DIVIDED

THE PERILS OF OUR GROWING INEQUALITY

EDITED BY
DAVID CAY JOHNSTON

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CONTENTS

INEQUALITY IS HOLDING BACK THE RECOVERY

Joseph E. Stiglitz

The American economy could recover much faster from the Great Recession, and our young people could have a more prosperous future, if we understood better the effects of inequality and took steps to reduce it, a Nobel Prize–winning economist explains.

The reelection of President Obama was like a Rorschach test, subject to many interpretations. In this election, each side debated issues that deeply worry me: the long malaise into which the economy seems to be settling and the growing divide between the 1 percent and the rest—an inequality not only of outcomes but also of opportunity. To me, these problems are two sides of the same coin: with inequality at its highest level since before the Depression, a robust recovery will be difficult in the short term, and the American dream—a good life in exchange for hard work—is slowly dying.

Politicians typically talk about rising inequality and the sluggish recovery as separate phenomena, when they are in fact intertwined. Inequality stifles, restrains, and holds back our growth.

When even the free market–oriented *Economist* argues—as it did in a special feature in October 2012—that the magnitude and nature of the country's inequality represent a serious threat to America, we should know that something has gone horribly wrong. And yet, after four decades of widening inequality and the greatest

economic downturn since the Depression, we haven't done anything about it.

FOUR FACTORS

There are four major reasons inequality is squelching our recovery.

The most immediate is that our middle class is too weak to support the consumer spending that has historically driven our economic growth. While the top 1 percent of income earners took home 93 percent of the growth in incomes in 2010, the households in the middle—who are most likely to spend their incomes rather than save them and who are, in a sense, the true job creators—have lower household incomes, adjusted for inflation, than they did in 1996. The growth in the decade before the crisis was unsustainable—it was reliant on the bottom 80 percent consuming about 110 percent of their income.

Second, the hollowing out of the middle class since the 1970s, a phenomenon interrupted only briefly in the 1990s, means that those families are unable to invest in their future, by educating themselves and their children and by starting or improving businesses.

Third, the weakness of the middle class is holding back tax receipts, especially because those at the top are so adroit in avoiding taxes and in getting Washington to give them tax breaks. The recent modest agreement to restore Clinton-level marginal income-tax rates for individuals making more than $400,000 and households making more than $450,000 did nothing to change this. Returns from Wall Street speculation are taxed at a far lower rate than other forms of income. Low tax receipts mean that the government cannot make the vital investments in infrastructure, education, research, and health that are crucial for restoring long-term economic strength.

Fourth, inequality is associated with more frequent and more severe boom-and-bust cycles that make our economy more volatile and vulnerable. Though inequality did not directly cause the crisis, it is no coincidence that the 1920s—the last time inequality of income and wealth in the United States was so high—ended with the Great Crash and the Depression. The International Monetary Fund has noted the systematic relationship between economic instability and economic inequality, but American leaders haven't absorbed the lesson.

Our skyrocketing inequality—so contrary to our meritocratic ideal of America as a place where anyone with hard work and talent can "make it"—means that those who are born to parents of limited means are likely never to live up to their potential. Children in other rich countries like Canada, France, Germany, and Sweden have a better chance of doing better than their parents did than American kids have. More than a fifth of our children live in poverty—the second worst of all the advanced economies, putting us behind countries like Bulgaria, Latvia, and Greece.

SQUANDERING OUR YOUNG

Our society is squandering its most valuable resource: our young. The dream of a better life that attracted immigrants to our shores is being crushed by an ever-widening chasm of income and wealth. Tocqueville, who in the 1830s found the egalitarian impulse to be the essence of the American character, is rolling in his grave.

Even were we able to ignore the economic imperative of fixing our inequality problem, the damage it is doing to our social fabric and political life should prompt us to worry. Economic inequality leads to political inequality and a broken decision-making process.

Despite Mr. Obama's stated commitment to helping all Americans, the recession and the lingering effects of the way it was handled have made matters much, much worse. While bailout money poured into the banks in 2009, unemployment soared to 10 percent that October. The rate in early 2013 (7.8 percent) appears better partly because so many people have dropped out of the labor force, or never entered it, or accepted part-time jobs because there was no full-time jobs for them.

High unemployment, of course, depresses wages. Adjusted for inflation, real wages have stagnated or fallen; a typical male worker's income in 2011 ($32,986) was lower than it was in 1968 ($33,880). Lower tax receipts, in turn, have forced state and local cutbacks in services vital to those at the bottom and middle.

Most Americans' most important asset is their home, and as home prices have plummeted, so has household wealth—especially since so many had borrowed so much on their homes. Large numbers are left with negative net worth, and median household wealth fell nearly 40 percent, to $77,300 in 2010 from $126,400 in 2007,

and has rebounded only slightly. Since the Great Recession, most of the increase in the nation's wealth has gone to the very top.

SOARING TUITION AND DEBT

Meanwhile, as incomes have stagnated or fallen, tuition has soared. In the United States now, the principal way to get education—the only sure way to move up—is to borrow. In 2010, student debt, now $1 trillion, exceeded credit-card debt for the first time.

Student debt can almost never be wiped out, even in bankruptcy. A parent who co-signs a loan can't necessarily have the debt discharged even if his child dies. The debt can't be discharged even if the school—operated for profit and owned by exploitative financiers—provided an inadequate education, enticed the student with misleading promises, and failed to get her a decent job.

Instead of pouring money into the banks, we could have tried rebuilding the economy from the bottom up. We could have enabled home owners who were "underwater"—those who owe more money on their homes than the homes are worth—to get a fresh start, by writing down principal, in exchange for giving banks a share of the gains if and when home prices recovered.

We could have recognized that when young people are jobless, their skills atrophy. We could have made sure that every young person was either in school, in a training program, or on a job. Instead, we let youth unemployment rise to twice the national average. The children of the rich can stay in college or attend graduate school, without accumulating enormous debt, or take unpaid internships to beef up their résumés. Not so for those in the middle and bottom. We are sowing the seeds of ever more inequality in the coming years.

The Obama administration does not, of course, bear the sole blame. President George W. Bush's steep tax cuts in 2001 and 2003 and his multitrillion-dollar wars in Iraq and Afghanistan emptied the piggy bank while exacerbating the great divide. His party's newfound commitment to fiscal discipline—in the form of insisting on low taxes for the rich while slashing services for the poor—is the height of hypocrisy.

There are all kinds of excuses for inequality. Some say it's beyond our control, pointing to market forces like globalization, trade liberalization, the technological revolution, the "rise of the rest." Others assert that doing anything about it would make us all worse off, by stifling our already sputtering economic engine. These are self-serving, ignorant falsehoods.

Market forces don't exist in a vacuum—we shape them. Other countries, like fast-growing Brazil, have shaped them in ways that have lowered inequality while creating more opportunity and higher growth. Countries far poorer than ours have decided that all young people should have access to food, education, and health care so they can fulfill their aspirations.

Our legal framework and the way we enforce it has provided more scope here for abuses by the financial sector; for perverse compensation for chief executives; for monopolies' ability to take unjust advantage of their concentrated power.

Yes, the market values some skills more highly than others, and those who have those skills will do well. Yes, globalization and technological advances have led to the loss of good manufacturing jobs, which are not likely ever to come back. Global manufacturing employment is shrinking, simply because of enormous increases in productivity, and America is likely to get a shrinking share of the shrinking number of new jobs. If we do succeed in "saving" these jobs, it may be only by converting higher-paid jobs to lower-paid ones—hardly a long-term strategy.

Globalization, and the unbalanced way it has been pursued, has shifted bargaining power away from workers: firms can threaten to move elsewhere, especially when tax laws treat such overseas investments so favorably. This in turn has weakened unions, and though unions have sometimes been a source of rigidity, the countries that responded most effectively to the global financial crisis, like Germany and Sweden, have strong unions and strong systems of social protection.

As Mr. Obama's second term begins, we must all face the fact that our country cannot quickly, meaningfully recover without policies that directly address inequality. What's needed is a comprehensive response that should include, at least, significant investments in education, a more progressive tax system, and a tax on financial speculation.

The good news is that our thinking has been reframed: it used to

be that we asked how much growth we would be willing to sacrifice for a little more equality and opportunity. Now we realize that we are paying a high price for our inequality and that alleviating it and promoting growth are intertwined, complementary goals. It will be up to all of us—our leaders included—to muster the courage and foresight to finally treat this beleaguering malady.

This piece originally appeared on the New York Times *Opinionator blog on January 19, 2013.*