Letter from America

America wakes up to inequality (again)

Angus Deaton argues that while the reduction of inequality has never been high a prioritiy in US public policy, recent developments have at least forced it back into focus. But when it comes to action there is nothing to match the radicalism of a century ago.

For many years, income inequality was not much of an issue in the United States, either among academics, politicians, or in public discourse. Changing events and better data have changed that, and today the topic has moved to the forefront of debate.

There are many unfamiliar things in a new country, and one of the most immediate, for me, when I first came to America, was the lack of interest in inequality, among either academics or the general public. In the late 1970s, when people would ask me to give a talk, I would mention optimal taxation as a possibility, and be met with blank stares. The idea that the government might maximize an inequality-averse social welfare function subject to incentive constraints seemed absurd to most American economists. 'A totally uninteresting social equilibrium' was one of the kinder comments. Another (then) colleague was fond of misquoting Proudhon to the effect that 'government is theft', a position that appalled me (then, though I have somewhat more sympathy after thirty years' experience of the US.) Another Princeton colleague, Alan Blinder, wrote his PhD thesis on income inequality and its effect on consumption, but found little, mostly because inequality changed so little from the 1950s to the mid-1970s; in Arthur Okun's famous phrase, studying income inequality was like watching the grass grow.

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In politics too, income inequality had little traction. Americans, unlike the British, are not interested in or disturbed by stories of 'fat cats', indeed they rather approve of them. Attempts by Democratic politicians to talk about inequality or redistribution were effectively met by cries of 'class warfare' from the Republicans. Americans, we were told, believed in the American Dream, that everyone could get rich if they tried hard enough. It was equality of opportunity that was important, not inequality of outcomes, and America, so the story went, was the land of opportunity.

Yet the politics has changed, as have events, and as have the data. The rise in income inequality after 1975 was apparent even from routine household survey data, but the extraordinary rise at the very top of the income distribution had to await the seminal work by Piketty and Saez. The documentation of the growth of top incomes, which appears to have resumed after the recession, has added fuel to other aspects of the discussion, on stagnant median wages, and on the effects of globalization and computerization on those at the middle of the income distribution. The grass has turned into a forest of beanstalks.

The rediscovery of inequality

President Obama proclaimed last year that income inequality is the defining challenge of our times. Bill De Blasio, fighting on an anti-inequality platform, was recently elected mayor of New York City in a landslide; he promised a special to tax on those city residents who earned more than $500,000 to pay for pre-elementary education for all of the city's children. (Currently the education initiative appears more likely to be enacted than the tax.) Alan Krueger, as Chairman of the Council of Economic Advisors in 2012, made a highly publicized speech (based on work by Miles Corak) showing that countries, like the US, with high income inequality were also those with the least equality of opportunity.

The popular press provides a daily diet of commentary on inequality. The *New York Times* runs a series called 'The Great Divide' with Joe Stiglitz contributing regular pieces on the baleful effects of inequality. The *Wall Street Journal* leads the counterattack. Economists, as always, are split. In 1998, Martin Feldstein commented that 'income inequality is not a problem in need of remedy'. Other economists have questioned the data, whether consumption inequality has risen as fast as income inequality (yes, though we have no data on consumption for the very top), and whether the exclusion of taxes and transfers, or government spending on healthcare, is not exaggerating inequality (yes) or reversing the trend (no). Though it would be ironic indeed if the rising cost of medical care were used as an argument to say that the bottom of the distribution is actually doing OK.

Greg Mankiw has been a vocal defender of the social value of the high salaries 'earned' on Wall Street and paid to CEOs (or by CEOs to themselves.) When I recently talked about my book *The Great Escape* at the (libertarian) Cato Institute, and questioned whether the mass popular grief at the demise of Steve Jobs of Apple would be replicated at the deaths of Lloyd Blankfein of Goldman Sachs or Jamie Dimon of JPMorgan Chase, it was suggested that this was because the public do not understand the social importance of what they do.

Was the 'gilded age' more compassionate?

There are many comparisons with the gilded age, and not only in the inequality data. It is indeed interesting to look at how the extreme inequality a century ago affected-politics, either to moderate the inequality, or to reinforce it. In her recent joint biography of Presidents Taft and (Teddy) Roosevelt, Doris Kearns Goodwin writes about TR's 'trust busting', attempts to rein in the illegitimate market power of the giant trusts in banking, oil and railways; TR saw the trusts as accumulating great wealth in a way that prevented competition and that immiserated a substantial share of the population.

Closer to (my) home is Woodrow Wilson's reaction to inequality, documented in Scott Berg's recent biography. While President of Princeton, Wilson was outraged by the fact that the college was effectively owned by the wealthy: Wilson's predecessor, Patton, liked to claim that he was running the finest country club in America, and noted that 'Princeton is a rich man's college and that rich men frequently do not come to college to study.' Wilson attempted to democratize the university but was defeated by the alumni and by his Board of Trustees, on which the 'rich men' were well represented. Two years after his resignation, he was elected President of the United States, where he succeeded in putting into law a number of anti-inequality measures, including reductions in tariffs, the creation of the Federal Reserve (to protect the country from the bankers during financial crises) and the introduction of the income tax on a permanent basis, which incidentally made it possible for Kuznets, Piketty and Saez to document top income inequality. Whether these policies would have reduced inequality is something that we will never know; the (First) World War (a name coined by Wilson) swept all before it.

What will happen this time round is impossible to tell, though we may hope that another World War might be avoided. Yet half way through Obama's second term, a President seen by many on the right as the most anti-rich President of all time, there is little sign of any reversal in the upward trend of inequality.