

Editorial Desk; Section A
The Victimless Income Gap?
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ITHACA, N.Y. -- Presidential aspirants since Ronald Reagan have urged us to ask whether we're better off now than we were four years ago. At any time from 1945 to the early 1970's, the answer for most Americans would have been a resounding yes. Throughout that period, incomes grew at about 3 percent a year for families up and down the income ladder.

Today, however, this question is more difficult to answer. Although the top 1 percent of earners now have more than twice as much purchasing power as in 1979, the real earnings of families in the middle have scarcely grown since then. The "income gap" between the rich and the middle class has thus grown sharply, and the conventional wisdom says that's bad.

But the conventional wisdom is now under challenge. Some revisionists, respected economists among them, are arguing that inequality doesn't really matter so long as no one ends up with less in absolute terms. They invoke the venerable Pareto criterion, first proposed by the Italian economist Vilfredo Pareto, which holds that a change in circumstances must be counted as a good thing if it makes at least some people better off without harming any others.

Using income levels to measure the well-being of individual families (standard practice among economists), the inequality optimists argue that since the rich now have much more money than before and the middle class doesn't have less, society as a whole must be better off.

But income level isn't everything. What the revisionists ignore is that increased spending at the top causes real, unavoidable harm to families in the middle, even those whose incomes have risen slightly. It harms them by raising the cost of achieving goals that almost every family cherishes.

Few middle-income parents, for example, would rest easy with the knowledge that their children were attending below-average schools. But since the quality of public schools is closely linked to local property taxes, which in turn are closely linked to local real estate prices, you cannot send your child to a public school of even average quality if you buy in a school district whose house prices are well below average.

The problem is that the average house built in the United States today (some 2,200 square feet) is roughly 50 percent larger than the average house in 1970, which means

that the buyer of the average-priced house must now carry a much larger mortgage than before.

Increased income inequality is the reason that the average house has gotten so much bigger. The process starts when sharply higher incomes prompt top earners to build larger houses. Perhaps you don't really care if your neighbor's house is bigger than yours. But -- just as you know that half of all drivers are below average (even though more than 90 percent of us insist that we're above average) -- you also realize that many others do care about relative house size. Thus when top earners build 25,000-square-foot houses, others just below them find their own 10,000-square-foot houses no longer adequate, and so on all the way down the income ladder.

So what? If you're an average earner and don't envy your neighbor's larger house, you can simply buy the same 1,500-square-foot house that people in your position bought in 1970. That would be a fine solution -- unless your goal is to make sure your children attend schools of at least average quality, in which case you'll have to spring for the bigger house, even if you don't care about the extra space. Or, worse, you may end up with an existing 1,500-square-foot house whose price has been bid up sharply because of its location in a good school district.

Increased spending at the top also imposes other costs on those below. If you buy a typical 3,000-pound sedan, your family will incur risks that didn't exist in the 1970's, since you'll now be sharing the road with 6,000-pound Lincoln Navigators and 7,500-pound Ford Excursions. So in self-defense, you may want to spend more for a bulkier vehicle.

And if you managed to choke down the cost of a home in a good school district, you'll need to spend more on your children's clothes or else endure the embarrassment in their eyes as they mingle with wealthier classmates. Your own clothes might have to come up a notch as well, since others are wearing more expensive clothes now and in job interviews you'll want to make a good impression. The gifts you give, the night out at the theater, the family vacation -- all are affected by the upward pull exerted by the sharply higher affluence of top earners.

So it's little wonder that our national savings rate is now negative, or that American families now carry an average of more than \$7,000 in credit card debt. Even though our economy is in the midst of the longest sustained boom in history, with the unemployment rate at a 29-year low, 1 American family in 68 filed for personal bankruptcy last year, more than seven times the rate in 1980.

No, it would not be great to turn back the clock to the 1970's. But let's not sugarcoat the prosperous present. Because the plain truth is that expansion of the income gap causes trouble after all -- even for middle class people who earn a little more than they used to.

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Drawing. (Paul Corio)