



Episode 483: What's the Truth About Inequality?

Guest: Scott Winship

WOODS: I really have to thank you. You are doing my listeners a tremendous favor, because as I said before we went on, mastering this inequality literature is no small accomplishment, and having read a lot of your stuff, I can see that you know this study and that stuff and what this one says and what that one says and correlation and causation. And the whole gamut of issues that are raised, you have written about, so rather than trying to master that literature myself, I'm just going to cheat by inviting Scott Winship onto the show.

Now, one of the things you've done is looked at the consequences of inequality, because we see a lot of Facebook memes and President Obama statements that inequality is dragging down the economy, it's holding back growth. I want to get to that in a minute. Before we get to that, I want to talk about the extent of inequality and not whether it's good, bad, indifferent, but we hear a lot about this. There's been a tremendous increase in inequality, and I don't know if they're talking about income inequality or wealth inequality or what, but what is the actual trend, and is it as extreme as people let on?

WINSHIP: Those are great questions to start off with. Yeah, the problem with inequality is it's such a multifaceted topic, that there all sorts of different little avenues to explore. If we start with income inequality, I think it makes sense to look at trends in two different ways: to first look at income concentration, which is the extent to which incomes at the top have been getting bigger and bigger, and that's kind of what's getting all the attention here in the last decade or so, but then secondarily you can think about income inequality within the 99%, if you want to use the Occupy Wall Street terms.

And just very quickly, I think what's interesting that a lot of people don't realize is that income inequality below the top hasn't really grown all that much since the 1980s. So if you look at, for instance, the income of the typical middle class household versus a typical poor household, that gap hasn't really risen since the last '80s. What has changed a lot is the extent of income concentration at the top, and so I think the best numbers here come from the Congressional Budget Office actually, which show that in 1979, the top 1% of households earned something like 10% of all the income that was earned in that year, and then fast forward to 2007 on the cusp of the Great Recession, that number was more like 20%. And so that's a real increase. In 1979, the top 1%'s

average income was something like 9x the average income for a middle class hold. In 2007, it was more like 22. So certainly a big increase over time. We can quibble about whether that's overstated a little bit, but I think very few people would argue that income concentration has not risen quite a bit over time.

WOODS: All right, I guess what we have to get to now is what effects does this phenomenon have on the average person? Because the strong implication is if some people are getting wealthier, this must be at the expense of everybody else.

WINSHIP: That's certainly what you hear I think when you read about the topic in the news, and I spent several months a couple years ago doing a pass through all the literature on this, because I sort of got tired of having arguments with people where no one was actually citing any literature, which typically is how these arguments go, and it was interesting. So I essentially looked at whether rising income inequality hurts the living standards of the poor and of the middle class, whether it affects financial stability – a lot of people think the financial crisis was caused by inequality – and whether it affects democracy and political inequality.

And kind of one by one, I showed in this piece that I wrote for *National Affairs*, that either the evidence is really mixed or it's just not that great, not good enough to really give us an answer one way or another. And essentially, the case that inequality has hurt any of these things is remarkably thin. If you actually confront anybody with studies on this stuff or challenge them to back up their assertions, there's just not a lot behind them.

WOODS: What about instead of just inequality, if we look at the issue of the actual wellbeing on an absolute level, not relative to anyone else, but the wellbeing of people, let's say, in the bottom three of the five quintiles of the income distribution. What can we say about where they've gone from, let's say, the 1970s or so to today?

WINSHIP: Great, so we're now 10 minutes in and we've gotten to quintiles, which I'm always glad to –

WOODS: (laughing)

WINSHIP: So quintiles are, for people who don't know, if you kind of think of the income distribution, lining everybody up from poorest to richest, quintiles essentially divide that up into fifths. So the middle quintile is kind of the middle class; the bottom quintile you can think of as the poor. And so if we look at the Congressional Budget Office data, which again, I think is the best source out there, it has some figures that surprise a number of people.

So for both the poor and the middle class the Congressional Budget Office says that the average incomes for those groups have risen by something like 35 possibly all the way up to 50% between 1975 and 2007, which I compare those two years, because they were both peaks in the business cycle. Incomes took a hit certainly in the Great Recession, but they're recovering, so eventually we'll have another business cycle peak

to compare 1979 to. But the 35 to 50% translates into roughly 10 grand. That's not an amount that any of us would be indifferent between having or not having today.

Now, critics will say well that's terribly slow growth on an annual basis, for instance. And well, it's hard to say without having some basis for comparison, so it is slower growth versus the 1950s and the 1960s, which were just this incredible period of income growth for everybody, and there are a lot of reasons for that and reasons why we're never going to go back to that. It's also less than certainly what the income growth at the top was.

But again, \$10,000 is a pretty substantial amount of money, and I think another important thing to remember is that the conventional, most-used numbers that get cited on this question, which just come from sort of the Census Bureau dumps that they do in September actually every year, are not the best numbers for tracking living standards over time. There are a number of problems with how they adjust for the rise in the cost of living. They don't include certain sources of income. The Congressional Budget Office I think has done the most careful job and it does show a surprising amount of growth for everyone, despite income inequality increasing.

WOODS: Before I forget, there's a point in one of your articles on this that, in trying to take on this claim that there's some kind of connection between the enrichment of the 1% and the impoverishment of everybody else, you seem to show – and again, you have to realize that correlation is not causation, but if I see a correlation that basically can't exist according to what my opponent claims, it does tend to undermine his argument – what is the actual relationship that at least where we see correlation between the rising fortunes of the 1% and the fortunes of everybody else, and the declining fortunes of the 1% and fortunes of everybody else?

WINSHIP: Right, so I think what's interesting is over time, the periods that are good for the top are also the periods that are best for the middle class and for the bottom. So what's interesting about the slow down in the growth in income for the middle class and for the poor is that it started in the 1970s, and that's important because income concentration didn't really start until the early to mid 1980s. So the slowdown in income growth really precedes the rise in income concentration by a decade, and the primary reason for that isn't a mystery; this happened in developed countries around the world, where productivity slowed down, and it's remained below for the most part what it was in the '50s and '60s. So over time, the top 1%, their fortunes and the fortunes of the middle class and poor tend to move together.

Now, what I think the Left focuses on is that around 1980, a lot of different things do change in ways that do correlate with rising inequality. But what I tried to show in my article is that, exactly as you say, correlation certainly is not causation. For the most part, you could – and to be clear, I am a supporter of immigration, particularly high-skilled immigration – but any argument that's made that correlates rising income concentration to problems that the middle class or poor are having, you can swap in the percentage of people in the United States who are immigrants and make the exact same argument. I would support neither of those arguments, but it just goes to show,

you can't simply say, well, inequality got worse over time and these other things got worse over time, and so it must be the case that inequality caused these other things to get worse over time.

WOODS: Are you familiar with any of this so-called happiness literature that tries to — well, it does a lot of things, but one of the recent points they've tried to make is that inequality seems to lead to less happy societies, whereas the more equal the society is, the happier it is. Do you know anything about that?

WINSHIP: I don't actually know that literature well; that's one of the few things I didn't take a look at in my article. There's another really important researcher named Lane Kenworthy, who is a sociologist and political scientist at the University of California - Santa Barbara, I believe. And Lane is a friend; he's a social democrat. His last book was actually called *Social Democratic America*. He would like to see us move more towards looking like Sweden. But he has looked at all of this in the same way that I have, and he generally tended to find the same results that I did, that essentially, the literature on happiness or on the health of individuals, whether physical or mental, which was another area I didn't look at, that essentially the literature is very thin on this stuff. It's mixed, and so what tends to happen is people selectively cite the study that makes the case they want to make. But the evidence really just isn't there when you dig into it.

WOODS: I'm going to link on the show notes page today, TomWoods.com/483, to an episode I did quite a while ago on Denmark as supposedly the world's happiest country. I had a professor from a university in Denmark come on and say it's not for any of the reasons that the propagandists in the U.S. are telling you. It's social trust; it's not anything; it's not a minimum wage; it's not family policy; it's not medical leave; it's none of that stuff, because that over time forms the basis of your future expectations. You get used to it. So it can't be the cause of permanent increases in happiness. It becomes your baseline. It becomes your plateau for the future. So anyway, he was fantastic on that stuff, so I'm going to link to that.

But I was curious about that, because it seems like they're trying to come up with all kinds of reasons that even if what they would perceive as the justice reasons for going after inequality don't persuade us, then we have these other really urgent reasons to go after it. For instance, they'll say — in fact, you point this out in your article, that one of the claims is that the greater the inequality seems to correlate with financial crises and economic instability of various kinds. What does the evidence seem to show about that?

WINSHIP: Well, this is a great case where there were kind of some claims by pretty prominent folks, and then everyone just sort of cited them without really stopping to think about whether there was anything there. So Robert Reich I think made the argument that the financial crisis was caused by rising inequality. One of the books on the financial crisis by Raghuram Rajan made the same claim; he's now the head of India's central bank, I think. And there were a couple of academic papers that made this claim as well.

What I cite in my article is a paper that came out after all of these claims, which directly took them on and essentially said I'm able to replicate their findings, but when I do this in a more sophisticated way, what he essentially found was that financial crises are caused by bubbles, by credit bubbles, which is not anything that is shocking, and it's true that inequality or income concentration also tends to rise during those same periods, but it's really a consequence of the credit bubble. And so he's able to disentangle those in a way those no one else tried to do before using data on crises going back to the 19th century. So I think that really deflates the claims that these previous folks have made.

The other thing that we haven't touched on that I've done a fair amount of work on is whether inequality hurts economic mobility, and this is another great area where as you say, the correlations really make things kind of complicated. In the United States, it turns out that economic mobility hasn't changed that much over the last, say, 50 years or so. Now that's a problem if you think that inequality has hurt mobility, because mobility is no worse now when inequality is high than it was several decades ago when inequality was much lower.

Similarly, if you look across countries, there were pretty strong correlations between how much inequality a country had and how little mobility that it had. That's a correlation to start with, as we talked about. But also, I think even the correlation is falling apart with new research essentially showing that the measure of mobility that was used in these analyses was not really a pure measure of mobility. It was kind of a measure of mobility. It was kind of a measure of inequality. And so unsurprisingly, a measure that looks worse the more inequality increases tends to also correlate with measures of income inequality. The latest research shows that, actually measured in a pure way, that mobility in the United States isn't any worse than in Canada, than in Sweden, which is pretty remarkable, and in Germany. And all those countries have more inequality than the United States, so again, the correlation there isn't even obvious.

WOODS: I want to read just a little passage from an article by Daniel Fernandez Mendez over at Mises.org on the subject of inequality around the world, and he's looking at the Gini coefficient, which is a metric that's used by some economists to try to track inequality.

And he says, "During the early nineteenth century, 35 percent of the global inequality found by the Gini index was due to differences across national borders. At the same time, 65 percent of the inequality was generated by differences in incomes within each country. But by the early twenty-first century, 85 to 90 percent of the inequality was due to differences across national borders, while only 10 to 15 percent of inequality was due to income differences within each country.

"In other words, the main source of inequality in the world has changed from the within-border inequality to cross-border inequality."

And he goes on to say, "This is clearly an indicator that inequality does not come from capitalism, but comes from the spread of industrialism and market institutions to different places at a different pace. If half of the world embraces markets and the other half doesn't, it is clear that the development of the first group makes the world more unequal, but this fact doesn't tell us anything about the inequality in the areas adopting market institutions. Indeed, the available data supports precisely this hypothesis: inequality across countries has risen from 15 Gini points to 60-63 Gini points, while within-border inequality has fallen from 28 points to 7-11 points."

That's a very interesting point, that at the very time that people are very concerned about inequality within countries, particularly the U.S., that has fallen in terms of the overall story of global inequality dramatically. The real story is countries that have sensible policies and countries that don't, countries where people are at a subsistence level and countries where people are more prosperous.

WINSHIP: Yeah, I think that's exactly right. I had done a study once where I attempted to look — the only time I've actually looked at countries outside the United States — where I tried to take on this claim that sort of, well, the United States it turns out has the same Gini as places like Nigeria, and so we ought to be indifferent essentially between living in these two countries because they have the same inequality levels, and took on the argument that countries with more inequality, that it hurt their economic growth. And it turns out that also does not look like it's true. There's no relationship between the two. In fact, in a lot of countries, particularly in the English-speaking world, countries that have more inequality actually have higher economic growth.

So I think the political context is incredibly important in thinking about inequality. You can have inequality levels that are high, like in the United States, but where we have a democracy, where we have to some extent a meritocracy, or you can have high inequalities in sort of the developing world, where you really do have autocrats at the top who are stealing from their people. Obviously those are two very different situations, and it amazes me sometimes that there are these papers that just look across countries and do correlations and don't make any attempt to distinguish between whether different types of high inequality might be better or worse for people.

WOODS: Scott, one of the things I appreciate about your work is that you insert the appropriate level of nuance. You don't say everybody who disagrees with me is an idiot, or the evidence in every single case clearly falls in one direction, so everybody else must be a blockhead. Your work has the tone of a scholar who is genuinely looking through the data, wanting to see what kinds of conclusions it's point to, and I do appreciate that, and I'm going to link to a couple of your pieces at TomWoods.com/483.

But having said that, having said that you appreciate nuance and you want to get everything just so, suppose you're in something like a presidential debate where you have 30 seconds to a minute, and somebody confronts you and says inequality is a

major issue in the United States today, and it's doing us tremendous harm. How would you try to summarize it in just that span of time?

WINSHIP: Well, I think I would say that, even as inequality has risen, the middle class and the poor have also increased their living standards, and ultimately that's what really matters. If people are seeing gains themselves, they're not all that concerned with what's going on at the top. And that's why inequality consistently ranks pretty low down when people talk about their own political priorities. When the economy goes through recessions and does poorly, people get more anxious, and some people blame inequality for that, but no one cared about inequality in the 1990s when incomes were rising across the board.

WOODS: Yeah, that is a good point and a good one to end on. Scott, if people want to follow your work, I'm already going to link to your archive at *Forbes*, but is there another place I should send them?

WINSHIP: Well, you can send them to our page at Economics 21, which is the research center at the Manhattan Institute that I'm affiliated with here in Washington D.C. That's just Economics21.org.

WOODS: Okay, I'll do that. I've had Diana Furchtgott-Roth on in the past too a couple of times, and I've been happy to refer people over to Economics 21, so we'll certainly do that as well. Thanks so much for your time today; we all appreciate it.

WINSHIP: Great, thank you, Tom.