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THE PRICE OF INEQUALITY

HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE

PREFACE

THERE ARE MOMENTS IN HISTORY WHEN PEOPLE ALL over the world seem to rise up, to say that *something is wrong*, to ask for change. This is what happened in the tumultuous years 1848 and 1968. Each of these years of upheaval marked the beginning of a new era. The year 2011 may prove to be another such moment.

A youth uprising that began in Tunisia, a little country on the coast of North Africa, spread to nearby Egypt, then to other countries of the Middle East. In some cases, the spark of protest seemed at least temporarily doused. In others, though, small protests precipitated cataclysmic societal change, taking down long-established dictators such as Egypt's Hosni Mubarak and Libya's Muammar Qaddafi. Soon the people of Spain and Greece, the United Kingdom, and the United States, and other countries around the world, had their own reasons to be in the streets.

Throughout 2011, I gladly accepted invitations to Egypt, Spain, and Tunisia and met with protesters in Madrid's Buen Retiro Park, at Zuccotti Park in New York, and in Cairo, where I spoke with young men and women who had been at Tahrir Square.

As we talked, it was clear to me that while specific grievances varied from country to country and, in particular, that the political grievances in the Middle East were very different from those in the West, there were some shared themes. There was a common understanding that in many ways the economic and political system had failed and that both were fundamentally unfair.

The protesters were right that something was wrong. The gap between what our economic and political systems are supposed to do—what we were told they did do—and what they actually do became too large to be ignored. Governments around the world were not addressing key economic problems, including that of persistent unemployment; and as universal values of fairness became sacrificed to the greed of a few, in spite of rhetoric to the contrary, the feeling of unfairness became a feeling of betrayal.

That the young would rise up against the dictatorships of Tunisia and Egypt was understandable. The youth were tired of aging, sclerotic leaders who protected their own interests at the expense of the rest of society. They had no opportunities to call for change through democratic processes. But electoral politics had also failed in Western democracies. U.S. president Barack Obama had promised "change you can believe in," but he subsequently delivered economic policies that, to many Americans, seemed like more of the same.

And yet in the United States and elsewhere, there were signs of hope in these youthful protesters, joined by their parents, grandparents, and teachers. They were not revolutionaries or anarchists. They were not trying to overthrow the system. They still believed that the electoral process *might* work, if only governments remembered that they are accountable to the people. The protesters took to the streets in order to push the system to change.

The name chosen by the young Spanish protesters in their movement that began on May 15 was "los indignados," the indignant or outraged. They were outraged that so many would suffer so much—exemplified by a youth unemployment rate in excess of 40 percent since the beginning of the crisis in 2008—as a result of the misdeeds of those in the financial sector. In the United States the "Occupy Wall Street" movement echoed the same refrain. The unfairness of a situation in which so many lost their homes and their jobs while the bankers enjoyed large bonuses was grating.

But the U.S. protests soon went beyond a focus on Wall Street to the broader inequities in American society. Their slogan became "the 99 percent." The protesters who took this slogan echoed the title of an article I wrote for the magazine *Vanity Fair*, "Of the 1%, for the 1%, by the 1%,"[1] which described the enormous increase in inequality in the United States and a political system that seemed to give disproportionate voice to those at the top.[2]

Three themes resonated around the world: that markets weren't working the way they were supposed to, for they were obviously neither efficient nor stable;[3] that the political system hadn't corrected the market failures; and that the economic and political systems are fundamentally unfair. While this book focuses on the excessive inequality that marks the United States and some other advanced industrial countries today, it explains how the three themes are intimately interlinked: the inequality is cause and consequence of the failure of the political system, and it contributes to the instability of our economic system, which in turn contributes to increased inequality—a vicious downward spiral into which we have descended, and from which we can emerge only through concerted policies that I describe below.

Before centering our attention on inequality, I want to set the scene, by describing the broader failures of our economic system.

The failure of markets

Markets have clearly not been working in the way that their boosters claim. Markets are supposed to be stable, but the global financial crisis showed that they could be very unstable, with devastating consequences. The bankers had taken bets that, without government assistance, would have brought them and the entire economy down. But a closer look at the *system* showed that this was not an accident; the bankers had incentives to behave this way.

The virtue of the market is supposed to be its efficiency. But the market obviously is *not* efficient. The most basic law of economics—necessary if the economy is to be efficient—is that demand equals supply. But we have a world in which there are huge unmet needs—investments to bring the poor out of poverty, to promote development in less developed countries in Africa and other continents around the world, to retrofit the global economy to face the challenges of global warming. At the same time, we have vast underutilized resources—workers and machines that are idle or are not producing up to their potential. Unemployment—the inability of the market to generate jobs for so many citizens—is the worst failure of the market, the greatest source of inefficiency, and a major cause of inequality.

As of March 2012, some 24 million Americans who would have liked a full-time job couldn't get one.[4]

In the United States, we are throwing millions out of their homes. We have empty homes and homeless people.

But even before the crisis, the American economy had not been delivering what had been promised: although there was growth in GDP, *most citizens were seeing their standards of living erode*. As chapter 1 shows, for most American families, even before the onset of recession, incomes adjusted for inflation were lower than they had been a decade earlier. America had created a marvelous economic machine, but evidently one that worked only for those at the top.

So much at stake

This book is about why our economic system is failing for most Americans, why inequality is growing to the extent it is, and what the consequences are. The underlying thesis is that we are paying a high price for our inequality—an economic system that is less stable and less efficient, with less growth, and a democracy that has been put into peril. But even more is at stake: as our economic system is seen to fail for most citizens, and as our political system seems to be captured by moneyed interests, confidence in our democracy and in our market economy will erode along with our global influence. As the reality sinks in that we are no longer a country of opportunity and that even our long-vaunted rule of law and system of justice have been compromised, even our sense of national identity may be put into jeopardy.

In some countries the Occupy Wall Street movement has become closely allied with the antiglobalization movement. They do have some things in common: a belief not only that something is wrong but also that change is possible. The problem, however, is not that globalization is bad or wrong but that governments are managing it so poorly—largely for the benefit of special interests. The interconnectedness of peoples, countries, and economies around the globe is a development that can be used as effectively to promote prosperity as to spread greed and misery. The same is true for the market economy: the power of markets is enormous, but they have no inherent moral character. We have to decide how to manage them. At their best, markets have played a central role in the stunning increases in productivity and standards of living in the past two hundred years—increases that far exceeded those of the previous two millennia. But government has also played a major role in these advances, a fact that free-market advocates typically fail to acknowledge. On the other hand, markets can also concentrate wealth, pass environmental costs on to society, and abuse workers and consumers. For all these reasons, it is plain that markets must be tamed and tempered to make sure they work to the benefit of most citizens. And that has to be done repeatedly, to ensure that they continue to do so. That happened in the United States in the Progressive Era, when competition laws were passed for the first time. It happened in the New Deal, when Social Security, employment, and minimum-wage laws were passed. The message of Occupy Wall Street—and of so many other protesters around the world—is that markets once again must be tamed and tempered. The consequences of not doing so are serious: within a meaningful democracy, where the voices of ordinary citizens are heard, we cannot maintain an open and globalized market system, at least not in the form that we know it, if that system year after year makes those citizens worse-off. One or the other will have to give—either our politics or our economics.

Inequality and unfairness

Markets, by themselves, even when they are stable, often lead to high levels of inequality, outcomes that are widely viewed as unfair. Recent research in economics and psychology (described in chapter 6) has shown the importance that individuals attach to fairness. More than anything else, a sense that the economic and political systems were unfair is what motivates the protests around the world. In Tunisia and Egypt and other parts of the Middle East, it wasn't merely that jobs were hard to come by but that those jobs that were available went to those with connections.

In the United States and Europe, things seemed more fair, but only superficially so. Those who graduated from the best schools with the best grades had a better chance at the good jobs. But the system was stacked because wealthy parents sent their children to the best kindergartens, grade schools, and high schools, and those students had a far better chance of getting into the elite universities.

Americans grasped that the Occupy Wall Street protesters were speaking to *their* values, which was why, while the numbers protesting may have been relatively small, two-thirds of Americans said that they supported the protesters. If there was any doubt of this support, the ability of the protesters to gather 300,000 signatures to keep their protests alive, almost overnight, when Mayor Michael Bloomberg of New York first suggested that he would shut down the camp at Zuccotti Park, near Wall Street, showed otherwise.[5] And support came not just among the poor and the disaffected. While the police may have been excessively rough with protesters in Oakland—and the thirty thousand who joined the protests the day after the downtown encampment was violently disbanded seemed to think so—it was noteworthy that some of the police themselves expressed support for the protesters.

The financial crisis unleashed a new realization that our economic system was not only inefficient and unstable but also fundamentally unfair. Indeed, in the aftermath of the crisis (and the response of the Bush and the Obama administrations), almost half thought so, according to a recent poll.[6] It was rightly perceived to be grossly unfair that many in the financial sector (which, for shorthand, I will often refer to as "the bankers") walked off with outsize bonuses, while those who suffered from the crisis brought on by these bankers went without a job; or that government bailed out the banks, but was reluctant to even extend unemployment insurance for those who, through no fault of their own, could not get employment after searching for months and months;[7] or that government failed to provide anything except token help to the millions who were losing their homes. What happened in the midst of the crisis made clear that it was *not* contribution to society that determined relative pay, but something else: bankers received large rewards, though their contribution to society—and even to their firms—had been *negative.* The wealth given to the elites and to the bankers seemed to arise out of their ability and willingness to take advantage of others.

One aspect of fairness that is deeply ingrained in American values is opportunity. America has always thought of itself as a land of *equal opportunity.* Horatio Alger stories, of individuals who made it from the bottom to the top, are part of American folklore. But, as we'll explain in chapter 1, increasingly, the American dream that saw the country as a land of opportunity began to seem just that: a dream, a myth reinforced by anecdotes and stories, but not supported by the data. The chances of an American citizen making his way from the bottom to the top are less than those of citizens in other advanced industrial countries.

There is a corresponding myth—rags to riches in three generations—suggesting that those at the top have to work hard to stay there; if they don't, they (or their descendants) quickly move down. But as chapter 1 will detail, this too is largely a myth, for the children of those at the top will, more likely than not, remain there.

In a way, in America and throughout the world, the youthful protesters took what they heard from their parents and politicians at face value—just as America's youth did fifty years ago during the civil rights movement. Back then they scrutinized the values *equality*, *fairness*, and *justice* in the context of the nation's treatment of African Americans, and they found the nation's policies wanting. Now they scrutinize the same values in terms of how our economic and judicial system works, and they have found the system wanting for poor and middle-class Americans—not just for minorities but for *most* Americans of all backgrounds.

If President Obama and our court system had found those who brought the economy to the brink of ruin "guilty" of some malfeasance, then perhaps it would have been possible to say that the system was functioning. There was at least some sense of accountability. In fact, however, those who should have been so convicted were often not charged, and when they were charged, they were typically found innocent or at least not convicted. A few in the hedge fund industry have been convicted subsequently of insider trading, but this is a sideshow, almost a distraction. The hedge fund industry did not cause the crisis. It was the banks. And it is the bankers who have gone, almost to a person, free.

If no one is accountable, if no individual can be *blamed* for what has happened, it means that the problem lies in the economic and political system.

From social cohesion to class warfare

The slogan “we are the 99 percent” may have marked an important turning point in the debate about inequality in the United States. Americans have always shied away from class analysis; America, we liked to believe, is a middle-class country, and that belief helps bind us together. There should be no divisions between the upper and the lower classes, between the bourgeoisie and the workers.[8] But if by a class-based society we mean one in which the prospects of those at the bottom to move up are low, America may have become even more class-based than old Europe, and our divisions have now become even greater than those there.[9] Those in the 99 percent are continuing with the “we’re all middle class” tradition, with one slight modification: they recognize that we’re actually not all moving up together. The vast majority is suffering together, and the very top—the 1 percent—is living a different life. The “99 percent” marks an attempt to forge a new coalition—a new sense of national identity, based not on the fiction of a universal middle class but on the reality of the economic divides within our economy and our society.

For years there was a deal between the top and the rest of our society that went something like this: we will provide you jobs and prosperity, and you will let us walk away with the bonuses. You all get a share, even if we get a bigger share. But now that tacit agreement between the rich and the rest, which was always fragile, has come apart. Those in the 1 percent are walking off with the riches, but in doing so they have provided nothing but anxiety and insecurity to the 99 percent. The majority of Americans have simply not been benefiting from the country’s growth.

Is our market system eroding fundamental values?

While this book focuses on equality and fairness, there is another fundamental value that our system seems to be undermining—a sense of *fair play.* A basic sense of values should, for instance, have led to guilt feelings on the part of those who were engaged in predatory lending, who provided mortgages to poor people that were ticking time bombs, or who were designing the “programs” that led to excessive charges for overdrafts in the billions of dollars. What is remarkable is how few seemed—and still seem—to feel guilty, and how few were the whistleblowers. Something has happened to our sense of values, when the end of making more money justifies the means, which in the U.S. subprime crisis meant exploiting the poorest and least-educated among us.[10]

Much of what has gone on can only be described by the words “moral deprivation.” Something wrong happened to the moral compass of so many of the people working in the financial sector and elsewhere. When the norms of a society change in a way that so many have lost their moral compass, it says something significant about the society.

Capitalism seems to have changed the people who were ensnared by it. The brightest of the bright who went to work on Wall Street were like most other Americans except that they did better in their schools. They put on hold their dreams of making a lifesaving discovery, of building a new industry, of helping the poorest out of poverty, as they reached out for salaries that seemed beyond belief, often in return for work that (in its number of hours) seemed beyond belief. But then, too often, something happened: it wasn't that the dreams were put on hold; they were forgotten.[11]

It is thus not surprising that the list of grievances against corporations (and not just financial institutions) is long and of long standing. For instance, cigarette companies stealthily made their dangerous products more addictive, and as they tried to persuade Americans that there was no "scientific evidence" of their products' dangers, their files were filled with evidence to the contrary. Exxon similarly used its money to try to persuade Americans that the evidence on global warming was weak, though the National Academy of Sciences had joined every other national scientific body in saying that the evidence was strong. And while the economy was still reeling from the misdeeds of the financial sector, the BP oil spill showed another aspect of corporate recklessness: lack of care in drilling had endangered the environment and threatened jobs of thousands of those depending on fishing and tourism in the Gulf of Mexico.

If markets had actually delivered on the promises of improving the standards of living of most citizens, then all of the sins of corporations, all the seeming social injustices, the insults to our environment, the exploitation of the poor, might have been forgiven. But to the young *indignados* and protestors elsewhere in the world, capitalism is failing to produce what was promised, but is delivering on what was not promised—inequality, pollution, unemployment, and, *most important of all*, the degradation of values to the point where everything is acceptable and no one is accountable.

Failure of political system

The political system seems to be failing as much as the economic system. Given the high level of youth unemployment around the world—near 50 percent in Spain and 18 percent in the United States[12]—it was perhaps more surprising that it took so long for the protest movements to begin than that protests eventually broke out. The unemployed, including young people who had studied hard and done everything that they were supposed to do ("played by the rules," as some politicians are wont to say), faced a stark choice: remaining unemployed or accepting a job far below that for which they were qualified. In many cases there was not even a choice: there simply were no jobs, and hadn't been for years.

One interpretation of the long delay in the arrival of mass protests was that, in the aftermath of the crisis, there was hope in democracy, faith that the political system would work, that it would hold accountable those who had brought on the crisis and quickly repair the economic system. But years after the breaking of the bubble, it became clear that our political system had failed, just as it had failed to prevent the crisis, to check the growing inequality, to protect those at the bottom, to prevent the corporate abuses. It was only then that protesters turned to the streets.

Americans, Europeans, and people in other democracies around the world take great pride in their democratic institutions. But the protesters have called into question whether there is a *real* democracy. Real democracy is more than the right to vote once every two or four years. The choices have to be meaningful. The politicians have to listen to the voices of the citizens. But increasingly, and especially in the United States, it seems that the political system is more akin to "one dollar one vote" than to "one person one vote." Rather than correcting the market's failures, the political system was reinforcing them.

Politicians give speeches about what is happening to our values and our society, but then they appoint to high office the CEOs and other corporate officials who were at the helm in the financial sector as the system was failing so badly. We shouldn't have expected the architects of the system that has not been working to rebuild the system to make it work, and especially work for most citizens—and they didn't.

The failures in politics and economics are related, and they reinforce each other. A political system that amplifies the voice of the wealthy provides ample opportunity for laws and regulations—and the administration of them—to be designed in ways that not only fail to protect the ordinary citizens against the wealthy but also further enrich the wealthy at the expense of the rest of society.

This brings me to one of the central theses of this book: while there may be underlying economic forces at play, politics have shaped the market, and shaped it in ways that advantage the top at the expense of the rest. Any economic system has to have rules and regulations; it has to operate within a legal framework. There are many different such frameworks, and each has consequences for distribution as well as growth, efficiency, and stability. The economic elite have pushed for a framework that benefits them at the expense of the rest, but it is an economic system that is neither efficient nor fair. I explain how our inequality gets reflected in every important decision that we make as a nation—from our budget to our monetary policy, even to our system of justice—and show how these decisions themselves help perpetuate and exacerbate this inequality.[13]

Given a political system that is so sensitive to moneyed interests, growing economic inequality leads to a growing imbalance of political power, a vicious nexus between politics and economics. And the two together shape, and are shaped by, societal forces—social mores and institutions—that help reinforce this growing inequality.

What the protesters are asking for,

and what they are accomplishing

The protesters, perhaps more than most politicians, grasped what was going on. At one level, they are asking for so little: for a chance to use their skills, for the right to decent work at decent pay, for a fairer economy and society, one that treats them with dignity. In Europe and the Unites States, their requests are not revolutionary, but evolutionary. At another level, though, they are asking for a great deal: for a democracy where people, not dollars, matter; and for a market economy that delivers on what it is supposed to do. The two demands are related: unfettered markets do not work well, as we have seen. For markets to work the way markets are supposed to, there has to be appropriate government regulation. But for that to occur, we have to have a democracy that reflects the general interests—not the special interests or just those at the top.

The protesters have been criticized for not having an agenda, but such criticism misses the point of protest movements. They are an expression of frustration with the political system and even, in those countries where there are elections, with the electoral process. They sound an alarm.

In some ways the protesters have already accomplished a great deal: think tanks, government agencies, and the media have confirmed their allegations, the failures not just of the market system but of the high and *unjustifiable* level of inequality. The expression “we are the 99 percent” has entered into popular consciousness. No one can be sure where the movements will lead. But of this we can be sure: these young protesters have already altered public discourse and the consciousness of ordinary citizens and politicians alike.

Concluding Comments

In the weeks following the protest movements in Tunisia and Egypt, I wrote (in an early draft of my *Vanity Fair* article),

> As we gaze out at the popular fervor in the streets, one question to ask ourselves is this: when will it come to America? In important ways, our own country has become like one of these distant, troubled places. In particular, there is the stranglehold exercised on almost everything by that tiny sliver of people at the top—the wealthiest 1 percent of the population.

It was to be but a few months before those protests reached the shores of this country.

This book attempts to fathom the depths of one aspect of what has happened in the United States—how we became a society that was so unequal, with opportunity so diminished, and what those consequences are likely to be.

The picture I paint today is bleak: we are only just beginning to grasp how far our country has deviated from our aspirations. But there is also a message of hope. There are alternative frameworks that will work better for the economy as a whole and, most importantly, for the vast majority of citizens. Part of this alternative framework entails a better balance between markets and the state—a perspective that is supported, as I shall explain, both by modern economic theory and by historical evidence.[14] In these alternative frameworks, one of the roles that the government undertakes is to redistribute income, especially if the outcomes of market processes are too disparate.

Critics of redistribution sometimes suggest that the cost of redistribution is too high. The disincentives, they claim, are too great, and the gains to the poor and those in the middle are more than offset by the losses to the top. It is often argued on the right that we could have more equality, but only at the steep price of slower growth and lower GDP. The reality (as I will show) is just the opposite: we have a system that has been working overtime to move money from the bottom and middle to the top, but the system is so inefficient that the gains to the top are far less than the losses to the middle and bottom. We are, in fact, paying a high price for our growing and outsize inequality: not only slower growth and lower GDP but even more instability. And this is not to say anything about the other prices we are paying: a weakened democracy, a diminished sense of fairness and justice, and even, as I have suggested, a questioning of our sense of identity.

A few words of caution

A few other prefatory remarks: I often use the term "the 1 percent" loosely, to refer to the economic and political power of those at the top. In some cases, what I really have in mind is a much smaller group—the top one-tenth of 1 percent; in other cases, in discussing access to elite education, for instance, there is a somewhat larger group, perhaps the top 5 percent or 10 percent.

It may seem to readers that I talk too much about the bankers and corporate CEOs, too much about the financial crisis of 2008 and its aftermath, especially (as I'll explain) since the problems of inequality in America are of longer standing. It is not just that they have become the whipping boys of popular opinion. They are emblematic of what has gone wrong. Much of the inequality at the top is associated with finance and corporate CEOs. But it's more than that: these leaders have helped shape our views about what is good economic policy, and unless and until we understand what is wrong with those views—and how, to too large an extent, they serve *their* interests at the expense of the rest—we won't be able to reformulate policies to ensure a more equitable, more efficient, more dynamic economy.

Any popular book like this entails more sweeping generalizations than would be appropriate in more academic writing, which would be replete with qualifications and footnotes. For this, I apologize in advance and refer the reader to some of the academic writing cited in the more limited number of footnotes that my publisher has allowed me. So too, I should emphasize that in castigating "bankers" I oversimplify: many, many of the financiers that I know would agree with much that I have said. Some fought against the abusive practices and predatory lending. Some wanted to curb the banks' excessive risk taking. Some believed that the banks should focus on their core businesses. There are even several banks that did just that. But it should be obvious that most important decision makers did not: both before the crisis and after it, the largest and most influential financial institutions did behave in ways that can rightly be criticized, and someone has to take responsibility. When I castigate the "bankers," it is *those* who decided, for instance, to engage in fraudulent and unethical behavior, and who created the culture within the institutions that facilitated it.

Intellectual debts

A book such as this rests on the scholarship, theoretical and empirical, of hundreds of researchers. It is not easy to put together the data that describe what is happening to inequality, or to provide an interpretation of why what was has been occurring has happened. Why is it that the rich are getting so much richer, that the middle is being hollowed out, and that the numbers in poverty are increasing?

While footnotes in subsequent chapters will provide some acknowledgments, I would be remiss if I did not mention the painstaking work of Emmanuel Saez and Thomas Piketty, or the work over more than four decades of one of my early coauthors, Sir Anthony B. Atkinson. Because a central part of my thesis is the intertwining of politics and economics, I have to stretch beyond economics, narrowly defined. My colleague at the Roosevelt Institute Thomas Ferguson, in his 1995 book *Golden Rule: The Investment Theory of Party Competition and the Logic of Money-Driven Political Systems*, was among the first to explore with some rigor the fundamental puzzle of why, in democracies based on one person one vote, money seems to matter so much.

The link between politics and inequality has, not surprisingly, become a focus of much recent writing. This book, in some sense, picks up where the excellent book by Jacob S. Hacker and Paul Pierson, *Winner-Take-All Politics: How Washington Made the Rich Richer—And Turned Its Back on the Middle Class*,[15] leaves off. They are political scientists. I am an economist. We all grapple with the question of how the high and growing inequality in the United States can be explained. I ask, How can we reconcile what has happened with standard economic theory? And though we approach the question through the lens of two different disciplines, we come to the same answer: to paraphrase President Clinton, "It's the politics, stupid!" Money speaks in politics, as it does in the marketplace. That that is so has long been evident, and brought forth a bevy of books, such as Lawrence Lessig's *Republic, Lost: How Money Corrupts Congress—And a Plan to Stop It*.[16] It has also become increasingly clear that growing inequality is having a major effect on our democracy, as reflected in books such as Larry Bartels's *Unequal Democracy: The Political Economy of the New Gilded Age*[17] and Nolan McCarty, Keith T. Poole, and Howard Rosenthal's *Polarized America: The Dance of Ideology and Unequal*

Riches.[18]

But how and why money should be so powerful in a democracy where each person has a vote—and most voters, by definition, are not in the 1 percent—has remained a mystery, on which I hope this book will shed a little light.[19] Most importantly, I try to illuminate the nexus between economics and politics. While it has become evident that this growing inequality has been bad for our politics (as evidenced by the pack of books just mentioned), I explain how it is also *very* bad for our economy.

A few personal notes

I return in this book to a subject that drew me into the study of economics a half century ago. I was initially a physics major at Amherst College. I loved the elegance of the mathematical theories that described our world. But my heart lay elsewhere, in the social and economic upheaval of the time, the civil rights movement in the United States, and the fight for development and against colonialism in what was called then the Third World. Part of this yearning was rooted in my experience growing up in the heartland of industrial America, in Gary, Indiana. There I saw at first hand inequality, discrimination, unemployment, and recessions. As a ten-year-old, I wondered why the kindly woman who took care of me much of the day had only a sixth-grade education, in this country that seemed so affluent, and I wondered why she was taking care of me, rather than her own children. In an era when most Americans saw economics as the science of money, I was, in some ways, an unlikely candidate to become an economist. My family was politically engaged, and I was told that money wasn't important; that money would never buy happiness; that what was important was service to others and the life of the mind. In the tumult of the 1960s, though, as I became exposed to new ideas at Amherst, I saw that economics was much more than the study of money; it was actually a form of inquiry that could address the fundamental causes of inequity, and to which I could effectively devote my proclivity for mathematical theories.

The major subject of my doctoral dissertation at MIT was inequality, its evolution over time, and its consequences for macroeconomic behavior and especially growth. I took some of the standard assumptions (of what is called the neoclassical model) and showed that under those assumptions there should be a convergence to equality among individuals.[20] It was clear that something was wrong with the standard model, just as it was clear to me, having grown up in Gary, that something was wrong with a standard model that said the economy was efficient and there was no unemployment or discrimination. It was the realization that the standard model didn't describe well the world we lived in that set me off on a quest for alternative models in which market imperfections, and especially imperfections of information and "irrationalities," would play such an important role.[21] Ironically, as these ideas developed and gained currency within some parts of the economics profession, the opposite notion—that markets worked well, or would, if only the government kept out of the way—took hold within much of the public discourse. This book, like several of those that preceded it, is an attempt to set the record straight.