What is behind the rise of the Occupy Wall Street (OWS) movement? How should we think about its focus on income disparities between the top 1 percent and the bottom 99 percent? And finally, how might this incipient movement alter the distribution of wealth and power in the United States? In this essay, we consider these three inter-related questions and provide some initial answers.

POLITICS: WHY NOW?
Inequality in the U.S. has risen dramatically over the past 40 years. So it is not too surprising to witness the rise of a social movement focused on redistribution. The more difficult question is why it took 40 years. It turns out that the U.S. provides a particularly stark example of the paradox where increased pre-fiscal income inequality may be associated with less redistribution (Meltzer and Richard 1981, Ale-sina et al. 2001, Campante 2011). For instance, the U.S. stands alone among the Organization for Economic Co-operation and Development (OECD) countries in experiencing an increase in pre-fiscal income inequality during the 1980s and 1990s and yet engaging in less redistribution (Kenworthy and Pontusson 2005).

One explanation of this paradox focuses on mobilization of political resources (Korpi 1983, Bradley et al. 2003). Greater inequality may reflect as well as exacerbate factors that make it relatively more difficult for lower-income individuals to mobilize on behalf of their interests. Over the past two decades we have seen the near disappearance of private sector labor unions, which historically have been the primary institution in the economic and political sphere pushing for higher wages and social insurance programs. This is particularly relevant given the wealth composition of donors to left versus right social movements. For example, entities like Americans for Prosperity funded by David and Charles Koch contributed towards the mobilization of the conservative Tea Party activists (Mayer 2010, Skocpol and Williamson 2002). Given the greater collective action problem on the left, relatively large expected gains from mobilization are needed to surmount the costs.
Yet, even the economic crisis of 2007 did not initially produce a left social movement. We suggest that in part, this is due to the interplay between social movements and electoral processes. A belief that we have a well-functioning electoral process dulls the incentives for independent social movement activism. The election of Barack Obama as the president of the U.S., along with a solid Democratic majority in Congress, likely served such a role. Only after it became increasingly clear that the political process was unable to enact serious reforms to address the causes or consequences of the economic crisis did we see the emergence of the OWS movement.

By 2011, most of the banks that played a central role in the financial crisis had emerged largely unscathed. Profitability had been restored thanks to public guarantees and infusion of liquidity, and executive compensation proceeded to grow, not shrink, in the aftermath of the crisis. At the same time, the enactment of austerity at the state and local government level was exacting large costs on workers who had little to do with the economic crisis, and the federal government appeared to have no appetite for further countercyclical measures after the 2009 stimulus wound down.

This experience elucidated the extent to which the state had been captured by the elite. “Banks got bailed out, and we got sold out”—as a popular OWS slogan went—because apparently the very wealthy had an immense sway over both major political parties. The elite were not primarily actors, musicians or sports superstars: they tended to be CEOs, finance executives, and Wall Street lawyers (Bakjia et al. 2010). Their wealth came from ties to capital, and often it came from specific ties to financial sector profits. This power ensured that the deregulation of the financial sector would proceed unhindered during the 1980s and 1990s, that bank bailouts would come with few strings attached during the crisis, and that few redistributive social policies would be enacted. Besides the failure of the private market to generate broad-based prosperity, there was also government failure that prevented a policy response. Behind both failures was the immense growth in upper-tail inequality—the income share of the top 1 percent or the 0.1 percent—as a separate phenomenon.

In part, this was due to the availability of data. As better income data became available, a stark picture emerged of incredible gains at the very top (Piketty and Saez 2003). In 1970, the top 1 percent made less than 10 percent of total pre-tax income. This was roughly in line with most European countries. However, by 2007, the share of the top 1 percent in pre-tax income had increased to 23.5 percent. This higher up the distribution of income one looked, the inequality in the U.S. to levels not seen since the 1920s. This increase in inequality since the early 1970s has been pervasive throughout the distribution of income. There have been large increases in the wage gap between those who have a college degree and those who do not, but there have also been large increases within each of these two groups. Economists have spent a lot of time trying to account for this increased inequality and have come up with explanations such as changes in technology, changes in labor market institutions, slowdowns in educational acquisition, and increases in globalization. However, less attention has been given to upper-tail inequality—the income share of the 1 percent or the 0.1 percent—as a separate phenomenon.

For some time, we have known that there has been an enormous explosion in income inequality in the U.S. to levels not seen since the 1920s. This increase in inequality since the early 1970s has been pervasive throughout the distribution of income. There have been large increases in the wage gap between those who have a college degree and those who do not, but there have also been large increases within each of these two groups. Economists have spent a lot of time trying to account for this increased inequality and have come up with explanations such as changes in technology, changes in labor market institutions, slowdowns in educational acquisition, and increases in globalization. However, less attention has been given to upper-tail inequality—the income share of the 1 percent or the 0.1 percent—as a separate phenomenon.

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more extreme was the inequality. For example, the income share going to the top 0.1 percent grew from 1.9 percent in 1970 to 8.2 percent in 2007 (Figure 1). Changes in tax policies amplified pre-tax earnings trends. Between 1970 and 2007, the top U.S. marginal tax rate dropped from 60 percent to 35 percent, while the maximum capital gains tax rate dropped from 32 percent to 15 percent.

During the 1990s and 2000s, most economists viewed the growth in the upper-tail inequality as largely representing the same phenomenon as the growth in wage inequality elsewhere—primarily a change in the demand for skills through technological change, with some role for policy. The fact that hedge fund managers were making a lot more than the median worker in the U.S. was thought to be the same phenomenon as an engineer making more than a janitor. When factors specific to upper-tail inequality were considered, the discussion was often about mechanisms amplifying the underlying growth in skill demand, such as the superstar theory. For example, the growth in firm size was offered as an explanation for the tremendous growth in CEO pay, as the CEO’s actions were now multiplied over a larger base (Gabaix and Landier 2008).

Missing from all this was a discussion about how upper-tail earnings inequality could be better understood as an increase in the power of those with control over financial and physical capital. The exceptions were mostly outside of mainstream economics (e.g., Duménil and Lévy 2004). Consider three pieces of evidence. First, there has been a broad decline in the labor share of income from around 66 percent in 1970 to 60 percent in 2007. Moreover, as measured, labor income includes compensation going to top executives—the modern day equivalent of
the nineteenth century capitalist. The exclusion of their compensation would show a substantially greater drop in labor’s share. Additionally, most of the growth in executive compensation has been capital-based, i.e., through stock options but appears in national accounts as labor income (Frydman and Molloy 2011).

Second, based on tax data, the majority of income at the top comes from capital-based earnings (capital gains, dividends, entrepreneurial income and rent). In 2007, this proportion was 62 percent and 74 percent for the top 1 percent and 0.1 percent, respectively (Figure 1).

Third, the biggest driver of upper-tail inequality—both in terms of capital and wage-based income—was finance, the sector which governs the allocation of capital. Between 2002 and 2007, 34 percent of all private sector profits came from the financial sector. Meanwhile, studies of financial sector pay setting suggest that the exorbitant finance premium in earnings was driven by financial sector profits (Philippon and Resheff 2009, Crotty 2011).

Overall, a focus on the 1 percent concentrates attention on the aspect of inequality most clearly tied to the distribution of income between labor and capital. This type of inequality is seen as being the least fair, as economic rents and returns to wealth are often perceived as unearned income (Atkinson 2009). Most people have very different notions of distributive justice over income perceived as being earned as opposed to being “found money,” and this is borne out in a host of experimental studies (Thaler 1999, Cherry et al. 2002, Oxoby and Spraggon 2008, Durante and Putterman 2009). Therefore, OWS’s focus on upper-tail inequality, as opposed to say the gap due to educational attainment, accords with what we know about social preferences on inequality.

**POLITICAL ECONOMY: WHAT ARE THE CHANNELS OF CHANGE?**

While it is far too early to assess the long-run impact of the Occupy movement, we think there are two likely channels through which OWS could affect the distribution of income. The first and most obvious way is by influencing public policy. The second mechanism is more subtle, but may be equally as important: shifts in norms that govern private-sector pay setting behavior.

We think OWS has already begun to influence the public policy making process. President Obama, for example, seems much more willing to discuss inequality—as suggested by his speech in Osawatomie, Kansas in December 2011, and further his State of the Union address in January 2012.

How does a social movement affect politics? First, it provides information. Polling trends suggests awareness of conflict between the rich and rose dramatically by end of 2011, concurrent with the OWS movement. Over two-thirds of respondents in a Pew poll believed that there were “strong conflicts” between the rich and the poor—higher than in the past two decades. Google search trends show a greater interest in “inequality” of late than any in previous period when data is available (Figure 2). The focus on inequality can have an effect through changing individual or higher order beliefs, and through increasing the salience of certain frames (e.g., “bankers’ bonuses”) in the public discourse. Of course, it is an open question whether any of this leads to longer-term policy shifts—especially challenging in a majoritarian setting (Iversen and Soskice 2006).

A second mechanism involves directly shifting pay norms. The literature on Social Structures of Accumulation has long argued that pay-setting
processes are epochal (see McDonough et al. 2010 for recent work from this perspective). A newer body of empirical work also suggests that such norms, while amorphous, may have historically anchored top pay (Piketty and Saez 2003, Levy and Temin 2007, Frydman and Molloy 2011). Even after the financial crisis, Wall Street bonuses remained high. However, the end of 2011 saw a sizeable reduction in bonuses for the first time in many years. While it is difficult to directly link this to OWS, the reductions may reflect changes in financial executives' beliefs about what practices are socially or politically acceptable. A durable, but much more challenging, legacy for OWS would be to help restore the “outrage constraint” on top pay (Bebchuk and Fried 2003).

Does the Occupy movement portend a more egalitarian future? To a large extent, this will be determined by the persistence of activists and others in mounting additional challenges to the political and economic elite over the coming year. OWS organizers have staked out a claim. “Our finances are weak, but our spirit is strong. We are the 99 percent. Our spring is coming.” The distribution of wealth and power in the United States may well depend on the accuracy of this political meteorology.
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NOTES
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2. World Top Incomes Database: http://184.168.89.58/sketch/

REFERENCES AND FURTHER READING


