Saku Aura, Associate Professor of Economics at the University of Missouri

Interviewed by Christian Clark

CC: Do you think there is a problem with the level of economic inequality today, and what is your overall assessment of it?

SA: So the biggest channel, which I think it's a problem, is that it's first of all, obviously, it's a problem that some people in our society have better economic resources. That's a traditional why we care. You care about people in poverty. The second reason why I think it's a problem is that it's self-perpetuating and it deals with the political process because people with more money have a lot more influence, but that's really almost a political science reason rather than an economic reason. I mean, if everything else is equal and someone gets more money, that's a good thing for society. But if that means if we also deal with decision-making that more rewards those people that have money, that's a problem. That's why I worry about it. We have had quite a dramatic change in income distribution over the last 30 years, and you might argue that has led to guilty political processes along the way.

CC: Have you seen a significant change in the middle class over the last decade, decade and a half?

SA: Significant change, it's actually longer. It's more like three decades. First of all, people have kind of killed their view of middle class. But if we define middle class literally in the median of the income distribution, then the evolution of their incomes has been stagnant for three or four decades now. A lot of people define middle class more casually, where you think people like doctors and lawyers and faculty and people like that are middle class, but that's actually not middle class. We're talking easily the upper quartile and even the top decile of income distribution. And that part of the distribution has done much better. Really the story of U.S. income distribution over three or four decades has been the higher up in the income distribution you are, the better you've done relatively.

CC: How do you personally define the middle class?

SA: I would think that probably the literal one is the most objective one to use. But then we have to start thinking a little bit. We have to then refresh our view of who we think of as middle class. This is more elementary school teachers or people who are working in manufacturing jobs and those like that. That's the bulk of middle class and not necessarily the lawyers and the doctors.

CC: What do you think are some reasons that have gotten us to this point in terms of income inequality?

SA: There's a very logical economic literature on this. The two main arguments that have been put forth: First there's an argument about trade and how trade has eroded high paying, relatively low skill jobs from the U.S. That's somewhat controversial and most economists tend to think trade overall is a beneficial thing for society, but there's an argument that it's negatively impacted income distribution. The second main argument is for most of the story, save for the very rich, is something called skill bias technological change. Really since the 1970s, the process in the economy, the production and whether the U.S. produces value added has changed in a way that more skills, more education — the higher the returns of those. So basically it's been a market process where specialized knowledge that requires a large educational investment has been rewarded, and these traditional low skill jobs — I don't want to call them low skill jobs, but (the wages of) lower skill requirement jobs have been quite stagnant. The benefit at the very, very top is there have also been a huge change in capital markets and the competition in the financial sector. That has changed the sort of the top one or two percent of the income distribution. There's also been some tax code changes. But those are probably quite minor in their effect compared to the actual processes that happen in the economy.

CC: What kind of tax code measures?

SA: If you took a really long view, tax code is still a lot less progressive than it was in the 1970s or even the early 1980s. There were some dramatic changes in tax code over Reagan years. The progressivity has slowly crept up so it was a little higher in the Clinton years, then Bush years, then Obama has increased the progressivity a little. We're still not back where we were in the 1970s, but very few people, and I count myself in those people, would not want to go back that far. What I'm saying is that tax code and conscious policy measures have not been the big players. It's more sort of how the world has changed, not how the policies have changed.

CC: I understand what you're saying, but can you help me understand what it was like in the 70s?

SA: So in the 70s, the top marginal federal tax rate, if I remember correctly, was 50 (percent). I think now it's 38 (percent). I should double-check that. Regan cut it to 28 (percent), so that was huge — I might be off with those numbers one percentage either way. So the U.S. federal income tax when you just look at the top marginal tax rate would look more like the continental European income taxes before the early 80s, then it sort of really — the U.S. and the United Kingdom sort of had major reforms. All the other countries followed much later and much less drastically.

CC: The biggest economic theory during Regan's tenure was trickle down theory. Do you agree with trickle down economics?

SA: The joke is that it's too early to tell. The idea of trickle down economics is kind of a sound byte in the sense that there is a token of truth to it, but like any political slogan, it's went way, way too far. It's entirely possible that you have tax code that is too punitive of labor and people who are working hard and investing, and by cutting taxes you increase economic activity enough that's beneficial for most people. That's the idea of trickle down economics. What is generally refuted is a related idea that Reagan pushed. The idea is that by cutting taxes, you can generate more tax revenue. That idea — that tax cuts could increase tax revenue, which is often cited by conservative politicians — is generally viewed as mostly implausible under sort of scenarios. There are some very specific scenarios where there are contemporary counterexamples, but when we talk about general levels of tax nobody believes that cutting taxes can increase revenue.

CC: How would you assess the media's coverage of economic inequality?

SA: Nobody was paying any attention to it until pretty much Occupy Wall Street. There was kind of a blind spot to it and now once again it's been in the headlines again for several years. It's like media coverage of everything. Media has a tendency to often basically just tell good stories rather than provide facts. So while it's important to communicate to people human faces about poverty, if you just — a lot of newspapers have long stories about poverty. They don't necessarily have much analytics behind it. And like it or not, there's always going to be poverty in society. It's not clear you truly informing the readers or the viewers when you basically focus solely on the human interest side and not on the cold facts on what has happened over decades or different places. I wouldn't say all of it is like that, but that's often a problem. And then, a good example is that there was this very influential book by Thomas Pikkety that was published last spring. The discussion sort of gets sidetracked — some people are arguing over whether what Pikkety did was wrong or right instead of the bigger problem that it's sort of been personalized over Pikkety, and not about the bigger problem, which was the inequality.

CC: What are some of the cold facts or ideas that you would like to see worked into the media stories more?

SA: One of them, which I think has been covered a lot, is the fact that both the stagnancy of the incomes of the middle class and the people below, and sort of what I would also probably want be more highlighted, although this goes somewhat against what I said earlier, is to make people truly understand what it means to be a single mother trying to raise a child while you're receiving a ton of benefits and complying with a ton of requirements. Not necessarily a human interest story, but the cold hard facts along the lines that this is how much a typical family in this situation spends on both the monetary and time resources in these ways. One of the things, which have been brought up by several economists lately, is that for a lot of families, money is not the only constraint that truly matters. It's also time. If you're a single mother, you don't have much income, you have to comply with the requirements in the welfare system and you have to find some place for child-care arrangement. You don't necessarily have transportation, and to sort of understand

and get a complete picture of what this life is like, so it can be more understood by the larger section of the population.

CC: Should we reverse this trend? If so, how?

SA: This is one of the things that I highlight when I teach public economic classes. We look at some numbers that indicate progressivity of taxes, or income inequality distribution, and if you compare across the industrialized nations, the U.S. sometimes looks bad in some sense. The size of the government is not something you can say is good or bad, but you can say that we have a very non-progressive tax system, we have a fairly small government, and we have income inequality. The flip side of it is that the U.S. is by far — if you leave some small, particular countries out of the comparison such as Luxembourg — richest when we look at cross domestic product per capita. Most economists think that there is a trade-off between the level of economic activity and how aggressively you want to pursue egalitarian tactics to make the income distribution more equal. People typically think that's a political choice, and in the U.S. it seems quite a large portion of the population is fine with the choice being made currently. If you ask how that could be partially fixed, I could tell you could have more aggressive, progressive tax system. You could go more aggressively after capital income. You could go more aggressively after corporate income tax bases.

CC: What do you think that would do to the U.S. economy?

SA: It would presumably lower our growth for at least some of those measures. It would probably have real cost in terms of future economic growth and employment. So there are no free lunches in society. That's basically what I'm saying. If you take a very long view, then there are things you could do. There I'm thinking of like — this is an extremely long view — there is quite a lot of argument lately that universal pre-kindergarten programs targeting lower socioeconomic status children might have long-term effects on their educational attainment and then later on their labor market prospects. Another thing which actually clearly the U.S. could do better than it currently does is the K-12 education system seems to be geared toward getting everybody into college and the non-college bound students are at best given some sort of paraprofessional training in high school while a lot of other industrialized countries have starting from grade nine or 10, there are sort of more paraprofessional training that is given in K-12 schooling that leads to better earning potential than a high school diploma. Those kinds of programs — the non-academic side of K-12 education has always ben an ugly stepchild in the U.S. That's one area where we should clearly do better in the long run. Those are sort of the least controversial types. Taxes could have an effect quite soon but it would probably come at very high costs, especially if you do something drastic. I hope in the longer run we do something mostly about our education system. That's the easiest part to fix, although it takes a very long time.