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The Ideological and Political Roots of American Inequality

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GROWING INEQUALITIES' IMPACTS

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1. Three arguments for inequality

To address properly the growing inequality in the advanced democracies, particularly in the United States but also increasingly in the UK and continental Europe, I believe it is necessary to review the main arguments for inequality, and to inquire into their legitimacy. There are, today, two main arguments for inequality: first, an ethical one, that individuals deserve to benefit from what nature and nurture endows them with, and second, an instrumental one, that inequality is good for everyone. The first argument is presented in its most compelling form by the philosopher Robert Nozick, who in his 1974 book, *Anarchy, State and Utopia,* advanced the idea that a person has a right to own himself and his powers, and to benefit by virtue of any good luck that may befall him, such as the luck of being born into a rich family, or in a rich nation. Any voluntary exchanges that take place between persons are legitimate, and in this way, it is not hard to imagine that a highly unequal distribution of income and wealth can be built up fairly rapidly from these unequal endowments. Nozick is the first the admit that actual capitalist economies are not characterized by historical sequences of legitimate, voluntary exchanges: there is much coercion, corruption, and theft in the history of all societies. But Nozick's point is that one can imagine a capitalism with a clean history, in which vastly unequal endowments of wealth are built up entirely from exchanges between highly talented, well educated people and simple, unskilled ones, and this unequal result is ethically acceptable if one accepts the premise that one has a right to benefit by virtue of one's endowments – biological, familial, and social – or so he claims.

The second major argument for inequality is the instrumental one: that only by allowing highly talented persons to keep a large fraction of the wealth that they help in creating will that creativity flourish, which redounds to the benefit of all, through what is informally called the trickle-down process. In a word, material incentives are necessary to engender the creativity in that small fraction of humanity who have the potential for it, and state interventions, primarily through income taxation, which reduce those material rewards, will kill the goose that lays the golden eggs.

A third argument for inequality, which is currently most prevalent in the United States, is one of futility: even if the degree of inequality that comes with laissez-faire is not socially necessary in the sense that the incentive argument claims, attempts by the state to reduce it will come to naught, because the government is grossly incompetent, inefficient, or corrupt. Thus, better to let the rich keep their wealth and invest it profitably, than to hope that the state can manage it more fruitfully. Incredible as it may seem, it is now becoming increasingly popular in certain circles of economists in the United States to say that the productivity of government investment is zero.

Many in this audience – and I mean especially the Europeans – may think it somewhat pedantic for me to rehearse these views, which they consider to be self-evidently wrong or false. But I do so because these views have taken a strong hold on the minds of many Americans, and the consequences for the United States, and therefore for the world, will be dire, I believe, if this popular ideology is not successfully challenged. The United States is not Germany in 1931, but it may well be Germany in 1921 – I do not wish to push the analogy too far, because the US is not suffering under a punitive Versailles treaty. The details are quite different in the two periods, but the event of a right-wing populist movement growing in the United States to a dangerous degree has a non-trivial probability. It is incumbent upon us, as intellectuals, to equip ourselves to counter it.

2. Philosophical responses

The philosophical response to Robert Nozick's libertarianism came primarily from two political philosophers, John Rawls and Ronald Dworkin. (My use of the word 'response' is somewhat anachronistic, as Rawls's major book was published three years prior to Nozick's.) Rawls maintained, *contra* Nozick, that the thesis of self-ownership was not right – rather, that the distribution of many attributes of persons was, in his parlance, morally arbitrary, and hence the individual did not have a moral right to benefit exclusively from their physical possession. Rawls certainly included among such attributes one's biological endowment and the family and circumstances into which one was born. Rawls attempted to construct an argument that, if rational, self-interested beings were shielded from the knowledge of the luck they would sustain in the birth lottery, which assigns genes and families, they would opt for a highly equal distribution of wealth – indeed, for that distribution which maximizes the wealth that the poorest class of people would have. His main argument for this thesis was wrong – knowing decision theory would have helped Rawls – but nevertheless, many found the recommendation of the so-called 'maximin allocation' of income and wealth attractive, because they found the premise of the moral arbitrariness of the distribution of genetic and social assets attractive.

The error in Rawls's argument that those in an original position, behind a veil of ignorance, would choose a highly equal distribution of income, came from his assumption that the decision makers postulated to occupy this position were completely self-interested. Self-interested individuals may be willing to take some risk in the birth lottery – they may be willing to accept some possibility of an unlucky draw in return for the possibility of a lucky draw. So advocating a strongly equalizing tax system may not be in their interest – better perhaps to gamble on being lucky and not to have to pay a large tax to compensate the unlucky ones, in that event. This does not mean that a strongly equalizing tax system is ethically wrong: but to justify it with the kind of argument Rawls wished to construct requires that individuals care at least to some degree about others. Rawls's attempt to derive equality of results from premises of rationality and self-interest fails. Granted, such a derivation, were it to be valid, would be compelling, but it is not valid. A stronger premise of empathy, altruism or solidarity is required to derive equality as an outcome in the Rawlsian framework.

There was another aspect of Rawls's theory that was unattractive to some: there was no evident place in it for the role of personal responsibility and accountable choice. Virtually all of us believe, to some degree at least, that individuals should be held responsible for their choices – we may insist that they be properly informed, provided with adequate education during youth, and so on, but there comes a point at which outcomes for individuals may legitimately differ due to choice. Rawls gestured towards recognizing this kind of legitimate inequality when he called for equalizing primary goods, rather than income – but then he often said that income was the most important of the primary goods. How, then, could he at once advocate equalizing bundles of primary goods and holding people responsible their choices of income – leisure bundles, preferences for which might legitimately differ across persons?

Ronald Dworkin, in 1981, published a pair of articles which addressed this problem in a radical, new way. He advocated what he dubbed 'resource equality,' as opposed to both welfare equality and primary-goods equality. In Dworkin's view, people should be held responsible for their preferences, but not for their resources – where resources include many of the goods that Rawls called morally arbitrary, such as genetic endowments and the social and familial circumstances of one's childhood. This is not the place to go into detail about Dworkin's recommendation for redistribution: suffice to say that it called for compensating individuals for the bad luck of the birth lottery but holding them responsible for many of the choices they make as adults. Thus, a degree of equality was recommended that was less than Rawlsian, but far more than exists in most advanced democracies today. Perhaps the income distributions of the Nordic democracies are the closest approximation to a Dworkinian distribution.

3. Economic theory

I wish to discuss both the influence of macro and micro economic theory on our views about inequality. I will dismiss macro-economic theory quite curtly. Its two pillars, rational expectations and the efficient markets hypothesis, have both been quite effectively demolished by the current financial and economic crisis.

Rational expectations is simply a premise of mathematical convenience. Suppose that agents are making decisions under uncertainty, which is, of course, ubiquitous in the real world. Suppose, for example, each individual is deciding how much education to take, under an assumption about the probability distribution of wages associated with each level of education he/she might acquire. If one is interested in the long-run properties of such a process, one needs to make some assumption about the relationship between the prior distributions of wages conditional upon educational levels that people hold, and the actual distribution of wages which occurs after people are educated and acquire jobs. The simplest – and indeed, focal—assumption that one can make is that these distributions are the same: that is, people take, as their prior, the distribution that is in fact realized. This is the rational expectations hypothesis. Although mathematically convenient as a way of closing the model, the assumption is impossible to justify as empirically accurate. The reason the assumption is convenient is that there is no simple way to close the model without it.

The efficient markets hypothesis says that the prices in stock markets accurately summarize all the information that is available about the expectations of the future values of firms. A consequence of this hypothesis is that bubbles cannot exist in stock markets – or , if housing is efficiently priced, in housing markets.

The financial crisis and concomitant economic crisis which we have recently experienced are not possible under these two views. Diehard advocates of these views argue that there was no housing bubble, and there is currently no involuntary unemployment: those who are unemployed are rationally investing in the search for new jobs. Somewhat less militant advocates of these views do not reject the claim that a crisis occurred, but rather construct Ptolemaic arguments purporting to demonstrate that nothing could have been done to prevent it, and that, in particular, any aggressive intervention by the state would have then or will now only make things worse.

My own take is that the hold these views have on macro-economists demonstrates that economics is not yet a science. For a theory to be a science, it must be falsifiable. I do not see how any real event could falsify the main tenets of current macro-economic theory, if the current crisis could not. History suggests that individuals who have long-held views or methods do not change: we can only hope that a new generation of macro-economists will emerge, whose members have the courage and intellectual power to re-construct the theory. With respect to our topic of inequality, it need hardly be said that so-called fresh-water macro – that practiced in the mid-west of the United States near the Great Lakes -- takes no particular interest in inequality. One of its tenets is what I called the futility thesis – that any attempt by the state to redress inequality would only make things worse.

There has also been an important transformation in micro-economic theory during the past thirty years, and although less noted, it may be just as important as the rational-expectations revolution in macroeconomics, for our views on inequality. Economists have long realized that markets perform two functions: they *coordinate* economic activity, and they *provide incentives* for the development of skills and innovations. It is not easy to give a definition which distinguishes precisely between these two functions, but there is no question that a conceptual distinction exists.

Let me give two examples. An important problem facing Soviet planners was called the transportation problem. There are a number of plants in the nation which produce steel, with various fixed capacities, and a number of locations in the nation which demand steel – in various quantities. There is a cost of shipping steel from any supplier to any demander – these costs vary. What is the optimal plan? How much should each steel producer ship to each market, so that all demands are satisfied, and transportation costs are minimized? This problem led the Soviet mathematician L. Kantorovich to co-invent linear programming in the 1940s, for which he and Tjalling Koopmans, in the United States, jointly received the Nobel prize in economics.

Competitive prices can solve this problem without linear programming. If competitive prices for transport and prices of steel at the various producers characterize this market, then each demander orders steel to minimize its costs, the steel market clears, and indeed, the market will have found the mathematical solution to the cost-minimization problem. This is an example of prices performing a coordinating function.

Consider , now, the problem that I alluded to earlier. A young person is deciding on how much education to take, and wishes to maximize a utility function in which both future income and the nature of the occupation are important. Prices (which is to say expected wages) guide him/her to make the decision. We should think of this as an instance of where the market is performing an incentive function – it is inducing the individual to make a choice on which skill to develop based on his self-interest, and if the market is well functioning (competitive), the aggregation of all such choices will be Pareto efficient.

Now neither of these examples is pure. Indeed, in the transportation problem, equilibrium prices are realized as the result of managers of firms having the incentive, for some reason or other, to minimize costs, and in the education example, the market is coordinating the allocation of workers to occupations in a way which is, under some assumptions, Pareto efficient. And, indeed, in any example, there will be both a coordination and an incentive interpretation of the market's role. I maintain, nevertheless, that there is a distinction between these two roles, and that each example illustrates different mixes of the coordination and incentive functions of the market.

In the last thirty or forty years, the economic theorist's view of the market has changed, from being an institution which performs primarily a coordination function to one that is primarily harnessing incentives. Indeed, the old definition of micro-economics was the study of how to allocate scarce resources to competing needs. This is entirely a coordination view. The elegant theorem at the pinnacle of this view is that equilibrium prices in a competitive economy with no externalities, no public goods and a complete set of markets will induce an allocation of resources which is Pareto efficient. That kind of efficiency is the mark – perhaps the definition of -- successful coordination. The technique that provided the intellectual justification of the coordination view was general equilibrium theory: it reached its apex in the 1950s and '60s.

It may surprise you to hear that the phrase 'principal-agent problem' was only introduced into economics in 1973, in an article by Steven Ross. In the principal-agent problem, coordination is not the primary issue – rather, a principal must design a contract to extract optimal performance from an agent whose behavior he cannot perfectly observe. This is par excellence an incentive problem.

The technique which developed to analyze incentive problems was game theory – more specifically, parts of game theory called contract theory and mechanism-design theory. The problems that are analyzed typically involve small numbers of individuals, where markets do not exist, and the individuals must set prices or write contracts to 'get the incentives right.' But the idea that incentives are the real guiding force which markets must address extends to much larger groups of actors – even to entire economies. Some economists have even gone so far as to say that prices have no coordinating function at all: rather, they say we should look at all economic exchanges as episodes of bargaining between individuals; what determines the price of the exchange is the relative power of the two bargainers – in the sense of how scarce the commodity they are each supplying is – and prices simply ratify these fundamentals. Under this view, markets do not coordinate at all, they simply provide the venue for bargaining.

Why did this transformation of microeconomic theory occur? This is a fascinating question, and I do not have the full answer. A partial answer is that economists sought to explain the economic failure of the centrally planned economies, which only began to seriously transpire in the 1960s and 1970s. But the logic here is muddy: certainly one might conclude that it was the lack of markets that brought about economic failure in those economies. But was it because, lacking markets, coordination failed, or because incentives were left unharnessed? There are myriad stories of both coordination and incentive failures: coordination failure is illustrated by long queues for consumer goods, and rationing of industrial inputs, and incentive failure is illustrated by the Soviet joke, told by workers about managers, “They pretend to pay us, and we pretend to work.” In other words, one might equally well interpret the inefficiency of centrally planned economics as illustrating that planners cannot replace the coordination function of the market, or that lack of market competition makes it impossible to harness incentives.

What is the import of the change in emphasis of the market’s role for the problem of inequality? I believe it is to reënforce the importance of material incentives: more radically, to justify the view that the very high salaries and incomes, for those at the top, that have come to characterize capitalist economies in the last thirty years, are necessary for efficiency.

To see this, I propose a simple thought experiment. Suppose that there were an economy where individuals cared only about the kind of occupation in which they engaged, and the amount of education they required to qualify for the occupation. Assume that there is a variety of preferences in the population over occupations and education. Wages are not important to people, as long as they suffice to purchase a certain minimum of consumption. There is one firm, which produces a single consumption good that everyone needs, and the firm can produce this good using many different possible combinations of workers employed in the various occupations. The firm wishes to maximize its profits, which will equal the revenues from selling the output to consumer-workers, minus the wage costs of the workers. A vector of occupational wages, and a price for the output good, comprise a competitive equilibrium for this economy if, at those wages and prices, all the occupational labor markets clear and indeed the demands for workers in the various occupations put forth by the firm, maximize its possible profits at those wages and price.

Now the peculiar thing about this economy is that workers do not care about wages: they make decisions about what occupation to engage in solely by looking at the attributes of the occupations and the educational requirements to enter them. Each worker chooses the occupation and concomitant educational level which maximizes his utility over the available choices. Equilibrium wages are ones which will direct the profit-maximizing firm to demand *exactly the supplies of occupations* which are on offer by the population.

I propose that in this economy, the market is providing primarily a coordination function.Granted, the firm has, by hypothesis, an incentive to maximize profits: but in some sense the *main* function of the market is to coordinate the fixed occupational choices of workers with the firm’s demands for workers in the various occupations.Some workers will, indeed, earn more than others at the equilibrium, because their wages are higher: but, by hypothesis, as long as all wages are sufficiently high with respect to the price of the output, these wages form no part of workers’ decisions.

Suppose one now imposed a purely redistributive income tax on workers. (It may be hard to see why one might wish to do so, if workers do not care about their consumption levels, but this is a thought experiment.) Then the occupational choices of workers will be unchanged. Indeed, the equilibrium wages and price of output will not change. All workers will choose exactly the occupations they chose before, and the firm will produce the same amount of output as before, with the same profits: all that will happen is a redistribution of the consumption good among worker-consumers. This is a case where redistributive taxation has no effects on occupational and productive choices. There are no efficiency consequences to taxation.

Consider, now, the polar opposite model, where workers care only about income and the education they must endure to qualify for different occupations. They do not take into consideration the characteristics of occupations at all. A wage vector will still allocate workers to different occupations, but this time the nature of the occupation is unimportant for workers – the wage makes it possible for them to optimize their trade-off between income and time-consuming education. Here, wages are providing an important incentive function, and workers will choose different occupations only because they have different degrees of antipathy towards education, or to time lost from earning income while going to school. If we introduce an income tax, occupational choices will change: indeed, there may be considerable real effects on occupational structure if the tax is sufficiently large, and it might be that a considerable number of workers are made worse off than before. In a word, redistribution is no longer costless.

The punch line I am proposing is this: to the extent that the market is primarily a device for coordination, taxation can redistribute income without massive efficiency costs. But if the market is primarily a device for harnessing incentives, the efficiency costs of redistribution may be high. I believe that the transformation in micro-economic theory that I have described – one that views the market primarily has harnessing incentives, as opposed to coordinating – provides an important intellectual foundation for the inadvisability of interfering with markets rewards via a redistributionsist state policy.

4. Ideological strategies

If one is to mount a serious challenge to the growing inequality that concerns us all, one must have a sound intellectual foundation. Indeed, I would say that the success of the conservative tide in the United States is in large part a consequence of the successful intellectual work that the right-wing has engaged in since the mid-1970s. The right-wing took theory seriously. In the 1970s, a number of right-wing think tanks were formed: the Cato Institute, Manhattan Institute, and Heritage Foundation. The American Enterprise Institute and the Hoover Foundation had been founded earlier – in 1943 and 1919 respectively. The Mont Pelerin Society had its first American meeting in 1958, and brought Friedrich Hayek to the University of Chicago. (Incidentally, his salary at Chicago was paid for ten years by private right-wing money, and when that grant lapsed, Chicago released him.)

Right-wing foundations – Scaife, Olin, and Bradley – deliberately undertook the strategy of creating these think tanks in the 1970s to counter what they considered to be the left-wing bias of academia, in large part the consequence of the transformation of ideas of students and intellectuals during the Civil Rights Movement and Vietnam war. Their function was to create a sound conservative ideology, with the following tenets: that freedom is possible only under laissez-faire, that governments are corrupt and inefficient, and that interference with markets is always bad for economic welfare. These ideas were promulgated through the media, in many publications, and by providing expert testimony to legislators. Since the television and newspaper media are typically owned by wealthy interests, they were surely not indifferent to helping propagate these ideas. The Fox News Network is only the latest and most vulgar example of this collaboration.

While liberal, and in some cases, left-wing ideology did develop in the social sciences in the United States – with the exception of economics, where the trend has been, as I have indicated, primarily to the right – the left did not produce a public presence as formidable as the right. In particular, Ronald Reagan was a wonderful spokesman for the right, and he also performed what in hindsight was probably the critical move in demoralizing the labor movement, by firing 11,000 federally employed air traffic controllers during their 1981 strike. Strike action in the US decreased markedly after this event, and trade-union membership is now below 10% in the private sector. In contrast, Canada's union density, which was the same as that in the US in 1960, has remained at the same level, slightly above 30%. Reagan's action against the air controllers was only part of the Republican strategy of turning a blind eye to employer intimidation of unions, or of workers trying to organize unions, which has been instrumental. As unions were the main, if inadequate, schools for solidarity of the American working-class, their disappearance has left workers more vulnerable to the individualistic and anti-state, anti-tax ideology of the right.

Following my introductory list of key arguments for inequality, I think that there are three key ideas that we must address, to provide a sound intellectual basis for advocacy of a more equal society – and as you can see, I think that this intellectual task is of utmost importance. Ideas really do trickle down, even if money does not! We must argue:

First, that children should not be disadvantaged by the bad luck of being born into a poor or poorly educated family. I believe that there is considerable support for this idea in the advanced democracies – but often the *consequences* of view have not been thoroughly understood by citizens, or implemented in policy. Consider education, for example. In the United States, the average amount of state (federal, state, municipal) funding for the education of advantaged children is far greater than for disadvantaged children. A moderate liberal goal is to equalize funding for all children. But the correct policy is to invest *more* state funds in disadvantaged children than in advantaged ones, to compensate them for their family's lack of resources. To the extent that disadvantaged children are of a minority race or a minority nationality, it is more difficult to win citizens to this implementation of the requirements of equal opportunity, due to racism and anti-immigrant sentiment. Intellectually, winning this battle means confronting Nozick's libertarianism, and in particular the tenet that a person has a right to benefit from his or her good luck in the birth lottery.

A more radical view, that I also hold, is that we must extend the compensation to include genetic bad luck. There is no reason, from the ethical viewpoint, that individuals who are less mentally endowed should have poorer material conditions than the better endowed. To the extent that this occurs, it can only be excused by the necessity of incentive payments to wage earners and the infeasibility of redistribution. There is no ethical basis for it, for such a basis can only exist by advocating the right to benefit from good luck.

Secondly, we must understand the true division of labor in the market's coordination and incentive roles. I think this is, intellectually, the most difficult problem and probably the most politically important one. What I here propose is a question for research, rather than an answer. As I said earlier, I believe that the degree to which redistribution is feasible with small efficiency costs is closely related to how important material incentives are for productive activity. Although economic theory has shifted on this question during the last generation, it is far from obvious that the shift is empirically justified – by which I mean, we do not know that the market's role in incentive provision is as important as current economic theory contends.

My current view is that material incentives are important for the great majority of workers, in their role in directing educational and occupational choices, but that they are far less important for the high fliers at the top of the income and wealth distribution, and indeed for innovation. I do not mean that the high fliers and innovators do not like their huge incomes, but rather that these incomes are not socially necessary, in the sense that we would lose innovation and good corporate management without them.

Let me outline some details of my view. Many people think that the high incomes paid to corporate management, and in particular to those in the financial sector, are due to monopolistic elements – back-scratching among interlocking directorates of firms made possible by shareholder apathy, for example. I do not endorse this view; I believe it is entirely possible that the high salaries and bonuses these people receive are competitive, in the sense that each is receiving his expected marginal product as evaluated by the board that hires him. Even if this is not so, and those monopolistic elements do exist, I will make my argument under the competitive assumption, because it makes the argument stronger. In other words, I claim that *even if* CEO salaries are competitive, they are inefficient. Their existence is a market failure.

The theoretical argument for the possibility that these salaries are competitive is that, if you are the pilot of a very large ship in Arctic waters, a very small change you make in the angle of the rudder can significantly affect the probability of the ship's impact with an iceberg. If you are the CEO of a large corporation, with $10 billion in annual revenues, a very small difference in the quality of your decisions may make a 1% difference in annual revenues, which is to say a $100 million difference. If the hiring board is convinced that you are just slightly better than the next candidate, you can probably bargain for $25 million or so of your $100 million marginal product, or maybe more. Empirically, we note that the market for management of CEOs of American firms is international – much less so than the market for management of Japanese firms or even continental European firms. This is an indication that the US market is more competitive than these other markets. I suggest that the truth may be that US CEOs are receiving their marginal products and European CEOs are receiving less than their marginal products (as are, a fortiori, Japanese CEOs), due to social custom and, perhaps, popular opposition to obscenely high salaries in these societies.

But the payment of these high salaries is inefficient because, even if the expected marginal product of the incumbent CEO is $100 million greater than the next best candidate, the social costs of creating a class with such huge wealth are large. First, the institution creates a class which has great power to influence politics. Members of this class, if private campaign financing is legal, will make large contributions to political parties to maintain their privileges. Secondly, as we have seen in the financial sector, paying such huge salaries on the basis of expected marginal product can induce behavior that is far too risky from the social viewpoint. This negative externality is not internalized by the firm, because, inter alia, of the implicit insurance provided by the state against failure in the case of a bad outcome on these risky gambles. This is why the US government's allowing Lehman Bros. to go bankrupt in September 2008 so scared the financial sector, and why the government effectively reversed itself a few days later by rescuing the insurance firm AIG.

Notice that this argument differs from the one given by a financial mogul, who explained that his firm continued to engage in the risky behavior that led to the crisis by saying "As long as the music plays, we have to continue to dance." That cute explanation suggests that the big Wall Street firms were in an inefficient Nash equilibrium. My argument, in contrast, is that they may have been in an *efficient* Nash equilibrium – as long as they all failed together they would all be rescued. Thus, the behavior was efficient from the viewpoints of the players – private gains on the upside of the gamble, and socialization of losses on the downside. The fact that 2010 has been a banner year for the Wall Street banking houses indicates that they have done quite well out of the crisis, thank you.

My final argument is that the most important reward for the very high fliers is not money income, but power – power over others, and the respect of their peers. If these high salaries were taxed at very high rates, I do not think we would see a significant change in productive behavior. (One might have to make the taxation international, to prevent migration.) What other occupation could these high fliers choose which would give them the same power and respect of their peers? Will they, alternatively, be satisfied to retire and play golf or read poetry?

I have argued that these high incomes are inefficient, because of risk-taking externalities that they induce, that they are unnecessary for incentive provision, and that they create a class with disproportionate political power. Finally, there is the very important negative externality of the creation of a social ethos which worships wealth. Ordinary people lose self-esteem, and do what they can to ape the consumption behavior of the very wealthy.

In sum, the positive social value of the institution of extremely high salaries that the leaders of the corporate world, and in particular, of the financial sector, receive, is a big lie. It may well be a competitive outcome, but it is a market failure which could be corrected by regulation or legislation. In the US, at least, there are no visible prospects for such legislation, and I maintain that this is due, in no small part, to the hold of the incentive argument for inequality on the voting population.

I believe, in contrast, that incentive pay for the *working* population in general is important. The experience of China since 1979 is an example: I do not attribute the Chinese growth rate of over 8% per annum in this period entirely to the lack of coordination which existed prior to 1979 due to the absence of markets. On the other hand, I do not think that material incentives, especially in the wealthier countries, are as important as many economists insist.

We see a very large difference in relative material rewards to skilled labor across the advanced democracies – at its most extreme, between the Nordic countries and the United States – without concomitant efficiency differences. Once basic needs are met, I believe that people put substantial weight on the nature of their work. Now, European workers have chosen to work substantially less than American workers, which may well be a reaction to high taxes. But I have never heard a conservative economist argue that people should vote for low taxes, for otherwise they will choose to spend more time on family vacations.

Most of the people in this room could increase their income by changing occupations, but we do not, because we think our work is important, or we find it interesting. Cuba, apparently, produces the best physician corps in Latin America, although its doctors are not well paid. . The social provision of good education turns out to be much more important than high physician salaries in generating a supply of capable physicians. The Soviet Union had no dearth of doctors, or mathematicians, although these occupations received smaller material incomes than some skilled manual workers.

So although material incentives are important for ordinary workers, they are probably the least important for those workers who pay significant taxes in market economies – namely, those whose incomes are high, and have interesting careers. If my conjecture is correct, there would be no major impediments to substantial redistribution, on account of incentive problems.

Thirdly, I believe that we must counter the view that the state is inefficient. This is, I think, a particularly American view, so it is probably not appropriate to spend much time on it here. Let me just mention one anecdote. In November 2010, Gregory Mankiw, a conservative Harvard economist, formerly in the Bush administration, wrote a column in the business section of the *New York Time*s in which he gave this argument for keeping income taxes low. High-paid actors might make fewer films if they were more highly taxed, and economists like him might give fewer public lectures for which they are paid high fees. Thus, there would be a social loss resulting from higher taxation on high fliers. Not once in the article did Mankiw mention that, with those taxes, we could build more bridges and perhaps even high-speed rail. That’s because, in the conservative American view today, government productivity is zero.

5. Current American politics

Many people believed that the 2008 election of Barack Obama signaled a sea change in American politics, the end of the political pendulum's swing to right. Conventional political science predicted that the Republican Party would move towards the center. But the opposite happened: the Republican Party has moved to the right. At the time of the election, two-thirds of the populace supported health care reform, but by the time the bill was passed over a year later, barely one-half did. The insurance companies and the Republican Party succeeded in turning about 20% of the populace against the reform, relying principally upon two arguments: that a government-run health service was an infringement of freedom, and that for the average household costs would increase without any concomitant increase in the quality of care.

The fact that most of the claims of the opponents were lies is not the main point; rather, we must ask, why were so many vulnerable to them, and why did the Democrats, and Obama in particular, not succeed in challenging the lies more effectively?

I believe that the narrative of self-interest, which has been so carefully nurtured by the right-wing think tanks, was of key importance. The Democrats did not argue, as I believe they should have, that it was a travesty of justice that the richest country in the world left 44 million of its citizens uninsured. They did not argue that social solidarity required this legislation. Indeed, the right-wing Fox news commentator Glenn Beck, perhaps anticipating such an argument, said that when you hear someone speak of social justice, that's a code word for *socialism.* Many in the United States have come to believe that unbridled self-interest is ethically fine, in part because, via the invisible hand, it is said to have such wonderful consequences. There had been, in the original health-care reform bill, a so-called public option, federally provided insurance that would compete with private insurance. But this was dropped from the bill, because conservative Democrats did not support it. Whether this was because they were beholden to insurance companies for campaign finance, or because their constituents opposed it as creeping socialism, I am unsure. The watered-down bill eventually passed, but with *not one* Republican legislator voting for it in either the Senate or the House of Representatives.

With regard to capping salaries of the two big investment bankers, Obama said, "I know both these guys, they are savvy businessmen. I , like most of the American people, don't begrudge people's success or wealth. That is part of the free market system." My suspicion is that Obama does not believe what he said; but the fact that he said it is indicative of the American ethos which he believed he must play to. The Dodd-Frank bill, regulating the financial sector, which passed during the summer of 2010, is an inadequate instrument, which even centrists say will not prevent another financial crisis. Perhaps this was the best that Obama could do given the balance of political forces. One must recall that he appointed Lawrence Summers, architect of banking deregulation under Bill Clinton, as his economic guru – again, perhaps indicating the political power of finance in the United States at present.

In 2001, President George W. Bush enacted temporary income tax cuts, which were to expire at the end of 2010. Making these cuts temporary was evidently the most he could hope to do at that time. The Republican Party, newly empowered after the mid-term elections of November 2010, demanded to extend these cuts permanently. The Obama administration initially agreed to extend them for the bottom 98% of income earning households, but to allow the cuts to expire for households with income over $250,000 per annum. Allowing those cuts to expire would pay for the envisioned deficit in the social security fund three times over. But, in the last days of December 2010, the administration caved in, under threat that if it did not, the Republicans would refuse to extend federal unemployment insurance to those who had been unemployed more than 99 weeks. In other words, Obama, an apparently liberal president, believed that he could not make the Republicans take the blame for refusing to support the unemployed should he not give in on the absurd right-wing demand to maintain reduced taxes on the wealthy; rather, should he hold the line on taxing the wealthy, popular approval would turn against *him* for not supporting the unemployed. The lesson here is not mainly that Barack Obama is personally weak: it is, rather, what his political calculation tells us about the ideological stance of the voting population.

Franklin D. Roosevelt was a centrist governor from the state of New York, when he was elected president in 1932. But by 1936, he was saying this:

> For twelve years this Nation was afflicted with hear-nothing, see-nothing, do-nothing Government. The Nation looked to Government but the Government looked away. Nine mocking years with the golden calf and three long years of the scourge! Nine crazy years at the ticker and three long years in the breadlines! Nine mad years of mirage and three long years of despair! Powerful influences strive today to restore that kind of government with its doctrine that that Government is best which is most indifferent[1].

Those same powerful forces are at work today in the United States, but one can hardly imagine Barack Obama speaking as FDR did. Those powerful forces have become even more so in the past thirty years. In the period 1977-2007, 57% of the economic growth of the United States went to the richest 1% of households: in after – tax accounts, over 40% went to these households. It is this massive increase in inequality which lies behind the right-wing movement in American politics today – abetted by racism which has enraged a segment of the white population with the election of a black president. The Tea Party movement, despite its popular and mass nature, has been financed by big right-wing money. It is hard to say whether it will be a flash in the pan, but its present existence is

1 Speech at Madison Square Garden, October 31, 1936.

indicative of the social ethos. That a political party which openly supports the economic interests of the wealthiest 2% of the population, against those of the great majority, can nevertheless garner the support of approximately one-half of the voters is the sign of a dangerous situation.

6. What can we do?

My view, too, was that the Republican Party, after its defeat in the 2008 election, would gravitate towards the center. This, after all, is the logic of political competition in normal times. Evidently, these are not normal times. The conjunction of a right-wing, anti-tax, individualistic ethos, a hugely enriched class at the top of wealth distribution, an economic crisis, and a black president in a country where the racism from slave times, although much reduced, still exists, has brought about an abnormal dynamic. If we continue on this trajectory, there will be inadequate state financing to improve the deteriorating American educational system, and to rebuild our crumbling infrastructure. The real incomes of the majority of households will continue to decline, and the American social fabric will become even more frayed. The US will compete, less and less effectively, with China and the other developing nations who are replacing it as the manufacturing center. American xenophobia will increase, and international tensions will rise. The world will fail to address global warming, because the American right-wing has convinced many that the threat is a hoax; their motive for doing so, I conjecture, is that addressing the problem would require state intervention, which they abhor.

Most social scientists who study inequality have focused upon measuring its degree, and studying the micro mechanisms through which it is produced. Micro mechanisms include a substantial variety of processes: how tax policy contributes to the distribution of wealth, how the intergenerational transmission of income and wealth occur, what role education plays or could play in modifying the distribution of income, how neighborhoods and social networks affect behavior and choices which have an impact on distribution.

Of course we must understand these processes. But in a sense, I think understanding them is of secondary importance, with regard to the massively important phenomenon of increasing inequality in the advanced democracies. I believe that *democracy works* in the advanced countries, in the sense that policies can only survive if they are approved by the majority (or a substantial fraction) of the electorate. Now the electorate may have poor information, or may have learned an ideology which does not serve its true interests, or may subscribe to a social ethos which prizes a kind of *de jure* individual freedom over a secure livelihood, but in the end, the electorate must acquiesce to social policy in our advanced democracies. This is surely one great accomplishment of the political revolutions that began in 1776 and 1789.

Today, I think the most important problem for the social science of inequality is understanding how electorates have come to acquiesce to policies which increase inequality, and to try and reverse this acquiescence. To an extent, revealing the logic of the micro mechanisms is one strategy for doing so. A second strategy is the philosophical one, of arguing that justice requires equality – the last 40 years in political philosophy have seen a lively debate about exactly what kind of, and how much of that kind of equality, is required. A third strategy is showing how the inequality-increasing policies that electorates have agreed to have been aggressively advocated and proselytized by the wealthy, in order to maintain their material privileges. This work is mainly done by historians and some political scientists. A fourth strategy is critiquing the social ethos of individualism and greed which has grown immensely since the second world war: the ethos to replace it is one of solidarity. This strategy overlaps with the third one, since (I believe) the nurturing of the individualistic ethos has been a conscious strategy of the wealthy, and perhaps its most powerful weapon. Finally, I believe, as I have said, that we must do the research to challenge the view that interfering with the incentives the market provides necessarily reduces economic welfare.

Of course, this list is incomplete. I hope others add to it. We must become more imaginative academic entrepreneurs. We must not be afraid of being old-fashioned, when we advocate a solidaristic world view. It has become fashionable to say the Enlightenment is dead, and that social democracy is passé. I militantly oppose these claims. The Enlightenment provided the theoretical basis for political democracy and the importance of science, and social democracy is the one great success of the solidaristic ethos which has survived the twentieth century into the twenty first. As the fine, recently deceased historian Tony Judt wrote, to the extent that we forget this heritage, ill fares the land.

We, a gathering of those most concerned with inequality in academia today, are facing a situation where we must move from describing the phenomenon we study, to figuring out how to bring evidence to bear against the ideology which foments it. That ideology has created a monster, capable of inflicting truly disastrous consequences on civilization. Because theory and ideas are our métier, we have a vital role to play.

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Information on the GINI project

Aims

The core objective of GINI is to deliver important new answers to questions of great interest to European societies: What are the social, cultural and political impacts that increasing inequalities in income, wealth and education may have? For the answers, GINI combines an interdisciplinary analysis that draws on economics, sociology, political science and health studies, with improved methodologies, uniform measurement, wide country coverage, a clear policy dimension and broad dissemination.

Methodologically, GINI aims to:

- exploit differences between and within 29 countries in inequality levels and trends for understanding the impacts and teasing out implications for policy and institutions,
- elaborate on the effects of both individual distributional positions and aggregate inequalities, and
- allow for feedback from impacts to inequality in a two-way causality approach.

The project operates in a framework of policy-oriented debate and international comparisons across all EU countries (except Cyprus and Malta), the USA, Japan, Canada and Australia.

Inequality Impacts and Analysis

Social impacts of inequality include educational access and achievement, individual employment opportunities and labour market behaviour, household joblessness, living standards and deprivation, family and household formation/breakdown, housing and intergenerational social mobility, individual health and life expectancy, and social cohesion versus polarisation. Underlying long-term trends, the economic cycle and the current financial and economic crisis will be incorporated. Politico-cultural impacts investigated are: Do increasing income/educational inequalities widen cultural and political ‘distances’, alienating people from politics, globalisation and European integration? Do they affect individuals’ participation and general social trust? Is acceptance of inequality and policies of redistribution affected by inequality itself? What effects do political systems (coalitions/winner-takes-all) have? Finally, it focuses on costs and benefi ts of policies limiting income inequality and its efficiency for mitigating other inequalities (health, housing, education and opportunity), and addresses the question what contributions policy making itself may have made to the growth of inequalities.

Support and Activities

The project receives EU research support to the amount of Euro 2.7 million. The work will result in four main reports and a final report, some 70 discussion papers and 29 country reports. The start of the project is 1 February 2010 for a three-year period. Detailed information can be found on the website.

www.gini-research.org

GINI GROWING INEQUALITIES’ IMPACTS

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