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## Reasons for hope on easing pay gap



By Mark Zandi, May 25, 2014

It is rare for a book written by an academic economist to make it to the top of bestseller lists. But this year Thomas Piketty's historical tome on the concentration of income and wealth, *Capital in the Twenty-First Century*, has captured the collective imagination.

Piketty's gloomy thesis is that the gulf between the haves and have-nots, now arguably as wide as it has ever been in the United States, is destined to grow even wider. He thus suggests that those on the bottom rungs of the income ladder are largely stuck there. Recent protests by McDonald's workers seeking higher pay could therefore be only the start of increasing social unrest.

Piketty's work deserves careful attention, and there is no doubt that the concentration of wealth and income is a problem that should be addressed. But even if policymakers do nothing, the issue has likely peaked, or soon will do so before beginning to subside on its own. Books about income inequality won't be on bestseller lists a decade from now.

There is a wide and growing gap in income and wealth. Not since the roaring 1920s have the fortunes of the super-wealthy dwarfed the economic wherewithal of everyone else. Evidence of eroding economic mobility - the ability to move up and down the income ladder - is also compelling.

Even more important, living standards are increasingly skewed. The share of the pie consumed by the wealthy has significantly increased. Twenty-five years ago, those who made enough to rank in the top 5 percent of income earners (the equivalent of just over \$250,000 per year in today's dollars) accounted for about one-fifth of all consumption. Today, it is closer to one-third.

Inequality may have even contributed to the Great Recession of 2007-09, as lower-income households borrowed heavily, leading up to that historic downturn. Many factors contributed to this, but a key one is that people borrowed to keep up their spending even as their incomes were falling further behind. Of course, such a strategy can't work for long, and it didn't.

Globalization has been a major driver of inequality. U.S. workers with lesser skills and education have had to compete head-on with lower-paid foreign workers, particularly since China's entry on the global economic scene a couple of decades ago. The flight of production and jobs overseas has made things much worse for many families.

At the same time, highly skilled U.S. workers have benefited enormously, gaining a huge global market for their talents. CEOs of large multinational corporations can command multimillion-dollar salaries, and rock stars and basketball players even more than that as they reach consumers worldwide.

Meanwhile, the economic success of China and much of the rest of the emerging world has created a new, growing middle class of consumers who are buying more of what Americans make. This includes everything from agricultural products to financial services. Globalization is therefore a growing net plus for U.S. workers across most industries, occupations, and pay scales.

Another factor in inequality has been technological change. Middle-income jobs are especially vulnerable as more work is done via computer code. Think about ticket kiosks in airports, which slashed the number of live agents standing behind counters. The people who once held these jobs could either move up the income ladder by gaining new skills and education, or move down.

Meanwhile, the economic rewards of this technological shift appear to accrue to a tiny group of talented individuals. Billionaires are made each time Facebook or Google acquires a five-person start-up firm with a cool new app.

Yet remember that technology can also disrupt entrenched businesses and sources of wealth. Not long ago, for example, newspaper companies were the among the most profitable anywhere. The Internet upended these firms, and their owners are much less well-off today. Technological change may have exacerbated inequality to date, but it is not clear that it will continue to do so.

Another contribution to inequality comes from the 30-year decline in inflation. In the early 1980s, runaway prices were far and away our biggest economic problem. The Federal Reserve changed this by imposing higher interest rates, which has meant higher unemployment: The economy has operated at less than full employment more often than not since then. This has helped hold down wages by reducing workers' bargaining power. Labor's share of the nation's economic output has fallen, while the share going to owners of companies has soared. U.S. companies are as profitable as they have ever been.

However, this dynamic is set to change. Inflation is now below the Fed's target, and Chair Janet Yellen is appropriately focused on unemployment and underemployment. As the job market continues to tighten, workers' negotiating power will improve, their wages will rise more quickly, and business profitability will weaken. The income and wealth divide will narrow.

The future thus isn't nearly as bleak as Piketty argues in his book. Still, policymakers can't be passive. They can actively lean against income and wealth inequality by boosting resources for education and retraining, reforming immigration laws to help millions of low-paid undocumented workers utilize their skills, and changing campaign-finance laws so that billionaires can't dominate elections. Larger inheritance taxes would also make a difference.

We shouldn't shrug off the wide gap between the haves and have-nots, but neither should we assume our economic system is incapable of lifting everyone's fortunes. The American Dream isn't a mirage. We just need to reaffirm it.

Mark Zandi is chief economist of Moody's Analytics. [help@economy.com](mailto:help@economy.com)

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