in the distribution," Saez told me, and it's "very strong once you pass that threshold of the top one percent." Canada's and the United Kingdom's Stinking Rich followed a similar (though less pronounced) trend, but Japan and France did not; in the latter two countries, the Stinking Rich received about the same proportion of national income (about 2 percent) as the Stinking Rich did in all five countries prior to the Great Divergence. In a 2009 paper, Saez and Piketty surveyed several other industrialized nations; in none of them did the Stinking Rich come anywhere near the 7.7 percent share of national income found in the United States.

For all three groups—Sort of Rich, Rich, and Stinking Rich—the truly dizzying gains have occurred since the early 1990s, the trend interrupted only by the dot-com bust of the late 1990s and the sub-prime bust of the late aughts. The part of the Great Divergence attributable to high-income growth—economists call it the *upper tail*—is exempt from most of the analysis

presented thus far in this series. Relatively few of these high-earners are immigrants, relatively few make their fortunes through trade with China or Mexico, and while most of them are well-educated, they enjoy much higher incomes than most people at educational levels as high or higher. Princeton's Bartels told me his theory that partisan difference accounts for the Great Divergence can't really be applied to the upper tail because Democrats have been no more eager than Republicans to redistribute money away from the Stinking Rich (again: my term, not his). The new fin-reg law (which hadn't yet passed when we spoke) may change that calculus, but probably not by much.

A different logic applies to Jacob Hacker and Paul Pierson's theory that inequality was created largely by a growth in corporate lobbying that influenced both Republicans *and* Democrats. Their construct is a conscious effort to incorporate Saez and Piketty's research into a government-based model. In Hacker and Pierson's view, if you can't explain the rise of the Stinking Rich then you can't explain the Great Divergence—or at least what I'll call the Great Divergence, Part Two, which began in the mid-1990s and continued through the aughts as the more humdrum quintile-based divergence essentially halted (the bottom 20 percent actually crept up a little). Egalitarians could have declared victory if incomes for the Stinking Rich hadn't continued spurting upwards like Old Faithful.

Who are the Stinking Rich? Their average annual income is **about \$7 million**. Most of them likely work in finance, a sector of the U.S. economy that **saw its share of corporate profits** rise from less than 10 percent in 1979 to more than 40 percent in the aughts. The rest of the Stinking Rich are in good measure likely divided between the corporate and entertainment worlds. Among the latter two, the Rich and especially the Stinking Rich are often beneficiaries of the Winner Take All phenomenon (Kaus calls it the "Hollywood Effect"), in which those deemed best in their field are, thanks to improved technology, able to disseminate praise for their work across a broader geographic area and sell their services to many more people than they ever could in the past. Where once an accomplished chef presided over a single successful restaurant, today he can aspire to become a celebrity chef on the Food Network, which in turn can help him sell a cookbook and open additional restaurants around the country.

This logic doesn't apply to Wall Street, whose incentive structure, as documented in Michael Lewis's books *Liar's Poker* and *The Big Short*, simply went berserk starting in the 1980s with the development of ever-more-complex financial instruments increasingly divorced from traditional notions of value. An explanation of how finance came to take over the U.S. economy would require its own *Slate* series, but Saez, Hacker and Pierson argue plausibly that the

industry's deregulation (and the protection it received from a few well-placed Democrats like New York Sen. Chuck Schumer) played a large role.

Nor does Winner Take All logic apply to executive pay; corporate executives don't serve a constituency any bigger than before. In 2005 Carola Frydman and Raven Saks, two young economists at Harvard (later MIT) and the Federal Reserve, respectively, **surveyed compensation records** on file at the Securities and Exchange Commission dating back to 1936, two years after the SEC was created. They found that pay for top executives declined sharply during World War II, increased modestly from the mid-1940s to the mid-1970s, and took off like a rocket during the 1980s and 1990s. Frydman and Saks were especially struck by the "considerable stability" during the 1950s and 1960s, a time when firms were growing rapidly and the economy was booming. Frydman and Saks noted that changing tax policy had some influence on executive compensation, but otherwise they couldn't really account for the change. Saez suggested to me that it may be because corporations today are less likely than they once were to promote from within. Instead, they have created their own Hollywood-style star system of corporate chiefs who move restlessly from one company to the next, thereby bidding up their cost. Is this rational? That's "a very hard question," Saez told me. **Scholarly estimates** of CEOs' impact on profits have run as low as 4.5 percent, but Saez thinks they're probably more influential than that. "CEOs make decisions that have huge consequences," he said. "They must have a huge impact."

### ***Part Nine: How the decline in K-12 education enriches college graduates.***

The National Bureau of Economic Research is a nonprofit and rigorously nonpartisan think tank best-known today as the place where a committee of economists makes the official call about **when recessions begin and end**. But it owes its existence to a **friendly dispute** that arose in 1916 between a conservative named Malcolm Rorty, who worked as a statistician for the American Telegraph and Telephone Company, and a liberal economist named Nahum Stone, who worked as a labor arbitrator. The topic was the distribution of income in the United States.

Stone had written about income distribution for a socialist monthly, and Rorty, who disagreed with Stone's conclusions but admired the quality of his scholarship, invited him to lunch. "Would it not be a great step forward," Rorty proposed, "if we had an organization that devoted itself to fact finding on controversial economic subjects of great public interest?"<sup>14</sup> Funds were

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<sup>14</sup> The Progressive Era (1890-1920) was defined in large part by a powerful belief that social problems could be resolved through rigorous scientific inquiry by trained experts. Other institutions the Progressive movement left behind include Hull House, *The New Republic*, the civil service, Consumer's Union, the Federal Trade Commission, and the Food and Drug Administration.

secured from the Carnegie Corporation and the Commonwealth Fund, and an Episcopal seminary set aside office space in lower Manhattan. When the National Bureau of Economic Research opened its doors in 1920, its **first project** became a two-volume survey of the distribution of income in the U.S. One of the study's authors was our old friend Willford I. King (see part one).<sup>15</sup>

Today the NBER is headquartered not in New York but in Cambridge, Mass., in a glass-and-concrete mid-rise along Massachusetts Avenue, the street that connects Harvard to the Massachusetts Institute of Technology. The NBER draws heavily on the economics faculties of both universities. I paid a visit there to ask Harvard's Lawrence Katz and Claudia Goldin about their theory of income inequality.

Computerization eliminated many moderately-skilled jobs, and it increased demand for workers with a college or graduate-level education. But for various reasons cited in part four of this series, computers don't seem by themselves to be a major cause of the Great Divergence. Katz and Goldin argue in their 2008 book, *The Race Between Education and Technology*, that lots of other technological advances throughout the 20<sup>th</sup> century created comparable (sometimes *greater*) demand for a better-educated labor force. Yet these earlier changes didn't typically generate income inequality. Why was the advent of computers different?

For Katz and Goldin, the solution to this riddle isn't that computerization created a larger *demand* for better-educated workers than did previous innovations. Rather, it's that during the earlier upheavals the education system was able to increase the necessary *supply* of better-educated workers. During the Great Divergence the education system has *not* been able to increase the supply of better-educated workers, and so the price of those workers (i.e., their incomes) has risen faster relative to the general population. At a time when the workforce needed to be smarter, Americans got dumber. Or rather: Americans got smarter at a much slower rate than they during previous periods of technological change (and also at a much slower rate than many other industrialized democracies did). That was great news for people with college diplomas or advanced degrees, whose limited supply bid up their salaries. It was terrible news for everyone else.

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<sup>15</sup> King **remained** at the Bureau for seven years before taking an economics professorship at New York University, where he evolved into a full-fledged crank opposed not just to the New Deal but to any and all government regulation of business.

If we were to compile a list of the ways in which the United States has made both itself and the wider world a better place, then at or very near the top would be its commitment to universal education. We no longer think of education for all as a particularly novel or controversial goal. But at the start of the 20<sup>th</sup> century it was both. The **first public high school** in the United States was established as early as 1821 in Boston, but it wasn't until the early 20<sup>th</sup> century that high schools spread rapidly outside major cities, and **it wasn't until 1933** that the majority of high-school-age kids in the United States actually attended high school. High schools differed from the college preparatory schools that preceded them in two ways. They were government-funded, as college-prep schools only sometimes were (**Boston Latin** was; New York's **Collegiate School** wasn't). And they were meant to serve not just teenagers who would go on to college, but also teenagers who would bypass college and enter the workforce at 18.

Europeans, Katz and Goldin observe, thought that America's egalitarian approach to education was soft-hearted and wasteful. They preferred a system that selected only the most promising adolescents for further schooling, and even then the child's parents usually had to pay for it. As late as the 1930s, Katz and Goldin note, "America was virtually alone in providing universally free and accessible secondary schools." But while Continental sophisticates scoffed, America's better-educated masses became a vital component to its superior performance in a world economy that could no longer easily accommodate anyone whose education stopped at age 12 or 13.

In the early part of the 20<sup>th</sup> century, office workers had to know how to operate typewriters and adding machines. They had to master bookkeeping, billing procedures, and stenography. These and other necessary skills were more easily acquired by high school graduates. The need for high-school-educated employees was not confined, as you might suppose, to the rapidly growing white-collar workforce. Farmers had to master elementary genetics to grow **hybrid corn**. Factory workers often had to know algebra and geometry, how to read mechanical drawings, and at least the basics of how electricity worked. As early as 1902, the personnel chief at National Cash Register Company in Dayton, Ohio, said, "In the factory we like the boys to have a high school education if possible." The need for ever-more-educated workers persisted to the point that by the century's end, college displaced high school as a threshold requirement. In 1950 only 8 percent of all full-time workers were college graduates. By 2005, about 32 percent were, and an additional 29 percent had some college education.

Throughout the first three-quarters of the 20<sup>th</sup> century a growing supply of better-educated workers met the demand created by new technologies. **The 1944 G.I. Bill**, which paid tuition for returning servicemen, played an important role; so did the Sputnik-inspired **National Defense**

**Education Act**, which increased federal spending on schools at all levels and created (at the suggestion of **Milton Friedman!**) a student-loan program for colleges. With the passing of each decade, the average 24 year-old had close to one additional year of schooling. These gains virtually halted starting with 1976's cohort of 24 year-olds. Educational attainment started growing again in the 1990s, but at a much slower rate. Here's another way to put it: The average person born in 1945 received two more years of schooling than his parents. The average person born in 1975 received only half a year more of schooling than his parents.<sup>16</sup>

The abrupt halt and subsequent slowdown of gains in educational attainment began at about the same time as the Great Divergence. Prior to the Great Divergence, the country enjoyed at least three decades of growing income equality, an epoch that Goldin and Boston University economist Robert Margo have termed "**The Great Compression.**" Between 1900 and the mid-1970s, U.S. incomes became dramatically more equal while educational attainment climbed. But starting in the mid-1970s and continuing to today, incomes became dramatically *less* equal while educational attainment stagnated. Katz and Goldin believe this is not a coincidence.

Unlike the computerization trend, the slowdown of educational attainment gains is not occurring in all industrialized nations; it is uniquely American. Remember those Europeans who scoffed at the Yanks' misty-eyed commitment to universal education? Around the middle of the 20<sup>th</sup> century they started to wise up and expand educational opportunities in their own countries. By the end of the century Europe had caught up with or exceeded average educational attainment in the U.S. According to the Organization for Economic Cooperation and Development, the United States has proportionally fewer high school graduates (measured as the percentage of young people at the typical graduation age) than Germany, Greece, the United Kingdom, Ireland, and Italy. "We have the most-educated 55 year-olds in the world," Katz told me. "But we're in the middle of the pack for 25 year-olds."

The trend was likely kicked off by the end of the Vietnam draft in 1973. College students had received deferments. Until 1968 graduate students received deferments, too. The deferments had the effect of inflating college and grad-school enrollment, already enlarged by the Baby Boom, thereby lowering the market price for college graduates. Between 1970 and 1976 college enrollment increased by **50 percent**; it would be three decades before college enrollment increased that much again. In 1976 the Harvard economist Richard B. Freeman published a book titled *The Overeducated American* that argued the monetary return on a college education—what economists call the "college premium"—had dropped to its lowest level since World War II. But

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<sup>16</sup> These calculations, Katz and Goldin explain, assume both sets of parents were 24 at the time of their child's birth.

with the Vietnam draft gone and the last of the Baby Boomers graduating from college, that trend began to reverse itself. It was no longer necessary to enroll in college if you wanted to stay out of Khe Sanh, and fewer kids were reaching college age. As a result, the college premium began to grow. It's been growing **ever since**. Goldin and Katz calculate that it accounts for two-thirds of the increase in income inequality during the Great Divergence.

Why did the trend continue? Katz and Goldin are somewhat tentative on this point, but clearly it represents a failure by elementary and secondary schools to provide education relevant to the economy's growing demands, a task they performed much better during the first half of the 20<sup>th</sup> century. Katz and Goldin blame America's colleges and universities, too—not for any educational failing (the United States is a **global leader** in higher education) but rather for tuition costs, which took off in the 1980s and have accelerated **well in excess of general inflation** ever since. High school graduates aren't receiving a significantly better education, on average, than their parents did, partly because elementary, middle, and high schools are inadequate, and partly because the cost of a college education is increasingly prohibitive.

We have now reviewed all possible causes of the Great Divergence—all, at least, that have thus far attracted most experts' attention. What are their relative contributions? Here is a back-of-the-envelope calculation, an admittedly crude composite of my discussions with and reading of the various economists and political scientists cited thus far :

- Race and gender is responsible for none of it, and single parenthood is responsible for virtually none of it.
- Immigration is responsible for 5 percent.
- The imagined uniqueness of computers as a transformative technology is responsible for none of it.
- Tax policy is responsible for 5 percent.
- The decline of labor is responsible for 20 percent.
- Trade is responsible for 10 percent.
- Wall Street and corporate boards' pampering of the Stinking Rich is responsible for 30 percent.
- Various failures in our education system are responsible for 30 percent.



Most of these factors reflect at least in part things the federal government either did or failed to do. Immigration is regulated, at least in theory, by the federal government. Tax policy is determined by the federal government. The decline of labor is in large part the doing of the federal government. Trade levels are regulated by the federal government. Government rules concerning finance and executive compensation help determine the quantity of cash that the Stinking Rich take home. Education is affected by government at the local, state, and (increasingly) federal levels. In a broad sense, then, we all created the Great Divergence, because in a democracy, the government is us.

It seems obvious to me that a decades-long trend toward income inequality is destructive to any nation, and particularly to one founded on democratic ideals. But it isn't obvious to everybody. Some people have questioned whether it's worth fretting about. In the next and final installment, I'll consider their arguments and try to explain why we'll all be better off when the Great Divergence ends—or, better yet, reverses itself.

### ***Part Ten: Why We Can't Ignore Growing Income Inequality.***

*Clarence the Angel: We don't use money in heaven.*

*George Bailey: Comes in pretty handy down here, bub.*

—Frank Capra's *It's A Wonderful Life* (1946)

The Declaration of Independence says that all men are created equal, but we know that isn't true. George Clooney was created better-looking than me. Stephen Hawking was born smarter, Evander Holyfield stronger, Jon Stewart funnier, and Warren Buffett better able to understand financial markets. All these people have parlayed their exceptional gifts into very high incomes—much higher than mine. Is that so odd? Odder would be if Buffett or Clooney were forced to live on my income, adequate though it might be to a *petit-bourgeois* journalist. Lest you conclude my equanimity is in any way unique (we *Slate* writers are known for our contrarianism), Barbara Ehrenreich, in her 2001 book *Nickel and Dimed*, quotes a woman named Colleen, a single mother of two, saying much the same thing about the wealthy families whose floors she scrubs on hands and knees. “I don't mind, really,” she says, “because I guess I'm a simple person, and I don't want what they have. I mean, it's nothing to me.”

It is easy to make too much of this, and a few conservatives have done so in seeking to dismiss the importance (or even existence) of the Great Divergence. Let's look at their arguments.

**Inequality is good.** Every year the American Economic Association invites a distinguished economist to deliver at its annual conference the Richard T. Ely Lecture. Ely, a founder of the AEA and a leader in the Progressive movement, would have been horrified by the 1999 lecture that Finis Welch, a professor of economics (now emeritus) at Texas A&M, delivered in his name. Its title was “*In Defense of Inequality.*”

Welch began by stating that “all of economics results from inequality. Without inequality of priorities and capabilities, there would be no trade, no specialization, and no surpluses produced by cooperation.” He invited his audience to consider a world in which skill, effort, and sheer chance played no role whatsoever in what you got paid. The only decision that would affect your wage level would be when to leave school. “After that, the clock ticks, and wages follow the experience path. Nothing else matters. Can you imagine a more horrible, a more deadening existence?”

But something close to the dystopia Welch envisioned already exists for those toiling in the economy's lower tiers. Welch should have a chat with his office receptionist. Or he could read *Nickel and Dimed*, or the 2010 book *Catching Out* by Dick J. Reavis, a contributing editor at *Texas Monthly* who went undercover as a day laborer. Waitresses, construction workers, dental assistants, call-center operators—people in these jobs are essentially replaceable, and usually have bosses who don't distinguish between individual initiative and insubordination. Even experience is of limited value, because it's often accompanied by diminishing physical vigor.

Welch said that he believed inequality was destructive only when “the low-wage citizenry views society as unfair, when it views effort as not worthwhile, when upward mobility is impossible or so unlikely that its pursuit is not worthwhile.” Colleen's comment would appear to suggest that the first of these conditions has not been met. But that's only because I omitted what she went on to say: “But what I would like is to be able to take a day off now and then ... if I had to ... and still be able to buy groceries the next day.” Colleen may not begrudge the rich the material goods they've acquired through skill, effort, and sheer chance, but that doesn't mean she thinks her own labors secure her an adequate level of economic security. Clearly, they don't.

Welch judged the growing financial rewards accruing to those with higher levels of education a good thing insofar as they provided an incentive to go to college or graduate school. But for most of the 20<sup>th</sup> century smaller financial incentives attracted enough workers to meet the economy's growing demand for higher-skilled labor. That demand isn't being met today, as Harvard economists Claudia Goldin and Lawrence Katz have shown. Welch also said that both women and blacks made income gains during the Great Divergence (duly noted in [our installment on race and gender](#), though the gains by blacks were so tiny that it's more accurate to say blacks didn't lose ground). But that's hardly evidence that growing income inequality unrelated to gender or race doesn't matter. Finally, Welch argued that the welfare state has made it too easy not to work at all. But the Great Divergence had a more significant impact on the working middle class than on the destitute.

**Income doesn't matter.** In most contexts, libertarians can fairly be said to place income in very high regard. Tax it to even the slightest degree and they cry foul. If government assistance must be extended, they prefer a cash transaction to the provision of government services. The market is king, and what is the market if not a mighty river of money?

Bring up the topic of growing income inequality, though, and you're likely to hear a [different tune](#). Case in point: "[Thinking Clearly About Economic Inequality](#)," a 2009 Cato Institute paper by Will Wilkinson. Income isn't what matters, Wilkinson argues; consumption is, and "the weight of the evidence shows that the run-up in consumption inequality has been considerably less dramatic than the rise in income inequality." Wilkinson concedes that the available data on consumption are shakier than the available data on income; he might also have mentioned that consumption in excess of income usually means debt—as in, say, [subprime mortgages](#). The thought that the have-nots are compensating for their lower incomes by putting themselves (and the country) in economically ruinous hock is not reassuring.

Wilkinson further argues that consumption isn't what matters; what matters is utility gained from consumption. Joe and Sam both own refrigerators. Joe's is a \$350 model from Ikea. Sam's is an \$11,000 state-of-the-art Sub-Zero. Sam gets to consume a lot more than Joe, but whatever added utility he achieves is marginal; Joe's Ikea fridge "will keep your beer just as cold." But if getting rich is only a matter of spending more money on the same stuff you'd buy if you were poor, why bother to climb the greasy pole at all?

Next Wilkinson decides that utility isn't what matters; what matters is buying power. Food is cheaper than ever before. Since lower-income people spend their money disproportionately on food, declining food prices, Wilkinson argues, constitute a sort of raise. Never mind that

Ehrenreich routinely found, in her travels among the lower middle class, workers who routinely skipped lunch to save money, or brought an individual-size pack of junk food and called that lunch. Reavis reports that a day laborer's typical lunch budget is \$3. That won't buy much. The problem isn't the cost of food per se but the cost of shelter, which has **shot up so high** that low-income families don't have much left over to spend on other essentials.

Declining food prices affect higher-income people too. But Wilkinson writes that the affluent spend a smaller share of their budget on food and a much larger share on psychotherapy and yoga and cleaning services. And since services like these are unaffected by foreign competition or new efficiencies in manufacturing, Wilkinson argues, providers can charge whatever they like.

Tell it to Colleen! I recently worked out with my new cleaning lady what I would pay her. Here's how the negotiation went. I told her what I would pay her. She said, "OK." According to the Bureau of Labor Statistics, the median income for a housekeeper is **\$19,250**, which is \$2,800 below **the poverty line for a family of four**.

A more thoughtful version of the income-doesn't-matter argument surfaces in my former *Slate* colleague Mickey Kaus's 1992 book *The End of Equality*. Kaus chided "Money Liberals" for trying to redistribute income when instead they might be working to diminish social inequality by creating or shoring up spheres in which rich and poor are treated the same. Everybody can picnic in the park. Everybody should be able to receive decent health care. Under a compulsory national service program, everybody would be required to perform some civilian or military duty.

As a theoretical proposition, Kaus's vision is appealing. Bill Gates will always have lots more money than me, no matter how progressive the tax system becomes. But if he gets called to jury duty he has to show up, just like me. When his driver's license expires he'll be just as likely to have to take a driving test. Why not expand this egalitarian zone to, say, education, by making public schools so good that Gates' grandchildren will be as likely to attend them as mine or yours?

But at a practical level, Kaus's exclusive reliance on social equality is simply inadequate. For one thing, the existing zones of social equality are pretty circumscribed. Neither Gates nor I

spend a lot of time hanging around the Department of Motor Vehicles. Rebuilding or creating the more meaningful spheres—say, public education or a truly national health care system—won't occur overnight. Nurturing the social-equality sphere isn't likely to pay off for a very long time.

Kaus would like to separate social equality from income equality, but the two go hand in hand. In theory they don't have to, but in practice they just do. Among industrialized nations, those that have achieved the greatest social equality are the same ones that have achieved the greatest income equality. France, for example, has a level of income inequality **much lower** than that of most other countries in the Organization for Economic Cooperation and Development. It's one of the very few places where income inequality has been going down. (Most everywhere else it's gone up, though nowhere to the degree it has in the United States.) France also enjoys what the World Health Organization calls the **world's finest** health care system (by which the WHO means, in large part, the most egalitarian one; this is the famous survey from 2000 in which the U.S. ranked 37<sup>th</sup>).

Do France's high marks on both social equality and income equality really strike you as a coincidence? As incomes become more unequal, a likelier impulse among the rich isn't to urge or even allow the government to create or expand public institutions where they can mix it up with the proles. It's to create or expand private institutions that will help them maintain separation from the proles, with whom they have less and less in common. According to Jonathan Rowe, who has written extensively about social equality, that's exactly what's happening in the United States. In an essay titled "The Vanishing Commons" that appeared in *Inequality Matters*, a 2005 anthology, Rowe notes that Congress has been busy extending copyright terms and patent monopolies and turning over public lands to mining and timber companies for below-market fees." In an 'ownership' society especially," Rowe writes, "we should think about what we own in common, not just what we keep apart."

**Inequality doesn't create unhappiness.** Arthur C. Brooks, president of the American Enterprise Institute, **argued this point** in *National Review* online in June. What drives entrepreneurs, he wrote, is not the desire for money but the desire for earned success. When people feel they deserve their success, they are happy; when they do not, they aren't. "The money is just the metric of the value that the person is creating."

Brooks marshaled very little evidence to support his argument, and what evidence he did muster was less impressive than he thought. He made much of a 1996 survey that asked people how successful they felt, and how happy. Among the 45 percent who counted themselves “completely successful” or “very successful,” 39 percent said they were very happy. Among the 55 percent who counted themselves at most “somewhat successful,” only 20 percent said they were happy. Brooks claimed victory with the finding that successful people were more likely to be happy (or at least to say they were), by 19 percentage points, than less-successful people. More striking, though, was that 61 percent of the successful people—a significant majority—did not say they were “very happy.” Nowhere in the survey were the successful people asked whether they deserved their happiness.

Let’s grant Brooks his generalization that people who believe they deserve their success are likelier to be happy than people who believe they don’t. It makes intuitive sense. But Brooks’ claim that money is only a “metric” does not. **Looking at the same survey data**, Berkeley sociologist Michael Hout found that between 1973 and 2000 the difference between the affluent and the poor who counted themselves either “very happy” or “not too happy” ranged from 19 percentage points to 27. Among the poor, the percentage who felt “very happy” fell by nearly one-third between 1973 and 1994, then crept up a couple of points during the tight labor market of the late 1990s. Hout also observed that overall happiness dropped a modest 5 percent between 1973 and 2000.

**Quality of life is improving.** This argument has been made by too many conservatives to count. Yes, it’s true that an unemployed steelworker living in the 21<sup>st</sup> century is in many important ways better off than the royals and aristocrats of yesteryear. Living conditions improve over time. But people do not experience life as an interesting moment in the evolution of human societies. They experience it in the present, and weigh their own experience against that of the living. Brooks cites (even though it contradicts his argument) a famous **1998 study** by economists Sara Solnick (then at the University of Miami, now at the University of Vermont) and David Hemenway of the Harvard School of Public Health. Subjects were asked which they’d prefer: To earn \$50,000 while knowing everyone else earned \$25,000, or to earn \$100,000 while knowing everyone else earned \$200,000. Objectively speaking, \$100,000 is twice as much as \$50,000. Even so, 56 percent chose \$50,000 if it meant that would put them on top rather than at the bottom. We are social creatures, and establish our expectations **relative to others**.

**Inequality isn’t increasing.** This is the boldest line of conservative attack, challenging a consensus about income trends in the United States that most conservatives accept. (**Brooks**: “It is factually incorrect to argue that income inequality has not risen in America—it has.”) Alan

Reynolds, a senior fellow at Cato, made the case in a [January 2007 paper](#). It was a technical argument hinging largely on a critique of the tax data used by Emmanuel Saez and Thomas Piketty in the [groundbreaking paper](#) we looked at in our installment about the superrich. But as Gary Burtless of Brookings noted in a [January 2007 reply](#), Social Security records “tell a simple and similar story.” A [Congressional Budget Office analysis](#), Burtless wrote, addressed “almost all” of Reynolds’ objections to Saez and Piketty’s findings, and confirmed “a sizable rise in both pre-tax and after-tax inequality.” Reynolds’s paper didn’t deny notable increases in top incomes, but he argued that these were due to technical changes in tax law and/or to isolated and unusual financial events. That, Burtless answered, was akin to arguing that, “adjusting for the weather and the season, no homeowner in New Orleans ended up with a wet basement” after Hurricane Katrina.

That income inequality very much matters is the thesis of the 2009 book *The Spirit Level*, by Richard Wilkinson and Kate Pickett, two medical researchers based in Yorkshire. The book has been criticized for [overreaching](#). Wilkinson and Pickett relate income inequality trends not only to mental and physical health, violence, and teenage pregnancy, but also to global warming. But their larger point—that income inequality is bad not only for people on the losing end but also for society at large—seems hard to dispute. “Modern societies,” they write,

will depend increasingly on being creative, adaptable, inventive, well-informed and flexible communities, able to respond generously to each other and to needs wherever they arise. These are characteristics not of societies in hock to the rich, in which people are driven by status insecurities, but of populations used to working together and respecting each other as equals.

The United States economy is currently struggling to emerge from a severe recession brought on by the financial crisis of 2008. Was that crisis brought about by income inequality? Some economists are starting to think it may have been. David Moss of Harvard Business School has produced [an intriguing chart](#) that shows bank failures tend to coincide with periods of growing income inequality. “I could hardly believe how tight the fit was,” he [told](#) the *New York Times*. Princeton’s Paul Krugman has similarly been [considering](#) whether the Great Divergence helped cause the recession by pushing middle-income Americans into debt. The growth of household debt has followed a pattern strikingly similar to the growth in income inequality (see the [final graph](#)). Raghuram G. Rajan, a business school professor at the University of Chicago, [recently argued](#) on the *New Republic*’s Web site that “let them eat credit” was “the mantra of the political establishment in the go-go years before the crisis.” Christopher Brown, an economist at Arkansas State University, wrote a [paper](#) in 2004 affirming that “inequality can exert a significant drag on

effective demand.” Reducing inequality, he argued, would also reduce consumer debt. Today, Brown’s paper looks prescient.

Heightened partisanship in Washington and declining trust in government have many causes (and the latter slide *predates* the Great Divergence). But surely the growing income chasm between the poor and middle class and the rich, between the Sort of Rich and the Rich, and even between the Rich and the Stinking Rich, make it especially difficult to reestablish any spirit of *e pluribus unum*. Republicans and Democrats compete to show which party more fervently opposes the elite, with each side battling to define what “elite” means. In a more equal society, the elite would still be resented. But I doubt that opposing it would be an organizing principle of politics to the same extent that it is today.

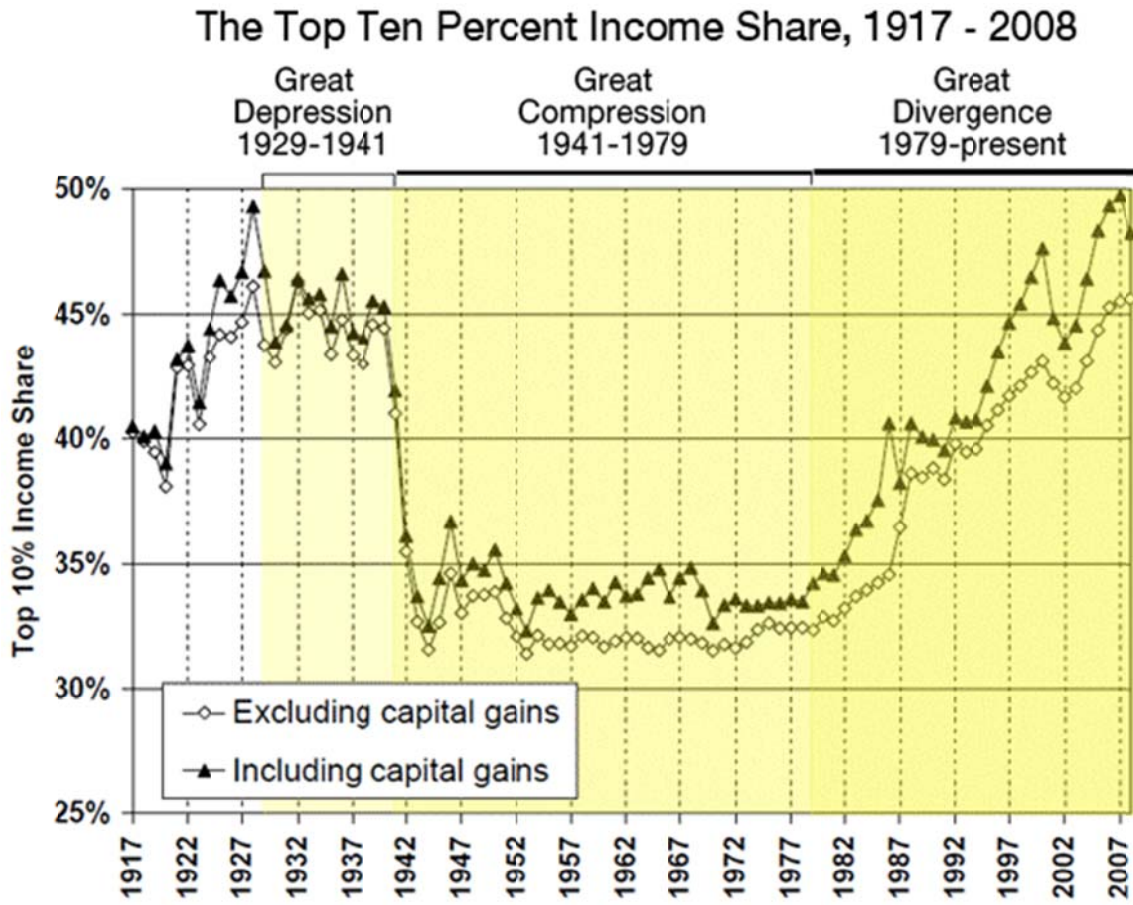
I find myself returning to the gut-level feeling expressed at the start of this series: I do not wish to live in a banana republic. There is a reason why, in years past, Americans scorned societies starkly divided into the privileged and the destitute. They were repellent. Is it my imagination, or do we hear less criticism of such societies today in the United States? Might it be harder for Americans to sustain in such discussions the necessary sense of moral superiority?

What is the ideal distribution of income in society? I couldn’t tell you, and historically much mischief has been accomplished by addressing this question too precisely. But I can tell you this: We’ve been headed in the wrong direction for far too long.

--v.--



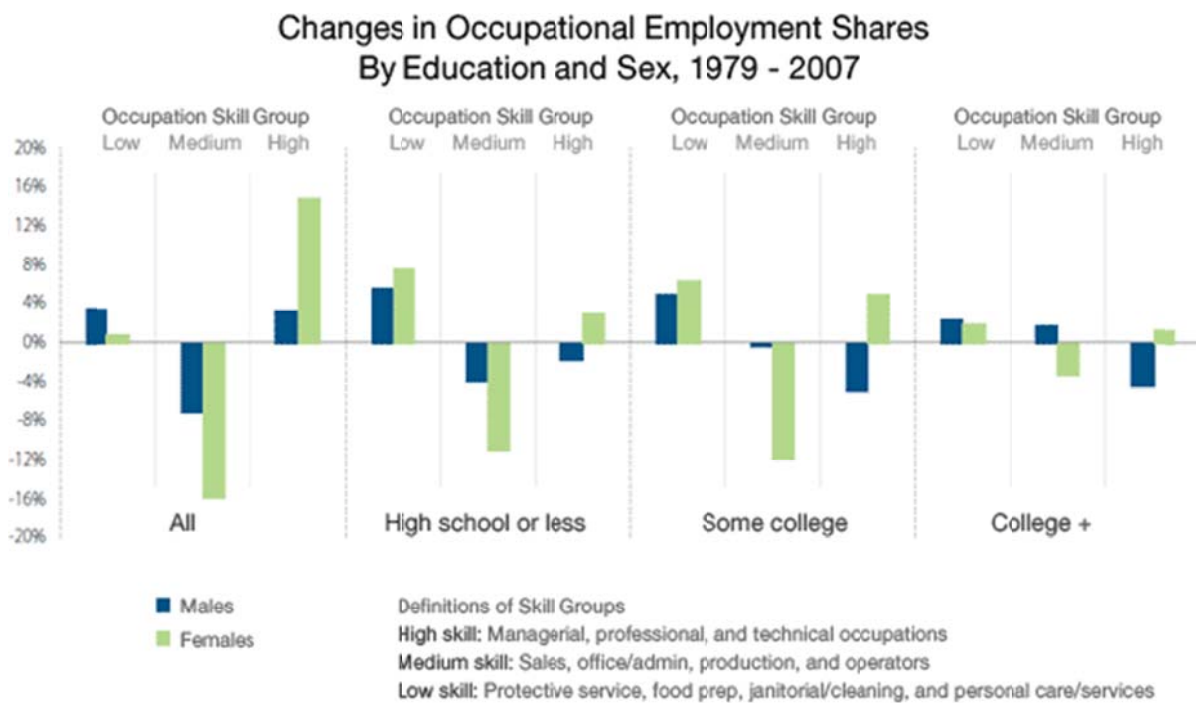
Here is a snapshot of income distribution during the past 100 years:



Income is defined as market income (and excludes government transfers).  
In 2008, top decile includes all families with annual income above \$109,000.

Source: Thomas Piketty and Emmanuel Saez.

Far from contributing to the Great Divergence, women have, to a remarkable degree, absented themselves from it. Take a look at this bar graph by David Autor, an MIT labor economist:



Source: David Autor and Center For American Progress.