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How to Think about Inequality

Peter Wehner and Robert P. Beschel, Jr.

The issue of income inequality has never before been central to American politics. Though concern for the poor, disputes over welfare programs, and complaints about "the rich" have of course featured prominently in our public debates, Americans have generally avoided open class warfare, to the nation's great credit and benefit. But in the 2012 presidential election—one of the most consequential contests in decades—the divide between rich and poor in America promises to be a focal point.

This unusual emphasis on inequality is partly the doing of President Obama, who seems to believe that stoking class resentments is his best ticket to re-election. In a much-discussed speech in Osawatomie, Kansas, in December 2011, Obama argued that income inequality "distorts our democracy." He said that "breathtaking greed" had contributed to America's economic troubles and that this was a "make-or-break moment for the middle class." The president insisted that the kind of "gaping inequality" we are experiencing "gives lie to the promise that's at the very heart of America: that this is a place where you can make it if you try."

Extending the theme to his 2012 State of the Union address, Obama presented the "defining issue of our time" as a choice: "restore an economy where everyone gets a fair shot, everyone does their fair share, and everyone plays by the same set of rules," or "settle for a country where a shrinking number of people do really well while a growing number of Americans barely get by." The *Washington Post* understood the

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president's message exactly, and summarized it in the next morning's front-page headline: "Obama: Nation must address inequality."

Liberal commentators have added their voices to the inequality chorus. Paul Krugman of the *New York Times* has written that income inequality puts "the whole nature of our society" at risk; "extreme concentration of income," he argues, "is incompatible with real democracy." Bloomberg columnist Jonathan Alter insists that "[t]he collapse of the American middle class and the huge transfer of wealth to the already wealthy is the biggest domestic story of our time." And the *Washington Post*'s E.J. Dionne, Jr., has declared that the recent unleashing of "egalitarian sentiments" is a response to the "injustices of our time."

Then there is Occupy Wall Street, the protest movement that began in New York's Zuccotti Park but spread quickly to cities across America. To the extent that the political agenda of OWS was discernible, it targeted what its adherents view as rapacious capitalism and income inequality. The movement's political slogan — "We are the 99%," referring to the concentration of wealth among the top 1% of income earners — has spread swiftly among the public. Paul Taylor, executive vice president of the Pew Research Center, has said the slogan is "arguably the most successful" since the Vietnam era's "Hell no, we won't go."

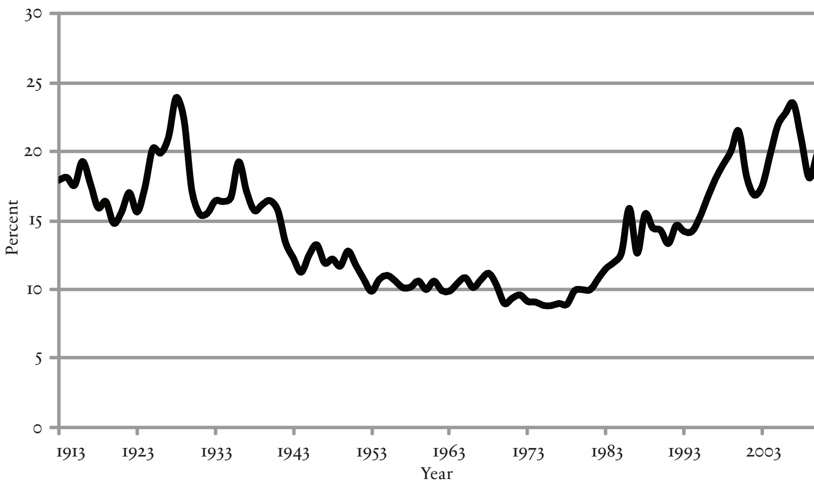
Whether conservatives like it or not, income inequality is now a pressing issue in American politics — one that must be confronted, and soon. Part of that effort will require combating prevalent misperceptions about inequality with facts — about the true extent of income gaps in America, and about the overall levels of prosperity enjoyed by our citizens. This effort will also require highlighting the injustice of the left's suggested remedies for income inequality, and the degree to which those proposals represent a radical departure from America's ideals and traditions. Most important, conservatives will need to offer solutions to the genuine problems obscured by the fuss over inequality — namely, low social mobility and the real plight of the nation's poor.

THE STATE OF INCOME INEQUALITY IN AMERICA

Income inequality in America has historically fluctuated, and, in recent years, the divide between rich and poor seems to have grown. The chart on the next page, compiled by Emmanuel Saez of the University of California, Berkeley, and Thomas Piketty of the Paris School of Economics, traces the share of total national income held by Americans

in the top 1% of income earners since 1913 — a reasonable (if unavoidably imperfect) measure of wealth concentration. In the early part of the 20th century, the gap in wealth and income was large, especially just before the Great Depression. By the 1930s, however, income disparity began to decrease, a trend that dramatically accelerated in the 1940s. By the 1950s, the United States had entered a period that economic historians Claudia Goldin and Robert Margo call the "Great Compression": a stretch during which the distribution of wealth between the middle class and the rich was relatively small. By the late 1970s, though, this era had come to an end; income inequality began to rise, and the nation entered a period that some economists have dubbed the "Great Divergence."

PERCENTAGE OF NATIONAL INCOME HELD BY THE TOP 1% OF EARNERS, 1913-2010



SOURCE: Emmanuel Saez and Thomas Piketty, "Income Inequality in the United States," *Quarterly Journal of Economics*, 118(1), 2003, 1-39. Data updated by the authors in March 2012. Income earners are defined by pre-tax income, including capital gains.

Just how great was this rise in income inequality? According to a 2011 report by the Congressional Budget Office, between 1979 and 2007, after-tax income for the highest-income households grew more than it did for any other group. The CBO found that income grew by 275% for the top 1% of households, by 65% for the next 19%, by just under 40% for the next 60%, and by 18% for the bottom 20%. (The CBO examined the span from 1979 to 2007 because those end points — both years before recessions — allowed for comparisons between periods of similar overall economic activity.)

A closer look reveals that almost two-thirds of the rising share of the top percentile in income went to the top 0.1%, who saw their real incomes rise more than 400% from 1979 to 2005. Between 1974 and 2007, the share of pre-tax income earned by the richest 0.01% of households went from less than 1% of national income to more than 6%. All told, between 1980 and 2005, more than 80% of the total increase in income went to the top 1% of American households.

These numbers indicate increasing income inequality, but they hardly offer a complete picture. For one thing, income inequality has increased in almost every nation in Europe, too; the trend, while more pronounced in America, is thus hardly confined to our shores. It is also important to note that, in the periods examined, individual households did not remain fixed in the income distribution. As the CBO explains, its study

> does not reflect the experience of particular households. Individual households may have moved up or down the income scale if their income rose or fell more than the average for their initial group. Thus, the population with income in the lowest 20 percent in 2007 was not necessarily the same as the population in that category in 1979.

In other words, there is a significant amount of movement, or income mobility, across income quintiles. The CBO study examined the differences between the rich and poor in 1979 and the rich and poor in 2007, but not whether people who were rich or poor in 1979 remained so in 2007. In fact, many people do not remain in the same portion of the income distribution over time: About half of those in the bottom income quintile in 1996, for instance, had moved to a higher income group by 2005, while some 30% of taxpayers in the top income quintile in 1996 had fallen to a lower quintile by 2005.

To complicate the picture even more, George Mason University economist Tyler Cowen argues that, while income inequality is rising, inequality of personal well-being is dropping. "In terms of immediate political stability," he writes, "there is less to the income inequality issue than meets the eye." Cowen explains:

> [T]he inequality of personal well-being is sharply *down* over the past hundred years and perhaps over the past twenty years as well.

> Bill Gates is much, much richer than I am, yet it is not obvious that he is much happier if, indeed, he is happier at all. I have access to penicillin, air travel, good cheap food, the Internet and virtually all of the technical innovations that Gates does. Like the vast majority of Americans, I have access to some important new pharmaceuticals, such as statins to protect against heart disease. To be sure, Gates receives the very best care from the world's top doctors, but our health outcomes are in the same ballpark. I don't have a private jet or take luxury vacations, and — I think it is fair to say — my house is much smaller than his. I can't meet with the world's elite on demand. Still, by broad historical standards, what I share with Bill Gates is far more significant than what I don't share with him.

Empirical evidence supports Cowen's anecdotal observations. Last year, the University of Chicago's Bruce Meyer and Notre Dame's James Sullivan reported that, between 1980 and 2009, "median income and consumption both rose by more than 50 percent in real terms.... Our results provide strong evidence that the well-being of the middle class and the poor has improved considerably over the past thirty years."

Furthermore, any examination of income inequality in America must take account of taxation, which has a significant leveling effect. Indeed, as those in the top 1% have seen a sharp rise in their wealth, they have also paid an increasing share of the nation's taxes. According to CBO, the top 1% of earners now pay 40% of all federal taxes, compared to less than 20% in the 1970s. Today, according to research by the OECD, income taxes in America are the most progressive among the rich nations of the world; as the *Wall Street Journal*'s Stephen Moore observed in February, the "richest 10% of Americans shoulder a higher share of their country's income-tax burden than do the richest 10% in every other industrialized nation, including socialist Sweden."

These mitigating facts are crucial to remember when talking about income inequality. Even so, they are not enough to explain away what is clearly a growing divide between the nation's rich and poor. To fully understand what is driving this trend, we must examine both timeless facts about human achievement and new developments that are rapidly changing the nature of the American economy.

THE ROOTS OF INCOME INEQUALITY

Several causes give rise to income inequality, beginning with the human condition itself. No two people possess the same talent, the same drive, the same life experience, or the same form of intelligence. Because gifts, talents, and skills are unevenly distributed, so is income.

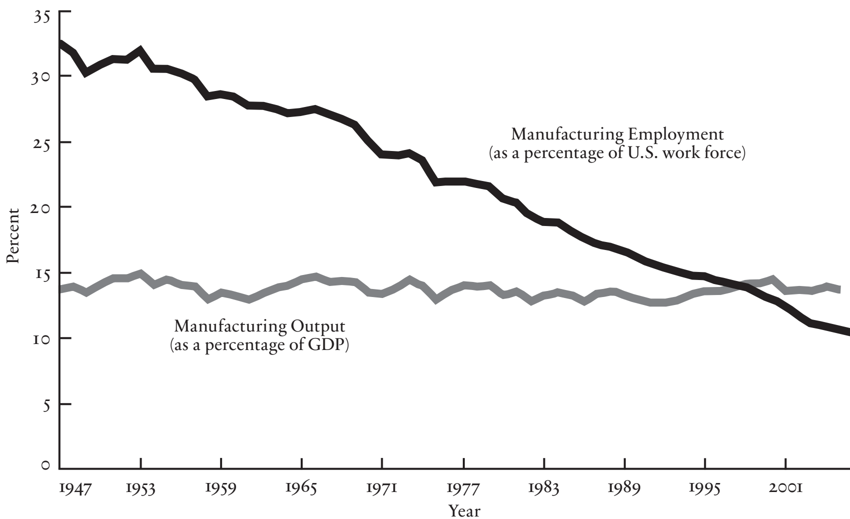
This connection between differences in skill and talent and differences in income has only strengthened in modern times, as advances in technology have moved us toward an economy that favors skilled over unskilled labor, with an unprecedented premium put on "brain over brawn." Writing earlier this year in *Foreign Affairs*, Stanford's Francis Fukuyama explained:

> [T]he real villain [in fueling inequality] is technology. In earlier phases of industrialization—the ages of textiles, coal, steel, and the internal combustion engine—the benefits of technological changes almost always flowed down in significant ways to the rest of society in terms of employment. But this is not a law of nature. We are today living in what the scholar Shoshana Zuboff has labeled "the age of the smart machine," in which technology is increasingly able to substitute for more and higher human functions. Every great advance for Silicon Valley likely means a loss of low-skill jobs elsewhere in the economy, a trend that is unlikely to end anytime soon.

Evidence to support Fukuyama's claim—that the modern economy works to the disadvantage of the low-skilled—abounds. For example, consider the effects of a few key changes in the past half-century: tremendous advances in communications technology and the rapidly declining costs of air travel, shipping, and international phone and data lines. When combined with the reduction in trade barriers, these developments have led to a massive expansion in the interconnection between America's economy and those of the rest of the world. This increased integration has, in turn, led to a large increase in a variety of corporate practices—outsourcing, near-shoring, off-shoring, multi-sourcing, and the like—that have taken advantage of cheaper foreign labor. The losers have been those on the bottom rungs of the American economy, who have watched jobs that a few decades ago might have sustained decent lifestyles in America vanish as their functions are moved overseas.

Another innovation that has come at the expense of low-skilled workers is the increased automation of production lines, which allows for efficiency increases that enable greater production with fewer manufacturing workers. It is often said that the American manufacturing sector is in decline, but in fact manufacturing is declining in terms of employment, not in terms of output or its share of the economy. As the chart below demonstrates, the increasing efficiency of American manufacturing has come at the expense of lower-skilled workers.

REAL MANUFACTURING OUTPUT AND EMPLOYMENT



Source: Bureau of Economic Analysis; Bureau of Labor Statistics.

Then there's the matter of the influx to America of low-skilled immigrants, mostly from Mexico — a trend that some economists (like Harvard University's George Borjas) argue has had a detrimental effect on the wages and job opportunities of low-skilled American workers. Exactly how detrimental is hard to pinpoint; other economists (like David Card of the University of California, Berkeley) contend that the influx of immigrants creates new jobs (by increasing the demand for goods and services) at nearly the rate at which immigrants take up jobs that would otherwise go to Americans. There is no question, however, that the increased labor-market competition resulting from recent mass immigration puts downward pressure on wages for Americans

with lower levels of education and skills, even as it reduces the cost of living for Americans higher up the income distribution.

These dynamics have resulted in what some commentators refer to as the "hollowing out" of the middle class, especially the lower middle class. At the high end of the economy, those with professional, technical, or managerial skills that allow them to compete at a global level have done well. Low-end service occupations that cannot be readily outsourced or made redundant through technology—such as cleaning, personal care, and food preparation—have seen job numbers remain relatively steady as well (though wage growth in these industries has generally been stagnant). But workers in between—those suited for middle-skilled white- and blue-collar jobs—have been hit hard. Indeed, as Don Peck of the *Atlantic* has noted, in the first two years of the Great Recession, almost one out of every 12 white-collar jobs in sales, administrative support, and non-managerial office work vanished; one of every six blue-collar jobs in production, craft, repair, and machine operation did the same.

Other factors have contributed to income inequality as well, including new competitive forces in society that allow people at the top of their professions to reap vastly greater gains than they would have 50 or 100 years ago. In their 1995 book *The Winner-Take-All Society*, economists Robert Frank and Philip Cook argue that certain markets are defined by two major characteristics: reward by relative (rather than absolute) performance, and concentration of rewards in the hands of a few top performers.

Professional baseball is a prime example. For most of the game's history, salaries were a simple multiple of the national median family income. In 1950, the median family income in America was $3,319 a year, while the average Major League Baseball player's salary was around four times that amount: $13,228. But by 2010, after the explosion of television revenues and the growth of free agency, the average major-league player was bringing home $3.3 million a year—nearly 67 times the median family income (just under $50,000). And, as Frank and Cook observe, these increases have accrued only to those at the top of the profession: In 2010, the maximum salary for a first-year player in the minors was just $850 per month.

Not many Americans are professional ballplayers, to be sure. But the winner-take-all model has come to dominate a number of other professional sectors, most conspicuously art, acting, music, the legal profession, and corporate management. In the last case, the winner-take-all approach can be observed in changes to compensation packages, which

have come to rely more heavily upon incentive pay in the form of bonuses and stock options. The effect on executive compensation has been dramatic: During the 1970s, for instance, CEOs were paid around 30 times the rate of the average worker; in 2010, according to calculations by the Economic Policy Institute, the CEO-pay figure was estimated to be around 243 times the average wage.

Societal changes, too, have had an effect on inequality. According to the late political scientist James Q. Wilson, the work-force participation rate of women has roughly doubled since the mid-point of the 20th century, with women placed in well-paid jobs at comparable rates to men since the early 1980s. This means that married-couple households are increasingly dual-earner households. As a result, married-couple households — which declined from almost two-thirds of all households in the mid-1970s to one-half of all households in 2006 — have much higher incomes than do other household types (and inequality is generally measured by the household, not by the individual earner).

This trend is exacerbated by the fact that there is increasingly a divide along lines of education and income separating Americans who marry from those who do not. According to a report released last December by the Pew Research Center, 64% of adults with college degrees are married, compared to 47% of those with a high-school education or less. Pew compares these figures to those from 1960, when, the report says, "the most educated and least educated adults were about equally likely to be married."

Moreover, as the Brookings Institution's Isabel Sawhill notes, it is not only that Americans with higher educational attainment are far more likely to marry and less prone to divorce: They are far more likely to marry each other. "Men used to marry their secretaries," Sawhill observes. "Now they marry the woman they met in med school." As a result, stable two-income professional families are increasingly occupying one end of the economic spectrum, while at the other, single parents are struggling to provide. As Sawhill notes, in America today, two-parent families are "making out like bandits."

Evidence suggests that this divide is self-perpetuating, in large part because of a widening education gap between rich and poor. Education has rightly been seen as the most reliable and durable equalizer when it comes to achieving success — financial and otherwise — in our society. But according to Stanford University sociologist Sean Reardon, the

achievement gap between children from high-income families (defined as children from families at the 90th percentile of income distribution) and children of low-income families (defined as children from families at the tenth percentile of income distribution) is roughly 30% to 40% larger among children born in 2001 than among those born 25 years earlier. And as Susan Dynarski and Martha Bailey found in a University of Michigan study, college-graduation rates, too, increasingly vary by income. According to a *New York Times* report on the findings, the study

> looked at two generations of students, those born from 1961 to 1964 and those born from 1979 to 1982. By 1989, about one-third of the high-income students in the first generation had finished college; by 2007, more than half of the second generation had done so. By contrast, only 9 percent of the low-income students in the second generation had completed college by 2007, up only slightly from a 5 percent college completion rate by the first generation in 1989.

Thus, as the income gap between rich and poor families has widened, so has the educational-achievement gap between their children—in turn making it less likely that future generations will narrow those divides.

Unless something is done to change course, these various drivers of inequality are likely to further widen the gaps in income and wealth in American society. But as we have seen, the roots of inequality are extraordinarily complex and defy simplistic partisan explanations, not to mention remedies. Some, of course, can be addressed with fairly straightforward solutions; others, however, are far beyond the ability of a single administration—or even a single nation—to resolve. Indeed, despite noble intentions, public policies aimed at reducing inequality have often proved counterproductive. Before lawmakers rush to address inequality through legislative fixes, then, they would do well to examine the ways in which federal initiatives—chiefly through entitlement programs and the tax code—have themselves played an enormous role in widening the income divides that alarm so many Americans today.

THE ROLE OF PUBLIC POLICY

In today's policy debates about inequality, it is common to hear complaints about how our tax code is insufficiently leveling. Among those

on the left, the prevailing theory holds that incomes are up, marginal tax rates are down, and the wealthy are therefore shirking their responsibilities and need to be more heavily taxed. President Obama himself has often alleged that, under our system, the rich do not pay their "fair share," proposing a tax hike on the wealthiest Americans as his remedy.

But contrary to this popular understanding of government's role in income inequality, recent tax reforms have actually produced a federal income tax that is somewhat *more* progressive, not less. As noted above, the wealthy make a larger contribution to the U.S. Treasury today than they did four decades ago.

This misplaced focus on tax rates obscures the real ways in which federal policy drives inequality. The tax code does play a part, though not in the way the left usually alleges: The problem is not tax rates, but rather tax *expenditures*.

The term "tax expenditures" describes a constellation of deductions, deferrals, credits, exclusions, exemptions, and lower rates through which the government elects to forgo revenues that would otherwise accrue to it. In rough order of importance, the list includes the exclusion of employer contributions for medical insurance, the exclusion of pension contributions and earnings, the deduction for mortgage interest on owner-occupied homes, the deduction for state and local taxes, deductions for charitable contributions, capital-gains exclusions on home sales, the child-care credit, and the taxation of capital gains at different rates (among several others). The Tax Policy Center estimates that such tax expenditures account for somewhere between one-quarter and one-third of all federal benefits and subsidies granted to the public; in fiscal year 2008, the Office of Management and Budget estimated their cost to be $878 billion.

The distributional effects of tax expenditures differ significantly. Child-care credits and the Earned Income Tax Credit benefit Americans with modest incomes. Deductions for items such as student loans, higher-education expenses, and self-employed medical-insurance premiums provide the biggest gains to middle-income taxpayers. Lower tax rates on capital gains and dividends disproportionately benefit the top 1% of taxpayers and provide relatively little income gain for anyone else. (They are the reason behind the oft-cited claim that Warren Buffett pays a lower effective tax rate than his secretary.) Indeed, the CBO has singled out changes in the treatment of capital gains enacted after 2001 as

one of the major factors behind the recent reduction in the effective tax rate for the highest-income households. In 1979, for instance, the amount that such households paid in federal taxes as a share of household income was nearly 40%; by 2006, it had declined to roughly 30%.

The other noteworthy example of a highly regressive tax expenditure — one that surely contributes to income inequality — is the mortgage-interest deduction. Currently, the size of qualifying home loans is capped at $1 million, plus an additional $100,000 for home equity. On average, around a quarter of American households claim this deduction, but that percentage varies widely among income groups. In 2008, for instance, fewer than 10% of households earning $30,000 or less claimed this deduction; among those making $200,000 or more, however, the claim rate was more than 70%.

In a paper published last year, Georgia State University's Andrew Hanson and Zackary Hawley, along with the American Action Forum's Ike Brannon, found that Americans claiming this deduction are highly concentrated in upper-income households in the suburbs of a few major metropolitan areas and along the coasts. As the three reported in the *Weekly Standard* in December:

> ...not only are [taxpayers] more likely to be buying houses and taking the deduction in Greenwich than in Peoria, but the very nature of any tax deduction in a progressive tax code means that the average benefits of the Greenwich homeowner dwarf what the Peorian is getting. Someone with a $1 million mortgage who earns over $300,000 a year could see the government essentially giving him a $20,000 a year subsidy for his home, while a [homeowner] making $70,000 a year with a $150,000 mortgage would not receive a penny, since his puny deduction (under $2,000) would be less than the standard deduction.

The example of the mortgage-interest deduction illustrates the ways in which tax expenditures, not tax rates, foster income inequality — and why many of the inequality critics therefore have their redistributionist sights set on the wrong problem in our tax code. But their efforts would be spent more wisely still trying to reform an area of public policy that suffers from even greater flaws: our system of government transfer payments.

Our massive federal old-age entitlement programs — Social Security and Medicare — were originally designed to take money from younger taxpayers who, because they were employed, could afford to pay for the basic needs of their fellow citizens who were too old to work. Those workers would make such contributions on the understanding that, when they themselves grew older, younger workers would provide them with support through the entitlement system in the same way. Resources would thus be transferred from a more prosperous demographic to supply a safety net for the elderly poor.

Today, even though these programs are bankrupting the country, their champions maintain that such income transfers remain necessary to preserve "fairness" in our economic system. But in an ironic twist, recent years have seen government transfer payments actually become *less* progressive. Increasingly, entitlement benefits are going to wealthier seniors at the expense of lower-earning young people. For example, in 1979, households in the lowest income quintile received 54% of all transfer payments; in 2007, those households received just 36% of transfers.

To understand this shift, it is important to remember that, while Social Security benefits are progressive, the program itself is not means-tested; even the wealthiest retirees receive payments. And in the case of Medicare — the costs of which are exploding, due in part to rising health-care expenses — benefit levels are not influenced by income or assets (though wealthier people do pay some higher premiums). As both of these programs are open to virtually all Americans 65 and older, their benefits are accruing to a demographic that is growing both in size (thanks to the Baby Boomers) and in wealth.

To appreciate just how well off this demographic is, consider this: In November, the Pew Research Center reported that, over the past quarter-century, households headed by older adults have made dramatic gains in economic well-being relative to those headed by younger adults. In 2009, the average net worth of households headed by adults ages 65 and older was a record 47 times that of households headed by adults under the age of 35 ($170,494 versus $3,662, in 2010 dollars). Back in 1984, the ratio was 10-to-1. (This widening age-based wealth gap has been driven primarily by rising home equity.)

Thus the second-wealthiest cohort (by age) in America is benefiting from the nation's most expensive federal entitlement programs (together, Social Security and Medicare now cost about $1.2 trillion a

year, and that cost is set to balloon). Worse yet, Social Security and Medicare are largely funded by payroll taxes, which are applied at a flat rate to all workers. Many lower-income workers do not pay any income taxes, since we have a progressive income-tax system that exempts them from payment, but they do pay payroll taxes. The entirety of their contribution to the federal Treasury therefore goes to providing benefits to older people who are generally wealthier than they are. As a House Budget Committee analysis concluded, these changes in demographics and wealth distribution have "reduced the share of transfer payments received by lower-income households while increasing the share received by middle- and upper-income households," making our system of transfer payments increasingly regressive.

From tax policies to the structure of our entitlements, then, public programs — including those intended to reduce disparities in wealth — are widening the divide between rich and poor. Those fixated on income gaps, especially on the left, would be wise to remember this fact before advancing new redistributive public policies that could prove just as counterproductive in reducing inequality.

INCOME INEQUALITY AND JUSTICE

Disseminating accurate data about the economics of inequality and the effects of public policy is an essential task for conservatives, as is putting today's inequality figures in their proper historical context. Even more important, however, is advancing a serious moral argument about an issue central to any serious discussion of inequality — the issue of justice.

Indeed, those on the left who decry inequality frequently place justice at the heart of their arguments. For a society based on the concept of equality to tolerate such vast differences in wealth is, to their way of thinking, a moral failing. So unjust are these gaps, in fact, that Americans in all classes and income brackets should forfeit prosperity simply to narrow the divides. Many liberals sound as though they would be willing to see the poor get poorer, so long as the rich lost ground as well.

This view has been expressed by the *New Yorker*'s George Packer, who, lamenting the sorry economy of the late 1970s, wrote that "life in 1978 was inconvenient, constrained and ugly." But despite that stagnation, Packer went on to add, from where America stands today, 1978 looks "pretty good" — in large part because the distribution of income then was more equal. In Packer's view, income inequality is

the moral "ill that underlies all the others"; "[l]ike an odorless gas, it pervades every corner of the United States and saps the strength of the country's democracy."

We saw a variation of this attitude in a 2008 debate between Democratic presidential aspirants Barack Obama and Hillary Clinton, when ABC's Charles Gibson asked Obama why he would support raising capital-gains taxes given the historical record of government's losing net revenue as a result. "Well, Charlie, what I've said is that I would look at raising the capital-gains tax for purposes of fairness," Obama replied. His mask slipped, if only for a moment, and revealed that his aim when it comes to taxes isn't, as he and other liberals often argue, simply to raise revenues. Rather, it is to advance their understanding of "fairness," which they take to be synonymous with justice, both taken to mean that the rich should never have too much more than the poor.

To be sure, in the American political context, equality has always been bound up with our notion of what is fair and just — though not in the way Obama, Packer, and others on the left would argue. America's concept of justice is in fact rooted in one of the most far-reaching and radically egalitarian political statements in history: the Declaration of Independence. The link between justice and equality is made explicit in that document, which states: "We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable rights, that among these are life, liberty and the pursuit of happiness. That to secure these rights, governments are instituted among men, deriving their just powers from the consent of the governed."

Americans have long believed equality in the realm of political rights to be indispensable to a just order, understanding that these are natural rights, given by God rather than by the state. But the same cannot be said of equality in income and living standards, which is why Americans much more easily tolerate disparities in material well-being. The Declaration's description of "the pursuit of happiness" as an equal, unalienable right has never been taken as a justification to use the power of the state to level out all income differences between individuals.

Americans have generally appreciated the difference between political equality and material equality in part because they understand that a crucial element of justice is due reward. In a free and just society, people get what they deserve — what they earn, what they are owed. To deny

people the fruits of their labor is itself a form of injustice. One of the best interpreters of America and the Declaration, Abraham Lincoln, in fact understood a just, equal political order to be one in which every man is able to reap the due material rewards of his work. In an 1858 debate with rival Stephen Douglas, Lincoln observed that, "in the right to eat the bread, without the leave of anybody else, which his own hand earns, [the black man] is my equal and the equal of Judge Douglas, and the equal of every living man."

Lincoln was channeling an insight articulated seven decades earlier by James Madison, who wrote in Federalist No. 10:

> The diversity in the faculties of men, from which the rights of property originate, is not less an insuperable obstacle to a uniformity of interests. *The protection of these faculties is the first object of government*. From the protection of different and unequal faculties of acquiring property, the possession of different degrees and kinds of property immediately results; and from the influence of these on the sentiments and views of the respective proprietors, ensues a division of the society into different interests and parties. [Emphasis added.]

Since the founding era, Americans have understood that, in a democratic, capitalist society, gaps in income are inevitable. We have made our peace with this fact. Yet it is worth noting that democratic capitalism has done far more to create wealth, advance human flourishing, and lift people out of destitution than any other economic and political system. By contrast, history shows that movements aimed at eliminating inequality often lead to enormous economic inefficiency and, in the most extreme cases—the French Revolution, any of the Marxist projects of the last century—to the loss of liberty and the rise of political repression.

Of course, in America today, the vast majority of people concerned about inequality are not Marxists in theory or in practice. Some are motivated by sacred doctrines: After all, Jesus maintained that it was easier for a camel to pass through the eye of a needle than for a rich man to enter into heaven. Others adhere to secular philosophies of justice as fairness, like the one laid out by John Rawls in his *Theory of Justice*. Most simply believe that wide disparities in income and living standards pose

a danger to our social well-being, and their concerns are not baseless. Nevertheless, a policy agenda that has as its top priority the elimination of income gaps (rather than greater prosperity for all) poses grave dangers to our social well-being, too. It not only encourages resentment but also threatens the American economy — because a narrow focus on closing gaps tends to go along with reduced overall growth, bringing down the top rather than lifting up the bottom.

In fact, one of quickest paths to increased income equality — a severe recession — dramatically *worsens* economic outcomes for all. Citing data from Emmanuel Saez and Thomas Piketty, the *Atlantic*'s Megan McArdle has observed that

> income inequality falls during recessions, and particularly during prolonged crises. Crises destroy capital, and top incomes tend to be more tightly linked to capital than those of average workers. If you work for a wire factory that goes bankrupt, you may well have a rough year or two before you find another job, and your income may never fully recover. But if you own that factory, it will be years before you have an income even close to what you enjoyed before — and it's very possible that you'll never get there at all.
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> Note that this is not an argument about who suffers more during a recession; it is self-evident that a worker who loses a third of their $20,000 annual paycheck is much worse off than an owner who loses two thirds of their $500,000 annual draw. But the measured gap between their incomes will still shrink dramatically.

Would the cause of justice be better served by preserving a constant state of recession? Obviously not. In an ideal world, of course, it would be better not to have enormous gaps in income; certainly, as the late economist Arthur Okun noted, a "mixture of equal rights and unequal economic status breeds tensions between the political principles of democracy and the economic principles of capitalism." But we do not live in an ideal world, and the tradeoffs that come with strict material equality suggest that democracy and robust capitalism — with all their flaws — offer a vastly preferable system not just for the wealthy but for the poor and the middle class as well.

That said, Americans should not be blithely inattentive to the ways in which income inequality can threaten a just social order. The most

obvious case is when income inequality results not from disparities in merit but rather from a corrupt system—one that is gamed in a way that helps the rich and powerful while denying opportunity to the rest of society. In Russia, for example, corruption is one of the main obstacles to economic growth; according to the Russian think tank INDEM, in 2005, bribes accounted for one-fifth of Russia's GDP. A review of recent surveys by Robert Orttung of American University found that 20% of Russian businesses do not see anything wrong with paying bribes. In this sort of pay-to-play economy, being rich or poor will have very little (if anything) to do with reaping the due rewards of one's talent, initiative, and work; in such a system, inequality will necessarily be a manifestation of injustice.

Another concern arises when income disparities sharply increase as the standard of living of the poor decreases, which erodes a sense of national unity and solidarity. If inequality in America were being caused by the wealthy becoming richer as the underclass became more impoverished—if America were becoming a nation of mansions on the hilltops surrounded by destitution in the valleys—the result could be dangerous levels of resentment and anger, and even widespread civil unrest.

Fortunately, however, neither of these problems is behind inequality in America today. While crony capitalism is sometimes evident in our country (and has surely increased in the past few years), we are nowhere near becoming Russia. And while we have seen a significant shift in public perceptions of class conflict in American life, the Pew Research Center's Andrew Kohut reports that it does not seem to signal an increase in grievances toward the wealthy; Pew shows that key attitudes toward the wealthy have in fact remained largely unchanged. And a recent Gallup poll found that 52% of Americans called the rich-poor gap "an acceptable part of our economic system" while only 45% said it "needs to be fixed"—a reversal of the figures from 1998. In another Gallup survey, only 2% of Americans listed the "divide between rich and poor" as the most important economic issue facing the country. Seventeen economic issues were considered to be of greater importance, including jobs and unemployment, the national debt, economic instability, outsourcing of jobs overseas, the housing crisis, and gas prices.

Clearly, then, America is neither an oligarch's paradise nor a seething cauldron of class resentment. "What the public wants is not a war on the rich," Kohut reports, "but more policies that promote opportunity." And

it is indeed increasing opportunity, rather than achieving strict income equality, that should be the foremost aim of economic policy today.

AN OPPORTUNITY SOCIETY

If America truly sought above all to reduce income inequality, several policies could swiftly achieve this goal. Policymakers could impose a top marginal tax rate of 90% on the wealthy, simply confiscate their money, or deport them. Caps could be placed on the earnings of CEOs, actors, and professional athletes; Washington could seek to bring about another Great Recession, or to reduce the work-force participation rate of women. All of these policies would certainly have a leveling effect—though clearly none of them would be wise, and none of them has any serious advocates.

A far better way to mitigate inequality is to increase opportunity. Indeed, social mobility is the central moral promise of American economic life; the hallmark of our system is the potential for advancement and greater prosperity rooted in merit and hard work, rather than in the circumstances of one's birth. This was a key insight of Lincoln, who noted that "[t]he progress by which the poor, honest, industrious and resolute man raises himself, that he may work on his own account and hire somebody else...is the great principle for which this government was really formed." He went on to say:

> I don't believe in a law to prevent a man from getting rich; it would do more harm than good. So while we do not propose any war upon capital, we do wish to allow the humblest man an equal chance to get rich with everybody else...I want every man to have the chance—and I believe a black man is entitled to it—in which he *can* better his condition—when he may look forward and hope to be a hired laborer this year and the next, work for himself afterward, and finally to hire men to work for him! That is the true system.

But while social mobility has long been at the heart of the American Dream, the truth is that social mobility in this nation is too low. Many European countries now have as much social mobility as, and more opportunity than, the United States; today, a child's future depends on parental income more in America than it does in Canada and Europe.

Whether one judges by intragenerational mobility (meaning movement within or between income brackets and social classes within an individual's lifetime) or intergenerational mobility (movement within or between income brackets and social classes occurring from one generation to the next), the United States is less mobile than it should be. As the Brookings Institution's Isabel Sawhill and Ron Haskins noted in a 2009 *Washington Post* op-ed:

> If you are born into a middle-class family in the United States, you have a roughly even chance of moving up or down the ladder by the time you are an adult. But the story for low-income Americans is quite different; going from rags to riches in a generation is rare. Instead, if you are born poor, you are likely to stay that way. Only 35 percent of children in a family in the bottom fifth of the income scale will achieve middle-class status or better by the time they are adults; in contrast, 76 percent of children from the top fifth will be middle-class or higher as adults.

The problem in America today is therefore not wealth but rather persistent poverty. And the right way to deal with income inequality is not by punishing the rich, but by doing more to help the poor become richer, chiefly by increasing their social capital. This means not simply strengthening the bonds of trust and mutual respect among citizens, but also equipping Americans—especially the poor—with the skills, values, and habits that will allow them to succeed in a modern, free society.

Formulating a comprehensive social-capital agenda capable of achieving these aims will require enormous deliberation and effort by policymakers, economists, social scientists, and moral theorists. And in the face of America's deep cultural and structural problems, assembling such a platform will be a hugely complicated task. Even so, the broad outlines of a social-capital agenda are already beginning to make themselves apparent.

First, such an agenda should reform federal tax laws and other policies that make work less rewarding to lower-wage employees. The profoundly regressive payroll taxes that fund our entitlement programs, for example, need to be rethought. The eligibility rules for a number of our key public-assistance programs (especially Medicaid and the Earned Income Tax Credit) are designed in ways that discourage

higher-paying work (since benefits diminish or disappear abruptly as income rises); they therefore discourage investments in the kind of self-improvement often necessary to obtain such work. These and other social programs must be structured to encourage recipients to make more productive use of their talents.

Second, our education system must do a better job of providing poorer Americans with the tools they need to rise. The members of our society most in need of such tools are those now stuck in the worst-run and most dysfunctional schools and denied any promising alternatives. Some combination of public-school reform and private-school choice will be essential to ending the intergenerational cycle of poverty and failure.

Third, our badly broken immigration system needlessly worsens the circumstances of less-skilled workers. We make it extremely difficult for employers to bring highly skilled immigrant workers to this country, but far too easy for them to hire low-skill immigrant workers (who are often in this country illegally). Thus the very Americans already engaged in extreme competition with lower-skilled workers abroad are being subjected to further competition with lower-skilled immigrants at home. Meanwhile, the wealthier Americans benefiting most from globalization are shielded from its effects on their own employment prospects. This arrangement is clearly backward, and calls out for sensible reform.

Finally, and perhaps most difficult of all, the nation must work to strengthen the commitment to marriage and responsible child-rearing among the working class and the poor. This will, for the most part, be a job not for government but for the institutions of civil society, and perhaps especially for religious institutions that can speak with some moral authority. Government can help, however, by reinforcing such mediating institutions (rather than undermining them in an effort to displace them, as has too often happened in recent years); by strengthening them on the margins; and by finding appropriate ways to reward and encourage personal responsibility.

REFRAMING THE DEBATE

These are very broad outlines, of course, but they begin to define the contours of a real social-capital agenda. These principles—all directed toward increasing mobility and opportunity—should inform any policy agenda that claims to advance economic justice in America. As we have seen, income inequality as such is not the problem with our country today; an

overly narrow focus on wealth gaps therefore distracts us from the very real challenges that do need to be met. Indeed, embracing policies aimed explicitly at leveling incomes is almost certain to harm both the rich and the poor—and it is not at all clear how such a universal reduction in prosperity would serve the cause of justice or benefit the nation.

But as the rhetoric about inequality in this year's election season makes clear, America still has a long way to go before it appreciates the dangers inherent in our fixation on income gaps. Only by framing the issue properly can conservatives refocus the country's attention where it belongs, and thereby truly help the poor—by restoring their access to the opportunity that really constitutes, to borrow President Obama's phrase, "the promise that's at the very heart of America."