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JOSEPH E. STIGLITZ

WINNER OF THE NOBEL PRIZE IN ECONOMICS

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THE PRICE OF INEQUALITY

HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE

WITH A NEW PREFACE

THE PRICE OF INEQUALITY

JOSEPH E. STIGLITZ

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More Praise for

THE PRICE OF INEQUALITY

by Joseph E. Stiglitz

"Joseph E. Stiglitz's new book, *The Price of Inequality*, is the single most comprehensive counterargument to both Democratic neoliberalism and Republican laissez-faire theories. While credible economists running the gamut from center right to center left describe our bleak present as the result of seemingly unstoppable developments—globalization and automation, a self-replicating establishment built on 'meritocratic' competition, the debt-driven collapse of 2008—Stiglitz stands apart in his defiant rejection of such notions of inevitability. He seeks to shift the terms of the debate."

—Thomas B. Edsall, *New York Times Book Review*

"Sweeping. . . . Passionate about the need for political reform."

—Jacob Hacker and Paul Pierson, *New York Review of Books*

"[Stiglitz] does liberal thinkers everywhere an immensely important service: He gives them a trenchant, engaging tool for arguing economics from the left in 2012. . . . Stiglitz writes clearly and provocatively. . . . A thoughtful, step-back analysis of what's driving inequality and why it is dangerous."

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"In *The Price of Inequality*, Joseph E. Stiglitz passionately describes how unrestrained power and rampant greed are writing an epitaph for the American dream. . . . In the process, Stiglitz methodically and lyrically (almost joyously) exposes the myths that provide justification for 'deficit fetishism' and the rule of austerity. . . . *The Price of Inequality* is a powerful plea for the implementation of what Alexis de Tocqueville termed 'self-interest properly understood.' "

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To Siobhan and Michael and Edward and Julia,
In the hopes that they will inherit
a world and a country that are less divided

Preface to the Paperback Edition

It was clear from the reception of *The Price of Inequality* that it had hit a chord. Not just in the United States but around the world as well, there is mounting concern about the increase in inequality and about the lack of opportunity, and how these twin trends are changing our economies, our democratic politics, and our societies. As I traveled around the United States and through Europe discussing inequality, its causes and consequences and what could be done about it, many people shared with me their personal stories of how what was going on was affecting them, their families, and their friends. Behind these stories, though, was a raft of new data that also has a bearing on the arguments of the book. In this preface to the paperback edition, I want to share some of the more telling moments from these discussions of inequality, provide some of the new data that reinforce my original conclusions, and examine other changes to the political and economic landscape. In the United States, the most important development was the bruising presidential contest of 2012 and the eventual reelection of Barack Obama; in Europe it was the continuation of the euro crisis, with its profound effects on inequality.

Early on in my book tour, in Washington, DC, I realized the magnitude of the student loan crisis. Student after student described the dilemma that they confronted: there were no jobs; the best use of their time—and the best way to enhance their prospects—was to go to graduate school. But unlike the child of a well-to-do parent, they would have to pay for the graduate school themselves, with student loans. They were already frightened by their current indebtedness, knowing the near impossibility of discharging these debts even in the worst of circumstances.[2] They didn't want to take on even more loans, and their sense of disillusionment, of hopelessness, was sobering and sad. Their bitterness increased as they looked around at peers with wealthy parents, who could take unpaid internships to beef up their resumes. The children of ordinary Americans can't afford that. They have to accept whatever temporary job they can get, no matter how dead-end. Data subsequently released would only have confirmed those impressions. While tuition and fees in public colleges and universities increased, on average, by a sixth between 2005 and 2010[3]—understandable given the cutbacks in government budgets[4]—median income continued to shrink.[5] (In some states, like California, matters were even worse: inflation-adjusted tuition increased by 104 percent in public two-year schools, by some 72 percent in public four-year schools, between 2007–08 and 2012–13.)[6] Getting ahead seemed almost impossible.

Perhaps the statistics that most resonated as I met with groups from coast to coast—and the ones that most surprised foreign audiences—were those relating to lack of opportunity in America. Both those in America and those abroad had simply assumed that America was the land of opportunity. A Pew poll showed that the vast majority of Americans—some 87 percent—agree that "our society should do what is necessary to make sure that everyone has an equal opportunity to succeed."[7] But it was obvious that we weren't.

The crisis continues to hurt those in the middle and at the bottom

It has been more than half a decade since the recession began. The jobs deficit—the difference between the actual number of jobs and what employment would be if the economy were functioning normally—keeps growing. And the incomes of ordinary Americans keep shrinking. As the economic slump grinds on—as this book goes to press, more than five years after the beginning of the Great Recession—the combined consequences of persistent inequality, of a deficient safety net, and of growing austerity are increasingly felt.

Those at the top, of course, have continued to be helped by the Federal Reserve. Its low-interest rates were designed to help bolster stock prices. Those prices have now returned to their precrisis level (though, adjusted for inflation, they are still lower). Anyone who had the wherewithal and gumption to stay in the market has fully recuperated. The wealthiest 5 percent of Americans, who own more than two-thirds of all household stock wealth, are back on track.[8] Those at the top continued to garner for themselves an enormous share of the nation's income. As even the typically "free market"–oriented *Economist* observed, "In America the share of national income going to the top .01% (some 16,000 families) has risen from just over 1% in 1980 to almost 5% now—an even bigger slice than the top .01% got in the Gilded Age."[9] Warren Buffett, himself a member of the superrich who has recognized the harm of America's egregious inequality, took to the pages of the *New York Times* in the fall of 2012 to underline the divergence by a different measure: the 400 wealthiest Americans took home an hourly "wage" of $97,000 in 2009 (the last year for which the IRS has provided data)[10]—a rate that has more than doubled since 1992.[11]

Those in the middle and at the bottom, who have much of their wealth in housing, have not fared so well. Recently released data show that in the period of the recession, from 2007 to 2010, median wealth—the wealth of those in the middle—fell by almost 40 percent,[12] back to levels last seen in the early 1990s. All of the wealth accumulation in this country has gone to the top. If the bottom had shared equally in America's increase in wealth, its wealth over the past two decades would have gone up by some 75 percent. Newly released data also show that those at the bottom suffered even worse than those in the middle. Before the crisis, the average wealth of the bottom fourth was a *negative* $2,300. After the crisis, it had fallen sixfold, to a negative $12,800.[13]

Not surprisingly, the persistent economic slump has led to a continuing weakening of wages: real wages have declined, by nearly 1 percent for men and more than 3 percent for women from 2010 to 2011 alone.[14] So have incomes of the typical American. Adjusted for inflation, median household income in 2011 (the most recent year for which we have data) was $50,054, lower that it was in 1996 ($50,661).[15]

The text (chapter 1) describes how households with those of limited education are faring even worse, and have seen marked decreases in their standards of living.[16]

These disturbing trends in income and wealth inequality were outdone by even more disturbing evidence about inequalities in health. As medical care has improved, life expectancy has increased—on average, in the United States, by some two years between 1990 and 2000. But for the poorest group of Americans there has been no progress, and for poor women life expectancy has actually been declining.[17]

Today, women in the United States, on average, have the lowest life expectancy of women in any of the advanced countries.[18] Educational attainment, which is often tied in with income and race, is a large and growing predictor of life span. Non-Hispanic white women with a college degree have a life expectancy that is some ten years greater than the life expectation of black or white women without a high school diploma. Non-Hispanic white women without a high school diploma lost about five years of life expectancy between 1990 and 2008.[19] The three-year decline in life expectancy of white males without a high school diploma over the same period was only slightly less dramatic.[20]

Decreases in income and decline in standards of living are often accompanied by a multitude of social manifestations—malnutrition, drug abuse, and deterioration in family life, all of which take a toll on health and life expectancy. Indeed, these declines in life expectancy are often considered more telling than income numbers themselves. In the years after the fall of the Iron Curtain, incomes in Russia fell, but perhaps a more reliable indicator of how bad things were was provided by data showing a dramatic fall in life expectancy. Not surprisingly, health care experts have drawn parallels between recent declines in the United States and what happened in Russia. Michael Marmot, director of the Institute of Health Equity in London and a leading expert on the relationship between incomes and health, observed that "the five-year decline for white women rivals the catastrophic seven-year drop for Russian men in the years after the collapse of the Soviet Union."[21]

While there is no agreement about the causes of these large changes, one important factor (not adequately reflected in income statistics) is the growing lack of access to health insurance among the groups at the bottom of the population.[22] One of the main objectives of Obamacare (the Affordable Health Care Act) was to remedy this, but the recent Supreme Court decision[23] giving states the right to opt out of Medicaid expansion without losing funding makes it likely that a significant fraction of the population will remain uncovered.

The Inequality "Debate"

As I traveled around the world and as reviews of the book came in over the last year, I was heartened at how little challenge there was to the book's central theses.[24] The magnitude of the inequality and the lack of opportunity was hard to deny. As usual, academics quibble: levels of inequality might look a little better depending on how we value the benefits supplied by Medicare, Medicaid, and employer-provided health insurance.[25] While spending on these has gone up, much of this increase can be attributed to rising medical costs. It's not that the benefits themselves have increased.[26] On the other hand, the numbers would look considerably worse if we took into account the increased economic insecurity. It was equally hard to deny that the United States was no longer the land of opportunity portrayed by Horatio Alger stories of "rags to riches." Nor was there any attempt to deny that much of America's concentration of wealth at the top was a result of rent seeking—including monopoly profits and the excessive compensation of some CEOs and, especially, that of the financial sector. As expected, a few critics (including a former head of the Confederation of British Industry)[27] suggested that I paid less attention to market forces than I should have and, correspondingly, gave too much weight to rent seeking. As I explain in the text, it is essentially impossible to single out any one factor's relative contribution, given how intertwined the various forces shaping inequality are; there can be honest differences of opinion. But as I emphasize in chapter 2, markets don't exist in a vacuum. They are shaped by our politics, often in ways that benefit those at the top. Moreover, while we may be able to do only a little to change the direction of market forces, we can circumscribe rent seeking. Or at least we could, if we managed to get our politics right.

Most heartening to me was the fact that even more conservative publications joined the discussion. In an excellent special report, the *Economist* highlighted the extent of the increase in inequality and the reduction in opportunity, and agreed with most of our diagnosis and many of our prescriptions.[28] Noting, as I had, that much of America's inequality, especially at the top, was due to rent seeking,[29] the *Economist* concluded, in particular, that "inequality has reached a stage where it can be inefficient and bad for growth."[30] Sharing our concern about the lack of opportunity in the United States, the report cites results obtained by Sean Reardon of Stanford[31] that the "gap in test scores between rich and poor American children is roughly 30–40% wider than it was 25 years ago."[32] Not surprisingly, the *Economist*'s recommendations began with an "attack on monopolies and vested interests" and then moved on to ways of improving economic mobility, where the "target should be pre-school education, as well as more retraining for the jobless."[33] It even recognized the need for more progressive taxation, including "narrowing the gap between tax rates on wages and capital income; and relying more on efficient taxes that are paid disproportionately by the rich, such as some property taxes."

The debate was more intense, though, around an argument (made explicitly in a book published shortly after mine)[34] that was based on another variant of trickle-down economics. In this new version of an old myth, the rich are the job creators; give more money to the rich, and there will be more jobs. The irony was that the author of this book, like the presidential candidate whom he supported, was from a private-equity firm with a well-established business model that involved taking over companies, piling on debt, "restructuring" by firing large number of workers, and selling out one's stake (it was hoped) before the firm subsequently went bankrupt. There were, of course, real innovators in the economy, and they did create jobs; but even the firm that had become iconic of America's success, Apple, whose market value in 2012 was larger than that of General Motors at its peak, had only 47,000 employees in the United States.[35] In a world of globalization, creating market value had become entirely separated from creating employment. There was no reason to believe that giving more money to America's wealthy would lead to more investment in the United States: money goes to where returns are highest, and with America's downturn, returns often look higher for investments in the emerging markets. And even when there is investment in the United States, it's not necessarily investment related to job creation: much of the investment is in machines designed to replace labor, to destroy jobs.

Remarkably, in the heyday of unbridled capitalism, the early years of this century, a period in which inequality at the top increased at historic rates, there was *no* private-sector job creation. And if we exclude construction—based on a real estate bubble—the record looks even worse.

Not only doesn't the money given to the top not necessarily go into "job creation" and innovation; some of it goes into distorting our politics, especially in this new era of unbridled campaign contributions ushered in by *Citizens United*. What we have seen quite clearly is that a common use of wealth is to gain advantage in rent seeking, perpetuating inequalities through the political process. Later in this preface I'll describe some of the telling examples of rent seeking that have come to light just in the past year.

The same old "myth" that we should celebrate the wealth of those at the top because we all benefit from it has been used to justify the maintenance of low taxes on capital gains. But most capital gains accrue not from job creation but from one form of speculation or another. Some of this speculation is destabilizing, and played a role in the economic crisis that has cost so many jobs.

The presidential campaign

In the campaign, the word "inequality" wasn't heard often—indeed, given the attention focused on the 1 percent by the Occupy Wall Street movement, the absence of attention to the issue might seem surprising, until one remembers that much of the more than $2 billion spent on the campaign was raised (by both parties) from persons in the 1 percent—and one wouldn't want to offend them. But the wound of America's growing inequality festered not far beneath the surface. When the Democrats talked about protecting the middle class, they were really saying that the American economy has not been delivering for most Americans, that only those at the top have benefited from the increase in GDP. Any economic agenda focusing on the middle class is, by its nature, an agenda centered on shared prosperity; and that means halting and reversing the trend of growing inequality.

Perhaps the moment when inequality moved closest to being front and center in the campaign was when Mitt Romney suggested that 47 percent of Americans were paying no income tax, living off of government handouts.[36] The statement, made at a $50,000-a-plate fund-raiser in lavish settings in Boca Raton, Florida, stirred up its own hurricane. The irony, of course, was that people like Romney are the true freeloaders: the taxes that he has said he is paying (as a percentage of his *reported* income) are (at 14 percent in 2011) far less than those of people with substantially less income.

What Romney said reflects views held by many Americans, and not just those in the 1 percent. Many of those who are working hard feel that they are being taken advantage of, that their taxes are being used either to bail out rich bankers or to provide welfare payments for people who refuse to work. They see themselves as "victims," and this perception has played a role in the rise of the Tea Party, which seeks to downsize government. Nothing perhaps gave more impetus to this movement than the huge gifts to the banks and the bankers; government stepped in to help those who had caused the crisis, and did little to help those who suffered. The Tea Partyers and others sympathetic to them were right to be outraged, but their diagnosis was wrong: without government, they would have suffered even more; without government, the banks would have abused them even more. The government didn't do what it should have done to prevent the crisis and banks' exploitive behavior—or to resuscitate the economy or to help those that were suffering from the economic downturn—but, given the imbalances in American politics, it is perhaps more remarkable what *was* done.

In his remarks, Romney articulated a set of widespread misunderstandings. First, even those who don't pay income taxes pay a host of other taxes, including payroll, sales, excise, and property taxes.[37] Second, many of those receiving "benefits" paid for them—through Social Security and Medicare contributions funded out of payroll taxes. They're not free riders. We should remember why those programs were started: before the arrival of Medicare and Social Security, the private sector left most elderly bereft of support, the market for annuities essentially didn't exist, and the elderly couldn't get health insurance. Even today, the private sector doesn't provide the kind of security that Social Security provides—including protection against market volatility and inflation. And the transactions costs of the Social Security Administration are markedly lower than those in the private sector. In addition, many of the people who receive government benefits without paying for them are our young, obviously unable to pay, say, for their own education. But spending on them is an investment in the country's future.

An efficient system of social protection is an important part of any modern society. The market failed to provide adequate insurance, for instance, for unemployment or disability. So the government stepped in. But people receiving those benefits typically paid for them, either directly or indirectly, through contributions they or their employer made on their behalf to these insurance funds. Aside from a person's right to draw benefits from programs they helped fund, social protection can make for a more productive society. Individuals can take on more high-return, high-risk activities if they know there is a safety net that will protect them if things don't work