Rising Inequality and Disappearing Middle Class

As of 2007, the top 1 percent of households owned 34.6 percent of all privately held wealth, and the next 19 percent had 50.5 percent. That means that just 20 percent owned 85 percent of the wealth, leaving only 15 percent of the wealth for the bottom 80 percent.

However, when Norton and Ariely (2011) conducted a study of Americans’ perception of income inequality, they found that 90 percent or more of the 5,522 respondents thought that the top 20 percent has about 60 percent instead of 85 percent of the wealth in America. When asked about an ideal wealth distribution they said that the top 20 percent would own between 30 and 40 percent of the privately held wealth.

Also, contrary to what many believe, people in the US “enjoy less economic mobility than their peers in Canada and much of Western Europe” (DeParle, 2012, January 5). Fewer people are moving up and the gap between the middle class and the upper income brackets continues to grow. William Julius Wilson argues that “rising inequality is beginning to produce a two-tiered society in America in which the more affluent citizens live lives fundamentally different from the middle- and lower-income groups. This divide decreases a sense of community” (Tavernise, 2011, November 16).

Republican Mitt Romney characterizes discussion of this inequality as “the politics of envy.” Elizabeth Warren, the democratic candidate for a US Senate seat in Massachusetts, sees it as a call to reclaim the social contract—those who use the resources provided by society have an obligation to reinvest in that society so that more have an opportunity to prosper (Blow, 2012, January 14). What can be done to provide better access to opportunities to prosper?

Inequality and Lack of Mobility

The Foundation for Child Development’s report on the declining fortunes of middle-class families and their children found that the gap in real family income separating the typical child in a middle-class family from the typical child in a high-income family expanded by more than 56 percent from 1985 - 2008 (Hernandez, 2011):

- **Children in middle-class families were losing ground long before the Great Recession.** Children in middle-class families lost ground economically compared to children in high-income families almost continuously in the past quarter century (1985-2008), driven, in part, by declines in secure parental employment beginning as early as 2000. By the first full year of the Great Recession which began in December 2007, children in middle-class families had already experienced an eight-year period (2000-2008) during which real family income dropped by more than $4,000. By comparison,
children from high-income families saw their fortunes dip by just $139 in the same time frame.

- **The income gap between families is widening.** The gap in real family income separating the typical child in a middle-class family from the typical child in a high-income family expanded by more than 56 percent from $57,800 in 1985 to $93,100 by 2008. This $93,100 divide is now nearly the size of the gap that separated children in low-income and high-income families in the mid-1980s.

- **Children in middle-class families are increasingly relying on public programs for services that many of their parents cannot afford and cannot take for granted.** In recent years, public policies have acted as a broader safety net for the middle-class by providing greater access to health insurance and Pre-Kindergarten, two indicators that researchers have identified as critical for children’s long-term well-being and success. The level of employer coverage has declined over the past decade, but increases in Medicaid and the creation of CHIP [Children’s Health Insurance Program] have more than compensated for the employer decline and have resulted in a sharp decrease in the number of uninsured children despite the reduction in employer-sponsored coverage.

- **The precarious situation of the middle-class is also reflected by an increasing number of one-parent middle-class families.** The proportion of children in middle-class families living with one parent increased from 14 percent to 23 percent. Meanwhile, the gap in the proportion living in one-parent families that separates children in middle-class families from children in high income families expanded from 9 percent to 16 percent between 1985 and 2007. One reason these findings are of concern is that children in one-parent families tend to be less successful in school than children in two-parent families.

- **More recently, and also reflecting the precarious situation of the middle-class, the gap in secure parental employment separating children in middle-class and high-income families widened by one-third between 2000 and 2008.** The proportion of children with a securely employed parent in the home (working full-time year-round) declined by 3 percentage points between 2000 and 2008 for children in upper-middle-class and middle-middle-class families and by 8-9 percentage points for children in lower-middle-class and low-income families, while children in high-income families experienced a tiny dip of 0.5 percentage points.

- **Overall child well-being increased especially between 1992 and 2000, with 2000 marking a historic peak, but then child well-being deteriorated substantially across the eight years that followed from 2000 to 2008.** In fact, nearly one-half of the improvements registered between 1992 and 2000 were wiped out by the deterioration that occurred between 2000 and 2008. The post-2000 deterioration resulted from changes including declines in the median family income and in the proportions with a securely employed parent or with very good or excellent health, and from increases in the proportions in one-parent families, obesity in children, and children with activity limitations.

Some economist like Steven Davis of the University of Chicago argue that inequality is an incentive for people to achieve and climb the social ladder. The incentive might be there but
the paths are often blocked and the opportunities are limited. As Paul Krugman (2012, January 9) summarizes the current situation:

The failure starts early: in America, the holes in the social safety net mean that both low-income mothers and their children are all too likely to suffer from poor nutrition and receive inadequate health care. It continues once children reach school age, where they encounter a system in which the affluent send their kids to good, well-financed public schools or, if they choose, to private schools, while less-advantaged children get a far worse education.

Once they reach college age, those who come from disadvantaged backgrounds are far less likely to go to college -- and vastly less likely to go to a top-tier school -- than those luckier in their parentage. At the most selective, "Tier 1" schools, 74 percent of the entering class comes from the quarter of households that have the highest "socioeconomic status"; only 3 percent comes from the bottom quarter.

And if children from our society's lower rungs do manage to make it into a good college, the lack of financial support makes them far more likely to drop out than the children of the affluent, even if they have as much or more native ability. One long-term study by the Department of Education found that students with high test scores but low-income parents were less likely to complete college than students with low scores but affluent parents.

According to Jason Deparle (2012, January 5), “One reason for the mobility gap may be the depth of American poverty, which leaves poor children starting especially far behind. Another may be the unusually large premiums that American employers pay for college degrees. Since children generally follow their parents' educational trajectory, that premium increases the importance of family background and stymies people with less schooling.” More than half of children from high-income families finish college, up from about a third 20 years ago. Fewer than 10 percent of low-income children finish, up from 5 percent.

Also according to Deparle, Masrkus Jantti, a Swedish economist, found that 42 percent of American men raised in the bottom 20 percent stay there as adults. This is a level of persistent disadvantage much higher than in Denmark (25 percent) and Britain (30 percent). Just 8 percent of American men at the bottom rose to the top 20 percent. That compares with 12 percent of the British and 14 percent of the Danes. Miles Corak, an economist at the University of Ottawa, found that just 16 percent of Canadian men raised in the bottom tenth of incomes stayed there as adults, compared with 22 percent of Americans.

The Pew Charitable Trust’ mobility study (2011) revealed that:
- In the United States, there is a stronger link between parental education and children’s economic, educational, and socio-emotional outcomes than in any other country investigated.
- Family background begins affecting children early in life: across countries, disparities in children’s outcomes by family background occur as early as they can first be measured.
They exist for both cognitive and socio-emotional outcomes and usually are larger for the former.

- Preschool exposure can have lasting positive effects on educational and economic disparities by family background, especially for low- and middle-income children.
- Disparities in early child outcomes persist into adolescence.
- The evidence demonstrates that average differences in measurable child outcomes early in life continue up to university age and likely beyond.

Another important factor that is impacting the middle class is the major global restructuring of the economic system. According to Alpert, Hockett, and Roubini (2011, October) there is a global excess of labor, capital, and capacity to produce goods, while wages are stagnant and demand for products is low. With the rise of more competitive workforces into the world economy, production has shifted to other countries depressing wages in the US and increasing wealth for the few. Over the past two decades there has been:

> [T]he steady entry into the world economy of successive waves of new export oriented economies, beginning with Japan and the Asian tigers in the 1980s and peaking with China in the early 2000s, with more than two billion newly employable workers. The integration of these high-savings, lower wage economies into the global economy, occurring as it did against the backdrop of dramatic productivity gains rooted in new information technologies and the globalization of corporate supply chains, decisively shifted the balance of global supply and demand. In consequence, the world economy now is beset by excess supplies of labor, capital, and productive capacity relative to global demand. This profoundly dims the prospects for business investment and greater net exports in the developed world — the only other two drivers of recovery when debt-deflation slackens domestic consumer demand. It also puts the entire global economy at risk, owing to the central role that the U.S. economy still is relied on to play as the world’s consumer and borrower of last resort. (p. 3)

It is going to be difficult to create more jobs in the US if there is a cheaper, quality workforce ready to produce products in many other parts of the world.

**What can be done to provide better access to opportunities to prosper?**

*Reduce Taxes in order to Encourage Job Creation*

Mitt Romney and many other Republicans have been arguing that reducing taxes on the rich and corporations will lead to job creation and, thereby, benefit everyone else. Republicans insist that the American people and corporations pay very high taxes. However, according to the Citizens for Tax Justice (2011, December 22) the US has the third lowest taxes of any developed country. US taxes are at the lowest level they have been since 1958 and are the third lowest level of total taxes of the Organization for Economic Cooperation and Development (OECD) countries:
Republicans claim also that the US has the second highest corporate tax rate in the world. However, because of corporate tax breaks and loopholes, the US actually has the second lowest corporate taxes as a share of GDP in the OECD. Thirty major corporations, including Verizon, Boeing, and General Electric, paid nothing in corporate taxes over the last 3 years. Rather than cutting corporate taxes, Citizens for Tax Justice suggest that the sensible solution is to pass revenue-positive corporate tax reform.

![Total 2009 Taxes as a % of GDP](image)

Does cutting taxes create jobs and raise revenue? Citizens for Tax Justice argues:

Tax cuts for the rich have been regarded as a magic elixir that could unleash economic growth, while simultaneously increasing government revenue. The reality is that the tax cuts that have been tried for over 30 years have proven to be a stunning failure in all regards. In fact, history has shown that the tax rate on the wealthy simply has nothing to do with economic growth. Just consider the strong growth that occurred after President Clinton increased taxes versus the dismal growth following the Bush tax cuts.

Not surprisingly, tax cuts have been definitely proven to reduce revenue. Even President Bush's own Treasury Department concluded that tax cuts do not create enough economic growth to come close to offsetting their costs or raising revenue. The Bush tax cuts cost $2.5 trillion in their first decade and the Reagan tax cuts cost $582 billion.

Even when they receive tax credits or state grants in order to foster job creation, corporations do not always follow through, especially if their customers are losing income and diminishing their demand for goods. According to a report from the Texans for Public Justice (2011, November), most of the Texas Enterprise Fund projects defaulted on jobs:

- 24 **non-performing** projects (37 percent) failed to deliver on their original 2010 job promises;
- Only 17 **performing** projects (26 percent) complied with their 2010 job commitments;
- The Governor’s office terminated 11 failed projects (17 percent) prematurely.
• 7 projects are **troubled** (11 percent), usually because they defaulted on 2010 job pledges but covered the shortfall with job credits earned by exceeding their job targets in past years;
• Five **fraud** projects (8 percent) deceptively claim that they created more jobs than they actually did (many of TEF’s largest grants are frauds); and
• One **weak** project claims “new” jobs that had hiring dates *predating* its TEF contract. (pp. 1 – 2)

According the Citizens for Tax Justice website, *The Des Moines Register* carried a story about Iowa firms defaulting on job creation pledges after receiving tax credits:

> That a slew of tax credit programs in Iowa have failed to live up to their job-creation promises is further evidence that while companies will happily take taxpayer money when it’s offered, no amount of corporate pork can make a company hire people when there’s no demand for its products.

The reasons for these failures should be obvious. When the economy is weak, businesses generally can’t sell as much of their product as they used to. You can throw money at them and ask them to hire more people, but ultimately it doesn’t make sense for a company to bring on more employees unless there’s some new, unmet demand that needs to be filled. In good economic times, companies simply rake in tax credit dollars and create jobs they would have created anyway. But in bad economic times, companies rake in tax credit dollars, the façade collapses, and you end up with exactly the situation we see in Iowa.

**Or Revise the Tax Code to Share the Burden, Increase Consumption, and Support Investment in Needed Infrastructure that will Foster More Jobs**

Besides arguing that raising taxes on the rich will kill job creation, Republican also claim that raising taxes is unfair because about half of Americans in the US do not pay taxes. According to Citizens for Tax Justice:

> [T]he basis of this claim is data showing that 47 percent of Americans did not owe federal income taxes in 2009 when the recession was at its peak. The claim ignores federal payroll taxes, state and local sales, income, and property taxes that all Americans pay. Three quarters of American households actually pay more in payroll taxes than federal income taxes...Many low income Americans do not pay federal income taxes because they benefit from tax credits like the earned income tax credit (EITC), which incentivize work while providing much needed support to working low and middle class family budgets.

New York Governor Andrew Cuomo has proposed a tax plan that spreads the burden. The new tax rates will range from 6.45 percent for income between $40,000 and $150,000 (for married couples) to 8.82 percent for income over $2 million. Tax brackets will be indexed to the rate of inflation and will take effect in 2012. The new top tax bracket will expire at the
end of December 2014; the others will be permanent (Kaplan, 2011, December 7).

A December 20, 2011 *New York Times* Editorial called for tax reform as part of agenda to revitalize the middle class:

Tax reform is essential. But there is no way to build public consensus for broad reform without first reversing the lavish tax breaks for the rich. In addition to letting the high-end Bush-era tax cuts expire at the end of 2012, Mr. Obama could call for all forms of income to be taxed at the same rates, rather than allowing lower rates for investment income, which flows mostly to wealthy Americans. Income tax rates also need to be adjusted at the top of the scale, so that the affluent, say, couples with taxable income of $400,000 a year, are not paying the same top rate as multimillionaires.

Ian Ayres and Aaron Edlin (2011, December 19), propose an alternative, tax inequality itself:

What we call the Brandeis Ratio -- the ratio of the average income of the nation's richest 1 percent to the median household income -- has skyrocketed since Ronald Reagan took office. In 1980 the average 1-percenter made 12.5 times the median income, but in 2006 (the latest year for which data is available) the average income of our richest 1 percent was a whopping 36 times greater than that of the median household.

[We] propose an automatic extra tax on the income of the top 1 percent of earners -- a tax that would limit the after-tax incomes of this club to 36 times the median household income...Billionaires could double their current income without the tax kicking in -- as long as the median income also doubles. The sky is the limit for the rich as long as the "rising tide lifts all boats." Indeed, the tax gives job creators an extra reason to make sure that corporate wealth does in fact trickle down.

Here's how the tax would work. Once a year, the Internal Revenue Service would calculate the Brandeis ratio of the previous year. If the average 1-percenter made more than 36 times the income of the median American household, then the IRS would create a new tax bracket for the highest 1 percent of income and calculate a marginal income tax rate for that bracket sufficient to reduce the after-tax Brandeis ratio to 36.

This new tax, if triggered, would apply only to income in excess of the poorest 1-percenter -- currently about $330,000 per year. Our Brandeis tax is conservative in that it doesn't attempt to reverse the gains of the wealthy in the last 30 years. It is not a "claw back" tax. It merely assures that things don't get worse.

*Just Create Jobs or Restore Job Quality*

Many of the jobs currently being created in the US are low-paying service jobs in the home health care and food service industries. Paul Osterman (2011, December 28) calls for improving the quality and pay of work in order to regain a strong middle class and reduce poverty:
At the bottom of the labor market, 20 percent of adults in the U.S. today work in jobs that pay poverty wages, wages that would not raise a family of four above the poverty line, even with full-time, year-round work.

Farther up the ladder, jobs have been disassembled. It used to be that a skilled job, either white- or blue-collar, paid decently, provided reasonable benefits and offered security. We left that reality behind long ago. Only about half of jobs in the U.S. today provide pensions.

Job security has eroded; many who are laid off face a substantial risk of falling into poverty. Even if laid-off workers are lucky enough to find new jobs, they are forced to take a 20 percent pay cut…Any serious effort to address the travails of the middle class must include taking on the challenges of making the job market more fair...For those earning poverty wages, the answer is to raise standards and to enforce them. Today's minimum wage is more than $3 below its value in 1968, after accounting for inflation. Today, too many employers avoid paying overtime to employees who have earned it, and effective enforcement of the law to avoid this wage theft is important. A stronger voice for workers, such as unions, can improve economic outcomes, but the law today is stacked against union organizing.

We need a new social contract -- between employers and employees. In the past, when many American firms did well, they shared profits and productivity gains with their employees. That is no longer the standard. In the past, CEOs were praised if they showed a commitment to their work forces, if they saw human capital as their key competitive asset. That, too, has changed. We cannot return to the placid labor market of the 1950s and '60s, but we can certainly rekindle a sense of mutual commitment and fairness…[We] need real policy initiatives. These include increased public support for deepening training, investments in the human capital of the work force, which can come via the tax code and well-designed public-private training programs. Also important are modernized regulations that would make it difficult for employers to use subcontractors in occupations such as building cleaners or security guards and by doing so avoid responsibility for employees who work at their site. Giving employees an even playing field in deciding whether they want to be represented by a union can also make a big difference. In addition, governments can set an example by paying attention to the employment terms of firms that receive government contracts and to which local, state and federal governments contract out services.

The same New York Times Editorial (2011, December 20) about an agenda for the Middle Class also calls for “good jobs” that provide opportunities for more to prosper: “Mr. Obama must continue to offer stimulus bills that include spending for public works, high-tech manufacturing and an infrastructure bank.” At the same time Obama needs to counter when job creation (Keystone XL oil pipeline in particular) and environmental protection are at odds. Republicans have portrayed opposition to the Keystone XL oil pipeline as a job killer. “The truth is, oil addiction and the failure to invest in new energy sources will be far bigger job killers. What's
needed is a plan to create millions of clean energy jobs and to link those jobs to workers in fossil fuel industries who otherwise would be displaced. The climate bill that died in 2010 would have begun that transformation; the need to try again only becomes more pressing with each passing year.”

The editorial also calls for “generous tax credits for low earners, a higher minimum wage, and guaranteed health care so that wages are not consumed by medical costs. Job training efforts must also focus on the service sector, helping to build so-called career ladders, say, from home health aide to licensed vocational nurse.” In addition Obama should be doing all he can to stop foreclosures: “an antiforeclosure plan that is up to the scale of the problem would include unrelenting political pressure for principal write-downs of underwater loans, expanded refinancing for borrowers in high-rate loans, and forbearance for unemployed homeowners.”

Thomas Friedman also supports investment in infrastructure and tax reform:

I want to vote for a candidate who advocates an immediate investment in infrastructure that will create jobs and upgrade America for the 21st century -- ultrafast bandwidth, highways, airports, public schools, mass transit -- and combines that with a long-term plan to fix our fiscal imbalances at the real scale of the problem, a plan that could be phased in as the economy recovers (2012, January 21).

But he insists that as Christina Romer, the former chair of Obama’s Council of Economic Advisors, says, “Pairing additional strong stimulus with a plan to reduce the deficit would likely pack a particularly powerful punch for confidence and spending." And thereby contribute to fostering more employment.

Besides investing in infrastructure and quality jobs, The Foundation for Child Development calls for continued support of policies and programs that invest in education and health, the key factors that help low and middle income children to take advantage of the opportunities to prosper:

Today, the safety net has broadened to protect more children with access to Pre-Kindergarten and health insurance coverage. Without these policies, both Pre-Kindergarten enrollment and health insurance coverage would have fallen after 2000…In our democratic society, rising family incomes, increasing economic equality, and equal and growing opportunities for improved education and health were hallmarks of national success during the decades following the Great Depression and World War II…America is losing its way, as children in middle-class families fall further and further behind the most economically privileged children in our society. Earlier generations of Americans in the decades following the Great Depression invested in programs aimed at fostering greater access to education and increased health insurance coverage. Difficult trade-offs and choices must be made now, even in the face of hard economic times, to support these essential investments in children and the future of the nation. It is critical that policymakers not reduce funding for programs that children require to survive and thrive, if they are to ensure that children will become productive workers, informed citizens, and
effective parents for decades to come. Our national security depends on their healthy development.

We can ill afford major reductions in education, housing assistance, transportation, public health, veterans benefits, law enforcement and courts, environmental protection, Pell grants, environmental programs, low-income heating assistance, and many other “discretionary spending” programs. “As the economist Jared Bernstein has noted, this is the category of spending that helps people move up the income ladder, providing nutritious food, improving early education and job training and putting people to work” (NYT Editorial, Dec, 31).

What can help reduce inequality, reduce poverty, and bolster the middle class? Revise the tax code to reclaim the social contract, foster quality jobs, invest in infrastructure, health, and education, protect programs that encourage mobility, and implement a long term plan to reduce the deficit. In addition, as Alpert, Hockett, and Roubini argue, there is a need to bring manufacturing jobs back to the US and work with other nations to achieve a balance of trade.

In his State of the Union address, President Obama called for such an agenda:

> We can either settle for a country where a shrinking number of people do really well, while a growing number of Americans barely get by. Or we can restore an economy where everyone gets a fair shot, everyone does their fair share, and everyone plays by the same set of rules.

References


