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ISSUE

Is the Inequality in U.S. Income Distribution Surging?

YES: Steven J. Markovich, from "The Income Inequality Debate," *Council on Foreign Relations Backgrounder* (September 17, 2012)

NO: Thomas A. Garrett, from "U.S. Income Inequality: It's Not So Bad," *Inside the Vault* (Spring 2010)

Learning Outcomes

After reading this issue, you will be able to:

- Identify how income inequality is defined, what causes it, and what the consequences of income inequality are.
- Identify how income inequality in the United States has changed over time.
- Understand why there are political differences and debates over the size of the income inequality as well as ways to reduce it.
- Understand how government intervenes to soften the blow to market adjustments when there is a major economic crisis, such as the Great Recession of 2007.
- Understand that society should have a reduction in income and wealth inequality as a goal, in addition to achieving economic efficiency, although this may come at the expense of lower economic growth.

ISSUE SUMMARY

YES: Steven J. Markovich, contributing editor for the Council on Foreign Relations, believes that the level of income and wealth inequality has increased in the United States as well as in every European country during the past few decades. However, the disparity in income inequality is much higher in the United States than in most other developed countries of Europe and North America. His analysis shows that the average real family income of the top 1 percent rose to 275 percent from 1979 to 2007.

NO: Thomas A. Garrett, assistant vice president and economist at the Federal Reserve Bank of St. Louis, does not deny the fact that income and wealth inequality has been rising in the United States since 1970. However, he rejects the notion that the United States is experiencing a surge in inequality. He cautions that the data used by economists to measure income inequality overstate the true degree of inequality for several reasons.

It is well known that the level of income inequality has increased in the United States as well as in every European country during the past few decades. However, the level of income inequality stretches much higher in the United States than in most of the other developed countries of Europe and North America.

Growing inequality is one of the biggest social, economic, and political challenges that the United States is experiencing today. Despite the fact that the U.S. economy has grown considerably during the past three decades, there is a strong and prevailing public perception that the middle class and the poor have been left behind. Many economists believe that the woes of the middle class and the poor are in large part a consequence of globalization and technological change as well as a significant drop in union membership. In addition, culture may also play a role. The consensus of mainstream economists has long been that under the capitalist system, both the input and product markets are competitive; wages are determined by worker productivity and the market value of output produced. More educated and productive workers should receive higher wages than less educated and unproductive workers. In other words, any market economy has some workers whose skill levels and education are so low that income-earning possibilities are bleak. Therefore, it is important to understand that the income and wealth inequality is a by-product of a well-functioning capitalist system. However, if markets do such a good job in directing an economy's scarce resources and improving our economic condition, then why have we experienced so much skepticism about the virtues of capitalism in the past few years?

Economic analysis can provide some insight into why income inequality exists in a market economy. Income distribution can be skewed by any of the following factors:

- Discrimination based on race, age, and gender.
- Unequal opportunities to skills training, education, and other productivity-enhancing options.
- Labor market discrimination.

In addition, there are other sources of income and wealth inequality in the United States such as:

- Changing attitudes toward family formation: the rise in single-family female-headed households and high divorce rates.
- Old age and the decline of income and wealth.
- Unfortunate events, such as illness, accidents, and mental health problems.
- Culture and society, including lack of effective role models and development of behavioral traits that lead to failure, such as teenage pregnancies, school dropouts, weak work ethics, and low aspirations.

This issue looks at income inequality in the United States, providing a brief historical analysis of income inequality, its trends, its causes, as well as instruments for measuring it, and tools available to policymakers for reducing it. Two important tools used by economists and policymakers to measure income inequality are referenced by both Markovich and Garrett in this issue—quintile distribution of income and the Gini coefficient.

To analyze family and personal income distribution, the Census Bureau sorts households from the lowest incomes to the highest. It then divides these households into quintiles, or fifths, from the lowest 20 percent of households to the highest 20 percent. After totaling and averaging household incomes for each quintile, the Census Bureau calculates the percentage of income that goes to each quintile. If a society wishes to achieve absolute income equality, then all quintiles should receive 20 percent of aggregate income.

U.S. Income Distribution in 2010

Income group	Income range	Average income	Percent of total income
Bottom quintile	Less than $20,000	$11,034	3.3
Second quintile	$20,000 to 38,043	$28,636	8.5
Third quintile	$38,043 to $61,735	$49,309	14.6
Fourth quintile	$61,735 to $100,065	$79,040	23.4
Top quintile	More than $100,065	$169,633	50.2
Top 5 percent	More than $180,810	$287,686	21.3
Mean income = $67,530		Median income = $49,445	

Source: U.S. Census Bureau

Based on this measurement, over the past three decades, income distribution in the United States has been growing more unequal. As the table below shows, in 2010 the average income of the poorest fifth of households was less than a quarter of the average income of households in the middle, and the richest fifth had an average income of more than three times that of households in the model. Furthermore, the incomes of the richest fifth of the households were, on average, about 15 times as high as those of the poorest fifth. However, it is important to know that these numbers are only based on money income before taxes and ignore the value of employment-based fringe benefits and government-provided noncash benefits such as food stamps, Medicaid, and public or subsidized housing.

The second tool that is used by economists and policymakers to evaluate income distribution is the Gini coefficient. It is named after the Italian statistician Corrado Gini, who designed it in 1912. The coefficient values vary between 0 and 1—with 0 meaning that everyone has exactly the same income (absolute income equality) and 1 meaning that one person has all of the income and everyone else has none (absolute income inequality). During the 1970s, the Gini coefficient was 0.316 in the United States; however, it had increased to 0.378 by the late 2000s.

Income inequality, as measured either by the quintile distribution of income or the Gini coefficient, is only a snapshot of outcomes. Unfortunately, they do not explain why these income gaps have appeared or what the trend is over time. Like any snapshot, they can be misleading. Income inequality can increase for good reason, such as workers being more productive and rewarded with higher wages or poor children not having the same opportunities as wealthy ones. In addition, it is important to distinguish between equality of opportunity vs. equality of outcome. Some countries like the United States, China, and India put more emphasis on the equality of opportunity to help their population achieve upward mobility. On the other hand, the European countries seem to be more egalitarian, believing that there should not be a big income gap between rich and poor.

In the following selections, two authors explore a question that will be of primary focus for American economists as well as policymakers for many years to come. Is the inequality in U.S. income distribution surging? Markovich identifies several causes of income inequality and explains the possible economic, social, and political costs of surging inequality in the United States. In addition, he introduces several policy recommendations that might help reduce income inequality. Garrett's analysis is very similar. He does not deny the fact that income is distributed unequally in the United States. However, he rejects the notion that the United States is experiencing a surge of inequality. He cautions that the data used by economists to measure income inequality overstate the true degree of inequality for several reasons. For example, he argues that the data represent a snapshot for a single year, whereas the income of any individual household changes over time.

YES

Steven J. Markovich

The Income Inequality Debate

Introduction

In September of 2011, the Occupy Wall Street protests began in New York and quickly spread across the globe. Its "We are the 99 percent" slogan encapsulated popular angst over income inequality that had been rising steadily over the years. Today, inequality in the United States, measured by the standard Gini coefficient, is substantially higher than almost any other developed nation, and even some developing countries such as Russia and India.

While income inequality can be summarized in a few words, its multiple potential causes are more complex. Globalization and technological change have simultaneously led to greater competition for lower-skilled workers—many of whom have also lost union membership—while giving well-educated, higher-skilled workers increased leverage. Changes to tax rates, including favorable treatment for capital gains, may also play a role.

Rising U.S. Income Inequality

Income inequality in the United States has been rising for decades, with the top echelon of earners rapidly outpacing the rest of the population. According to the Congressional Budget Office, the average real after-tax household income of the top 1 percent rose 275 percent from 1979 to 2007. Meanwhile, income for the remainder of the top quintile (81st to 99th percentile) grew 65 percent. Income for the majority of the population in the middle of the scale (21st through 80th percentiles) grew just 37 percent for the same period. And the bottom quintile experienced the least growth income at just 18 percent.

Furthermore, in 1965, a typical corporate CEO earned more than twenty times a typical worker; by 2011, the ratio was 383:1, according to the Economic Policy Institute.

While many of the suspected drivers of rising income inequality—globalization, technological change and the rising value of education—affect other nations as well, few have seen as stark a rise in inequality. From 1968 to 2010, the share of national income earned by the top 20 percent rose from 42.6 to 50.2 percent, with gains concentrated at the very top. Meanwhile, the "middle class," the middle 60 percent, saw its share decline from 53.2 to 46.5 percent. This increasing income inequality is captured by the steady rise in the U.S. Gini coefficient, from 0.316 in the mid-1970s to 0.378 in the late 2000s. Today, the U.S. income distribution is one of the most uneven among major developed nations.

Globalization and De-Unionization

Economic forces underlie the growth of income inequality. Highly skilled workers have greatly benefited from worldwide opportunities, from the star actor whose movies reach a global audience to the entrepreneur who can quickly and cheaply bring a new product to market through Chinese contract manufacturing (*Forbes*).

Meanwhile, globalization has brought tough competition to other American workers who have seen jobs move overseas, wages stagnate, and unions decline. The median union member earns roughly a quarter more than a non-union counterpart. Forty years ago, a quarter of private sector workers were represented by unions, but today it is only 6.9 percent. Despite a workforce one-fifth of the size, the public sector has more union members.

Immigration likely pays a role in stagnant wages, especially among workers without a high school degree, of which immigrants make up about half. One study found that a 10 percent increase in the local immigrant population correlated with a 1.3 percent decline in the price of labor-intensive services, but it is difficult to disentangle this competitive effect from others on the labor market.

A noted free trade advocate, Alan Blinder, said that while beneficial for the United States as a whole, the increased labor competition from globalization will be painful for many Americans. He advocated for helping displaced workers through a stronger safety net, reforming education, and encouraging innovation and entrepreneurship (*WashPost*). Fellow Princeton economist Paul Krugman believes that "we need to restore the bargaining power that labor has lost over the last thirty years, so that ordinary workers as well as superstars have the power to bargain for good wages" (*NYT*).

Education and Technological Change

Most high wages come from high-skill jobs that require a commensurate level of education. After decades of gradually narrowing, the college wage premium has grown dramatically since 1980, as the annual growth in the college educated workforce (2 percent) failed to keep pace with rising demand (3.27 to 3.66 percent) driven by technological change. In 2011, the median earnings of a worker with a bachelor's degree were 65 percent higher than a high school graduate's; holders of professional degrees (MD, JD, MBA) enjoyed a 161 percent premium. Higher educational attainment correlates both with higher earnings and lower unemployment.

However, college degrees do not guarantee good jobs. Falling communication and computer costs are leading to the offshoring and automation of some jobs that were once the purview of well-paid professionals, from scientists in pharmaceutical labs to finance and accounting jobs (*Businessweek*). There is a widening wage premium between those with advanced degrees and those with a bachelor's degree only. Since the 2000s, the wage premium for those with only a four-year degree has remained flat, while for those with advanced degrees it has continued to grow.

Gary S. Becker and Kevin M. Murphy of the University of Chicago see education as the major driver of rising income inequality. "In the United States, the rise in inequality accompanied a rise in the payoff to education and other skills. We believe that the rise in returns on investments in human capital is beneficial and desirable, and policies designed to deal with inequality must take account of its cause" (*TheAmerican*). To address income inequality, they argue for policies that would increase the percentages of American youth who complete high school and college, and against making the tax code more progressive.

In a recent survey, 80 percent of economic experts agreed that a leading reason for rising U.S. income inequality was that technological change has affected workers with some skill sets differently than others, but not all prominent economists agree. James K. Galbraith believes that "the skills bias argument—the notion that inequality is being driven by technological change and education and the supply of skills—is comprehensively rebutted by the evidence." He argues instead that the credit cycle has concentrated income in specific sectors, such as finance, tech and real estate (*WashPost*).

Income Tax Rates

One tool for addressing income inequality is a more progressive tax code. While some argue that shifting some money from the rich to the poor means that money can be used to create more social utility—the economic concept of declining marginal utility—other see this shift as unfair and unwise because it reduces the ability of more productive citizens to re-invest in the skills and businesses responsible for their higher relative income, thus retarding overall growth. While economic models and theories can attempt to quantify the relationship between inequality and growth, the optimum balance cannot be empirically determined.

The United States has generally cut top income tax rates over the past half century. When John F. Kennedy entered the White House in 1961, the top ordinary income tax bracket—applied to wages and savings interest—was more than 90 percent. Ronald Reagan slashed the top rate from 70 percent in 1981 to 28 percent after 1986. Tax increases under the first President Bush and President Clinton brought the top rate to 39.6 percent, but tax cuts signed by President George W. Bush and reauthorized by President Obama set it to 35 percent.

Tax rates on investment income in the form of capital gains taxes and dividends have also declined, with the current rate of 15 percent the lowest since 1933. Investment income ultimately is derived from the after-tax profits of corporations, whose tax rate has also declined since the Eisenhower-era, from more than 50 percent to today's marginal rate of 35 percent. Corporate income tax has declined steadily as a share both of corporate profits and as a percentage of GDP over the past half century.

The Social Security payroll tax, which funds both old age pensions and Medicare, is regressive because it is a flat rate that only applies to the first $110,100 of wages, in 2012. On the other hand, roughly half of U.S. taxpayers pay no additional federal income tax.

A Tax Policy Center analysis of all federal taxes found overall progressive taxation, with each quartile paying a successively higher rate and the top 0.1 percent paying an effective rate of 30.4 percent. While higher than the 14.1 percent borne by the middle quartile, 30.4 percent is lower than the historical rates paid by this small group, which is earning its largest share of national income since the Great Depression.

Social Program Support

The poverty rate tends to generally follow the economic cycle. As the economy reached new heights in 2000, the poverty rate fell to 11.1 percent—a rate not seen since 1973—but in 2010 the poverty rate had jumped back up to 15.1 percent.

Under President Lyndon Johnson's Great Society, most assistance was in the form of cash benefits to needy families. Through the 1970s and 1980s, non-cash benefit programs were created or accelerated, including college grants, food stamps, and housing assistance. The 1990s ushered in welfare reform, replacing federal cash assistance with TANF block grant to states, with work requirements and time limits. The refundable earned income tax credit, (created in 1975) was greatly expanded at this time, providing extra cash to workers in an effort to "make work pay."

Today, record numbers receive food stamps, though one in five Americans struggle to afford food (Stateline). The number of Social Security Disability Insurance recipients has surged by more than 22 percent since the recession began, as that program effectively acts as a long-term unemployment benefit for some (Bloomberg).

From Medicaid to unemployment benefits, many social support programs are driven by decisions at the state level. States have less flexibility to run deficits and many have cut programs to needy citizens. Pennsylvania recently joined other states in eliminating its general assistance program (Stateline). One caseworker observed: "My clients have lost an important source of funds for life's necessities, while they face longer waitlists for job training programs."

Bred for Success?

A longer-term source of income disparity is strengthening: It is increasingly difficult to reach a higher economic status than your parents. Many Americans take pride in the belief that everyone has a chance to "make it big" and rags-to-riches stories are almost legends. But today, more than 40 percent of those born into the lowest income quintile will stay there, and less than 30 percent will make an above-average income.

Among developed countries, only the United Kingdom has less class mobility; in 2006, the Brookings Institution found that 47 percent of U.S. parents' income advantages are passed to their children, greater than in France (41 percent), Germany (32 percent) or Sweden (27 percent). The countries with the highest mobility were Canada, Norway, Finland and Denmark, where less than 20 percent of economic advantages are passed to children.

Political Impact

The growing gap between the rich and poor may exacerbate political disunity. Economist Joseph E. Stiglitz of Columbia University examined this in his recent book, *The Price of Inequality*, and argued that no one has an interest in stark inequality. "The rich do not exist in a vacuum. They need a functioning society around them to sustain their position. Widely unequal societies do not function efficiently and their economies are neither stable nor sustainable" (*Vanity Fair*).

The Pew Research Center found increasing anxiety among America's middle class, with 85 percent expressing greater difficulty in maintaining their standard of living. While a majority of Americans see income inequality as a big problem (*TheHill*), polls also show more desire for economic growth and greater equality of opportunity (Gallup).

During the debate in late 2010 over whether to extend the Bush-era tax rates, influential behavioral economist Richard H. Thaler asked "whether we want a society in which the rich take an ever-increasing share of the pie, or prefer to return to conditions that allow all classes to anticipate an increasing standard of living" (*NYT*). The former chairman of Bush's Council of Economic Advisers, N. Gregory Mankiw, argued that raising his marginal tax rate would lead him—and many others—to work less (*NYT*). This tension between equality and growth is likely to remain unresolved for the foreseeable future.

Finally, an August 2012 paper by the Hoover Institution of Stanford argued that income inequality is not rising. Their analysis considered after tax income and added in non-cash benefits from employers and government programs, and calculated a decline in the U.S. Gini coefficient from 1993 to 2009. The authors argued that reducing income inequality would not improve economic well-being, and policymakers should instead target opportunity inequality.

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Thomas A. Garrett

NO

U.S. Income Inequality: It's Not So Bad

Each year, the U.S. Census Bureau releases data on the income levels of America's households. A comparison of the annual data over time reveals that the income of wealthier households has been growing faster than the income of poorer households—the real income of the wealthiest 5 percent of households rose by 14 percent between 1996 and 2006, while the income of the poorest 20 percent of households rose by just 6 percent.

As a result of these differences in income growth, the income of the wealthiest 5 percent of households grew from 8.1 times that of the income of the poorest 20 percent of households in 1996 to 8.7 times as great by 2006. Such figures commonly lead to the conclusion that income inequality in the United States has increased. This apparent increase in income inequality has not escaped the attention of policy makers and social activists who support public policies aimed at reducing income inequality. However, the common measures of income inequality that are derived from the census statistics exaggerate the degree of income inequality in the United States in several ways. Furthermore, although many people consider income inequality a social ill, it is important to understand that income inequality has many economic benefits and is the result of—and not a detriment to—a well-functioning economy.

An Inaccurate Picture

The Census Bureau essentially ranks all households by household income and then divides this distribution of households into quintiles. The highest-ranked household in each quintile provides the upper income limit for each quintile. Comparing changes in these upper income limits over time for different quintiles reveals that the income of wealthier households has been growing faster than the income of poorer households, thus giving the impression of an increasing "income gap" or "shrinking middle class."

One big problem with inferring income inequality from the census income statistics is that the census statistics provide only a snapshot of income distribution in the U.S., at a single point in time. The statistics do not reflect the reality that income for many households changes over time—i.e., incomes are mobile. For most people, income increases over time as they move from their first, low-paying job in high school to a better-paying job later in their lives. Also, some people lose income over time because of business-cycle contractions, demotions, career changes, retirement, etc. The implication of changing individual incomes is that individual households do not remain in the same income quintiles over time. Thus, comparing different income quintiles over time is like comparing apples to oranges, because it means comparing incomes of different people at different stages in their earnings profile.

The U.S. Treasury released a study in November 2007 that examined income mobility in the U.S. from 1996 to 2005. Using data from individual tax returns, the study documented the movement of households along the distribution of real income over the 10-year period. The study found that nearly 58 percent of the households that were in the lowest income quintile (the lowest 20 percent) in 1996 moved to a higher income quintile by 2005. Similarly, nearly 50 percent of the households in the second-lowest quintile in 1996 moved to a higher income quintile by 2005. Even a significant number of households in the third- and fourth-lowest income quintiles in 1996 moved to a higher quintile in 2005.

The Treasury study also documented falls in household income between 1996 and 2005. This is most interesting when considering the richest households. More than 57 percent of the richest 1 percent of households in 1996 fell out of that category by 2005. Similarly, more than 45 percent of the households that ranked in the top 5 percent of income in 1996 fell out of that category by 2005.

Thus it is clear that over time, a significant number of households move to higher positions along the income distribution, and a significant number move to lower positions along the income distribution. Common reference to "classes" of people (e.g., the lowest 20 percent or the richest 10 percent) is quite misleading because income classes do not contain the same households and people over time.

Another problem with drawing inferences from the census statistics is that the statistics do not include the noncash resources received by lower-income households—resources transferred to the households—and the tax payments made by wealthier households to fund these transfers. Lower-income households annually receive tens of billions of dollars in subsidies for housing, food and medical care. None of these are considered income by the Census Bureau. Thus the resources available to lower-income households are actually greater than is suggested by the income of those households as reported in the census data.

At the same time, these noncash payments to lower-income households are funded with taxpayer dollars—mostly from wealthier households, since they pay a majority of overall taxes. One research report estimates that the share of total income earned by the lowest income quintile increases roughly 50 percent—whereas the share of total income earned by the highest income quintile drops roughly 7 percent—when transfer payments and taxes are considered.

The census statistics also do not account for the fact that the households in each quintile contain different numbers of people; it is differences in income across people, rather than differences in income by household, that provide a clearer measure of inequality. Lower-income households tend to consist of single people with low earnings, whereas higher-income households tend to include married couples with multiple earners. The fact that lower-income households have fewer people than higher-income households skews the income distribution by person. When considering household size along with transfers received and taxes paid, the income share of the lowest quintile nearly triples and the income share of the highest quintile falls by 25 percent.

Is Policy Needed?

Income inequality will still exist even if the income inequality statistics are adjusted to account for the aforementioned factors. Given the negative attention income inequality receives in the media, it is important to ask whether reducing income inequality is a worthy goal of public policy. It is important to understand that income inequality is a byproduct of a well-functioning capitalist economy. Individuals' earnings are directly related to their productivity. Wealthy people are not wealthy because they have more money; it is because they have greater productivity. Different incomes reflect different productivity levels.

The unconstrained opportunity for individuals to create value for society—and the fact that their income reflects the value they create—encourages innovation and entrepreneurship. Economic research has documented a positive correlation between entrepreneurship/innovation and overall economic growth. A wary eye should be cast on policies that aim to shrink the income distribution by redistributing income from the more productive to the less productive simply for the sake of "fairness." Redistribution of wealth increases the costs of entrepreneurship and innovation, with the result being lower overall economic growth for everyone.

Poverty and income inequality are related, but only the former deserves a policy-based response. Sound economic policy to reduce poverty would lift people out of poverty (increase their productivity) while not reducing the well-being of wealthier individuals. Tools to implement such a policy include investments in education and job training.

Income inequality should not be vilified, and public policy should encourage people to move up the income distribution and not penalize them for having already done so.

GLOSSARY

Adjusted gross income Total income less statutory adjustments.

Business cycle The periodic but irregular up-and-down movements in economic activity, measured by fluctuations in real GDP and other macroeconomic variables.

Capitalism Economic system characterized by the following: ownership of private property; individuals and companies that are allowed to compete for their own economic gain; and free-market forces that determine the prices of goods and services.

Income Earnings received as wages, rent, profit or interest; payments received for providing natural, human capital and entrepreneurial resources in the market.

Inflation A sustained increase in the average price level.

Poverty A condition that occurs when people do not enjoy a certain minimum level of living standards, as determined by a government.

Productivity A ratio of output to input during a specified period of time. For example, output per worker is a measure of the productivity of labor during an hour, week, month or year. The productivity of workers can be increased through division of labor, investment in human capital and investment in capital resources.

Purchasing power A measurement of the relative value of money in terms of the quality and quantity of goods and services it can buy.

Quintile One of five equal parts of a range of data, each being 1/5th (20 percent) of the range.

Real income Income expressed in terms of the goods and services it can purchase.

Standard of living A measure of the goods and services available to a person in a country; the dollar value is calculated as per capita GDP.

Subsidies Financial assistance given by the government to individuals or groups.

Taxes Mandatory government fees on business and individual income, activities or products.

Taxable income Adjusted gross income less standardized or itemized deductions.

Transfer payments Payments by governments—such as social security, veterans' benefits and welfare—to people who do not supply goods, services or labor in exchange for the payments.

Wealth Accumulated assets such as money and/or possessions, often accumulated as a result of saving and investment.

Thomas A. Garrett is assistant vice president of the Federal Reserve Bank of St. Louis. He holds a PhD in economics from West Virginia University.

EXPLORING THE ISSUE

Is the Inequality in U.S. Income Distribution Surging?

Critical Thinking and Reflection

1. Outline the range of major policy options available to the U.S. government to reduce the income and wealth inequality. Which policy or policies do you believe are absolutely essential, and which are important but not crucial?
2. Are higher economic growth and more equitable distribution of income necessarily conflicting objectives? Outline the arguments both for and against the presumed conflict of objectives.
3. What are the major causes of income and wealth inequality in the United States today?
4. Name and explain the two measures used to determine the extent of income inequality.
5. How would you design a program aimed at reducing income and wealth inequality in the United States?

Is There Common Ground?

Income inequality and poverty are among the most contentious issues facing economists and politicians today. No one denies that income is distributed unequally in America. In fact, many believe that income inequality is a natural consequence of a well-functioning market economy. However, what should be the acceptable level of inequality in order to allow the market economy to achieve the desirable level of economic efficiency and growth? Should the market economy be concerned about issues, such as economic equity, social justice, and fairness?

How serious an issue is income inequality in the United States today? As we have already seen, income inequality has increased substantially since the 1970s. Today a large percentage of the American population does not share in the country's overall prosperity, even though it contributes a great deal to its success. Increasing income inequality is one of the most important reasons for why the poverty rate has not improved in the United States over the past 40 years despite the fact that the United States as a whole has become much wealthier. In addition to economic cost, there might be also a political cost associated with the high level of income inequality. For example, the extreme inequality in many developing countries, such as in Latin America, is usually associated with political instability because of tension between a very rich minority and the rest of the population that lives in poverty for the most part.

Many economists including Steven J. Markovich and Thomas A. Garrett are concerned about this widening income disparity. They believe that it might have long-lasting and damaging side effects. In theory, there is an ambiguous relationship between inequality and economic growth and prosperity. The existence of income inequality might help the country achieve a higher rate of economic growth because rich people save and invest by far more than poor people. In addition, people generally work harder, save, and invest more in response to incentives. However, a large income gap can be very inefficient for a country. It can prevent a large segment of the populations that is smart, hardworking, but poor from access to education and can cause resentment and anger, which might negatively affect the country's economic growth policies.

Traditionally, education has been one of the most important tools for low- and middle-income Americans to achieve new opportunities and upward economic mobility. However, today in America 40 percent of those born into the lowest income quintile will stay there, and less than 30 percent will make an above-average income. Unfortunately, if we do not provide poor young Americans with the same educational opportunities that we provide to rich young Americans to realize their potential, not only will we harm students, but we might also harm the nation as a whole.

Fundamentally, both Steven J. Markovich and Thomas A. Garrett agree with polices that would increase the percentage of American youth who complete high school and college in order to reduce income and wealth inequality in the United States. In addition, Markovich believes that changes to tax rates, including less favorable treatment for capital gains, may also help. However, unlike Markovich, Garrett is against making the tax code more progressive as a policy solution to reduce income inequality. Garrett concludes that "Income inequality should not be vilified, and public policy should encourage people to move up the income distribution and not penalize them for having already done so."

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