Bridging the Earnings Gap

Global Justice Forum Targets Income Inequality

By Rebecca McReynolds

There's one thing economists can actually agree on: Income inequality is accelerating in the United States and elsewhere in the developed world, and its long-term effects could derail economic growth, leaving future generations trapped in poverty. Still up for debate, though, are the magnitude of the gap, the underlying causes, and the role, if any, that governments and institutions can play in creating greater opportunity for those in the lower economic brackets to move up.

In October 2014, The Richard Paul Richman Center for Business, Law, and Public Policy at Columbia University used its 8th Annual Global Justice Forum to focus attention on the issue. "The objective was to explore in a balanced way the facts behind income inequality," explains Jesse Greene, Senior Fellow of the Richman Center. "How big is it? How do you measure it? What does the data tell us? What efforts have we made over the years to address it, and what's working and what's not working."

Broken into three panels, the forum considered the economic forces behind rising inequality; provided a perspective on the impacts of economic policy on housing, education and the labor markets; and explored judicial and regulatory policies that seem to be eroding workers' and consumers' access to remediation in the courts. Led by experts from academia, government and business, the forum offered a far-reaching discussion that helped define the parameters of the debate on income inequality and provided guidance on how to address this growing global concern.

Measuring the Effects of Income Inequality

Moderating the first panel, Pierre Yared, Associate Professor of Business at Columbia Business School, laid the groundwork for the discussion. Since 1980 the top 1% of earners doubled its share of U.S. total market income, from 10% to 20%, at the expense of a deteriorating share for the lower 80%. "Some have argued that this is a reason to increase the welfare state, while others say it is a reflection of the existence of the welfare state," Yared said.

Acknowledging that there are no easy answers because of the myriad forces driving the income gap, including technology and globalization, Yared pointed to three trends that underscore the growing concern over a perceived lack of fairness in the U.S. economy:

- Income inequality is growing within every income group. Even among the top 1%, corporate chief executives and hedge fund managers are doing significantly better than doctors, lawyers and other wealthy professional groups. "We are seeing a gradual transition to a 'Superstar System,'" Yared said.

- Income inequality is growing in conjunction with a significant increase in disparity within the labor market. Between 1965 and 2003, the average male without a high school diploma increased the amount of time devoted to leisure by 8 hours a week. In contrast, the average male with a college degree decreased his time devoted to leisure by 6 hours a week.
- Income immobility is becoming an even greater threat to society than inequality. Despite significant churning among the top 1% of earners, those in the lower echelons of income are losing ground. "Countries with a lower income mobility rate also have higher income inequality," Yared noted.

It's Everyone's Problem

Today's widening income gap poses a threat to economic sustainability, warned Alan B. Krueger, Bendheim Professor of Economics and Public Affairs at Princeton University and former Chairman of the White House Council of Economic Advisors under President Obama. Between 1979 and 2011, family incomes among the top quartile of earners grew at an average annual rate of 1.2%, while the lowest quartile saw annual incomes shrink an average of -0.4% a year. Middle-income families registered only 0.2% average income growth, falling far behind inflation. "The shift of income to the top 1% is a drag on aggregate demand," Krueger said, pointing to evidence from the International Monetary Fund high inequality slows economic growth.

Looking forward, the disparity between the top and bottom quartiles effectively generates a cycle of poverty that makes it increasingly difficult for lower income families to move up, Krueger added. This can be seen clearly in education trends. While education increases the prospects for upward mobility, the gap in the years of completed education between the top and the bottom quartile has grown exponentially. At the same time, the earnings gap between the median household headed by a college graduate and the median household headed by a high school graduate rose by $20,400 between 1979 and 2013, Krueger noted.

"Expanding the narrative on causes of rise in inequality is essential," Krueger said. "Inequality has increased because of economic forces and choices that we as a society make, including the institutions and practices that enforce norms of fairness at the workplace. Both government and private sector can address it."

Addressing Structural Changes in The Workforce

The question is how business leaders and policymakers should respond to this widening social chasm. Andrew L. Stern, the Ronald O. Perelman Senior Fellow at Columbia University's Richard Paul Richman Center for Business, Law, and Public Policy, provided context for the discussion by looking at today's job market and offering a sober view of the future for the American worker. "We are at a moment in history when a confluence of events join together to create significant change," he said.

That turning point can be either positive or negative, and we won't know for sure until we are able to look backward to analyze today's trends, Stern said. But looking backward from today, it's easy to trace the slow but steady economic decoupling between the economic growth and wage growth over the past generation.

"The 20th Century economy was all about growth," Stern said. Gross domestic product (GDP), productivity and wages all grew, helping the middle class rise with the tide. In the mid-1980s, though, wages started to decline even as GDP continued to rise. Today, the focus is on jobless growth. In 2011 the U.S. posted the same GDP it saw just before the economic collapse of 2008, but it got there with 11 million fewer workers.

"We are at a strategic inflection where when you say 'growth' you are talking about GDP and productivity growth, but those gains don't produce wage growth or job growth," Stern cautioned. "That's the new American Economy."

Desperately Seeking Solutions

Adjusting society to fit into this new economy will require reengineering our social safety nets and tax structure from the bottom up, said Michael Graetz, Columbia Alumni Professor of Tax Law at Columbia Law School. "Our uniquely complicated system of social insurance was designed in the 1930s and the 1960s for a very different world," he said. "Family composition was different, the work force was different and the United States had all the money back then."

Today, these systems face three glaring shortcomings, Graetz said. First, unlike other developed economies, the United States relies on income tax benefits to fund critical social insurance policies. For example, access to health care is still widely based on employer-sponsored health insurance, for which companies receive a tax break as an incentive for offering it to employees.

Other types of social insurance fall heavily on the shoulders of state and local governments, creating wide discrepancies in access to these essential services based on geography, not income or need. Finally, means testing policies that determine who qualifies for certain services or tax breaks effectively penalize additional income. "Marriage or taking an additional job can make a family worse off instead of better off," Graetz said.

"I think our risks are not economic and not technological," he said. "They are political. The inability to take a system like unemployment and update that in the face of the Great Recession is what we should all be worried about, regardless of our political stripes."

SIDEBAR

Real-World Implications

While economists debate the broader issues of how income equality is being measured and whether or not our social safety nets are working, Richard P. Richman, Chairman and

Founder of The Richman Group Inc., offered a glimpse into the reality of today's working poor. "Figures lie and liars figure," Richman said. "You can always use data to fulfill personal prejudice."

That is especially easy to do when measuring income equality strictly by the numbers, he said. The important measure, he argues, is a person's standard of living. As one of the largest owners of low-income housing in the country, Richman offered unique insight into the life of the average low-wage worker in America.

The typical tenant in one of his affordable-housing units is a woman with two children living on $32,400 a year. To qualify for low-income housing, tenants pay 30% of their income for rent and utilities, so that's $12,000. In most areas of the country workers need a car to get to a job, and car expenses on average cost $8,000 a year. That's leaves $12,400 for food, clothes, school supplies, after-school programs, holiday and birthday gifts. "Even if you can meet this budget, you don't have a cent left over," Richman says. "You can't even make a $1 contribution to a 401(k) program."

Adding to the cycle of poverty is that 40% of Richman's tenants don't have a savings or checking account. They are not part of the financial system, but because most affordable-housing property managers don't take cash or credit cards, residents use money orders to pay their bills. "Poor workers will spend $1,000 a year for financial services," he said.

SIDEBAR

Brazil: A Case Study

In the debate over how—or if—government policies can impact income inequality, Brazil offers a unique laboratory. When the country's dictatorship was toppled in 1985 and replaced by a democratically elected government, representatives from every social constituency had a hand in developing the country's new constitution, said Diogo de Sant'Ana, Vice-Minister, General Secretariat of the Presidency of the Republic of Brazil.

Since the adoption of the new constitution in 1988, social justice and social equality have been the guiding principals in setting public policy, and the results speak for themselves, he added. The government's policy to grow real minimum wage has led to across-the-board increases in workers' purchasing power. A targeted agenda to move day laborers and other casual workers into the formal job market, which provides them access to critical social services and worker protections, has boosted formal employment to 55% of total employment, up from 45% in 2003.

Overall, unemployment has dropped from 12% in 2003 to 4% in 2014, and 36 million Brazilians have moved out of extreme poverty. At the same time, the household income gap between richest 10% and the poorest 40% has decreased 24%, while the number of people pursuing higher education has grown 100%. "Only by combining socio- and economic equality can we create and sustain a strong economic future," Sant'Ana said. "You are more likely to succeed if you listen to civil society demands."