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America is no longer a land of opportunity

Joseph Stiglitz

US inequality is at its highest point for nearly a century. Those at the top – no matter how you slice it – are enjoying a larger share of the national pie; the number below the poverty level is growing. The gap between those with the median income and those at the top is growing, too. The US used to think of itself as a middle-class country – but this is no longer true.

Economists have justified such disparities by citing “marginal productivity theory”, which explains higher incomes through greater societal contributions. But those who have really transformed our society, by providing the knowledge that underpins the advances in technology, earn a relative pittance. Just think of the inventors of the laser, the Turing machine or the discoverers of DNA. The innovation of those on Wall Street, while well compensated, brought the global economy to the brink of ruin; and these financial entrepreneurs walked off with mega-incomes.

One might feel better about inequality if there were a grain of truth in trickle-down economics. But the median income of Americans today is lower than it was a decade and a half ago; and the median income of a full-time male worker is lower than it was more than four decades ago. Meanwhile, those at the top have never had it so good.

Some argue that increased inequality is an inevitable byproduct of the market. False: several countries are reducing inequality while maintaining economic growth.

Markets are shaped by the rules of the game. Our political system has written rules that benefit the rich at the expense of others. Financial regulations allow predatory lending and abusive credit-card practices that transfer money from the bottom to the top. So do bankruptcy laws that provide priority for derivatives. The rules of globalisation – where capital is freely mobile but workers are not – enhance an already large asymmetry of bargaining: businesses threaten to leave the country unless workers make strong concessions.

Textbooks teach us that we can have a more egalitarian society only if we give up growth or efficiency. However, closer analysis shows that we are paying a high price for inequality: it contributes to social, economic and political instability, and to lower growth. Western countries with the healthiest economies (for example those in Scandinavia) are also the countries with the highest degree of equality.

The US grew far faster in the decades after the second world war, when inequality was lower, than it did after 1980, since when the gains have gone disproportionately to the top. There is growing evidence looking across countries over time that suggests a link between equality, growth and stability.

There is good news in this: by reducing rent-seeking – finding ways of getting a larger share of the pie, rather than making the pie larger – and the distortions that give rise to so much of America’s inequality we can achieve a fairer society and a better-performing economy. Laws that tax speculators at less than half the rate of those who work for a living or make the innovations that are transforming our society, say something about our values; but they also distort our economy, encouraging young people to move into gambling rather than into more productive areas. Since so much of the income at the top is derived from rent seeking, higher taxes at the top would discourage rent-seeking.

America used to be thought of as the land of opportunity. Today, a child’s life chances are more dependent on the income of his or her parents than in Europe, or any other of the advanced industrial countries for which there are data. The US worked hard to create the American dream of opportunity. But today, that dream is a myth.

We can once again become a land of opportunity but it will not happen on its own, and it will not happen with a politics that focuses on cutting public education and other programmes to enhance opportunities for the bottom and middle, while cutting taxes for those at the very top. President Barack Obama’s support for these investments, as well as the “Buffett rule” that asks those at the top to pay at least as much in tax as a share of their income as those who are less fortunate, are moves in the right direction. Republican candidate Mitt Romney’s suggestion that we cut back on public employees is worrisome; as is his silence on whether capital gains on speculation should be taxed at a lower rate than income derived from hard work.

The country will have to make a choice: if it continues as it has in recent decades, the lack of opportunity will mean a more divided society, marked by lower growth and higher social, political and economic instability. Or it can

recognise that the economy has lost its balance. The gilded age led to the progressive era, the excesses of the Roaring Twenties led to the Depression, which in turn led to the New Deal. Each time, the country saw the extremes to which it was going and pulled back. The question is, will it do so once again?

The writer is a recipient of the 2001 Nobel Prize in economics and the author of the forthcoming 'The Price of Inequality'