

## General Discussion: Overview Panel

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*Chair: Alice Rivlin*

**Ms. Rivlin:** Thank you very much, Mervyn. Now before lunch we have a few minutes for parting shots. Your remarks can be comments or they can be questions addressed to either Marty or Mervyn. Bill.

**Mr. Poole:** I want to comment on the issue of egalitarian policies per se. I think that everyone in the room believes that antipoverty policies are an important issue and the responsibility of all of us to form views on.

I think that egalitarian ethical views are so deeply imbedded in culture that we often find it embarrassing to discuss the issue, and even to question the validity of that position.

As economists—and it seems to me that we've seen this in our discussion here—we often fall back, perhaps with some embarrassment, to the view that inequality is necessary to have efficient distribution and to encourage entrepreneurial activity. But in the United States, certainly, I think we can offer a much more positive view of income inequality.

If we look around this society at the use of wealth, we see that our great private universities have been endowed with the income and the wealth that has been created over the years. We see that our art

museums, our symphony orchestras—many aspects of this culture—have been supported by private wealth. The inequality has not all gone for narrow private use. Much of the wealth has, in fact, gone for public purposes. I think that has to be the starting point for discussing inequality per se, at least in the environment of this culture.

**Ms. Rivlin:** That, too, is perhaps a leaky bucket. Other comments?

**Mr. Feldstein:** I want to go back to spiteful egalitarianism for a second, to distinguish it from the point that Mervyn made. He said we have to think about distributional considerations when we deal with practical issues, like the design of the tax system. And I think there's a broad consensus in most countries that the rich can afford to pay more of the national tax bill. That reflects a view about the diminishing social marginal utility of income. A dollar is worth less to a millionaire than to somebody with \$10,000.

That's very different from a view that says giving a millionaire another dollar makes society worse off. Or taking a dollar away from a millionaire, not to help finance the national government spending, not to improve the art collection at the Metropolitan Museum, but just to make him a dollar poorer, that that would be a good thing. That's what I call spiteful egalitarianism. And I think that ought to be the starting point of the ethical argument. The Pareto principle says that if we make somebody, even a millionaire, better off, society is not worse off.

**Ms. Rivlin:** I haven't noticed a lot of spiteful egalitarians in this audience.

**Mr. Feldstein:** But the Gini coefficient is spiteful egalitarianism. If you add a dollar to a millionaire you make it worse. And everybody here seemed to take it for granted that increasing the Gini coefficient was a bad thing, regardless of the source. I'm saying that's a terrible measure. We should care about the issue of poverty and low income and not about the Gini coefficient that mashes together goods and bads.

**Ms. Rivlin:** Robert.

**Mr. Heller:** With all this discussion about Gini coefficients, I just can't resist the temptation to ask our organizers to put a piece of paper at the exits and, as we all walk out, write down our income. And I bet the Gini coefficient in this group of equally educated Ph.D.-level economists will be just as high as it will be for the population at large. Is that something to worry about? I haven't found anybody who really cares.

**Ms. Rivlin:** Some of us think we get psychic income from serving the public.

**Mr. Blinder:** I wanted to second Alice's remark about there not being spiteful egalitarians around here. There are very few in the whole country. Once you come to a community of economists, all of whom I think pledge allegiance to Pareto optimality, the number goes to zero.

Now the problem is that we know the main reason for the rise in the Gini coefficient since say, 1979. And it's not that a bunch of millionaires got another \$1,000, although there's been a bit of that. The main reason is the falling incomes of the poor. So in terms in the way Marty started his remarks, the main problem is not that the rich are getting richer, but that the poor are getting poorer. And that's indeed the reason that this is such a social concern.

Now were we to have lots of policies that added \$1,000 per capita to all the people in the upper 1 percent of the income distribution, there would be no reason to oppose those on nonspiteful egalitarian grounds. But the truth is that government can only do a certain number of things at a time. In fact, in our system, the government of the United States can hardly do anything at a time. One is about maximal. Therefore, there is a choice. If the government is going to promulgate tax-transfer, pro-entrepreneurship, whatever you want, policies, it is not going to be able to do everything. And it needs to pick and choose. There I would say, and I don't think this is spiteful egalitarianism, that we ought not to be choosing ones that add \$1,000

to the incomes of the millionaires, but the ones that add \$500 to the incomes of the very poor.

**Ms. Rivlin:** John.

**Mr. Berry:** Question for Marty on the issue of the efficiency. Laura Tyson described changes in the earned income tax credit (EITC) and increases in minimum wage, which had raised the real incomes of some of the poorer people, certainly working people. Do you think, looking at those effects, that there was any loss of economic efficiency associated with that change in government policy?

**Mr. Feldstein:** I have to say yes. Can I tell you of a study that shows that this substantial increase in marginal tax rates associated with the earned income tax credit has done that? No, I cannot show you such a study. I think that the EITC is misconceived by many people, because it is often described as matching or a way of raising the earnings for people who earn—for every extra dollar that you earn, you get a transfer payment from the government. And that is true over a narrow range of incomes. But after individuals get past that narrow range, the EITC gives you a fixed amount. You neither gain more nor lose anything. Then after a while, it “phases out.” And during that phase-out range, there is a substantial increase in the individual’s marginal tax rate because they are paying their regular marginal tax rate, the payroll tax for social security, plus the phase out of the EITC, so they are easily in the 60 percent marginal tax range. Somehow, that’s got to affect economic efficiency. Fortunately, other good things have happened in the economy, which have led to increases in employment among these groups affected by that. But I cannot believe that that kind of an increase in marginal tax rates doesn’t have adverse incentive effects.

**Mr. Lawrence:** There are those who think we should only be concerned about the bottom half. But I’d like to put on the table the argument for concern about the growing separation when the top half or the highest group actually enjoys rising incomes, while the rest do not. I think it has to do with the distinction between a kind of exit and voice.

Basically, if we have a society in which opinion leaders, in which those who are most affluent are able to separate themselves, to go and live in separate neighborhoods, to send their kids to separate schools, I think that under those circumstances, we can be concerned that they won't take into account the conditions under which the poor are living.

By contrast, a society in which the rich are forced to live together with the poor is likely to lead to a much greater extent to their exerting more voice rather than exit. So I think if we are concerned about the poor, there are reasons also to be concerned about the rich and their capacity to segregate themselves from the poor.

**Mr. Darby:** I guess several speakers have said the poor are getting poorer. I just wanted to reiterate that we haven't really examined that evidence. There's a real controversy over the measurement issues, in terms of whether the poor are getting poorer or whether the poor are getting richer, just not as fast as the rich. It seems to me that the weight of the evidence supports the view that the poor are getting richer but more slowly. And I think that's a very different situation from the claim that the poor are getting poorer, which requires focusing on certain measures and not others.

**Ms. Rivlin:** One thing that I think we have quite strong evidence of is that people with low skill and low education, in the United States, anyway, are not just relatively but absolutely worse off than their parents were. Now that may be something we can do something about. But it's not a question of being only relatively worse off.

**Mr. Darby:** I think that that depends upon the price index you use. If you use the Boskin Commission estimates of the bias in the consumer price increase, that goes away. If you add total compensation and welfare benefits, that goes away.

**Ms. Rivlin:** If we get enough adjustments in the price index, then we can all feel that we are a lot better off than we thought we were.

**Ms. Tyson:** My comment is that I'll wait for the study, Marty. But I

do want to go back to the concept of cultural norms. The EITC and the increase in minimum wage may be a very powerful tool for getting people reattached to the labor force who simply were not involved in it at all. And the reattachment itself changes their association to work going forward. So even though they may face a high marginal tax rate, which I don't think is as high as you are suggesting, at a certain point, the benefit to society and to that individual may well be worth the cost.

**Mr. Feldstein:** What is the phase-out rate of the EITC?

**Mr. Katz:** I think it is about 18 percent.

**Mr. Feldstein:** 18 percent on top of the 15 percent, on top of a 15 percent, on top of a state income tax.

**Mr. Katz:** It puts you in the high 40s to the mid-50s.

**Ms. Tyson:** But I do think the issue of what this is accomplishing goes back to what Assar said in his paper, that the value of having a job is a component of individual welfare in addition to the income it generates. It organizes life; it boosts self-esteem. And I think that's really the argument in favor of this very pro-work policy.

**Ms. Rivlin:** Yes, Mike.

**Mr. Mussa:** I recall in the winter of 1978 sitting in my apartment in Chicago listening to a CBS white paper on illegal immigration into the United States. And they were interviewing behind the screen a Mexican who had come up across the border and was working in a U.S. steel plant, which was then still open in Gary, Indiana. And they asked him whether he suffered from being separated from his family and so forth. And he said, "Yes, but you see here in Gary, Indiana, I earn \$22,000 a year as a steelworker and I can send much of that back to my family and we are all better off." I reflected on that, and I said, "\$22,000 a year! That's more than we're paying a new assistant professor with a Ph.D. from MIT in the Chicago Graduate School of Business."

Now, it is no longer true that steelworkers in the United States earn more than new assistant professors in the Graduate School of Business at the University of Chicago or other business schools. There have been changes in the way wages are arranged within the U.S. economy. And there has been a significant decline in unionized jobs, in a variety of industries that used to provide relatively high-wage employment to at least a certain number of high-school-educated or non-educated workers. That is undeniably a fact of U.S. labor market experience.

The question is whether it's a good thing or a bad thing that the U.S. economy has adjusted to a situation where steel is much more cheaply available in the international market, and that the demand for workers with the types of skills that earned \$22,000 a year in 1978, has indeed gone down. It does need to be recognized that, while a number of textile jobs that are not high-paying jobs in the U.S. economy has clearly declined, it is not only high-waged people, but everyone, who benefits from the capacity to purchase much lower-priced textile goods from K-Mart and Wal-Mart. That would not have been the case if we had preserved in this country a level of protection that would have kept 2½ million people employed in our textile and apparel industry.

*Ms. Rivlin:* June.

*Ms. O'Neill:* Everybody's been using the present tense to describe the growing inequality, and I'm not sure that's accurate, given that most of the data series that have been discussed do not go beyond 1994. It's my impression that since 1994, the real earnings of the general population have been increasing more rapidly than they had before and the earlier pattern of growing inequality has not continued. In fact, it seems to me that recently, the earnings of workers at lower educational levels have been increasing somewhat faster than those of more educated workers. The one exception may be the earnings of the very highest income group—the top half of the top 1 percent. Their incomes are not measured very well in standard data sets (like the Current Population Survey). But data from income tax records show that this group experienced a dramatic income gain

between 1994 and 1996. However, nonearned income such as capital gains may account for most of that increase.

Now, the big question is, what will happen as we go forward, and here I think a major concern is the group at the bottom—the welfare population of families headed by single mothers. There seems to be a kind of vicious circle operating for that group, in which dysfunctional parents tend to produce dysfunctional children, thereby perpetuating poverty from one generation to another. Mothers who've had their children out of wedlock have daughters who are more likely than other young women to have children out of wedlock and to go on welfare, and so on. Perhaps the recent welfare reform in the United States may finally begin to break that vicious circle. Welfare reform is a tough-love measure because it imposes a time limit on benefits, which is perhaps the most significant aspect of the plan. It means that you can't count on a lifetime—or even a very long stretch—of benefits. And that change may hold a key to altering behavior, particularly the behavior of young women who are approaching the age at which they might have an out-of-wedlock birth. It is not yet known whether such changes have already occurred, because of various problems with the measurement of out-of-wedlock births and changes in the way states are determining what is an out-of-wedlock birth. For a long while, incidentally, in California and certain other states, out-of-wedlock births were recorded by comparing the names of the mother and father. If they were different, instead of asking whether the couple were married, the state assumed that they weren't. That practice has been replaced over the past few years, which improves the accuracy of the statistics, but it also adds to the difficulty of determining whether a change has occurred. But my impression is that out-of-wedlock births have begun to come down a bit. And teenage births have also come down. So possibly, there is something hopeful in that department.

**Mr. Siebert:** I disagree a little bit with Mervyn King with respect to the empirical picture of the data. We have to be aware of the measurement issue. For instance, looking at German data and OECD data, the equivalence scale for households that you use may lead to completely different results.

Now taking account of this measurement issue, from the data that I have seen, including the Atkinson paper and the Lawrence Katz data, it is fair to say that if you compare the change in the Gini coefficients, the change has been much greater in the United States, the United Kingdom, and also the Netherlands. But in the three major continental countries—Italy, France, and Germany—changes have been rather slight and the trend is not very significant or not very conclusive, taking into account the measurement problem. So my conclusion is that the issue of *rising* income inequality is at least not a problem for the three major continental European countries. And in that sense, it is an Anglo-Saxon problem, counting the Netherlands and Belgium as Anglo-Saxon countries.

**Mr. Lindbeck:** I think Poole made an important observation, which no one responded to. We all agree that poverty has negative externalities. It destroys cities and makes life unpleasant even for people other than the poor. But we have to accept Poole's statement that richness, inequality at the top, has very strong positive externalities in the long run. What we call high culture today, what is that? It is the paintings created during the Renaissance in Italy and Holland, financed by rich businessmen and bankers competing with each other. Classical music was financed by rich, small feudal kings. The castles, which we visit as tourists, were built by rich people. The art in the nineteenth century was very much financed by art collectors, rich people in this century too. So what we call culture today, that is really a positive externality of an unequal distribution of the past. And we should keep that in mind, too.

**Ms. Rivlin:** We could bring back the Habsburgs, but they did have their downsides.

**Mr. Visco:** I would like to make three remarks. First, if you look at the requests the OECD now receives from policymakers, they have asked us to be less concerned about income inequality and more concerned about poverty and marginalization. So for policymakers, it seems to me that Marty's remarks are important. Poverty is the issue and not the general shape of the distribution of income. Second, I think that when one looks at poverty, the extent of poverty externalities is

extremely important, and the measurement issue is relatively less important. I understand that there is an underground economy that helps the poor, but this does not suffice in the sense that the simple fact is that a relatively large share of the population is poor. And whether the poor can benefit from an underground economy has other implications in continental Europe or in southern Europe like Italy, and this matters very much. The difference between the South and the North is at the end something that leads to employment of marginalized people in criminal activities, illegal activities that may at the end have other impacts and effects. Finally, even if it is true that there is less increase in inequality in continental Europe than in Anglo-Saxon countries, if one looks at the poverty levels, this is not anymore so: poverty has increased in continental Europe more or less as it has increased in Anglo-Saxon countries. In fact, poverty is linked to the increase in unemployment. Therefore, it is really important to try to understand how this poverty is concentrated. At the OECD, we are just producing a paper for our Economic Policy Committee, and I am still reviewing it, but one thing that is striking is that the long-term poor are more or less 2 percent to 4 percent of the population. Considering Germany, the United States, the United Kingdom, and Canada, it is more or less the same. However, they cover about half of the total time all individuals stay in poverty. So the long-term poor are really the part of the population that should be targeted. These long-term poor are those who will stay in poverty for six or more years. They are women, single parents, and disabled individuals. So it is important, I think, for policy recommendations to target very well, and with specific action, particular components of our population.

**Ms. Rivlin:** I think we've had over the last two days an extraordinarily good and lively discussion and it has done what a good discussion ought to. It's narrowed the issues. We're certainly, I think, all agreed poverty, deprivation, and lack of opportunity are things that ought to be of great concern to us, not only in our roles as central bankers but in our roles as citizens. There's much less agreement on whether inequality per se, if it isn't associated with an increase in poverty, is a bad thing. We've had a resounding vote of confidence for better education and better training. I don't think that's entirely

because professors are so heavily represented in the audience. But we've also had a recognition that it's very hard to do this well. We've had pretty strong votes of confidence for earning subsidies and that kind of encouragement of work. Above all, we have had the strong endorsement of sound monetary policy, but we haven't really come to grips with exactly what that means. And we are, therefore, left as central bankers with the hard choices that people presumably pay us to make at the margin. But I think that's where we like to be.

Let me express my thanks to Tom Hoenig for having hosted and managed this excellent meeting.