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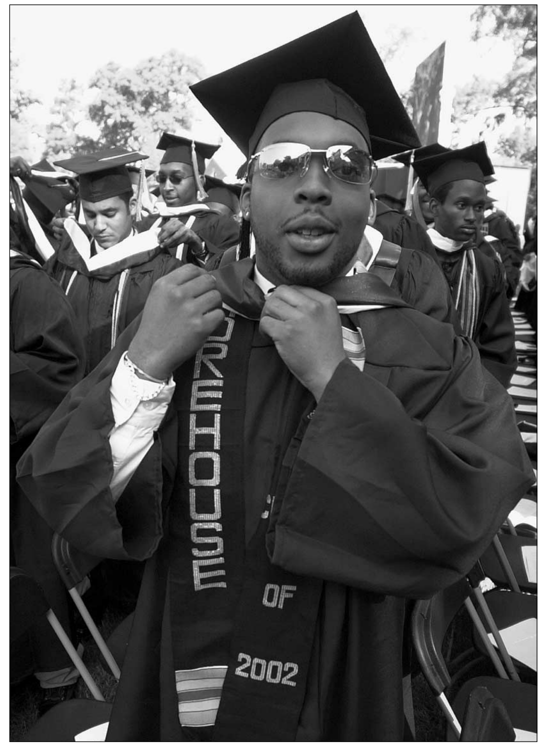
Upward Mobility

Does income inequality threaten the American dream?

Wealth has become more concentrated in the United States, with the top 1 percent of households now commanding a bigger share of the nation's prosperity than at any time since the 1920s. Average middle-class family incomes, meanwhile, have been mostly stagnant for more than 30 years. As the gap between the rich and everyone else grows wider, some sociologists and economists worry that the "Horatio Alger" dream of economic success through hard work and merit is dead and that getting ahead now depends mostly on your family's affluence, education and social connections. Others say living standards are rising for nearly everyone, newcomers still can find their fortunes here and middle-class Americans live better than their parents did. President Bush, meanwhile, is encouraging wealth creation, but critics say his "ownership society" proposals pose greater economic risks and won't help spread the nation's good fortune to all.



College graduates like David Hughes typically earn 50 percent more than workers with a high school diploma. But tuition increases are making it tougher for poor students to go to college.

INSIDE THIS REPORT

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Cover: College-educated Americans like David Hughes, a recent Morehouse graduate, typically earn 50 percent more than their peers with a high school diploma. But tuition increases are making it tougher for poor students to go to college. (Getty Images/Erik S. Lesser)

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Upward Mobility

BY ALAN GREENBLATT

THE ISSUES

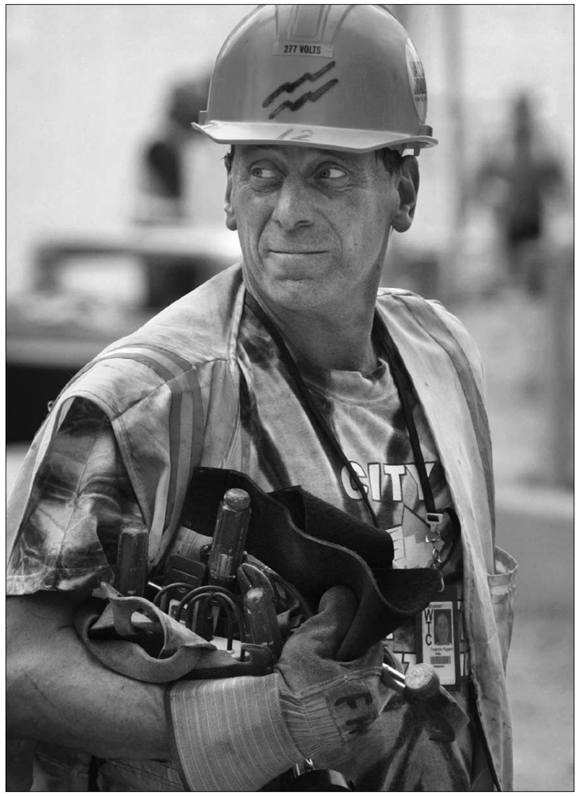
Jack Haugsland has gone farther than he ever could have dreamed while growing up next door to his father's service station in Madison, Wis. "We had gasoline fumes 24/7," he recalls.

Haugsland twice dropped out of college to come home and help with his four siblings. Between stints at college and in the Army, Haugsland drove a Greyhound bus for more than 10 years.

It wasn't a terribly promising start, but after he became a union representative, he was offered the chance to work as a manager himself. He soon began climbing the corporate ladder, bouncing around the country and even running a Greyhound operation in Saudi Arabia. For the past decade, Haugsland, 65, has been Greyhound's chief operating officer — the No. 2 official at one of the nation's largest transportation companies.

"You sometimes have to recognize opportunities and have the initiative to take advantage of those opportunities," Haugsland says. "A lot of time that takes a lot of extra effort and work."

Haugsland's story is just one more retelling of the American dream: dizzying success by dint of hard work. Stephen Girard and John Jacob Astor became America's two richest men during the early 19th century after arriving as immigrants without any special connections. [1] In our own time, real-life Horatio Alger stories continue to be written. * Ray Noorda, the son of a janitor, loaded rail cars as a young man but eventually became the top officer at Novell Corp., accumulating a $500 million fortune. [2] In his 2004 book *The Working Poor*, journalist David K. Shipler



Getty Images/Chris Hondros

Union construction jobs were once a ticket to the middle class. But as union membership has declined, good-paying construction work increasingly is going to immigrants willing to accept less pay and fewer benefits.

recounts how his grandfather got an 8-cent-an-hour job on the Jersey City docks and rose to become president of Bethlehem Steel's steamship lines. [3]

But now Shipler, along with many economists and sociologists, worries there aren't enough new names being added to the list because of growing income inequality. The richest 20 percent of Americans are watching their incomes rise at much faster rates than the rest of the population. For most people, that makes the ladder to success much steeper and harder — or at least no easier — to climb.

"A growing body of evidence suggests that the meritocratic ideal is in trouble in America," according to *The Economist*, a British news magazine. "Income inequality is growing to levels not seen since the Gilded Age, around the 1880s. But social mobility is not increasing at anything like the same pace." [4]

In 2000 the average income of the top 1 percent of American households was 189 times that of the bottom 20 percent, compared to 1979 when the top was earning 133 times as much. By 2001, *The Economist* reports, the top 1 percent of American households earned 20 percent of the income and held 33.4 percent of all net worth — their biggest slice since the 1920s. [5] Meanwhile, the middle class' share of total income was the lowest it had been for a half-century. [6] The disparity in wealth (tangible assets such as stocks, bonds and property) is even greater than the disparity in income.

"Everyone agrees that income inequality has gone up," says Katharine Bradbury, a senior economist at the Federal Reserve Bank of Boston. "[But] a lot of people argue that we don't have to worry about this because there's a lot of mobility — that the gap doesn't matter as much if people who are poor don't stay that way long."

Sociologists generally measure social mobility by comparing how many individuals move from one income group to another. For example, someone in the lowest 40 percent of income in 1990 might have reached the top 20 percent today.

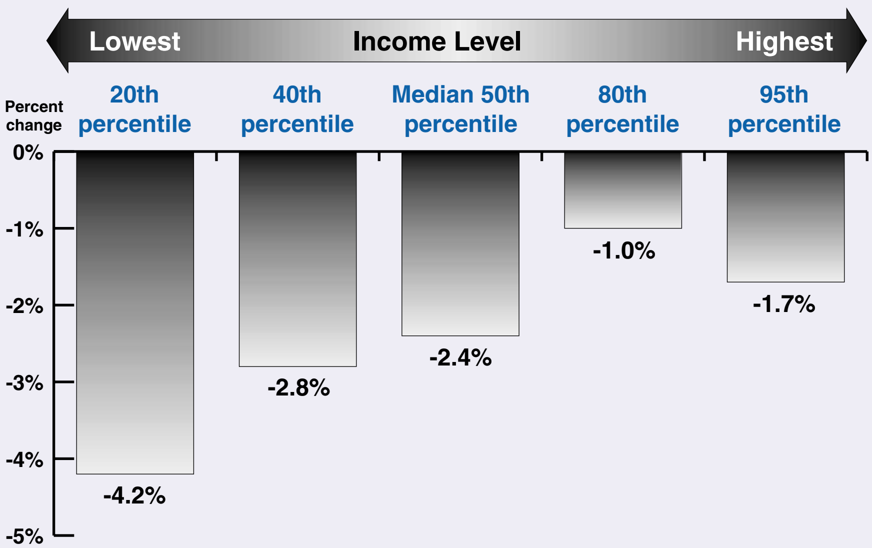
However, Bradbury's research shows that people no longer are moving up as much as before. During the 1990s, 40 percent of families stayed within the same income bracket that they

* The heartwarming stories of American author Horatio Alger Jr. (1834-1899) promoted the "American dream" — that any poor but deserving boy, armed with industriousness and ingenuity, can become successful.

Poor Lost Most Income During Recession

Income loss was unbalanced during the recession and jobless recovery from 2000 to 2003, with the greatest losses at the bottom and middle of the income scales than at the top. The largest declines occurred among the 20 percent of American families with the lowest incomes.

Change in real income, 2000-2002



Source: Lawrence Mishel, et al., The State of Working America, 2004-2005*, Economic Policy Institute, based on Census Bureau data*

started the decade in, compared with 37 percent in the 1980s and 36 percent in the 1970s. “Basically, people were somewhat more stuck in the ’90s than they were in the ’70s,” she says.

Several other studies reach similar conclusions, although it is notoriously difficult to gauge the success of groups of individuals and families across long periods. Most sets of numbers don’t show a great deal of change in the number of people moving up in income class today compared with 20 years ago, but there does seem to be a slight downward tilt.

Still, even if people aren’t moving up in rank, their living standards are improving over time. “By global or historical standards, much of what Americans consider poverty is luxury,” Shipler notes. “Most impoverished people in the world would be dazzled by the apartments, telephones, television sets, running water, clothing and other amenities that surround the poor in America.” [7]

Some conservatives, such as W. Michael Cox, chief economist at the Federal Reserve Bank of Dallas, maintain that rising living standards mean that even if some Americans are not as well off as others, everyone is doing better than they once were. Cox points to improvements in medicine, technology and the availability of cheaper consumer goods — thanks largely to trade globalization — in arguing that today’s poor are better off than even the upper middle class was 35 years ago.

The poor also receive the lion’s share of benefits from social programs funded by upper-income taxpayers, Cox points out. According to the Heritage Foundation, the top fifth of U.S. households pay 82.5 percent of total federal income taxes and two-thirds of federal taxes overall. The bottom 20 percent pay only 1.1 percent. [8]

Still, Shipler maintains that today’s working poor lack the financial cushion enjoyed by those with higher incomes and are just one failed car engine or bout of bad health away from losing their homes or their livelihoods.

Moreover, other observers say, the 1996 welfare reform law, which ended uncapped cash entitlements and imposed work requirements on recipients, hasn’t lifted people out of poverty because it did not provide sufficient support services such as child care. [9]

“We’ve turned the welfare poor into the working poor, but we haven’t helped their kids go to better preschools or reduced dropouts,” says Timothy M. Smeeding, director of the Center for Policy Research at Syracuse University’s Maxwell School. “We’re not increasing mobility in any real sense.”

Meanwhile, middle-class Americans also feel their jobs are more tenuous, thanks to new technology, the “downsizing” trend of the late 1980s and the globalization of the work force. During the 1980s and ’90s, U.S. companies eliminated a large number of middle- management jobs, creating more streamlined operations but fewer chances for advancement. [10] Today, many good-paying manufacturing jobs are being sent overseas, as are many of the high-tech jobs that were supposed to replace them.

“The pressure is going to be on the middle class, to a significant extent,” says Richard Freeman, a Harvard University economist and director of the labor studies program at the National Bureau of Economic Research. “Any job that has a lot of digitalization is at risk in this country. How are you going to get a wage increase if you’re competing with [lower-wage workers] overseas?”

However, Cox and other economists across the political spectrum maintain that education still is a readily attainable tool for any American seeking to get ahead in today's economy. And that fact alone, he says, makes upward mobility easier to attain than it once was.

"A hundred years ago, with the Industrial Age capitalists, to break into the top you had to have money from other generations," Cox says. "But there's a democracy of consumption in education. Anybody who goes to school and listens to the teacher is going to get ahead in this country."

Today's college-educated workers receive a larger wage premium over their high-school-graduate peers than their predecessors enjoyed 25 years ago. Frank Levy, an economist at MIT, says during the 1970s college graduates at age 30 could expect to make about 17 percent more than their peers who only finished high school. But as the industrial Midwest turned into the Rust Belt during the 1980s and many well-paid union jobs disappeared, Levy says, the wage premium for college graduates spiked to about 45 percent and has remained nearly constant since. [11]

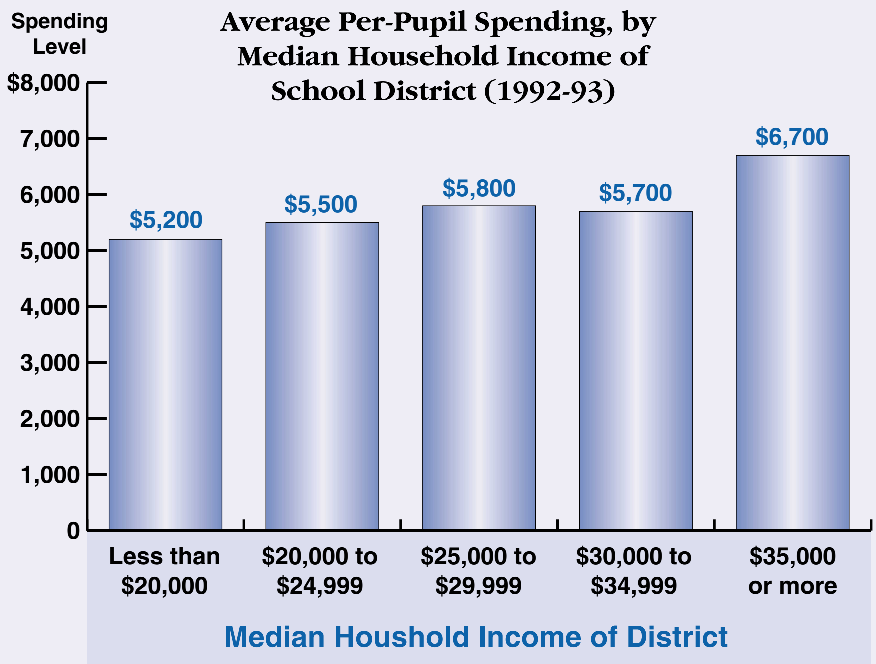
"Some form of higher education is now a prerequisite for middle-class success," Levy says.

The percentage of Americans who have graduated from college is higher than ever, but it's hardly universal: In 2003, only 27 percent of Americans 25 or older had college degrees, according to the Census Bureau. [12]

What about the remaining three-quarters of American adults? They may be out of luck, if you believe the more pessimistic observers. "There's basically no career ladder for people with modest levels of education," says Ruy Teixeira, a fellow at the Center for American Progress and the Century Foundation. "The best they can hope for is to land one of these low-level blue-collar jobs, and there are fewer of them."

Wealthy Districts Get Most School Funding

Spending on education is typically higher in wealthier than in poorer districts, largely because most funds for public schools are raised through local property taxes. Thus per-pupil spending in 1992-93 in districts with median household incomes above $35,000 was 27 percent higher than spending in districts with median incomes below $20,000.



Source: U.S. Department of Education, 1997

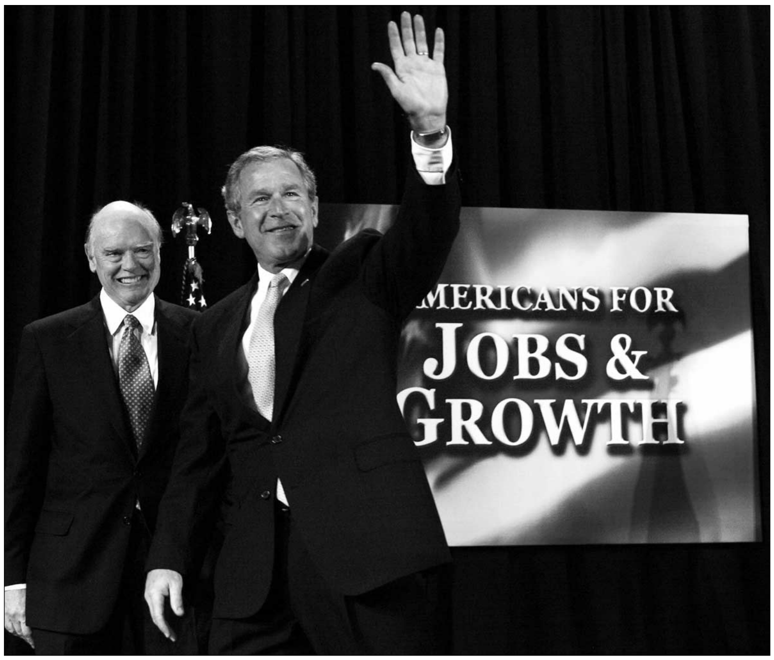
Making matters worse for blue-collar workers, real wages for high school graduates and dropouts alike have fallen since the 1970s. The fastest-growing job categories either require a college degree, such as teaching and nursing, or offer limited opportunity for advancement, such as customer service representatives. [13] "The whole thrust of the information age has been to reward education and widen the income gap between the educated and the uneducated," writes *New York Times* columnist David Brooks. [14]

The dark side of a meritocracy is that not everyone is good at the things that are rewarded with good pay. "The transition to an information economy has put a premium on people who are comfortable manipulating symbols and language, no question, and that has driven some income inequality," says Joseph Bast, president of the Heartland Institute, a research center in Chicago.

But the American entrepreneurial spirit is alive and well, Bast argues, and many people without highly specialized skills are moving up the managerial ranks in a handful of growing fields, such as health care. Real buying power and household income are still on the rise, he says, citing various Federal Reserve Bank studies that consider benefits and other factors that are not generally included in surveys of inflation-adjusted incomes.

And even the more pessimistic Teixeira says most people are still getting ahead, even if they can't hope to catch up with the wealthiest Joneses. "People perceive less security than they used to, even though, on average, they're living better than their parents," he says.

Many Americans believe they can beat the odds posed by growing inequality. They look upon the high incomes, large houses and fancy playthings of the wealthy not with resentment but with hope that eventually they'll share in such bounty. "All I can think of is, like, wow, I'd like to have this stuff some day," said Lori, a 24-year-old who has $8,000 in credit card debt, about the houses she cleans for a living in Maine. "It motivates me, and I don't feel the slightest resentment because, you know, it's my goal to get where they are." [15]



AFP/Paul J. Richards

President Bush says his "ownership society" program would help people to invest and manage their own money, but critics say the wealthy would mainly benefit. Treasury Secretary John Snow is at left.

As people debate the state of economic equity in this country, here are some of the specific questions they're asking:

Has social mobility declined?

Given the disproportionate growth in income enjoyed by top wage earners, as well as the upper class' greater share of the nation's wealth (savings, stocks, bonds, real estate and other investments), no one doubts that income disparities between the rich and everybody else have grown in recent years. But there's plenty of argument about how much that matters.

If those at the bottom and middle are still able to move up, income disparity is a temporary condition that is not too troubling. But if people don't have ready advancement opportunities, income inequality could lead to permanent class stratification — something no one wants in a democratic society.

Finding out whether people are still getting ahead, however, is tricky because it is difficult to track individuals across 20 or more years of their working life to find out whether they've advanced from where they started out. It's even harder to get a sense of how far children advance as adults relative to their parents.

"Social mobility is one of the hardest questions to get firm, empirical evidence on," says Jeff Madrick, director of policy research at the Schwartz Center for Economic Policy Analysis at the New School for Social Research and editor of *Challenge* magazine.

Cox, at the Federal Reserve Bank of Dallas, says survey information compiled by the University of Michigan shows that there is still plenty of economic mobility in the United States. "Only 5.1 percent of the people who were at the bottom [income level] in 1975 were still there in 1991," Cox says.

More anecdotally, he points out that the ranks of the super-rich are no longer closed off to all but the children of the wealthy. Citing statistics from *Forbes* magazine's annual roundup of the 400 richest Americans, Cox notes that in 1984, 146 of the richest 400 Americans attained their positions through inheritance, but by 2003 it had declined to 63.

"One hundred years ago, we had much less mobility between the income classes," he says.

But researchers at the Economic Policy Institute (EPI), a liberal think tank, say family income mobility slowed somewhat between the 1970s and '90s. The share of the population moving from the bottom fifth of the economic ladder to the top two-fifths declined, while the share of families in the top fifth grew. [16]

The change in both these sets of numbers may be slight, says Jared Bernstein, co-director of research at EPI, but they are heading in the wrong direction. "You're starting out further from others, and you're no more likely — in fact, less likely — to jump across that space," he says.

Christopher Jencks, a professor of social policy at Harvard University's Kennedy School of Government, says an individual's chances of bridging the income gap haven't changed much in recent decades. It may be hard to move up, but it's not any harder than it was a generation ago, he says.

Continued on p. 376

Will Bush's 'Ownership Society' Help the Poor?

As the centerpiece of his domestic agenda, President Bush wants to create an "ownership society" by increasing Americans' investment and wealth. To do that, he proposes cuts or outright elimination of federal taxes on income, savings, stock earnings and dividends, health expenses and inheritance. Most controversially, Bush wants to let workers shift part of their Social Security payments into "personal accounts" holding investments in stocks and bonds.

"We will widen the ownership of homes and businesses, retirement savings and health insurance," Bush said during his inaugural address in January. "By making every citizen an agent of his or her own destiny, we will give our fellow Americans greater freedom from want and fear and make our society more prosperous and just and equal."

Glenn Yago, director of capital studies at the Milken Institute, an economic think tank in Santa Monica, Calif., sees Bush's agenda as part of a presidential continuum, noting that Thomas Jefferson and Abraham Lincoln also were great promoters of ownership, encouraging the settling of the interior through land grants. "For the longest time in the U.S., proprietorship was key to being a part of the polity," Yago says. "The ownership-society debate is really not just about income distribution, it's about asset distribution as well."

Bush's program would give individuals more power to make their own economic decisions. While it's hard to find anyone opposed to that idea in theory, many critics worry that millions of individuals won't be able to rise to all its possible challenges.

"You're moving from a situation where you're pooling risk to a situation where you're putting more of the risk on individuals," says Frank Levy, an economist at the Massachusetts Institute of Technology. Levy argues that, given the other macroeconomic challenges ahead, such as increased competition from China and India and continuing changes in technology, the workplace is becoming more uncertain. Given the uncertainty and accompanying risk, he says it's unreasonable to ask America's workers to adapt and accept responsibility for their own retirements.

Levy and others argue that Bush's goals are unrealistic because many Americans have trouble meeting their current bills, let alone putting enough aside for the future. Two years ago, Bush proposed two new types of savings accounts that would have allowed people to shelter more of their income from taxes, with a limit of $7,500 per person — more than double current limits on Individual Retirement Accounts (IRAs). But fewer than 10 percent of Americans put away the maximum amounts allowed by current IRA and 401(k) plans. [1]

According to David Wright, a sociologist at Wichita State University, the top 1 percent of Americans owned 51.4 percent of all stocks, and the next 9 percent owned 37 percent. The bottom 90 percent only had 11 percent of the shares between them. Most Americans not only don't control sizable portfolios but aren't good savers either. Savings rates have been in decline for a quarter-century. Americans save less than the citizens of any other industrialized country — less than 1 percent of after-tax income in 2004. [2]

Because it protects assets, Bush's plan does have the potential of widening an already deep gap in wealth — savings, real estate and stock holdings — between top earners and people lower on the income scale.

"If you did it in a way that would let low-income people build up a stake, that would be great," says Matthew Miller, a senior fellow at the liberal Center for American Progress and former Clinton administration budget official. But he notes that the Bush plan lacks incentives that would help poor people sock money away — such as the cash payments the British government will soon set aside for all its young subjects. "The way the president has laid it out, it's basically rewarding people who already own everything," Miller says.

Perhaps sensing the greater burden Bush's proposed Social Security changes could place upon them, only about a third of Americans tell pollsters they support the idea. Support for the package seems to go up according to the size of one's income. [3]

Bush and his supporters argue that the ownership society platform has the potential to transform Americans' economic habits, encouraging them to think like investors so that they would not only put more money away but also understand, as Bush said in a campaign ad last year, that "if you own something you have a vital stake in the future."

Richard A. Epstein, director of the law and economics program at the University of Chicago, says the ownership society has the potential to "shake things up," much as Prime Minister Margaret Thatcher did in the England of the 1980s by encouraging wider investment in stocks and housing and overhauling the state pension system.

"It's your account — you can control how it's invested," says Harvey Rosen, chair of the president's Council of Economic Advisers. "This in itself is getting people adjusted to taking control of their financial lives."

But millions of Americans may not be able to take full advantage of the ownership society package. "Too many Americans do not have the skill set they need to become successful, self-reliant citizens in the free-market economy," says Robert Duvall, president of the National Council on Economic Education. "How can you talk about managing their retirement plans, when our studies show that 40 percent of Americans don't know what an annuity is?"

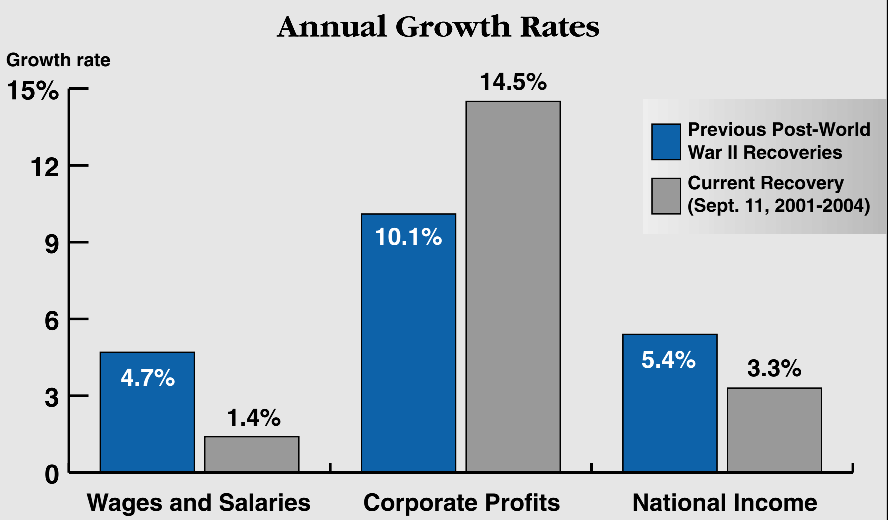
[1] John Cassidy, "Tax Code," *The New Yorker*, Sept. 6, 2004, p. 70.

[2] Drake Bennett, "Spendthrift Nation," *The Boston Globe*, Jan. 30, 2005, p. K1.

[3] See Jonathan Weisman, "Bush Social Security Plan Proves Tough Sell Among Working Poor," *The Washington Post*, April 18, 2005, p. A1.

Recent Gains Lag Far Behind Previous Increases

Worker salaries during the recent economic recovery grew at a slower rate than other post-World War II recoveries, but corporate profits during the recent recovery outpaced previous recoveries.



Sources: Center on Budget Policies and Priorities, based on Commerce Department data

Continued from p. 374

"It's not a story about how we used to be a more fluid, open society and now it's closed down," Jencks says.

Nothing proves that, says Cox, more than the continuing success of long-term immigrants. The poverty rate among immigrants who arrived before 1970 is lower than for the United States overall, Cox says, even though he admits that the poverty rate among recent immigrants — those who arrived after 1990 — is higher than among the population as a whole.

Jencks concedes that because the income gap has gotten wider the stakes for people wanting to move up the ladder have become greater. For some, the fact that the mountain has grown higher means it is now harder to climb. "The difference between the top and the bottom is getting wider," says Smeeding, a professor of economics and public administration at Syracuse, "and wider inequality at one point in time means movement up and down the income-distribution [ladder] is harder because you have to move further."

However, Smeeding says income differences are "just a small part" of the advantages enjoyed by the upper crust and, particularly, their children. Other advantages include wealth accumulation — because upper-income individuals can save more — and the ability to help children pay for first homes and college educations.

John Karl Scholz, an economist at the University of Wisconsin, has done research that suggests children whose parents were able to pay for higher education tend to perform better once they're out in the job market. "Certain kids have a leg up relative to other kids by virtue of what families they're in," Scholz says. "That could be anything from being read to as a kid to the quality of the neighborhood they grow up in."

Both Cox and Madrick agree that education is the key to moving up because of the specialized skills demanded by today's economy. But while Cox says anyone who pays attention in school can get ahead, Madrick is less optimistic. Education, he suggests, is fast becoming an inherited advantage. "It's an aristocracy of sorts, because access to education is through money, mostly because of the need to live in the right neighborhoods" in order to have access to good schools, Madrick says.

"My guess is that probably social mobility has decreased," he says. "If we know there is a greater inequality, a greater distance between the high and the low, and you haven't improved the ability to move from the low to the high or the middle to the high, something in America has gotten worse."

Is the middle class getting squeezed?

The journalist Barbara Ehrenreich once argued that children born into the middle class have less of a guarantee of maintaining their class status than either the rich or poor. "If you are born into the upper class you can expect to remain there for life," she writes. "Sadly, too, most of those born into the lower classes can expect to remain where they started out." Only membership in the middle class, she suggests, is not a matter of birth or background, but effort. [17]

Many economists say the middle class is hollowing out as the rich pull farther away from the poor, and the ranks in the middle thin out. After a long period of income stagnation between the 1970s and the late-1990s, middle-class lifestyles and comfort were propped up in many cases only because more women entered the workforce, creating two-income families.

Still, household debt is rising, as are the costs of real estate, health care and college tuition — each of which is growing faster than inflation. And many employers are cutting benefits for middle-tier workers, including health insurance subsidies and pensions.

As a result, millions of middle-class Americans feel their jobs and comfortable incomes are at risk due to globalization, economic and technological change and the decline of labor unions. Less than 8 percent of private sector workers are unionized today, compared to nearly 20 percent 25 years ago. The loss of a spouse's job can lead to major debt or, sometimes, loss of a home.

"It's not just the lower end — absolutely not — that's facing this feeling that they can't move up," says Beth Shulman, a former union official and author of the 2003 book *The Betrayal of Work.* "Even people making $60,000 can't afford many colleges."

Meanwhile, most states have cut their higher-education budgets sharply in recent years, leading to double-digit tuition hikes and leaving many parents and students wondering whether they can afford the upward-bound ticket of a college degree.

While it is true that college tuitions have been increasing faster than the historical norm, the College Board points out that after inflation, grant aid and education tax benefits are factored in, the average cost of attending a four-year college has actually dropped over the last decade. [18]

"There's no question that lots of middle class people feel squeezed," says Jencks, the social policy professor at Harvard, "but a lot of the reason they're squeezed is that they're kind of committed to a higher standard of living than they can afford, not that they couldn't get by on what they've got."

Jencks says income tends to fluctuate more than it did 30 years ago, another reason people adopt lifestyles that often must be underwritten by borrowing. "The message from the corporate employer community is, don't count on as much stability as you would have had 30 years ago," Jencks says, "yet a lot of people are ignoring that and saving less than they used to, not more than they used to."

Likewise, the Heartland Institute's Bast also doesn't see any real squeeze on the middle class. "People's expectations have gone off the board," but high hopes that don't pan out don't equal deprivation, he says.

The question of whether middle-class workers have more money than they used to depends on what measures you look at, he says. Average after-inflation income went down 8 percent between 1970 and 1998, but Bast argues that if benefits are taken into account as well, the picture looks brighter. "Household income increased dramatically — by 85 percent," he says.

Both Bast and Jencks believe the consumer price index has overstated inflation over the years. "If you measure real purchasing power . . . there's more that people can afford," Jencks says. "If you look at how they're doing compared to the middle class of the past, by most measures they're better off."

Should the government do more to close the income gap?

The idea that government has an important role to play in helping struggling citizens catch up with their wealthier neighbors has been a central tenet of modern liberalism. Not surprisingly, administration critics say that notion has gone out of vogue with conservatives dominating Washington politically.

Instead, the Bush administration is pursuing an "ownership society" agenda that would move government farther away from the business of making economic decisions for individuals. (*See sidebar, p. 375.*) Bush also has proposed cutting programs that specifically help the poor, including Medicaid, housing assistance and community development block grants. Unveiling his fiscal 2006 budget in February, the president said that "the poor and disadvantaged" need to ask whether "programs achieve a certain result. We get tired of asking that question, so finally [we] take resources and direct them to programs that are working."

Even on the left, many Democrats have grown skeptical about the idea of using the government to try to level the economic playing field. Former President Bill Clinton and about half the congressional Democrats supported the 1996 welfare reform law, which ended the entitlement to cash assistance.

"Part of the background of the struggles in the Democratic Party, between Clinton-era people and people to their left, is do they want to go back to the redistributive paradigm," says John Samples, director of the libertarian Cato Institute's Center for Representative Government.

Samples is skeptical that the government can play much of a role in the economic advancement of individuals. "The Constitution does not include a right to an equal, or closer to equal, income or distribution of wealth in the way that it includes a right to freedom of speech," he says.

Setting aside the question of whether government has a role in affecting economic outcomes, Samples and others doubt that the government can smooth out the financial differences between the rich and poor. "Despite massive amounts of money flowing through government in the name of reducing income inequality, this inequality has remained effectively unchanged," says Dwight Lee, co-director of the Center for Economic Education at the University of Georgia.

Government subsidies inevitably are structured to reward those with the strongest political connections, Lee says. "Most money that is transferred is not from the rich to the poor; it is from the politically unorganized to the politically organized," he says. "Can we expect those who have failed in market competition to succeed in political competition? The only reasonable answer is, 'Not very well.' "

However, the federal earned-income tax credit (EITC) program — created in 1975 and expanded several times since — gets kudos for helping the poor. "The earned-income tax credit is one of those rare anti-poverty programs that appeals both to liberals and conservatives, invoking the virtue of both government help and self-help," writes journalist Shipler. [19]

The credit is available to working people who earn less than $35,000 (depending on their marital status and number of children). Last year, 21 million Americans collected more than $36 billion through the program. [20] As a result of the credit, the lowest 40 percent of wage earners have a negative individual income tax burden, according to the Urban-Brookings Tax Policy Center — so they get back more than they put in.

Public education also enjoys nearly universal support. Both conservatives and liberals maintain that the best way government can help citizens is to provide quality public schools and access to higher education. Bush has increased federal spending on education by 40 percent since taking office in 2001, although he has proposed a slight cut this year.

Every state constitution except South Carolina's promises citizens will be provided with an education, and courts have ruled that these supersede other concerns, such as tax limitation laws. [21] Numerous states face billion-dollar lawsuits contending that they don't provide "adequate" public education. [22] Per-pupil spending tends to be higher in wealthier school districts because many districts still rely on property taxes to finance education.

Matthew Miller, a senior fellow with the Center for American Progress, recently published a book, *The Two Percent Solution*, in which he argues that the government could provide far better education and health care through innovative ideas, such as greatly increasing salaries for excellent teachers at inner-city schools, which would cost a total of 2 percent of GDP. "We've lost what ought to be central to our democracy — equality and access to a decent life," Miller says.

Academics have also suggested government-sponsored interventions to lift up all economic boats. Yale law professors Bruce Ackerman and Anne Alstott, for example, in their 1999 book *The Stakeholder Society* called for the government to provide all 18-year-olds with $80,000 for education or other purposes. The idea was to help all young Americans start out their adult lives on a strong financial footing, regardless of their parents' level of wealth. A much-scaled down version of the idea is being tried out in Britain.

Lee and Samples, however, say the government has neither the mandate nor the money to engage in such large-scale social experiments.

In response, Madrick, of the Schwartz Center for Economic Policy Analysis, says the government was once much more ambitious in creating programs to promote the general good, such as universal public education and the GI Bill. The government should return to that model, he argues, to respond to current needs.

"We're the richest society in the history of mankind," Madrick says. "In my view, the government has been widely irresponsible about many issues. We've had the rise of the two-worker family, and yet we still have no serious pre-kindergarten education in America or high-quality day care." (Disagreement over funding for child care has kept the federal welfare law, scheduled to be reauthorized in 2002, from being updated.)

Even Madrick and other liberals, such as Harvard economist Freeman, say the government doesn't have any business trying to rectify individuals' poor economic outcomes once it has provided a good education.

"The government should step aside and let us all compete fairly in the market, with some modest social insurance for those who fare poorly," Freeman says.

But many on the left believe government policy is heading entirely in the wrong direction: The federal tax system is being made less progressive just as the marketplace is producing greater inequalities.

Robert M. Solow, a Nobel Prize-winning economist, said in reviewing one of Madrick's books: "At a time when impersonal economic forces seem to be pushing by themselves in the direction of widening inequality, for public policy to be doing the same thing is not a technical mistake but a moral disaster." [23] ■

BACKGROUND

The Expanding Republic

"Social mobility," writes author Joseph Epstein, "has been one of the preponderant themes in American life." [24] The idea that America is a land of opportunity is more than a cliché: The nation's economic opportunities have extended to millions of native poor and penniless immigrants alike.

Yet America, which once attracted primarily European immigrants seeking escape from the limitations of rigid class structures at home, now has the largest gaps between rich and poor in the industrialized world. The periods of greatest economic growth in this country have generally been periods when wealth becomes more concentrated in fewer hands.

Throughout U.S. history, such periods of growing income inequality have typically triggered political challenges, with the citizenry electing candidates promising a more egalitarian distribution of wealth. "Two kinds of power seem always in competition in

Continued on p. 380

Chronology

1960s-1970s

The long postwar boom gives way to rising oil prices, inflation and stagnant family incomes.

1962
Michael Harrington's *The Other America* exposes poverty during a time of affluence, influences President Lyndon B. Johnson's "war on poverty" programs.

1965
Congress passes numerous "Great Society" programs, including Medicare, Medicaid, Head Start and the Higher Education Act.

1968
Number of U.S. millionaires passes the 100,000 mark.

1975
Congress approves the earned-income tax credit (EITC), in part to offset the burden of Social Security taxes and to provide an incentive to work.

1979
U.S. manufacturing employment peaks at 21.4 million workers.

1980s-1990s

The country's longest period of uninterrupted growth creates new wealth but is slow to raise average family incomes.

1981
President Ronald Reagan convinces Congress to pass the largest tax cuts in U.S. history.

1982
Unemployment rates enter double digits for the first time since the Great Depression.

1986
Labor economists Barry Bluestone and Bennett Harrison contend that three-fifths of the net new jobs created in the economic expansion pay low wages.

1987
On Oct. 19 — "Black Monday" — the Dow Jones Industrial Average loses 23 percent of its value.

1992
Democrat Bill Clinton is elected president after promising to create "good jobs with good wages."

1996
Congress passes a welfare reform law that puts time limits on cash benefits to the chronically unemployed, ending a 60-year entitlement for cash assistance. . . . Advisory Commission to Study the Consumer Price Index finds the index had overstated the U.S. inflation rate for 20 years, exaggerating declines in real family income.

1997
Federal minimum wage is raised to $5.15 an hour; it has not been raised since.

1999
Dow closes above 10,000 mark for the first time. . . . Concerns about EITC abuses prompt IRS to audit tax returns of low-income workers at a higher rate than the returns of the wealthy.

2000s

President Bush begins to shift the federal government's focus away from social-assistance programs and toward creating tax incentives to encourage wealth accumulation.

2001
Congress passes $1.35 billion tax cut, the first of a series during President Bush's first administration. . . . The longest period of uninterrupted economic expansion ends as the country falls into recession.

2003
Bush proposes creating two new types of savings accounts that would allow individuals to shelter $7,500 a year from taxes, more than twice the amount allowed in current Individual Retirement Accounts (IRAs). . . . Number of Americans without health insurance grows for third-straight year, but net coverage falls only for families with incomes under $75,000.

2004
Homeownership rate hits 69 percent of U.S. households, an all-time high. . . . Federal appeals court upholds the "living wage" law in Berkeley, Calif., rejecting the first major challenge to civic ordinances requiring contractors to pay above-poverty wages.

Feb. 2, 2005
Bush's State of the Union address outlines his planned Social Security overhaul, including allowing workers to put up to 4 percent of their income into private investment accounts.

March 17, 2005
Senate rejects proposal to cut Medicaid by $14 billion.

April 13, 2005
House votes for the fourth time in four years to permanently repeal inheritance taxes.

April 20, 2005
Bush signs law making it harder for debtors to file for bankrupty to escape repayment.

America's Blue-Collar Military

When Charles Moskos graduated from Princeton University in 1956, about half of his class of 900 students — its ranks including a future *New York Times* columnist, governor of Delaware and president of Harvard — were drafted for the armed services. Out of Princeton's 1,100-member Class of 2004, however, only nine students have enlisted.

Moskos, a military sociologist at Northwestern University, argues that the military no longer serves as an institution in which all social and economic classes can mix. "That's how the military used to perform," he says, "moving people up the ladder of society and having privileged young people rub shoulders on an equal basis with less privileged youth."

No one denies that today's men and women in uniform are disproportionately members of racial minorities and from working-class backgrounds. "We look at where our soldiers come from and it's Middle America," says Leonard Wong, a professor of military strategy at the U.S. Army War College. "We get the fabric of America, but we don't get the fringes."

But the fact that the children of the wealthy tend not to serve is not necessarily new, says Robert L. Goldrich, a specialist in national defense at the Congressional Research Service. "There have been very few periods in American history when people from elite, Eastern universities served in very large proportions in the armed forces," he says.

David R. Segal, director of the University of Maryland's Center for Research on Military Organization, notes that in colonial times wealthy members of society — such as plantation owners and whale ship captains — were exempted from service in the militias. And during the Civil War, rich Americans could buy their sons out of conscription for $300 (about $6,000 in today's money). [1]

Even at the start of World War II, men from Harvard and Harlem did not serve together (the military wasn't desegregated until 1948), and the elites were shifted toward safer berths. "It wasn't until the end of the war, when they ran out of infantry, that they canceled a bunch of these elite programs," says James T. Quinlivan, a senior analyst with the RAND Corporation, a think tank in Santa Monica, Calif.

During the unpopular Vietnam War, many wealthy and well-educated Americans stopped feeling any obligation to serve. "For the first time, it was chic and righteous in influential power circles not to go to war," writes Myra MacPherson, a historian of the 1960s generation. "Avoiding Vietnam was more of a badge of honor than going." [2]

In 1973, President Richard M. Nixon abolished the draft. By the end of the '70s, the idea of military service had reached its nadir among the nation's privileged classes. "There was one year in the late 1970s when the Army had something like six college graduates join the enlisted ranks in the entire year," Quinlivan says.

While social classes may no longer mix easily in the military, it is still a place where millions of Americans can get a leg up the economic ladder. Lower-income recruits profit from the extensive training and college benefits provided by the services, which spend more than $200 million a year underwrit-

Continued from p. 378

our democracy," wrote Supreme Court Justice Robert H. Jackson during the 1940s. "There is political power, which is the power of voters, and there is the economic power of property, which is the power of its owners. Conflicts between the two bring much grist for the mill." [25]

During the first half of the 19th century, wealth became more concentrated, but tremendous New World prosperity created endless opportunity for all (except African-American slaves) and attracted great waves of immigrants. Europe in 1848 was the scene of revolutions and workers' barricades, but in the United States average people were too busy thriving to engage in such protests.

In the 1850s farm input and property values doubled. Congress' decision to give away public land to settlers — via the Homestead Act of 1862 — led to rapid settlement of the interior and helped turn a struggling ex-colony into a major nation. [26]

The Civil War, although devastating to the South, led to a surge in national income and Northern manufacturing. Annual capital investment in manufacturing jumped from $1 billion in 1860 to $10 billion by 1900. [27] During the late 1880s, a period Mark Twain dubbed the "Gilded Age," enormous fortunes were made by men like J.P. Morgan, John D. Rockefeller, Andrew Carnegie and Jay Gould — all of whom had avoided military service by paying substitutes to take their places and took full advantage of the economic opportunities presented by the war and its aftermath.

Political power swayed between the major parties from the 1870s until 1896, with agrarian third-party candidates running in several presidential elections and several Western states electing populist governors. Discontent over wealth concentration fueled the populism. In 1890, the top 1 percent of families held more than 50 percent of the nation's wealth — up from 29 percent in 1860. [28] Farm income in the 1890s was lower than it had been before the Civil War.

But the economy still grew fast enough to draw millions of newcomers — more than 20 million immigrants arrived on these shores between 1870 and 1910. [29] "The apparent rich-poor ing tuition for programs ranging from vocational/technical training through graduate school. [3]

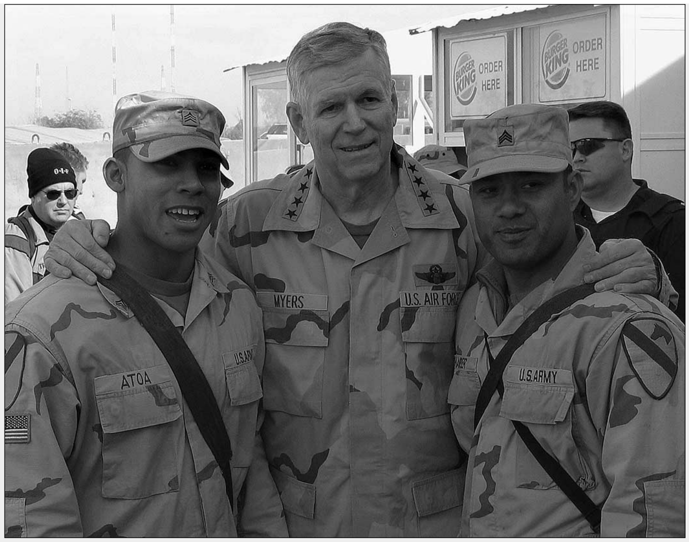
Moreover, in the all-volunteer military, personnel are serving longer, and officers typically are well educated — often holding advanced degrees earned while in uniform.

"If you look at current generals and admirals, most of them do not come from a military background . . . [nor] from the economic upper elite," says Theodore Stroup, former deputy chief of staff of the Army for personnel. "They're from blue-collar, working-class folks and got their college degrees through ROTC, military schools and Officer Candidate School."

But Moskos, Segal and others worry that today's citizenry doesn't feel the same commitment to foreign wars that it might if the children of congressmen and presidents still donned a uniform.

That's one reason public opinion has steadily soured on the war in Iraq, Moskos says. "The country only accepts casualties over the long term when we [also] have the privileged youth serving," he says. In part to answer such concerns, Rep. Charles Rangel, D-NY, has called for reinstating the draft, but President Bush insisted during the 2004 campaign that there would be no draft.

"A citizen who sees and acknowledges the deepening chasm separating those who serve from those whom they serve," writes Josiah Bunting III, president of the Harry Frank Guggenheim Foundation, "can only deplore a civic culture that removes the burdens of military service from those it has blessed most abundantly." [4]



AFP Photo/Rory Mullholland

Gen. Richard Myers, chairman of the joint chiefs, poses with enlisted troops in Baghdad last Dec. 14. The military helps lower-income Americans move up the economic ladder.

[1] Pete Hamill, "The Fellowship of the Ring," *The New York Times*, March 25, 2005, Section 7, p. 5.

[2] Myra MacPherson, *Long Time Passing: Vietnam & the Haunted Generation* (1984), p. 34.

[3] Michael R. Thirtle, *Educational Benefits and Officer-Commissioning Opportunities Available to U.S. Military Servicemembers* (2001), p. 51.

[4] Josiah Bunting III, "Class Warfare," *The American Scholar*, winter 2005, p. 18.

dichotomy concealed a huge engine of upward mobility," writes the British historian Paul Johnson. "The ability of America, led by New York, to transform immigrant millions — most of whom arrived penniless and frightened — into self-confident citizens, wealth creators and social and cultural assets, was the essential strength of the expanding republic." [30]

During this period, one of the biggest media stars was Horatio Alger Jr., who wrote hundreds of novels that are remembered as quintessential rags-to-riches stories of rural youths who overcame hardships to become successful in the big city. In reality, though, many of the stories were about young men who struggled until they came into their proper inheritances.

Depression to Compression

Although the government had taken a largely laissez-faire approach to business regulation during the Gilded Age, at the start of the 20th century social unrest — including violent strikes — led to more regulation. President Theodore Roosevelt, who railed against "malefactors of great wealth," created a Commerce Department to monitor corporate behavior and helped promote the 16th Amendment, ratified in 1913, which paved the way for graduated income taxes. By 1915, many states had passed laws to limit the length of workdays and to require companies to contribute to state insurance plans to compensate workers injured on the job. Some had passed minimum wage laws, and most had passed child labor laws.

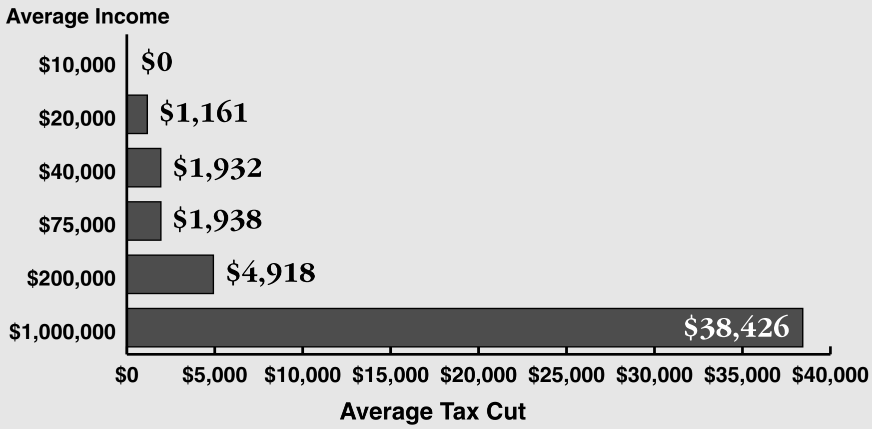
But progressive policies did little to dilute the concentration of wealth, which continued to increase during the 1920s as presidents Warren G. Harding and Calvin Coolidge adopted pro-business platforms. Congress, meanwhile, repealed taxes on excess profits and gifts.

Nevertheless, homeownership and participation in the stock market spread widely, even though average wage levels were stagnant. The young automobile industry accounted for 4 million jobs by 1929, about one-tenth of the work force. [31] Cars "gave farmers and industrial workers a mobility never enjoyed before outside the affluent

Wealthy Benefit Most From Tax Cuts

Income-tax cuts in 2003 saved a two-parent household earning $75,000 about $2,000, or 2.6 percent of the total family income, while a family earning $1 million gained almost $40,000, or almost 4 percent of its total income.

Average Income-Tax Cuts for Family with Two Children in 2003



Source: Tax Policy Center, a joint venture of the Urban Institute and the Brookings Institution

class," according to historian Johnson. [32] Meanwhile, union membership began to fall, with one organizer complaining, "As long as men have enough money to buy a secondhand Ford and tires and gasoline, they'll be out on the road and paying no attention to union meetings." [33]

All that changed with the stock market crash of 1929 and the Great Depression that followed. Union membership rose sharply during the 1930s, encouraged by the Wagner Act of 1935 (which allowed for collective bargaining). President Franklin D. Roosevelt's New Deal created Social Security and a federal welfare entitlement, as well as numerous new financial regulatory agencies. Roosevelt himself saw parallels between his efforts and the 19th-century battles against what he called "an unjust concentration of wealth and economic power."

World War II, however, put wealth expansion on the fast track. It created countless jobs for engineers, technicians and skilled workers, and farmers profited from higher prices. Manufacturing wages shot up 89 percent from 1939 to 1945. [34] The rich, meanwhile, paid hefty wartime taxes, and the top 1 percent saw their share of the nation's wealth drop from 17.2 percent in 1929 to 9.6 percent in 1946. [35]

The shift in wages was, perhaps, even more startling. In 1939 the middle three-fifths of wage earners were receiving only 47.8 percent of total wages, while the top fifth were earning 48.7 percent. But by 1949, workers in the middle were making 55.3 percent of all wages, compared with just 40.1 percent for the top fifth. [36]

Some economists refer to this mid-century period of rising income equality as "the great compression." The United States dominated world trade following the war, and Middle Americans benefited from the fast-growing economy as well as a wider availability of consumer goods. They were further helped by changes in government policy, including the increase in the dependent tax exemption in 1944 and that year's GI Bill, which paid for the college careers of millions of veterans.

Between 1952 and 1960, real family income rose 30 percent and jumped another 30 percent from 1960 to 1968. [37] Millions of Americans moved to the suburbs, where they bought homes and left behind the income disparities that had been natural to city life. Sociologists began to look at suburbs as the "true melting pot" — homogenous and nearly classless. "Disparities in income between suburban communities might be large, but such disparities within a particular community were usually small," writes historian Richard Polenberg. [38]

Road to Stagflation

Of course, not everyone shared in the prosperity. African-Americans had long been blocked from many jobs and were still victims of legal discrimination. [39] In 1964, President Lyndon B. Johnson declared an "unconditional war on poverty," saying that "we have the opportunity to move not only towards the rich society and the powerful society, but upward to the Great Society." [40] After his landslide re-election that year, Johnson pushed through a slew of civil rights laws and social programs, including Medicare, Medicaid, fair housing, the first major commitment of federal funds to mass transit, Head Start and the Higher Education Act.

Johnson's goal was to create new educational opportunities for the disadvantaged and reduce poverty among the elderly. But the Great Society came at a price. Combined with his prosecution of the Vietnam War, Johnson inaugurated a period of permanent deficits. His ideas also brought about resistance from Americans skeptical about such a dominant federal role in the welfare of individuals. The result was a voter backlash in the elections of 1966 and 1968. "Most American voters . . . had long since moved away from the politics of economic distribution," writes commentator Michael Barone. [41]

Distrust of government programs grew as poverty rates remained high and middle-class buying power was eroded by inflation. The Consumer Price Index (CPI) tripled between 1966 and 1982, as oil prices shot up. By the late 1970s the U.S. share of world manufacturing and trade was half what it had been in the immediate postwar period. By comparing the income, earnings and educational status of sons with their fathers at similar ages, sociologists found that most children were not exceeding the education and income levels their parents had achieved, according to the Department of Commerce's *Social Indicators, 1976*. [42] For the middle class, the bottom came in 1982, when unemployment rates reached double-digit rates for the first time since the Great Depression, and median family income dropped to mid-1970s levels.

Elected in 1980, President Ronald Reagan pursued a combination of tight monetary policy to fight inflation and loose fiscal policy — pursuing the largest tax cuts in the nation's history and heavy spending on defense and entitlements. "What I want to see above all is that this remains a country where someone can always get rich," he said. [43]

Following a recession early in Reagan's first term, the stock market began a record bull run, more than tripling in value between 1982 and 1992, creating perhaps the most rapid rise in income disparity ever seen. The richest 1 percent held 39 percent of the nation's wealth in 1989, compared with 22 percent in 1979. [44]

Reagan also triggered an anti-union movement among employers by breaking the air traffic controllers' union. Despite the disparities, however, many average Americans shared in the good times during the 1980s. Consumption increased dramatically; the number of shopping centers shot up by two-thirds. [45]

"It was an increasingly prosperous country, with almost universally and visibly rising living standards," writes Johnson. "Even those officially defined as 'poor' were manifestly living better." [46]

Getty Images/General Photographic Agency

New York City residents wait for free coal in 1931 during the Great Depression. President Franklin D. Roosevelt's New Deal programs — including Social Security — addressed what he called "an unjust concentration of wealth and economic power."

The poor of the early 1990s were living as well as the middle class had in the early 1970s, says Federal Reserve Bank economist Cox. [47]

Inside the Bubble

As world trade began to open up in the late 1980s, American industry found it had to downsize and streamline in order to compete with lower-cost companies overseas. The layoffs fell disproportionately hard on white-collar and middle-income workers. Arkansas Gov. Bill Clinton, whose unofficial presidential campaign slogan in 1992 was "It's the economy, stupid," won the presidency by complaining that "the rich got the gold mine and the middle class got the shaft."

Nevertheless, Clinton's most ambitious attempt at social engineering — his plan to provide universal health-care coverage — foundered of its own weight in 1994, leading to another Republican backlash in the midterm congressional elections that year. Clinton expanded some programs to aid the poor — notably the earned-income tax credit — but signed a 1996 law that ended the cash entitlement guaranteed under the old welfare program.

Clinton's fiscal austerity, which helped bring the federal budget into surplus by the end of his presidency in 2001, led to lower interest rates. Cheap money, along with the technology boom, lifted the stock market to record levels and created the longest period of uninterrupted growth in the nation's history (surpassing even Reagan's record).

But the mostly service-related jobs created by the largely non-union "new economy" were not as lucrative as the old economy's heavily unionized manufacturing jobs had been. By 1995, the bottom 40 percent of Americans had a lower net worth, adjusted for inflation, than they'd had in 1973. In fact, during the 1990s, the concentration of wealth in the United States surpassed that of Europe, according to New York University economist Edward N. Wolff.

However, by the late 1990s, fueled by a demand for labor in an overheated economy, real wages earned by lower- and middle-income workers began to rise rapidly for the first time in decades. Amidst the boom, *Forbes* magazine declared on a 1999 cover, "Everyone ought to be rich."

But not everyone was. *The New York Times* reported in September 1999 that "the gap between rich and poor has grown into an economic chasm so wide that this year the richest 2.7 million Americans, the richest 1 percent, will have as many after-tax dollars as the bottom 100 million" — more than double the 1977 ratio. [48] Microsoft Chairman Bill Gates alone owned as much as 40 percent of the U.S. population. [49]

The stock market peaked in April 2000 and then began the deepest one-year decline in its history. ■

CURRENT SITUATION

'Ownership' and Tax Cuts

President Bush cut taxes during each of his first four years in office. During his second term he would like to overhaul the federal tax system to make it flatter and fairer — perhaps even replacing the personal income tax with a national consumption or sales tax. More tax cuts are likely this year but Bush's plans to overhaul the tax system are on hold, at least for 2005, as he pursues other aspects of his "ownership society" package. (*See sidebar, p. 375.*) He has not yet released details of his plans to restructure Social Security but favors releasing at least a portion of each person's Social Security account for private investment.

"It makes sense to have people being able to own and manage their own money — a part of their own money in the Social Security system," he told an audience in Parkersburg, W.Va., on April 5, during a tour to promote his plan. "The American dream is built on the independence and dignity [deriving] from ownership."

Despite making it his top domestic priority, Bush has yet to convince most Americans that turning their old-age pensions into individual investment accounts is a good idea. Many critics of the ownership society proposals say they would only shelter the assets of the well-to-do without helping lower-income Americans save or invest more.

"If his plans are implemented, a lot of people are going to end up a lot poorer in their old age than they otherwise would have been," writes financial columnist James Surowiecki. "A lot of people will end up a lot richer, too. The result would be Social Security without the security part." [50]

Bush clearly believes in getting the government out of the way of individuals determining their own economic fortunes. During his first term, Bush and the Republican-led Congress were generous in funding domestic programs, despite the heavy tax-cutting. They increased federal spending on education by 40 percent and created an expensive, new prescription drug program through Medicare, set to take effect in 2006. But in his fiscal 2006 budget, Bush recommended slashing some social spending, such as Medicaid, adult education, housing assistance and community development block grants.

Although the government programs Bush wants to cut are designed to help poor or low-income individuals, he doubts their effectiveness. But his proposed changes in economic policy represent more than skepticism that a few social programs aren't delivering the best bang for the buck. Bush's proposals run counter to government policy for the past 70 years, challenging the social insurance programs that have provided health care, housing and income assistance to those who did not succeed in the free-market system.

Some critics of Bush's plan, of course, are fighting to protect funding for programs that date back to the New Deal or Great Society eras. During its budget deliberations in March the Senate blocked the president's proposed cuts to Medicaid and community development block grants.

But the general mood in Washington favors cutting both programs and taxes rather than expanding the government's role in personal financial matters. In April, the House voted, for the fourth time in four years, to permanently repeal the estate tax. Inheritance taxes were cut during the 2001 round of tax cutting and are set to be eliminated by 2010. The House rejected a Democratic amendment that would have preserved taxes on the three-tenths of 1 percent of estates worth more than $3.5 million for individuals or $7 million for couples.

Valuing Education

The 2001 recession hit state budgets hard because of the way their tax systems are set up, and their revenues have been slow to recover. There has been little desire to raise state taxes, so most states have been cutting spending to fill billion-dollar shortfalls. Most of the cuts have been in aid to cities and counties and to higher education.

Continued on p. 386

At Issue:

Are there two Americas?

SEN. JOHN EDWARDS, D-N.C.

FROM REMARKS IN DES MOINES, IOWA, DURING THE PRESIDENTIAL CAMPAIGN, DEC. 29, 2003

yes

Today, under George W. Bush, there are two Americas, not one: One America that does the work, another America that reaps the reward. One America that pays the taxes, another America that gets the tax breaks. One America that will do anything to leave its children a better life, another America that never has to do a thing because its children are already set for life. One America — middle-class America — whose needs Washington has long forgotten, another America — narrow-interest America — whose every wish is Washington's command. One America that is struggling to get by, another America that can buy anything it wants, even a Congress and a president.

Dividing us into two Americas — one privileged, the other burdened — has been his agenda all along. Just look at what he wants to do to our tax code. From the beginning, this president has had one solitary goal: to shift the tax burden away from the wealth of the most fortunate and onto the work of the middle class. He wants to cut the capital gains tax, eliminate the dividends tax and the estate tax and create new tax shelters for millionaires' stocks that are bigger than most people's salaries.

The president has a new name for this: He calls it the ownership society. After four years, we know what George Bush means by an ownership society: an America where those who own the most get the most, while those who work hardest own less and owe more. By the time he's done, the only people who pay taxes in America will be the millions of middle-class and poor Americans who do all the work.

Middle-class families have gone from being able to save for retirement or buy a house to now teetering on the edge of bankruptcy. These aren't poor Americans; they're the working middle class. And they are terrified that if something goes wrong — a lost job or a health-care disaster — they're just one bad break away from falling off the cliff. For these families, the American dream of building something better is being replaced by the hope of just getting by.

If the current trend continues, one out of seven middle-class families with children will go bankrupt by the end of the decade. It means the middle class — the foundation of our country — is sinking.

We cannot go on as two nations, one favored, the other forgotten. It is wrong to reward those who don't have to work at the expense of those who do.

ROBERT RECTOR
SENIOR RESEARCH FELLOW

REA S. HEDERMAN JR.
SENIOR POLICY ANALYST
THE HERITAGE FOUNDATION

FROM "TWO AMERICAS: ONE RICH, ONE POOR? UNDERSTANDING INCOME INEQUALITY IN AMERICA," AUG. 24, 2004

no

Class warfare has always been a mainstay of liberal politics. For example, vice presidential candidate John Edwards had declared, "There are two Americas . . . one privileged, the other burdened."

The income-distribution figures from the Census Bureau serve as the foundation for most class-warfare rhetoric. The Census figures, however, are incomplete and therefore misleading. In the first place, they ignore taxes and most of the social safety net. Each year, higher-income working families pay heavy taxes to support safety-net benefits for the less affluent. These benefits absorb over 8 percent of total personal income and represent a mammoth transfer of resources from those who work a lot to those who work less or not at all — a shift that is not reflected in conventional Census income-inequality figures.

When taxes and benefits are counted, the gap between the affluent and the poor shrinks noticeably. Is the distribution of income becoming less equal over time? According to conventional Census numbers, the income share of the top 5 percent of households rose from 15.8 percent of total income in 1980 to 21.7 percent in 2002. But all of that increase occurred in the 1980s and mid-1990s. For the past five years, the distribution of income has been static.

The top fifth of U.S. households, with incomes above $84,000, remain perennial targets of class-warfare enmity, but these families perform a third of all labor in the economy, contain the best educated and most productive workers and provide a disproportionate share of the investment needed to create jobs and spur economic growth.

Nearly all are married-couple families, many with two or more incomes. Far from shirking the tax burden, they pay 82.5 percent of total federal income taxes. . . .

In one sense, John Edwards is correct: There is one America that works a lot and pays a lot in taxes and another that works less and pays little, but the reality is the opposite of what he suggests. It is the higher-income families who work a lot and pay nearly all the taxes. Raising taxes even higher on hard-working families would be unfair and, by reducing future investments, would reduce economic growth, harming all Americans in the long run.

Continued from p. 384

As a result, many public universities have raised tuition by double-digit percentages in each of the last two years, even as many schools have stepped up their financial aid programs. [51] The big trend is toward merit-based scholarships. In an Arizona program inaugurated last year, for instance, high school students who exceed state graduation requirements in reading, writing and math are now eligible for a "high honors" tuition-waiver scholarship. Fourteen states now offer merit-based scholarships, which eat up 25 percent of state aid money — up from 10 percent a decade ago. [52]

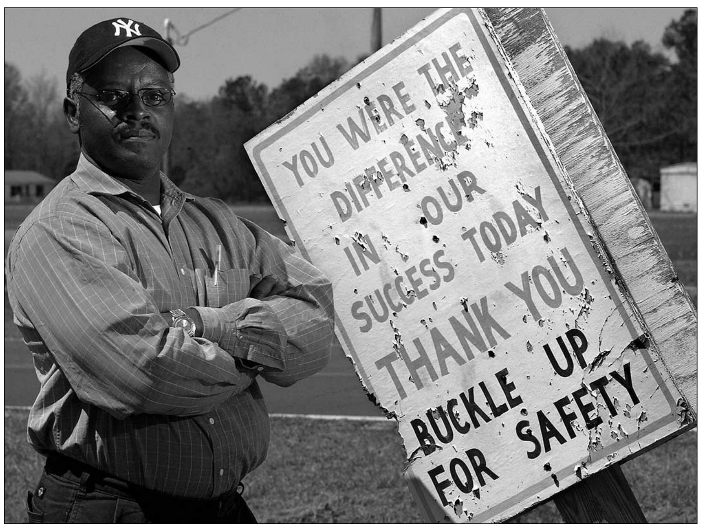
Tuition increases and the move toward merit — rather than need-based — scholarships have made it that much tougher for students from low-income families to attend college. A 2003 study found that only 3 percent of freshmen at the 146 most selective universities came from families in the bottom 25 percent of U.S. households, ranked by income. "There is even less socioeconomic diversity than racial or ethnic diversity at the most selective colleges," said Anthony P. Carnevale, vice president of the Educational Testing Service and a coauthor of the study. [53]

To address that problem, several top universities — including Harvard, Yale, Rice, Princeton and the University of North Carolina — recently announced generous aid packages to low-income students. Harvard, for instance, said families earning less than $40,000 would pay nothing toward their children's educations. [54]

States have been reluctant to cut K-12 funds, and many, in fact, are under court order to step up their school funding as a result of "equity" lawsuits claiming that states provide sub-par educations in low-income districts, violating state constitutional guarantees of an "adequate" education. [55] New York state, for example, is under court order to increase its spending by $1.4 billion in New York City alone. [56] States also complain that Bush has not fully funded the 2002 No Child Left Behind law, which imposes annual testing requirements from grade 3 through 8. [57]

Bush favors extending the law's requirements into high school, but state lawmakers are wary of that idea. The National Governors' Association in February hosted a summit on high school reform in Washington, D.C. Several states are considering overhauling their high schools to better educate an American work force that can compete in today's global marketplace.

"If we keep the system as it is, millions of children will never get a chance to fulfill their promise because of their ZIP code, their skin color or their parents' income," Microsoft's Gates told the governors' summit. "That is offensive to our values, and it's an insult to who we are."



AFP Photo/Paul J. Richards

Factory worker Arbie Keels, 48, lost his job at a now-defunct mobile home factory in Lumberton, N.C. Communities across the country have seen manufacturing jobs outsourced to workers overseas — triggering unemployment, bankruptcy and crime.

Health and Labor

States also have cut back on Medicaid, the state and federally subsidized health insurance program for low-income Americans. Many states expanded Medicaid eligibility during the 1990s economic boom, but since 2001 all states have cut Medicaid, either by reducing the amount paid to physicians or putting new limits on eligibility. Gov. Phil Bredesen, D-Tenn., for example, is trying to cut 323,000 individuals from his state's overburdened Medicaid system. Missouri is cutting 90,000 people from its rolls. Oregon has cut 62,000 from its state health plan over the last two years, with another 14,000 scheduled to be dropped by July 1. [58]

Cutbacks in health coverage at both the state and federal level are worrisome for millions of Americans, some 40 million of whom lack insurance. A series of RAND Corporation studies indicates that poverty contributes to high rates of obesity, injury, asthma and premature death. [59] British epidemiologist Michael Marmot argues in *The Status Syndrome* that both poverty and income inequality harm health.

"A lot of factors are in play in life expectancy, but it is notable that all but three of the 26 countries [with longer life expectancy than] the United States have more equal income distributions," he writes. [60]

Most Americans receive health coverage through their employers, but soaring premium costs are driving many employers to cut back — especially on coverage for workers with low-wage jobs. According to former union official Shulman, 80 percent of

American workers who earn salaries above $40,000 have health insurance, compared with less than half of those earning under $20,000.

Despite declining enrollment, organized labor has racked up some victories in recent years. More than 120 cities, including Los Angeles and New York, have enacted "living wage" ordinances requiring contractors and other companies that receive certain benefits from the city to offer salaries above the poverty level. [61] Berkeley's law, passed in 2000 and upheld by a federal appeals court last year, required covered employers to pay at least $9.75 an hour (the amount rises with inflation) and offer health coverage. [62] In addition, 14 states and the District of Columbia require employers to pay minimum hourly wages higher than the federal level, which has not been raised since 1997.

But corporate America is doing quite well at the dawn of the 21st century, both in the marketplace and in Washington. After-tax profits last year were at their highest levels in 75 years. Over the past three years, corporate profits increased by 60 percent, while wages rose by just 10 percent. [63] (*See graph, p. 376.*)

The Republican-controlled Congress this year has approved several measures long sought by the business sector, including protection from class-action lawsuits and a new law, signed by Bush on April 20, to make it harder for people to forgo debt repayments by declaring bankruptcy.

Since 1898, federal bankruptcy law has allowed individuals who went broke to make a fresh start by wiping out their debts. Under the new law, individuals earning more than their state median income will remain liable for debt repayment for up to five years. The Senate refused to exempt veterans or those whose debts were caused by medical problems or identity theft. But Congress retained an exemption for wealthy individuals after the Senate refused to limit "asset protection trusts," which allow citizens to shelter portfolios of any size from creditors and federal bankruptcy proceedings. [64]

Bush said the bill would make it easier for all Americans, especially the poor, to receive access to credit. The law's critics say credit card companies made it too easy for individuals to get into debt in the first place.

"These common sense reforms will make the system stronger and better so that more Americans — especially lower-income Americans — have greater access to credit," Bush said. "Bankruptcy should always be a last resort in our legal system," Bush added. "If someone does not pay his or her debts, the rest of society ends up paying them."

"Last night, [the GOP] repealed the estate tax, a gift to the wealthiest individuals in our society," Rep. John Conyers Jr., D-Mich., complained during House floor debate on the bankruptcy bill. "Today they pushed through the special-interest bankruptcy bill, punishing the very poorest members of our society." ■

OUTLOOK

Land of Opportunity?

Some critics say the bankruptcy bill, which has few provisions that affect corporations, could make individual entrepreneurs warier about starting businesses or taking other financial risks. Starting a business has always entailed a risk. But the potential rewards for making a big score have always been one of the major drivers of the American economy.

"The hope of earning large profits, not just average profits, inspires countless acts of risk-taking and experimentation that otherwise would not occur," says the Heartland Institute's Bast.

Several recent books — such as psychologist John D. Gartner's *The Hypomanic Edge: The Link Between (A Little) Craziness And (A Lot of) Success In America* — contend that the United States has always attracted and produced immigrants and others possessing a certain kind of exuberance. Hypomania, a condition in which a person thrives on risk and other excitement, may be an essential part of the American character, he maintains.

"These people have a boldness and a self-confidence that sets them apart from the average citizen," said Manhattan therapist Alden Cass. "Hypomania is great for business." [65]

Americans desire not just average comfort but great wealth, despite their longstanding belief in a classless society. They don't mind social hierarchies, as long as they, or their children, have a chance at reaching the head of the pack.

In researching his book *The Working Poor* journalist Shipler asked employers who could afford to offer their lowest-paid workers more money why they didn't do that. They told him "that if they raised their manual laborers' pay, they would have to do the same for their foremen, accountants and executives to maintain a substantial difference between salaries. In other words, the national ethic decries the disparity on one hand (such as complaining that some CEOs get 500 times their workers' lowest wage) while embracing the difference as virtuous. It is somehow morally wrong not to pay an accountant more than a secretary." [66]

As Shipler himself notes, Americans seek equality of opportunity, not of outcomes. Most people embrace the concept of a salary ladder, in hopes that they'll be able to climb to the top themselves.

But not everyone is able to take those steps. Most politicians believe now that education holds the key to prosperity, and many actions are being taken to improve public education. Still, nearly three-quarters of Americans don't acquire the college degrees that could potentially help them earn about 50 percent more than their high-school-graduate peers.

Some economists also worry that President Bush's ownership society agenda will exacerbate disparities, rewarding the already-wealthy and shifting more of the tax burden onto labor. "Unless we make a policy reversal . . . we're very likely to have a wealth distribution characteristic of Third World countries — a kind of have and have-not society that's absolutely at odds with American values," warns Anne Alstott, a Yale law professor.

Others worry that cuts in social insurance programs that pool risk, such as Medicaid and Social Security, will leave millions more vulnerable just as the economy is shifting due to global and technological pressures.

"Ownership programs are a complement, and they can't replace the [social welfare] programs," says Edward M. Gramlich, a member of the Federal Reserve Board. "Some will use them well, but others won't. As a humane society, it's great to talk about ladders, but I want to preserve nets, too."

Clearly, however, while some popular programs such as Social Security may be preserved in their present form, there almost certainly will not be any new large-scale government programs to match the efforts of the New Deal or Great Society. "We're seeing a great deal of middle-class unease, but there's not a sense that the public wants governmental intervention," says Bernstein of the Economic Policy Institute.

That's a relief to many people. Few Americans believe the government, rather than the free market, has made this the richest country in history. No one wants to see income and wealth disparities grow much larger. But preserving opportunities for striking it rich, rather than trying to level the economic playing field through confiscatory taxes or other means, should remain a central goal for society, say conservatives such as Cox of the Federal Reserve Bank of Dallas.

"America is still a land of opportunity," Cox says. "The Horatio Alger story still applies." ■

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FOR MORE INFORMATION

Bureau of Labor Statistics, 2 Massachusetts Ave., N.E., Washington, DC 20212; (202) 691-5200; www.bls.gov. The federal government's principal compiler of data on labor economics.

Economic Policy Institute, 1660 L St., N.W., Suite 1200, Washington, DC 20036; (202) 775-8810; www.epinet.org. A liberal think tank that focuses on research about low- and middle-income workers.

Federal Reserve Bank of Dallas, 2200 N. Pearl St., Dallas, TX 75201; (214) 922-6000; www.dallasfed.org. Like other regional offices of the Fed, the bank's economists track the nation's monetary policy, banking operations and economic conditions.

Heartland Institute, 19 South LaSalle St., Suite 903, Chicago, IL 60603; (312) 377-4000; www.heartland.org. A Chicago-based think tank that promotes conservative policies in education, health, environment and regulation.

The Heritage Foundation, 214 Massachusetts Ave., N.E., Washington, DC 20002; (202) 546-4400; www.heritage.org. A think tank that promotes conservative, free-market policies and limited government.

Maxwell School Center for Policy Research, 426 Eggers Hall, Syracuse University, Syracuse, NY 13244; (315) 443-3114; www-cpr.maxwell.syr.edu. Offers an interdisciplinary program that studies urban and regional issues, social welfare, education finance and income-security policy.

Michigan Program on Poverty and Social Welfare Policy, University of Michigan, 1015 E. Huron St., Ford School Annex, Ann Arbor, MI 48104; (734) 615-5389; www.fordschool.umich.edu/research/poverty. A joint program of the University of Michigan schools of public policy, social work and law that researches poverty and social-welfare policy.

Milken Institute, 1250 Fourth St., Santa Monica, CA 90401; (310) 570-4600; www.milkeninstitute.org. An economic think tank that promotes innovative ideas for increasing prosperity.

Russell Sage Foundation, 112 East 64th St., New York, NY 10021; (212) 750-6000; www.russellsage.org. Provides funding for and performs social science research. With the Carnegie Corporation, the foundation is sponsoring several working groups examining social inequality.

Urban Institute, 2100 M St., N.W., Washington, DC 20037, (202) 833-7200. A think tank that studies economic and social-policy trends and the effectiveness of government policies in such areas as taxation and housing.

About the Author

Alan Greenblatt is a staff writer at *Governing* magazine. He previously covered elections, agriculture and military spending for *CQ Weekly*, where he won the National Press Club's Sandy Hume Award for political journalism. He graduated from San Francisco State University in 1986 and received a master's degree in English literature from the University of Virginia in 1988.

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CITING *THE CQ RESEARCHER*

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