UNC SCHOOL OF LAW

NORTH CAROLINA BANKING INSTITUTE

Volume 18 | Issue 1 Article 8

2013

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INCOME INEQUALITY: PANEL ON FINANCIALIZATION, ECONOMIC OPPORTUNITY, AND THE FUTURE OF AMERICAN DEMOCRACY

BY TIMOTHY NOAH

Author Timothy Noah argues that income inequality is increasing in the United States. Noah explores the causes of this trend and examines how income distribution has changed throughout the twentieth and twenty-first centuries. He then compares income inequality in the United States with income distribution in comparable industrialized democracies. Finally, Noah considers income inequality's potential effects on the national economy.

I should start by saying I am not an academic, I am not a lawyer, I am not a sociologist of any kind; I am a journalist. My book, *The Great Divergence: America's Growing Inequality Crisis and What We Can Do About It*, is an attempt to bridge the gap between the general public and the very good work that academics have done on the question of why income inequality has been increasing over the last thirty-three years.[1] There are two types of income inequality that have occurred since 1979. One trend is a growing divergence between skilled labor and unskilled labor, or moderately skilled labor. This is sometimes called "broad-based inequality" or "quintile-based inequality." The other, simultaneous, trend is famously known as the one percent versus the ninety-nine percent, which is to say the affluent and the rich versus everybody else. By both measures inequality shrank for much of the twentieth century, from the early 1930s to the late 1970s. This rebuts any notion that income inequality or growing income inequality is somehow inherent to capitalism. Inequality began growing, for the first time in nearly half a century, in the late 1970s.

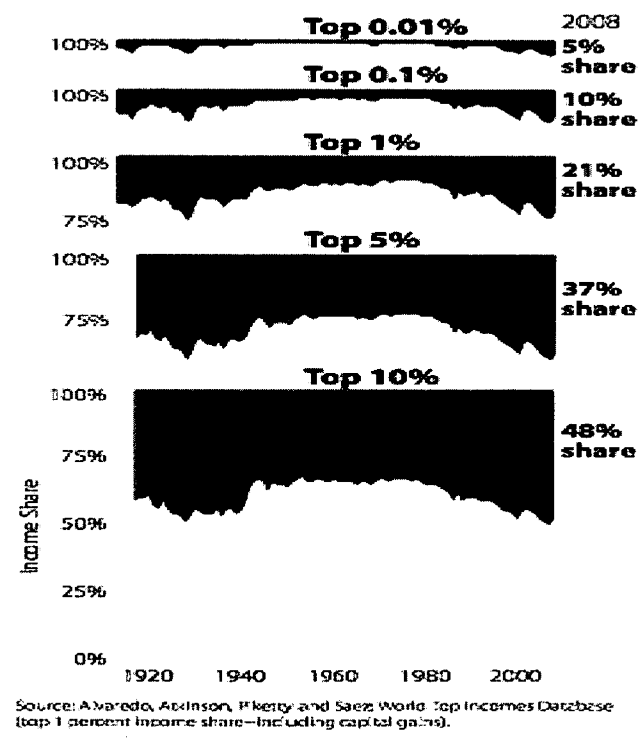
These two types of income inequality are not necessarily linked. Broad-based inequality has multiple causes. I am not going to discuss

1. TIMOTHY NOAH, THE GREAT DIVERGENCE: AMERICA'S GROWING INEQUALITY CRISIS AND WHAT WE CAN DO ABOUT IT (2012).

that much because I don't think it has much to do with the financialization of the United States economy, the theme of this panel.[2] The one-percent-versus-the-ninety-nine-percent type of inequality *is* linked to financialization and that will be my focus.

There is one significant way in which these two trends are linked and that is in the shrinkage of wages as a portion of GDP, which is now at a fifty-year low. There are lots of different ways to measure this, but the most credible studies suggest that we are seeing a shift in allocation of GDP from labor to capital. There are some pretty obvious reasons why that should occur that I will discuss later.

Income Share for the Top 10%, 5%, 1%, 0.1% and 0.01%



Source: Alvaredo, Atkinson, Piketty and Saez World Top Incomes Database (top 1 percent income share—including capital gains).

2. Donald Tomaskovic-Devey & Ken-Hou Lin, *Financialization: Causes, Inequality Consquences, and Policy Implications*, 18 N.C. Banking Inst. 167 (2013).

We see that over the last 100 years or so the income share for the top one percent shrank until the late 1970s, and then expanded. As of 2008, we had eighteen percent income share for the top one percent, which is twice what it was in the late 1970s. Note also the period from the 1930's through 1970's, which is known as the "Great Compression" (a term that Harvard University economist Claudia Goldin has applied to this period because incomes were compressing). That compression occurred during the Depression and World War II, which is perhaps not that surprising. But it continued during the post-war boom, which *is* surprising. Starting around 1979 we see that the top one percent started to regain income share, and that its share expanded and expanded.

There is a whole school of thought that says we should not think of the post-war U.S. economy as representative of anything because Europe was in rubble. That is not a very good argument because Europe did not stay in rubble for very long. We had the Marshall plan and we had the West German economic miracle, which really was miraculous, as Chart 1 demonstrates. By the 1960s, the West German GDP per capita was more than seventy percent of U.S. GDP per capita.[3]

Recessions are bad for rich people, and during the Great Recession of 2007-2009 we heard some people argue, "Why are we giving so much time and attention to income inequality? The problem is obviously solved because income share for the top one percent is going down." It's true that income share for the top one percent did go down from 2007 to 2009, and it went down more rapidly for the one percent than it did for everyone else. But please note that this sudden trend toward greater income *equality* did not outlast the recession. During the first two years of the current economic recovery, 2009 to 2011, the top one percent rebounded and the bottom ninety-nine percent did not. A shocking statistic you may have heard is that through 2010 the top one percent captured ninety-three percent of the economic recovery.[4] If you extend that timeline through 2011 you find that the top one percent captured *121 percent* of the recovery, which is to say that the top one

3. Paul Krugman, *The Europe-in-Rubble Excuse*, THE CONSCIENCE OF A LIBERAL, N.Y. TIMES Blog (November 19, 2012, 8:56 AM), http://krugman.blogs.nytimes.com/2012/11/19/the-europe-in-rubble-excuse/?_r=1.

4. Emmanuel Saez and Thomas Piketty just updated their findings and now they include 2012 preliminary estimates. *See* Emmanuel Saez, Striking it Richer: The Evolution of Top Incomes in the United States (September 3, 2013), *available at* http://elsa.berkeley.edu/~saez/saez-UStopincomes-2012.pdf.

percent recovered while the bottom ninety-nine percent of the population saw its income share shrink, which is really remarkable. So, clearly we have in effect two different economies for these two different groups.

The period since 2000 has, in the United States, been bad for both kinds of inequality—the broad-based kind and the one-percent kind. The Gini index, which is the main measure of broad-based inequality,[5] has increased every year except for 2002 and 2007. In 2011, which is the most recent year for which we have data, the increase was the biggest single-year rise that we had seen in two decades. Median income is down almost nine percent since 2000. Some will quibble that the calculation is based on pre-tax, pre-benefit dollars, and that when you figure in government redistribution through taxes and benefits things don't look as bad. But in fact, if you throw in taxes and benefits, median income has basically been flat during this period, which is certainly nothing to write home about.

In general, broad-based inequality grew in the 1980s, eased in the late 1990s during the tech boom, and started growing again in the 2000s. You often hear people congratulate Bill Clinton for presiding over the only period since 1979 when we saw a reduction in income inequality, and he does deserve some credit for that. But if he gets a pat on the back for that he should also get some blame for a stupendous rise in the one percent's income share during that same period. Remember, when you are talking about the growth in income inequality, you are talking about two distinct trends, and they do not always track each other.

Income inequality is without a doubt a global phenomenon, but it is worse in the United States than it is in comparable nations. That is especially true by the measure of the one percent versus the ninety-nine percent, which puts us dead last (or first, depending on how you look at it). Even though income inequality is a global trend, I think it is important to point out that it is not a universal trend. There are a number of reasonably advanced industrial democracies around the world where incomes have grown more equal. That has been especially true in Latin America, which for many years was the international poster child for income inequality. Today, Latin America is moving in the right

5. Gini doesn't really do a very good job of measuring the 1 percent versus the 99 percent.

direction even as we are moving in the wrong direction. Other countries where we are seeing growing income equality are Turkey, Greece (which I suppose is not a great example of anything right now), Chile, and Italy. In my book I include France in that list because the data at the time I wrote my book showed that France had also seen an increase in income equality. But a more recent study shows that inequality has lately increased a bit, so now the best one can say is that there is really no significant long-term net change for France. That is also true in Hungary and Belgium. Income inequality is not something that is destined to happen everywhere.

One argument people make about income inequality is that we do not really need to worry about it because we have so much intergenerational income mobility in the United States. My answer is that even if that were true, we would still have to worry about those left behind. But in fact it is not true. We do not have very good intergenerational mobility compared to other nations.[6] This has really changed in the United States, and I think people have started to recognize that. It became an issue in the 2012 primary race. Rick Santorum talked it up a lot. Santorum tried to blame it on Barack Obama, but that isn't fair, because America's slowdown in intergenerational mobility long precedes his presidency.

Alan Krueger, who until recently was chairman of the White House Council of Economic Advisers charted something he called the Great Gatsby curve drawing on research from a Canadian economist named Miles Corak.[7] The chart suggests that the more income inequality you have, the less mobility you're going to have. Another way of putting it is that the more income inequality you have, the more "heritable" income becomes, meaning you increase the likelihood that people will end up occupying the same position in the income distribution that their parents occupied. This is not definitive. The work on this is somewhat tentative, but it certainly is logical to suspect that income inequality would inhibit mobility because, as Isabel Sawhill of

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6. *See* Jason Long & Joseph Ferrie, *A Tale of Two Labor Markets: Intergenerational Occupational Mobility in Britain and the U.S. Since 1850*, 103 AM. ECON. REV. 1109 (2013).

7. *See* Miles Corak, *How to Slide Down the 'Great Gatsby Curve,' Inequality, Life Chances, and Public Policy in the United States*, CTR. FOR AM. PROG. (Dec. 2012), *available at* http://www.americanprogress.org/wp-content/uploads/2012/12/CorakMiddleClass.pdf.

the Brookings Institution has said,[8] and President Obama has repeated, "as the rungs of the ladder grow farther apart, the ladder gets harder to climb."[9]

Part of this story is the death of labor unions. That narrative is mostly a subplot of the broad-based inequality story, but it also figures in the rise of the one percent at the expense of the ninety-nine percent, because the portion of GDP dedicated to labor has, over time, shrunk relative to the portion dedicated to capital. An obvious explanation why is that union density within the private sector has been shrinking since the 1950s. It peaked in 1954 at about forty percent. Today it is at seven percent, which is the same level it stood at in 1933. A sentence I wrote in my book that I could have written at several points, particularly with respect to financial regulation, is, "It's as if the New Deal never happened."[10] That's certainly true with respect to the condition of unions today. This is the part of my book that is hardest for audiences to get interested in. What I say is: Look, if you're not interested in trying to figure out a way to save labor, then you should not be interested in income inequality. Take up chess or something, because you are not going to fix income inequality unless you can reverse labor's decline.

The other trend we have seen in recent years is the growing power of capital, which is what this panel is about. The two drivers of income growth for the top one percent have been the seemingly uncontrollable rise in compensation for high-ranking nonfinancial corporate executives and the growth of the deregulated financial sector. Executive compensation soared out of control due to stock-option compensation that is often unrelated to company performance. Not to beat up too much on Bill Clinton, but he has to take it on the chin for this too because he, with the best of intentions, limited the deductibility of CEO pay at a ceiling of one million dollars. Nell Minow, a corporate watchdog, told me that two things happened as a result. First, every CEO got a raise to one million dollars. Second, everyone started getting paid more and more in stock options, which for a long time were off the

8. *See* Isabel Sawhill, CENTER ON CHILDREN AND FAMILIES AT BROOKINGS, CCF BRIEF #48: ARE WE HEADED TOWARD A PERMANENTLY DIVIDED SOCIETY? (Mar. 2012), http://www.brookings.edu/~/media/research/files/papers/2012/3/30%20divided%20society%20sawhill/0330_divided_society_sawhill.

9. President Barack Obama, Remarks by the President on the Economy at Knox College, Galesburg, Illinois (July 24, 2013).

10. NOAH, *supra* note 1.

books, because corporations took the preposterous position that since they didn't know what the options were going to be worth when exercised, they couldn't value them at all. Since stock options were not on the books, they could be granted with impunity, and that is when things really went out of control.[11]

The other driver of income growth, the explosive growth of the deregulated financial sector, is what this conference is all about. A very good 2011 study looked at the question, "Who are the 0.1 percent?"

Table 3 – Percentage of primary taxpayers in top 0.1 percent of the distribution of income (excluding capital gains) that are in each occupation

	1979	1993	1997	1999	2001	2002	2003	2004	2005
Executives, managers, supervisors (non-finance)	48.1	45.7	48.4	47.1	42.6	40.6	40.5	40.9	42.5
Financial professions, including management	11.0	14.1	14.7	16.4	19.1	19.0	17.8	18.7	18.0
Lawyers	7.3	6.5	6.3	5.9	7.1	8.2	8.8	8.0	7.3
Medical	7.9	13.3	6.8	4.4	5.2	6.8	7.6	6.3	5.9
Not working or deceased	5.4	2.5	3.5	3.8	4.0	3.7	3.7	3.8	3.8
Real estate	1.8	1.3	1.8	2.1	2.5	2.9	3.0	3.3	3.7
Entrepreneur not elsewhere classified	3.9	3.0	2.8	2.7	2.8	2.9	3.2	3.0	3.0
Arts, media, sports	2.2	3.3	3.5	3.5	3.3	3.6	3.4	3.3	3.0
Business operations (nonfinance)	1.5	1.7	2.3	2.2	2.7	2.7	2.2	2.7	2.9
Computer, math, engineering, technical (nonfinance)	2.3	2.3	3.1	4.7	4.0	3.0	3.1	3.0	2.9
Other known occupation	2.9	2.1	2.2	2.6	2.5	2.5	2.4	2.5	2.7
Skilled sales (except finance or real estate)	2.2	2.9	2.9	2.6	2.4	2.3	2.3	2.3	2.3
Professors and scientists	0.8	0.8	0.7	0.8	0.9	0.9	0.9	0.9	0.9
Farmers & ranchers	1.4	0.2	0.5	0.5	0.5	0.5	0.5	0.5	0.6
Unknown	1.4	0.5	0.5	0.9	0.7	0.6	0.8	0.7	0.5

More than the one percent, it is really the 0.1 percent who are driving the increase in income share for people at the top. The majority of the 0.1 percent turned out to be either executives in the non-financial sector or financial professionals. If you go back to 1979 you see that forty-eight percent of this 0.1 percent were executives of nonfinancial companies. It's essentially the same today; nonfinancial executives' representation within the top 0.1 percent slipped only a little bit down to 42.5% as of 2005. The really striking change has occurred within the second biggest group, which is people working in the financial sector. They represented eleven percent of the top 0.1 percent back in 1979. Today they represent eighteen percent. While executives in nonfinancial companies have maintained their strong presence within this super-elite club, financial professionals have greatly increased their presence. The rest of the 0.1 percent includes lawyers, doctors, and people in real

11. *See* Frank Partnoy, INFECTIOUS GREED: HOW DECEIT AND RISK CORRUPTED THE FINANCIAL MARKETS 213-16 (2003); *see also* Kevin J. Murphy, *Explaining Executive Compensation: Managerial Power Versus the Perceived Cost of Stock Options*, 69 U. CHI. L. REV. 847 (2002).

estate. You hear a lot about the winner-take-all syndrome—the dramatic, technology-driven scaling up of the potential customer base for certain people occupying the very top of their professions—a phenomenon that mostly applies to the worlds of entertainment and sports. But the entertainment and sports professions are not a major contributor to income inequality. Yes, there are individuals who reap huge financial gains from their dominance in entertainment and sports, but there just are not that many of them. Arts, media, and sports represent only two percent of the 0.1 percent. The people you really want to keep your eye on are the financial professionals.