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Do the Math: The Rich Really Are Different

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Is extreme wealth inequality in the U.S. something that government can or should address? The answer depends on how it arises. If everybody has a shot at the top, maybe it's not so bad. If the wealthiest are exploiting some kind of advantage, the system may need fixing.

New research suggests that only the latter explanation makes mathematical sense.

The top 1 percent of earners in the U.S. take home about 20 percent of all income, nearly three times as much as in 1980. Experts variously attribute the trend to the meteoric rise of finance, three decades of tax reductions, technological advances or even a flaw at the heart of capitalism. In truth, nobody knows for sure.

Mathematics offers some useful insights. For one, it's actually pretty natural for a large fraction of income (or wealth) to end up in the hands of a small fraction of people. Thanks to chance alone, some will enjoy better investment returns than others, and will then be able to invest more than their less wealthy counterparts. A few will be lucky enough to enjoy a string of successes, multiplying their riches to extreme levels.

In other words, you don't need a conspiracy to get high inequality. You'd see it even in a society of genetically identical clones. Inequality alone doesn't imply that the wealthy have any inherent advantage.

In such a model, the share of wealth going to the top 1 percent varies with such factors as the level of redistributive taxes and the importance of investment income. This offers one possible explanation for what has happened in the U.S.: Maybe policy changes since 1980, including lower taxes and moves to encourage more people to save for retirement, have simply triggered a qualitative shift toward a higher level of inequality.

In a recent paper, however, a group of U.S. and French economists and mathematicians finds that the experience of the U.S. doesn't fit into such a simple model. Over the past four decades, inequality has increased much too quickly. If tax levels or investment income were the only drivers, the change should have taken a few centuries. Mathematically, there must be another driver, something that empowers the wealthy to take an increasingly large share of the pie.

The economists offer a couple candidates, such as the emergence of "superstar entrepreneurs or managers" who possess special skills or hold key positions, or "superstar shocks," such as better information or investment advice that give the rich an edge in getting richer. These factors, they calculate, would be enough to account for the rapid change in inequality witnessed in recent years.

Their research provides compelling evidence that recent trends in inequality really do reflect something new and different in the workings of capitalism. It suggests that the wealthy have, solely by virtue of their status, gained the ability to steer even more money their way. As the authors note, it also backs up the famous conclusion of the French economist Thomas Piketty -- that, in recent decades, inequality has exploded because the rate at which wealth generates more wealth has exceeded the pace of overall economic growth.

Assuming these insights hold up, policy makers are left to figure out what -- if anything -- can be done to reverse the dynamic, without stifling innovation and productivity. Here, economists have a lot more work to do.

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