The High Price of American Inequality
And What Might Be Done About It

Economic inequality in the United States is greater than in any other developed country, and it's growing. The impact of this inequality on our country is important, yet policy makers don't seem to take it sseriously. What's causing it? What can we do about it?

In the March 17, 2008, edition of the *Washington Post* were two articles on toll roads. The first concerned the ongoing attempt by the current US Department of Transportation to get the federal government out of the business of funding road building, thereby “encouraging” states to move toward toll roads where the users pay for construction and maintenance. And the second article was about a report from a Metropolitan Washington regionwide council that in order to relieve the disabling traffic congestion in the area such toll roads are now an absolute necessity precisely because both state and federal governments are pulling back from the costs of roads. The council is recommending that most of the *existing* area highways, the bridges into the District and even major District thoroughfares be at least partially converted to toll roads. Those able and willing to pay would zip by on their toll roads while the rest would stay stuck in traffic. The impact of toll roads will be to give the affluent a further advantage over others. The rich get richer and the poor get poorer.

Toll roads are but one small manifestation of the increasing economic inequality in the United States. Even the mainstream media has begun to notice the increasing disparities in income and wealth among Americans. Columnists regularly report that for the last thirty-five years (with the exception of a brief period in the 1990s) we have been growing steadily more unequal economically and that the disparity in income distribution in the United States is now greater than at any time since the Great Depression of the 1930s. It’s also now well known that the United States has far the most unequal income distribution among the world’s highly developed nations.

How unequal? Well, there’s a technical statistical measure that everyone uses (but, as far as I can tell, no one actually understands) called the “Gini coefficient,” according to which the UN ranks the United States 78th among the world’s nations, tied with Turkmenistan and Ghana. A more readily understandable statistic (from the book *Inequality Matters*) is that the wealthiest 5% of Americans have 59 percent of the country’s wealth, while the bottom 40 percent has only 0.3%.” David Cay Johnston, the lead tax reporter for *The New York Times*

, documents that the richest 28,000 people in the United States have more income that the 96 million poorest Americans. Those are difficult figures to compare in our imaginations, so Johnston offers an illustration in his book about the tax system *Perfectly Legal*: Those super rich would occupy only one-third of the seats at Yankee Stadium while 96 million is the number of people who live west of Iowa plus everyone in Iowa itself. And that's only income; wealth distribution is far more unequal.

What's curious, however, is that the increased awareness of inequality doesn't seem to have precipitated much active concern among policy makers, pundits, or, indeed, among the general population.

That strikes me as curious because perhaps the most important founding myth of our country is the equality of all persons. (Yes, I know, the founding *fathers* intended equality among *white men*, but the myth has long referred the equality of all persons.) Perhaps, we've been so unconcerned because by equality we meant "economic mobility" or "freedom of opportunity." Yet the research is that our inequality is deeply entrenched with relatively little economic mobility: People are highly likely to experience similar economic outcomes as did their parents. The child of poor parents has much less a chance of becoming rich than does a poor child in most other advanced countries, including those in old "class-bound" Europe. So, an important founding myth of our nation has been deeply undermined, yet we don't seem very upset about it. Curious.

Perhaps the primary reason for this lack of concern is a steady drumbeat of opinion (mostly from those who just happen to benefit from the current structure) that inequality doesn't really matter as long as all incomes are rising. As long as I'm doing better, goes the theory, why should I care that someone else is doing ten times as well. There are a number of problems with this argument.

First, even before the current recession most incomes have *not* been rising. The average real income of the bottom ninety per cent of the population actually declined between 1973 and 2000 while the income of the top one percent increased by 148 percent (and the increases for the top one-tenth and one-hundredth of one percent [the super rich] were far more dramatic). And during the last seven years, things have gotten considerably worse, so that incomes for all but the most wealthy have not kept up with inflation, that is, in real terms they've fallen. So, the poor, working class, and middle class are sinking or, at best, treading water while they watch the rich row by in their boats and the super rich steam by in their yachts. This is very different from the situation during the thirty years immediately after World War II, when the increases in American productivity were broadly shared, and the income of people in every income bracket increased by about the same percentage.

Second, inequality is important because increases in the income of affluent people can cause certain prices to rise for everyone thus making everyone else effectively poorer. If good schools can only be found in certain jurisdictions, for instance, it’s likely that the affluent will price the less affluent out of the market entirely … unless the poorer people—recognizing the importance of education—decide to spend too much of their income on housing. And so, statistics demonstrate that median house prices rise with increasing inequality. This phenomenon can easily be seen in my neighborhood where gentrification (bringing the affluent into the Washington DC home market) has made buying a house or renting an apartment unaffordable for all but the affluent, forcing the less affluent into less desirable neighborhoods. The cost of college education has skyrocketed far faster than the rate of inflation, making college simply unaffordable for many who are less wealthy.

Third, unequal societies tend to create fewer government programs to equalize things … soon, apparently, to include public roads. For the very wealthy (and, therefore, politically influential), rather than pay higher taxes to improve government services that everyone could use, it’s more cost effective to purchase needed services for oneself and then push for lower taxes. If I’m paying for private education for my child, I’m more likely to resist an additional tax levy for public schools than if my child were attending those public schools. If my privately purchased or employer-based health insurance is very good, I’m going to look less favorably upon government-funded (ie tax-supported) programs for universal health insurance. And, as in the United States, when the very wealthy tend to withdraw into their own enclaves protected by their own security guards, they’re less invested in increasing taxes for all sorts of local improvements from police protection to garbage pickup to repairing potholes. In fact, our society is moving in the direction where the rich pay for most everything privately while they clamor for tax reductions for the wealthiest.

Obviously, this relationship between inequality and government programs is a chicken-and-egg phenomenon: Fewer government resources (eg, less money for highway construction) mean lower quality public services (eg, congested highways) which pressure the wealthy to buy those services privately (eg toll roads) in a vicious cycle that increases pressure for lower taxes causing even poorer government services. Also lower taxes mean that less wealth will be redistributed, which also increases inequality. As we’ll see below, in the countries that have low levels of inequality, it is government transfers of income that actually account for much of the improved equality.)

The fourth reason is a bit more complicated, but affluent people tend to change the norms of society so that what were formerly luxuries are now perceived as needs. Orthodonture for moderately crooked teeth was considered a luxury when I was a child. By the time of my own child's adolescence twenty years ago, straightening her teeth was necessary among her generally affluent friends. Today, it would be considered a necessity by most everyone. If everyone else has a car, not only is a car a perceived necessity but the lack of public transportation or a network of sidewalks and bike paths (due to fewer people needing them) means that a car *is* a necessity, meaning fewer resources in a poor family for other things. Add to this the social pressure to have a *new* car or a larger house, and we find even middle-class people working far harder than they want to in order to "keep up appearances." These may seem like small psychological matters, but it's very clear, for instance, that the visions of "normal" affluence portrayed on television have profound impact upon the self-esteem of poor children.

Fifth, inequality matters because too high a level of inequality leaches away the glue in the social contract. When the rich live in a world absolutely different from the poor or middle-class, their isolation leads to misunderstanding of, and often resentment toward, the other members of society who are benefiting from the taxes that they, the wealthy, pay. (While the taxes paid by the wealthy measured as a percentage of income are little different from taxes paid by others, the wealthy pay a much larger dollar amount than do others). The wealthy tend not to have poor people as personal acquaintances, therefore cannot really understand their circumstances, and so feel less and less responsibility for people they can't comprehend.

Finally, intriguing studies suggest that *everyone* suffers in an unequal society. The economist Paul Krugman, for instance, cites statistical studies showing that as inequality increases, so does corruption. And there is increasing evidence from a variety of sources that the health of even the wealthy is better in a more egalitarian society than in a highly unequal one. The reasons are not yet well understood but probably have something to do with an egalitarian society being less stressful to live in.

So, inequality matters. But why is our society so unequal and what can we do about it? Some of the multiple causes of increasing inequality in the United States are complex and will be difficult to moderate.

- Increasing globalization puts many kinds American workers in direct competition with workers around the world who are willing to work for much less, thus drawing jobs out of the United States and putting downward pressure on many kinds of wages; but, then again, that dynamic is somewhat mitigated by lower prices for all consumers.
- For the last twenty-five years, American society has lived more and more by the ethos

of the unconstrained free market, so that not only have wages for some kinds of positions skyrocketed but there is less social opprobrium for, say, CEO salaries that dwarf the salaries of their employees.

- Large-scale illegal immigration puts downward pressure on wages and also brings in many people who are, initially at least, very poor.
- Discrimination and institutional racism have left large numbers of African Americans completely outside the normal economy. (For example, two-thirds of African American men who did not graduate from high school are, at any given time, unemployed.)

These are not only complex issues to understand but there is also some disagreement about their relative contributions to inequality; nor are there simple measures to fix them.

But at least two important causes of American inequality are straightforward: a non-progressive tax structure and low levels of government programs that equalize us. In the 1950s (during the entire administration of the Republican president, Dwight Eisenhower), the marginal tax rate on very high incomes was over 90%; today it has fallen to 35%. The tax rate on capital gains (the source of most of income accruing to from wealthy people) reached a high of almost 50% in the 1970s; it has gradually fallen to 15%. The result, of course, has been a drastic change in the distribution of government revenue sources. The payroll tax (accounting for 40% of US government revenue) is actually a regressive tax, meaning that the poor pay a far greater percentage of their income than do the very rich. (The tax rate is actually the same for all levels of income up to about $100,000, but there is no payroll tax on incomes above that level, nor, of course, on capital gains. The result is that the higher a person’s income is, the smaller the percentage of that income that will be subject to payroll taxation.) When all the exemptions and tax breaks are factored in, writes David Cay Johnston, the middle class actually pays the highest tax rate while the rich pay about the same percentage as the poor!

This essentially flat tax structure has at least three implications for inequality. First, the poor have to give up more of their income than they would under a progressive structure of taxation, making them poorer and making the country more unequal. Conversely, the rich get to keep much more of their income than they would under a progressive structure. And, third, the amount of government revenue drops because the wealthy account for such a large percentage of American income (remember those few people in Yankee Stadium making more than the poorest 96 million), meaning that there is less money for social programs to make the country more equal.

And that leads to the second major straightforward cause of inequality in the country: the relatively low levels of government wealth transfer from the rich to the poor. By “wealth transfer”

I mean both the effects of government taxation and the effects of government programs. There are obvious transfers of wealth like food stamps or welfare payments, but there are other more important sources of this wealth transfer. For instance, universal health care benefits everyone about equally, so, in essence, government-funded health care transfers wealth from the rich to the poor. Public education, social security, Medicaid, and Medicare are other examples.

Examining the statistics, one finds that it is this differential in wealth transfer that actually accounts for most of the difference in inequality between the United States and European countries. If you use the same international method to calculate poverty rates for the United States, Canada and Western Europe and if you calculate those rates before any government transfer of wealth, it turns out that the US poverty rate is among the lowest. But if you calculate that poverty rate after government transfers, the US poverty rate is by far the highest at 18% (the United Kingdom is 13% but all other European countries are 8% or under). So, the primary reason that other developed societies are more equal than American society is that, in essence, they take money from the rich and give it to the poor.

In other words, while some of the causes of American inequality are complex and would be fairly complicated to do anything about, two of the most important causes—taxes and government programs—are not complex at all and would theoretically be easy to correct.

To point out the obvious, both a tax structure that is non-progressive and low rates of government wealth transfer would theoretically be straightforward to fix. We know what to do! Even the United States knows how to structure a highly progressive tax because we've done it before (and it didn't seem to have a major impact on the economy). Whenever "redistribution of wealth" is mentioned, however, the image is of government checks sent to lazy people. Never mind that even in our poorest-run welfare programs such outcomes were by far the exception. In any event, we now have government transfer programs that have been demonstrated to decrease inequality *and* encourage work. The Earned Income Tax Credit (EITC), for instance, is our most successful anti-poverty program, but it also encourages work. The program works through refundable federal tax credits to give poorly paid heads of households refunds that increase (up to a maximum $4,700 a year) as their incomes rise to a certain level (thus rewarding work) and it tapers the credit down gradually as their incomes rise further (thus not discouraging work). It would be a relatively straightforward matter to rework the EITC so that no person who was willing and able to work would have an income below the poverty level. And other kinds of wealth transfer programs are also straightforward: A single-payer universal health insurance program where taxes paid the insurance premiums (like Medicare but for everyone), adequate government-supported childcare for all working parents, and far more adequate public transportation systems obviating the need for a car are all examples.

Income inequality is, in fact, inevitable under an unfettered free-market economy, but progressive taxation with government wealth transfer is a way to strengthen capitalism by pursuing a more equal society.

The continuing rise in American economic inequality is not only disturbing morally but also has dangerous implications for our society. Simply put, as societies become more unequal they become less cohesive and they tend to fall apart. (Increasing inequality was one of the primary fundamental reasons for the fall of the previous three western empires, Spain, Holland and Britain.) The increasing level of American inequality is not a mysterious phenomenon. We know where it comes from and we know what to do about it. As we begin to gather hope and confidence after seven years of political winter, it’s time to put the reduction of inequality on the top of our agenda.