Leaders must focus on fixing the inequality of labor income in the U.S.

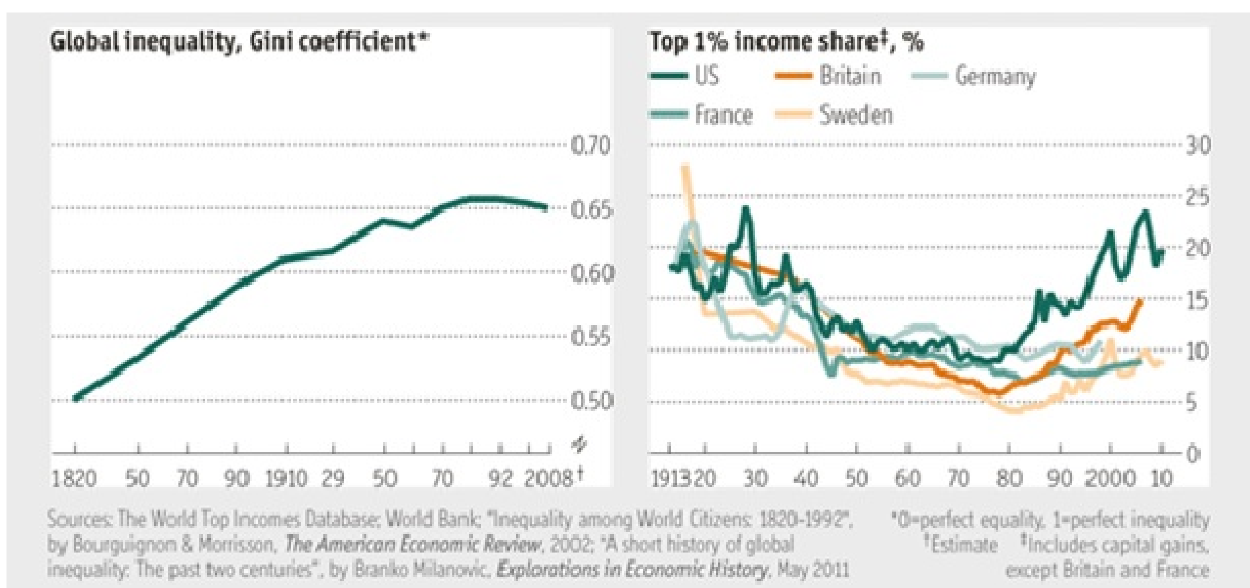
With income inequality now at levels greater than those seen during the Gilded Age, many have become concerned about the impacts of such societal discrepancies on democracy. **Mark Esposito** *and* **Terence Tse** *trace the history capital accumulation and income inequality in the United States and Europe, showing that the working class in the U.S. is getting poorer, even as their productivity increases. They write that American leaders should focus on fixing this trend as extreme inequalities undermine democratic values.*

What are the grand dynamics that drive the accumulation and distribution of capital? Questions about the long-term evolution of inequality, the concentration of wealth, and the prospects for economic growth lie at the heart of political economy. But satisfactory answers have been hard to find for lack of adequate data and clear guiding theories and leaps back to historians and theories of the past have been made in the attempt to provide an answer to an increasingly opaque scenario. Are we growing? If so, why aren't we creating new jobs? More and more people globally are pushed down to economic instability and lack of continued employment. In his recent research, a French scholar, Piketty, tries to tackle these questions and address the migration of capital from the activity of the real economy, towards the concentration of a fewer players (commonly called the top 1%).

The good news is that Piketty shows that modern economic growth and the diffusion of knowledge have enabled us to avoid inequalities on the apocalyptic scale predicted by Karl Marx. But we have not modified the deep structures of capital and inequality as much as we hoped for in the solid growth decades after World War II.

A recent analysis produced by *The Economist* shows that the Gini coefficient, a measure of income inequality, has globally been steadily on the rise since 1820 (shown in Figure 1). How do we explain this?

Figure 1: Global income inequality since 1820



The return of patrimonial societies in the Old World (Europe, Japan) may be one of the principal factors, since wealth-income ratios seem to be returning to very high levels in low growth countries.

In any slow-growth society, wealth accumulated in the past can naturally become very important for the current

situation, and, in the very long run, this can be relevant beyond national borders. The imbalance of wealth concentration today is comprised of a higher net tax rate of return for capital, contrasted by a diminishing growth rate. This would explain why current wealth inequality might reach or surpass 19th century oligarchic levels.

The main driver of inequality today—the tendency of returns on capital to exceed the rate of economic growth—threatens to generate extreme inequalities that stir discontent and undermine democratic values. Given the prevalence of inequality in many modern democracies today, whether democracy has failed its purpose has become a common topic to be discussed in educated lounges around the world as well as classrooms. The debate is still far from being resolved and the uprising of anti-democracy protests is becoming of alerting concern.

Credit: Glenn Halog (Creative Commons BY-NC 2.0)

If the above is true for the Old World, the New World (America) is developing a new inequality model that is basec more upon extreme labor income inequality than wealth inequality. While this may appear to be related to a more merit- based society, could it become the worst of all worlds?

Inequality in America follows and develops a different structure as in Europe: more egalitarian in some ways, more elitist in some other dimensions. We could inarguably say that Europe in the 19th century was very unequal. There was a scarcity of accumulated capital; perpetual demographic growth and large families inevitably reduced the level of inherited wealth and wealth concentration, which led to a high level of poverty and a true fragmented society. In contrast, the New World in the 19th century was considered the land of opportunity and the way capital was accumulated in the past did not matter that much. The northern states were in many ways more egalitarian than Old Europe, while the South suffered of profound ethnic, racial and societal ruptures, which made it more unequal by consequence.

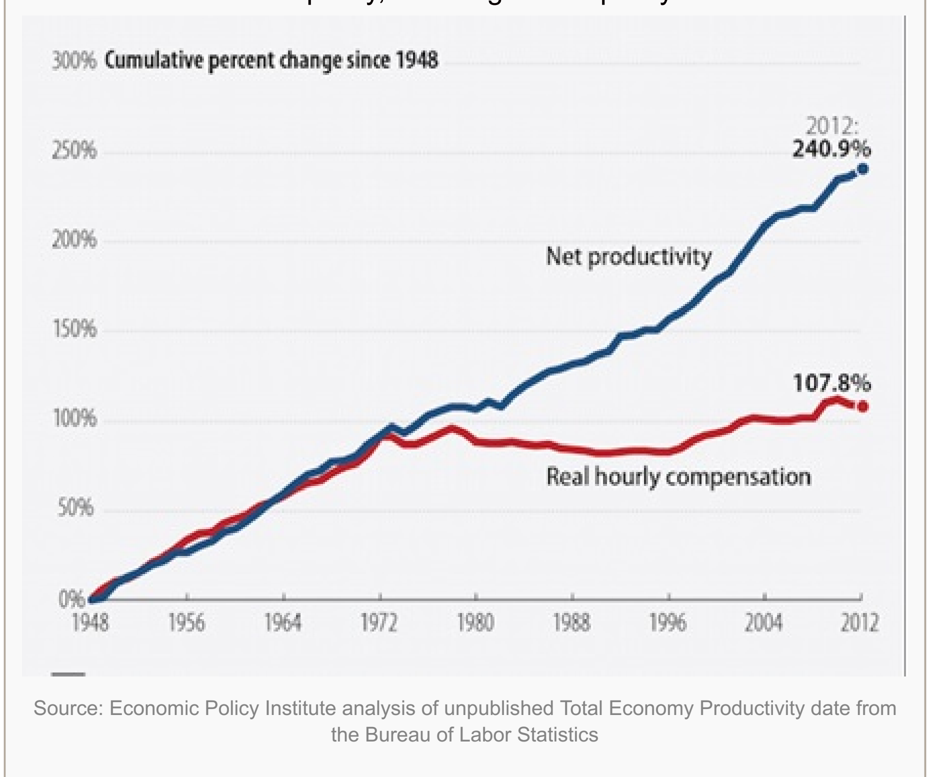
This can be true until the beginning of the 20 th century, where the misery of World War I, the Great Depression in 1929 and the impact of World War II, reduced drastically inequalities and turned the US as a country with the best ratio between income and labor productivity. These are the golden years of 1950, when the American middle class could benefit from solid paychecks and prospective of a flourishing future, supported by an hourly compensation which was somehow tagged to an increasing productivity. Those were times where the model of the American middle class worker was globally inspiring social movements and aspirations for a working class entrenched in dignity.

Figure 2: Divergent net productivity and real hourly compensation of production/nonsupervisory workers 1948-2012

Note: Data are for compensation of production/nonsupervisory workers in the private sector (in 2012 dollars), net productivity is for the total economy and is equal to the growth of output goods and services minus depreciation per hour worked.

But, as the research from the Economic Policy Institute demonstrates (shown in Figure 2), soon after the 70's, inequality appears in the US not only across the relative distribution of income, but as relative to the value of compensation versus net productivity. In other words, converted by inflation, middle class in the United States today, enjoys the same hourly compensation than in 1972, or slightly above it. But where is the rest of the net productivity surplus gone?

The structure of the US inequality in 2013 has less wealth inequality, but a higher inequality of labor income than Europe in 1913. Higher inequality of labor income in the US could reflect higher inequality in education investment; but it also reflects a huge rise of top executive compensation that it very hard to explain with education and productivity reasoning alone.



Source: Economic Policy Institute analysis of unpublished Total Economy Productivity date from the Bureau of Labor Statistics

While inequality never shares any positive trends, the US inequality dilemma produces a new paradigm in history: the working class is becoming poorer. This is where the new generation of American leaders should focus, to prevent a type of crisis of a kind we have never previously experienced.

The history of income and wealth inequality is always political, chaotic and unpredictable; it involves national identities and sharp reversals; nobody can predict the reversals of the future, but just the fantasy of what those could be can certainly concern us.

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Note: This article gives the views of the author, and not the position of USApp– American Politics and Policy, nor of the London School of Economics.

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