

Still Movin' On Up

The death of income mobility has been greatly exaggerated

by Donald L. Luskin

Starting on May 13, the *Wall Street Journal* ran a series of four front-page stories—totaling almost 10,000 words—about what it manifestly considered a major threat to the Republic. Two days later, the *New York Times* launched a series of a dozen stories about the same threat, most of the articles splashed on page one, above the fold: a total of nearly 50,000 words. *BusinessWeek*, the *Christian Science Monitor*, and the *Los Angeles Times* have taken up the story, too; Michael Kinsley, writing in the *L.A. Times*, even suggested that the *Washington Post* get into the act.

Was the furor about al-Qaeda? Iran? North Korean nukes? Nope. The sword of Damocles hanging over our national future—and discovered, coincidentally, by *all* of these mainstream liberal media outlets at once—is . . . income inequality. But a concerned citizen who wades through these tens of thousands of words, and pores over the studies they solemnly cite as authoritative, will find a simple, but highly reassuring, truth: *There's no story here.*

The *Journal* and the *Times* are exercised by reports that, over the last three decades, a new class of what the *Times* calls the “hyper-rich” has arisen in the United States, resulting in a disparity in incomes between rich and poor not seen since the 1920s: the most severe income inequality in the developed world today. How did this happen? As the *Times* explains it, “The hyper-rich have emerged . . . as the biggest winners in a remarkable transformation of the American economy characterized by, among other things, the creation of a more global marketplace, new technology and investment spurred partly by tax cuts.”

Fair enough. We have indeed seen a transformative era of economic growth. That era has indeed produced a whole new class of extremely wealthy individuals—or, more accurately, a whole new class of individuals became extremely wealthy as their reward for taking the risks that made that growth happen. And indeed tax cuts were at the root of it—supply-side tax cuts that increased the incentives for risk-taking in the first place.

But none of this is exactly man-bites-dog material. What the *Times* reports as news is a pattern that should be familiar to economic historians: Times of great prosperity have

been associated with greater income inequality (for example, the 1920s), and conversely times of economic decline have been associated with greater equality (the 1930s). The lines of causality here are complex, and no doubt run in both directions: Prosperity is both the cause and the effect of inequality, and decline is both the cause and the effect of equality. So ideological advocates of income equality for its own sake ought to be careful what they wish for.

The great prosperity of the last three decades has been dominated by American technological and commercial prowess. So no one should be surprised that the emergence of the new hyper-rich has been preeminently an American phenomenon. Today 341 of the world's 691 billionaires—including five of the top ten—are Americans. These aren't old-money names, either. You have to get all the way down to number 86 before you find a Rockefeller. At the top of the chart are Gates, Buffett, Ellison, Allen, Walton—precisely the people whose innovations and risk-taking made our current prosperity possible. Much of the rise in American income inequality could probably be erased in one fell swoop just by getting these 341 people to move to another country.

We need to focus, then, on the question: What *harm* has it done to have this new class of the hyper-rich on the American scene? The *Times* and the *Journal* both go on at length about how Americans who used to consider themselves very rich—one thinks inevitably of the Sulzbergers of the *Times*, and the Bancrofts of Dow Jones—are rather annoyed to have to compete socially with the new hyper-rich; old money has never liked new money. But in truth, the incomes of the hyper-rich have not come at the expense of anyone else. The poverty rate, for example, hasn't risen over the last 30 years; it has actually fallen slightly. Average after-tax, inflation-adjusted income has risen for every income quintile in the population. Yes, it has risen the most for the highest quintile, and risen the least for the lowest—but this can be explained to some extent by the great wave of immigration over the same period. The fact remains that income has risen for all: The rising tide *has* lifted all boats.

THREE CHEERS FOR DIVERSITY

Before the present era of transformative growth and its concomitant income inequality, many economists had expected the mid-20th-century trend toward greater equality to persist forever. According to the influential hypothesis of Simon Kuznets, nearly a half-century of steadily rising equality of income following the technology revolution that peaked in the 1920s was explained by the fact that more and more workers were joining the high-productivity sectors of the economy. Now it appears that what Kuznets described may be, in fact, a cyclical phenomenon that restarted at some point about 25 years ago. Income-inequality guru Emanuel Saez, an economist at the University of California at Berkeley, has written that “a new industrial revolution has taken place, thereby leading to increasing inequality, and inequality will decline again at some point, as more and more workers benefit from the innovations.”

In other words, at the beginning of each cycle a small band of risk-takers get extremely wealthy in the vanguard of economic transformation, but that's only a one-time effect.

For years afterward, everyone else in the economy adapts to the new, higher productivity potential that the new rich have made possible, and incomes gradually gravitate toward greater equality. Happily, then, those who hope for greater income equality need not wish for slower growth, or for the mass deportation of our billionaires. All that is required is patience—and hard work.

But income inequality will never go away entirely—and it's not at all clear that we should want it to. Even if a socialist-minded fairy godmother were to wave her magic wand and set all incomes to perfect equality, in a free economy they would immediately drift toward inequality owing entirely to voluntary choices made by each individual. Each of us would choose freely whether to work hard or take it easy; to marry a working spouse or a stay-at-home; to educate ourselves for a better job, or settle for less; to invest in income-producing securities, or just spend our money. All these things would determine our unequal incomes, just as they do today. To be sure, in the real world we don't make those choices from an initial position of equality. Some of us are born rich, others poor, most in between. Nevertheless it's choices like these that determine whether we will rise or fall within the class in which we are born, or move upward or downward to another class. So we shouldn't fear income inequality: We should celebrate it as "income diversity."

Changing our incomes by making choices different from those of our parents is called "income mobility." Both the *Wall Street Journal* and the *New York Times* correctly acknowledge this practice as fundamental to American life (and both happen to discuss Benjamin Franklin as its exemplar). Yet the papers argue that income mobility is on the decline just as income inequality is on the rise. You'd think that the emergence of a whole new class of the hyper-rich would prove that income mobility is alive and well (they had to come from somewhere, after all). But no.

The *Times* and the *Journal* cite many authoritative-sounding studies on declining income mobility. But to get an accurate picture of income mobility, you'd have to track hundreds of millions of individuals through time, monitoring changes across generations in such factors as their income, tax rates, wealth, lifestyle, and education. Looking back further than a couple of decades, robust statistics are hard to find in standard databases; you can't ask all the individuals concerned, because many of them are deceased. So researchers end up relying on surveys of small samples of people, containing what they can recollect about their parents' and grandparents' economic circumstances. As a result, hard facts about economic mobility are elusive, and studies about it are approximate and subjective at best.

Yet for all that, the *Times* and *Journal* stories are peppered with definitive-sounding statements, like this one from the *Times*: "One study, by the Federal Reserve Bank of Boston, found that fewer families moved from one quintile, or fifth, of the income ladder to another during the 1980s than during the 1970s and that still fewer moved in the 90s than in the 80s." If you follow the *Times*'s link to this study, it turns out actually to be about women in the workforce and what happens to families when a spouse dies; the more general findings cited by the *Times* are buried in an appendix. Yes, that appendix

shows that about 4 percent more households stayed in their income quintile during the 1990s than in the 1970s. But it also shows—though the *Times* doesn't mention this—that in the 1990s more households than ever jumped from the poorest quintile to the richest. But none of this is reliable anyway: A footnote reveals that the statistics are derived from the Panel Study of Income Dynamics database, an ongoing survey that tracks only 8,000 families out of a U.S. population of 295 million individuals.

The other studies cited are based on evidence equally unreliable, and come to conclusions even less interesting. At most, these surveys suggest that—maybe—income mobility has stopped improving over the last 30 years.

Perhaps the best research method for getting our arms around the slippery topic of income mobility is simply to take a poll, and ask people how they feel about it. The *New York Times* itself took such a poll, and its optimistic results are strikingly at odds with the paper's gloomy conclusions. Eighty percent of respondents said "it's still possible to start out poor in this country, work hard, and become rich"—up from 57 percent in 1983. Twenty-five percent said they believed their children's standard of living would be "much better" than their own—up from 18 percent in 1994. Forty-six percent said hard work is "essential" for getting ahead in life—up from 36 percent in 1987.

RESENTING PROSPERITY

So where's the beef? Everyone's gotten richer—and a few have gotten hyper-rich. And there's no real reason to think that income mobility isn't alive and well. So why this full-court press by the liberal mainstream media to create the impression that America is becoming a feudal society? Maybe it's a media thing; there's no other industry more obsessed with pigeonholing people by class. Here, for example, is how the *New York Times* sees its readers: They're "nearly three times as likely as the average U.S. adult to have a college or post-graduate degree, more than twice as likely to be a professional/managerial and more than twice as likely to have a household income exceeding \$100,000."

Or maybe it's a liberal thing. You're more likely to vote Democratic if you're convinced that "the rich" are keeping you from getting your fair share—you know, "Two Americas" and all that. And you're more likely to support liberal initiatives like affirmative action if you think that the American dream based on income mobility is falling apart. So liberal media outlets like the *Times* go through periodic frenzies about income inequality, regardless of who's in the White House. (Two typical *Times* headlines, from 1998: "In Booming Economy, Poor Still Struggle to Pay the Rent" and "Benefits Dwindle for the Unskilled Along with Wages.")

And, of course, the putative problem of income inequality is yet another opportunity for the liberal media to excoriate the Bush tax cuts. Whatever the problem—Social Security solvency, economic growth, outsourcing to China, budget deficits—repealing those tax cuts is always the liberal answer. In this case, the *Times* claims they "stand to widen the gap between the hyper-rich and the rest of America." This year Congress will vote on the

extension of President Bush's tax cuts on income from dividends and capital gains, and on making permanent the repeal of the estate tax. For the liberal media, demonizing the rich is a powerful way to fight against those conservative initiatives. There's good reason, though, to think it won't work. That *Times* poll that showed how much faith Americans have in their income mobility also produced a striking result about taxes on "the rich": Seventy-six percent of respondents said they opposed the estate tax.

About the Author

Mr. Luskin is chief investment officer of Trend Macrolytics LLC, an independent economics and investment-research firm.