Peter Mueser, Professor of Economics at the University of Missouri

Interviewed by Jessica Anania

JA: My first question for you would be what are misconceptions or mistakes that you see often in the media surrounding issues of inequality and the income gap?

PM: Well, I guess we've seen a tremendous increase in inequality in the U.S., especially, but across the world as well. Personally, one of the problems that I see is that it's easier to talk about the income dispersion and to talk about the increase in income dispersion, but it's also useful to have a sense of what income dispersion is like at different points in time. It's common to talk about there being some golden age 30 years ago when everyone was pretty much had the same income, and that never existed. Income inequality has always been quite dramatic and so if you look at variance, it's about the same as the mean for income across people, or I should say the standard deviation is about the same as the mean. That means that if you pick two people at random, there's a very good chance that one person makes twice the income of the other or something like that. Now that's become a little more dramatic. It might be that the average person instead of making twice as much, the average high person makes twice as much as the average low – maybe 60% more, its now twice as much, so there's been a change. Inequality has been very dramatic, certainly in the U.S., forever, and it's pretty high worldwide. Lower in some places, but higher in others. It's important to recognize though that certainly in the U.S., there was no golden age where everyone was pretty much the same.

JA: Looking at the shifts you've described, where things might have been closer to being equal, now they're more extreme, is there an amount of inequality that's best? Or is it something that we should be trying to keep as low as possible?

PM: I'm afraid I feel like that the answer should be yes, but certainly the way an economist thinks, if you don't have inequality you remove incentives. If the benefits of spending four years in college and learning skills make you more productive, if those don't show up in your paycheck, not enough people will choose to do that. Certainly, most economists would say you need some inequality to create incentives and in fact if you just think about concepts of fairness, the person who works 40 hours a week and another person who works 30 hours a week, if the person who works 40 hours a week is earning a third more than the person who works 30 hours a week, most of us would say that's pretty fair. Especially if that's a choice – if people are choosing how many hours to work. There's quite a bit of variation. And then the person who works very hard, presumably there's some benefit of that. So there's quite a bit of variation that most economists say is necessary or valuable, I should say, and then there's quite a bit of variation that people would say is fair and appropriate. Most of the focus on inequality among people who think it's a bad thing derives from the viewpoint that the inequality does not pay off to greater productivity or greater work or greater value provided to the economy. And the degree to which that's true is where the difference in opinion breaks down. Do I know what the perfect level of inequality is? I certainly have no idea. But I can tell you that the view of people who defend current inequality is well, look, people who are more productive because of technology are much more than in the past. You have large companies, you have the ability to reproduce at a higher ability, and that shows up in people's incomes. If you want to attract people to do work that's more valuable, you're going to get a low return for that. The people that say it's not valuable, they say the difference in income doesn't reflect actual productivity, that's very common, especially among non-economists. The view that someone that's making more is not producing more than someone that's making less is very common among non-economists and common among many economists too. That's the way we divide it up. There's also a lot of discussion about fairness and different conceptions of fairness. There are some economists who would say that if there were no benefit in terms of the economy, it would be appropriate to just equalize everyone's income. If people who were more productive would still be productive if you paid them less, then you should pay them less. And then there are other economists who say that they should get more just because they're more productive, even if they don't have anything to do with it. They were born more productive, they were born better, and therefore they deserve more. That's one of the most important divisions between people who think inequality is okay and people who think we should take action to reduce inequality.

JA: So what I'm hearing from you is that inequality is a motivator that can drive people to work harder, work better, and achieve more in some ways.

PM: Certainly, that's one of the main views that's most widely shared among economists, that that's the prime value.

JA: So when would inequality cross into becoming more of a stagnating force? When you're seeing more of a division in terms of people who can afford things like college, can afford to pursue these higher-level careers, and people who can't afford these things anymore. Do you see this division in terms of a shrinking middle class, with fewer opportunities for people in the middle class?

PM: What you're describing is a fairness concern. What you're saying is, look, one person doesn't have the opportunity to do something that another person did. And that's a reasonable way to view it, that if you have this idea that all people should have equal opportunity and they don't, then that on it's face is incorrect. The way you would defend that is you would say, well okay, the person who has better opportunity, why do they have that? Because their parents are rich. And then you have to back that out and say okay, what's the problem with their parents being rich? Their parents are rich presumably one of the things they can spend their money on is education for their kids. So then you have to back this up an say well, is it okay that their parents are rich? Is that justifiable? So we are back to that original point, at least one of the aspects of that is back to the original point. That the income is distributed in that particular way.

JA: So an economist may argue that there is no problem with inequality because life isn't fair and there's no reason it should be fair.

PM: Well, you might back that out to the parents, whether its fair to the parents to deny them the right to benefit their children. What you've done is move it a level back. If I say, look, why is that people work hard, what is it that money can buy? One of the main things money can by, one of the main reasons I want to be rich, is so I can give my kids opportunities, right? So if you take that away, you're removing one of the benefits of money. Remember, money itself isn't valuable, it's the things you can buy with it. So if you say I can't help my kids, you really start out and say all kids should have equal opportunity, and parents don't have any right to spend money on their kids to make their lives better, you're removing one of the main things that people want with their money. You may decide that's okay, but if you're doing that, it's sort of like taking their money away and then you have to argue that that's okay.

JA: That's an interesting point. So is there a way to address inequality without this conversation about denying people their ability to spend money the way they want to? Is there a middle ground?

PM: No, there really isn't. But you can back it out and say it's still unfair that these people have more resources than others, but you have to recognize what you're doing. By giving one set of people opportunities, you're denying rights to others. Just like taxing away people's money denies them the right to their money, denying peoples' right to spend money on their kids denies them the value of their money. So you're back to sort of a similar kind of thing. That doesn't mean you can't say it's appropriate. What I'm presenting to you is not an argument that I think needs to be the bottom line. You can certainly argue that you think its unfair that there's this much inequality and that you don't want to give parent's that right. That the unfairness to the kids is overwhelming. And of course you can deny them the right to spend money on their kids, or you can spend money on poorer people's kids to give them the same rights, but you have to find the money somewhere. So you're going to take that away from the rich people. So in the end you're dealing with is it fair to tax the right? Is it fair to reduce their total income? And we're back to where we were in terms of thinking about incentives.

JA: So I have two follow-up questions. First, in addition to what you're describing, I'm wondering what other things you think we need to know in terms of contextualizing this issue in an economic sense?

PM: One of the things economists say that other people don't seem to recognize is that incentives are important. And I don't know whether people you've talked to have recognized the incentive value of inequality, but that's got to be something that economists say all the time and they need to say it, because others don't seem to recognize it. And incentives matter in kind of subtle ways. It may be obvious that people who get more education make more money, but if you want to create incentives to get more education, then you do that partly by providing them with more money. One of the arguments in favor of redistributing is that you can argue that, look, some of those returns don't reflect productivity. Is it really true that of the people who make the most money, at the very top – people making more than a billion in year, half of them are running hedge funds. Is a hedge fund really doing something very valuable? There's certain investment strategies that people put tremendous amounts of money into and some people are good at. Are those investment strategies really contributing to the public good? It's possible to show that certain kinds of investment strategies even when they're very profitable, are essentially transferring money from people who don't do things as well to people who do do things as well. It's what economists call zero-sum games. And those resources of the people who get it, who do that really well, are basically resources they're taking from others. Now, as to whether how much high incomes are a function of people undertaking that behavior, have you ever heard of rent-seeking behavior? Rent-seeking behavior is what I've just described. It's the sort of term that economists use when I undertake some kind of behavior that gets benefits to me simply by removing those benefits from someone else. Its in contrast what economists focus on and think is dominant in the economy, where when I get resources, when I get rich, I'm doing something that's providing value to someone else. So when Bill Gates runs Microsoft, he gets extraordinarily rich, but on the other he's providing a service. If he didn't exist, would other people be better or worse off? Bill Gates might be a slightly controversial example, but one could certainly make the argument that the software work he did, did make the world better off and of course it made him very rich. If you do something that's valuable – if the difference between the very rich and the average person is that they produce something that's really valuable, then the argument for removing that inequality is much smaller. If on the other hand, the very rich just figured out how to steal better and more successfully than others… have you seen the movie the Wolf of Wall Street? That's rent seeking behavior. Here's a guy who's making close to 50 million a year at one point, and all of that was essentially being stolen from others. Just really clever stealing. If the very richest people are making their money that way, then it's not very hard to say that taking their money away from them would be bad. And so what he's doing is formally – the economic expression is rent seeking behavior – in contrast to what you might say is productive activity.

JA: So it definitely matters what assumption you look at these issues with in terms of how people are making their money.

PM: it matters a lot in terms of how you think about inequality, and certainly how the average person thinks about inequality. One of the theories of what's caused increasing inequality is that technology has changed and its made it more valuable for people like bill gates to be working and made them more productive. And so when they get lots of money, it's just a reflection of the high productivity those people have in an environment, which has changed and made them more productive. We want to encourage people to be like that. All those entrepreneurs – the thousands of companies that do software things that start up every year – a few of them are really successful. Those high returns for being successful are what incentives those people. Its good for those of us that aren't doing it too, if what they're doing is productive activity. On the other hand, the more people who do what the wolf of Wall Street does, and get very rich that way, it actually makes us poorer. They're just stealing from us. So with rich people, which is the dominant model? If almost everybody who gets really ,really rich is doing so by rent seeking behavior that's very easy to say not a bad thing to just take their money away from them. But if almost everyone is doing something that's productive is very rich, then its much harder to justify higher taxes. Not impossible, but harder. And it does depend very much whether you think Bill Gates – and all of the people who work and produce things like software entrepreneurs – if all those people would have been willing to work hard if you taxed them at 75 or 80 percent. We used to have tax rates that high. Then you can say okay, that's a society that still has a value on production. So even if you believe that the very richest people are usually productive, if you believe they're productive in ways that wouldn't be influenced by taxing them more, and then you can justify taxing them. It's not a justification that everyone buys, but it's a justification that many people do. You can say, well Bill Gates may actually be that productive, but he still doesn't get to keep all his money because even if you give him only a third as much money as you gave him, he would still be awfully rich and would still have worked just as hard as he worked. If you're a libertarian, then taxation is theft. You say, if Bill Gates was that productive, then he deserves that money. There are a number of divisions. The libertarian view really says that you deserve what you get. A social welfare analysis says that the only justification for having really high incomes is if you create incentives to be productive.

JA: So bringing up political views, like libertarian, when journalists are covering these issues, do you think it's important that this issue has some polarization? Or do you think you should cover this issue without polarizing it politically? If yes, how do you do that?

PM: Well, of course journalists survive by making things controversial, right? Some things shouldn't be as controversial as they are. I would be in favor of just trying to get the background straight, and figure out how things are changing or have changed and what the arguments are for the various sides. In the US, you have sort of picking two opposite sides. A recent paper by the Harvard economist Mankiw said what's happening, the reason we have more inequality, is because of the technology we have more people who are really productive and make us all better off, even though those people are really rich. He talks about those people, and he is one of those people. He makes a few million dollars a year off taxes alone. So he's in a different class than any academic. And then there's Krugman, who of course won a Nobel Prize. He says what's happening is that we've just let the economy go crazy. We've let the rich get richer because our institutions have shifted to just pay off the people at the top. The reason that inequality has increased isn't because technology has changed, but because we have different institutions than we had 30 years ago. He's absolutely right. We have fewer unions. Unions are less important in the economy than they were 30 years ago by a lot. And he says norms have changed.

The only thing – if you're making $250,000 – if you were making that kind of money in the sixties, you would view yourself as rich. Now if you're making $250,000 a year – in fact, there was a politician who said you're middle class if you make that. Middle class is up to $200,000 a year. Now you may know that $200,000 is about four times the average income in the US. So if you're going to say someone is middle class at up to four times the average, that's interesting definition. But the person making $200,000 a year can look up at the contrast to the situation that was in the 1960s. there are probably two or three times as many people making more than you, many of them a lot more than you. And so what Krugman says is that everyone has shifted around, and money has become all that's important. The doctor who used to think about serving his patients, he's realizing that he's not an elite and he needs to figure out a way to make more money and do things differently. You can see how the Krugman versus Mankiw argument is sold. I've sort of jumped around, I'm sorry.

JA: That's okay. I actually have two follow up questions to that. You brought up the middle class, and sort of this skewed definition, so how would you define the middle class or do you think this middle class even exists as people imagine it does? I'm also getting from you that journalists really need to understand the economic science behind these issues when they're covering them. Is there anything else journalists can do to improve their coverage?

PM: The first question – I'm not going to be able to really give you a definition. People tend to have a definition of the middle class, and it's people sort of like them. It's a person making $150,000 or $200,000 a year view themselves as middle class. I talked to someone who was living during the 1930s, in the great depression, living in a two acre, beautiful mansion in a suburb of New York. I know that her father was making $10,000/ year, which is probably between five and 10 times what the average person was making in the 1930s. They had servants. What did she say? Well, we were middle class. We weren't rich. We were just getting along.

It's absolutely true that if you define the middle class - I've talked about numbers, and every number you'd want to adjust for inflation – a person in the 1930s making $10,000 per year is more like a $100,000 per year accounting for inflation. But if you take a given gap around the average, the mean or the median, then that's going to have fewer people. If someone is saying that middle class is declining, that's a definition of income dispersion, and it's not clear how meaningful it is other than to say that there's increasing income dispersion. I'm not saying people don't argue about what the middle class is – politicians will do it, people who don't know any better will do it, and journalists will do it because other people are doing it. But I would push against it. It's about the least useful sort of argument you can come up with. I can't really answer the second question, but you get a sense that I have a sort of feeling about the sorts of mistakes. I guess redefining class is one of them. And the first thing I said, which is that there's always been a lot of inequality. There was never an age where pretty much everyone was earning the same.

JA: So just to sum up what you're saying since this project is direct at journalists, what I hear you saying is that journalists just really need to educate themselves about the science behind these issues. That there's a lot debate behind more arbitrary concepts, like what is the middle class, is income inequality good or bad, and you're saying these issues have always existed, that these might not be the real discussions. Is that correct?

PM: Yeah. Whether it's good or bad I think is a legitimate question though, just a complicated one. What the middle class is I don't think is a meaningful question.

JA: And then is there a meaningful question you think journalists should be asking that they are not?

PM: I think what's caused increasing inequality is a very meaningful question. I tend to think that technological change is quite important, but Krugman is quite explicit that he thinks it's not. I think he's wrong, and Mankiw argues the other side strongly. But increasing technology and changes in technology, I do think are important. One thing to keep in mind is that if you give an explanation that's really focused on American institutions, you probably want to think for a while about whether the trend you're talking about has only occurred in the US. In fact, inequality has increased throughout the world in all the developed countries. It's increased more here than in other countries, but it's not something that's unique to the US by any means. That's part of the reason I think technology is part of the explanation. Technology has shifted around the world. Institutions have also shifted, but not as dramatically.