Chapter 15: Rags to Riches or Riches to Rags—Neither is Especially Likely

The income gap between the rich and the poor has been slowly but steadily widening for roughly the past 35 years. The gap has periodically generated considerable public attention, usually focused on particular instances. We marvel, and are perhaps as envious as resentful when we hear about the professional athlete’s or movie star’s latest gigantic contract. We wonder who is rigging the game when a corporate CEO cashes in millions in stock options while the company he directs performs poorly (I have no desire to be sexist in using “he,” but the overwhelming majority of big corporate CEO’s in America today are male). Politicians accuse each other of class warfare and selectively report numbers to the public to justify their support for or opposition to tax cuts. But we have seldom, if ever, had a sustained public discussion about income distribution—what it is, how it is changing, what the consequences might be, and whether we should want it to take on any particular pattern.

Income inequality has always been a sensitive subject to take on, for labor economists, politicians, or the general public. There is always a suspicion that those questioning, or openly complaining about the people at the top of the income pyramid might be doing so out of envy or resentment. Likewise, there is recognition—at least amongst labor economists—that income differentials do provide positive incentives, and high incomes might reflect extremely high and/or extremely valuable productivity. High salaries can also be justified as a compensating differential for doing especially difficult or disagreeable work.

How we measure income inequality can have a huge impact on what we perceive to be the result. For example, if we look at the distribution of income at any point in time, it’s like taking a photograph. We would expect to find that older, more experienced, and better-educated workers earn higher incomes than their younger counterparts. By itself, such a finding does not seem to represent any sort of a problem, as long as we expect that as the younger workers got more education and experience, their incomes will rise to levels comparable to what their elders had been making. That transition over time is more like a movie than a photograph. Recent articles in The Wall Street Journal, one by David Wessel and an op-ed piece by Alan Reynolds, explore the critical dimension of income mobility over time.

Wessel reports that improvements in the data and methodology used to study income mobility over time have put a dent in the longstanding impression America had of itself as the land of great opportunity relative to the rest of the world. Living standards have certainly increased for the population as a whole, but more recent evidence suggests that income mobility has not changed much in the past three decades, and may not be as robust as previously believed. Canadian economist Miles Corak’s study, cited by Wessel, suggests that among wealthy countries, the least income mobility is in the U.S. and Britain.

Mr. Reynolds, from the Cato Institute, a think tank with strong advocacy for free markets, argues that the data are too ambiguous to be of great interest or concern. Some studies indicate increasing mobility, while others indicate reduced mobility, but none of them are statistically conclusive. He goes on to offer some explanations for why incomes vary so much. One important reason is the amount of labor supplied: “Households with two full-time workers earn five times as much as households in which nobody works.” He cites a 1980 study by Princeton’s Alan Blinder that found the top 20 percent of earners provided 30 percent of weeks worked, compared to only 7.5 percent of weeks worked coming from the lowest 20 percent. That disparity alone would suggest a four to one ratio if weekly compensation were the same. Reynolds also offers evidence in support of age, experience, and education contributing to one’s earnings to further support his conclusion that income mobility is still alive and well in America.

Mixed data and anecdotal evidence leave others less convinced. Wessel quotes Nobel Prize winner Gary Becker from the University of Chicago, a long-time believer in upward mobility, as having some reluctant doubts:

“T do believe that it’s still true if you come from a modest background it’s easier to move ahead in the U.S. than elsewhere, but the more data we get that doesn’t show that, the more we have to accept the conclusions.”

More on the anecdotal side, Joel Millman looked at career opportunities from the New York City subway system, along with a more general overview, and found that opportunities for low-wage
workers to work their way to the top in organizations have been diminished over time. He cites reduced training within organizations, increased outsourcing of low skill, low wage functions, and declining unionization as principle causes of this decline, leaving a less than rosy scenario for many:

“For too many of our people, entry level no longer means entry level, it means dead end,” said Rodney Glenn, director of training for Transport Workers Union Local 100.

Sources:

a. One old cliché says, "A rising tide lifts all boats." If living standards are rising, should we be concerned about disparities in income? What are possible negative consequences of wide disparities in income?

b. Mr. Reynolds states in his op-ed, "To repeat, there is no hard evidence that it has become harder to get ahead through hard work in school and on the job." Does this statement, or other evidence discussed in chapter fourteen in Modern Labor Economics indicate that everyone in the income distribution is "getting what they deserve?"

c. America has some policies that redistribute income and wealth, though their overall effects are generally considered to be modest. The principle of providing equal opportunity over equal outcomes appears to have been a stronger guide to policy over the past half-century or so. What barriers to equal opportunity do you see preventing those from the bottom from rising up, or protecting those at the top from falling down?