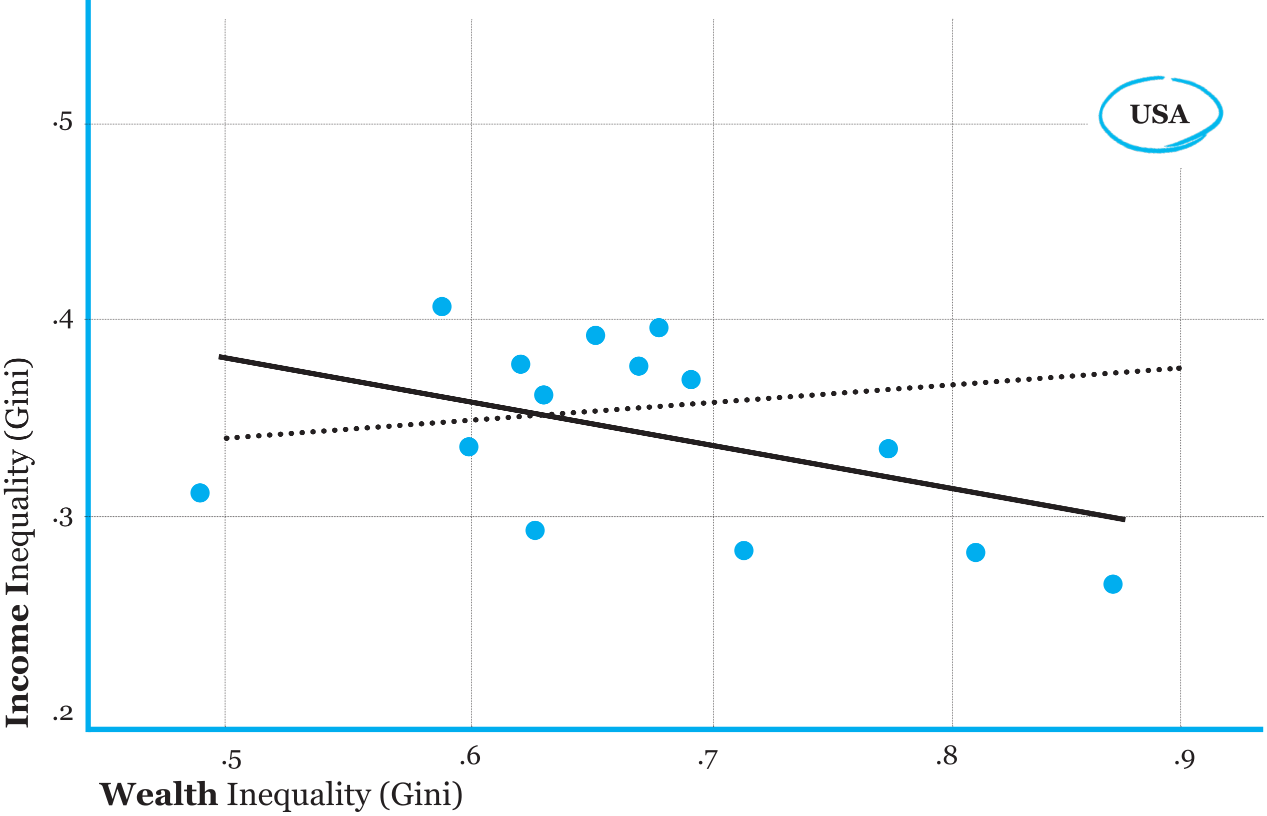
JAMES M. & CATHLEEN D.
**STONE FOUNDATION**

# Upping the Distributional Economics Game

**JAMES M. STONE**



# Upping the Distributional Economics Game

JAMES M. STONE

## Introduction

To earn a substantial fortune requires some measure of talent, plenty of hard work, and a whole lot of luck. To give it away well is at least as difficult. Many a painstakingly built fortune has been dissipated ineffectively in the giving phase or directed posthumously toward purposes the builder of the wealth would never have favored. To avoid these hazards, and having already provided economic security for our children, my wife Cathy and I are bequeathing upon death virtually the entirety of the family estate to the support of just two philanthropic causes. Our tightly defined focus is in line with our joint determination that, in order to maximize the rather limited influence we can exert from our graves, we should reject the path most commonly taken by fortunate people, which is the establishment of a foundation with wide subject matter discretion and a long life. Our plan, to the contrary, is designed not only to constrain our post-mortem giving narrowly by subject matter but also to direct that the funds be disbursed and put to work quickly.

Each of us was primary in the choice of one recipient focus area, but we can comfortably state that we both admire the other's selection. My wife's choice was the study of environmental sustainability. Mine was the study of economic inequality. I use the word "study" in this context because we have determined that the sole beneficiaries of our philanthropic trust will be colleges and universities. Believing the pen to be mightier than the sword, at least most of the time (and less costly to finance just about all the time) our aim is to impact the development of prevailing thought in both of our areas of interest. Absent an unforeseen economic catastrophe, we expect to leave behind sufficient assets to reach realistically for observable impact. In the case of my choice, which is the subject of this essay, I hope that following my death there will be at least 30 institutions of higher learning with well-endowed academic centers to study the causes and consequences of the accelerating wealth and income inequality I have observed with discomfort. The essay that follows offers a more specific explanation of what I intend to do with my agreed portion of our estate and why I have chosen this course.

## Stirrings

The direction of my philanthropic path was set gradually over more than 60 years. The primal impetus, the first calibration of the compass, came farther back than I can actually recall. Sometime in my elementary school years, I began to understand the distinction between inclusivity and exclusivity. I doubt I knew those words then, of course, or anything about the economic side of inequality. What I saw at the personal level was that inclusivity meant allowing me to participate in backyard team sports despite my meager athletic talent. Similarly, inclusivity meant I could enjoy playtimes with whomever I liked regardless of the playmate's parentage. Exclusivity meant not permitting me to join the local dancing school because Pelham, New York had retained a measure of anti-Semitism well after it was losing its acceptability elsewhere. Since my parents were thoroughly secular and no one ever mentioned ethnicity in our household, I was slow to accept that I could be classified by others as a member of any particular religious or ethnic group. Exclusivity also conveyed an acceptance of snobbery and elitism devoid of meritocratic foundations. I cannot remember a time in my life when I didn't recoil from bloodline elitism and ridicule social snootiness. I never shared my classmate's adoring fascination with kings, queens, dukes, and other tiared aristocrats. Rightly or wrongly, I have always taken as a given that power to make society's decisions ought to belong mainly to the most profound thinkers and the otherwise most able to contribute, rather than those with the bluest blood. On a global level, I took inclusivity to mean acceptance of due process democracy and equal rights for all people. The United States having just come out of a brutal war to save the world from Nazism, it was easy even for a young child to see that extreme exclusivity tempted descent to the nadir of evils. I developed an early proclivity to favor the downtrodden and the underdogs, which might help explain my deep and loyal support of the once hapless Brooklyn Dodgers of baseball over the self-assured New York Yankee dynasty. Although my father was a liberal Republican (a rarified breed today but often spotted in New York at the time) and my mother was a colorfully unpredictable Independent, I pronounced myself a Democrat at about age 10.

The groundwork for the next declination of the compass was provided during my early adolescent years, although any obvious impact would be long delayed. Students of my vintage were routinely treated in school to a set of attractive facts about our country's economic inclusivity. The standard junior high school lesson at the time declaimed that our land was free of the shameful economic inequities of Central American banana republics, European hereditary aristocracies, and ancient oriental empires. Thanks to the enduring wisdom of our Founding Fathers and the power of our free-market economic engine, we were told, our consciences need not be burdened by the consequences of extreme wealth and income inequities. The United States could boast about the highest level of distributional equity and the most fluid social mobility ever seen in human history. I had confidence and pride in the tale at first, but doubt slowly began to surface as the breadth of my education expanded and the nuances around the truth became more apparent. It took only a few years, and a little learning about the blatant racial and gender disparities extant during that era, to see that nothing about equality was that simple. Still, even after discarding the most blatant elements of exaggeration inherent in the pretension, I had faith back then that, when the burgeoning civil rights movement triumphed over anachronistic biases, our society could make its way to new peaks of distributional economic fairness. My confidence in that aspiration would gradually be eroded as my education broadened and, every bit as crucially, some of the lofty economic facts underwent an infelicitous retrogression.

The perfectibility of human endeavors is always naught but wishful thinking, and this should never be confused with informed prognostication. Too often in human history, things have actually gotten worse. Distributional equity in the United States not only failed to march toward perfection since my school days, it reversed course entirely. Historically, the most widely accepted measure of distributional equity has been the Gini coefficient, an index of how far from full distributional parity a country's wealth or income sits. A Gini coefficient of zero, which no country actually has and no sensible country seeks, would imply precisely equal distribution throughout the population. Just a few decades ago, the United States, which had previously been praised as an estimable standout in recognition of its favorable income distribution, was still showing a Gini comfortably near the mean of its Western democracy peer group. More recently, however, as modern fortunes ballooned and urban poverty became ever more entrenched, the North Atlantic community norm for Gini values grew — but our own nation catapulted itself right out of the pack. We became a standout once again, but this time in the undesirable direction. Today, the United States leads the peer group, both before and after taxes and transfers. This brings our country quite near the contemporary worldwide pinnacle for income inequality among well developed nations. Our wealth Gini, a less frequently measured or discussed index, is by every account a great deal higher than our income Gini. And there are now indices in use other than Gini that reinforce the same conclusions. If the United States was ever on the path to the equitable distribution of wealth and income I had so esteemed, our dear country surely missed a turn. The disillusionment that accompanied the deflation of an overly optimistic paradigm was surely a factor in fueling my present passion.

Yet another influence on my bearings was supplied inadvertently by the Harvard economics department. As a student in the first year introductory course, I was told by our teaching fellow that the field of economics could be divided into two subspecialties — equity and efficiency. Efficiency, as the teaching fellow used the term, didn't quite mean what the dictionary suggests. The plain English definition of efficiency could be applied to addressing any challenge, including the topics of my current interest, but the usage my teacher conveyed was narrower. He meant efficiency in the maximizing of tangible output measures rather than anything as subjective as fairness or justice. When I use the term here, I am adopting his vocabulary and his simple distinction. An economist, he said, could elect to build a fine academic career around studying either efficiency or equity. I naively took this as a descriptor of two roughly equal branches within the field. I became an economics major in part because I was attracted to studying equity. As I went on toward completion of my undergraduate and graduate economics programs at Harvard, it became clear to me that the two subfields were anything but equal in professional promise or prestige. In fact, almost no one on the senior faculty at the time wrote about equity and just about everyone concentrated on efficiency. The path to success in the Harvard Economics Department appeared to be lined with papers refining abstruse models of market efficiency. One needs only to peruse back issues of the *American Economic Review* or the *Quarterly Journal of Economics* to see the evidence of the imbalance. Problems that could not be solved neatly with calculus, regression analysis, and matrix algebra seemed barely worth addressing.

I had a pivotal conversation in the midst of my graduate studies with one of Harvard's brightest stars in economics. The story is presented here with an apology because its telling will sound boastful, but it wouldn't make sense otherwise. Wassily Leontief was among the first winners of the Nobel Prize in economics. I was humbled always to be in his presence as a student. After class one day, he pulled me aside and asked me to stay and chat with him. I wasn't sure he even knew who I was, but apparently that was wrong. "I'm leaving Harvard and you should, too. The whole field of economics is headed in the wrong direction," he said, his eyes slightly moistening. He then went on to tell me that he was fed up with the economics department, and, in fact, with the whole of the profession, for wasting its time on petty mathematical exercises undertaken to prove unimportant points about efficiency. He woefully assigned disproportionate shares of the blame to himself and Paul Samuelson. The other students in his graduate school class, he told me, would become economics professors somewhere and be happy with that. But, he asserted — brightening in affect — that I was better than the others, and therefore I should promptly drop out to do something more useful with my life. “Address the big questions,” he said. “Those,” he insisted, “are the only ones worth your time.” Needless to say, this advice was unexpected. The conversation lasted no longer than five minutes, and, of course, I did not follow his advice and abandon the Ph.D. program. He left while I stayed to get my degree. But all through the pursuit of my doctorate and into my years of teaching I was haunted by Leontief’s words. About ten years later, I saw him at a Harvard economics department social event for the first time since the discourse. He was in his nineties then, so I doubted he would remember me or the nature of our long past conversation. But he did. And he asked me what I had done since that time. When I told him I had spent eight years in government service, then started a business, he threw his arms around me in a Russian bear hug, smiled a broad smile, and exclaimed, “You listened!” I guess I had.

## Deeper Underpinnings

My time at Harvard also introduced me to evolutionary biology. Through the study of natural selection, I came to understand more about the origins of inclusivity and exclusivity. From the earliest days of social behavior among our hominid ancestors, there has been tension between two competing strategies for genetic and cultural success. The inclusive strategy has been to extend the tent and put out the welcome mat, sharing wealth and power in the hope that collaborative work, cross-pollination of ideas, and trade would enrich all while avoiding genetically costly strife. At the opposite pole has sat an exclusive strategy by which the most powerful establish hierarchical castes take advantage of everyone they can subjugate, appropriating the bulk of the resources for themselves and their allies at the aristocratic top. The leaders can gain even more by rallying their followers to fight and plunder any enemy tribe they can characterize as unworthy. Since both of these overarching strategies can produce genetic and cultural evolutionary successes, it is not surprising that competing and opposing urges are deeply engrained in our species. Inclusivity and exclusivity form a perpetual Taoist circle within the human soul, never to be resolved into a straight line. There is no certainty as to which approach will be more effective in a given circumstance of time and place, but it is certain enough which is the more admirable.

At a visceral level, inclusivity remains the most compelling and consistent of my political principles. On an economic plane, the notion that some people are endowed with great hereditary status and wealth while other souls, sometimes worthier and abler, go hungry was enough to set my compass in the direction that led to my philanthropic choices. A reasonably fair distribution of wealth and power is a necessary corollary of inclusiveness. Pluralism, conveying a broad spread of political influence, wealth, income, and social privilege, is the best antidote to exclusive autocracy. The only organizational structures for a society I have ever found appealing were built around inclusive pluralistic meritocracies with generous safety nets for the unfortunate. The achievement of an admirable meritocracy implies setting reasonable boundaries on the concentration of wealth and power among the members of a society and limits as well on the unearned inherited privileges of their unproven offspring. Andrew Carnegie brilliantly quipped that dynasties of bequested wealth reminded him of the potato plant—with the only valuable part being underground. My generation, the so-called baby boomers, was proud to consider itself unusually idealistic. We were confident and determined that we would leave our progeny a better world than the one we found. That was our generational program and our commitment. In quite a number of dimensions, including the improvement of economic equality, we have failed to make good on it. The economic environment that my cohort is leaving behind, while richer in the aggregate, is one of less vibrant pluralism, less generosity, and less coherence than the one we found. Just look around. My course of philanthropy may be seen as an attempt to stay with the original program of my formative years.

## A Worsening Problem

The hardest task in distributional economics is defining the goal with even a modicum of precision. It is easier to talk about what the goal is not. The objective surely cannot be to fashion a society in which all, regardless of effort and talent, have exactly the same wealth and income at their disposal. Even V. I. Lenin came to see the warts on that notion. It is sufficient to observe of absolute parity, as Harvard's distinguished biologist E. O. Wilson, has put it: "Great idea, wrong species." The opposite corner solution, where the monarch and the court own everything and everyone else is a serf or a slave to the nobility, is even easier to reject. Europe in the Dark Ages demonstrated what comes of this model — centuries of starvation, illiteracy, and stagnation. The challenge is to identify the spot between these poles where the balance is optimized for the benefit of society as a whole. Issues not solely of equity, but also incentives, politics, practicality, and others too numerous to list, are implicated in the weighing. The academic literature on this topic, unfortunately, is skimpy and vague. Among the objectives of my philanthropic project is to encourage the strengthening of that literature. This is, I am confident, just the kind of question Wassily Leontief was calling on our shared profession to examine. For me, and for now, however, it is sufficient to know that the inequality needle is pointed quite far from any balancing point I could feel comfortable with.

Several factual observations provide circumstantial evidence that the situation is off-kilter. One is that the inequality has risen so dramatically from where it was just a few decades back, and the wealth and income gaps are continuing to accelerate. Unless the optimum has shifted radically, one would have to convince oneself that our society had too much equality in the past to assert that we are doing better now. Another evidentiary pointer is the extent to which the inequality indices for the United States have diverged sharply from those of our peers. Our nation, Russia, and China (the latter two nations ironically having not long ago embraced egalitarian Marxism) are running away with the gold medals for unequal distribution, with Gini coefficients for income now sitting at nearly twice those of the rest of the developed world.

This essay is not meant to pass as a research paper on wealth and income distribution, and I have no wish to burden the reader with a hefty load of statistics. A few numbers, though, may help to elucidate how this topic captured so much of my attention. The easiest facts to keep in mind are that inequality in family wealth and income are more extreme today in the United States than they have been in almost 100 years and that the gaps are still growing. Believing that wealth distribution is even more impactful for a society than income distribution (though the race for that prize is a close one), let me begin there. The top 10% of Americans by income now own 70% of the country's wealth and well more than 90% of its financial assets. Those at the very summit, the top one-percent of 1%, have a combined net worth roughly equal to that of the lower two-thirds. The concentration reflected by these numbers is dramatically more top-heavy than when I was young and a great deal more pronounced than in any Western European country today. The United States in the last fifty years has created more wealth than any nation in world history, but the fruits have been increasingly impounded at the tip of the economic pyramid. In one recently measured ten-year period, total wealth here grew by over $10 trillion … and 119% of that cornucopia went to the upper 5% of households. And, yes, that's more than all of it. Wealth in the top bracket grew by more than the total because the middle class wealth share actually contracted during the period. Those of us who are at the fortunate corner of the distribution can be grateful for our rewards without believing for a second that this is the way things ought to be.

The same general point can be made by observing income. The median wage in this country has barely risen in real terms for fifty years. While income in the middle brackets was stagnating, income for the upper 1% tripled. Defenders of the status quo insist that inequality is of minor consequence as long as there exists ample opportunity and upward paths of mobility for the talented. This isn't my view, but the argument holds at least a kernel of value worthy of consideration. Surely an unequal society characterized by abundant mobility based on individual merits is better than an alternative society with outcomes based solely on starting position. But mobility in the United States, alas, appears to be declining hand in hand with measures of parity. Solid data suggests that the odds of rising from the poorest deciles to the middle or above have been falling over time for quite a while now. In our time, a college graduate from the lowest income quintile actually stands no better chance of being in the top two income quintiles at age 40 than a high school dropout from the top quintile. It is a matter of logic, moreover, that relative mobility statistics cannot tell the whole story. The greater the share of a nation's wealth and income potential is impounded and sequestered in the elite brackets, the less benefit can be found in moving up through the various brackets that lie below the summit. Put another way, talent and toil can only bring rewards in proportion to what is available to be shared rather than sequestered. Look again to the Dark Ages and ask how much it really mattered whether a serf climbed a bracket or two. When too much of the wealth is impounded at the top, mobility is necessarily of less consequence than in a society with access to assets spread availably throughout the distributional pyramid and with the fluidity of new wealth not just streaming upward. The acceleration of rigid wealth concentration within a durable elite inevitably imposes a dimmer on the bright hopes long offered by the American Dream.

## Does Increasing Inequality Really Matter?

It is easy enough to establish that wealth concentration is escalating. This observation is a matter of fact. But is that so bad, some may ask? Perhaps incentivizing extraordinary creativity and effort, with benefit to the populace as whole, depends on the promise of lavish rewards without limit. The relevant phrase in the implied question is "without limit". Highly conspicuous extremes of economic disparity almost certainly impose non-trivial political and economic costs on a society. There is no logical basis for insisting that a laissez-faire absence of limits yields the ideal balance between incentives and equity considerations. The supporting academic literature on this tradeoff is scarce and lacking in rigor. No straightforward analytical tool is available to tell us where, between the two easily rejected extreme answers, the optimal degree of economic egalitarianism in a society can be found.

I believe the disparities have gone too far. My youthful objections to extreme wealth concentration were based on an intuitive and subjective sense of fairness. I cannot banish such value judgments from my argument today, but I can be a bit more specific now about the potential threats that excessive inequality poses. The first danger I would cite remains the damage to our nation's traditional notions of justice. There is something wrong with an environment in which high school dropouts from wealthy families do just as well as college grads from poor backgrounds. It is painful to watch struggling middle-class families gain little from economic boom years, as has recently been the case. It is every bit as discomforting to imagine a future in which conspicuous consumption by the few provides an ever more visible, interminably expanding, contrast with the lifestyles of the many. By John Rawls's notion, a just society is one in which virtually all would sign off on its economic distribution pattern before knowing where on the ladder they would actually find themselves. Our own society would surely not qualify as just by this standard. And access to goods and services is not the only arena in which economic inequality has unfair consequences. Consider, for example, how financial disparities play out in our criminal justice system. We should all be proud to associate ourselves with the motto over the doorway of our Supreme Court calling for Equal Justice Under Law, but there is all too much truth in one wry observer's assertion that a defendant who is guilty and rich stands a better chance in our courts than one who is poor and innocent. Our nation has an admirable judicial record by historical standards, but increasingly inordinate disparities in means can only carry us back and away from this accomplishment.

Perhaps the most worrisome of clear and present threats from extremes of inequality is the harm wrought upon democracy. Were there no other reason for concern about the widening wealth and income gaps, the multifaceted adverse impact on our democracy would be sufficient. It should be obvious that at least some degree of economic pluralism is a precondition for political democracy. The republic envisioned by our Founding Fathers was premised on tacit assumptions that applied to a largely pre-corporate agrarian and mercantile economy but no longer fit the picture today. The rich in their day were certainly rich and the poor unquestionably struggled, but the spread from top to bottom (at least among those of European stock) was narrower by leagues than what we observe today. Democracy simply cannot work its beneficial magic in a society where wealth is massively concentrated in the hands of a few. It would be foolhardy, if not insincere, for anyone today to challenge the observation that the wealthier classes have more claim on the levers of political influence than the working classes and the underemployed. Political contributors always gain an extra measure of access and sway with politicians. I have never sought commercial sway, but I can testify to the expanded access first-hand. And there is a reinforcing cycle to the politics of imbalance that allows the economically powerful to exert their influence and shape the formation of rules and laws that will further enhance their relative advantages.

When the scales of distributive justice are sufficiently out of whack, the psychology of public policy can take an unwelcome and ugly turn. A society can lose its essential unifying spirit absent equitable sharing of economic gain with its broad middle class. America's social and political cohesion, sustained by a historically rare public consensus with respect to basic values, has played an indispensable role in making ours a great nation. Our middle classes have prospered, and that prosperity has nurtured a generous cast of mind toward those less fortunate. As the members of the middle class begin to feel mistreated and pessimistic for their families' futures, though, their sentiments tend to turn against the lower classes. We see this plainly in the politics of recent years. We should be cautioned in our own time by the words of the poet, William Butler Yeats, who wrote of his fears in another period of deep division: "the centre cannot hold...The best lack all conviction, while the worst are full of passionate intensity." I fear for our republic as middle class insecurities expand and middle class generosity contracts. The contemporary struggles of the majority, and their growing estrangement from the common weal, extend an invitation to demagogues who can seize the moment to turn us against one another with passionate intensity.

A society needs broad public acceptance that its distribution of wealth is tolerably fair to avoid widespread disillusionment and any number of other adverse societal consequences. If cynicism that the economy is a rigged game grows unchecked, large fractions of society may become alienated from constructive civic participation. While full-scale revolutions are rare, and the rich are not likely to be hung from lamp posts anytime soon, less violent forms of hazardous destabilization occur with much greater historical frequency. The already disappointing rates of civic participation can easily fall still lower, enhancing the power of single-issue voters, haters, and the simply delusional. Careers in crime can become magnets to those who feel left out and hopeless. The extremists who take the stage on both the far right and the far left are nurtured and sustained by the same middle-class frustrations. This is the landscape that favors the demagogues and the bearers of the aggressive, heroic promises that have so often preceded catastrophe.

The impact of money on politics, embodied in the buying of access and influence as well as the ownership of media outlets, has always been a disquieting wrinkle in the philosophical case for democracy. Concerns about oligopolistic media power are especially valid today as the Internet brings novel concentrating vectors of its own. I maintain some faith, however, that the actual harm is moderated when there are enough differing voices among the powerful that truth and decency, rather than selfish plutocracy, may emerge from the cacophony. Given that one special interest's gain is frequently the next one's loss, a plethora of fat cats feasting off each other's plates will tend to limit what each can devour. This is the case for pluralism, and, although not every malefactor has a well-heeled adversary, that case has considerable merit. Pluralism is the antipodal adversary of concentration. Yet every narrowing in the sharing of economic prosperity we witness at this time, on either the individual or corporate level, reduces the benefits of pluralism. Concentration of political contributions, of lobbying expenditures, and of media influence all serve to undermine pluralism and thus reduce its palliative force as a protector of democratic government.

Compounding the damage to the national psyche and to the functioning of representative democracy, excessive wealth concentration can inflict direct pecuniary damage on an economy. It is tautological that those who don't share in prosperity and growth are harmed, but there may also be an accompanying detrimental impact on the aggregate economic pie. An economy with a super-concentrated distribution of wealth and income moves money where the marginal propensity to consume is least. Sequestration of wealth at the top invites a lethargy of activity not present when the fruits of growth are widely shared. Societies characterized by extreme inequality, moreover, will likely be as stingy toward essential social investments, such as infrastructure and public education, as they will be toward aiding their disadvantaged. History suggests that oligarchies and aristocracies have always tended to spawn less vibrant economic engines than societies with strong middle classes. And when prosperity is not shared, opportunities for individuals to rise and contribute to their full potentials are not shared well either. One can only imagine how much creativity and talent is wasted in a society that fails to stretch all of its human potential to the maximum, but this is exactly what happens when privilege rather than merit begets privilege and whole classes of people are hard pressed to find paths of opportunity. Where too much wealth is locked in place over generations, resources and prospects for achievement will no longer flow to those who will use them most effectively for the benefit of all. It is beyond realistic imagination that a hereditary aristocracy of wealth can be the best friend of prosperity or innovation.

## Why Is This Happening Now?

It is easier to believe something is happening if, beyond mere statistics, one can establish a logical inference that it *ought* to be happening under the circumstances. Not surprisingly, with respect to the acceleration of wealth inequality, it is simpler to establish that the worrisome trends are occurring now than to explain why they should be expected to happen now. Yet that is just what is needed for an inference test. Surely there must be something special about the winds of the 21st Century that engender such a rapid thrust toward concentration of assets at the top. In exploring the promoters of this super-sizing, it is useful to keep in mind that ours is not the only country with that distributional drift. Some less developed nations have nearly unbelievable disparities. Some of the wealthier nations of the Middle East have never put any value on equitable distribution of wealth. Russia and China have reinvented their traditional wealth and income gaps, Russia with its new breed of oligarchs, and China by risking a modern reformulation of its traditional rarified hierarchy. Within the Western world, the United States now bears the dubious distinction of leadership by a length in wealth inequality. The United Kingdom, Australia, and Canada are a few lengths behind us in the march toward a higher Gini, but they are following a similar track. The other European powers, including Germany and France, are a lap back but also seem to be headed the same way. Our nation's leadership in this regard is particularly worrisome owing to our special place as an economic role model for the rest of the world.

Four principal causative vectors for our present trajectory come to mind. One is the amazing expansion of technology companies in recent years and, along with their expansion, a rapid march toward knowledge-based employment markets. Contemporary high technology enterprises are often characterized by substitution of capital for labor, natural-monopoly networking characteristics, and an ability to foster unparalleled branding. It is easy, moreover, to observe that tech companies tend to favor the hiring of the already privileged and fortunate for their most highly compensated jobs. And they reward lavishly their founders and leaders. These features necessarily provide a thrust in the direction of inequality. There is ample reason for concern, and even belief, that the bifurcation between knowledge workers and those in the service economy will continue to widen and define a future class structure, or, worse still a caste structure, in which the many will primarily work in humble service to the few.

A second factor is globalization which, like technology, is a positive force across many of its dimensions, but also serves as a driver of increasing corporate and individual wealth concentration. Unrestricted free trade has long been controversial in some quarters for its proclivity to reward adherence to the bottom in wage levels, worker conditions, and environmental protections. Its impact on distributional inequality should now be added to the list of the legitimate concerns with a purely market-driven outcome. The law of comparative advantage assures us that, in a globalized world of free trade, division of labor and specialization across nations will provide a push toward maximization of overall output. As each country concentrates its economic activity increasingly on what it does most effectively, the world will look more and more like a single well-run business entity. The enhancement of world national product in this manner is not as wonderful as it sounds. It is a mixed blessing at best. Imagine that one nation is the unrivaled world leader in banking and artificial intelligence technology. With untrammeled free trade, that nation might surrender its manufacturing and agricultural activities to other countries with cheaper labor, while its lucrative specialties might allow it to prosper mightily as it does so. Not only would it then be vulnerable in times of international hostility or strain, it would surely have trouble maintaining full employment for the broad population at attractive wages. I use banking as one of the exemplars because, while that sector has shined in our era in terms of profits, it has provided no net job growth in the United States for the last thirty years. The sectoral expansion of its gains has had more impact on compensation at the senior levels than on full-spectrum employment or middle class wage levels. High tech companies have been better providers of new jobs than banking, but not across the same wide spectrum that manufacturing has historically covered. The principle of comparative advantage operates with nearly irresistible force. It is hard not to see globalization as relentlessly pushing sophisticated nations toward concentration in sectors of the economy whose rewards go disproportionately to an intellectual and entrepreneurial elite.

The financialization of modern economies is yet another factor powering wealth concentration. This is so for reasons that go well beyond banking's hiring and compensation patterns. The use of leverage, through debt or derivatives that magnify gain or loss on investments for both operating corporations and investors, has undergone an incredible expansion. Long ago, in hunter-gatherer societies, the best hunter or gatherer might have been fractionally better fed than the average member of the tribe. Eons later, the best farmer might have produced several times the crop yield of a less skilled or less industrious neighbor. In the early modern era, executives of manufacturing companies might have been paid hundreds of times more than their workers. But today, with nearly unlimited financial leverage multiplying raw gains and losses, a top banker, trader, or corporate executive can aim for rewards many thousands of times what those without their tools for multiplicative gains can claim. This phenomenon is praised by some for enhancing overall efficiency, but it comes with the corollary consequence of pushing money inexorably toward the top. Access to financial leverage is a privilege that is anything but universally shared.

Some scholars suggest, I think correctly, that a key contributor to inequity is simply the difference between the return on equity investments and the rate of annual increase in wages. For the last hundred years, stocks have produced an average annual return of over 10%. These gains go disproportionately to those well-heeled enough to own a stock portfolio. Wages, which go to the workers rather than the owners, are tethered to the growth rate of the whole economy, which runs at more like 2% or 3% per year. To some degree this element of the wealth concentration trend simply constitutes an intractable feature of a market economy, but it is exacerbated in these times by government policies, at home and abroad, that hold interest rates to near zero – a regime which pushes investable funds toward stocks and helps sustain bull markets. Equity investors as a group are gaining from this, and those who use leverage are gaining even more. Entrepreneurs and private equity investors can do especially well when equity markets are strong and debt is cheap. The leverage available through the use of derivatives, like debt, can compound the gains that current markets provide. Derivatives can also compound losses, but the impacts of gains and losses are asymmetrical. Upsides are almost always shared with the decision makers in the form of bonuses and capital gains, while downsides tend to fall mainly on the institutions they work for or, in the worst cases, on taxpayers via bailouts. Excessive leverage, moreover, imposes systemic risk to the whole economy by threatening contagion whenever the impenetrable webs of parties and counterparties are imperiled by any large participant's failure to meet its obligations. In short, a surplus of leverage creates potential economic instability while financially favoring those rich enough to employ it in large quantities. This is double trouble.

We should not overlook a fourth accelerant to the blaze of wealth concentration – self-inflicted wounds. A panoply of public policy sins contribute to the outcomes we are witnessing. Some are acts of commission, in the form of special interest legislation. More are acts of omission, failures to create or employ statutory and regulatory protections. While I cannot cite a formal proof of this conclusion, it is not unreasonable to place a good bit of emphasis on this source of the problem in the United States. As harsh as these next words may sound, it is hard to characterize some of these failures as other than the legalized cousins of corruption that arise from our largely unconstrained campaign finance system. Only the most naïve or cynical observer would fail to acknowledge today that large corporations, their leaders, family dynasties, and wealthy individuals exert exaggerated influence over society's rules. When contributions are effectively unlimited and elections are heavily dependent on spending, it is inescapable that every tilt toward the wealthy in public policy will tend to make the next one all the more likely. Only a voter rebellion can reverse this slide.

I have written elsewhere at some length on my prescriptions for better public policies. There is no good reason to repeat those arguments here. Instead I will offer just a few sentences of summary. Somewhere in the last century, antitrust enforcement wandered away, or was eviscerated. The maximum individual tax rate is lower now than it was for most of my life, and effective tax rates for the wealthy are even lower by comparative historical standards. Income from investing one's wealth is taxed far more favorably than income from work. Nominal corporate taxes have been reduced and effective rates are down even more. But the blue ribbon for the worst public policy goes to the abandonment of the estate tax, the fairest and least economically disruptive of all taxes. Despite its 1797 pedigree in this country, this tax has seen exemptions, preposterously generous trust laws, and step-up rules for capital gains cut its bite to virtually nil. Surely we do not need to allow unlimited wealth to pass to individuals who have won a genetic lottery but who have bestowed no gifts of effort or genius upon the society. Gift and estate taxes have gradually been degraded to the point that they now provide only about one-half of one percent of federal revenues.

Not all of the desirable policy improvements, of course, are related to distributional economics. I wouldn't suggest that for a moment. I applaud, to pick a pair of examples, those who carry on the fight for better campaign finance laws and for more successful and ambitious public schools. I do my small part on those fronts as well, but I fear my potential impact at the margin on these matters cannot be compared to what I can hope to accomplish in the economic arena.

## So Many Questions

If I knew the answers to all of the hard questions about wealth inequality or how to remedy the imbalances I have cited, I would probably be devoting my funding to political action rather then academic centers. But I don't. To make the point, I offer just two of the many possible examples of questions I hope to see addressed by the fine minds we seek to engage.

To repeat a concern raised earlier, it is not easy to decide how much to assess the actively productive entrepreneurs who have envisioned and run the remarkable growth engines we see today. We all know the childhood nursery fable about the couple whose goose can lay golden eggs but whose impatience impels them to cut open the goose in search of more gold. The couple, of course, find themselves with nothing but a dead goose. As a society, we will need to ask whether limiting the fortunes of our best entrepreneurs will drive them to cease their exceptional contributions and thus disadvantage the whole nation. The problem here is that individuals of genius and relentless drive really can make a difference in history, or at least in the speed of historical progress. And, while one might suppose that the wealthiest among us are no longer motivated by money, experience tells me otherwise. The most affluent entrepreneurs I know continue to be drawn by, and sometimes even obsessed with, the bragging rights and the competitive scorecards that accumulation of wealth offers. It is far from apparent that the engines of change that remarkable individuals have conceived and constructed would continue to run as well or advance as rapidly if converted into bureaucracies. Taking account of the adverse impacts of inequality and the needs for social and infrastructure spending, I am fully comfortable favoring steeper taxes than we have today. But how much the increases should be, in what form they ought to be imposed, and when during the cycle of life they should be paid, I still consider open issues fully worthy of study.

The link between corporate and individual concentration also poses issues I am unsure how our society should best handle. It is fairly clear that one cannot separate concerns about the distribution of individual wealth from policy decisions about the structure of the corporate sector. Today's rush toward corporate concentration, with all of its implications for individual wealth, is particularly concerning in the technology and financial sectors. Modern technological and financial tools are necessarily double-edged swords. Yes, they permits us to accomplish things not even imaginable a few years ago, but contemporary gains can bring with them serious societal hazards. Fair competitive prices and maximization of new competitive entrants find no friend in gargantuan companies under the best of circumstances, and especially so when they yield to temptation and engage in bullying and monopolistic marketplace strategies. It seems apparent that — side by side with all of their undeniable contributions to modern life — technology companies and banking institutions at their present scale accelerate concentration of wealth far more aggressively than the agriculture and manufacturing businesses that dominated economies of the past. The academic theory of labor markets seems to have fallen behind the times with respect to these sectors. The challenges that face us today in this arena are not just more of the same. We must be watchful of self-fueling and accumulative corporate power lest we find ourselves all working for, and bowing to, a mere handful of mega-enterprises and corporate titans of historically unprecedented wealth. At the same time we must take care not to undermine the gifts of the contemporary era. Only Luddites seek to throw out the babies with the bathwater. Finding a balance that takes all of these considerations wisely into account is no simple matter.

Debates about the optimal levels of financial equality have been around almost as long as civilization itself, and corporate scale has been controversial since the birth of the corporate form. I cannot assert for a minute that I know the best answers to all of the questions in these domains… or even all the questions.

## Our Selected Approach

The goal of this philanthropic initiative is not modest. It is nothing less than to fulfill the promise of modern economics by having it pay as much attention to issues of distribution and equity as to those of efficiency. Put another way, I hope to nurture an arguably new, and certainly much expanded, sub-profession within economics to study issues of equity. As a conclusion to these thoughts, it may be useful to address a few of the questions I am being asked by those who hear of our foundation's work.

***Why is the emphasis only on economics and not on other related fields? And why do you talk about wealth more than income?*** Actually, the emphasis is neither solely on economics nor solely on wealth. I am using the word economics loosely here to encompass every aspect of the topic, and surely not to ignore or exclude any social science that deals with the causes and consequences of wealth inequality. While economics is plainly central to the issues at hand, we are already funding sociologists and political scientists as well as economists. Interdisciplinary study is more than welcome.

As for urging grant recipients to include wealth studies in their work rather than just income, this is by no means even the slightest criticism of those who look at income disparities. Both current income and wealth matter, and they are intricately intertwined. I am persuaded that wealth matters somewhat more, though, given that wealth concentration has a more lasting generational and dynastic impact than income disparities, and it almost surely has more political and sociological consequence. This is especially so with regard to the effects of wealth concentration at the top of the pyramid, which taken to excess, appears especially threatening to both justice and democracy. More important for our thinking, though, it should be beyond argument that wealth inequality is the more understudied than income inequality. Wealth is under-examined in part because the data to support scholarship on wealth is less available than for income. I would like to see that disparity reduced. But also there is this. A Harvard dean once told me that he could readily raise money from rich people to study the poverty tail of the income distribution but no one of means had yet offered his school money to study great wealth. Mirrors, it seems, can be painful. I applaud heartily, and plan to support, additional study of income inequality, but the greater intellectual hole to fill arises from the paucity of the study of wealth.

***Why are you funding only universities, especially when they are institutions particularly resistant to direction?*** Our concentration is on institutions of learning because they have more permanence and stability than issue-centric nonprofits and political entities of any stripe, two other obvious choices for funding. Universities are hard to capture or corrupt. And, yes, they cannot be directed readily by their donors, which will serve to limit my own influence after our gifts are given, but that is more virtue than vice. We will not be trying to tell the academic institutions what to do or how to do it. I have a reasonable degree of faith that exploration and discovery of truths will produce salutary effects naturally, if adequate resources can only be made available. It may take the work of thousands of scholars to change society's too-passive notions about inequality, but nurturing that effort is precisely our philanthropic mission. And it is not without forethought that we look to create programs at every level of the educational ladder. Among the activities we have funded already are undergraduate courses, stipends for graduate students, post-doctorate positions, and the hiring of both junior and senior faculty members. At some point, we will find a university host for a scholarly journal in our chosen field. The pipeline won't be complete until there is support for very mile of it.

***Of all the ways you can try to improve the world, why did you choose this as the most important subject?*** I didn't. There is no implied assertion in this choice that wealth inequality is more important than climate change, nuclear proliferation, or existential threats to democracy. These are all chronic issues of the gravest impact. There are also many acute problems in our world – famines, pandemics, and wars, just to name a few. I selected my philanthropic focus in part because, with resources of the scale I can offer, there is a greater chance of having an impact in this area than in most of the others. The pen can prove mightier than the sword only if it is inked properly ... and a goodly fraction of the required ink may be within my means. Given my training as an economist, moreover, I can probably allocate funds more sensibly and knowledgeably here than in other areas of concern.

While yielding the power of command by giving to universities, I am proceeding with an instinctive confidence that the work engendered by our gifts will help right a worsening balance. Every sign and signal tells me that our society is tilting too far toward economic inequality. If you believe a country can be judged by how decently it treats its least fortunate, or that its middle classes will be civically responsible and generous only when their hard work is fairly rewarded, then shifting too great a proportion of the gains of economic growth to the wealthy is unpropitious and even downright dangerous. The changes required are far from trivial, and the risks of inaction or, alternatively, of explosive and rash action are all too real. Let us all hope that a clear intellectual roadmap can be developed, allowing reversal of the current misguided trend, while taking care that the remedies applied to excessive wealth concentration are never worse than the malady.

James M. Stone
*Boston, 2021*