The dubious case for the deserving rich [1]

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Source: Globe and Mail
Format: Article
Publication Date: 26 Jun 2013

EXCERPTS:

Harvard University economist Gregory Mankiw, chairman of the Council of Economic Advisers under U.S. President George W. Bush and, more recently, a key economic adviser to Republican presidential candidate Mitt Romney, mounts a spirited defence of the very rich in an article to be published in the next issue of the Journal of Economic Perspectives.

Mr. Mankiw's central argument, recently highlighted by Chrystia Freeland in her Globe and Mail column, is that very high incomes reflect exceptional productive contributions by highly talented individuals, which benefit the rest of society.

These returns to skill and effort are, according to Mr. Mankiw, "just deserts" determined by the free market, which do not come at the expense of the bottom 99 per cent and should not be taxed more than is necessary in order to finance basic public goods.

Mr. Mankiw views the rising income share of the top 1 per cent - who now collect almost $1 in every $5 of income in the United States - as the result of technological changes and globalization, which have expanded potential returns to entrepreneurial "superstars."

This benign view of soaring inequality is consistent with the core assumptions of many economists, but is not shared by those who have most closely studied the phenomenon of rising top incomes.

A paper for the same journal by Tony Atkinson of Oxford University and colleagues underlines that the rise of the top 1 per cent has been much more marked in the United States, and to a lesser extent Britain and Canada, than in other advanced industrial countries facing the same broad economic forces of globalization and technological change.

Different top income shares and trends across countries that have achieved more or less the same levels of economic growth, such as Germany and the United States, suggest that institutions and public policies make a difference. Stronger unions and different norms of corporate governance have kept top incomes more in check in countries such as Germany, without compromising economic performance.

It is difficult to swallow Mr. Mankiw's contention that the gains of the very rich have not come at the expense of labour. As Ms. Freeland notes, the rise of the 1 per cent has coincided with a shift of income away from labour and a squeeze on middle-class jobs.

Entrepreneurs and successful CEOs such as the late Steve Jobs of Apple Inc., certainly deserve to be well rewarded for their creative talent and leadership capabilities. But the fact remains that Mr. Jobs was able to accumulate vast wealth in part because he outsourced almost all manufacturing operations to very low-wage countries and maintained a highly "flexible" workforce at home.

It is hard to believe that Mr. Jobs would have been any less creative or Apple less successful if Chinese workers assembling Apple products were paid a decent wage and enjoyed decent working conditions.

Mr. Mankiw dismisses the argument that the very rich have earned windfall incomes, or "rents," by rigging markets in their favour and by wielding political power.

However, as argued at length by Nobel prize-winning economist Joseph Stiglitz in his recent book The Price of Inequality , the sky-high returns to the titans of Wall Street leading to the financial crash of 2008 are, to say the least, hard to justify on the basis of genuinely productive contributions. Indeed, financial excess and the self-serving actions of insiders wrecked the global economy and stuck taxpayers with the enormous costs of bailouts.

Mr. Stiglitz also argues that high levels of inequality undermine genuine equality of opportunity, citing evidence that many of the most affluent come from privileged backgrounds and inherit their advantaged position. Rather offensively, Mr. Mankiw says he is untroubled by evidence of limited mobility between income groups from one generation to the next, since "smart parents are more likely to have smart children."

But there is far more to this issue, as argued in a major contribution to this collection of papers by Canadian economist and Economy Lab contributor Miles Corak. He shows that countries differ a great deal in the extent to which they achieve the American dream of genuine equality of opportunity for children.

Children in the United States are more likely to remain in the same income class as their parents than in other countries, because of under-investment in income supports for poor families, as well as in child care and early learning and quality public education for all.

At the other end of the spectrum, the affluent in the United States are able to purchase advantage for their children by preparing them for and sending them to the private colleges that serve as recruitment platforms for the next elite.

Nepotism plays a role as well. Mr. Corak tells us that the top 1 per cent, including in Canada, are much more likely to have been employed at some point in their careers by a previous employer of their fathers than are the rest of us. As the old adage goes, it is not just what you know, but who you know, that counts in life.

Finally, Mr. Mankiw says little about the very real issue of transmission of wealth between generations. While many members of the corporate elite come from modest backgrounds, many others (not least in Canada) have been the beneficiaries of large family fortunes and have risen to the top of family-owned corporate empires.

Inequality is, as Mr. Mankiw argues, driven in part by rewards to talent and effort. But there is much more going on when it comes to explaining why the very rich are doing so well.

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