Economic Inequality Is Not Sustainable

A Top Heavy 1 Percent Will Topple Without a Stable Middle Class

By Heather Boushey

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President Obama inherited an economy in virtual meltdown, with job losses at over 20,000 per day the month he was inaugurated. But the problems ran much deeper than a typical run-of-the-mill recession. Long before the Great Recession of 2007-2009, the old rules of the game—where if you work hard and play by the rules, you can earn a decent life—had begun to fall by the wayside.

The economic recovery of the 2000s—from the peak in 2000 to near the end of 2007—middle America didn't benefit from the economy's growth. Over that time period, the economy grew by nearly 18 percent, as measured by gross domestic product, yet median household income fell by 0.6 percent. Further, over the past few decades, with the exception of the full employment years of the late 1990s, the U.S. economy became increasingly unequal. The incomes of the families at the top grew by an average of 1.2 percent per year between 1979 and 2009, while those at the bottom saw incomes fall by 0.4 percent per year.

The conservative narrative is that rising inequality is just fine for America because the gains for those at the top will eventually trickle down to middle America. But that's not what's happened over the past few decades. In fact, just the reverse occurred.

An economy top heavy with wealth is not good for our country or our economy. Inequality isn't just bad for the 99 percent who've been left behind; it is actually responsible for some of the biggest problems facing Americans today—high home foreclosures, high unemployment, and an inability to get ahead. It's critical that we reverse it.

Take, for example, the housing bubble of the 2000s. It was facilitated in no small part by exotic mortgages that were sliced and diced and sold to investors who pushed home prices to hitherto unknown heights. And when it popped, millions of American families—through no fault of their own except the decision to buy a home—were left with mortgages greater than the value of their homes. High rates of foreclosure still plague our economy.

What is less-often discussed (until recently) is the role that inequality played in making the Great Recession and the subsequent slow recovery happen in the first place. Inequality has been rising for decades for most Americans in the form of stagnating incomes for the majority and sky-rocketing incomes for those at the very top. When income stopped growing, families responded by working more and borrowing more. As consumer activist Elizabeth Warren (with her daughter Amelia Warren Tyagi) documented, American's debts are the direct result of a hollowed out middle class. Families borrowed to make ends meet, to cover health care costs, to put a child through college, and to purchase a home in a neighborhood with good schools.

The financial sector was only too happy to oblige. Increasingly unencumbered by regulation and flush with cash, Wall Street created a variety of new ways to extend credit. Basically, America didn't get a raise and the financial sector said, "Don't worry, buddy, we'll loan you the money to pay the bills." Of course, the whole thing was unsustainable. Thus came the Great Recession and the struggle ever since among everyday Americans to make ends meet.

But we can reverse this destructive course—if we understand what we are up against.

Recent research by economists Michael Kumhof and Romain Rancière at the International Monetary Fund shows that investors were recycling their higher incomes into loans, a process that is inherently unstable in the face of stagnant incomes for low- and moderate-income households. As demand dries up because of stagnating incomes, those at the top have great incentives to expand credit to keep up purchasing power, but if incomes do not recover, this, as we have seen, is an unstable system.

Wall Street also used its burgeoning wealth to benefit their industry, not the nation as a whole. Recent research by University of Chicago Booth School of Business professors Atif Mian, Amir Sufi, and Francesco Trebbi shows that higher campaign contributions from the financial services industry are associated with an increased likelihood of voting for legislation that transfers wealth from taxpayers to that industry.

Sky-high incomes for those in finance allowed them to sell loans to the 99 percent and buy legislation that transfers wealth from taxpayers to themselves. And, on top of all this, these same sky-high incomes increasingly encouraged the best and the brightest young people to enter finance instead of engineering, medicine, or teaching, all which enhance our economy's productivity.

But we know what works for all Americans. Growth that works for all of us keeps going. IMF economists Andrew Berg and Jonathan Ostry find that inequality is associated with poorer economic outcomes. They examined how long spells of sustained economic growth lasted across 174 countries. What they found was striking: The more equal the country, the longer it was able to sustain economic growth.

What happens to 99 percent of Americans should be the focus of our nation's economic policy. But, too often, that doesn't happen. Focusing exclusively on deficit reduction is the wrong policy. Focusing solely on cutting spending is the wrong policy. Focusing on jobs is the right policy now and in the future. Investing in our future is the right policy—through government spending that strengthens our economy and our economic competitiveness alongside responsible action to reduce our long-term federal budget deficits over time as the economy improves.

Have no fear. We can reverse inequality. The United States remains one of the wealthiest nations on the planet. The notion that we cannot afford to fix our economy is, quite simply, rubbish. We can if we have the political will.

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