Inequality in America: A Policy Agenda for a Stronger Future

2014 Moynihan Prize Lecture

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It is a real pleasure for me to accept this award named in memory of one of America's great statesmen and thinkers, Daniel Patrick Moynihan.

Our intellectual paths crossed in many ways. Some 20 years ago, serving in the Clinton Administration as a member and then chairman of the Council of Economic Advisers, I became fascinated with the role of secrecy in government. It was natural that I would be interested in the subject: a major focus of my work in economics had been information—including the incentives that market participants had for revealing and not revealing relevant information. Secrecy and transparency were the counterpoints in the political sphere. No one working in government could fail to notice the excessive focus on secrecy, the lack of transparency—even on the part of those who publicly preached transparency.

Of course, the defining work in this area was Senator Moynihan's book *Secrecy: The American Experience,* and when, at about the same time that he wrote that book, I wrote a paper on secrecy (later given as the Oxford Amnesty Lecture at Oxford in 1999[2]), I was more than pleased that he called me in to discuss it, and that he circulated it among his Senate colleagues.

He shared with me an abiding concern about the poverty and inequality that afflicted our country. It was this concern about poverty and inequality that led me to shift away from what I had thought would be my life's work, in theoretical physics, to economics. The subject was the focus of my Ph.D. dissertation. And it is the subject of my most recent book, *The Price of Inequality.*

The subject is at last beginning to get the attention it deserves. It is the subject of my talk this afternoon.

Growing inequality within most countries around the world is one of the critical issues facing the world today. We sense that it is morally wrong. We sense that it cannot be justified. We

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[2] "On Liberty, the Right to Know and Public Discourse: The Role of Transparency in Public Life," Chapter 8 in *The Rebel Within*, Ha-Joon Chang (ed.), London: Wimbledon Publishing Company, 2001, pp. 250-278. Also published in Globalizing Rights, Matthew Gibney (ed.), Oxford: Oxford University Press, 2003, pp. 115-156. (Originally presented as 1999 Oxford Amnesty Lecture, Oxford, January 1999.)

sense that it is dividing our societies and undermining our democracies. And we are right in sensing this harm.

These effects of inequality should be more than enough to steel the resolve to do something to reduce this growing inequality. But even if one didn't care about these effects, there are further reasons to fight inequality. It undermines our economies.
In this short lecture I want to describe the nature of this growing inequality, its multiple dimensions, say a few words about its origins, explain why it is has such adverse effects, and argue that this inequality is not inevitable: it is a result of policies and politics. There are policies that would simultaneously reduce inequality, heal some of the divides in our societies, and strengthen our economies.

I will focus my remarks on the United States, simply because America has achieved the distinction of becoming the country with the highest level of income inequality among the advanced countries. But unfortunately the United States has been a trend setter. As others have followed America's lead, they too have seen increasing inequality.

The multiple dimensions of inequality

There is no single number that can depict all aspects of society's inequality, but matters have become worse in every dimension. *Income* inequality is one of the most obvious indicators: In the United States, more than a fifth of all income goes to the top 1%. This is a level of income concentration that, until the 2000s, the United States had not experienced since before the Great Depression. It is twice the proportion a short 30 years ago. And it's getting worse. Since the so-called recovery began after the Great Recession of 2008-2009 – in other words, since the U.S. economy returned to growth – *95% of the gains in income* have gone to the top 1%. Even within the top 1%, there is inequality, with ultra-high income earners in the top .1 percent taking home some 11.3% of total income in 2012, some three to four times the number thirty years ago.

Wealth is far more concentrated than income. The wealthiest 1% of Americans holds 35% of the wealth, and even more when housing wealth is not counted. This too is on the upswing. For the quarter century before the Great Recession, the rich were getting wealthier at a more rapid pace than everyone else. When the crisis hit, it depleted some of the richest American's wealth because stock prices declined, but many Americans also had their wealth almost entirely wiped out as their homes lost value. After the crisis, the wealthiest 1 percent of households had 225 times the wealth of the typical American, almost double the ratio 30 or 50 years ago. (Just one example of the extremes of wealth in America is the Walton family: the six heirs to the Wal-

Mart empire command wealth of $90 billion, which is equivalent to the wealth of the entire bottom 42 percent of U.S. society. [3] The numbers may not be as surprising as they seem, simply because those at the bottom have so little wealth.)

Inequality plays out along ethnic lines in ways that should be disturbing for a country that had begun to see itself as having won out against racism. Between 2005 and 2009, a huge number of Americans saw their wealth drastically decrease. The net worth of the typical white American household was down substantially, to $113,149 in 2009, a 16 percent loss of wealth from 2005. That's bad, but the situation is much worse for other groups. The typical African American household lost 53 percent of its wealth—putting its assets at a mere 5 percent of the median white American's. The typical Hispanic household lost 66 percent of its wealth. [4] In the years of "recovery," as stock market values rebounded (in part as a result of the Fed's lopsided efforts to resuscitate the economy through increasing the balance sheet of the rich), the rich have regained much of the wealth that they had lost; but not so for the rest of the country. [5]

At the same time that income has become ever more concentrated at the top, more people are in poverty at the bottom. Some 22% of American children live below the federal poverty level. This is perhaps not surprising, given that the inflation adjusted median income of a male worker with only a high school degree has fallen by 47% from 1969 to 2009.

Equally disturbing, there has been a hollowing out of the middle class—long the core strength of our society—which has seen its income stagnate. Median household income, adjusted for inflation, today is lower than it was in 1989, a quarter century ago. For large segments of the American population, matters are even worse. A full-time male worker today makes less than 40 years ago.

[3] See for example Josh Harkinson, 2012, "6 Walmart Heirs Hold More Wealth Than 42% of Americans Combined," *Mother Jones*, July 18, available at http://www.motherjones.com/mojo/2012/07/walmart-heirs-waltons-wealth-income-inequality

[4] See Paul Taylor, Rakesh Kochhar, Richard Fry, Gabriel Velasco, and Seth Motel, 2011, "Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanics," Pew Research Center report, available at http://www.pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf.

[5] That this is the case can be clearly seen by examining what has happened to different kinds of wealth since the end of the crisis. Stocks, which are disproportionately owned by the wealthy, have done very well. Stock market values in the United States increased $13 trillion from January 2009 to December 2013, according to data from the Center for Research in Security Prices. Meanwhile, home values, which account for much of middle class wealth, have not enjoyed a strong recovery: one fifth of American homes were still underwater as of Spring 2014 – their owners owe more on their mortgages than the market says their houses are worth. For a concise discussion of this, see 'What Housing Recovery?" by Peter Dreier, *The New York Times*, May 8, 2014, available at http://www.nytimes.com/2014/05/09/opinion/what-housing-recovery.html?ref=opinion&_r=0.

This recession has made the plight of those in bottom and middle far worse. For most, there is no recovery. Still, the data just presented should make clear that the problems I have been discussing pre-date the crisis.

As disturbing as the data on the growing inequality in income are, those that describe the other dimensions of America's inequality are even worse: There are, for instance, marked inequalities in health, reflected in differences, for instance, in life expectancy.[6] Despite its high expenditures on health care per capita, Americans live shorter lives than their counterparts in other high-income countries, a fact partly attributable to inequality. A study conducted by the U.S. Social Security Administration showed that men born in 1941 who lived past age 60 and had average earnings in the top half of the distribution lived 5.8 years longer than the same cohort in the bottom half of the earnings distribution. This gap is much larger than it once was, indicating that income may be more predictive of life expectancy than ever before.[7]

There are many reasons for these inequalities in health outcomes. The poor are exposed more to environmental hazards. [8] What is particularly disturbing is the large numbers of Americans who do not have access to the basic necessities of life. Until the American Affordable Care Act, more than a sixth of Americans had no health insurance. Even though about one in seven Americans depend on the government for basic food, still a comparable number go to bed hungry on a regular basis, not because they are on a diet, but because they or their families cannot afford adequate nutrition.[9]

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[6] A report from the Institute of Medicine of the National Academies ranked the United States last and second-to-last for life expectancy of males and females respectively in a comparison to 16 other high-income countries, despite the fact that the United States spends much more on health care for every person than any other country. The United States also performs poorly on a variety of other health indicators compared to other high-income countries in the study, which cites inequality and poverty as partial explanations. See "U.S. Health in International Perspective," available at http://www.iom.edu/Reports/2013/US-Health-in-International-Perspective-Shorter-Lives-Poorer-Health.aspx. The Centers for Disease Control have published work that shows the strong links between a variety of different aspects of inequality in the United States and health outcomes. See Centers for Disease Control and Prevention, 2013, "CDC Health Disparities and Inequalities Report — United States, 2013," available at http://www.cdc.gov/mmwr/pdf/other/su6203.pdf.

[7] See Hilary Waldron, 2007, "Trends in Mortality Differentials and Life Expectancy for Male Social Security-Covered Workers, by Socioeconomic Status," U.S. Social Security Administration, Office of Retirement and Disability Policy, available at http://www.ssa.gov/policy/docs/ssb/v67n3/v67n3p1.html.

[8] See Janet Currie, "Inequality at Birth: Some Causes and Consequences," *American Economic Review,* May, 2011, pp. 1-32.

[9] In the US even upwardly mobile individuals—those born into poverty who successfully navigate their way out—have worse outcomes. This may be due to the stress associated with high levels of inequality. See for example Tianyi Yu *et al.*, "Is Resilience Only Skin Deep?: Rural African Americans' Socioeconomic Status–Related Risk and Competence in Preadolescence and Psychological Adjustment and Allostatic Load at Age 19," *Psychological Science* 24(7): 1285-1293.

Perhaps the most invidious aspect of inequality is that of opportunity. Equality of opportunity—the "American dream"—has always been a cherished American ideal. But data now show that this is a myth: America has become the advanced country not only with the highest level of inequality, but one of those with the least equality of opportunity. The life prospects of a young American are more dependent on the income and education of his parents than in other developed countries. We have betrayed one of our most fundamental values. And the result is that we are wasting our most valuable resource, our human resources: millions of those at the bottom are not able to live up to their potential.

A number of studies have noted the link between inequality of outcomes and inequality of opportunity. When there are large inequalities of income, those at the top can buy for their offspring privileges not available to others, and they often come to believe that it is their right and obligation to do so. And, of course, without equality of opportunity those borne in the bottom of the distribution are likely to end up there: inequalities of outcomes perpetuate themselves. For the United States, this should be deeply troubling: given our low level of equality of opportunity and our high level of inequality of income and wealth, it is possible that the future will be even worse, with still further increases in inequality of outcome and still further decreases in equality of opportunity.

While America has been winning the race to be the most unequal country (at least within the developed countries), unfortunately, much of what I have just described for America has been going on elsewhere. The more countries follow the American model, the more the results seem to be consistent with what has occurred in the United States. The UK has now achieved the second highest level of inequality among the countries of Western Europe and North America, a marked change from its position before the Thatcher era. Germany, which had been among the best performers within the OECD now ranks in the middle.

Most disturbing are the patterns that have emerged in the economies of transition, which at the beginning of their movements to a market economy had low levels of inequality in income and wealth (at least according to available measurements). Today, China's inequality of income, as measured by its Gini coefficient is roughly comparable to that of the United States and Russia.[10] Across the OECD, since 1985 the Gini has increased in 17 of 22 countries for which data is available—often dramatically. [11]

[10] Some caution should be exercised in comparing different countries' Gini coefficients: in addition to the well-known flaws in the measure, different databases have used slightly different methodologies or income data to arrive at their respective figures, and thus figures are different depending on the data source. Nevertheless, many different studies confirm these broad trends.

[11] See Organisation of Economic Co-operation and Development, 2011, *Divided We Stand*, OECD Publishing, available at http://www.oecd.org/social/soc/dividedwestandwhyinequalitykeepsrising.htm.

Today, I want to make several observations concerning the growing inequality that I have just described.

The first observation is that this inequality is largely a result of policies—of what we do and don't do. The laws of economics are universal: the fact that in some countries there is so much less inequality and so much more equality of opportunity, the fact that in some countries inequality is not increasing—it is actually decreasing—is not because they have different laws of economics. (France and Norway are examples of OECD countries that have managed by and large to resist the trend of increasing inequality; Brazil and several other Latin American countries have actually managed to reduce the level of inequality, albeit from a very high level. The Scandinavian countries have a much higher level of equality of opportunity, regardless of how that is assessed. The European countries with public health care systems succeed much better in achieving equality of health outcomes.)[12]

Every aspect of our economic, legal, and social frameworks helps shape inequality: from the education system and how it is financed, to the health system, to tax laws, to our governing bankruptcy, corporate governance, the functioning of our financial system, to anti-trust laws. In virtually every domain, the United States, for instance, has made decisions that help enrich the top at the expense of the rest.

The second observation entails looking at the current levels of inequality in a historical context. While I have emphasized the growth of inequality in the last third of a century, Thomas Piketty in his recent book notes that the preceding four decades should perhaps be viewed as a historical anomaly: we are returning to the high levels of inequality that prevailed in the 19th century and into the 20th, in the years before the Great Depression. Piketty concludes that inequality going forward is likely to get worse. [13] I will comment on this forecast later. But his analysis has some profound implications: it means that the optimism expressed by Kuznets (referred to as the Kuznets curve), that after an initial period during which inequality would increase in the process of development, there would be a decrease, may well be wrong. Countries should not accept today increasing inequality, in the blind faith that it will eventually be reversed.

[12] See for example Cathy Schoen *et al.*, 2010, "How Health Insurance Design Affects Access to Care and Costs, by Income, in Eleven Countries," *Health Affairs* 29(12): 2323-2334. The study reports large disparities in access to care for Americans, depending on their income.

[13] Thomas Piketty, 2014, *Capital in the Twenty-First Century*, Cambridge Massachusetts : The Belknap Press of Harvard University Press.

The third observation is that much of the inequality at the top can't be justified as "just deserts" for the large contributions that these individuals have made. If we look at those at the top, they are not those who have made the major innovations that have transformed our economy and society; they are not the discoverers of DNA, the laser, the transistor; not the brilliant individuals who made the discoveries without which we would not have had the modern computer. Disproportionately, they are those who have excelled in rent seeking, in wealth appropriation, in figuring out how to get a larger share of the nation's pie, rather than enhancing the size of that pie. (Such rent seeking activity typically actually results in the size of the economic pie shrinking from what it otherwise would be.) Among the most notable of these are, of course, those in the financial sector, who made their wealth by market manipulation, by engaging in abusive credit card practices, predatory lending, moving money from the bottom and middle of the income pyramid to the top. So too, a monopolist makes his money by contracting output from what it otherwise would be, not by expanding it.

The inaptness of the "just deserts" argument was shown by the Great Recession, a recession which in no small measure was caused by the financial sector which itself is responsible for so much of our inequality today. Even as they were bringing their firms and the global economy to the brink of ruin, the managers of these firms walked off with multi-million dollar bonuses.

The notion that large fractions of our inequality are associated with rent seeking is supported by a look at the composition of the wealthiest and top income earners. But there is additional evidence.

Three striking aspects of the evolution of our economy in the last 35 years are (a) the increase in the wealth to income ratio; (b) the stagnation of median wages; and (c) the failure of the return to capital to decline. Standard neoclassical theories, in which "wealth" is equated with "capital" would suggest that the increase in capital should be associated with a decline in the return to capital and an increase in wages. The failure of wages to increase has been attributed by some (especially in the 1990s) to skill-biased technological change, which increased the premium put by the market on skills. Hence, those with skills saw their wages rise, and those without skills saw them fall. But recent years have seen a decline in the wages paid even to skilled workers. Something else must be going on. While in production functions with multiple inputs (say multiple kinds of labor) an increase in capital does not necessarily increase the wages of each type of labor (capital and unskilled labor can be substitutes rather than complements), if the production function exhibits constant returns to scale (a standard assumption in neoclassical theory), then the average wage must increase.[14] This does not seem to be happening.

There are two alternative explanations. Both are related to different forms and aspects of rent seeking. The first is that rents are increasing (the fraction of income that is appropriated by monopolists and by other forms of exploitation). These rents are captured by (large) owners of capital, and since they are, at least in part, marketable, the present discounted value of these rents themselves become part of "wealth." But an increase in this form of wealth does not lead to an increase in the productivity of the economy—or to an increase in the average wage of workers; to the contrary, it reduces the amounts received.

The second is that there may be other assets—like land—that can increase in value. These assets may not be very directly related to the production of goods and services[15], and indeed, with more wealth invested in these assets, there may be less invested in real productive capital. (A disproportionate part of America's savings in the years before the crisis went into the purchase of housing, which did not increase the productivity of the "real" sectors of the economy.)

Monetary policies that lead to low interest rates can increase the value of these fixed assets—an increase in the value of wealth that is unaccompanied by any increase in the flow of goods and services. By the same token, a bubble can lead to an increase in wealth—for an extended period of time—again with possibly adverse effects on the stock of "real" capital. Indeed, it is easy for capitalist economies to generate such bubbles (a fact that should be obvious from the historical record, [16] but which has been confirmed in theoretical models.[17]) There has been a "correction" in the housing bubble (and in the underlying price of land); but we should not be confident that there has been a *full* correction. We still may be on a "bubble" trajectory. The increase the wealth-income ratio may still have more to do with an increase in the value of rents than an increase in the amount of productive capital.

Still another piece of evidence supporting the importance of rent-seeking in explaining the increase in inequality is that showing that increases in taxes at the very top do not result in

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[14] Assume a constant returns to scale production function with two types of labor, L_1 and L_2. Then $F_{L1}L_1 + F_{L2}L_2 + F_K K = F$, so $F_{L1K}L_1$ _ + $F_{L2K}L_2 + F_{KK}K = 0$, from which it follows immediately that the average wage must increase when capital is increased.
[15] Though they may be reflected in GDP, and may be related in particular to the value of housing services.
[16] See Carmen Reinhardt and Kenneth Rogoff, 2009, *This Time Is Different: Eight Centuries of Financial Folly,* Princeton, NJ: Princeton University Press.
[17] See, for instance, Karl Shell and Joseph E. Stiglitz, 1967, ""Allocation of Investment in a Dynamic Economy," *Quarterly Journal of Economics*, 81: 592-609, and Frank Hahn, 1966, "Equilibrium Dynamics with Heterogeneous Capital Goods" *Quarterly Journal of Economics* 80: 633–46..

decreases in growth rates. If these incomes were a result of their *efforts,* we might have expected those at the top to respond by working less hard, with adverse effects on GDP. [18]

Piketty's recent research has emphasized a different aspect of the "just deserts" argument: the increasing fraction of inequality arising from inheritance. For those who believe that capitalism is a "fair" system, this has proven particularly disturbing.

The idea that one shouldn't worry about inequality because everyone will benefit as money trickles down, has been thoroughly discredited. In some ways, I wish it were true, for if it were, it would mean that the average American would be doing very well today, because we have thrown so much money at the top. But the statistics I gave a few minutes ago show trickle-down is a fallacy: while the top has been doing very well, the rest has been stagnating.

In the absence of a change in the degree of inequality, if mean income (GDP) increases, everyone can benefit. But I emphasized earlier that there has been a large increase in inequality, and this gives rise to an increasing disparity between the mean and the median, between what is happening on average, and what is happening to the typical individual. Those at the very top, in the 1% or the .1%, can see their income increase; while incomes for the bottom 99% (or the bottom 99.9%) can actually decrease. That is what has been happening.

An economic system that only delivers for the very top is a failed economic system. Begrudgingly, we have to admit that our economic system is a failed system. If the failures were of a short duration, that would be one thing. But they have been persistent—and there is no evidence of a turnaround.

Some go further: it is not just that everyone will benefit from trickle down, but, they argue, we *need* inequality to grow. One of the popular misconceptions is that those at the top are the job creators; and giving more money to them will thus create more jobs. America is full of creative entrepreneurial people throughout the income distribution. What creates jobs is *demand*: when there is demand, America's firms (especially if we can get our financial system to work in the way it should, providing credit to small and medium-sized enterprises) will create the jobs to satisfy that demand. And unfortunately, given our distorted tax system, for too many at the top, there are incentives to destroy jobs by moving them abroad.

[18] Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva, 2011, Taxing the 1%: Why the top tax rate could be over 80%," *VOX*, December 8, 2011, available at http://www.voxeu.org/article/taxing-1-why-top-tax-rate-could-be-over-80 (accessed July 7, 2014).

This growing inequality is in fact weakening demand—one of the reasons that inequality is bad for economic performance. The reason that inequality leads to weak demand is easy to understand: those at the bottom spend a larger fraction of their income (they need to, just to get by) than those at the top.

The weaker demand is just one of the *economic* prices we pay for the high level of inequality of outcomes and inequalities of opportunities. The problem of weak demand is compounded by the flawed responses to this weak demand by monetary authorities, by lowering interest rates, which can easily give rise to a bubble, the bursting of which leads in turn to recessions. This indeed describes what has happened in recent years.

Thus, the IMF[19] finds that countries with greater inequality tend to be marked by greater instability.

(This is not the only possible response: fiscal authorities could lower taxes on say the middle class, or increase government investments in infrastructure, technology and education. But the Bush administration took exactly the opposite strategy—lowering taxes on the rich. These responses are perhaps not a surprise: as I will explain, economic inequality translates into political inequality, and those have a tendency to seek their own advantage.)

There are still other reasons that inequality is bad for the economy and growth. One of the reasons is that today, inequality is associated with rent seeking, and rent seeking distorts the economy.

Another is the observation made earlier that inequality of outcomes is associated with inequality of opportunity, and that means that those unfortunate enough to be borne at the bottom of the income distribution are at great risk of not living up to their potential. We thus pay a price not only in terms of a weak economy today, but lower growth in the future. With nearly one in four American children growing up in poverty,[20] many of whom face not just a lack of educational opportunity, but also a lack of access to adequate nutrition and health, the country's long-term prospects are being put into jeopardy.

A third is related to the corrosive effect of inequality on morale, especially when it cannot be well-justified (and as we have noted, the inequality evidenced in the US and elsewhere cannot be justified). There is a widespread understanding of the adverse effects of corruption on

[19] Andrew Berg and Jonathan Ostry, 2011, "Inequality and unsustainable Growth: Two Sides of the Same Coin?" IMF Staff Discussion Note No. 11/08, April, International Monetary Fund.
[20] See http://www.childstats.gov/americaschildren/eco1a.asp (accessed March 30, 2014).

morale, societal solidarity, and the functioning of the economy. But increasingly, inequality in the US is viewed as *unfair,* arising out of a corrupt political and economic system.

Still two further reasons are related to the political economy of inequality: societies with greater inequality are less likely to make investments in the *common* good, in say public transportation, infrastructure, technology, and education. The rich don't need these public facilities, and they worry that a strong government which could increase the efficiency of the economy might at the same time use its powers to redistribute. Moreover, with so many at the top making their money from financial market shenanigans and rent-seeking, we wind up with tax and other economic policies that encourage these kinds of activities rather than more productive activities. When we tax speculators at less than half the rate that we tax workers, and when we give speculative derivatives priority in bankruptcy over workers, and when we have tax laws that encourage job creation abroad rather than at home, we wind up with a weaker and more unstable economy.

We used to think of there being a trade-off: we could achieve more equality, but only at the expense of giving up on overall economic performance. Now we realize that, especially given the extremes of inequality achieved in the US and the manner in which inequality is generated, greater equality and improved economic performance are complements.

This is especially true if we focus on appropriate measures of growth. If we use the wrong metrics, we will strive for the wrong things. Economic growth *as measured by GDP* is not enough—there is a growing global consensus that GDP does not provide a good measure of overall economic performance. What matters is whether growth is sustainable, and whether *most* citizens see their living standards rising year after year. This is the central message of the International Commission on the Measurement of Economic Performance and Social Progress, which I chaired.[21] Since the beginning of the new millennium, our economy has clearly not been performing in either of these dimensions. But the problems in our economy have been manifest for longer. As I have emphasized, a key factor underlying America's economic problems today is its growing inequality and the low level of opportunity. We need to focus not on what is happening on average, or to those at the top, but how the economy is performing for the typical American, reflected for instance in median income.

[21] The Committee's report was released in 2009, and published as Joseph Stiglitz, Amartya Sen, and Jean-Paul Fitoussi, 2010, *Mismeasuring Our Lives,* New York: The New Press. The Organisation for Economic Co-operation and Development (OECD) has since continued work in this vein with it Better Life Initiative (http://www.oecd.org/statistics/betterlifeinitiativemeasuringwell-beingandprogress.htm) and its High Level Expert Group on the measurement of economic and social progress, convened in 2013.

People care about security, and yet our GDP statistics do not reflect the decline in economic, health, and other aspects of security. We value opportunity *directly*, not just for the benefits which it might bring to conventionally measured GDP. And as inequality increases, so does insecurity. Everyone, even those higher up the rungs in the ladder, worry about slipping down: they know the consequences. Once this is taken into account, recent performance in the US and elsewhere looks every worse.

The weaknesses in our economy have important budgetary implications. The budget deficits of recent years are a result of our weak economy, not the other way around. If we had more robust growth, our budgetary situation would be far improved. That's why investments in decreasing inequality and increasing equality of opportunity make sense not only for our economy, but for our budget. When we invest in our children, the asset side of our country's balance sheet goes up, even more than the liability set: any business would see that its net worth is increased. In the long run, even looking narrowly on the liability side of the balance sheet, it will be improved, as these young people earn higher incomes and contribute more to the tax base.

But if we look at these issues the wrong way, focusing only on the liability side of the balance sheet, the budgetary weaknesses will lead to cutbacks in public investments –including those that help ameliorate inequality—and we reinforce the vicious circle upon which we have been embarked, with lower investment in the public sector including education leading to a weaker economy and more inequality, leading to still lower investments and growth.

The big change in our understanding of inequality is, as I have suggested, the high economic price we pay, especially when it reaches the extremes that it has in America. This idea has now become mainstream. It is embraced by the IMF. No one is advocating the other extreme: complete equality. Incentives are important. But so is a society's sense of fairness. We have lost the balance.

So far, I have focused on the economic costs of our inequality. But we also pay a high price for this inequality in terms of our democracy and nature of our society. A divided society is different—it doesn't function as well. Our democracy is undermined, as economic inequality inevitably translates into political inequality. I describe in my book how the outcomes of America's politics are increasingly better described as the result of a system not of one person one vote but of one dollar one vote. And just as we described earlier how the rules of the economic game affect the outcomes, so too in the realm of politics: with the rich having more and more influence, they write the rules of the political game to give them more power and influence, which means economic inequality gets even more translated into political inequality, and the political inequality gets translated into ever more economic inequality.

With extreme inequality, the nature of our society changes in fundamental ways. Those at the top come to believe that they are entitled to what they have. And this can lead to behaviors that themselves undermine the cohesiveness of society. Those excluded from prosperity begin to expect the worst from their governments and leaders. Trust is eroded, along with civic engagement and a sense of common purpose.

For countries, like the United States, who seek a position of leadership in the world, and for those who believe we would have a better world were more countries to become committed to market economies with democracy, there are further adverse effects: Will other countries want to emulate an economic system in which most individuals' incomes are simply stagnating? A political system which seems to be captured by the wealthy?

The fact that inequality is created by policies—it is not the ineluctable result of economic forces--means there is a glimmer of hope. Policy created the problem, and it can help get us out of it. There are policies that could reduce the extremes of inequality and increase opportunity—enabling our country to live up to the values to which it aspires. There is no magic bullet, but there are a host of policies that would make a difference. In the last chapter of my book, *The Price of Inequality,* I outline 21 such policies, affecting both the distribution of income before taxes and transfers and after.

Let me list a few of the key policies that could make inroads in our high level of inequality. We need macroeconomic policies that maintain economic stability and full employment. Nothing is worse for those at the bottom and the middle is a higher level of unemployment. Today, workers are suffering thrice over: from high unemployment, weak wages, and cutbacks in public services, as government revenues are less than they would be were our economies functioning well. (Central bank policies focusing on inflation have almost surely been one of the factors contributing to the growing inequality.)

We need to move more people out of poverty, strengthen the middle class, and curb the excesses at the top. Most of the policies are familiar: more support for education, including pre-school; increasing the minimum wage; strengthening the earned-income tax credit; giving more voice to workers in the workplace, including through unions; more effective enforcement of anti-discrimination laws; better corporate governance, to curb the abuses of CEO pay; better financial sector regulations, to curb not just market manipulation and excessive speculative activity, but also predatory lending and abusive credit card practices; better anti-trust laws, and better enforcement of the laws we have; and a fairer tax system—one that does not reward speculators or those that take advantage of off-shore tax havens with tax rates lower than honest Americans who work for a living.

If we are to avoid the creation of a new plutocracy in the country, we have to retain a good system of inheritance and estate taxation, and ensure that it is effectively enforced. We need to make sure that everyone who has the potential to go to college can do so, no matter what the income of his parents—and to do so without undertaking crushing loans. We stand out among advanced countries not only in our level of inequality, but also in our treatment of student loans in our bankruptcy proceedings. A rich person borrowing to buy a yacht can get a fresh start, and have his loans forgiven; not so for a poor student striving to get ahead. A contingent loan program of the kind employed by Australia shows that there are alternatives—ways which provide access to all who can benefit from a college education without imposing the risks of hardship that the United States does.

The special provisions for capital gains and dividends not only distort the economy, but, with the vast majority of the benefits going to the very top, increase inequality—at the same time that they impose enormous budgetary costs: $2 trillion dollars over the next ten years, according to the CBO.[22] While the elimination of the special provisions for capital gains and dividends and taxing capital gains on the basis of accrual, not just realizations, is the most obvious reform in the tax code that would improve inequality and raise substantial amounts of revenues, there are many others that I have discussed elsewhere[23].

In the past, when our country reached these extremes of inequality, at the end of the 19th century, in the gilded age, or in the Roaring 20s, it pulled back from the brink. It enacted policies and programs that provided hope that the American dream could return to being a reality.

Other countries have done likewise: Brazil, torn by even greater inequality than the US, has shown how concerted policies focusing on education and children can bring down inequality within the span of less than two decades.

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[22] See Congressional Budget Office, 2013, *The Distribution of Major Tax Expenditures in the Individual Income Tax System,* May, p.31, available at http://cbo.gov/sites/default/files/cbofiles/attachments/TaxExpenditures_One-Column.pdf (accessed March 28, 2014). This figure includes the effects of the "step-up of basis at death" provision, which reduces the taxes that heirs pay on capital gains. Not including this provision, the ten-year budgetary cost of preferential treatment for capital gains and dividends is $1.34 trillion.

[23] See Joseph E. Stiglitz, forthcoming, "Reforming Taxation to Promote Growth and Equity," Roosevelt Institute working paper.

We are now at one of these pivotal points in our history. I hope we once again will make the right decisions. We will only do so if we come to terms with what has been happening in our country, the growth of the inequality and the lack of opportunity; and only if we come to understand the high price we are paying for this inequality. It will require the kind of scholarship and statesmanship that Senator Moynihan so well exemplified.