

Redistribution for Growth?

Income Inequality
and Economic Recovery



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FOREWORD

Studies on income distribution usually point into one direction only: wages are stagnating or declining, rural-urban income differentials growing, Gini coefficients climbing and other indicators of income disparities are worsening as well. The gap between the rich and the poor is rapidly widening in most countries. Only a few countries appear to be able to withstand this trend or turn it back. Economic growth in emerging economies may have been important to finance the reduction of absolute poverty, but in developed and emerging economies alike, it is accompanied with an increase in inequality.

Today, a new world economic crisis is looming and there is growing concern that the world economy has entered a phase of structural stagnation and further growth is hampered by the existing level of inequality. Justice based criticism on income disparities is joined by macro-economic considerations calling for a new growth model based on balanced current accounts and an increase in household consumption.

Under the title »Redistribution for Growth? Income Inequality and Demand-Led Economic Growth in Emerging Economies« the Shanghai Academy of Social Sciences (SASS) and the Friedrich-Ebert-Stiftung (Shanghai Office) jointly organized an international conference on May 10-11, 2011 to discuss the interplay between economic growth, income inequality and the need for redistribution policies. Country reports focused on emerging economies (Brazil, China, India, Mexico, South Africa) but for comparison, developed economies (Germany, South-Korea, USA) were included.

Encouraged by the acclaim which greeted the conference and the fascinating contributions to the debate the Friedrich-Ebert-Stiftung decided to publish the contributions – most of them revised – in two volumes, one in Chinese, the other in English.

The Shanghai Academy of Social Sciences (SASS) and the Friedrich-Ebert-Stiftung would like to thank the authors involved in this publication for their valuable contributions.

No bilingual book is possible without translators. Mrs Wu Xiaozhen translated the Chinese contributions into English, while Professor Zheng Chunrong, Dr. Zhang Haibing and Dr. Xue Lei translated the English-language articles into Chinese. James Patterson copyedited all the English texts for publication. We owe them our thanks for their professional work.

We hope that this publication will be of interest.

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XI

ECONOMIC DEVELOPMENT AND INEQUALITY IN THE UNITED STATES SINCE 1979: INEQUALITY AS POLICY *

John Schmitt

1. INTRODUCTION

Since the end of the 1970s, the United States has seen a dramatic increase in economic inequality. While the United States has long been among the most unequal of the world's rich economies, the economic and social upheaval that began in the 1970s was a striking departure from the movement toward greater equality that began in the Great Depression, continued through World War II, and was a central feature of the first 30 years of the postwar period.

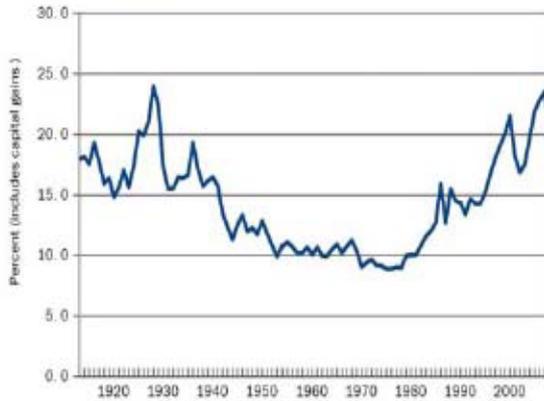
This short essay seeks to provide an analysis of the postwar period in the United States, particu-

larly of the last three decades. My argument is that the high and rising inequality in the United States is the direct result of a set of policies designed first and foremost to increase inequality. These policies, in turn, have their roots in a significant shift in political power against workers and in favor of their employers, a shift that began in the 1970s and continues through today.

The first section of the paper briefly documents the size of the rise in U.S. inequality and puts this change into historical context. The second section sketches an explanation for rising inequality, one that differs from the deeply rooted, but poorly articulated vision that lurks just be-

* Acknowledgments: This paper adapts and updates «Inequality as Policy: The United States Since 1979», originally published as a CEPR briefing paper and reprinted in the *real-world economics review*. The author thanks the Friedrich Ebert Foundation and participants in the FES-Shanghai Academy of Social Sciences symposium on «Redistribution for Growth» for many helpful comments.

Figure 1: Share of total income to top 1 %, US, 1913-2008



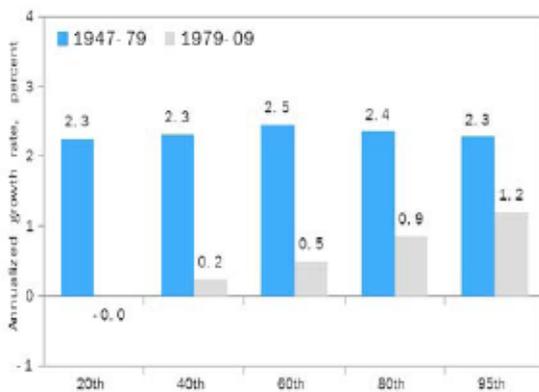
Source: Piketty and Saez 2003.

low the surface of the standard political discourse in the United States.

2. RISE OF INEQUALITY

As economists Thomas Piketty and Emmanuel Saez have documented meticulously, for most

Figure 2: Real family income growth, US, 1947-2010



Source: Census Bureau.

of the 20th century, economic inequality in the United States was falling or flat.¹ (See Figure 1.) The last 30 years of increasing economic concentration are the exception, not the rule, of the last century of economic development in the United States.

From a peak just before the 1929 stock market crash through the early 1950s, wage and income inequality, broadly measured, were declining. From the early 1950s through the late 1970s, inequality was flat, or even falling slightly. Since the late 1970s, however, inequality has skyrocketed, climbing back to levels last seen in the 1920s. In 1979, for example, the top one percent of all U.S. taxpayers received about 8 percent of national income; by 2007, the top one percent received over 18 percent. If we include income from capital gains in the calculation, the increase in inequality is even sharper, with the top one percent capturing 10 percent of all income in 1979, but over 23 percent in 2007.

The Piketty and Saez data are only the simplest way to demonstrate the rise in economic inequality in the United States over the last thirty years. Separate survey data, for example, show that even as family income inequality increased sharply in recent decades, the rate of growth in family incomes has declined at almost all levels (see Figure 2). A full discussion of the many dimensions of increasing polarization across (and within) education levels, gender, race, and region are well documented in *The State of Working America*, produced every other year by the Economic Policy Institute.² The Piketty and Saez data, however, are sufficient to show an enormous increase in economic concentration that is unprecedented in modern U.S. history,

¹ See Emmanuel Saez's homepage <http://elsa.berkeley.edu/~saez/> and <http://elsa.berkeley.edu/~saez/TabFig2008.xls> and Piketty and Saez 2003; updated to 2008 in 2011.

² See <http://www.stateofworkingamerica.org>.

roughly double in size and duration of the run-up in inequality in the 1920s.

3. INEQUALITY AS POLICY: CHANGING POWER RELATIONS

Early on, many conservative analysts in the United States went to great lengths to deny the increase in inequality, a particularly difficult task given that a host of survey and administrative data sets covering wages, compensation, incomes, and even net worth all showed sharp increases in inequality. From the late-1980s, however, the mainstream of the economics profession had turned its attention instead to explaining the rising inequality. The bulk of the profession fairly quickly settled on two likely suspects: «skills-biased technical change» and, to a lesser degree, «globalization».

According to the first explanation, the diffusion of computers and related technology in the early 1980s steadily increased the demand for skilled workers relative to less-skilled workers, driving up the wages and incomes of more-educated workers and depressing the wages and incomes of less-educated workers. From a political perspective, the skills-biased technical change view had several convenient features. At face value, it appeared to be broadly consistent with the data (even though economists on the left, such as David Howell (1999) and Lawrence Mishel (2009), and more mainstream economists including David Card and John DiNardo (2002), Alan Manning (Goos and Manning 2007), and others have presented strong critiques). At least as importantly, however, the technological explanation removed policy, poli-

tics, and power from the discussion of inequality, by attributing rising economic concentration to “technological progress,” a force that could be resisted only at our peril. The skills-biased technical change explanation also put significant limits on the terms of policy debates: the problems of the three-fourths of the U.S. workforce without a university degree were either the result of the poor personal decision not to pursue enough education, or, at most, a sign that, as a society, we needed to invest more in education.

The second standard, though less favored, explanation for rising inequality was the elusive idea of «globalization» (Bivens 2008). In the most common view, globalization is supposed to have lowered the earnings of less-educated workers by putting them in direct competition with low-wage workers around the world. This competition put pressure on wages through international trade in goods and services; through the relocation or threat of relocation of production facilities to overseas locations; through competition with immigrants in local labor markets; and through other channels.

Globalization is the less favored explanation in the standard political discourse not because it does not offer what is at face value a coherent explanation of the rise in inequality, but because, by acknowledging the social costs of the increased integration of markets, the globalization explanation threatens to derail an important economic project of the elite. Economists and politicians in the United States spent much of the 1980s and 1990s arguing that the expansion of trade was the only path to national prosperity. In this context, blaming widening inequality on the same process of globalization

that was supposed to be making us richer became quite awkward.

But the main problem with globalization as an explanation for rising inequality is that the typical ways in which the discussion is framed obscure the underlying process through which globalization actually acts on inequality. The standard framing presents globalization, like technological process, as an exogenous force, something that happens to us. In reality, globalization is a complex process of integrating capital, product, and labor markets, where almost every characteristic of those newly integrated markets is the subject of, or should be the subject of, political and regulatory debate.

Contrary to the standard framing, which presents globalization as something that no nation can escape or even attempt to shape, we can choose the terms under which we integrate capital, product, and labor markets across countries. Over the last 30 years we have indeed “chosen” a particular form of globalization in the United States – a form that benefits corporations and their owners at the expense of workers and their communities. If we had chosen globalization on different terms, however, economic integration would not have required rising inequality. Another globalization is possible.

In opposition to these two standard explanations for the recent rise in inequality, I want to offer an alternative view, one that explains inequality as a function of power, sustained by politics, and implemented as policy. In this alternative view, it is not technological progress nor the inevitable march of globalization, but rather the sharp shift in the strength of capital and employers relative to workers that explains

the increasing concentration of wages, income, and wealth over the last three decades.

The decline in inequality from the end of the 1920s through the end of the 1970s – evident in the Piketty and Saez graph – was a function of a series of social movements over that same period that worked to reduce economic and social inequality. The 1930s saw the ascendancy of the U.S. labor movement, which went from a small force scattered across the national geography and industrial structure to an institution representing over one-third of U.S. private-sector workers by the mid-1950s. The civil rights movement of the 1950s and 1960s pressed for political, social, and economic equality for blacks. The women’s movement of the 1960s and 1970s fought for social and economic equality for women. The labor movement, the civil rights movement, and the women’s movement separately, but especially together, changed the way U.S. corporations did business.

Wages and benefits rose for all workers, union and non-union. Employers were legally and socially prohibited from paying minority and women workers less than white men for the same work. Together with the environmental and consumer movements of the 1960s and 1970s, which sought to constrain U.S. businesses engaged in endangering the environment and consumers, these social movements had the effect of increasing incomes for those at the bottom and lowering incomes for those at the top (by raising the cost of doing business).

Throughout the entire period, employers resisted each of these movements (labor, civil rights, feminist, environmental, and consumer).

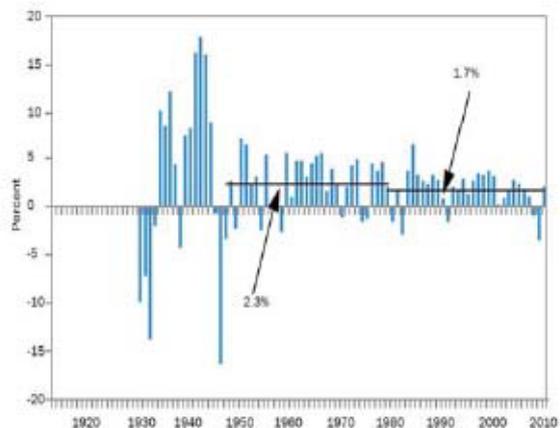
The economic elite, while eventually comfortable with the social aims of all of these movements, almost uniformly opposed the accompanying legislation, including: making union organizing easier; guaranteeing workers' health and safety; prohibiting discrimination against racial minorities and women in labor markets and in other markets such as housing and credit; protecting the nation's air and water; and ensuring the safety of consumer products. From the 1930s through the 1970s, capital generally fought a losing battle, able to shape and contain the specific policies that grew out of the various social movements, but ultimately unable to prevent the enactment and enforcement of a host of policies that worked strongly against employers' immediate economic interests.

By the end of the 1970s, however, employer opposition coalesced and the economic disruption caused by two oil crises in the 1970s gave capital and employers a political opening. Even while Jimmy Carter, a Democrat, was in the White House, a subtle but important shift in U.S. politics occurred – a shift away from the core constituency of the Democratic party (labor, women, racial minorities, and environmentalists) – and toward employer interests (see Hacker and Pierson 2010; Bowles et al 1984; Baker 2007). By the time Carter lost the presidency to Ronald Reagan in 1980, the corporate backlash against almost fifty years of social progress was in full swing.

The backlash was sold as a response to the economic crisis of the 1970s and the emphasis was overwhelmingly on improving the efficiency of the U.S. economy, which was described (and is still described today by many on the right) as

sclerotic, overly unionized, and overly regulated. (A great irony here, which Figure 3 illustrates, is that economic growth was more rapid in the early postwar period than it has been since the mid-1970s.) Each of the major policy initiatives of the last three decades claimed to offer important efficiency advantages. The long decline in the inflation-adjusted value of the minimum wage was supposed to correct a distortion in the low-wage labor market. The deregulation (more accurately, re-regulation) of the airline, trucking, railway, financial, and telecommunica-

Figure 3: Change In real GDP per person, US, 1930-2010



Source: BEA and Census data.

tions industries was supposed to lower consumer prices in those markets. The liberalization of foreign trade through a plethora of bilateral and multilateral trade agreements was similarly supposed to lower consumer prices on imported goods. The privatization of many federal, state, and local government functions – from school bus drivers to the administration of welfare policy and even much of the U.S. war in

Iraq and Afghanistan – was supposed to lower the cost of government. The steady, policy-enabled, deterioration of unionization in the private sector – from over one-third of workers in the 1950s to about eight percent today – was supposed to improve the competitiveness of U.S. firms.

These policies, sold as ways to enhance national efficiency, however, also had another common thread. They all worked to lower the bargaining power of workers relative to their employers. In many cases, the alleged efficiency gains have not materialized. In every case, however, the negative impact on workers has been obvious and substantial. The inflation-adjusted value of the minimum wage is now about 30 percent lower than it was at its peak in the 1960s. Workers in deregulated industries – airlines and trucking, most obviously – have seen their wages and benefits stagnate and fall. Even many mainstream economists acknowledge an important role for corporate-oriented international trade and commercial agreements in depressing the wages of less-educated workers, who have been forced to compete directly on world markets with workers often making only a small fraction of U.S. manufacturing wages. Privatization has been a windfall for the companies who win government contracts, while their main efficiency gains hinge on their ability to pay non-unionized, private-sector workers less than more unionized public-sector employees. The huge decline in unionization in the private sector has decimated the U.S. working class, which depends on the union wages and benefit premium to secure a middle-class standard of living.

Taken together, these policies – a low and falling minimum wage; the de- or re-regulation of major industries; the corporate-directed liberalization of international capital, product, and labor markets; the privatization of many government services; the decline in unionization; and other closely related policies – are the proximate cause of the rise in inequality. Of course, the underlying cause is a shift at the end of the 1970s in the balance of economic and political power following almost five decades of ascendancy of labor and other social movements.

I am not simply arguing that the explosion of inequality was a side-effect of these policies. I am arguing, rather, that the explosion of inequality – what is, effectively, the upward redistribution of the large majority of the benefits of economic growth since the late 1970s – was the purpose of these policies. The purported efficiency gains, which were realized in some cases but not in others, were merely a political distraction.

4. BEYOND WAGES AND INCOME

So far, I have focused on the rise of wage and income inequality and the explanations for it. But the main problems that U.S. workers face cannot be solved simply with faster or even more equal real wage growth.

One key challenge for U.S. workers is job security. In the United States, with rare exceptions, workers are what our legal code refers to as »at-will employees« – that is, employees work at the will of the employer, with no legal claim to their job or to severance pay in the case of layoff.³ To be clear, in the overwhelming majority of cases,

³ For a review of relevant U.S. labor law, see International Labor Organization, <http://www.ilo.int/public/english/dialogue/ifpdial/info/termination/countries/usa.htm>.

U.S. employers can fire a worker without reason or advanced notice and without any legal obligation to provide severance pay. The major exceptions to this arrangement are the 13 percent of the workforce that is unionized and a small share of high-end workers such as company officers who negotiate individual contracts with their employers. One remnant of the civil rights and women's movement is that employers cannot fire workers for reasons of race, ethnicity, gender, religion, or certain other characteristics; but an employer can fire a worker without notice for almost any other reason: for arriving late to work, for refusing to work overtime, for arguing with the boss about a schedule change, or essentially any reason, reasonable or not, that does not involve discrimination. The "employment at will" doctrine creates a profound structural imbalance of power between the overwhelmingly non-unionized workforce and their employers.

Another challenge is the lack of a comprehensive and reliable social safety net. Historically, for example, only about 40 percent of unemployed workers receive unemployment insurance benefits and these are stingy by international standards (see Greenstein and Stone 2007).

The large majority of U.S. workers also depend on their job (or their spouse's job) for health insurance. With the typical employer-provided health insurance plan costing about \$5,000 per year for individual coverage and about \$13,000 per year for family coverage, higher wages alone will not go far in providing quality health insurance, particularly for lower- and middle-income workers (Kaiser Family Foundation and Health Research & Educational Trust, 2009: 24).

All of these non-wage issues – the lack of legal job protections, the lack of a safety net for most of the unemployed, the strong dependence of workers on their employers for health insurance, and others including the lack of any legally mandated paid time off – are major challenges for workers at almost all levels of wage distribution. But these problems are particularly acute for low-wage workers, who are not just the worst paid, but also the least likely to have union representation, the least likely to have employer-provided health insurance (or insurance of any kind), and the least likely to have any form of paid time off.

5. CONCLUSION

The increase in inequality has given rise to a tremendous jump in household indebtedness. With workers' wages and their families' incomes under increasing pressure, many households have turned to ever-higher levels of debt to finance their consumption. In 1979, debt held by householders equaled about 75 percent of household income. At the peak of the last business cycle, debt had risen to over 135 percent of household income. The housing bubble was an integral part of this rise in indebtedness and it was precisely the collapse of the housing market that set off the Great Recession. The relatively rapid loss of about \$6 trillion in housing wealth had a devastating impact on household consumption.

In the standard neoclassical economics framework, low wages are simply a symptom of low levels of skill. Wage levels, however, are also a function of unionization rates; the level of the minimum wage; the entire regulatory frame-

work governing the terms and conditions of employment, from job security legislation to paid time off; the size and scope of the public sector; the degree of competition in national and international product markets; and other fundamentally political issues, all of which have little or nothing to do with workers' skills.

The sharp and sustained increase in economic inequality in the United States over the last 30 years is not a reflection of a national preference for inequality (discussed more blandly as «flexibility»), and not the continuation of an inexorable increase in inequality from 1776 to the present. The last 30 years, in fact, mark a significant departure from a five-decade trend toward greater economic and social equality. What changed was not the demand for skilled workers, but the balance of power between workers and their employers.

The way forward is clear, but appears largely blocked on the political front. In the short run, the federal government must use fiscal policy to make up for the collapse in private consumption and investment. In the medium- and long-term, economic policy must lay the groundwork for wage- and income-led growth. Doing so will require a substantial policy reversal. Policies that restore the connection between productivity growth and real-wage increases are probably the most important way forward, including: raising the minimum wage; expanding union representation; building a modern social insurance system that addresses the needs of the contemporary workforce, including universal child-care, guarantees of paid sick days, socially funded paid family leave, and legally mandated paid vacation and holidays; expanding existing social insurance, such as unemployment insurance, health care, and pensions; and improving access to quality education at the primary, secondary, and post-secondary levels.

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