<u>Political Parties, Income Inequality and Public Policy</u>

One of the most important issues facing our nation is the dramatic increase in income inequality over the past 40 years. While the share of income going to the richest 1% of American households has over doubled in the past 40 years, the share of income going to much poorer groups has declined sharply. This raises a number of important questions. Should government policy attempt to reduce income inequality? If so, by how much? How should our nation respond to a reduction in the relative size of the middle class, and reductions in social protections that private employment use to more fully provide (e.g., health care and pensions)? Given the reliance of elected government officials on campaign contributions, to what extent is increased income inequality causing public policy to favor the wealthy over other income groups? The purpose of this reading assignment is to: (1) examine the electoral incentives of our two political parties in formulating policies dealing with these topics; (2) survey the level of income inequality and how it has changed over time; and (3) explore various possible public policies, and the costs and benefits they would provide both for our nation as a whole and for California.

Before looking at the electoral incentives of our two major political parties on economic policy it is important to keep a couple of thoughts in mind. A significant amount of the material in this reading assignment compares the United States to the other wealthy democracies of the world (e.g., Canada, Great Britain, Sweden, Japan, etc.). Relative to the other wealthy democracies of the world, the United States has a much higher level of both income inequality and poverty and a weaker social safety net (e.g., not insuring all Americans for health care, a low minimum wage and less generous social welfare programs). I realize that the previous statement is "uncomforting." Naturally we want to think that our nation is, by any measure, "the best." Realistically, nations can only achieve certain outcomes. For example, it would be either extremely unlikely, if not impossible, for a nation to have the lowest poverty rate, the least income inequality and the lowest taxes. By comparison to the other wealthy democracies of the world the United States ranks high on some policies that attempt to equalize opportunity (e.g., higher education) but not so high on policies that impact the equality of result (i.e., the rich have more in relation to the poor in the United States than in other wealthy democracies).

My interest is not in arguing that the American social welfare system is either better, or worse, than that used by the other wealthy democracies in the world. Rather, my interest is in explaining the impact of different social welfare systems on both income inequality and mobility (i.e., the chances of someone born into a poor family become either middle class or wealthy). Since the United States has the highest level of income inequality and the weakest social safety net of all the wealthy democracies of the world, the obvious comparison to make is between us and the nations which have less income inequality and a stronger social safety net. If I were teaching this class in a nation with a very strong social safety net (e.g., Sweden) then I would compare it to nations that have weaker social safety nets (e.g., Great Britain and Canada – moderately strong social safety nets and the United States – a weak social safety net). However, since I am teaching this class in the wealthy democracy with the weakest social safety net, the most important comparison is not between the weak social safety net we have and an even weaker social safety net (although I will touch on this when I look the various Republican

proposals), but rather between a weak social safety net and a somewhat stronger social safety net.

It is certainly true that some Americans desire an even weaker safety net than we have. For example, there are some (such as myself when I was the age of most of you taking this class) who would do away with the Social Security and unemployment compensation programs on the basis that since they require people to pay taxes to support these programs they violate a person's freedom to spend their money as they choose. Since the vast bulk of Americans disagree with such a position and it is an approach that no wealthy democracy in the world embraces, I am not going to spend valuable time discussing it. Instead, since most Americans desire less income inequality than we have, I will examine the record of nations that have lower income inequality and a stronger social safety net than we do (e.g., the economic growth rate, level of freedom, etc.) and discuss policies that would significantly reduce the very high level of income inequality we have, that are easily "affordable," and would actually enhance the performance of our democracy.

An additional reason for the material I will cover is that public opinion surveys consistently show that while Americans desire less income inequality than we have and are very concerned about the current and future living standards of both the poor and middle class, most Americans have very little knowledge of what the other wealthy democracies have actually achieved in this regard. Furthermore, what opinions we do have are typically much more negative than is warranted by the evidence (i.e., we typically do not realize how well these stronger safety nets perform). If we wanted to we could actually reduce income inequality considerably while increasing both income security and income mobility (i.e., increasing the chances that those born into middle and low income families would have higher future incomes than is currently the case) and still retain a high level of economic growth, political freedom and have a better functioning democracy. So, as a first step we need to examine why we have the policies we do. A major step toward this end is to examine the electoral incentives of our two major political parties.

Electoral Incentives of the Two Major Political Parties

A major theme of this course is that the two major political parties provide voters very clear policy choices. Many times I've mentioned that the voter who votes "the candidate" and not "the party" will often make a mistake. A candidate's party affiliation tells you a lot of what is politically important about them. A related theme is that the reason the parties provide a clear and predictable "choice" is that, economically, they represent very different groups of voters. Lower-income voters are a much more important part of the Democratic Party coalition than of the Republican Party coalition. By contrast, higher-income groups, especially business, are a much more important part of the Republican Party coalition than the Democratic Party coalition. Nowhere is this difference more clear, or important, than on two economic issues that noticeably impact the degree of income inequality and are frequently at the center of political campaigns: unemployment and inflation. Will we start by examining how unemployment and inflation affect income inequality. It then makes sense to see what incentives each of the major political parties has to supply various unemployment and inflation levels.

Unemployment has a large impact which disproportionately falls on low and middle-income voters. Each additional percentage point in unemployment yields a *decline* of about a tenth of a percentage point in the share of income going to the poorest and next poorest 20% of American households. For example, if the share of income going to the poorest 20% of American households was 4.0% (i.e., the poorest 20% of American households received only 4% of the income of all U.S. households combined), a one percentage point increase in unemployment would lower this share to 3.9% (Douglas A. Hibbs, The American Political Economy, Harvard University Press, p. 80 - the seminal work in this important field). As unemployment compensation replaces only 22% to 37% of lost income (depending upon what state the unemployed person resides in), unemployment has very important consequences, especially for the poor (Hibbs, p. 58).

The *nonmonetary* cost of unemployment is also quite high. A sustained *one* percentage point increase in the unemployment rate ultimately produces *30,000 extra fatalities per year* (through increased crime, loss of health benefits, alcoholism, suicide, etc.- Hibbs, p. 50). To put this in perspective, it is worth noting that over a 9 year period the United States sustained just under 60,000 casualties in the Vietnam War.

Like unemployment, inflation also affects income groups differently. However, the costs of inflation fall much more on higher income groups than do the costs of unemployment. Due to appreciating home values and indexed government benefits (e.g., Social Security payments are increased to offset the affect of inflation), the poorest 80% of American households are relatively unaffected by inflation. However, inflation has a much greater adverse impact on the richest 20% of American households. This is because the sources of income that makeup a greater percentage of the income of low and middle-income households, wages and salaries, are less affected by inflation than are income sources that flow almost exclusively to higher-income households (interest bearing securities, stocks, bonds, etc. – Hibbs, pp. 88-89).

Any political party will need to better serve the interests of it's supporters than the opposition party. Otherwise, those voters are likely to vote for the opposition party. As you'll soon see, Democratic and Republican voters place different values on unemployment and inflation. This is particularly important because unemployment and inflation typically involve "tradeoffs" (just keep reading – it will "make sense"). Often policies which *reduce* unemployment *increase* inflation. Thus, there is frequently a tradeoff between unemployment and inflation (i.e., what is better for one goal is worse for the other goal).

The *Blinder Rule* provides a relationship between unemployment and inflation that government can utilize in order to reduce either unemployment or inflation in the short-run (typically thought to be two years or less). The Blinder Rule states that a 1 percentage point *increase* in unemployment *above* the *natural rate of unemployment* (whatever level of unemployment is necessary to keep inflation the same – i.e., not either increasing or decreasing - today about 4%) endured for a year *lowers* the core or underlying inflation rate (excludes food, shelter and energy) ½ of 1 percent (i.e., .5%).

A useful concept in understanding the "politics" of unemployment and inflation is the *marginal substitution rate*: the number of percentage points that unemployment would have to *decrease* if inflation *increased* by one percentage point for the President's support within the group to remain the same (just keep reading – it will make sense after an example). Political scientists have found that the marginal substitution rates of voters are,

roughly, as follows: *Democrats .90, Independents 2.0 and Republicans 1.5.* These numbers can be interpreted as follows: if 80% of Democrats support President Obama and inflation *increases* 1 percentage point (which hurts Obama – voters don't like inflation) and unemployment *decreases* .9 of a percentage point (which helps Obama – voters prefer lower unemployment) Obama's popularity among Democrats would remain at 80% (i.e., unchanged).

Democratic voters are less averse to inflation than either Independents or Republicans. This is because it takes *less* of a reduction in unemployment to satisfy Democrats for a one percent increase in inflation than for either Republicans or Independents (i.e., .9 is less than either 1.5 or 2.0). Thus, as Democratic Presidents are more strongly supported by the poor (who are more adversely affected by unemployment), wouldn't one expect that Democratic Administrations would produce lower unemployment and higher inflation than Republican Administrations? Yes! That's also what happens in the "real world."

Voter aversion to unemployment and inflation was behind the "politics" of the Obama Stimulus Plan. The Democrats were willing to run a larger federal deficit in order to more stimulate the economy and reduce unemployment than were the Republicans. This was, in large part, because the Democratic voter base is poorer, and more affected by unemployment than the Republican voter base. That's also the difference in health care: the Democrats are more willing to reduce the Bush Tax Cuts (that predominately favor higher-income households) and apply this money to reducing the number of Americans without medical insurance. Democrats are poorer, and less likely to have medical insurance than Republicans.

Political scientists have long studied these questions. The following summarizes what we have found: after four years Democratic Administrations produce unemployment rates approximately 2% lower and inflation rates approximately 4% higher than Republican Administrations (Hibbs, pp. 248-254).

If you go back through American political and economic history, you'll see similar partisan differences toward unemployment and inflation. Typically, policies that produce greater relative economic stimulation and, hence, lower unemployment rates, but risk higher inflation (e.g., printing more money, lowering interest rates, running larger government deficits), have been more strongly supported by the Democratic Party because such policies more benefit middle and low-income households. The Republican Party, more sensitive to the economic interest of the wealthy (hence to reducing inflation), have typically been either less supportive, or opposed, to highly economically stimulative policies.

Additional insight can be gained if we examine relative living standards. We can estimate your standard of living by taking your income, adding the value of government benefits you receive (e.g., food stamps) and subtracting taxes. This concept is called "net income." The ratio of "net" income (money income plus the value of government programs minus taxes) of the richest 20% of American households to the poorest 40% of households is typically over 2.0 (i.e., the richest 20% of the households have over twice as much "net" income as the entire poorest 40%). The richest 20% of households have over 3.5 times as much money income as the poorest 40% of households. The difference is that "net" income subtracts out taxes and includes the value of many government programs. Thus, government reduces income inequality. This is one

important reason why liberals like government more than conservatives. Political scientists have found that the ratio of net income of the richest 20% of American households to the income of the poorest 40% of American households is lower under Democratic than Republican Administrations (Hibbs, pp. 232-242). Thus, the poor get more in relation to the rich under the Democrats.

Recent research by political scientists shows that *all* income groups up through the 95th percentile (i.e., all but the richest 5% of households – today those earning about $200,000, or less, per year) gain under the Democrats relative to the Republicans. However, the poor gain at greater rate under the Democrats (Larry Bartels, Unequal Democracy, Princeton University Press). Thus, while the rich gain under the Democrats, income inequality is lower under the Democrats.

Brief Macroeconomic History of the U.S.

It's important to begin this discussion by addressing the logic of capitalism or the free market. As Benjamin Radcliff notes, "The market economy has much to recommend it. Indeed, few people, whatever their ideological commitments, deny that the market as a central organizing principle provides advantages in both material prosperity and human liberty unrealized by any prior mode of economic production. Still, any form of social organization involves inevitable conflicts that arise spontaneously from the structure of that organization. As both Adam Smith and Karl Marx were perceptive enough to see, the principle conflict in capitalist societies is in the asymmetry of power between workers who must as a matter of necessity sell their labor power as a commodity in order to survive, and those who buy that commodity in pursuit of their own private interests. Without this asymmetry … workers would not agree to the sale of their labor power at a rate that allowed employers to profit by its purchase, and the system of capitalism as we understand it could not exist. The natural conflict between employer and the employed thus finds expression in the attempts of each either to reduce or expand the degree of this asymmetry. The smaller the asymmetry, the greater is the relative bargaining power of workers, and thus the greater in the wealth that their labor helps bring into being. Conversely, of course, the larger the disparity in bargaining position, the greater is the ability of employers to use that position to strike more advantageous compromises with workers." (Benjamin Radcliff, *The Political Economy of Human Happiness: How Voters' Choices Determine the Quality of Life*, page 157) This conflict is at the heart of the political debate over the welfare state. The goal of more liberal political parties is to reduce the asymmetry between employers and employees by such policies as making unionization easier, more progressive taxation and increasing the generosity of the welfare state. Conversely, the goal of conservative parties is to increase the asymmetry by pursuing the opposite set of policies (i.e., making unionization more difficult, the tax system less progressive and reducing the generosity of the welfare state).

While there are certainly benefits from automation, it appears that at the current time automation is increasing the asymmetry between employers and employees. For example, as Ana Swanson notes, "The relationship between factories and workers has changed over the past decades, and it's unlikely to go back. Over the past 35 years, the United States shed about 7 million manufacturing jobs. And some industries, such

as textiles and apparel, have disappeared almost entirely. Yet American factories actually make more stuff than they ever have, and at a lower cost. Manufacturing accounts for more than a third of U.S. economic output — making it the largest sector of the economy. From that perspective, it's hard to argue that American manufacturing today is anything but a success. The reason, of course, is that productivity has risen so sharply. Technology, and automation specifically, allows manufacturers to make more than ever before, at a much lower cost. The economics are unavoidable and irreversible. Although a human welder may earn $25 an hour, a robot welder costs around $8 an hour over a five-year period, according to estimates from the Boston Consulting Group. The group projects that the cost could fall to as little as $2 an hour within 15 years" (Ana Swanson, Wonkblog, Washington Post, November 28, 2016). Thus, while American manufacturing companies are doing well American manufacturing workers are not.

In order to understand the economic policies that political candidates and parties mention it is useful to have a *short* discussion of U.S. macroeconomic policy. Macroeconomics refers to the behavior of the U.S. economy whereas microeconomics refers to the behavior of individual businesses and persons. Our interest is in macroeconomics. What might be termed "neoclassical" macroeconomics was the dominant approach from just after the Civil War until the Great Depression of the 1930s. "The free market was assumed to yield full employment (i.e., no/low unemployment), to grow without limitation, and to correct any imbalances that might develop." (Barry Clark, "Inequality and the Great Recession", Challenge, Vol. 54, No. 3, May-June 2011, p. 60 – this is an excellent and easily "readable" discussion of macroeconomic policy). Recessions (no growth or negative growth – i.e., a reduced value of the economy and rising unemployment) were thought to be the result of external forces (e.g., wars or droughts). Neoclassical economics viewed income inequality as desirable because investment was thought to be the stimulus to innovation and economic growth. Since the higher one's income the greater the percentage of their income they save/invest and the smaller percentage of their income they spend, the greater the share of income the rich possess the greater the investment, and hence, economic innovation/growth. By this view, a major goal of macroeconomic policy was to keep the costs of production low (e.g., low taxes, little government regulation of business, low wages – through the absence of labor unions and a low minimum wage) in order to increase profits and investment. This view predominated until the Great Depression, struck in 1929. Unemployment was as high as 25% during the Great Depression.

British economist John Maynard Keynes explained the Great Depression as, fundamentally, a lack of demand. Thus, if the non-rich lacked sufficient money to purchase goods, the economy would not reach its' full potential because businessmen would not open new business, or expand current ones, if they felt they could not sell the resulting products or services. Therefore, instead of the neoclassical view that high rates of economic growth almost necessitate the rich having a very large share of the income, Keynesianism argued that it was critically important that economic demand be sufficient. Realistically this meant that middle and lower-income groups, who spend a greater share of their income than upper income groups, need to have a significant share of the national income (through a minimum wage, labor unions, etc.). If economic demand was

insufficient, Keynes argued that the government should increase its' spending and be willing to run large deficits (i.e., spend more money than it receives in taxes). When unemployment fell and consumers could provide sufficient demand to purchase the goods and services that a vigorously growing economy required, then the government could run surpluses to pay down the debt it incurred during recessions (i.e., spend less than it received in taxes). Running surpluses would allow the government to reduce the growth rate of the economy (which had increased by deficit spending) and reduce the rate of price increases (i.e., inflation).

Keynesian economic theory was undermined by the simultaneous occurrence of both high inflation and high unemployment in the late 1970s and early 1980s. Keynes' approach of spending more to reduce unemployment was effective when unemployment was high and inflation was low (as is typical during recessions or depressions). However, if both unemployment and inflation were "high" at the same time, Keynes approach seemed ineffective. Simultaneously high unemployment and inflation in the United States were caused by three factors: (1) it was difficult for government to reduce expenditures in periods of low unemployment because government programs built a group of beneficiaries who made it difficult politically to reduce or terminate programs that were designed to be a temporary stimulus to reduce unemployment; (2) once businessmen realized that, should a recession develop, the government would run deficits to increase demand and reduce unemployment, there was little reason to reduce prices if unemployment increased (i.e., increased unemployment and the reduced ability of people to spend money – which would lead businesses to reduce prices – would not be necessary if government would quickly re-stimulate the economy); (3) increased corporate mergers and acquisitions produced a two-tiered economy – large conglomerates who could more afford to raise prices and wages on the one hand and small businesses and farmers who were more susceptible to free market forces on the other hand and; (4) increased globalization – whereby the stimulus from U.S. government deficits and low interest rates (which make borrowing money easier and should increases the amount of money borrowed – hence economic growth) could be offset by reduced demand for American products in foreign countries and outflows of U.S. capital to nations with higher interest rates (i.e., where investors could earn more money on savings).

The aforementioned difficulties of Keynesian economics, plus the renewed political strength of a Republican Party whose ideology was similar to neoclassical economics, resulted in a rebirth of neoclassical economics under several different names (e.g., supply-side economics and rational expectations). One such economic philosophy was called supply-side economics. This approach is similar to neoclassical economics in that it favored policies that made "supplying" goods or services easier: tax cuts for the wealthy to increase investment, reduced government regulation of business and low labor costs through weakening unions and not having the minimum wage keep pace with inflation. Mainstream conservative economists were leery of many of the claims of supply-side economics. For example, one central claim of supply-side economics is that tax cuts pay for themselves by generating enough additional economic growth to fully pay for the tax cut. For example, a 20% tax rate on $100 raises $20 in revenue for the government. If the tax rate were reduced to 10% but the economy doubled in size to $200, then a 10% tax rate would still raise $20 in revenue. In this case the tax cut would be self-financing. Most mainstream conservative economists didn't think this would happen. It didn't. While

estimates vary and a precise estimate is fraught with some difficultly, a reasonable estimate is that the federal government lost about $.75 in revenue for each $1.00 in tax cuts from both the Reagan tax cuts of 1981 and the Bush tax cuts of 2001 and 2003 (i.e., only about 25% of these tax cuts were "self-financing" – my source for this estimate is 2012 Republican presidential nominee Mitt Romney's principal economic advisor, Dr. Gregory Mankiew – see http://gregmankiw.blogspot.com/2007/07/on-charlatons-and-cranks.html). Given that both the Reagan and Bush tax cuts each represented about 2% of the U.S. economy while the Trump tax cut is approximately 1, these cuts greatly increased the size of the federal deficit.

In 2012 election the Republican presidential candidates offered tax and budgetary plans that reflected neoclassical economics. The eventual nominee, former Massachusetts Governor Mitt Romney, offered a tax plan that had the following major components: (1) made all the Bush tax cuts permanent (which lowered income tax rates, repealed the estate tax and reduced capital gains taxes - almost 40% of the Bush tax cuts go to the richest 1% of households); (2) lowered the corporate tax rate from 35% to 25%; and (3) repealed the .9% tax increase on wages and the 3.8% tax on investment income of high-income individuals that would have provided some of the funding for the Obama Health Care Plan. Romney's tax plan would "actually raise taxes on many lower-income Americans, while sharply cutting taxes at the top. More than 80% of the tax cuts would go to people making more than $200,000 a year, almost half to people making more than $1 million a year." (Paul Krugman, "Romney Isn't Concerned," New York Times, February 2, 2012).

The picture was similar for the 2016 Republican presidential candidates. Each candidate wanted to retain all of the Bush tax cuts and reduce the progressivity of federal taxes (i.e., the wealthy would have a smaller share of the federal tax burden). Their basic approach was to reduce the tax burden on upper income households either by reducing the income tax rate for high income earners (e.g., Jeb Bush would reduce the highest federal income tax rate from the current 39.6% to 28%), taxing all income at the same rate rather than a higher rate for higher incomes (e.g., Ben Carson, Rand Paul, Ted Cruz, Rick Perry, Marco Rubio says his eventual goal is a flat tax – Patricia Cohen, "Republican Presidential Candidates Rally Around Flat Tax," New York Times, May 15, 2015 and Danny Vinik, "Marco Rubio and Mike Lee's Tax Plan is Setback for Tax Reform," The New Republic, March 16, 2015) and/or reducing taxes on money made with money (i.e., investments – Rand Paul, Marco Rubio, John Kasich) rather than money made with labor. Additionally, all of the 2016 Republican presidential candidates wanted to eliminate the estate tax. Since an individual has to inherit over $5,000,000 to pay any estate tax at all, this would save very, very wealthy inheritors much money. This tax is only paid by the richest two-tenths of 1% of estates (i.e., the poorest 99.8% of estates pay nothing). The 10 year cost of eliminating the estate is approximately 269 billion dollars (http://www.cbpp.org/research/ten-facts-you-should-know-about-the-federal-estate-tax). To put this lost revenue in perspective it is equal to just over 80% of the entire cost of the Pell Grant program for college students that many of you in this class are benefitting from (http://atlas.newamerica.org/federal-pell-grant-program). While some of the Republican tax plans are too vague to give a precise distribution of the benefits here are the percentage of benefits that would go to the richest 1% of households under the tax plans

of the 2016 Republican presidential candidates: Marco Rubio – 34%, Donald Trump – 37% and Jeb Bush 52% (see http://ctj.org/ctjreports/2015/11/marco_rubios_tax_plan_gives_top_1_an_average_tax_cut_of_more_than_220000_a_year.php#.VlcnrXarS00 http://ctj.org/ctjreports/2015/09/donald_trumps_10_trillion_tax_cut.php#.Vlcn73arS00 http://ctj.org/ctjreports/2015/09/jeb_bush_tax_plan_turning_populism_on_its_head.php#.Vlcm7narS00). By contrast, all of the 2016 Democratic presidential candidates wanted to retain, or increase, the share of the federal tax burden borne by the richest 1% of households.

The method by which some Republicans would increase taxes on money made with labor (i.e., middle and low-income earners) is typically through some sort of national sales, or consumption, tax (i.e., like what you pay at the cash register to the state of California when you buy a product – e.g., Ted Cruz, Mike Huckabee). Since the sales tax rate you pay *does not* increase with income (each Californian pays a 7.5% state sales tax rate *regardless* of their income – the rate varies by counties/cities but everyone in that county/city pays the *same* rate) a national sales, or consumption, tax is more regressive (i.e., more borne by middle and low income groups) than the federal income tax. Thus, reducing the share of federal taxes paid through the more progressive income tax and replacing this lost revenue with money from a more regressive sales, or consumption, tax would make the federal tax system more regressive than at the present time.

In late 2017 the Trump tax cut was passed by Congress without any Democratic support. Some of the principle features of this tax cut are a reduction of the maximum corporate income tax to 21% (from 35%), initially lower rates for all federal income tax payers, increasing the amount of money that can be inherited without taxation from $5.6 million dollars to $11.2 million dollars (a level high enough that only 1 estate in 1,000 would pay the tax) and limit the amount of state and local taxes individuals can deduct from their federal income taxes to $10,000 (which adversely affects high income tax states such as California – many Californians will get a tax increase, not a tax cut from this plan). As with the previous Republican tax cuts the benefits are highly skewed in favor of the well-to-do. The non-partisan and widely respected Tax Policy Center has estimated, approximately 38% of the benefits in 2019 go to the richest 5% of the households (i.e., those households with an annual income of approximately $200,000 per year, or more) with this percentage increasing to 44% by 2025 (http://www.taxpolicycenter.org/sites/default/files/publication/149851/2001628-distributional_analysis_of_the_tax_cuts_and_jobs_act_as_passed_by_the_senate_1.pdf). It is important to note that from 1965 to 2014 (i.e., *prior* to the Trump tax cut) all taxes (federal, state and local) as a percentage of income *decreased* by 2.1% for the top .1% (richest 1 household out of 1,000) but *increased* by 4.3% for the poorest 50% (https://www.nytimes.com/2017/12/17/opinion/taxes-inequality-charts.html). Furthermore, by 2027 because of the Trump tax cut the after-tax income of top .1% (richest 1 household out of 1,000) will *increase* by 3% but the after-tax income of the poorest 50% will *decrease* by 2% (https://www.nytimes.com/2017/12/17/opinion/taxes-inequality-charts.html). This is because the tax changes most beneficial to middle and low income individuals will either expire, or be more slowly adjusted for inflation, than the provisions more benefitting very high income individuals.

The Trump Administration has argued that it's tax cut will so stimulate growth that the Trump tax cut will pay for itself. For reasons mentioned previously, this is extremely unlikely. It is important to mention that if the proponents of this tax cut were so sure that it would pay for itself there was a very straightforward way to guarantee this: rescind the tax cut if the cut does not pay for itself. No such guarantee is in the legislation. Furthermore, the Federal Reserve Board (the federal agency that regulates the supply of money and credit) and most economists believe that because productivity growth (output per hour of work) is slow and likely to remain so (http://www.nber.org/papers/w19895) growth rates greater than about 2.1% are likely to generate increasing inflation (see Federal Reserve Board Chairperson Janet Yellin's comments in https://www.nytimes.com/2017/03/12/business/trump-fed-interest-rate.html). In order to keep inflation for igniting the Federal Reserve Board is almost certain to raise interest rate if the growth rate exceeds about 2%.

It's also important to point out that while the corporate tax cuts are permanent many of the individual tax cuts are not. Thus, the rates could increase in the future. Moreover, the cost of living (inflation) calculator in the Republican tax cut is less generous than under current law so that many of the individual tax cuts will be less generous in the future (on both these points see "What's in the Final Republican Tax Bill, New York Times, December 16, 2017 – https://www.nytimes.com/interactive/2017/12/15/us/politics/final-republican-tax-bill-cuts.html?hp&action=click&pgtype=Homepage&clickSource=story-heading&module=first-column-region®ion=top-news&WT.nav=top-news).

If the 3%-6% growth rates that the Trump Administration predicts actually occurred for several months the Federal Reserve Board would simply raise interest rates to a level where individuals and corporations reduced the amount of money they borrowed (i.e., fewer cars and homes would be purchased) to a point that the growth rate would then fall to about 2% (see https://www.nytimes.com/aponline/2017/12/11/us/politics/ap-us-federal-reserve.html?_r=0). For these reasons only 1 out of the 42 famous economists surveyed by the University of Chicago's Initiative on Global Markets thought that the Trump tax cut would spur significant economic growth above what would have otherwise occurred (the 1 supporter later admitted he misread the question). Additionally, all of the these economists thought that not only would the Trump tax cut not pay for itself but that the federal deficit (i.e., the difference between what the federal government receives in taxes and what the federal government spends) will be substantially higher ten years from now (http://www.igmchicago.org/surveys/tax-reform-2). It is also important to point out that the growth estimates typically estimated do *not* include the impact of budget reductions that the increased federal deficits will likely trigger. As mentioned previously, since the federal typically loses about $.75 for each $1 it reduces federal taxes, the Republican tax cut will, in all probability reduce the tax revenue the federal government receives. Reasonable estimates suggest that the Republican tax cut will increase the federal deficit by more than 1 trillion dollars over the next decade (https://www.nytimes.com/interactive/2017/11/28/us/politics/tax-bill-deficits.html) This reduced revenue will almost certainly mean that Congress will reduce the amount of money spent on a variety of programs.

As Bruce Bartlett, a senior economic advisor to former Republican President George W. Bush put it, "The long-term goal of Republicans is to shrink government until

it is so small it can be drowned in a bathtub, in the words of tax-cut crusader Grover Norquist. This is a moral issue for them and has nothing to do with economics. That is why they push tax cuts continuously, regardless of economic circumstances. Republicans think there is only so much freedom to go around and it's a zero-sum game; when government gets bigger, the people necessarily lose freedom. Norquist, whom I have known for 43 years, figured out a long time ago that taxes are the key political battleground and that all debates about taxes, whether to raise them or cut them, benefit the Republican Party. He also understands something called "starve the beast," which says that domestic spending programs can only be cut when there are large budget deficits. Thus, contrary to popular belief, Republicans love budget deficits because it gives them the political cover to do what they really want: downsize government." (http://www.nydailynews.com/opinion/republicans-cynical-long-game-taxes-article-1.3663405)

The Very Recent Past

By 2016 the United States had rebounded from the worst recession since the Great Depression of the 1930s. Over the 2008-2014 period the average annual unemployment rate in the U.S. was 7.9%, with a high of 9.6% in 2010. As of mid- 2018 the unemployment rate was at low level of approximately 4%. A good case can be made that much of the suffering caused by the high unemployment rates of the 2008-2015 period (increased poverty, homelessness, hunger, etc.) was unnecessary. The root cause of the high unemployment rates we experienced over the 2008-2015 was insufficient demand. American businesses had a tremendous amount of money to invest. However, since consumers had less money to spend than before the recession began (2007) there was little reason to invest because businesses simply will not be able to sell the increased products or services their investments would've produced. We were in a situation similar to the beginning of the Great Depression: the wealthy had a very high share of the national income while the relative amount of spending by middle and low income-groups has been reduced because their share of the national income has greatly decreased over the past 30 years. Additionally, due to lax regulation of banks and lending institutions more home loans were made in the period leading up to the Great Recession (i.e., through late 2007) than the income of the borrowers could sustain. Increased lending increased the demand for housing, which further increased housing prices. As housing prices increased people borrowed more money against what they thought was their increased wealth. Many people reasoned that since their house was worth more their wealth was greater and they could immediately enjoy their increased wealth by borrowing money against the value of their home. As home prices decreased the income/spending that middle and low-income groups gained through the appreciation in the value of their homes was greatly reduced. This occurred in a number of nations besides the United States (e.g., Ireland, Spain, etc.).

In 1990, the average American household's debt was equal to 83% of their income. By 2007, average household debt had increased to 130% of income. Eventually, the imbalance between what home owners, and those desiring to own homes, could afford materialized and fewer people could make the payments on the homes they had purchased or borrow against the equity they had in their current home. As home loans dwindled, a significant source of consumer spending was lost. Today, household debt has

been reduced to approximately 105% of household income. However, reducing consumer debt relative to income when income is stagnant, or declining, meant that consumers would have to spend considerably less money than previously. Reduced consumer spending meant that businesses would need fewer employees which, in turn, greatly increased unemployment.

"Corporate profits were 25% to 30% higher at the official end of the Great Recession than they were before it started (2007). Meanwhile, wages as a share of national income fell to 58%. That's the lowest wage share had been since it began to be recorded after World War II." "If wages were at their postwar (World War II) average of 63%, U.S. workers would earn an extra $740 (billion) this year (2012) or about $5,000 per worker. That's a lot of consuming power." (Barbara Garson, Los Angeles Times, May 14, 2013, page A11)

So, what should the federal government's response have been? The "short answer" is that the government should've replaced the spending that consumers cutback. If the government doesn't provide this spending/stimulus, who will? Private individuals can't/won't do this. President Obama did produce a stimulus plan to reduce unemployment. A very plausible estimate of the relationship between stimulus and unemployment is as follows: 300 billion dollars of stimulus will reduce the unemployment rate by 1%. The Obama Stimulus Plan was approximately 775 billion dollars spread over two years. Given the composition of the Obama Stimulus Plan (e.g., tax cuts – which have low stimulative value) it was equivalent to about 510 billion dollars of stimulus rather than 775 billion dollars. This means that, due to the Obama Stimulus Plan, the unemployment rate, was about 1.7 percentage points *lower* that it would have been without the plan (510/300 = 1.7 - see Paul Krugman, "Stimulus Arithmetic," New York Times, January 6, 2009). To fully offset the decline in consumer spending and reduce unemployment back to the pre-recession level of 4.6% the stimulus package would've needed to be at least *three* times the size of the Obama Stimulus Plan and spread over *more* than two years. To make hiring feasible, businesses need to know that government support will last long enough to keep demand high enough to make hiring economically viable. It's not that the Obama Stimulus Plan "didn't work," it was simply too small relative to the magnitude of the problem.

Had the Obama Stimulus Plan been larger it would've meant larger federal deficits. The deficit is simply how much more the government spends than it receives in taxes. Large deficits, brought about by the need to finance World War II, are what ended the Great Depression. After World War II the U.S. economy grew briskly and the federal deficit and debt (debt is simply the total of the annual deficits) as a percentage of the size of our economy were reduced. Any debt is best thought of in relation to your ability to pay it. Thus, I'd rather owe $100, but have $1,000 to pay the debt, than owe only $5 but have just $10 to pay it with. It's *not* the *absolute* size of the debt that matters most but rather the debt *relative* to your ability to pay it. Thus, we could've benefitted from a return to Keynesian economics (see previous discussion of Keynesian economics). Inflation has been quite low over the past decade. Larger federal deficits over the 2008-2014 period would've produced lower unemployment rates (and much less misery) but not likely resulted in inflation rates similar to the 7%-9% range of the late 1970s-early 1980s.

As the recent recession unfolded many economists thought that the federal government needed to do two things to improve the economy: (1) provide a larger stimulus

than the Obama Stimulus Plan; and (2) more strongly regulate the financial markets (to avoid the bad loans that precipitated our current problems). This was difficult for the Republican Party: their ideology and voter base (high income individuals, business owners, etc.) views as desirable a large share of income going to high income groups (e.g., tax cuts greatly favoring the wealthy, reduction in the power of labor unions, low minimum wages, etc.) and government regulation (of banks and other financial institutions and instruments – e.g., derivatives) as undesirable. By contrast, Keynesian economics, by increasing the relative income of middle and low-income groups and using government spending to offset reduced personal and business spending, is a much better fit to the philosophy and voting base (i.e., middle and low-income voters) of the Democratic Party.

Income Inequality in the United States and Internationally

An important related topic to what we have been discussing is the degree of income inequality in the United States, as well as other nations, and how this is changing over time. The following data will be of great value to us in this regard. As the data below indicate, in 2016 the richest 5% of households in the United States received 22.5% of the income of all U.S. households combined. This is over *4 times* as much income as this group would have if income were distributed equally. Thus, if income were distributed equally 5% of the households would receive 5% of the income, not 22.5%.

Income Inequality in the United States (1970-2016) and Other Wealthy Democracies (Mid-1980s)

	Japan	U.K.	Sweden	1970 U.S.	1990 U.S.	2016 U.S.
Richest 5%				16.6%	18.5%	22.5%
Richest 10%	22.4%	23.4%	28.1%			
Richest 20%	37.5%	39.7%	41.7%	43.3%	46.6%	51.5%
Next Richest 20%	23.1%	24.8%	21.0%	24.5%	24.0%	22.9%
Middle 20%	17.5%	17.0%	16.8%	17.4%	15.9%	14.2%
Next Poorest 20%	13.2%	11.5%	13.1%	10.8%	9.6%	8.3%
Poorest 20%	8.7%	7.0%	7.4%	4.1%	3.8%	3.1%

Source: Berry, Bourguignon and Morrisson, pp. 62-63 in Lars Osberg, ed., Economic Inequality and Poverty and various tables from:
http://www.census.gov/hhes/www/income/data/historical/inequality/index.html

Notice that the share of income going to low-income groups is smaller in the U.S. than the other nations and is also decreasing over time (e.g., the poorest 20% had 4.1% of the income in 1970 but only 3.1% in 2016). Additionally, note how much greater share of income the richest 5% of U.S. households gained than other income groups over the 1970-2016 period (see the data immediately above).

While the preceding percentage distributions of income are important, it can be more meaningful if we connect the distribution of income to *actual* dollar amounts of income. For example, as the data immediately ahead show, if your household had an income of $225,251 in 2016, your household's income was higher than approximately 95% of American households and lower than approximately 5% of American households.

Connecting the Income Distribution to Actual Income in the U.S. - 2016

Minimum Income to be in the Richest 1% of Households - $389,436*
Minimum Income to be in the Richest 5% of Households - $225,251
Income of the Household at the 80th Percentile - $121,018
Income of the Household at the 60th Percentile - $ 74,869
Income of the Household at the 40th Percentile - $ 45,600
Income of the Household at the 20th Percentile - $ 24,002
(https://www.census.gov/hhes/www/income/data/historical/household/ - except for richest 1%)
*For California the minimum income to be in the top 1% in 2016 was $453,772.

The largest income gains of the last two decades have gone to the richest 1% of American households. From 1993 to 2015, approximately *52%* of the increase in household income in the U.S. went to the richest *1%* of the households (i.e., households earning over $389,000 in 2016). The following data shows the change in the share of income going to very high income groups. For example, the "1/10th of 1%" column refers to the richest household out of a typical 1,000 households (i.e., 999 households out of 1,000 have a lower-income). Additionally, over the 1980-2008 period, 98% of the income growth went to the richest 10% of income earners (http://www.stateofworkingamerica.org/pages/interactive#/?start=1980&end=2008 – calculated by economist Emmanuel Saez http://www.econ.berkeley.edu/~saez/). As Barbara Garson points out, "Between 1971 and 2007, U.S. hourly wages, adjusted for inflation, rose by 4%. (That's not 4% a year; it's 4% over 36 years!) during those same decades, productivity increased by 99% - that is, it nearly doubled. In other words, the average worker's productivity rose 25 times more than his pay." (Barbara Garson, Los Angeles Times, May 14, 2013, page A11).

Return of the Gilded Age: Income Shares within the Richest 10%

Year	10%	1%	½ of 1% (richest 1 of 200)	1/10th of 1% (richest 1 of 1,000)
1920	39.0	14.8	11.1	5.4
1940	45.3	16.5	12.3	6.0
1960	33.5	10.0	7.1	3.3
1970	32.6	9.0	6.3	2.8
1980	34.6	10.0	7.2	3.4
1990	40.0	14.3	10.5	5.4
2000	47.6	19.3	15.3	8.8
2008	48.2	19.6	15.5	9.1
2015	50.5	22.0		10.9

(Emmanuel Saez- http://elsa.berkeley.edu/~saez/ Income and Wealth Inequality – the 2015 data are from economist Mark Frank –
http://www.shsu.edu/~eco_mwf/Top%20Income%20Shares%20Table%202015.pdf
The income concept in 2015 doesn't include capital gains whereas the data prior to 2015, includes capital gains and excludes government transfers and taxes – thus, like a distribution of income before government gets involved)

Since we live in California let me mention that income is more unevenly distributed in California (and the wealthier states in general) than in the U.S. as a whole. For example, whereas in the U.S. in 2015 the richest 1% had 22% of the income the corresponding figure for California was 25.5%.

If you include government transfers and subtract taxes from 1979 to 2006, the richest 1% of households had a *256%* increase income while middle-income households (40th-60th percentiles) had a *21%* increase and low-income households (1st-20th percentiles) only an *11%* increase (Jacob Hacker and Paul Pierson, Winner-Take-All Politics, p. 23).

In the United States today, the richest 1% of households have over *1.7* times as much income as the *entire* poorest 40% of households combined (e.g., in 2014 the richest 1% of the households received approximately 20% of the income whereas the poorest 40% receive approximately 11.5% of the income (look at the poorest two quintiles and you'll see they received 8.3% and 3.2% of the income – which equals 11.5% - 20%/11.5% = 1.74). As Los Angeles Times columnist Tim Rutten noted, between 1992 and 2007 America's 400 richest households increased their average income by 399%, while the poorest 90% of American households gained just 13% (Tim Rutten, LA Times, 2/24/10 using Emmanuel Saez and Thomas Piketty's data - http://elsa.berkeley.edu/~saez/) .

Notice how much greater the share of income going to the richest 1% is today than it was 20-40 years ago. This is much greater than other wealthy democracies are willing to tolerate. For example, in 2014 the richest 1% of the households in the U.S. had approximately 20% of the total income of all U.S. households. This is roughly *twice* as high a percentage as in Canada, Japan, Great Britain, the Netherlands, Sweden, Switzerland, France, Spain, Australia and New Zealand (Hacker and Pierson, Winner-Take-All Politics, page 39). While there is some mobility (i.e., families moving in and out

of either the richest 20% or the poorest 20%) only 3%-6% of U.S. households go from either the richest 20% to the poorest 20%, or vice versa, over a decade. Thus, there is not that much mobility.

The Canadian middle class is now richer than the American middle class. Additionally, as you'll see in class, median income (50% are above this figure and 50% are below it) is growing faster in both Canada and many European nations than in the United States. In the coming years the income of the middle class in a number of European nations will exceed American middle class incomes (Nicholas Kristof, "It's Now the Canadian Dream," New York Times, May 14, 2014).

While the growth in per capita GDP is, on average, somewhat greater in the United States than in Canada and Europe, the growth in incomes at the very top of the income distribution is so much greater in the United States that average growth rates are highly misleading. Consider France. From the mid-seventies to the late 2000s, the US average income grew at 1% percent per year. But if one strips out the growth that went to the top 1% of the income ladder (40%), the rate drops to only 0.6%. This means that on the base of the 99% of the population of America, incomes in France grew faster than in the US in the past 40 years. As you'll soon see, France was one of the slower growing OECD nations (see Nicholas Kristof, "It's Now the Canadian Dream," New York Times, May 14, 2014 and David Leonhardt and Kevin Quealy, "The American Middle Class Is No Longer the World's Richest," New York Times, April 22, 2014).

In California, between 1987 and 2009, *more than 33%* of the income gains went to the *richest 1%* of Californians, and *almost 75% went to the richest 10%* while the bottom 90% received just over 25% of the growth in incomes. During the last two decades, the average income of the richest 1% of Californians *increased by more than 50%*, after adjusting for inflation, while the average income of the middle fifth (i.e., the 40th – 60th percentiles) *decreased by 15%*. In 2009, the average income of the richest 1% of Californians was *$1.2 million – more than 30 times* that of Californians in the middle fifth. California's income gap is wider than most other states. (LA Times, 11/23/11 page A17)

There are certainly a number of potential causes for the dramatic increase in income inequality in the United States over the past 40 years (e.g., the impact of computers/software programs on the relative value of different types of work). However, we should not underestimate the impact of changes in public policies that are directly under the control of elected officials on the tremendous increase in income inequality over the past several decades. Over approximately the past 15 years the income inequality data produced by University of California economist Dr. Emmanuel Saez (covering the period 1913-2014 frequently updated and also for many wealthy democracies - http://elsa.berkeley.edu/~saez/) has been the primary source for the tremendous increase in studies of income inequality. Professor Saez himself has produced a tremendous number of high quality studies. The following quotation is from a recent interview with Dr. Saez concerning the both the impact of changes in public policy on income inequality and the support for the traditional economic notion that income in a function of the value of one's contribution to the economy:

"…The changes in income concentration are just too abrupt and too closely correlated with policy developments for the standard story about pay equaling productivity to hold everywhere (i.e., if a worker continued to work the same number of hours but produced

twice as much per hour worked as previously then their income would double). That is, if pay is equal to productivity, you would think that deep economic changes in skills would evolve slowly and make a gradual difference in the distribution—but what we see in the data are very abrupt changes. Basically all western countries had very high levels of income concentration up to the first decades of the 20th century and then income concentration fell dramatically in most western countries following the historical narrative of each country. For example, in the United States the Great Depression followed by the New Deal and then World War II. And I could go on with other countries. Symmetrically, the reversal—that is, the surge in income concentration in some but not all countries—follows political developments closely. You see the highest increases in income concentration in countries such as the United States and the United Kingdom (Great Britain), following precisely what has been called the Reagan (Republican President from 1981-1988) and Thatcher (Conservative Party Prime Minister of Great Britain from 1979-1990) revolutions: deregulation, cuts in top tax rates, and policy changes that favored upper-income brackets.

You don't see nearly as much of an increase in income concentration in countries such as Japan, Germany, or France, which haven't gone through such sharp, drastic policy changes. There have been a key number of policy developments, especially cuts on top tax rates in a number of countries, that have led to a surge in pre-tax top incomes in those countries, the best example again being the United States and the United Kingdom. All the data we've gathered from so many countries over so many years tells you that, indeed, the level of top tax rates plays a large role in pre-tax income concentration. The key question is, what is the mechanism that leads higher or lower top tax rates to lower or higher top incomes?

The standard story among economists is that if those in the top bracket earn more that's because they are working more and contributing more to the economic pie. So in that scenario, reducing top tax rates and having higher incomes at the top would be a good thing. However, if that were the case, the growth in top incomes should not come at the expense of lower incomes and it should stimulate economic growth. The difficulty, however, is that if you look at the data you don't see clear evidence that countries who cut their top tax rates and experienced a surge of top incomes did experience overall better economic growth. An alarming fact in the United States concerns the patterns of economic growth of the top 1 percent versus the bottom 99 percent. We know that in the long run economic growth leaves all incomes growing. If you take as a century long picture, from 1913 to present, incomes for all have grown by a factor of four. But then when you look within that century of economic growth, the times at which the two groups were growing are strikingly different. From the end of the Great Depression to the 1970s, it's a period of high economic growth, where actually the bottom 99 percent of incomes are growing fast while the top 1 percent incomes are growing slowly. It's not a good period for income growth at the top of the distribution. It turns out that that's the period when the top tax rates are very high and there are strong regulations in the economy. In contrast, if you look at the period from the late '70s to the present, it's the reverse. That's a period when the bottom 99 percent incomes are actually growing very slowly and the top 1 percent incomes are growing very fast. That's exactly the period where the top tax rates come down sharply. So, of course this doesn't prove the rent-seeking scenario ("rent" doesn't mean renting an apartment but rather

that a factor of economic production – e.g., income from investment or labor – increases income more than it's value to the economy warrants) but it is more consistent with it than with the standard narrative." (interview with Dr. Saez published online 2/28/2013 at http://www.bostonreview.net/BR38.1/emmanuel_saez_david_grusky_income_inequality_taxes_rent_seeking.php).

Recent work by political scientists confirms the impact of tax rate changes and politics on the level of income inequality in the United States. Over the 1976-2008 period the share of income going to the richest 1% of taxpayers rose 12 percentage points – from 8.9% of income to 20.9% of income. Enns, et. al. found that approximately 45% of this 12 percentage point increase (i.e., about 5.4% which is 45% of the 12 percentage point increase) was due to reductions in the tax rates paid by the richest 1%, while another 28% of this increase (i.e., 3.36% which is 28% of the 12 percentage point increase) was due to the increasing polarization of Republican and Democratic parties in Congress. According to sophisticated measurements developed and refined by political scientists over the past several decades Democrats in Congress have become slightly more liberal while Republicans have become much more conservative. The greater conservatism of Republican senators means they are more likely to achieve the 41 votes necessary in the Senate to prevent a bill reducing income inequality from becoming law. The remaining 26.5% of the increase remained unexplained (Peter Enns, Nathan Kelly, Jane Morgan, Thomas Volscho and Christopher Witco, "Conditional Status Quo Bias and Top Income Shares: How U.S. Political Institutions Benefit the Rich," (http://web.utk.edu/~nkelly/papers/inequality/csqb.pdf). While certainly not the only reason, conservative tax policies and the increasing conservatism of the Republican Party are major reasons why income inequality in the United States has increased so much over the past several decades.

One could look at the preceding income inequality data showing the relatively small percentage of income middle and low-income Americans receive and still have this question: although middle and low-income Americans have a noticeably smaller share of the income than in other wealthy democracies, don't middle and low-income Americans live at a higher standard than middle and low-income people all the other wealthy democracies? The short answer is "*not necessarily*." "The idea that the median American (middle – i.e., if you rank 101 households from richest to poorest the median would be the 51st household – 50 would be richer than the median household and 50 would be poorer than the median household) has so much more income than the middle class in all other parts of the world is not true these days," said Harvard economist Lawrence Katz. "After-tax middle-class incomes in Canada – substantially behind (the U.S.) in 2000 – now appear to be higher than in the United States." "A Gallup survey conducted between 2006 and 2012 showed the United States and Canada with nearly identical per capita (per person) median income (and Scandinavia – Norway, Sweden and Denmark – with higher incomes). And tax records collected by Thomas Piketty and other economists suggest that the United States no longer has the highest average income among the bottom *90 percent* of earners. The source for the quotations and other information in this paragraph is David Leonhardt and Kevin Quealy, "The American Middle Class Is No Longer the World's Richest," New York Times, April 22, 2014.

Additionally, “the poor in much of Europe earn more than poor Americans.” A family at the 20th percentile (i.e., where 80% of the households have a higher income) of the income distribution in this country (U.S.) makes significantly less money than a similar family in Canada, Sweden, Norway, Finland or the Netherlands.” For example, in 2010, at the 20th percentile income in both the Netherlands and Canada was *15% higher* than in the United States. The source for the quotations and other information in this paragraph is David Leonhardt and Kevin Quealy, “The American Middle Class Is No Longer the World’s Richest,” New York Times, April 22, 2014.

However, “Americans at the 95th percentile of the distribution – with $58,600 in after-tax per capita income (about $233,000 for a family of four) not including capital gains (e.g., the profit from selling an asset such as stock or a house – which can be considerable for upper-income households) still make more than *20 percent more* than their counterparts in Canada, *26 percent more* than those in Britain and *50 percent more* than those in the Netherlands. For these well-off families, the United States still has easily the world’s most prosperous economy.” The source for the quotations and other information in this paragraph is David Leonhardt and Kevin Quealy, “The American Middle Class Is No Longer the World’s Richest,” New York Times, April 22, 2014.

One fundamental reason the poor in the U.S. have a lower standard of living than in several other nations is that, after taxes, the U.S. transfers only about *one-third* the percentage of income to the poorest 20% of households (1.5%) as does the average (4.2%) of the world’s wealthy democracies (i.e., the nations of Western Europe, Canada, Japan, etc. – Marco Mira d’Ercole, “Income Inequality in OECD Countries: How Does Japan Compare?, Japanese Journal of Security Policy, Vol. 5, No. 1, June 2006, pp. 1-15, see page 9). Additionally, *labor unions*, which are typically the strongest advocates for public policies that primarily benefit middle and low-income households, are *much weaker* in the U.S. than in Europe (Hacker and Pierson, Winner-Take-All Politics, pp. 56-61). Additionally, while older Americans (age 55-65) have higher levels of literacy and technological skills, younger Americans don’t. “Those between 16 and 24 rank near the bottom among rich countries, well behind their counterparts in Canada, Australia, Japan and Scandinavia and close to those in Italy and Spain” (David Leonhardt and Kevin Quealy, “The American Middle Class Is No Longer the World’s Richest,” New York Times, April 22, 2014).

In this light it is worth noting that approximately 38% of the benefits from the Bush Tax Cuts go to the richest 1% of the households (i.e., the same households who have been receiving a much higher share of personal income over the past 40 years). The richest *1%* of U.S. households receive *more* money from the Bush Tax Cuts than the *entire poorest 70% of U.S. households combined* (roughly households with annual incomes of about $90,000 or less). Primary sources for the past several paragraphs are: “Year by Year Analysis of the Bush Tax Cut,” Citizens for Tax Justice, www.ctj.org, page 2 and Paul Krugman, “For Richer,” New York Times, October, 2002.

In terms of assessing the degree of economic inequality, income is only part of the picture. We also need to examine wealth. Wealth is a storehouse of assets: trusts, stocks, bonds, etc. whereas income is what you live on over a short period – say, a year. As the following statistics will make clear: Wealth is even more unequally distributed than income. In the United States the *wealthiest 1%* of households have over

33% (2006-2007, 35%) of the national wealth while the *poorest 50%* of households have approximately *7%* of the national wealth (sources: Lester Thurow, Generating Inequality, pp. 14-15; Los Angeles Times, September 17, 2000, p. M2, Article on Estate Tax; Los Angeles Times, Sept. 20, 2011, p. A11). While Americans' ***average*** net wealth is an impressive $310,000 (ranked 4th behind Switzerland, Australia and Norway), ***median*** net wealth is only $45,000 (i.e., if you take 101 households the median would be the middle, or 51st wealthiest household i.e., "the middle" – 50 households would be wealthier than the median and 50 would be less wealthy than the median). This places the U.S. 19th. This is below every wealthy nation except Israel. It is even less than Spain and Taiwan (Jacob Hacker and Paul Pierson, American Amnesia, 2016, page 36).

A very compelling case can be made that the previously mentioned income and wealth data actually *understate* the "true" level of inequality. Here's why: they do *not* take into account need, supplement sources of income and non-monetary bonuses (just keep reading). For example, if your family has a remedial health care need (e.g., an autistic child) you have to spend some portion of your income to pay for this special need. Poor families disproportionately have such needs. Additionally, poor people do not have the same ability to borrow money from friends in the event of an emergency as wealthier people (i.e., the friends of the poor tend to also be poor and cannot as readily give, or loan, money to a poor friend in need). Furthermore, middle and upper-income groups get non-monetary bonuses much more frequently than the poor. For example, if you're flipping the Whoopers for Burger King, I'll bet you didn't go to work in a company car! But Burger King Executives probably did. A company car doesn't count as "income."

What Americans Think About Inequality

So far, we've seen that the United States has a much *higher* degree of income inequality than other Western democracies and that the degree of income inequality in the U.S. is increasing *substantially*. Since a democratic political system should, in part, be guided by public opinion it is reasonable to ask: What does the American public think about the degree of income inequality? Depending upon how the question is asked, Americans do tend to think the rich have too much in relation to middle and low-income groups.

To keep this short, a rather large amount of research tells us the following: (1) Americans vastly *overestimate* their chances of becoming rich; (2) vastly *underestimate* the degree of income inequality (i.e., do not think the wealthy are as wealthy as the actually are); and (3) have a difficult time connecting public policy to economic outcomes (e.g., not that many see the Bush tax cuts as a tremendous redistribution to the wealthy - that the Bush tax cuts primarily go to high-income households and these tax cuts will require reducing funding for programs that primarily benefit middle and low-income households). All of this greatly helps conservatives. For example, you are less likely to support raising taxes on the wealthy if you think: (1) you will become wealthy; (2) the wealthy really aren't "that wealthy"; and (3) don't know much about the distribution of the benefits from the Bush tax cuts or the service reductions they will necessitate. When Americans are shown the *actual* degree of income inequality, their

support for government efforts to reduce the income differences between the rich and poor approximately *doubles* (from 25%-30% to almost 60% - Jacob Hacker and Paul Pierson, Winner-Take-All Politics, p. 155).

Americans do desire a less unequal distribution of wealth. Recently, two scholars tried an interesting experiment. Currently, wealth in America is distributed as follows: the richest 20% of households (percentiles 81-100) have approximately 84% of the wealth, the next richest 20% (i.e., percentiles 61-80) have approximately 11%, the middle quintile (i.e., percentiles 41-60) have approximately 4%, the next poorest 20% (i.e., percentiles 21-40) have approximately .2% (two tenths of 1%) and the poorest quintile (i.e., percentiles 1-20) have approximately .1% (one tenth of 1%).

Not being told what nations had what distribution of wealth, Americans were offered three choices: (1) the current American distribution of wealth; (2) perfect equality (i.e., each quintile getting an equal – 20%- share of the wealth); or (3) the current Swedish distribution of wealth [the richest 20% of households (percentiles 81-100) approximately 36% of the wealth, the next richest 20% (i.e., percentiles 61-80) approximately 21% of the wealth, the middle quintile (i.e., percentiles 41-60) approximately 18% of the wealth, the next poorest 20% (i.e., percentiles 21-40) approximately 15% of the wealth and the poorest quintile (i.e., percentiles 1-20) approximately 11% of the wealth]. According to Michael Norton of the Harvard Business School and Dan Ariely of Duke University, the results were as follows: 47% chose Sweden's distribution, 43% chose perfect equality while only 10% chose the current American distribution. (source: Michael I. Norton and Dan Ariely, 2011, "Building a Better America - One Wealth Quintile at a Time," Perspectives on Psychological Science, Vol. 6, No. 1, pp. 9-12).

Our views of how much inequality we should tolerate are, in part, driven by the environment we live in. Immediately after World War II there was a significant decrease in wage inequality (i.e., a reduction in the difference in pay per hour of work between a physician and a bricklayer). The most likely reason for this was that higher income workers had just served in the military with lower income workers. This common experience, especially under "life and death circumstances," made it more difficult for higher income workers to rationalize their higher incomes (Lester C. Thurow, Generating Inequality). Today, Americans are probably more willing to tolerate higher levels of income inequality because we don't have such common experiences. In fact, many upper income people live in communities of similarly wealthy people and in gated communities that "wall them off" from much contact with people of lower incomes.

How Should We Measure "Well-Being"?

While income is important, it is probably NOT as good a measure of the quality of life as other measures. For example, if someone spends $1,000 on diabetes medicine it counts as part of GDP. However, wouldn't the same person have a better life if they didn't have diabetes but spent $750 on a computer? Since $1,000 is greater than $750, in this example GDP would be higher for diabetes oriented spending than for buying a computer. But in this example "well-being" would be greater with less total spending (i.e., not having diabetes and needing to spend $1,000 on it) but buying a new computer (for only $750). GDP (Gross Domestic Product) only measures the *monetary* value of the economy. It tells *nothing* about *how* the money is used or any *non-monetary* value

(e.g., the value of security – e.g., certain employment versus the same money earned through uncertain employment). For this reason, a number of economists and other social scientists (political scientists, sociologists, psychologists, etc.) have developed more encompassing measures of well-being than the amount of GDP per person. For example, some measures subtract various "bads" (e.g., pollution and traffic congestion) from GDP. Others have developed measures that include adjustments for many of the following: national health, the functioning of the political system, job security and measures of community well-being. Typically, on such indicators, the United States ranks *lower* than the *high tax* and *strong welfare state countries* of Northern Europe (e.g., Norway, Sweden, Denmark, Finland, and the Netherlands). The United States is not out-ranked by all of these nations on each indicator. However, on the five such indices I am familiar with, the United States was ranked last among these six nations on four of the five indicators and was third on the fifth indicator (Jeffrey D. Sachs, The Price of Civilization, Random House, 2011, page 208).

If we just examine reported life satisfaction (i.e., how satisfied the average person in that nation reports themselves as being) nations with much less income inequality and stronger social safety nets (e.g., Denmark, Sweden, Finland, Canada, Switzerland and the Netherlands) have *higher* life satisfaction than the U.S. So do a number of nations that are much poorer than we are: Malta, Ireland and Iceland (http://www.nationmaster.com/graph/lif_lif_sat-lifestyle-life-satisfaction). A reduction in income inequality and a stronger social safety net could easily *increase* the life satisfaction of the American public. The smallest government *does not* seem to produce the most satisfied citizenry. Similarly the 2016 World Happiness Report concludes that citizens in nations with high income inequality and weak safety nets tend, on average, to be *less* happy than citizens in nations with *lower inequality* and *stronger safety nets*. In order here are the 9 happiness nations in the world: Denmark, Iceland, Norway, Finland, Canada, The Netherlands, New Zealand, Australia and Sweden (the U.S. ranked 13th – see http://worldhappiness.report/).

One of the prime reasons the U.S. scores lower on many "satisfaction" measures than many European nations is that while the very low U.S. tax burden allows people, especially higher income people, to keep more of their income the comparatively U.S. safety net means that lower-income will have higher stress as more of them lack basic needs (e.g., all Americans aren't guaranteed health care, America currently has the highest level of food insecurity of any wealthy democracy, much homelessness, etc.). While it may be easier for Americans to either get a job promotion or purchase luxury goods (e.g., large homes, expensive vacations, etc.) studies show the effect of such items on satisfaction typically erodes quickly. Thus, if you get a promotion at work you are likely to initially be more satisfied than previously. However, after a few months this greater satisfaction is often lost while the relatively low level of satisfaction by the poor in the United States through the absence of basic needs lowers the average level of satisfaction enough that it is below most European nations on most indicators (Jeffrey D. Sachs, The Price of Civilization, Random House, 2011, page 208; Arthur C. Brooks, "A Formula for Happiness," New York Times, December 14, 2013). One related point worth making: people make worse, not better, decisions under stress. Thus, as one of the two economists who won a Nobel Prize for this research explained to me in an email: one of the reasons the poor in the United States often make poor decisions is

that their basic needs are often not meet. He went on to explain how this had caused him to think our safety net needed to be strengthened, not weakened.

Two OECD researchers, Romina Boarini and Marco Mira d'Ercole, have compiled material deprivation data from surveys in various nations. Each survey asked identical or very similar questions about seven indicators of material hardship: inability to adequately heat one's home, constrained food choices, overcrowding, poor environmental conditions (noise, pollution), arrears in payment of utility bills, arrears mortgage or rent payments, and difficulty making ends meet. From least stress to most stress, here are the rankings: Sweden, Denmark, Norway, Finland, Australia, The Netherlands, The United Kingdom, German, Ireland, France, Belgium, Spain (the U.S. ranked 14th – Lane Kenworthy, "A Decent and Rising Income Floor", May 2015 – https://lanekenworthy.net/a-decent-and-rising-income-floor/ - this a short article taken from Kenworthy's forthcoming book, The Good Society). Material hardship increases stress and makes us a less healthy nation.

If I were reading this when I was the age of most of you in this class (far too many years ago!), I would have felt like raising the following three points: First, just because someone begins life poor doesn't mean they have to remain poor. Second, wouldn't government attempts to reduce income inequality reduce the incentives for people to earn high-incomes, thus lowering the overall quality of life in the United States? Third, wouldn't a government large enough to undertake the programs necessary to greatly help low and middle-income households lead to a reduction in basic American freedoms (e.g., freedom of speech, press, etc.)? All of these are important considerations. Fortunately, political scientists, economists and sociologists have thoroughly studied these topics. Let's examine what they've found. While the research is far too numerous to summarize in this short a reading, I can give you the "gist" of it.

Economic Mobility in the United States

While it is true that anyone can "rise from the bottom and get to the top," it is also true that where you begin life is strongly related to where you end it. To offer an opinion, the high levels of income inequality in the United States would be much more defensible if everyone had an equal chance. This would mean that the income of your parents would be unrelated to your eventual income. That is not the world we live in!

If you compare the eventual income of two children from different families, on average, the child from the richer family receives an annual income that is higher than the child from the poorer family by approximately 30%-40% of the difference in the incomes of their parents (study results courtesy of Sociologist Christopher Jencks). For example, a child from a family that made $100,000 per year would, on average, out earn a child from a family that made $25,000 by approximately $25,000 per year (the difference in their parents incomes was $75,000 – i.e., $100,000 - $25,000 = $75,000; 33% of $75,000 = $25,000). Thus, if later in life the child of the poorer family was earning $25,000 per year and the child of the richer family was earning $50,000 per year, you could say that the difference was *entirely* due to background. Given that the average U.S. household has an income of around $60,000, the $25,000 annual "dividend" the child from the $100,000 household has over the child from the $25,000

household is important (it would be about 40% of the average income – i.e., $25,000 is roughly 40% of $60,000).

From different sources I can also tell you the following concerning mobility between income groups over the life cycle: (1) children born into the poorest 20% of households have approximately a 42% chance of ending up in the poorest 20% themselves, a 24% chance of ending up in the next poorest 20% and only a 6% chance of ending up in the richest 20%. Conversely, those born into the richest 20% of households have nearly a 40% chance of ending in the richest 20% themselves, while only a 6% chance of ending up in the poorest 20%; (2) Father's and Son's incomes in the U.S. correlate at about .43 (correlation ranges from 0 to 1.0 so this is a moderate correlation – taken from an average of several studies), and is *higher* in the U.S. (i.e., *less* mobility) than in Sweden, Norway, Finland, France, Spain, Germany, and Canada. Socioeconomic factors (i.e., intelligence, schooling, parent's wealth, etc., account for only about 1/3 of the differences – Rags to Riches? 2004 - www.tcf.org and Hacker and Pierson, Winner-Take-All Politics, page 29). "Indeed, the United States now has close to the lowest level of upward mobility in the advanced industrialized world." "Roughly two in three Americans born in the bottom fifth of income either stay there (42 percent) or rise just into the next fifth (23 percent) An American boy whose dad is in the bottom fifth has only a 30 percent chance of climbing into the top half. A Canadian boy has a 38 percent chance. This 8-point difference might seem small but it's not. With 138 million American men, 8 percentage points represent 2 million boys escaping the bottom fifth into the top half." (Hacker and Pierson, American Amnesia, 2016, p. 37).

Some important reasons mobility is so low in the United States is that we do not spend much on social welfare programs (relative to other wealthy democracies), we work longer hours than Canadians and Europeans do and we have a much more unequal distribution of income and wealth. The poor in the United States lack both the money and time to devote to raising their children that upper income families possess (Nicholas Kristof, "It's Now the Canadian Dream", New York Times, May 14, 2014; David Brooks, "The Opportunity Gap," New York Times, July 12, 2012). Where you start *is* strongly related to where you finish. Since you can't pick which family you're born into, this means that luck is very important in terms of your eventual position in the income distribution! This is troubling because "luck" isn't "merit."

Consider how the Bush and Trump tax cuts impact mobility from low to high-income groups. First, by reducing the estate tax and reducing other taxes on high-income individuals, the both tax cuts give the wealthy more wealth to leave their heirs. Obviously, this makes it more difficult for most of you to try to amass more wealth than the heirs of the currently very wealthy due to the fact these heirs will be given such a tremendous head start on you. Second, by reducing the revenue of the federal government, the both the Bush and Trump tax cuts will all but require reductions in programs that help low and middle-income people ascend the economic ladder (e.g., the Pell Grant Program for poor college students, health care for the poor, job training, public transportation, etc.). In this same it is important to mention that, "The vast majority of OECD countries (these are the wealthy democracies of the world – Great Britain, France, Canada, Norway, etc.) either invest equally in every student or disproportionately more in disadvantaged students. The US is one of the few countries doing the opposite (Hacker and Pierson, American Amnesia, 2016, p. 35)." So, would

repealing the estate tax (the tax on inherited wealth) with ensuing reductions in programs that help low and middle-income people increase their future earnings reward "luck" or "merit"? The Bush and Trump tax cuts reveal a very pertinent fact about economic policy: there is often a great difference between programs that help the *non-wealthy acquire* wealth versus policies that *protect* the wealth of those who *already* have it. What is good for one group is not necessarily good, and often harmful, for the other group. Approximately 75% of American household *lose* under the Bush tax cuts. Since it is hard to imagine how someone can lose out of a tax cut, let me explain. Roughly, the poorest 20%-25% of American households are too poor to pay federal income taxes. Thus, any reduction in government services that would occur because of reduced federal revenue resulting from the Bush tax cuts would automatically adversely affect the most needy U.S. households.

Since the Bush and Trump tax cuts reduce federal revenue, they will likely increase the size of the federal deficit. This means that the federal government will have to borrow more money. Increased federal borrowing will increase the cost of a loan. For approximately the poorest *75%* of American households, the value of foregone government services (e.g., less money to subsidize public transportation, health care, etc.) and additional borrowing costs (to finance a home or car) was *larger* than the value of their Bush tax cut. While it's too early to get a precise estimate of the percentage of "losers" under the Trump tax cut, without a doubt for a sizeable number of low income people their tax cut is likely to be smaller than the value of lost government service, increased borrowing costs and increased medical insurance costs (due to the removal of the requirement that everyone purchase insurance).

In order to get a complete picture of the Trump tax cuts we'll need to have them operate for several years. However, we can better asses the Bush tax cuts. The real gains from the Bush tax cuts went to households with incomes much higher than the median. The average Bush tax cut was $1,126 but 83% of households receive less than $1,126 and 53% of households receive only $100, or less! The "average" gain of $1,126 is achieved by having a relatively small number of households receive very large amounts of money. The median U.S. household (i.e., half the households have a higher income and half the households have a lower income) receives only $217 from the Bush tax cuts ("Year-by-Year Analysis of the Bush Tax Cuts Shows Growing Tilt to the Very Rich," Citizens for Tax Justice, www.ctj.org, June 12, 2002). That's why an "average" can be misleading. The *median* tax cut (half the households above and half below) provides a much more accurate picture of what the typical household receives than the *mean* cut. This is why the Bush Administration always mentioned the mean tax cut rather than the median tax cut (i.e., it looks like the average household gains more – they don't, but it appears that way).

Before leaving the Bush/Trump tax cuts, one additional point should be made: relative to other policy options these tax cuts are one of the very *least* effective, and most *costly*, methods of stimulating the economy and, ultimately, reducing unemployment. As economist research indicates: lower-income households spend a higher percentage of each additional dollar they receive than higher-income households. For example, a household with a $40,000 annual income will spend a higher percentage of each additional dollar it receives than a household with a $200,000 annual income. This is because lower-income households have greater unmet needs

than higher-income households (e.g., replacing a worn out television set, car, etc.). By showering more money on the richest 1% of households (i.e., households with incomes above $370,000) than on the *entire* poorest 70% of households *combined*, the Bush tax cuts place the *most* money in the hands of those *least* likely to spend it.

Contrast this with the policy options favored by the Obama Administration and Congressional Democrats: reducing payroll taxes (e.g., Social Security and Medicare taxes), extending unemployment compensation and spending more money on infrastructure (e.g., roads, bridges, etc.). Since payroll taxes take a greater percentage of income from low-income than from high-income households and the unemployed (as we saw earlier) are more likely to come from low and middle-income groups, *every* dollar spent on *either* payroll tax reduction or unemployment compensation will generate *more spending* than the *same* number of dollars spent through the Bush tax cuts. The following indicates how much additional economic activity occurs per dollar spent: extending unemployment compensation - $1.60; payroll tax reduction - $1.09; extending the Bush tax cuts - $.35 (i.e. for each dollar given to tax payers through the Bush tax cuts, we only receive 35 cents of additional economic activity – only a fourth as much per dollar spent as on unemployment compensation – i.e., $.35 is about ¼ of $1.60 - and about 1/3 as much as reducing payroll taxes – i.e., $.35 is about 1/3 of $1.09 - source: "Zandi Estimates Show "Democratic" Measures in Tax Cut – UI Deal Boost Economy, "Republican" Measures Add to Deficit Risks," Center for Budget and Policy Priorities – December 22, 2010 – available at www.cbpp.org - these are similar findings to the nonpartisan Congressional Budget Office).

Since *all* income groups will save *some* percentage of the money they receive (i.e., lower-income households will save some money, just not as a great percentage as higher-income households), having the government *directly* spend money is *more* stimulative than tax cuts. For example, if a household receives a tax cut of $1,000 and spends $930 of it (i.e., saves $70), this is *less* spending than results from having the government directly spend the *entire* $1,000. Thus, having the government directly spend money is more highly stimulative and, ultimately, reduces unemployment *more* than the *same* amount of money spent through tax cuts.

Given the previous discussion of which income groups are most harmed by either unemployment or inflation, and the fact that lower-income groups vote more Democratic than higher-income groups, isn't it clear why the two major political parties choose very different policies concerning unemployment, inflation, taxation and extending health care coverage? Both major U.S. political parties are pursuing policies that more benefit their supporters than the policies of the opposition party. That makes sense.

Do High Taxes Reduce the Incentive to Earn and Reduce Growth?

Previously I raised the possibility that high taxes would undermine economic growth. Thus, if the government both taxes and spends a large share of the economy won't we end up with more equal slices of a smaller pie (or a pie that isn't growing as fast as it otherwise would)? While this is an important point, the evidence in favor of it is *not* compelling. As the textbook in this course mentions, tax rates as a percentage of the economy are much *lower* in the U.S. than in most wealthy democracies: U.S. - 27%,

Canada – 34%, Germany – 35%, Great Britain – 37%, Italy – 41%, France – 44% and Sweden - 51% (Thomas Patterson, The American Democracy, 10th alt. ed., p. 17). Additionally, governments in the U.S. spend a *smaller* percentage of the economy and provide a *weaker* social safety net than European democracies. For example, the U.S. is the *only* wealthy democracy that does *not* guarantee health care to *all* citizens. Moreover, governmentally provided child care/day care, while *commonplace* in the other wealthy democracies, is not a "right" in the United States. Furthermore, governmental provided pensions (Social Security in the United States) are *less* generous in the U.S. than in other wealthy democracies. Therefore, the working poor in the United States have to purchase very costly benefits/services (often health insurance and/or out-of-pocket medical expenses, child care and enhanced retirement benefits) which are typically governmentally provided in other wealthy democracies (David Brady, Rich Democracies, Poor People, Oxford University Press).

If the "big government reduces growth" argument is true, since U.S. governments spend *less* of the economy, tax *less* and provide *weaker* social guarantees than European nations, the U.S. should have a *higher* economic growth rate. The truth is that the U.S. growth rate is about *average* among the wealthy democracies of the world. From 1990-2005 per capita (i.e., per person - to adjust for differences in population size between nations) growth rates were as follows: U.S. - 85%, Netherlands – 86%, Norway – 134%, France – 60%, Australia – 91%, Canada – 69%, Denmark – 80%, United Kingdom – 111%. "Since 1980, per capita real G.D.P. (Gross Domestic Product) – which is what matters most for living standards - has risen at about the same rate in America and in the E.U. (European Union - 1.95 percent here; 1.83 percent there - Paul Krugman, "Learning From Europe," New York Times, January 11, 2010). From the mid-seventies to the late 2000s, the US average income grew at 1% percent per year. But if one strips out the growth that went to the top 1% of the income ladder, the rate drops to only 0.6%. This means that on the base of the 99% of the population of America, incomes in France grew faster than in the US in the past 40 years (Nicholas Kristoff, "It's Now the Canadian Dream," New York Times, May 14, 2014 and https://www.oecd.org/unitedstates/Tackling-high-inequalities.pdf see page 7).

Notice in the previous data on per capita GDP growth rates that France was one of the *slower* growing economies listed. Thus in faster growing nations (e.g., the Norway, The Netherlands, etc.) where grow is spread more evenly across the income distribution than in the U.S. (which it is in virtually all other wealthy democracies) middle class incomes are growing faster than in the U.S. The fact that growth in per capita GDP in the U.S. is so concentrated on very high groups is one of the prime reasons that the Canadian middle class now has a higher standard of living than the U.S. middle class and that the middle class in a number of European nations are likely to have higher incomes than the American middle class in the years ahead (Nicholas Kristoff, "It's Now the Canadian Dream," New York Times, May 14, 2014). As economist Peter Lindert of the University of California at Davis put it, "No matter how you torture the data, there is no negative relationship between a commitment to the welfare state and the growth rate in how well off we are." While taxes may reduce the willingness of some to work as hard, many of the purposes for which tax dollars are spent (e.g., education, infrastructure, etc.) *increase* the growth rate.

One last point on GDP growth rates. Comparing national GDP levels doesn't measure the value (i.e., quality or efficiency) of goods and services – just their total cost. This penalizes nations such as Sweden who – through a more efficient and effective medical system, better pre-school, and less material hardship/stress - produce better health outcomes (e.g., longevity, infant mortality) at far less cost than the U.S. Money spent on health care can't be spent for any other life enhancing purpose. It could easily be argued that to compare living standards in the U.S. and Sweden we should subtract from U.S. GDP the 5.2% of additional GDP the U.S. spends on health care (U.S. – 17.1%, Sweden – 11.9%).

As Jeffrey Sachs notes, "Anti-tax ideologies in the United States claim that Europe pays a heavy price because of its higher taxes. This is hard to swallow, however, given that northern Europe is ahead of the United States on most indicators of material well-being: educational performance, subjective well-being, poverty rates, life expectancy, and so forth. Yes, it's true that GDP (Gross Domestic Product) per person is still higher in the United States than in most of Europe (though not higher than in Norway, for example), but that really doesn't prove much about taxes or even about social well-being. U.S. GDP per person may be higher, but the average living standard of the median citizen is not: much of America's higher GDP reflects higher health care costs, longer work hours and less leisure time, longer commutes, more military spending, and a high proportion of income at the very top on the income curve. More important, the higher GDP per person *predates* (i.e., came before) differences in tax systems, stretching back to the late nineteenth century. In 1913, for example, America was 52 percent richer than Western Europe, and in 1998, it was also 52 percent richer than Europe. America's long-standing advantage in GDP per person has been in its geography rather than its economic system. America has vastly more land and natural resources per person than Europe does." (Jeffrey D. Sachs, The Price of Civilization, Random House, 2011, page 225) Let me mention the qualifications of the source for this material, Jeffrey Sachs. Sachs is extremely qualified to make these comparisons. He is a former Harvard Economics Professor who has served a number of Eastern European governments on the transition from communism to free market economies as well as many developing nations. Sachs is currently the Director of the Earth Institute at Columbia University.

As Paul Krugman notes, "if you look systematically at the international evidence on inequality, redistribution, and growth — which is what researchers at the I.M.F. did — you find that lower levels of inequality are associated with faster, not slower, growth. Furthermore, income redistribution at the levels typical of advanced countries (with the United States doing much less than average) is "robustly associated with higher and more durable growth." That is, there's no evidence that making the rich richer enriches the nation as a whole, but there's strong evidence of benefits from making the poor less poor." (Paul Krugman, "Inequality is a Drag," New York Times, August 7, 2014 – also see Jonathan D. Ostry, Andrew Berg and Charalambos G. Tsangarides, "Redistribution, Inequality, and Growth," International Monetary Fund, February, 2014).

Additionally, Gale, Krupkin and Reuben note that, "Over the 1970-2012 period, taxes as a percentage of GDP (Gross Domestic Product – i.e., the value of a nation's economy) were 7 percentage points *higher* in the rest of the combined countries in the Organization for Economic Co-operation and Development (the world's rich

democracies) countries (32%) than in the United States (25%). Yet, annual per capita growth (growth per person) was *virtually identical* (1.8%) in these countries and the United States." (emphasis added – see William Gale, Aaron Krupkin and Kim Reuben, "The Growth Mirage: State Tax Cuts Do Not Automatically Lead to Economic Growth," September 8, 2015, Tax Policy Center, page 4, http://www.taxpolicycenter.org/UploadedPDF/2000377-the-growth-mirage.pdf).

Concerning state taxes Gale, Krupkin and Reuben find that "… neither tax revenues (i.e., taxes as a percentage of state income) nor top marginal income tax rates (i.e., the state tax burden borne by high income households) bear any stable relationship to economic growth rates across states and over time." (see source above – page 6). This is not that surprising because states cannot run deficits (i.e., spend more than they receive in taxes). Thus, typically a reduction in state tax rates means that state will have to reduce spending which often reduces economic growth as much, or more, than any boost the tax cut may produce. Reducing state spending on infrastructure (roads, highways, bridges, etc.), education, health care and food (e.g., increased hunger – hungry students don't learn as well, have higher medical costs) often reduces both current and future state economic growth.

As mentioned previously, tax rates are NOT highly progressive in the United States. The rich pay a higher percentage of their income in taxes than the poor, but not greatly so. All federal taxes together (i.e., income taxes, Social Security taxes, etc.) take approximately 9.4% of the income of households making $16,000 per year, approximately 20.5% of the income of households making $52,000, approximately 27.2% of the income of households making $200,000 per year and approximately 34% of households making $18,000,000 per year. (Thomas Piketty and Emmanuel Saez, "How Progressive is the U.S. Federal Tax System," Journal of Economic Perspectives, Winter, 2007, available at: http://elsa.berkeley.edu/~saez/).

It is very important to mention that federal taxes have been made much less progressive over time. To demonstrate the impact of reduced federal tax progressivity consider the following: "In 2000, the richest 1 household in 1,000 (i.e., .1 of 1%) had about *7.3%* of total national after-tax income. If the effect of taxes on their income had remained what it was in 1970, they would have had about *4.5%* of after-tax national income (Jacob Hacker and Paul Pierson, Winner-Take-All Politics, page 49). This would be a *reduction* of approximately 38% in their after-tax income (7.3% - 4.5% = 2.8 - 2.8 is approximately 38% of 7.3). This decrease in federal tax progressivity was *prior* to both the Bush and Trump tax cuts (which, as previously discussed, overwhelmingly benefit households with very high incomes).

State and local taxes are even *less* progressive than federal taxes. Thus, if you add state and local taxes to federal taxes (i.e., to obtain "total taxes") the tax burden is *less* favorable to the poor (i.e., less progressive) than for federal taxes alone. State and Local Taxes are a *greater* percentage of personal income for the poorest 20% of a state's households than for the wealthiest 1% of a state's households in *virtually every state (all but one).* In California state and local taxes take approximately 11.3% of the income of the poorest 20% of households while taking only 7.2% of the income of the richest 1% of households. (Citizens for Tax Justice, Who Bears the Burden)

Some argue that income taxes fall much too heavily on the wealthy. For example, in California, the wealthiest 10% of the taxpayers pay approximately 75% of the state income tax. While true, this argument is misleading for two reasons: (1) the most important

consideration is taxes as a percentage of income and *not* the percentage of a tax borne by a particular income group – thus, if California's state income tax was only to raise $1 and Steven Spielberg paid that $1 he would have borne 100% of the state income tax burden – however, $1 would be virtually 0% of his income – thus it's the percentage of income *paid* in a tax and *not* the percentage of a tax that a particular income group pays that is the important consideration; (2) this calculation *excludes* all taxes except the income tax (e.g., state sales taxes, property taxes, etc.) – when we include *all* state and local taxes and fees, the percentages mentioned above and the conclusion – that state and local taxes are a higher percentage of income for the very poor than the very rich – *is* correct.

As a percentage of income, state and local taxes in California are slightly higher than average but California should not be considered a high state and local tax state. Federal, state, and local taxes combined are approximately 32% of state income - which is typically about the 9th highest burden in the nation. However, much of this is because California has a higher average family income than most states and, as a result, a higher federal income tax burden. *As a share of personal income, California typically ranks about 18th (out of 50 states) in state and local tax burden with state and local revenues equal to approximately 17% of personal income.*

The research I mentioned previously (Sachs, Krugman and Gale, et. al.) explain many of the reasons why some of the very high tax countries (who also have more extensive regulation of business than the United States) have better business climates than we do. Many factors other than tax rates affect the business climate of a nation (e.g., technology, government sponsored research and development, the financial system, health care costs, infrastructure, the education/skills of the workforce, crime, etc.). By one famous ranking system the United States has the 12th best business climate in the world. A number of high tax, strong social safety net countries score higher (Finland - #3, Sweden - #5, Norway - #8, Germany - #11 - https://www.globaldynamismindex.com/gdi.html).
Forbes (a famous business magazine) rates the high tax/strong safety ned Scandinavian countries (Norway, Sweden, Denmark and Finland) as the best nations for capitalism while Europe contains two-thirds of the top 25 nations. Forbes ranks the U.S. ranked 22nd (http://www.forbes.com/sites/kurtbadenhausen/2015/12/16/the-best-countries-for-business-2015/#48b52cd67364). *The basic point is this: the current U.S. combination of the highest level of income inequality among the wealthy democracies, the lowest overall taxes of the wealthy democracies and the weakest social safety of any wealthy democracy is not necessary to achieve a comparatively good level of economic growth*. While there may be justifiable philosophical reasons for American citizens not having the same protections as citizens in other wealthy democracies (e.g., citizens without health care coverage, comparatively little government financial support for low wage workers, few governmentally paid apprenticeships for non-college young people, high levels of food insecurity, not requiring paid family and medical leave, etc.) simply saying either "we can't afford it" (remember that as a share of our economy taxes in the U.S. are 7% *lower* than the average of the world's wealthy democracies) or that such protections will have ruinous consequences for economic growth is *not* well supported either by the record of the other wealthy democracies or comparing states within the United States (i.e., high tax states versus low tax states).

The Free Market and Social Insurance Programs

While a *free market* (defined as voluntary exchanges between mutually consenting individuals) *is very good* at channeling resources into their most productive use (e.g., How much should be invested in book stores vs. clothing boutiques?), it is *not very good* at providing broad-based social insurance (e.g., health care, retirement pensions, etc.). As political scientist Jacob Hacker notes, “In the fiercely competitive market of economic textbooks, multiple sellers appeal to multiple buyers who have good information about the comparative merits of relatively similar products. Competition squeezes out inefficiencies and yields optimal outcomes. But ‘markets’ for social insurance (e.g., health care, retirement plans, etc.) don’t work like this. In particular, information in these markets is both scarce and unequally distributed. Consumers, for example can saddle private insurers with “adverse selection,” which occurs when only high-risk folks buy insurance.”

For example, suppose just those people highly likely to get cancer buy health insurance. The rates would be extremely high because there would be few “healthy” people to spread the costs of the cancer patients over. That’s why compulsion (i.e., a government requirement that each person buy health insurance) is necessary if we desire broad-based health care coverage. That’s also why the government needs to regulate what level of benefits insurance companies can offer. Without such regulations, insurance companies can offer low-risk individuals (e.g., the young and healthy) minimal coverage at low rates while excluding coverage for costly items. While such policies would be inexpensive to those insured under them, they would *not* bring in the amount of money necessary to avoid having high-cost patients pay a prohibitively high price for the services they use. For example, without shifting much of the cost to healthy individuals, how could someone with a minimum wage job pay for open heart surgery? They couldn’t. That’s why the costs need to be shifted to healthier patients.

On the producer side, health insurance companies can take steps to avoid costly patients (e.g., by denying coverage to people with unhealthy family histories). All of this is why health insurance aimed at achieving social objectives (e.g., that everyone have health insurance) has never worked well, or indeed at all, without some governmental support and regulation (e.g., a requirement that everyone buy health insurance, that health insurance companies sell only policies covering a very wide range of conditions and subsidies for the poor to help them buy insurance).

While discussing government regulation, it is important to discuss government rationing. For example, in the debate over President Obama’s health care plan opponents claimed that the government would determine what care patients received. Furthermore, they claimed the government could deny care (e.g., “Death Squads for the Elderly”). Health care is a scarce resource. It uses limited resources and, hence, not all possible uses of those resources can be undertaken. This means that health care *must* be rationed.

Every health care system in the world, including our own (even before President Obama’s health care plan became law), *rations* health care. For example, would you pay an additional $200 per month for health care in order to prolong the life of terminally ill patients an average of 3 months? If “yes,” how about $400 per month? Once you say “no” (i.e., refuse to pay), you are rationing health care (Peter Singer, “Why We Must Ration Health Care,” New York Times, July 19, 2009). The only options we have are to

determine how much money we will spend on health care, who makes the rationing decisions and by what criteria. To those who think the government shouldn't make rationing decisions, let me offer the following question: Would you prefer to have a government panel – typically headed by physicians – make the necessary rationing decisions or would you rather have a for-profit insurance company make them? That's the choice we actually have.

We can choose the criteria by which we ration. At the current time we largely ration "by price/ability to pay." Thus, you get what health care you can afford. This is not the only principle by which we could ration health care. Should a patient's effort affect their ability to receive health care? For example, if your doctor tells you to quit smoking and/or lose weight, should a person who follows such advice receive better health care than someone who doesn't?

Government policies do have important effects on the rationing decisions that all health care systems must make. For example, cigarette taxes reduce cigarette smoking. Economists have found that a 10% increase in the cost of cigarettes reduces smoking by about 3%-4%. Thus, cigarette taxes reduce the amount of smoking which, in turn, reduces the onset of a large number of adverse health consequences (e.g., cancer, heart attack, stroke, etc.). Without cigarette taxes, the demands on our health system would be even greater. Assuming the same amount of money to spend, *without* cigarette taxes we would have *less* money to "ration" to other health care needs (e.g., diabetes) which would mean less treatment for those with important medical needs. One of the reasons to mention this is that many of those who claim the Obama Health Care Plan will lead to government rationing of health care to the elderly are the same individuals/groups who oppose government regulations (e.g., soda taxes, meat taxes, restaurant menu labeling requiring disclosure of calories, fat, sodium, etc.) which would greatly reduce adverse health consequences (e.g., obesity) which, in turn, would leave more money for the health care needs of senior citizens.

Broad-based government programs, such as Medicare (a government health care program for senior citizens), have two big cost saving advantages over a completely free market social insurance system: (1) compulsion – i.e., requiring everyone to buy health insurance lowers the cost because the cost of the "expensive" individuals (e.g., those likely to be ill) is spread over a large group (e.g., the healthy) and; (2) administrative cost (e.g., the typical private health insurer spends about 10% of its outlays on administrative costs, weeding out sick people, etc. whereas the government run Medicare program spends between 2%-3% of its budget on administrative costs). The preceding are two of the major reasons why the #*1* ranked (by the World Health Organization) French health care system spends only *half* as much money per person as the *37th* ranked U.S. health care system (France - $4,118, U.S. - $8,508). I'm sure former congressman Dick Armey spoke for many when he said, "The market is rational; government is dumb." However, this would *not* seem to be the case with the provision of social goods. Some of the material in the preceding seven paragraphs was adapted from Jacob Hacker, "Bigger and Better," The American Prospect, May 6, 2005.

None of the current Republican presidential candidates' health care plans, or those offered by Republicans in Congress, requires all Americans to purchase health insurance. Thus, the Republican health care plans do not shift as much of health care costs to healthy persons as do Obamacare and the proposals of the Democratic presidential candidates.

This is one of the principal means to reduce the rate of increase in health care costs. Additionally, the subsides to help middle and low income Americans purchase health insurance under the Republican plans are lower, often considerably so, than under Obamacare. Furthermore, the Republican health care plans typically offer less regulation of what must be included in a health plan (i.e., allow the plans to cover fewer conditions than Obamacare) and reduce government's ability to restrain cost increases. The primary method by which the Republican health care plans reduce cost is to pay for less service (i.e., less coverage). *Depending upon your view of the role of government you could see the Republican health care plans as good or bad. Regardless of your views, the following is accurate in comparing all of the Republican health care plans to Obamacare: all of the Republican health care plans cost the government less money and cover fewer people for fewer medical situations (meaning many will either receive less health care or have to pay for it themselves). None of the Republican health care plans view health care as a social insurance in which everyone is protected and everyone contributes to the cost thereof. None of the Republican health care plans require individuals to purchase health insurance. Not requiring individuals to purchase health insurance eliminates one of the major ways to reduce costs for those who need health care: shift some of the costs from those needing health care to all those who aren't currently in need of it. By contrast all of the Democratic presidential candidates supported Obamacare and want to strengthen it (i.e., cover more people for the same, or more, services).*

It is important to point out that government run programs such as Medicare *aren't* the same as government ownership of productive assets. Medicare doesn't *own* hospitals or employ doctors. Rather, it contracts with *privately owned* hospitals and *private* physicians. I should also mention that government programs such as Medicare and Medicaid (a government run health care program for the poor) currently pay substantially *more* of our nation's health care costs (approximately 47%) than private insurance (approximately 35%). Thus, realistically, we can't "get the government out of health care."

It should also be mentioned that the democracies of Western Europe are, in the main, not socialist nations. Socialism means that the government *owns* the modes of production and distribution. For example, socialism in the U.S. would mean that the government would *own* the major fast food outlets (e.g., McDonalds, Wendy's etc.) as well as communications companies (e.g., Verizon). Neither the United States nor most all of the democracies of Western Europe (e.g., Great Britain, France, Denmark, Sweden, etc.) are socialist. There is a *huge* difference between having *higher* tax rates and government spending than the United States (which the governments of Western Europe do have) and having the government *own* the major providers of goods and services (which the governments of Western Europe typically do not do).

<u>The Size of Government and Personal Freedom</u>

The last of the three previously mentioned "considerations" about the size of government concerned the impact of the size of government on personal freedom. Often libertarian/free choice advocates seem to view maximizing individual free choice at the current time above all other goals. There is certainly a good argument to be made that values other than individual free choice at the current time are important (e.g., equality – the living standards of the poor, stability – minimizing the depths of a recession, security,

the functioning of the political system, etc.). Furthermore, protecting *future* free choice may involve restricting *current* free choices. For example, requiring a person to pay taxes to provide health care for the poor can be viewed as a restriction on the freedom of those who don't need government health care but also as an *increase* in freedom for those who receive care. For example, if a person would die without government provided health care their future free choice would be eliminated. How many free choices can you make when you're dead?

Equating the size of government with personal freedom is difficult. Since government can only institute one set of priorities libertarians/free choice advocates see governmental action (e.g., requiring you to pay taxes to support public transportation) as a restriction of individual free choice. This assumes that at any one point in time the number of free decisions is fixed. By this reasoning if government makes more decisions individuals will make fewer decisions.

However, the number of decisions isn't fixed. While requiring you to pay taxes to finance public transportation may reduce personal freedom the public transportation system *increases* personal freedom. Many people can now go to places that they couldn't go without public transportation. Public goods require you to pay taxes to support but also increase freedom of choice. For example, would most Californians have more freedom if the beaches were sold to private individuals or if the State of California operates them? At least to me, it is far from obvious that selling off state beaches to private individuals would increase the freedom most Californians enjoy. If the State of California sold the beaches those who purchased them would likely not permit the rest of us to use the beaches. Additionally, if state taxes were reduced taxpayers would have a greater freedom of choice in spending their money. However, if these state tax cuts resulted in higher fees for U.C. and CSU students fewer students would attend college. Not attending college would reduce both the future incomes and occupational choices of the individuals who did not attend college due to the budget reductions resulting from the state tax cuts. In short, it would reduce their future freedom. So, would such a state tax cut result in a "net" gain or loss in freedom?

In a related vein, I can understand someone opposing the requirement to buy health insurance on the basis that it denies the freedom not to buy health insurance. However, before concluding that a requirement to buy health insurance reduces personal freedom, consider the ramifications that *not requiring* individuals to purchase health insurance has for personal freedom, as well as other possible societal values (e.g., fairness, security, etc.). If we do not require individuals to purchase health insurance, the "more healthy" (those less likely to need medical care) are less likely to buy insurance. Without a governmental regulation requiring all individuals to buy health insurance there would be fewer "healthy" insured people to spread health care costs over. Consequently, the cost of purchasing health insurance for the "less healthy" would increase. As the cost to the "less healthy" increases, fewer of them will be able to afford health insurance. If the lack of health insurance causes them either to not receive health care, or receive care at a time when their condition is no longer as curable (e.g., receiving late stage cancer treatment in an emergency room rather than early stage treatment when their disease would have been more curable), these individuals are more likely to die prematurely. This will certainly reduce their individual freedom. As mentioned previously, how much freedom can you use when you're dead? Thus, a relatively *small loss* in freedom for a

large group of people (requiring each person to purchase health insurance) will provide a *much larger* amount of freedom (to make *all* the decisions living people can make) for a *smaller group* of people (the unhealthy). If so, has the amount of freedom either increased or decreased? It's not so easy to answer! You would have to balance the loss of *many small* amounts of freedom against a *fewer large* gains in freedom.

When thinking about the amount of freedom individuals in a nation have it is important to focus on the ability of people to tolerate other peoples' choices. For example, is individual freedom of choice maximized by (1) removing force (e.g., not forcing people to pay Social Security taxes, taxes to support food stamps, etc.) - with the possibility of economic hardship (without these government programs they could die or, at least, face very dire circumstances), or by (2) reducing economic hardship (e.g., forcing people to pay taxes but receiving food stamps, Social Security, etc.) with the possibility of political restraints (e.g., not protesting government policy because you might fear the loss of government benefits if you protest)? While libertarian/small government advocates argue for option #1 (i.e., removing force with the possibility of economic hardship), a good case can be made for option #2 (i.e., removing economic hardship with the possibility of political restraints – Kenneth Dolbeare and Patricia Dolbeare, <u>American Ideologies</u>, 3rd ed., 1976, pp. 56-68). Many government actions that reduced individual freedoms have occurred during periods of economic hardship (e.g., Hitler coming to power in Germany, Proposition 187 in California that denied benefits to illegal immigrants, and a significant amount of Donald Trump's 2016 support – see Thomas Edsall, "Who Are the Angriest Republicans", <u>New York Times</u>, March 30, 2016). People tend to be less tolerant, and more willing to limit the freedom of those they do not like or understand, when their own economic circumstances worsen.

While governments can greatly curtail freedom (e.g., the former Soviet Union), governments can also tax much more highly than in the United States, run health insurance programs, provide many more social guarantees than we have in the United States and still maintain a very high level of freedom. This is a topic political scientists have studied at length. We have devised interesting measures of freedom and democracy. People in the democracies of Western Europe are typically as "free" as Americans. For example, free speech in Great Britain is as great as it is in the United States. Additionally, some Western European nations actually have higher scores on some measures of democracy than the United States. Typically, this occurs because of lower voter turnout and fewer major political parties in the United States.

As mentioned previously, the private market won't distribute social goods (e.g., insuring everyone for health care, eliminating poverty, etc.) in a way that citizens need. Before we had Social Security, a large percentage of the elderly were destitute. Free market mechanisms alone can't solve such problems because private income is inadequate to pay for social needs (i.e., the poor are "poor" because their marketable resources – e.g., labor, etc., don't provide enough money). The "big picture" is that, if we wanted to, our nation could reduce economic inequality significantly and still have an equally vibrant, growing economy with the same level of freedom we currently enjoy. This is really a question of values (i.e., Do we want to?) rather than possibilities (i.e., Could we?)

One last point about the consequences of governmental attempts to redistribute income concerns the performance of our democracy. Increased redistribution of income

and wealth might well *improve* the functioning of democracy in the United States. What some refer to as *"the Debilitating Cycle"* is a very important problem: greater income inequality leads to a greater reliance of politicians on campaign contributions from the wealthy, which, can easily cause these same politicians to adopt policies that even more favor the wealthy, which starts the same cycle again (Larry Bartels, Unequal Democracy, Princeton University Press).

A recent study shows how different the policy preferences of the wealthiest 1/10th of 1 percent (those with a net worth of approximately $40 million or more) from those of the average American. Relative to the average American, the very wealthy are: (1) *much more* concerned about budget deficits; (2) *much more* favorable to *cutting social welfare programs*, especially Social Security and health care; (3) are *considerably less supportive* of an above-poverty-level minimum wage, or having the federal government "see to" or provide jobs for the unemployed; (4) *much less supportive* of providing broad educational opportunities; (5) *much less* willing to redistributive income to those poorer than themselves; (6) *less* willing to raise taxes on high income groups (e.g., *less* supportive of having an estate tax); and (7) are *less* willing to regulate either the stock market or businesses (Benjamin I. Page, Larry M. Bartels and Jason Seawright, "Democracy and the Policy Preferences of Wealthy Americans," Perspectives on Politics, March, 2013, pp. 51-73). Now think of how the increased share of income going to this group increases the reliance of politicians on the campaign contributions of a group which is *much more* conservative economically than the general public. This is highly likely to cause public policy to be skewed away from the interests of average Americans.

While extremely high income groups have received a greatly increased share of the income over the past 40 years, the percentage of the workforce that is represented by unions (an obviously group that would oppose the views of the very wealthy on virtually all of the policies just mentioned) has greatly declined (1954 – 32%, today 13%). This combination (a greatly increased share of income/wealth going to very wealthy citizens coupled with a greatly declining percentage of the workforce unionized) means that the political incentives of politicians have, on economic issues, moved considerably to the political right over time. For example, through June 2015 over 50% of the money contributed to the 2016 Republican presidential candidates came from *only 130 families* (Paul Krugman, Republicans Against Retirement, New York Times, August 17, 2015). This is likely a very, very wealthy group with political opinions as conservative as those mentioned in the previous paragraph. Obviously, this affects the types of policies the Republican presidential candidates can offer. Contributions to the Democratic presidential candidates are also concentrated, but not to the degree of the Republicans. This is also a major reason why public financing of campaigns, such as the Patriot Dollars proposal discussed later in this reading, could greatly increase the representation of the vast bulk of the American public.

Republican and Democratic Party Proposals for the Present and Future

Let's apply the aforementioned considerations (size of government and economic growth, size of government and freedom, and public sector vs. private social welfare programs) to the philosophy of the two major parties toward both our current and future economic problems. President George W. Bush proposed a series of policies to deal with

our nation's economic future that were collectively referred to as "The Ownership Society." The idea is that each individual citizen would "own" items that had previously been provided by the government. For example, if each individual citizen can choose how to invest their money in a personal Social Security Account you could say that person "owned" their retirement. If a person were either given a set amount of money to spend by the government for health insurance (i.e., a health insurance voucher) and/or saved money in a Health Savings Account to use for medical expenses, you could say that person "owned" their health care. Similarly, if a person saved money for college in an Educational Savings Account, you could say that person "owned" their college education. Since these ideas are at the core of many 2016 Republican presidential candidates' proposals, they should be discussed in some depth.

Since we've discussed health care at length let's see how "The Ownership Society" would have changed American health care policy and the degree of health care security American's have. Former President George W. Bush did not favor requiring all Americans to purchase health insurance. He did favor, and at his urging, Congress did pass legislation setting up Health Savings Accounts in 2003. In 2008, an individual could contribute up to $2,400 per year to such an account ($5,800 for a family). The gains from this investment are not taxed and the money could be withdrawn to pay the deductable under a health insurance policy. This is a tax free method of investing for those fortunate enough to have the money to participate. Not surprisingly, those most likely to contribute to Health Savings Accounts are much richer than average (Edwin Park, "GAO Again Confirms Health Savings Accounts Primarily Benefit High-Income Individuals," Center for Budget and Policy Priorities, May 19, 2008 – available at www.cbpp.org). How would a family of four persons living in the Los Angeles area on $40,000 per year have the left over income (i.e., after paying rent/mortgage, food, clothing, etc.) to put in a Health Savings Account? They wouldn't.

Suppose you need a heart operation and your insurance only pays for expenses above $25,000. If you had saved the maximum allowed per year for ten years in a Health Savings Account, you could pay the entire deductable (i.e., $25,000) from this account. If you felt you would be healthy, this could be a good gamble. If you don't think you'll need the insurance (i.e., remain healthy), buy a less expensive health insurance policy (i.e., one with a high deductable).

Now, look at the relationships between wealth/education and health: (1) more well-educated and higher-income individuals are more likely to value delayed gratification – i.e., foregoing something today for a greater future gain - in this case, eating healthier food, maintaining a healthier weight, not smoking, etc. than less well-educated and lower-income individuals; thus, (2) more well-educated and higher-income individuals are less likely to need medical attention than less well-educated and lower-income individuals; and (3) more well-educated and higher-income individuals are more likely to contribute to Health Savings Accounts than less well-educated and lower-income individuals. By not requiring people to buy insurance and by allowing people to put money into Health Savings Accounts, higher-income people, who are typically more healthy, are able to remove money that would've gone into an insurance pool from which the unhealthy could benefit. Thus, the practical effect of Health Savings Accounts is to reduce the ability to spread medical costs over a larger, healthier, population. Withdrawing money that a healthier population would have put into an insurance pool and, instead, placing it in the

hands of higher-income households means that the costs of health insurance to the less healthy population, disproportionately drawn from middle and low-income households, will increase. All of this works to the advantage of higher- income individuals.

The Ownership Society proposal for education (another tax-free savings plan) has a similar effect to the Health Savings Accounts. Here's why: (1) higher-income individuals are much more likely to have the necessary money to put into such an account; (2) citizens are more likely to vote in favor of increased taxes for education when they have children in the public education system; and (3) the money from an Educational Savings Account will either more allow students to afford a private college and/or reduce their need for more funding for state run colleges. For example, the money from the account means they are less likely to need financial aid than other students. Points 1-3 mean that the educational "gap" between students from lower and higher-income households will increase.

This is similar to the effect that government vouchers (e.g., a government check for $1,000 per child) for K-12 schools typically have: (1) the vouchers don't cover the entire cost of education; so, (2) the household must put money together with the voucher in order to afford a private school; (3) higher income households are better able to pay these costs; (4) more children from higher-income households are placed in private schools; (5) this reduces the willingness of higher-income households to vote in favor of school bonds for public schools; therefore, (6) the educational "gap" between children from low-income and high-income households increases.

One of the reasons I stress the importance of a candidate's political party affiliation is that it is, typically, a relatively accurate predictor of a candidate's issue positions. George W. Bush is no longer president. Today, the Republican Party does not use the term "Ownership Society." However, the proposals of many of the 2012 and 2016 Republican presidential candidates, as well as chief Republican Congressional Budget architect, Speaker of the House of Representative Paul Ryan of Wisconsin, were very similar to what I have previously outlined. I'll mention Congressman Ryan's proposals in depth because they have been the basis of the post-Bush proposals on taxation, entitlement programs (Social Security, Medicare, food stamps, etc.) and the federal budget for both Republican congressional and presidential candidates.

Congressman Ryan calls his plan, "The Roadmap for America's Future." His plan would: (1) cut federal taxes of the richest 1% of households by 50% (i.e., in half – this is *in addition* to the tax cuts this group would receive by making the Bush Tax Cuts permanent); (2) replace some of the lost revenue from the tax cuts for the richest 1% of households with a much more regressive consumption tax on most goods and services (i.e., paid much more by middle and low-income households – families with incomes between $50,000 and $75,000 would face a *tax increase* of around $900 per year); (3) freeze discretionary domestic spending (keep in mind that, that after adjusting for inflation and population growth, this would mean a 25% *reduction* over 10 years in such items as public transportation, etc.); privatize Social Security (i.e., individual accounts) and; (5) replace Medicare for senior citizens with a voucher (i.e., an amount of money to buy health insurance). Since the Ryan plan doesn't require all citizens to buy health insurance and includes Health Savings Accounts, health care costs will increase (see previous discussion). These increases would occur at the same time that Ryan wants to reduce Medicare spending. Thus, senior citizens would have much poorer health care under the

Ryan plan than currently. The 2016 Republican presidential candidates seem very supportive of Ryan's proposal to replace Medicare with a voucher (e.g., Jeb Bush, Marco Rubio, Ted Cruz, Bobby Jindal - http://correctrecord.org/the-gops-50th-birthday-gift-for-medicare-massive-cuts-or-total-repeal).

As Paul N. Van de Water notes, "The Ryan plan proposes large cuts in Social Security benefits — roughly 16 percent for the average new retiree in 2050 and 28 percent in 2080 from price indexing alone — and initially diverts most of these savings to help fund private accounts rather than to restore Social Security solvency." This is very similar to former President George W. Bush's proposal for Social Security. Unlike Bush's Social Security Proposal, the Ryan Plan protects those whose investments result in less income than under the traditional Social Security program. Ryan's guarantee would encourage seniors to make more risky investments. Why not gamble on an investment with large possible gain (but also large possible loss) when the federal government insures you against loss?

While the Ryan Plan does include a protection for senior citizen's whose investments yielded a return lower than what they would have received under traditional Social Security, it is extremely *unlikely* that this guarantee would be paid in full. Here's why: Ryan would use government revenues to replace the lost income to senior citizens whose investments performed poorly. The cost of this guarantee would be very high. Given the reductions in other programs that would be required to fully fund this guarantee (e.g., in defense, education, environmental protection, etc.) it would be extremely unlikely to be fully realized.

The reason I discussed the Bush and Ryan plans so thoroughly is two-fold: (1) it shows how long this approach/philosophy has been at the center of what the Republican Party has been trying to accomplish; and (2) that the increased federal deficits brought about by the passage of the Trump tax cut is likely to allow the Republican controlled Congress to institute much more of the Bush and Ryan plans over the next couple years (e.g., reducing Medicaid – increasing the number of Americans without medical insurance, possibly converting Medicare into voucher rather a guarantee of a particular level of care, etc.). One important feature of the Trump tax cut was to remove the requirement that individuals purchase health insurance. From the estimates I've seen what is likely to happen is that younger/healthier people (such as those of you in this class) will be less likely to buy health insurance. Reducing the pool of healthy people will mean the remaining people with health insurance will be, on average, less healthy which will then trigger increases in the cost of their insurance (estimate to be about 10%). This an additional reason why many will lose out of the Trump tax cuts [i.e., their tax cut will be smaller than the value of the lost public services due to budget cuts (e.g., cuts in public transportation), increased borrowing costs (e.g., to finance a car) and higher medical insurance costs]. My principle sources for the discussion of Congressman Ryan's "Roadmap for America's Future" are: Paul N. Van de Water, "The Ryan Budget's Radical Priorities: Provides Largest Tax Cuts in History for the Wealthy, Raises Middle Class Taxes, Ends Guaranteed Medicare, Privatizes Social Security, Erodes Health Care," Center for Budget and Policy Priorities, July 7, 2010 – available at www.cbpp.org and Paul Krugman, The Flimflam Man, New York Times, August 5, 2010.

A couple points about Social Security are worth mentioning. First, Social Security is an insurance plan to keep the elderly and disabled from living in poverty. It is NOT a

savings plan that should evaluated on how much a person's investment grows. Thus, unlike a savings plan, benefits are NOT necessarily related to the contribution you make. In order to keep a large segment of the elderly and disabled from falling into poverty, the program has to payout greater benefits relative to the amount contributed for lower income earners. This is why it is *not correct* to compare Social Security benefits to some hypothetical retirement plan. Relatedly, this IS why *Social Securities' benefits are guaranteed. Thus, unlike 401k plans, Social Security provides a guaranteed level of benefits rather than have benefits tied to the performance of an investment (e.g., the stock market).*

Second, relative to the size of the economy and a person's income, *Social Security is less generous than similar programs in Europe.* For 67% of the current retired population, Social Security provides over-half of their income. For more than one-third of the current retired population, Social Security provides 90% of their income (Los Angeles Times, Sept. 18, 2011, page B10). As current trends show that a *smaller* percentage of workers today have retirement plans through their employer and a smaller percentage of these plans provide a guaranteed benefit, future generations are likely to be *more* dependent on Social Security than current retirees (Jacob Hacker, The Great Risk Shift, Oxford University Press). Thus, rather than reducing Social Security benefits and/or raising the retirement age, an excellent argument can be made for *increasing* the amount of money Social Security pays to recipients.

Third, while in roughly 25 years Social Security will only be able to pay approximately 77% of the scheduled benefits (77% of future benefits should be as large as 100% of current benefits for most – i.e., 77% is not necessarily a "cut"), this situation is easily correctable. To put this deficit in perspective, if we either devoted .8 of 1% more of our economy to Social Security (e.g., applying the Social Security tax to *all* income and not just that portion under $107,000 – we've raised the income subject to Social Security taxes 43 times in the past) or cancelled the Bush Tax Cuts for those making $250,000 and above, Social Security would be *entirely* solvent for the next *75 years* (i.e., longer than most of you reading this will be alive – see Policy Basics: Top Ten Facts about Social Security, Center for Budget and Policy Priorities, www.cbpp.com).

Fourth, as most political scientists who study government social welfare policies in the United States, Canada and Europe will agree, one of the most important "keys" to keeping Social Security strong is to retain it's *universal coverage* (i.e., everyone receives benefits). This is why those whose philosophy is against governmental social insurance programs (i.e., Social Security, health care, etc.) typically argue to reduce or eliminate the benefits Social Security pays to upper-income earners (i.e., "means testing" – those "of means" don't receive benefits): politically it is easier to reduce spending for a program which is perceived as a "welfare" program (i.e., benefits only the poor) than for a program in which *everyone* benefits (e.g., see Jonas Pontusson, Inequality and Prosperity: Social Europe vs. Liberal America, Cornell University Press). This is one of the prime reasons that those whose political philosophy is similar to Congressman Ryan want to "means test" Social Security (i.e., exclude those who have high incomes): by changing the program from an "insurance" (where everyone who pays the premiums receives the benefits) to a "welfare program" (where only those who are needy receive benefits) it will make Social Security less popular, and therefore, easier to reduce funding for in the future.

In 2011, the Republican controlled House of Representatives passed Congressman Ryan's updated version of the "Roadmap for America's Future" called the "Path to Prosperity." While the "Path to Prosperity" omitted altering Social Security, it did the following: (1) retained all of the Bush Tax Cuts (including those for households earning over $250,000 per year); (2) further reduced the top income tax rate to 25%; (3) converted Medicare into a voucher system with the increase in the voucher limited to the overall rate of inflation (i.e., not to the rate of medical inflation which is much higher – had this plan been in effect the previous 10 years, senior citizens would have had approximately 30% less money for health care); and (4) converted Medicaid (for low income households) into a block grant program for states (i.e., a state gets a fixed total of money from the federal government that is not necessarily based on the number of recipients or the change in the cost of medical care). This makes it far easier to reduce funding for Medicaid in the future. The 2012 Republican presidential nominee, Mitt Romney, supported the Ryan Plan. He even chose Ryan as his running mate (i.e., candidate for Vice-President).

Depending upon your values, you could either favor, or oppose, programs such as "The Ownership Society" or Congressman Ryan's, "Roadmap for America's Future," "The Path to Prosperity," and the proposals of the 2016 Republican presidential candidates. However, the outcomes under these plans are *not* disputable: they significantly *reduce* economic security and *increase* economic inequality. *Regardless of whether one agrees or disagrees with the philosophy of the Republican Party, the following conclusion about the impact of their proposals is inescapable: they would significantly weaken what is already the weakest social safety net of any wealthy democracy in the world while simultaneously increasing the degree of after-tax income inequality in what is already the most economically unequal wealthy democracy in the world.*

Many of the proposals of the 2016 Republican presidential candidates would weaken Social Security. Rand Paul and Marco Rubio want to exclude wealthier Americans from receiving Social Security benefits (Paul Krugman, "Republicans Against Retirement," New York Times, August 17, 2015). As mentioned in the preceding discussion, this would weaken the political support for Social Security and would make it politically easier to reduce Social Security benefits in the future. Ted Cruz (R-Texas) wants to revive the Bush Privatization plan I previously discussed (Paul Krugman, "Republicans Against Retirement," New York Times, August 17, 2015). Many of the 2016 Republican presidential candidates want to raise the age for receiving Social Security benefits (Jeb Bush, Marco Rubio, Rand Paul and Scott Walker – see Paul Krugman, "Republicans Against Retirement," New York Times, August 17, 2015). Think of the practical consequences and hardships this would impose. First, many older Americans are not physically able to do the job they have done over their working career (Paul Krugman, "Republicans Against Retirement," New York Times, August 17, 2015). Second, as private pensions are weaker today than previously (Jacob Hacker, The Great Risk Shift, Oxford University Press) and the hourly wages of many middle income workers have either been flat (i.e., unchanged after adjusting for inflation) or reduced (see previous discussion in this reading), older workers are *more*, not *less*, dependent upon Social Security than previously. Third, think back to Michael Hiltzik's article (the first newspaper column you read this semester) showing that increasing the age that citizens would be eligible for Medicare by one year would save the federal government 5.7 billion dollars but *cost* society as a whole *twice* as much (i.e., approximately 11.4 billion dollars – Michael

Hiltzik, When Government Does Things Better than Private Enterprise, Los Angeles Times, December 11, 2012).

It is interesting to note that, over time, income is less stable. Thus, an income earner is less likely to have as secure, or stable, an income as they did 40 years ago (Jacob Hacker, The Great Risk Shift). Additionally, the private sector is providing fewer social guarantees that it did a decade, or more, ago. Today, fewer jobs come with health insurance and guaranteed retirement income. Thus, personal economic "risk" is greater. Which of the following seems more appropriate: as personal economic risk increases, you need the government less; or, as personal economic risk increases, you need the government more. The two parties differ widely. The Republican Party approach (i.e., "The Ownership Society," "The Roadmap for America's Future," opposition to Obamacare, etc.) is to load increased personal economic risk back on the individual (i.e., less governmental guarantees – giving senior citizens a voucher rather guaranteed Medicare – same with health care for the poor; reducing taxes on high income earners that can be applied to public services for middle and low-income earners) while the Democratic Party approach is more in favor of using the government to offset increased personal financial (e.g., the Obama Health Care Plan – making health care more affordable for middle and low-income earners, increases the Pell Grant program for low-income college students, reducing the Bush tax cuts, increasing government deficit spending and increasing regulation of financial markets).

If your preference is to try to help those in middle and low-income circumstances, here are some tax changes that would provide the money for policies (discussed later) that would further your goals. First, repeal both the Bush and Trump tax cuts. As mentioned previously, they are heavily tilted to high income groups. Additionally, allowing the Bush tax cuts to simply expire would cut the federal deficit by more than half. Second, adopt a wealth tax. In 2008, France, Norway, Switzerland and five other wealthy democracies adopted this tax. As mentioned previously, the average growth rate of these economies is similar to our own. Just a 2% annual wealth tax on households owning more than $7.2 million in assets (the richest ½ of 1% of households) would bring in at least $70 billion dollars per year (this is a conservative estimate – see Bruce Ackerman and Anned Alstott, "Tax the Wealth," Los Angeles Times, Sept. 20, 2011, p. A11). Not only would this help reduce the deficit and/or fund programs that could increase both the economic opportunity and security of those with middle and low incomes, it would also address the "debilitating cycle" discussed previously. Income inequality in the U.S. today is far greater than in Europe and approaching the level of many unstable democracies in Latin America.

Deciding on the aforementioned approaches to solving our problems are the decisions you really make at the ballot box. This is why I mention to you so often that the person who votes the candidate and not the party is much more likely to cast a vote in favor of policies they oppose than a voter who understands the policy differences between the parties, chooses the party that is closer to their views, and, votes for the candidates of that party.

Why Not Policies that Would More Help Middle and Low-Income Households?

From the preceding discussion it is clear that most of the income gains over the past several decades have gone to very high income households with little gain for most

of the rest of U.S. households. Additionally, for middle- income earners "real hourly compensation per hour" (i.e., dollars per hour worked after adjusting for taxes and inflation) is basically unchanged over the past 35 years. Furthermore, companies are providing less generous fringe benefits (e.g., health care and pensions). Given all of this, a reasonable question might be: How come we keep getting policies most benefitting the very wealthy? Given that politicians are elected by voters, most of whom would have a strong self-interest in more progressive taxation (i.e., the rich paying a greater share of the tax burden), more public services (e.g., government provided health care, better public transportation, a more generous Social Security system, government subsidies to low-wage workers salaries, etc.), why aren't we getting such policies? Instead, it seems that as the wealthier get an increasing share of the national income, we adopt policies that will either help them get an even larger share of national income, or at least do not redistribute much income to middle and low-income groups.

This is a critically important topic. In order to address it, we need to start back with the strong commitment America has to absolutist individualism (i.e., to make the individual as reliant upon themselves as is practically possible). Almost by definition, this value system means that there will not be a large role for government either in redistributing income or providing services. Thus, it means that, relative to other wealthy nations that have a less strong commitment to absolutist individualism (e.g., Western Europe, Canada, Japan, Australia and New Zealand), American governments will do *less* to protect their citizens from the economic hazards of life. For example, while the Democratic Party will provide greater governmental protection from economic hazard than will the Republican Party, the Democratic Party is not, in an "international sense," a liberal party. If we put the Democratic Party in Great Britain, France or Canada, it would be a centrist party, not a "left/liberal" party.

In addition to the overall conservatism of the electoral choices we have (i.e., between a centrist Democratic Party and a conservative Republican Party), absolutist individualism also has an important impact on the political system victorious candidates operate within. As you remember from the readings/discussions earlier in the semester, our government structure makes it difficult for the government to act. For example, we have the separation of executive and legislative power. So, a president could veto an act of Congress. This doesn't happen in Canada and most all of Western Europe because, desiring a more activist government, they use a parliamentary system. In a parliamentary system the prime minister (i.e., the corollary to our "president") is selected by the ruling party in the legislature. Thus, the executive and the legislature won't be opposed to each other. Therefore, in a parliamentary system you could *not* have divided government – where one party controls the presidency and another party controls the Congress. If this weren't enough to make it difficult for the government to act, in the U.S. Senate, 41% (i.e., a minority) can block the action of a majority. Since the least populated 21 states account for approximately 11% of the U.S. population, but 42% of the U.S. Senate, a smaller minority of the population can block action desired by a much larger population (Jacob Hacker and Paul Pierson, 2010, "Winner-Take-All Politics: Public Policy, Political Organization and the Precipitous Rise of Top Incomes in the United States," Politics & Society, Vol. 38, No. 2, p. 171). As is often noted, our political system is much more geared to stopping action than taking action. All of this makes it much more difficult for the federal government to take action.

While both our strong commitment to absolutist individualism and the framework of our political system (e.g., the separation of powers), make it difficult for the government to pass laws, there also appears to be a substantial conservative bias in legislator's perceptions of their constituent's political opinions. In the most comprehensive study to date of state legislators (composed of nearly 2,000 state legislators), the study reports "… there is a striking conservative bias in politician's perceptions, particularly among conservatives: conservative politicians systematically believe their constituents are more conservative than they actually are by over 20 percentage points, while liberal politicians also typically overestimate their constituents' conservatism by several percentage points. A follow-up survey demonstrates that politicians appear to learn nothing from democratic campaigns or elections that leads them to correct these shortcomings." "These findings suggest a substantial conservative bias in American political representation and bleak prospects for constituency control of politicians when voters' collective preferences are less than unambiguous." ("What Politicians Believe About Their Constituents: Asymmetric Misperceptions and Prospects for Constituency Control," David E. Broockman and Christopher Skovron, Working Paper, 2013).

There are important changes in the balance of domestic political power that have taken place over the past 35 years that make it even more difficult for the federal government to act on behalf of the interests of middle and low-income citizens. In a "nutshell," here's what happened: (1) after suffering a large number of political defeats through the 1960s under both political parties, during the mid-1970s business groups (the U.S. Chamber of Commerce, the National of Manufacturers, the National Federation of Independent Business, etc.) decided to invest tremendous amounts of money both in lobbying members of Congress and contributing to political campaigns; (2) the relative strength of the counter-weight to business, labor unions, declined precipitously (in 1954 – 32% of the workforce was unionized - today only 13%), and with it a tremendous loss in both political information supplied to middle and low- income households and political participation by these citizens (i.e., unions contacting their membership with information on political issues, the membership then contacting elected officials); (3) the interest groups that have formed on the political left have dealt more with the concerns/interests of well-educated higher income voters rather than the working class (i.e., environmentalism, women's rights and gay rights do not deal with the distribution of the tax burden, subsidies for low-wage workers or extending governmental provided health care); (4) due to both increased population and the rise of television, the cost of campaigning for public office greatly increased; and, (5) the increasing share of income going to very high income groups meant that politicians became much more dependent upon the very rich, a group which far more conservative on economic issues than the average American (see previous discussion of the opinions of the wealthiest 1/10th of 1%), for campaign funds. For all these reasons the political position of business has become much more advantaged relative to labor (Jacob Hacker and Paul Pierson, Winner-Take-All Politics, pp. 116-123).

As a result of their greatly increased political strength, business political action resulted in the election of more Republicans (who are philosophically compatible with the desire of business to reduce the progressivity of the tax structure, reduce government regulation of business and reduce the size of many government domestic

political programs). Where the political conditions meant that Democrats were likely to be elected (e.g., Obama in 2008), the increased political strength of business and the resulting increased costs of campaigns meant that Democratic candidates would now have to depend on business for a greater share of their financing. The "price" of this would be that once elected, Democrats could not pursue policies that were as strongly opposed by business as when Democrats were less dependent upon business for their campaign contributions. Furthermore, as the wealthy received a greater share of the income, this meant that a greater percentage of campaign dollars would come from the wealthy. Again, this made it more difficult for Democrats to pursue policies that would either redistribute the wealth and/or regulate business. Put another way, all of these factors pulled both political parties in a more economically conservative direction and reduced the redistributive capability of the Democratic Party. This isn't the "entire story," but it certainly is "the big picture" of it.

Think of the political consequences of policy philosophies such as The Bush Tax Cuts, The Ownership Society, The Roadmap for America's Future and The Path to Prosperity. All of these policies accomplish three goals of many (but not all) conservative leaders: (1) they shift the distribution of the tax burden away from taxing investments (i.e., money made with money – income sources primarily of very high-income households) toward higher taxes on labor (i.e., taxes more paid by income from wages and salaries – the principle sources of income for the poorest 90%, or more, of households - by relying on consumption taxes); (2) reduce the amount of money redistributed to middle and low-income groups through public programs (e.g., mass transit, job retraining, guarantees for Social Security, Medicare, etc.); and (3) increase the size of the federal deficit to the point that future Democratic Administrations will have difficulty in undertaking programs primarily benefitting middle and low-income households (e.g., notice how difficult it is for Obama to get the necessary funding to implement his health care plan due to the size of the federal deficit – greatly swelled by the Bush tax cuts).

The political consequences of the above mentioned policies significantly reduce the incentive for low and middle-income people to participate in the political process (e.g., vote) because they will perceive that government is not that helpful to them (i.e., their taxes will increase and the value of their government benefits will decrease). So, why invest time and effort in politics? This protects high-income households from future adverse political events. Thus, if increasing income inequality might cause low and middle-income people to desire income redistribution, make it difficult for the government to accomplish this and reduce the incentives for low and middle-income people to get involved in the political process. The goals and methods of many important conservative leaders (through their own statements) are well documented (see Larry Bartels, Unequal Democracy; Michael J. Graetz and Ian Shapiro, Death by a Thousand Cuts; Jacob Hacker and Paul Pierson, Off Center; and Benjamin I. Page and Lawrence R. Jacobs, Class War?)

Policies to Reduce Income Equality and Enhance Our Political System

What could we do? The basic answer is to undo the changes of the past 40 years and adopt a social welfare system similar to the other wealthy democracies of the world. While any proposed "reforms" would spark opposition from those who do well

under the current system, I'll mention two possible changes that would greatly alter the political landscape in a direction much more favorable to middle and low-income groups. First, make it easier for workers to unionize. Canada offers a compelling lesson. According to the survey evidence, American workers are as favorable to unionization as Canadian workers (Jacob Hacker and Paul Pierson, Winner-Take-All Politics, p. 58). However, over the past 50 years, the gap between the percentage of the Canadian workforce that is unionized and the percentage of the U.S. workforce that is unionized has steadily increased (Canada: 1960 - 32%, 2011 – 29.7%|U.S.: 1960 - 31%, 2011 – 11.8% - Kris Warner, 2012, "Protecting Fundamental Labor Rights: Lessons from Canada for the United States," Center for Economic and Policy Research, page 3). Without a lengthy discussion, the differences over time are mostly attributable to differences in public policies governing the unionization process. Not surprisingly, this was one of the earliest results of increased business political strength: make it more difficult for workers to unionize. Notice that unified Republican control in Wisconsin and Ohio (i.e., where the Republican Party controls the governorship and both houses of the state legislature) has not only opposed making it easier to unionize but rather has made it virtually impossible for public sector workers to effectively unionize.

The second change would be to enact Yale Law Professor Bruce Ackerman's proposal for campaign financing, called "Patriot Dollars": have the federal government give each voter an ATM valued at $50 for each federal election cycle (i.e., every two years). This money could only be used for campaign contributions (i.e., all unused money would be returned to the federal government – "yes" it could be done – the technology to ensure this does exist). A voter could give their contribution to one, or a series, of candidates (Matthew Miller, The 2% Solution, pp. 172-180). By not limiting how much individuals, businesses or unions contribute, this policy would *not* be invalidated by the Supreme Court. The Supreme Court has ruled that restricting how much an individual, or group, can contribute violates their free speech (i.e., money equals speech). Since Professor Ackerman's proposal does not limit speech, it is constitutional. By greatly increasing the amount of campaign money available, Professor Ackerman's proposed policy would reduce the tremendous monetary advantage of both business and the wealthy.

If the United States adopted the two aforementioned changes (easier unionization and the governmentally provided $50 per voter campaign contribution) it would change the political landscape in a manner that would significantly increase the chances that policies similar to those discussed immediately ahead would be adopted. Such policies would provide a much greater standard of living, and security, to those in middle and low-income circumstances.

If the goal is to reduce income inequality and increase income security while keeping a commensurate level of economic growth, the most important fundamental change is to realize that a more activist government will be necessary. If present economic trends continue (i.e., greater personal economic risk and less personal economic security – small increases in hourly wages for most middle and low-income workers, reduced employer provided health care and less generous and secure private sector retirement benefits), the obvious "solution" is to have the federal government provide the benefits that the private sector use to provide. This means having the federal government supplement wages (i.e., to provide cash payments to those who

work but earn little), provide a health care benefits package to all citizens similar to Canada and Western Europe, provide child care/day care to working mothers and increase the amount of money Social Security provides to retirees.

In studies that compare the poverty rates of various nations, the consensus among scholars is that poverty is best thought of as a relative concept. Put another way, poverty is really a type of economic/social exclusion. The impoverished person is, at least economically, excluded from participating in much of what the society they are a member of has to offer. In contemporary America (as well as in Canada and Europe), a person without access to a computer could reasonably be considered "impoverished." Lack of access to a computer might not prove fatal, but it would greatly limit their economic, social and cultural opportunities.

The median is a positional measure that divides a group into two equal parts. For example, if you rank-order 101 households from richest to poorest the median income would be the income of the 51st household (i.e., 50 households would have a higher income and 50 households would have a lower income). In poverty research the generally accepted standard is that a household is "impoverished" if it does not have an income equal to at least 50% of the median household income in that nation at that time (David Brady, Rich Democracies, Poor People, Oxford University Press, pp. 23-44).

One of the primary difficulties the United States faces in confronting this situation "head on" is the following core set of beliefs about poverty: (1) poverty is the fault of the victim; (2) economic growth will greatly reduce poverty; (3) government intervention will increase poverty. Each of these beliefs, at best, is "suspect. " For example, while it is true that single-mother households are much more likely to be impoverished than two-parent households and that U.S. has the highest rate of single-mother households among the wealthy democracies, even if every single-mother household in the U.S. were not poor, the poverty rate in the U.S. would still be much higher than in most wealthy democracies. Similarly, variation in educational attainment (e.g., in some wealthy democracies a higher percentage of adults have graduated from college than in other wealthy democracies) does *not* explain much of the variation in poverty rates among the wealthy democracies. Thus, while the well-educated typically have higher incomes than the less-well educated, this is not a fundamental reason while some wealthy democracies have much lower poverty rates than other wealthy democracies. Furthermore, when economic growth in the U.S. has been higher than in the bulk of wealthy democracies, the U.S. poverty rate has been substantially higher than in the overwhelming majority of other wealthy democracies. Greater economic growth *does* reduce the poverty rate in the U.S. However, what this means is that the U.S. poverty rate (typically around 17% of households with Great Britain and Canada around 12%, and the Scandinavian countries – Norway, Sweden and Denmark – around 6.5%) fluctuates around a *much higher* average than in other wealthy democracies and even at it's lowest level, is *much higher* than most all other wealthy democracies (David Brady, Rich Democracies, Poor People, Oxford University Press, pages 52-56). *Fundamentally, a nation's poverty rate is much more the result of political choices (i.e., what policies it enacts) rather than the attributes of it's population (e.g., educational attainment). Thus, the United States could "choose" to have a much lower poverty rate if we so desire* (David Brady, Rich Democracies, Poor People, Oxford University Press).

The preoccupation with the three aforementioned “core” beliefs about poverty has distracted us from the “big picture”: *the main reason that the U.S. has a much higher poverty rate than the vast bulk of wealthy democracies is that we don’t spend nearly as much of our economy as do other wealthy democracies on income transfers (i.e., direct cash payments to either the unemployed, the working poor and the elderly) and do not provide universal health care and childcare*.

I am going to close this section by outlining several policies that would greatly reduce the poverty rate in the United States, increase the growth of our economy and revitalize our democracy. Some years ago Nobel Prize winning economist Edmund Phelps proposed a government employment subsidy for full-time private sector workers. The following is similar, but a bit more generous than Phelp’s original plan (Matthew Miller, <u>The 2% Solution</u>, pp. 162-171). Assuming a minimum wage of $8 per hour, here’s how such a plan might operate: a worker earning the minimum wage of $8 per hour would receive a $4 per hour subsidy from the federal government (i.e., their “total wage” would be $12 per hour - $8 per hour from their employer plus $4 per hour from the federal government = $12 per hour) with the subsidy decreasing by 10% for each additional dollar per hour they earned. For example, if a worker received a pay raise from $8 per hour to $9 per hour their federal wage subsidy would be reduced from $4 per hour to $3.60 (i.e., $4 reduced by 10% is $3.60 or, alternatively, $3.60 is 90% of $4). Thus, if their wage from employment went from $8 to $9 per hour, this worker would go from a “total wage” of $12 per hour to $12.60 per hour ($9 + $3.60 = $12.60). For each additional dollar per hour their employer pays them, their “total wage” increases. Since the value of the subsidy decreases *less* than the increase the employer pays, there is a strong incentive for an employee to work for a higher wage from their employer. The subsidy would be entirely eliminated for workers earning $18, or more, per hour.

President Obama has proposed raising the federal minimum wage (remember California has a higher than minimum wage than the federal government requires) from $7.75 to $9.00 per hour. The 2016 Democratic presidential candidates proposed an eventual minimum wage of $15 per hour. When such proposals are made, opponents of minimum wage increases typically argue that increasing the minimum wage will increase unemployment (i.e., if employers have to pay more per hour for employees they will respond by hiring fewer employees and/or having employees work fewer hours). Regardless of the impact of minimum wage increases on unemployment (there is controversy in the professional economic literature on this point) since the wage subsidy proposal does NOT increase the minimum wage (i.e., it is a supplement added from government funds to an employees’ wage, NOT a requirement that employers pay their workers more money) it is NOT vulnerable to such criticism. Furthermore, far from discouraging work and rewording laziness, the wage subsidy plan *encourages* work by making work pay *more* (i.e., the normal wage plus the value of the wage subsidy). The more work “pays”, the more leisure “costs” (i.e., each hour you don’t work costs you more when income per hour is higher than when it is lower). Moreover, by making work pay more, and increasing the cost of not working in a legitimate occupation (e.g., selling drugs), the wage subsidy plan will reduce government expenditures by reducing the occurrence of two circumstances which increase government costs: (1) crime (by offering more money for being employed in non-criminal employment) and; (2) teen

pregnancy (by increasing the cost of not working – having children typically reduces the hours a mother can or will work). Finally, since the wage subsidy only goes to those working, it is NOT what most people think of as "welfare" (i.e., providing benefits to those not working).

Based on Phelp's original estimate of the cost, a "back-of-the-envelope" estimate would be that this plan, initially, would cost about $150 billion dollars per year beyond what we currently spend through the earned income tax credit. This estimate is almost certainly "too high" (Matthew Miller, The 2% Solution, pp. 169-170) but I want to err on the side of conservatism. Furthermore, Phelps himself estimated that within a few years the *entire* plan would be *self-financing*. The reduced costs of crime (police, court costs, prison costs, etc. - individuals who earn more are less likely to commit crimes), welfare, plus greater tax yields from more profitable businesses (these higher wage workers will have more income to spend which will increase business profits), would likely recoup the *entire cost* of the plan (Matthew Miller, The 2% Solution, pp. 169-171). Obviously, we could also extend this plan to part-time workers. When asked about the wage subsidy plan a senior economic advisor to President George W. Bush remarked this is the sort of thing we would do "if we were serious" (Matthew Miller, The 2% Solution, page 168).

Particularly as we reduce budgets it is very important to mention the tremendous impact education has on earnings. In 1975 those with a bachelor's degree out earned those with a high school diploma by approximately 60%. By 2008 this differential rose to approximately 100% (Jeffrey D. Sachs, The Price of Civilization, 2011, p. 15). Unfortunately, the United States ranks 12th in the percentage of 25 to 34 year olds with at least an associate's degree (i.e., graduation from a community college - Jeffrey D. Sachs, The Price of Civilization, 2011, p. 20). Since education is primary a function of state and local government, I have included increased funding for higher education in my discussion of policy options for California.

An additional policy change that would be of tremendous benefit to low and middle-income households is universal childcare. Child care/day care costs are very expensive, especially for low-income families. In addition to helping children, universal childcare increases the incentive to work. Let me explain. For low-income households, much of the income benefit from a low wage job is reduced if the family has to purchase childcare. By lifting this burden from low income households, the economic "value" of work is significantly increased. Universal childcare is commonplace among the wealthy democracies of the world.

To demonstrate the impact of universal childcare on both inequality and mobility, I am going to use an analysis of Sweden's system. "… In all high-income countries, the parents' socioeconomic status shapes a child's educational and earnings prospects, but much less so in Sweden than elsewhere and much more so in the United States. In Sweden, even a child growing up in relative poverty has almost the same education and earnings prospects as a child growing up at the top on the income curve. Esping-Andersen (the leading expert on the Swedish system and one of the most well-published academics in the world on welfare systems) suggests convincingly that Sweden's distinction lies *not* in its support for public education, which is roughly matched by other countries, *but* in its public support for families and their children from the *earliest* age, even before formal schooling. All of Sweden's families have access to

affordable high-quality day care, which is publicly provided. This enables mothers to work without leaving their children behind in an unsafe environment. Female heads of household, a group marked by a high rate of poverty in the United States, are *not* poor in Sweden. Remarkably, the poverty rate for female headed households in Sweden is only 4 percent (according to Esping-Andersen) compared to a 30% rate in the United States (Census Bureau data from 2009). Similarly, *all* of Sweden's children are afforded high-quality preschooling. The main point, according to Esping-Andersen, is that it is the provision of public services, notably the *universal access* to affordable day care, even more than income support to families, that is key to the elimination of poverty among families with children." (Jeffrey D. Sachs, The Price of Civilization, 2011, p. 198).

The importance of a person's early years to their eventually success in life is also dramatized by education. While there have been many controversies over teacher ratings for middle and high schools, a significant amount of research indicates that the critical period is actually in the middle and lower grades (e.g., grades 1 through 6). Concerning high school dropouts one study reports, "Research shows that a student's decision to drop out stems from loss of interest and motivation in middle school, often triggered by academic difficulties and resulting grade retention. Research also shows that a major cause of retention is failure to master content needed to progress on time, which in many cases, is the result of not being able to read proficiently as early as the 4th grade" (Jeffrey D. Sachs, The Price of Civilization, 2011, p. 195).

I am now going to outline both the costs and financing mechanisms for the policies I've mentioned. At the outset, let me mention just *switching from the U.S. health care system to either a Western European or Canadian style health care system would save much more money than would be needed to pay for all of the policies I am discussing (i.e., would provide universal health care, the Patriot Dollar system of campaign finance, Phelp's wage subsidy program and universal childcare)*. Since the U.S. spends about 16% of it's economy (i.e., GDP) on health care while Canada and Western European nations spend between 8.5% to 11.2% of GDP ("Health Care Spending in the United States and Selected OECD Countries," http://www.kff.org/insurance/snapshot/OECD042111.cfm) the difference is about 4.8% to 7.5% of GDP. The total cost of the programs I'm discussing is only about 2.7% of GDP (the programs would cost roughly $400 billion dollars per year which is about 2.7% of the $14.7 trillion U.S. GDP - 2010). Additionally, switching health care systems would also eliminate all future financial shortfalls for Medicare. Just changing our health care system to a Canadian/Western European system would not only cover our *entire* population, but *reduce* the per person cost of health care by about $2,000-$2,500 *per person per year*. If we switched health care systems, taxes would increase, but this would be *more than offset* by the savings. For example, if your taxes increase by $100 per month, but your take-home pay increases by $200 per month (due to less money deducted by your employer for health insurance) or your medical expenses decrease by $200 per month (by reducing the amount you have to pay out of your own pocket for health insurance/expenses), your standard of living would *increase* by $100 per month. Having all income subject to Social Security taxes (rather than eliminating the tax for income above $106,800) would keep the system solvent for the next *75 years* (Janemarie Mulvey, "Social Security: Raising or Eliminating the Taxable Earnings

Base", Congressional Research Service, September, 2010, p. 2 – see http://aging.senate.gov/crs/ss9.pdf).

While the case for switching to a Western European or Canadian style health care system is very persuasive (examine the World Health Organization rankings of health care systems and their cost), it is not a politically realistic option. So, let me briefly outline methods of paying the costs. First, the annual costs: Phelp's wage subsidy - $150 billion (remember Phelps estimates that plan would cost nothing – i.e., be entirely self-financing with a few years – but estimating "conservatively" I am assuming the plan brings no savings); universal childcare - $150 billion (this estimate is also likely to be "much too high" – see the discussion in Robert Kuttner, "The Squandering of America's Assets," Challenge, January-February, 2008, p. 87); and the Patriot Dollars campaign finance system – $4 billion (Matthew Miller, The 2% Solution, p. 195 – to be conservative I increase Miller's estimate from $3 to $4 billion).

Currently, the United States is the only wealthy democracy in the world that does not guarantee health care to all citizens. While the Patient Protection and Affordable Health Care Act (the Obama health care plan) is not a universal health care program (i.e., not everyone will have medical insurance), it greatly *increases* the percentage of the U.S. population that are medically insured from approximately 83% (as of 2011) to 90% (i.e., 10% uninsured). If the law were fully implemented the percentage insured would rise to 93%. In 18 states the Republican Party has blocked full implementation of the law. This is the primary reason only 90%, rather than 93%, of Americans currently have health insurance. As fewer jobs contain health care and increasing health care costs are causing Americans to drop their health insurance, the gains in coverage previously mentioned *understate* the impact of the program. Thus, without the Patient Protection and Affordable Health Care Act the percentage of Americans with health insurance would've been lower than the 83% figure at the time the law was adopted.

As previously, I am going to "overstate" the cost of the program. The Congressional Budget Office estimates that the Patient Protection and Affordable Health Care Act will have an annual cost of $96 billion. There is good reason to think that the various cost containment features of the legislation will reduce the rate of increase in health care costs. Thus, without the Patient Protection and Affordable Health Care Act, future health care costs would likely be higher than the will be under this law (for an excellent discussion of both the politics and policy of the Patient Protection and Affordable Health Care Act see Lawrence R. Jacobs and Theda Skocpol, Health Care Reform and American Politics, Oxford University Press, 2010).

The annual cost of the programs above is $400 billion (Phelp's wage subsidy - $150 billion, Universal Childcare - $150 billion, Patriot Dollars - $4 billion and the Patient Protection and Affordable Health Care Act - $96 billion). Together, these programs cost approximately 2.7% of the value of the U.S. economy (i.e., $400 billion is approximately 2.7% of $14.7 trillion – the value of the U.S. economy – GDP – in 2010). The simplest method of financing these programs is to follow the advice of former Reagan Administration economic advisor/Harvard Economics Professor Martin Feldstein and former Director of the Office of Management and Budget under President Obama Peter Orszag and simply let the Bush Tax Cuts expire. This would save approximately $368 billion dollars per year (see Paul Van de Water, Chye-Ching Huang, Chuck Marr, Chad Stone and Brian Highsmith, "Supercommittee Should Develop Balanced Package of

Tax Increases and Spending Cuts," September 27, 2011, p. 4 at www.cbpp.org). To do accomplish this, Congress did not need to do *anything*. Unless reenacted, the Bush Tax Cuts would have expired on December 31, 2012. Since the aforementioned programs have an annual cost of $400 billion, and allowing the Bush Tax Cuts to expire would produce $368 billion in additional revenue, we are only $32 billion "short" (i.e., $400 billion - $368 billion = $32 billion). This remaining $32 billion would be more than paid for by instituting Ackerman and Alstott's wealth tax. This tax would raise over $70 billion dollars per year in additional revenue (see previous discussion).

If repealing the Bush and Trump tax cuts and instituting Ackerman and Alstott's wealth tax seems "too hard" on the wealthy, consider the following: (1) the wealthy did very well, as did the economy as a whole, under the tax rates that would be in effect if the Bush and Trump tax cuts were repealed (i.e., economic growth was *greater* under the *higher* tax rates of the Clinton Administration than during the Bush Administration); (2) over the 1980-2008 period *98%* of the income gains went to the richest *10%* of American households (i.e., exactly those that gained, by far, the most under the Bush tax cuts – see http://www.stateofworkingamerica.org/pages/interactive#/?start=1980&end=2008); (3) the share of income going to the richest 1% of American income earners more than *doubled* between 1970 and 2010 (from about 7% to over 18% of personal income); (4) reducing the concentration of income and wealth at the top of the income distribution would likely *improve* the performance of our democracy by reducing the previously discussed *"debilitating cycle"* (i.e., where the increasingly concentration of income and wealth among the very rich increases the reliance of politicians on campaign contributions from the very rich which, in turn, leads politicians to enact policies which further advantage the very rich); (5) many of the very rich inherited their wealth which rewards "luck" (you can't pick your parents/grandparents) not "merit"; and (6) much of the income of very wealthy citizens was made possible by taxpayers.

For example, while Henry Ford made a fortune from developing the Ford automobile, he wouldn't have been successful unless taxpayers and/or government provided roads, street lights, a public education system to provide an educated workforce to design, build and sell Ford cars, a highway patrol to keep the highways safe and national defense in order to protect Ford's assets from being seized by a conquering nation or destroyed in a war fought in the United States. Similarly, would Bill Gates and Steve Jobs have been able to amass vast fortunes without the research and development provided by the National Science Foundation (an agency of the federal government which provided many of the protocols used for the internet)? In all of these cases, it is misleading to say that these individuals achieved their success "alone", or without government help. Since taxpayers provided much of the requirements for their success, doesn't it seem reasonable to suggest that taxpayers were investors in these projects and, as such, should reap the rewards of their investment (through tax payments)? A final point, even if *all* of the above policy and tax changes were adopted, by comparison to the other wealthy democracies of the world the U.S. Social Safety net would still be *"weak"* and taxes would still be *"very low."* It's not "big government."

Why Government Budgets Are Probably Too Small in a Democracy

There are good reasons to think that government budgets are *too small* in a democracy. First, consider the power of advertising. Isn't the purpose of the tremendous amount of advertising private companies buy to get you to spend money on their product rather on an alternative use of the same money (e.g., higher taxes to provide government benefits)? If the private sector didn't convince the public to spend more money on their products, and less on the government than if they didn't advertise, private companies would be wasting a large portion of the money they spend on advertising.

Second, there is ample evidence that the public does not have a good sense of not only the benefits other citizens derive from government programs, but of the value they themselves derive from government programs. The percentage of people who (a) benefit from various government programs, and (b) claim in response to a government survey that they 'have not used a government social program' are as follows: Home Mortgage Interest Deduction (a huge benefit for home owners) – 60%, Student Loans – 53.3%, Child and Dependent Tax Credit – 51.7%, Earned Income Tax Credit – 47.1%, Pell Grants – 43.1%, Medicare – 39.8% and Food Stamps – 25.4%. Since they don't receive a check in the mail for tax credits, citizens are particularly likely to forget the benefits they receive from tax credits (i.e., that their taxes are lower than they otherwise would be). Additionally, government social programs are often stigmatized as "welfare." But many people benefit from such programs without realizing it.

Third, many of those who most benefit from government programs vote the least frequently. As discussed in both class and the readings, lower income citizens disproportionately benefit from government social welfare programs. Additionally, lower income citizens vote less frequently than middle and upper income citizens. So, wouldn't the obvious political incentive be for politicians to provide lower government benefits to the poor than would be provided if the poor voted in proportion to their strength in the population?

Fourth, many upper income individuals might prefer a greater government effort to help the poor if they thought they might be poor in the future. It doesn't take much "courage" to favor low taxes and oppose government spending to help the poor when the person in question, either by their current economic position (upper income) or a realistic assessment of their future economic position (e.g., being born into a wealthy family, being close to completing medical school, etc.) strongly suggests that they aren't likely to become poor. Would this same individual be as likely to oppose government programs for the poor if they did NOT know (or have a pretty good idea) of their future economic position?

Fifth, business will underinvest in research that aids many firms but which they receive a benefit less than the cost of the research. Additionally, since business can often not estimate the value of basic research (i.e., research aiming to increase knowledge but that is not geared toward specific applications) the government must fund it. Basic research often produces spectacular gains in living standards. For example, between 1946 and 1965 the U.S. government funded 18 of the 25 largest advances in computing technology. Furthermore, the U.S. Defense Dept. literally created the internet through setting up its precursor (ARPANET – on these points see

Jacob Hacker and Paul Pierson, American Amnesia, pp. 39, 65-66). *Thus, private sector advertising, the lack of knowledge of the benefits of government programs, the lower voter participation of those more likely to benefit from government programs, upper income voters knowing their likely future economic position (i.e., their reduced need for government help) and the lack of incentives for business to invest in basic research the amount government spends is likely to be smaller than if these conditions did not hold.*

A person's political philosophy is likely to their willingness to spend money to reduce income inequality. If you are political liberal, you probably viewed the programs I mentioned previously (the wage subsidy, universal child care, the Obama Health Care Plan and the Patriot Dollars campaign finance reform) favorably. However, if you are liberal you have to face the question of how far you would go (i.e., how much of your money would you spend) to reduce income inequality?

If your political philosophy is conservative, your support for such programs is less certain. If you are politically conservative, a reasonable question to ask is: What are you trying to "conserve"? On the one hand you could answer that you were trying to conserve freedom and since taxes reduce a person's freedom to spend their money as they please, the government should be very small and taxes very low. If so, you would probably not support the programs I mentioned previously. Thus, you could say that while income inequality and insecurity in the United States are very high in relation to other wealthy democracies, the government should not reduce freedom in order to reduce income inequality and increase income security. That's certainly a philosophically defensible position. It could be useful, however, to consider the following two questions: (1) Is freedom the only value that matters? (i.e., inequality, poverty, the performance of democracy – think back to the discussion of the "debilitating cycle" - don't matter much); (2) Does a small government actually deliver the most freedom? Think back to the discussions of whether "net freedom" (i.e., subtracting the losses in freedom from the gains in freedom) would increase if: (1) the State of California sold off public beaches to private citizens and; (2) if taxes were reduced but fewer students could go to college and hence suffer a reduction in career choices later in life.

A second answer to the question of what you are trying to conserve might be as follows: an America where the benefits of economic growth and technological change are widely shared, such as occurred between the end of World War II (1945) and the early 1970s (i.e., where economic growth was high and the share of income going to very high income groups decreased substantially). If this is what you are trying to conserve, then the programs previously mentioned could be quite beneficial to your goal.

If your political philosophy tends toward the conservative side of the spectrum here's one additional thought to consider: is freedom or personal responsibility the greater goal? Many are attracted to conservatism out of a sense of personal responsibility. They feel that government help makes people less responsible for their actions. People should bear the costs of their actions. However, government regulation/taxing often makes people more responsible for their actions. Government taxes on smoking help offset the increased medical costs for government health care plans (e.g., Medicaid and Medicare) that smokers cause as result of harming the health

of both themselves and non-smokers (e.g., second-hand smoke). In such cases, bigger government (i.e., more regulation) actually results in *more*, not less, personal responsibility. So there is frequently a tension between personal freedom and personal responsibility. Furthermore, not taxing/regulating smoking can not only reduce personal responsibility but also freedom itself. If smoking causes both smokers and non-smokers to die prematurely then it reduces long-term freedom (i.e., you can't make free choices when you're dead). We could easily apply this same reasoning in support of taxes on sodas, meat, energy drinks, etc.

It is very important to focus on what is likely to be a very popular approach to the plight of the poor. Given that it occurred in 2012 it might seem a bit dated but I think you'll see it's quite applicable to the current time. Mitt Romney, the 2012 Republican Presidential nominee, made a statement that I would guess captured the thoughts of many when he said: "We have a very ample safety net, and we can talk about whether it needs to be strengthened or whether there are holes in it. But we have food stamps, we have Medicaid, we have housing vouchers, we have programs to help the poor."

Marc Thiessen's Comments on Mitt Romney

Now the reaction to Romney's comments from Washington Post editorial writer Marc Thiessen. "So Romney is fine with an entire class of Americans being permanently on food stamps, Medicaid, housing vouchers and other government welfare programs? His solution for our fellow citizens trapped in poverty and dependency is to find holes in the safety net and repair them? That is not conservatism. That is liberalism. The left judges compassion by how much money we spend, which is why the liberal project is to strengthen the safety net and grow the nanny state. The conservative project is to help people escape the safety net. Conservatives seek to create an opportunity society where we can lift people out of lives of dependency. We are not okay with having millions of Americans trapped in poverty and living on the dole. We are not okay with multiple generations trapped in government welfare. We believe in a society where the poor have opportunities for advancement. We want them to have the education and skills they need to find good jobs, get off public assistance and to move up to the middle class and beyond-as far as their ambition and ability will take them." (Marc Thiessen, "Romney's liberal message on poverty," Washington Post, February 6, 2012)

Response to Marc Thiessen's Comments on Mitt Romney

The viewpoint expressed immediately above is important. It deserves a reasoned response. I will do my best to provide one. Since Thiessen stresses the notion that the poor are dependent upon the government and that this is bad, let us examine this further. Having a job would seem to be the cornerstone of either reducing, or eliminating, the governmental dependency Thiessen talks about. *First, our economy does not, and will not, generate sufficient jobs to employ all of the poor who want to work.* The Great Recession, which began in late 2007, caused the economy to lose approximately 8 million jobs. Put another way, for the nine year period from 2007 through 2016, the unemployment rate was high enough to leave several million job

seekers without employment. How could these people be expected to work over this period when the jobs simply aren't available? Furthermore, as explained very early in this writing, Republican/Conservative Administrations and politics weight reducing inflation more highly than Democratic/Liberal Administrations. Think back to the Obama Stimulus plan's effect: unemployment was 1.7% lower than it otherwise would have been. This plan was opposed by the Republican Party. If you follow the questioning of Federal Reserve Board Chairman Ben Bernanke by members of Congress, you will find that conservatives worry much more about inflation (i.e., fearing inflation will increase) while Democrats are much more concerned about reducing unemployment. If you equate the Republican Party with a more conservative philosophy than the Democratic Party (which is certainly reasonable), then conservative policies produce less employment than liberal policies. As much research by political scientists and economists has found, more liberal administrations typically produce lower unemployment and higher inflation than conservative administrations (see earlier discussion and sources cited therein). So, the policies of the very philosophy Thiessen favors actually produces less employment, and hence, less opportunity for the poor than more liberal administrations/politicians.

One of the central tenets of modern economic policy that writers such as Thiessen typically omit is the widely held belief by economic policymakers that an economic growth rate of more than about 4% per year will produce a dangerously high level of inflation. Put another way, if the growth rate in the economy appeared to be high enough to actually employ all those who wanted to work, the inflation rate would move into, as policymakers see it, a danger zone. What would happen is that as economic growth exceed about 4% per year the federal reserve would raise interest rates, making borrowing more costly and, thus, ultimately reducing the economic growth rate and employment. Since the Great Recession started, millions of Americans cannot find work and the economy will not likely grow sufficiently to employ them for many years, if ever.

Second, many jobs simply do not provide the level of compensation necessary to provide workers with a standard of living that Americans would consider "decent." Working 40 hours per week, 50 weeks per year, at $9 per hour translates into an income of $18,000 per year. Most such jobs do *not* come with either health care or retirement benefits. Think of your family living on such an income. Is this how you want low wage workers to live? *The very government programs Thiessen refers to are the only bulwark such low workers have against living on an income that does not adequately provide even the "essentials" of life.*

Many of those eligible for governmental assistance either don't know about it, or for some other reason don't apply. I will use the food stamp program as an example. One-third of those eligible for food stamps do *not* apply (Lisa Levenstein and Jennifer Middlestadt, "Food Stamp Fight," Los Angeles Times, February 6, 2012). Furthermore, food stamps only provide approximately 70% of the money necessary to provide what the U.S. Department of Agriculture says is a nutritionally adequate diet ("Introduction to SNAP" – Supplemental Nutrition Assistance Programs, Center for Budget and Policy Priorities, www.cbpp.org, page 7). Over *three times* as many households that receive food stamps had at least one worker than relied solely on government assistance ("Introduction to SNAP" – Supplemental Nutrition Assistance Programs, Center for

Budget and Policy Priorities, www.cbpp.org, page 5). Finally, each $1 spent on the food stamp program generates $1.72 in economic activity. Think back to the previous discussion of how much economic activity per dollar spent was generated by other programs that benefit the poor (e.g., extending unemployment compensation - $1.60; payroll tax reduction - $1.09) versus the economic stimulation per dollar of the Bush Tax Cuts ($.35). *Thus, the food stamp program helps generate the very economic activity that helps reduce the unemployment rate*.

Thiessen's comments also raise several other points. First, as of the 1996 welfare reforms, beneficiaries of direct cash welfare (as opposed to food stamps) have a time limit of 5 years. *Thus, generations of the same family could not be on cash welfare for entire lifetimes because each person is restricted to 5 years.* Second, Mitt Romney supported the previously discussed Ryan Budget, which would've required large reductions in what is, by far, the weakest social safety net of any wealthy democracy in the world. No other wealthy democracy has pursued the type of system Thiessen desires. Third, the Ryan Budget would require large spending reductions in exactly the types of programs (e.g., education) that would make the poor/unemployed more competitive in today's labor market. *Fourth, the previously discussed wage subsidy plan increases the incentive for people to work because it "makes work pay more" for low-income workers than it current does. Thus, if we adopted such a plan, it would use government programs to increase, not decrease, work effort.*

Before closing, I am going to discuss one last topic that invariably comes up in discussions of government policy: waste. One of the most important findings from the study of citizen attitudes toward government programs is this: people typically think that unpopular spending programs (e.g., welfare and foreign aid) makeup a much larger share of the budget than they actually do. In studies I read many Americans think that welfare and foreign aid *each* account for 10%, or more, of federal spending. *Actually, welfare and foreign aid each account for less than 1% of federal spending.* That's quite a difference! *Additionally, fraud in welfare programs is quite low. For example, the error rate in the food stamp program is 2% (92% of the money goes to the beneficiaries while approximately the remaining 6% is the cost of administering the program). Since one-third of those eligible for food stamps do not receive them, we spend much less on food stamps than we would if fraud were completely eliminated and everyone who was eligible for foods stamps participated* (on these topics see "Introduction to SNAP" – Supplemental Nutrition Assistance Programs, Center for Budget and Policy Priorities, www.cbpp.org). Furthermore, eliminating politicians "pet projects" (e.g., "earmarks" – the famous "bridge to nowhere") are .1% of GDP (i.e., one tenth of one percent). *The "big picture" is that we will not meaningfully reduce the budget deficit by eliminating "waste, fraud and abuse." Waste, fraud and abuse simply aren't large enough to have a discernible impact on budgets.*

In my experience, Americans typically don't have much information about the policies/degree of inequality and living standards in the other wealthy democracies of the world. That's one of the major reasons I wrote this material. A Today show reporter asked 2012 Republican Presidential nominee Mitt Romney, "Are there no fair questions about the distribution of wealth without it being seen as envy, though?" To which Romney replied, "You know I think it's fine to talk about those things in quiet rooms and discussions about tax policy and the like. But the president has made this

part of his campaign rally. Everywhere he goes we hear him talking about millionaires and billionaires and executives and Wall Street. It's a very envy-oriented, attack-oriented approach and I think it'll fail" (http://blogs.chicagotribune.com/news_columnists_ezorn/2012/01/shhhhh.html). Perhaps. However, the tremendous redistribution of income and wealth to the richest Americans over the past 30 years amid stagnating, or declining, incomes for many of our citizens coupled with the weakest social safety net and lowest tax rates of any wealthy democracy in the world should indicate that, regardless of one's thoughts on such topics, we certainly need to talk about them publicly. There are many stakeholders in our nation (e.g., the very wealthy, financial institutions, business interests such as health insurance and pharmaceutical companies, etc.) who have a strong interest in us not realizing that a greater government role doesn't necessarily mean either less freedom or economic growth.

None of this is to say that our current policies are "wrong" or that, in comparison to the other wealthy democracies of the world, the American conservative's vision of a small government with low taxes, high levels of inequality and a low degree of economic security are "wrong." However, if we want to provide greater economic security and reduce income inequality in America, there are very viable options to both our current policies and conservative proposals.