



A TV in Every Home!

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U.S. income inequality has increased significantly since the 1970s after several decades of stability, and there are consequences, including a rise in populism.

Income inequality refers to the extent to which income is distributed in an uneven manner among a population. Most of the increase in U.S. income inequality can be traced to gains going to those near the top of the income distribution, according to the Federal Reserve.

In fact, Thomas Piketty, a French economist, reports that from 1977 to 2007 three-fourths of the income growth in the United States went to the top 10% of households.

Rising income inequality can have a broad effect on the economy, reducing aggregate demand for goods and services, which can hurt businesses.

As an example, consider a family with an annual income of \$10 million. Let's assume that family owns 10 TVs, which seems like a reasonable number for such an affluent household. So, TV manufacturers as a whole sell 10 TVs as a result of this \$10 million.

Now, assume that instead of living on \$10 million per year, the affluent family lives on \$2 million, which is still more than comfortable. The other \$8 million is split between 32 other households, each earning \$250,000 per year. Each of these households—our original affluent family and the other 32, so 33 total—will own at least one TV. So, there is a net additional demand for TVs.

This example is intended for illustrative purposes only, but it illustrates how rising income inequality can reduce demand—and it applies not just to TVs, but to virtually all goods and services.

While income inequality reduces demand, over time it also increases populism, which is exactly what we are observing today, both in Brexit and Donald Trump's election to U.S. president. As the political class is perceived to be ignoring the needs of ordinary people, support for the concerns of those people rises.

What can be done? Germany and Scandinavia have demonstrated that governments can effectively redistribute the benefits of income growth by supporting employment and incomes with regional and industrial subsidies.

Among the most effective interventions of this type is the spending of money on high-quality vocational education and re-training outside of universities, creating non-academic routes to a middle-class standard of living.

Will something similar occur with Trump's election, give that he campaigned, in great part, as a savior of ordinary people? Certainly, a major driver of Trump's win is the struggling middle class feeling ignored. And some of his proposed policy changes, such as an increase on infrastructure spending, could increase employment.

Apart from infrastructure spending, however, none of Trump's "remedies" for the middle class fall into the category of enabling people to earn a middle-class income on a sustainable basis. So the picture is uncertain.

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