CONSERVATISM AND THE REAL PROBLEMS OF INCOME INEQUALITY

Patrick M. Garry

Since the recession that began in 2008, the issue of income inequality has been a central tool of political strategizing. Progressives have used the issue as a sword against conservatives, accusing the latter not only of indifference toward the plight of working Americans but of actually welcoming the widening gulf between rich and poor, as if conservatives want nothing more than to see the wealthy become wealthier, even if it is at the expense of the poor. At the same time, however, conservatives have shied away from the issue, perhaps afraid of how the issue might feed the big-government agenda of liberalism.

Even though they have had a sympathetic ear in the White House for fifteen of the past twenty-three years, progressives have used the inequality issue to put conservatives on the defensive, blaming them for the failure of the middle and working classes to match the progress made by the upper income groups. This assault against conservatives has been deceptive and distorted, but at the same time conservatives have often retreated by trying to dismiss the extent of the widening income gap.

The inequality issue is not the simple problem the left makes it out to be. The left argues that inequality is the cause of all other economic woes, specifically a diminishing upward mobility. But in reality, it is just the other way around. Inequality is less a cause than a symptom of our economic woes. The widening income disparity is a result of diminishing upward mobility, which in turn is the result of various technological, globalization, and governmental policy factors. For progressives to ignore these factors and focus only on taxing the rich is to disregard all the obstacles facing upward mobility, including the left's own misguided policies.

The public is right to worry about wage stagnation and economic mobility, as well as the rising costs of education, health care, and raising a family. But all these problems are not simply the result of income inequality. If anything, inequality is a reflection of these problems. Therefore, conservatives must address the actual mobility problems being

Patrick M. Garry is a professor of law and the author of *Conservatism Redefined: A Creed for the Poor and Disadvantaged*. He writes frequently on how conservatism serves the interests of poor and working Americans.

felt by working and middle class Americans through, for example, lowering the cost of higher education, improving secondary education, and easing the cost of raising a family through expanding the child tax credit. Conservatives must seize inequality as their issue, not only because of the failed policies of the left but also because it is a problem that goes to the heart of the conservative vision of society. It is an issue that must be addressed if conservatives are to provide a workable governing vision that can be embraced by all of society.

Given the wage stagnation and weak employment gains of recent years, it is not surprising that many economists claim that the gap between rich and poor is at its widest since records began forty-five years ago. This gap widened even throughout the recovery. From 2010 to 2013, only the households at the very top of the income ladder saw gains, while families in the bottom 40 percent saw their incomes decline over that period, according to the Federal Reserve. Meanwhile, household incomes in the middle stagnated.

The real incomes of the poorest fifth of Americans, which began their decline during the Bush administration, have continued to decline even throughout the economic recovery from the 2008 recession. Although the wealthiest Americans have seen substantial gains since the 2008 recession, the poverty rate remains two full percentage points above what it was in 2007, and more than three percentage points above what it was in 2000. If the rate today were what it was in 2000, ten million fewer Americans would be living in poverty.

Not only has the middle class experienced wage stagnation, but the supply of midwage jobs has shrunk proportionally more than jobs at the top or bottom. A polarization or hollowing out of the labor market has eliminated many of the jobs traditionally available to the middle class. The wealthy and highly educated are doing well, and the number of low-wage, unskilled jobs are increasing, as are government benefits to low-income individuals. But the middle class is struggling against the trend of decline.

According to the Pew Research Center, 61 percent of all adults lived in middle-income households in the early 1970s. By 2012 that figure had fallen to 51 percent. Meanwhile, the numbers living in upper- and lower-income households both increased. The middle-class share of national income fell from 62 percent in 1989 to 45 percent in 2012, while the share of national income received by upper-income households rose from 29 percent to 46 percent during the same period.

For black Americans, the situation is much worse. Black median household income is almost 14 percent less than it was in 2000, and the poverty rate for black Americans is nearly five percentage points higher than in 2000.

These developments in turn have affected public opinion about the economy. In 2000 the majority of Americans believed job opportunities would be better for the next generation than for their own. Today the number who think so stands at just 16 percent. Majorities now believe that the ability of young people to afford college will never return to the way it was and that workers will never again feel as secure in their jobs as they once did.

The growing income gap has been driven by the anemic economic growth since the end of the recession. But it has also been escalated by the Federal Reserve's attempt to counter the drag of the antigrowth policies of the federal government and to stimulate artificially the economy through its $4 trillion quantitative easing policy—a policy that drove short-term interest rates nearly to zero. This also led to a surging stock market that in turn substantially increased the wealth of the richest Americans, who had significant stock investments. At the same time it vastly decreased the income received by the elderly, who saw declining interest payments on their savings. Ironically, even though the American economy has officially recovered from the 2008 recession, middle-class jobs and incomes have not recovered.

While Fed policy did boost profits in the financial markets, it did nothing to combat wage stagnation or the reduced share of wages in gross national income. The share of wages in the national income has decreased from 65 percent in 2008 to 61 percent in 2013, while the share of profits in the national income over the same period has risen from 11 percent to 15 percent. Indeed, a significantly smaller share of the nation's income goes to labor than it did thirty years ago.

A debt-based monetary system has produced a debt-driven economy, which rewards those with the financial acumen and assets to invest in the market, while eroding the earnings of working Americans. Increased financial-sector profits accrue mainly to upper-income recipients, who are relatively few in number, while the decreased share of wages affects the relatively larger number of workers—thus leading to greater income inequality.

The eroding middle class cannot rely for help on the elite, who increasingly occupy an almost completely different economy than that in which the middle class is struggling. And because the political class is dominated by these elites, who are largely isolated from the ebbs and flows of the private economy, it no longer represents farmers and industrial workers dependent on private-sector economic growth. Moreover, the private-sector worker has been replaced in the Democratic Party by the public-sector unions, which are more interested in expanding government than expanding the economy. Consequently, progressives have lost sight of the basic need for economic production, presuming that money just results from certain professions and that tax revenues just appear because they have been set in law. Economic production—the anchor and output of the middle class—has been downgraded vis-à-vis government.

In many communities, the elite are withdrawing from the social institutions and venues relied upon by the middle and working classes. Indeed, in this age of globalization, the elites have more in common with their counterparts in other countries than they do with the middle class in America, as reflected in the elitist disdain for the values of patriotism and military service.

The implications of this social polarization are ominous. As Aristotle observed more than two millennia ago, middle-class-dominated societies are the most stable, just, and compassionate ones. Aristotle argued that the wealthy tend to be arrogant and reckless, and that the economically insecure tend to be resentful and destructive. But members of the middle class tend to have more moderate desires, be more open to reason, and have stronger communal ties and civic participation. Similar observations were made by Christopher Lasch in *The Revolt of the Elites*, where he argued that the social elites were undermining America's republican vitality with their asocial cultural values and absence of civic responsibility.

Progressive elites argue that income inequality lies at the core of what is wrong with America. Consequently, the crisis of income inequality demands and justifies a more active government agenda of redistribution, including higher taxes, higher spending on government entitlements, and higher regulation of business: in other words, expanding the public sector. And the left has used this call for bigger government to paint themselves as defenders of the working and middle classes, regardless of the fact that a bigger government has not only failed to alleviate the income gap but has widened it.

In the progressive view, the mere existence of income inequality provides an indictment to the free market economy. But this highly partisan position irrationally presumes that everyone should have the same income or that everyone wants to live the same kind of life that would produce similar incomes.

Although the left frequently talks about income inequality, it is really focusing on wealth inequality. Income is more reflective of present economic trends. It is more essential to how people live and what opportunities exist for them. Income is more immediate and more vital to livelihoods. Wealth, on the other hand, is often more a product of what has happened in the past. Therefore, a focus on wealth misses the picture of what is happening to that broad group of people in the middle and lower end of the income-distribution spectrum. A focus on wealth seems to reflect more a desire to confiscate or penalize a certain class of households, rather than to empower the broader group of households. For people in the middle- and lower-income levels, it's all about earnings and income, not about wealth.

The Fed's monetary policy for a long time has been much more effective in boosting balance-sheet wealth than in spurring real income growth, which results from capital investment that in turn spurs job growth. Because of Fed policies, corporate managers have often chosen financial engineering tools—for example, debt-financed share buybacks—over the kind of capital investment that would create wage-paying jobs. This is largely because financial markets have rewarded the former. In a rising asset-price environment, businesses engage in asset manipulation, not capital investment, and are more concerned with balance-sheet wealth than with business investment, which is the only way to boost real economic growth. Wealth creation comes from strong, sustainable growth that turns productivity into labor income, and then to more business investment. Federal Reserve–engineered balance-sheet wealth creation provides no shortcut to real growth.

One way in which progressives have attempted to reduce income inequality is by raising the minimum wage. But this is hardly a remedy. At least half of the minimum wage earners are not in the lowest household-income bracket, and even fewer are their household's primary earner—they in fact may be children or spouses of a primary earner who makes a higher income. So raising the minimum wage is not a great way for lifting up the incomes of the poorest households in America. The minimum wage will benefit those lucky individuals who keep their minimum-wage jobs, but it will decrease the number of such jobs in the future.

The other progressive measure for addressing inequality is to raise taxes on the higher-income households. But again, this measure greatly exaggerates what actually can be done. A recent Congressional Budget Office study on *The Distribution of Household Income and Federal Taxes* finds that the top 20 percent of American households finance 100 percent of the transfer payments to the bottom 60 percent, as well as almost 100 percent of the tax revenue collected to run the federal government. Sixty percent of U.S. households are already net tax recipients, collecting more in transfer payments than they pay in federal taxes—about $10,000 more. The next highest 20 percent pays only $700 more in federal taxes than it receives in government transfer payments. Therefore, the top 20 percent of households are financing nearly the entire federal tax burden, along with almost the entire system of entitlements and transfer payments.

This is not to say that taxes cannot or should not be increased on the wealthy, depending on what effect those taxes would have on economic growth; it is just to say the current taxation system is not the cause of or the remedy for inequality. The problem is much more complex than simply taxing the rich.

Revenues from a tax on high incomes also do not necessarily result in programs actually aimed at lifting up the lower- and middle-class incomes. Take education, for instance, where higher levels of government spending have coincided with an eroding middle class, lower skill levels for workers, and stagnating wages. Nor does higher government spending do anything to give families the freedom to choose the schools their children attend. (An educational approach that focuses directly on expanding the skill levels of working Americans might embrace an array of job-training initiatives operated through the private sector that would be more helpful for the lowest income groups than is traditional higher education, the benefits of which these groups are often handicapped from receiving.)

The only certainty produced by higher taxes is bigger government. Indeed, it is not even certain what revenues would be produced by such taxes, since higher-income individuals will increasingly shift their money into various tax shelters. Thus, sky-high income and wealth taxes would not raise much revenue for very long, and any revenue is likely to fund government programs, not checks to the needy.

Contrary to the stated aims of liberalism, a state-by-state analysis shows that the blue states following liberal policies have bigger income gaps than do red states that follow more conservative, growth-oriented policies. So, at the minimum, redistributionist policies like raising tax rates or the minimum wage fail to achieve greater income equality. And at worst, such policies actually worsen the inequality by dampening the economic opportunity and mobility needed by lower income individuals.

Thomas Piketty writes in *Capital in the Twenty-First Century* that wealth inequality can lead to the rise of plutocracy and the end of democracy. But even more likely to lead to the rise of plutocracy is the massive growth of elite-led central government, with its corresponding crony capitalism, that the left espouses as a remedy to wealth inequality. This isn't to say that extreme wealth inequalities pose no problem for a democracy; it just means that the left's proposed cure is no cure at all.

It often appears that the progressive approach reflects not a desire to uplift the lower income classes but an envy toward the upper classes. However, government policy based on social envy can be toxic for American culture, just as it has been for many Latin American countries. Social envy and anger over income inequality might make for potent politics, but it only damages the cultural cohesion that lower-income Americans desperately need. There is no reason to cater to the rich, but it does no good to vilify them. The challenge is to rally the nation around a unifying vision that can produce upward mobility for all.

One such vision involves the uplifting role of work. According to the *Wall Street Journal*, nearly seven million Americans are stuck in part-time jobs. They want full-time jobs, but those jobs are not available. There are still two million fewer full-time workers than there were in 2007. And only 47 percent of all adults are working full-time.

The proportion of Americans in the labor force is at a thirty-six-year low. For decades, wages constituted about 55 percent of total national income. But in the wake of the Great Recession, that measure dropped to 50 percent. High-wage industries have lost a million positions since 2007, and the highest job growth is occurring in low-wage, low-skill industries that often do not even offer full-time work, relying instead on a large part-time workforce.

Even after the end of the Great Recession, tens of millions of working-age Americans remain jobless, working part-time involuntarily or having dropped out of the workforce. According to the Bureau of Labor Statistics, almost ninety-one million people over age sixteen are not working, which is a record high.

The decline in job creation corresponds with a decline in new business start-ups, which in many industries is near a thirty-five-year low. Indeed, if the rate of start-up formation after the Great Recession had been equal to what it was during the Reagan recovery, 760,000 additional jobs would have been added in just one year. But job creation during the present age has been inhibited by government action. The National Federation of Independent Business reports that worries about the expansion of the regulatory state and the increasing burdens of bureaucratic red tape have become small businesses' primary concerns.

The progressive attempt to spur economic growth and prosperity through government spending has not worked. Such spending has increased so much that the federal debt held by the public, as a share of GDP, grew to nearly 80 percent in 2014. But, as demonstrated by the decline in median household incomes, government spending does not produce economic growth. This is a lesson that has long been known because the multiplier for government spending is less than one, which means that a dollar of government spending produces less than a dollar of economic growth.

For decades following World War II, the U.S. economy grew at an average annual rate of 3.3 percent. But the recent growth rates are much lower: a negative 2.8 percent in 2009; 2.5 for 2010; 1.8 in 2011; 2.8 for 2012; and 1.9 in 2013. Recent economic policy has essentially relied on three approaches: a huge boost in government spending, which was supposed to create new jobs; a tax on the wealthy, which was supposed to address the growing inequality; and a reliance on the Federal Reserve zero-interest-rate policy, which hasn't increased median family income but instead fueled a record stock market and significantly added to the wealth of the already-wealthy, who have significant stock holdings and whose incomes are less reliant on wage levels than are the incomes of middle- and working-class people.

A belief in growth of opportunity, fueled through a dynamic private sector, constitutes a primary conservative belief—an essential conservative belief since Abraham Lincoln: the belief in work, the freedom to work, the ability to reap the full rewards of work, and the opportunity to work.

Just as it was with Abraham Lincoln, work should be at the center of conservative thought and policy. Work is fundamental both to a healthy individual and a healthy society. The true measure of society should be how well it provides work opportunities to individuals and how well it rewards those individuals for the work they perform. The measure should not be, as the liberal approach so often sees it, whether some individuals have more money than others, or whether government could somehow equalize the material resources of people. The measure should not be all the programs that government is administering, but rather the work opportunities and rewards available to individuals.

The progressive political culture no longer seems to have a high regard for blue-collar-type work. Progressives celebrate actors and rock stars and investor billionaires and academics and nonprofit-foundation bureaucrats, but they don't seem to value the blue-collar culture of working hard with one's hands for eight hours a day and going home to a family and painting the garage at night, and then coaching a sixth-grade baseball team on the weekends. Progressives talk a lot about the act and rewards of consumption—of all the things people might buy or own or enjoy—but they rarely talk about the act and rewards of production.

Production is essential for a healthy society—consumption is simply the reward of production. Yet in the progressive mindset, an unemployed worker is not someone to be channeled back into productive work but a statistical victim of a free market who needs to be transformed from independent worker to a dependent beneficiary of governmental largesse. To progressives, the unemployed are a necessary and valuable resource—people who justify a larger government role and presence in American economic and social life. Progressives, in fact, have a rather dismissive and pessimistic view of blue-collar workers: since they really don't think such workers can support themselves or better themselves, why not put them on the government dole?

Work is the pathway to the middle class, and independence is the hallmark of the middle class. But progressive policies often enhance dependency. Progressives resist giving the middle class control over their Social Security accounts, despite the fact that the Social Security system run by the government is going broke. They resist giving individuals control over the structure of their health care, even though nearly every assurance made by the government concerning Obamacare has proved false. They resist giving families their choice of schools, even though the public schools assigned to their children are themselves failing. Progressives even resist the work requirement in welfare, even though work leads to independence. Conversely, eliminating the work requirement only expands dependency. And dependency only degrades the capacity of the citizenry to operate as a check on government.

The flip side of increasing dependency is denying the opportunity for advancement, and huge bureaucratic government programs often do nothing to facilitate advancement. Government has a static nature—it responds to static conditions and entrenches static programs. Sometimes this is a good thing. Government builds roads and bridges that are meant to be static. It monitors environmental quality, which is meant to remain at a livable level. It establishes a social safety net, which ensures to everyone a basic income status necessary for survival. But static does not produce change or progress. Static cannot create jobs and enhance social mobility. Static might be all right for the wealthy, like Warren Buffett, but static is not what the struggling members of society want. They need the dynamism of the private-sector economy.

The conservative approach to income inequality takes a bottom-up focus, rather than a top-down one. It seeks to lift up the bottom, rather than to bring down the top. It seeks to maximize the opportunities for the least well-off through maximizing the income and economic opportunities of the whole society, rather than simply targeting the most well-off for what may eventually become punitive taxation, irrespective of how this taxation would affect all the lower brackets.

A policy agenda serving this focus includes increasing upward mobility through education that empowers workers, and regulatory and tax reform that sparks job creation and wage growth. Conservatives must fight crony capitalism, which benefits the politically connected, and orient tax policy to benefit families and the middle class, not just to penalize the rich.

Welfare programs that incentivize work have been far more successful in boosting incomes and mobility than simple cash-assistance programs. The U.S. Census Bureau estimates that the Earned Income Tax Credit lifted 5.4 million people out of poverty in 2010 alone. Conservatives advocate expanding this EITC to childless adults, reducing the marriage penalty by adding a second-earner deduction, and reducing the disincentives to work in other welfare programs. Conservatives also propose reforming the child-care tax credit to make it easier for single mothers to reenter the workforce, get off welfare, and take advantage of opportunities for upward mobility.

Unfortunately, the current welfare system largely serves the goal of providing a social safety net, rather than that of moving people out of poverty. Although the first goal is necessary for survival, the second goal is vital for achieving upward mobility. However, the overall design of the entitlement and social welfare system has greatly decreased the motivation of recipients to find work that would take them off those benefits. Furthermore, government housing policies expanding home ownership have made it more difficult for the poor and working class to move to geographic areas where jobs are more plentiful. Because it is especially difficult to sell a house in an economically depressed area, the people most in need of mobility become trapped in that depressed area.

Since the recession's official end in 2009, real hourly wages have fallen by 2.6 percent. In large part, this has occurred from a hollowing out or polarization of the labor market, through which middle-skill and middle-earning occupations have disappeared. A study by the National Employment Law Project found that between 2008 and 2012, midwage occupations represented 60 percent of jobs lost, but only 22 percent of jobs recovered. Meanwhile, lower-wage occupations accounted for only 21 percent of jobs lost, but 58 percent of jobs gained back. This downward mobility in terms of job availabilities stems from current government policies. And a widening income inequality is an inevitable result of downward mobility. No government tax hikes or entitlement programs can ever make up for this hollowing-out effect.

A social polarization between a small upper class, an eroding middle class, and a large lower class will only intensify, predicts libertarian economist Tyler Cowen in his book *Average Is Over*. But contrary to such predicted trends, conservatives want to preserve the traditional American upward mobility to all income and skill levels. Cowen's world is not the preferred world of conservatives—a world where the top 10 to 15 percent do very well, the middle stagnates, and the bottom falls further behind. But this is all premised on the fact that the middle and bottom will not have sufficient education to advance. In the modern world, the economic returns to job skills have increased, as have the penalties to the unskilled.

Conservatives need to recognize that a core challenge facing America is not simply income inequality per se but rather wage stagnation and a restriction of upward mobility. The problem is a declining mobility from the bottom and a wage stagnation for the middle class. The real issue is not income inequality but the level of opportunity for economic mobility. A study published by the National Bureau of Economic Research found that the widening income gap has not translated into a lowered economic mobility—in fact, there is a 0.6 percent higher chance for a child born in 1986 to move from the bottom 20 percent of household income to the top 20 percent than for a child born in 1971. Nonetheless, the study did conclude that the rate of upward mobility has essentially flattened in recent years, despite periods of economic growth and an expansion of welfare programs. This stagnating rate of upward mobility is the primary conservative concern, not simply the abstract levels of income differences.

Future conservative tax policy should focus on the needs of the average American. This focus could include a significant increase in the child tax credit, which would do more to provide meaningful tax relief to middle- and working-class families than any reduction in personal income tax rates.

Currently, the tax code works against parents, who have to pay just as much in taxes as childless adults, even though the costs parents incur in raising children constitute an additional contribution to the future of society. These costs are borne almost entirely by the households doing the child-rearing, even though the benefits that come when the children reach working age—for example, through the social insurance systems—are broadly shared by everyone in society. Therefore, the child tax credit should try to compensate for this additional contribution, and it should be applied against both income taxes and payroll taxes, especially since most middle- and working-class parents pay more in payroll than in income taxes.

Making the child tax credit applicable to payroll taxes suggests yet another area of tax reform. For too long Republicans have focused their tax-reform energies on the individual and corporate income tax systems, on the assumption that payroll taxes cannot be changed because they finance the social insurance programs. But the largest tax most families face is the payroll tax, not the income tax. It is the payroll tax that directly affects the earnings of all working Americans, thus determining the effective tax burdens on working- and middle-class families.

Owing to the realities of the tax system, only upper-income households tend to be significantly burdened by high income taxes. Therefore, any strategy of cutting income taxes plays into the liberal charge that conservatives care only about the rich. A better strategy is one focused on lessening the overall tax burden on working- and middle-class households.

A tax proposal aimed directly at low-income households is the expansion of the Earned Income Tax Credit. This is a much better help to low-wage individuals than an increase in the minimum wage. Whereas an increase in the minimum wage to $9 an hour would result in a loss of approximately 100,000 jobs, according to Congressional Budget Office estimates, an increase in the EITC does not cause any burden on employers. Furthermore, not all low-wage earners reside in low-income households, and an increase in the minimum wage received by a child or spouse of a higher-income individual will not do anything to alleviate poverty.

The Earned Income Tax Credit directly targets low-income families rather than just low-wage workers. Moreover, since the EITC operates through the tax code, it has the benefit of being financed disproportionately by those with the highest incomes; on the other hand, raising the minimum wage operates as a burden on those employers who hire low-wage labor. And normally such employers are not wealthy individuals.

The lessons of the past, as well as the challenges of the future, indicate that conservatives cannot just oppose the left's polarizing use of the inequality issue, for to do so would reinforce the image that conservatives are not concerned about the growing income gaps, and thus not concerned about the struggles of working- and middle-class America. What conservatives must do is articulate a broad agenda that seeks to lift burdens from workers and middle-class families, as well as to open up opportunities for economic advancement. And this broader agenda must go beyond the traditional mainstays of conservative policy—for example, across-the-board tax cuts and regulatory reform. Such an agenda would do much in erasing the image of conservatism as caring only about the rich.

Economic growth and economic mobility are not the same thing, and conservatives must resist presuming that strength in the former translates to strength in the latter. Conservatives do not want to repeat the performance of the Bush years, when economic growth coincided with stagnant wages and rising health-care costs. Instead, conservatives must speak directly to the desire of working- and middle-class voters for economic opportunity and mobility—a desire that is far deeper than any desire simply to tax the rich more. This is why the progressive focus on income inequality may unite their activists but does not speak powerfully to voters. But this failure gives conservatives the opportunity to offer voters a true understanding of today's real economic challenge and how it might be addressed.