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The Great Leveling: A Note

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ABSTRACT: Peter H. Lindert and Jeffrey G. Williamson, in their book *Unequal Gains: American Growth and Inequality since 1700* (Princeton University Press, 2016), explore the reasons for the decline in the share of income captured by top earners in industrialized nations. Embedded in their take on the "Greatest Leveling" is a push for progressive redistribution policies, based on old misconceptions from Malthus and the Classical economists.

KEYWORDS: inequality, economic growth, Piketty, Malthus

JEL CLASSIFICATION: B12, N11, N12, O15

In a core chapter in their book, *Unequal Gains: American Growth and Inequality since 1700* (Princeton University Press, 2016), Peter H. Lindert and Jeffrey G. Williamson present "The Greatest Leveling of All Time," circa 1910 to 1970. In this chapter, the two prominent economic historians explore the reasons why "virtually every industrialized country went through a pronounced decline in the share of income captured by the those at the top" (p. 194) combined with significant economic growth.

The modern norm is that economic growth causes measured income inequality to increase. The authors ask "Will the bottom 99 percent ever have such good fortunes again?" (p. 195) They note

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that "The interpretive stakes are high. Understanding the causes of this combined leveling and strong growth would inform today's policy debate." What caused this combined great leveling, i.e., more economic equality and strong economic growth?

What I found lurking in this chapter was an elaborate attempt to put the best face on their normative views concerning economic equality. The "leveling" is typically explained by a combination of the world wars, Spanish Flu, and the Great Depression which destroyed capital, killed off labor, and reduced the growth of the population and work force. Our authors would very much like to downplay these factors and to showcase progressive redistributive policies as the main cause.

They consider three general possibilities. First, the cause(s) could be something "we could control," (p. 195) such as more progressive policies. Second, it could be something understandable, but beyond policy control or just a fluke. Third, it could be something we can neither forecast nor control. They note that the leveling occurred in most industrialized countries both before and after the adoption of progressive taxation and transfers, i.e. welfare for the low-income population. They show that it was not just that the top 1 percent saw its share fall by 50 percent, income grew more equal even within the bottom 99 percent.

Lindert and Williamson note that for "some countries, it was mostly a matter of sharp inequality reductions during World War II." (p. 198) They note that this was especially true in Japan whose military and occupation governments enacted land reform, confiscated assets, and imposed high taxes to subdue the wealthy during the period from 1937 to 1950. In the US and several other countries, gains occurred for low-skilled labor vs. high skill labor during World War II, but in the US, wages remained compressed after wage controls were removed. "Something more fundamental must have been at work." (p. 199)

They do note that "White-collar workers generally lost ground in both world wars, not regaining it after either war." (p. 202) But they conclude on the basis of the evidence:

> In many, if not most, cases, the occupational rates were not dictated by government policy but rather by *market forces*. Thus, our search for causes of the Great Leveling within the lower 99 percent must focus on the

> *market fundamentals* that could have pushed the entire occupational wage structure towards equality even in the absence of changes in government wage-setting policies. (p. 202)

I have emphasized "market forces" and "market fundamentals" here because it appears the authors want it emphasized.

The authors identify six likely causes of the great leveling. The first of which is uncontrollable shocks such as war, macroeconomic instability, i.e. the Great Depression, and political shocks, i.e., "(especially the leftward shifts that expanded fiscal redistribution). The first two are understandable but are hard to control. The third is clearly within the control of the political process." (p. 207)

The authors agree, "Piketty is surely on the mark here. His explanation combines periods of diverse historical shocks into a single, long chaotic era from the 1910s to 1970s." (p. 207) Here they are downplaying the really important factors: World War I, the Spanish Flu, the Great Depression, and World War II in favor of random chaos. They also strangely note that the shocks they wish to emphasize have a common denominator—a political shift to the left—and then they homogenize all these shocks and supposed shifts to the left into "progressive fiscal redistribution." (p. 208) That is an unbelievable transformation, from wars and depressions to progressive redistribution!

Thomas Piketty is correct that World War I, the Great Depression, and World War II are the three primary events which most of the industrial world had in common, along with the Spanish Flu. These events were also episodes that destroyed or suppressed vast amounts of capital around the world. They were also events that killed or disabled more than one million Americans and tens of millions of young adults around the world who would have been highly likely to get married and have children. In the case of the Great Depression, family formation and child bearing decreased precipitously. The population growth rate was about half the normal level. So, the fact that labor gained while the income from capital relatively fell is not big surprise. Labor income also increased as a result of the Black Plague. Harsh immigration restrictions stopped the flow immigrants and this largely explained the gains to low-skilled workers vs. high skilled workers. Notice that immigrants are not permanently low-skilled, low-wage workers, but often move up the income distribution ladder.

The fact that marginal income tax rates were exorbitant during and after World War I and World War II had virtually nothing to do with redistribution in the typical sense. Rates were raised to pay for the US's role in these tragedies. The top 1 percent was a very small number of taxpayers and they paid little taxes in the highest marginal rate category. The fact that Lindert and Williamson claim that the 2 percent – 10 percent experienced little relative change strongly suggests that the highest 1 percent of income earners turned their income earning assets into tax free income earning assets, such as municipal bonds or kept other income within their corporations as retained earnings, as has been shown by Gene Smiley and Richard H. Keehn.

There are five other causes that Lindert and Williamson discuss. Some of them, such as the reduction in labor supply growth rates, stems from the primary causes above, while others are probably not very relevant or temporary, but they are all framed to readers as if all causes might have a roughly balanced impact.

This chapter also reveals a little of what the authors know about the history of economic thought. In what might be the only reference to the history of economic thought in the book, the authors discuss the impact of labor supply on incomes. They correctly note that any ratio of income per capitalist relative to labor would be affected by changes in labor supply. "This inequality argument goes back at least to David Ricardo and Karl Marx." (p. 209)

In fact, the argument does go back further in time, to Malthus. His "Principle of Population," which is now considered invalid when applied to capitalism, says that population is limited by subsistence and that an increase in production of food will increase population and this will create a tendency to keep labor at a subsistence existence. The Classical model of some of the leading classical economists shows that capitalists accumulate greater and greater amounts of capital while labor is held at subsistence. This misconception and other errors of Classical economics is what led Marx to his theory of the exploitation of labor. In turn, this theory seems to be the force behind our authors' ideology and their zeal for progressive redistribution policies which they define as taxing the rich and subsidizing low income poor people.

It is possible to have greater income equality and greater economic growth. It simply requires more free market policies and less government interventionism. It is too bad that more economists do not know this simple fact.

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