Income Inequality and Education

George Rebane - 30 May 2007 (first posted on my *Union* blog on 3 June 2007)

You earn more money the more education you have. This astounding conclusion was recently reported in the May/June 2007 issue of *The American* by two leading lights in economics – Nobel laureate Gary Becker and Clark Prize winner Kevin Murphy. It is astounding to the many Americans and our government who behave as if high earners are somehow stealing money from the low earners and must therefore be punished. This punishment comes in the form of being constantly lambasted in the populist media and having more of their earnings confiscated by the state.

Smarter people, it seems, have the ability to find jobs that pay more or start enterprises that ultimately make them wealthy. And whenever you combine economic freedom with increased levels of schooling in a population, you will see income inequality develop and grow. It doesn't take rocket science to understand that if two people, say, a high school dropout and a college graduate, start with annual wages of $25,000 and $50,000 respectively. In ten years with 6% annual increases their initial wage disparity of $25,000 will grow to almost $45,000 at which time they will earn $44,771 and 89,542. The starting $25,000 gap will have grown to almost $45,000. But in the real world the graduate will probably have additional opportunities at jobs with wage increases over the years that will average significantly higher than 6% per year. In the meanwhile the under-educated dropout will be struggling to keep his salary increasing at 6%.

Now at least half of our citizens and government think that such a gap should be reduced by confiscating more of the graduate's earnings through progressive taxation. This message on punishing the fruits of education is not lost on the graduate or the dropout. To protect the earning power of his meager and readily replaceable skills, the dropout must join with others in similar straits to seek government protection for jobs through collective bargaining that is enforced by the police powers of the state. The dropout's more attractive alternative is to get his belated GED certificate and get a government job that becomes a sinecure to early retirement with all benefits paid.

The graduate's alternative is to attempt to retain her higher earning's by paying tax accountants to discover loopholes in our unbelievable tax code and/or exposing herself to extra risk through various investments. If she fails, she suffers her losses quietly and ignominiously. If she succeeds, then she continues as a member of the 'rich' and remains under the magnifying glass of journalists and politicians as a target of further leveling policies. This is the general process under which the educated compare their rewards to the less educated and attempt to explain to their children why it pays to stay in school. The national dropout rates show it's not easy to convince kids to stay in school.

Becker and Murphy's research also shows that "the upward trend in the returns to education is not limited to one segment of the population. Education premiums for women and African Americans have increased as much as, or more than, the premiums for all workers." They go on to state that "the proportion of black women who attend colleges and universities jumped from 24 to 43 percent between 1974 and 2003, while the proportion of white men rose only from 41 to 49 percent." The latter is important because the data show that women gain more from a college education than men.

The bottom line from this research is that more education is the most demonstrable cause of significantly higher wages over the long haul and therefore the cause of the much decried income inequality. Becker and Murphy's punch line question is "Should an increase in earnings inequality due primarily to higher rates of return on education and other skills be considered a favorable rather than an unfavorable development? (They) think so. Higher rates of return on capital are a sign of greater productivity in the economy, and that inference is fully applicable to human capital as well as to physical capital."

The now obvious conclusion from all this is that "instead of lamenting the increased earnings gap caused by education, policymakers and the public should focus attention on how to raise the fraction of American youth who complete high school and then go on for a college education."

But our governments at all levels have other ideas that attach the most limiting and visible anchors to the educated producers in our society. At the federal level Becker and Murphy feel "it will be a disaster if the focus remains so much on the earnings inequality itself that Congress tries to interfere directly with this inequality rather than trying to raise the education levels of those who are now being left behind." What the authors of the study do not state is that our politicians pander to the simplest thought patterns of the less educated voters – 'them that's got more should pay them that's got less regardless of how the more and the less got what they got'.

The only sustainable solution, short of reducing us all to a uniform level of poverty, is to encourage more investment in human capital. The two economists end their report with the delicacy of those who might seek future government research funding, observing that "attempts to raise taxes and impose other penalties on the higher earnings that come from greater skills *could* (emphasis mine) greatly reduce the productivity of the world's leading economy by discouraging investments in its most productive and precious form of capital – human capital."

I suppose that the next astounding results from this line of research will show that in an era of accelerating technology and globalization, imposing penalties on higher earnings that come from greater skills *will* indeed reduce our leading economy to a lagging economy. (see also 'Brain-Draining our Future')