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U.S. Tolerance of Income Inequality

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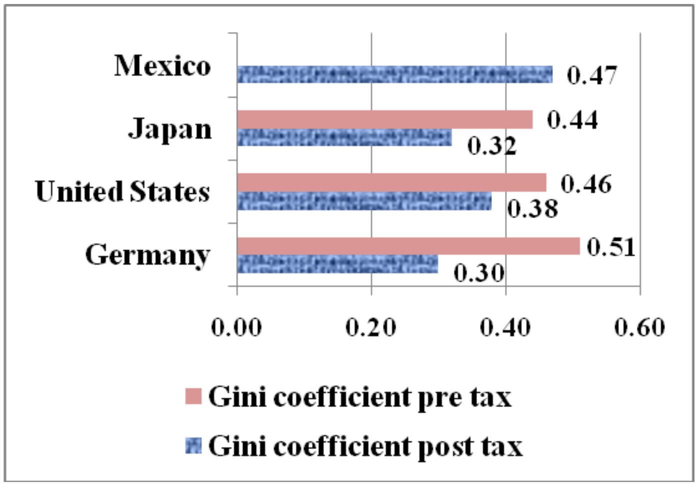
Tolerance of the extent of income inequality varies among countries. Acceptance of income inequality is higher in the United States than in any other developed country. Many U.S. conservatives argue that significant differences in family or individual income levels stimulate activist entrepreneurs to try harder and that this leads to more economic growth than would be the case if income inequalities were substantially lower. Call this the philosophical argument for income inequality. Groups that seek to retain the current degree of U.S. inequality do not call attention to the extent and sophistication of the special pleading of the rich.

The position taken by governments in developed European countries and Japan is that national cohesion would be disrupted if the differences in individual and family incomes were substantial. This different philosophical concept leads them to enact tax policies to reduce inequality. Most Western Europeans and Japanese decry the "savage capitalism" that exists in the United States, as is evident from their voting habits and the practices of their governments. Many conservative U.S. critics of President Barack Obama's financial rescue package and his health care proposals deplore the "socialistic" tendencies that he is introducing, and they tend to liken these to practices in Western European countries.

The acceptance of large inequalities in Latin America was justified as being necessary to engender economic growth after the countries of the region became independent in the 19th century—and the argument was made that these inequalities could be rectified later. They were not rectified; Latin America today is the most unequal region in the world. In Asia, the prevailing sentiment was much like that in Europe—that the struggle for more income equality should go hand-in-hand with economic development. Capitalism in Latin America relating to income inequality tends to follow the pattern in the United States, and in Asia inequality is seen much as it is in Western Europe.

The Gini coefficient is a widely used measure of inequality that permits comparison among countries.[1] The higher the coefficient, the greater is the inequality. Figure 1 shows this comparison for four representative countries.

Figure 1: Gini Coefficient before and after Taxes for Mexico, Japan, United States, and Germany in the Mid-2000s



Source: OECD.Stat.

Gini coefficients are reasonably similar across countries before taxes. Figure 1 shows that inequality is less after taxes—much more so in Japan and Germany than in the United States. The graph makes clear that redistribution of income through the tax and budgetary structure has relatively low priority in the United States. The Mexico bar shows the country's post-tax coefficient; the before-tax figure is not available.

Emmanuel Saez, an economist at the University of California at Berkeley, is a leading scholar on income

[1] If all families (or individuals if broken down that way) received the identical percentage of national income as their percentage of total population, there would be no inequality. Inequality arises when the percent of national income received is lower than the identical percentage of families (or individuals) in the total population.

inequality in the United States.[2] His analysis concludes that the share of the top income decile of U.S. families (the 10 percent of families with the highest incomes) received 49.7 percent of national income in 2007. That percentage is probably lower today because of the 2008–2009 recession. The families in the top 1 percent of the population, he says, captured half of all economic *growth* from 1993 to 2007. Broken down by the two administrations of that period, he says that the top 1 percent of families captured about 45 percent of the economic growth during the Clinton expansionary years from 1993 to 2000 and 65 percent of the growth during the Bush expansionary years from 2002 to 2007.

Other indicators of the relatively high degree of U.S. inequality among developed countries can be given. According to the Institute for Policy Studies, the ratio between the pay of average chief executive officers in the United States and U.S. workers was 319 to 1 in 2008.[3] Recent ratios for the other three countries in Figure 1, according to the *Economist*, are Japan 11 to 1, Germany 12 to 1, and Mexico 47 to 1.

Even if the figures given above are not exact, this does not contradict the reality of U.S. tolerance—even promotion—of inequality. The prevailing political mantra in the United States is "no new taxes"—which has a nice political ring, but this position, if it prevails, means that the U.S. tax system will not be used as it is in Europe and Japan to reduce inequality. The central philosophic argument given to justify the relatively high U.S. inequality is that this leads to higher U.S. growth rates than in Europe and Japan. Do they? The U.S. economic growth rates were lower than those in Japan for many years, but have been higher in more recent years; and the long-term economic growth comparison with Europe varies over the decades. It is evident, however, that the consequences of unemployment are more severe in the United States than they are among other developed nations—even omitting the aggravation of loss of health care insurance when this is tied to employment, as it largely is in the United States.

The compensation ratio between CEOs and ordinary workers in the United States was between 30 and 40 to 1 during the 1960s, 1970s, and 1980s, considerably less than it is now. What happened over the last 20 years or so that widened the ratio? There is no single answer to this question. It is evident that the power of special interests—business leaders to be precise—has grown more than that of labor. This answer does not tell us why this happened. The U.S. economist Mancur Olson devoted much of his writing to this theme.[4] He argued that small, cohesive, well-placed groups can lobby for actions favorable to their members and prevail over much larger but less well-organized interests. He also made the point that success in this lobbying did not benefit the country as a whole, but rather brought about a different distribution of the benefits. Isn't this what happened in recent U.S. economic outcomes, such as in the housing market bubble, the removal of much of the regulation of financial institutions, and the bailouts of banks? By contrast, many families, collectively much more numerous than mortgage lenders and bankers, are losing their homes because of sub-prime mortgages.

I, along with much of the U.S. population, learned a great deal about how our system works from the economic breakdowns of the last few years. The ability of the financial institutions to capture a disproportionate share of U.S. income is a sad lesson in what special pleading can accomplish. Analysts have now documented just how much the very rich benefited from government economic and taxation policies of the past 20 years. Today, about 17.5 percent of people in the U.S. labor force have no work; and this is but one consequence of the failure to resist special pleading. U.S. society is resilient, but is not immune to deep changes if it is evident how much the deck is stacked against average families.

The extent of U.S. economic inequality that now exists was aggravated by the extent of special and successful pleading in recent U.S. history. If efforts at financial reform and reducing the vast differences in compensation between executives and workers are stymied—as current special pleading seeks to accomplish—the damage done to the U.S. polity could be substantial.

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[2] I will draw in the following comments from Saez, "Striking It Richer: The Evolution of Top Incomes in the United States," *Pathways Magazine*, Stanford Center for the Study of Poverty and Inequality, winter 2008, updated with 2007 estimates, August 5, 2009.

[3] The Institute for Policy Studies (IPS) receives much financial support from U.S. labor. The comparison in the text comes from IPS, 16th Annual Executive Compensation Survey, September 2009.

[4] His seminal book was *The Logic of Collective Action*, first published by Harvard University Press in 1965.