



# Popular Economics

*Promoting the Popular Understanding of Economics*

## Financial FAQs

### **Inequality Retards Economic Growth**

According to Stanford economist Paul Romer, mitigating inequality is the next great challenge in American Economics. Inflation and depressions have been largely controlled by the Federal Reserve since 1981, and we don't seem to have a problem with economic growth. Our Gross Domestic Product has grown 3.5 percent per year over the past 75 years (including the Great Depression) and averaged 3.3 percent since 2003, in spite of last quarter's meager 0.6 percent growth rate.

But along with growth has come higher inflation; so much so, that economists are now warning of a possible Fed rate hike at the June or August convening of the FOMC to tame it. Is inflation going up, coming down, or going nowhere? Fed Chairman Bernanke's latest inflation alarms have caused the 10-year Treasury Bond yield to pierce 5 percent, boosting 30-year fixed mortgage rates by three-eighths percentage points to 6.5 percent with a 1-point origination fee.

Economic growth has been uneven, in part because of soaring gas prices that hurt working families. Housing prices in the top coastal markets are averaging + \$1 million because the top 1 percent of income-earners corralled 17.4 percent of total U.S. income in 2005, up from 8.2 percent in 1980, according to economists Thomas Piketty and Emanuel Saenz. Their incomes now average more than \$1 million per year, according to the U.S. Census Bureau, while the bottom 20 percent had average earnings of just \$9,676, which is one-half the minimum poverty level.

Economists have only recently been studying its causes. There is a general consensus that education plays a role, as well as the Digital Age that has spawned so many fortunes for the entrepreneurial new agers. Microsoft's Bill Gates was a Harvard dropout, illustrating that a college education isn't a necessary prerequisite for success in the new economic age.

But there are other institutional factors coming to the fore as well. Globalization has encouraged companies to move manufacturing to cheaper labor climes, with white-collar computer jobs migrating overseas, as well. This has left the lower-paying service jobs (that cannot be exported) as the growth sector.

Taxation policies have also lowered the highest marginal income-tax rate to 36 percent, down from 70 percent in 1980 and 95 percent in the 1950s, which has steered more wealth to the already wealthy (while taxes for the middle and lower income classes have barely budged).

As if to confound Bernanke and the inflation hawks, the latest inflation numbers are good news. Consumer spending continued unabated and debt loads increased, but the core consumption expenditure index rose just 0.1 percent in April and has fallen back to 2 percent year-over-year within the Fed's inflation target zone. The Federal Reserve Beige Book also reported moderate inflation levels in all its districts.

Barron's columnist Alan Abelson believes that the Labor Department's May unemployment report hid some weakness, in spite of the 157,000 increase in payroll jobs. I.e., if those folks who want to work but are not officially in the labor force (because of not having looked for work within the past 4 weeks) were added to said work force the unemployment rate would be 5 percent, not 4.5 percent.

We in fact do not know for sure which direction the economy is growing. The NAR and Mortgage Bankers Association warn that many more defaults and foreclosures may be in the offing as almost \$1 trillion in adjustable rate mortgages will adjust upward over the next 2 years. That is probably why mortgage volumes are surging at the moment.

PPI—The wholesale Producer Price Index surged 0.9 percent in May due to a 4.1 percent rise in energy prices—gas prices soared 10 percent, for instance. Year-over-year wholesale prices are up 4.1 percent,

but core inflation without food and energy is up just 1.6 percent, within the Fed's target. The higher energy costs are not being passed on to so-called finished goods, so we fail to see why the Fed is worried.