

The lesson of US income inequality

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Published: August 25 2008 03:00 | Last updated: August 25 2008 03:00

As Barack Obama, the Democratic presidential candidate, quietly prepares for Denver, the focus at the convention will be on drama and psychodrama. The drama comes from doubts about whether Mr Obama can give the speech of his life; the psychodrama from the Clintons, who have muscled their way into two prime-time speaking slots.

Dynastic strife and do-or-die live performances are hard to beat. But the assembled officials should also turn their attention to the academic universe of charts, equations and carefully honed arguments in Claudia Goldin and Lawrence Katz's fine new book, *The Race Between Technology and Education*. Goldin and Katz, both professors of economics at Harvard, tackle the most important US economic trend, and, hence, most critical domestic issue - growing income inequality.

The gap, according to Goldin and Katz is as great today as it was in the Gilded Age. Even so, this trend is hard to discuss in the US. The country still bills itself as the land of opportunity, one in which, as a recent business advice book put it, everyone aspires to become "the millionaire in the mirror". Most Americans are anxious about any argument that is a call to "class war". Instead, the angst caused by growing income inequality and median wage stagnation, tends to be redirected at softer, foreign targets in the form of attacks on immigration or trade.

Goldin and Katz have no such squeamishness. The first third of their book rigorously documents how income distribution in the US has changed over the past century, drawing comparisons with the rest of the world. These are useful in figuring out what is unique about the US. The professors remind us of one reason why the 20th century earned its nickname as "the American Century": over the past 100 years, Americans got a lot richer, with income per capita increasing a whopping five- or six-fold.

This almost continuous growth of the national pie masks some dramatic shifts in which group grabbed the largest slices. Goldin and Katz point out that for the first three-quarters of the century, income inequality fell: "Americans grew together". This chimes with the nostalgia many Americans, even those ungraced by PhDs in economics, feel for this period recalling the postwar years of 1947 to the mid-1970s as a halcyon time for the middle classes.

Things changed abruptly in the mid-1970s. Since then, Goldin and Katz say, America has experienced "exploding inequality". It now has the most unequal income and wage distributions of any high-income nation. Moreover, the gap has grown within socioeconomic groups, as well as between them. Among lawyers, for example, those who went to the top law schools saw their incomes increasing much faster than those who went to second-tier institutions. At the bottom of the income scale, family incomes stagnated, or even fell. Another recent study found that between 1997 and 2001 the top 10 per cent of US earners received 49 per cent of the growth in aggregate real wages and salaries. The top 1 per cent received a whopping 24 per cent - nearly double the 13 per cent which went to the bottom half of US earners.

Goldin and Katz's careful documentation of the changes in income distribution is an important public service. This alone would make their book essential reading. Yet they also offer a powerful explanation for what has driven changes in income inequality and point to solutions for addressing it.

They dismiss the populists' two favourite culprits - immigration and trade - in short order (possibly too short; my only quibble with this work is that I would have liked to read more on trade). Instead, Goldin and Katz are persuaded by a view common amongst professional economists - that technological change is a major driver of the growing gap between rich and poor.

But Goldin and Katz give a twist to the assertion that "computers did it". The real point, they say, in

an argument buttressed by historical comparisons and technical analysis (if you cannot quite remember what a logarithm is you may want to skip this part) is the race between the demand for skilled workers, as created by new technologies, and the supply of them, as created by the educational system.

When advances in mass education outpace technological change, income inequality declines; but if educational improvements stall, as they have in the US since the 1970s, technology takes the lead, widening the wage gap. The good news is that if Goldin and Katz are right, the cure for income inequality is one most Americans would intuitively support: improving mass education. Mr Obama's spin-doctors should start translating Goldin and Katz's book into a campaign slogan at once.

The writer is the FT's US managing editor

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