How Rising Income Inequality Threatens Access to the Legal System

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Abstract: Incentives that lead sellers to introduce quality improvements and cost-saving innovations in competitive markets also ensure that no opportunity to cheat consumers remains unexploited. That difficulty underlies many American laws. But many people lack the income necessary to pay for legal interventions against unjust treatment, preventing them from meeting basic needs, like protection against financial fraud and abusive relationships. Growing income inequality has made this justice gap worse by reducing public funds available for legal aid in real terms, while also making it more difficult for low-income people to make ends meet. Simple policy changes could ease both problems without sacrifices from anyone. Those who could afford tax increases necessary to pay for more social services, including competent legal representation for everyone, resist this step because they believe that it would make it harder to buy the special things they want. But that belief is incorrect because the supply of special things is limited. The ability to bid successfully for them is unaffected by higher taxes, which do not affect relative purchasing power.

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When Mary Hicks's Washington, D.C., landlord was unresponsive to her repeated complaints about mold and mildew in her bathroom and holes in the walls, she began to withhold rent.[1] Her landlord sued her and threatened to evict her. Unable to afford a lawyer, Hicks sought help from a local law clinic. Advocating on her behalf in court, volunteer student attorneys blocked her eviction and persuaded the court to order the necessary repairs. In the process, they also discovered that the $975 in monthly rent she had been paying was far in excess of the level permissible under local ordinances. The court ordered her rent reduced to $480.[2]

Mary Hicks was lucky. According to a recent survey, more than 70 percent of low-income American households had been involved in civil legal disputes during the preceding twelve months, and in more than 80 percent of those cases, they lacked

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effective legal representation.[3] These disputes often involve issues far more serious than rental housing violations: they include custody disputes, health care coverage, child support, home foreclosures, domestic violence, disability access, veterans' benefits, bankruptcy, and divorces. That so many people must confront the legal system without help is obviously troubling. But progress toward a solution will require not only moral outrage, but also a clearer understanding of how market forces have contributed to this problem.

Many of Adam Smith's modern disciples celebrate his theory of the "invisible hand," which, in their telling, holds that market forces harness selfish individuals to serve the broader interests of society. As Smith wrote, "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."[4]

The invisible hand is a concept whose importance is difficult to overstate. Others before Smith understood that firms develop product-design improvements and cost-saving innovations not to serve humanity, but to increase their profits by capturing market share from rivals. But Smith saw more clearly than others that the story does not end there. Rivals are quick to copy new designs and improvements in production methods, and the resulting competition drives prices down to levels just sufficient to cover the new, lower costs of production. The ultimate beneficiaries of this process, Smith argued, are consumers, who enjoy a continuing stream of better and cheaper products.

Yet Smith was far more circumspect than many of his modern disciples about the power of the invisible hand. He understood that self-interest alone would not lead to the greatest good for the greatest number. He believed that markets could not function adequately in the absence of an elaborate foundation of laws and ethical norms of the sort he described in detail in his *The Theory of Moral Sentiments* (1759), published almost two decades before his *The Wealth of Nations* (1776).

More recently, George Akerlof and Robert Schiller, both Nobel laureates in economics, published *Phishing for Phools* (2015), in which they argue that the same incentives that lead sellers to introduce quality improvements and cost-saving innovations also ensure that no profitable opportunity to cheat consumers will remain unexploited.[5] Behavioral economics suggests that such opportunities are abundant.

Behavioral economists work largely at the intersection of economics and psychology. Much of their attention has focused on impulse-control problems and systematic biases in people's perceptions, judgments, and decisions. As the late Amos Tversky, a Stanford University psychologist and a founding father of behavioral economics, liked to say, "My colleagues, they study artificial intelligence. Me? I study natural stupidity."

As research in this vibrant field has conclusively demonstrated, market forces alone are far from sufficient to eliminate widespread opportunities to exploit consumers. One can believe that markets have dramatically improved the human condition and, at the same time, believe that unless consumers also enjoy the protection of a well-designed system of laws and regulations, it is not reasonable to expect society to be just.

Even with well-considered consumer-protection laws and regulations on the books, however, there remains the matter of enforcement. Access to the legal system requires costly resources that should be employed only when they are likely to generate commensurate benefits. Most societies let families decide for themselves whether it makes sense to incur the necessary expenses to mount civic legal interventions. That might be a defensible position if everyone had adequate income. But many lack the income necessary even to consider such interventions.

Their inability to intervene often prevents them from meeting such basic needs as access to health care, safe and habitable housing, and protection against financial fraud and abusive relationships. As Martha Bergmark, executive director of Voices for Civil Justice, put it, "Individuals face really high stakes in the civil justice system. You can lose your children, you can lose your home, you can lose your livelihood without having legal help to get you through complicated legal proceedings."[6]

An important component of the social safety net in the United States has been the Legal Services Corporation (LSC), the nonprofit corporation created by Congress with bipartisan support in 1974. But as LSC President James Sandman acknowledges in his contribution to this issue of *Dædalus*, estimates suggest, conservatively, that about 80 percent of the civil legal needs of poor people in America remain unmet.[7]

No one argues that this state of affairs is desirable. The support shortfall, which the LSC calls the "justice gap," has grown not just because of decreasing congressional appropriations in real terms for the LSC, but also because the real purchasing power of low-income families has shrunk significantly. As I will explain, both declines are indirectly related to a common set of market forces.

During the three decades after World War II, incomes in the United States rose rapidly and at about the same rate – a bit less than 3 percent a year – for people at all income levels. The country had an economically vibrant middle class. America's roads and bridges were well maintained, and impressive new infrastructure was being built. The nation enacted Medicare, Head Start, the Earned-Income Tax Credit, and other features of a more ambitious and comprehensive social safety net.

The past four decades present a striking contrast. The economy has grown much more slowly than it had earlier, and virtually all income growth has been accruing to those atop the income ladder. The share of total income going to the top 1 percent of earners, which stood at 8.9 percent in 1976, had risen to 23.5 percent by 2007, but during the same period, the average inflation-adjusted hourly wage had declined by more than 7 percent. Much of the nation's infrastructure had fallen into grave disrepair, and safety net programs faced growing shortfalls and threats of closure or privatization.

In *The Winner-Take-All Society* (1995), economist Philip Cook and I argue that these changes were driven largely by new technologies and market institutions that afford growing leverage for the talents of the ablest individuals.[8] For example, the best option available to patients suffering from a rare illness was once to consult with the most knowledgeable local practitioner. But now that medical records can be sent anywhere with a single keystroke, today's patients can receive advice from the world's leading authority on that illness.

Such changes didn't begin yesterday. Alfred Marshall, the great nineteenth-century British economist, described how advances in transportation enabled the best producers in almost every domain to extend their reach. Piano manufacturing, for instance, was once widely dispersed, simply because pianos were so costly to transport. Unless they were produced close to where buyers lived, shipping costs quickly became prohibitive. With each extension of the highway, rail, and canal systems, shipping costs fell sharply, and at each step, production became more concentrated. Worldwide, only a handful of the best piano producers now survive. It is, of course, a good thing that their superior offerings are now available to more people. But an inevitable side effect has been that producers with even a slight edge over their rivals went on to capture most of the industry's income.

Many of the environmental changes that have been occurring over time are analogous to reductions in shipping costs. That's true, for example, of reductions in tariff barriers and better communication technologies. Perhaps even more important has been the fact that an increasing share of what makes a product valuable is accounted for by the ideas embedded in it. Ideas don't weigh anything, so they are costless to ship.

Cook and I argued that these changes help explain both the growing income differences between ostensibly similar individuals and the surge in income inequality that began in the late 1960s. In domain after domain, we wrote, technology has enabled the most gifted performers to extend their reach and consolidate control of their market.

Growth in income inequality helps explain not only changes in government funding levels for services provided by the American social safety net, but also changes in the ability of low-income Americans to pay for those same services privately.

Many factors have contributed to America's failure to maintain historic levels of public investment in infrastructure and social services. But one in particular stands out: citizens' demands for government services have outstripped government tax revenue. That phenomenon, in turn, has many causes, among them the sharply rising costs of health care and pensions associated with our aging population. But as Table 1 suggests, an additional contributing factor has been a long-term decline in the nation's top marginal tax rate. Many tax cuts were adopted in the hope that they would stimulate economic growth by enough to prevent a decline in overall tax revenues. That hope proved a fantasy. The nonpartisan Congressional Budget Office estimated that the George W. Bush tax cuts reduced federal revenue by $2.9 trillion between 2001 and 2011. And in a widely cited *New York Times* article, Bruce Bartlett, a senior economic advisor in the Ronald Reagan and George H. W. Bush administrations, argued that the actual revenue shortfall caused by the Bush tax cuts was considerably larger.[9]

Because winner-take-all markets are highly competitive, successful contestants are almost invariably highly talented and hardworking. When thinking about the reasons for their own success, then, it is perhaps only to be expected that the narratives they construct are heavily shaped by memories of the long hours they put in, the difficult problems they solved, and the many formidable opponents they vanquished. Being spectacularly successful may reinforce the natural sense of entitlement to income produced by the fruits of one's own labor. As the seventeenth-century British philosopher John Locke wrote, "yet every man has a Property in his own Person. This no Body has any Right to but himself. The Labour of his body, and the Work of his Hands, we may say, are properly his."[10]

But a more important change in the environment has been the capacity of successful individuals to influence the political system's response to their grievances about high top marginal tax rates. The role of money in contests for political

Table 1
Maximum Marginal Tax Rates on Individual Income in the United States

Year	Tax Rate
1966	70%
1982	50%
1987	38%
1995	39.6%
2018	37%

Source: Tax Policy Center, "Historical Highest Marginal Income Tax Rates," March 22, 2017, http://www.taxpolicycenter.org/statistics/historical-highest-marginal-income-tax-rates.

office had been growing even before the Supreme Court's *Citizens United* decision in 2010, and has grown even more rapidly since then.

Congresspeople today spend an average of five hours per day calling potential donors, many of whom have clear preferences about marginal tax rates. Referring to the Tax Cuts and Jobs Act of 2017, which significantly cut corporate taxes and marginal tax rates for top earners, Republican Representative Chris Collins of New York said, "My donors are basically saying, 'Get it done or don't ever call me again.'"[11] In the wake of the enactment of that legislation, government borrowing has spiked sharply, provoking additional calls to cut social services.

Every human judgment depends critically on relevant frames of reference. On a sixty-degree day in Miami in November, is it cold out? What about a sixty-degree day in Montreal in March? Residents in Miami would be reaching for the heaviest coat they owned – I know because I grew up there – while the Montrealers would be celebrating the warmth of spring. Or suppose you are driving with your daughter to visit her grandparents and she asks, "Are we almost there yet?" If ten miles remain on a twelve-mile journey, you'll say no. But if those same ten miles remain on a 120-mile journey, you'll say yes. Everyone understands how frames of reference shape judgments like these. Yet in traditional economic models, evaluation is independent of context. A century from now, economists will look back in wonder at that fact.

Standard economic models, which ignore the role of context, assume that each person's spending is completely independent of what others spend. But if context matters, that can't be right. Growing income inequality in recent decades has changed the contexts that shape spending decisions in ways that have made it more expensive for most families to achieve basic goals. People at the top of the income ladder are building bigger houses, for example, simply because they have more money. There is no indication that the larger mansions of the wealthy make middle- and low-income people unhappy directly. On the contrary, the nonrich have a brisk appetite for pictures and video footage of the luxuries of the rich. But the larger houses of those at the very top shift the frame of reference that defines what those just slightly less wealthy consider necessary or desirable, so they, too, build bigger, and so on, all the way down the income ladder.

Without invoking this process, which I call *expenditure cascades*, it is difficult to explain why the median new house in the United States is now 50 percent larger than in 1980. Failure to keep pace with what peers spend on housing means not just living in a house that seems uncomfortably small, but it also means having to send your children to inferior schools, because better schools are almost always those in more expensive neighborhoods.

Figure 1 shows the toil index, a simple measure I constructed to track one important cost of rising inequality for middle-income families. To send their children to a school of at least average quality, median earners must buy the median-priced home in their area. The toil index plots the number of hours the median earner must work each month to achieve that goal. When incomes were growing at the same rate for everyone during the post–World War II decades, the toil index was almost completely stable. But income inequality began rising sharply after 1970, and since then, the toil index has risen in tandem. It now takes approximately one hundred hours a month to be able to afford that median home, up from only forty-two hours in 1970.

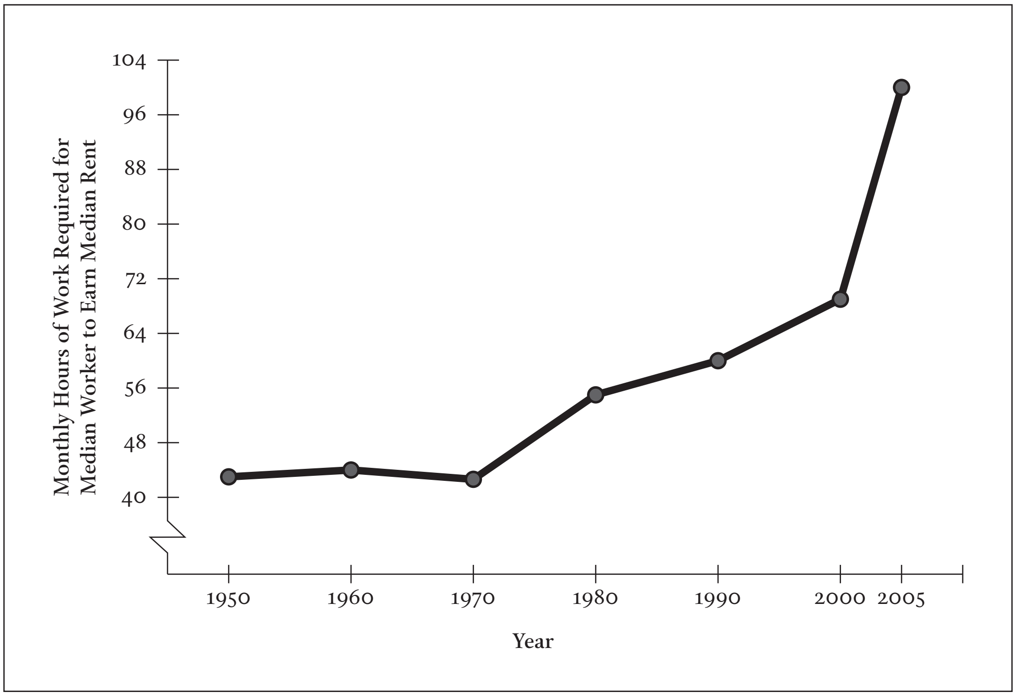
It's not just homes. Why does the average American wedding now cost $31,000, almost three times as much as in 1980? There's been an expenditure cascade there, too: Like a good school, a special celebration is a relative concept; it must stand out from what people expect. But when everyone spends more, the effect is merely to raise the bar that defines special, without improving anyone's relative position. Does anyone believe that couples who marry today are happier because their weddings cost so much more? The reverse may in fact be true. In one large sample of women, the marriages of those whose weddings cost more than $20,000 failed at more than three times the rate of those whose weddings cost between $5,000 and $10,000.[12]

The median real wage in the United States is actually lower now than it was in the 1980s. If middle-income families must now spend more than before to achieve basic goals, how do they manage? They are exploiting every available option: saving less, borrowing more, working longer hours, and moving farther from work. Census data reveal clear links between these responses and regional variations in the growth of inequality.[13] Of the one hundred largest U.S. counties, those where income inequality grew most rapidly were also those that experienced the largest increases in three important symptoms of financial distress: divorce rates, long commutes, and bankruptcy filings. Standard economic models, which ignore context, predict none of these relationships.

The upshot is that even though people near the top of the income ladder have enjoyed unprecedented prosperity since 1970, those farther down are finding it more difficult than before to make ends meet. The Legal Services Corporation was inadequately funded even at the time of its creation in 1974, but the organization's inability to meet its clients' needs has increased dramatically in the years since.

The good news is that a relatively simple set of policy changes could ease both revenue shortfalls and household budget distress without requiring painful sacri-

Figure 1
The Toil Index



Source: Robert H. Frank, "Supplementing Per-Capita GDP as Measure of Well-Being," American Economic Association Annual Meeting Papers, Denver, Colorado, January 7, 2011.

fices. Yet the people who could easily afford the tax increases necessary to pay for a more complete suite of social services, including competent legal representation for everyone, do not agree: they believe it would make it harder for them to buy the special extras they want. But that belief is incorrect. The problem, as noted, is that the standards that define "special" in many domains of consumption are highly elastic. When everyone spends more, those standards adjust accordingly. Much private spending is thus mutually offsetting, much like across-the-board increases in weaponry in military arms races.

Before even learning how long his archrival's yacht would be, the multibillionaire shipping magnate Stavros Niarchos instructed his naval architect to design a yacht fifty feet longer than the one Aristotle Onassis was building. If Niarchos's goal was to own a boat that would seem special, he succeeded, at least temporarily. But in the process, each man ended up with a vessel too large to visit many of the most beautiful ports of the world. Each might well have been happier had he built a little smaller.

The central role of context in evaluation causes prosperous people to overestimate the pain they would experience from a tax hike. Most of the events in life that leave someone with less money – home fires, job losses, business losses, divorces, serious illnesses, and the like – are ones that reduce his or her income while leaving others' incomes unaffected. In such cases, Americans really do find it more difficult to buy what they want. But matters unfold differently when everyone's spendable income goes down at once, as when all pay higher taxes.

Because across-the-board declines in disposable income don't affect relative purchasing power, prosperous families could actually pay higher taxes without having to make any painful sacrifices. Failure to recognize that simple fact has helped spawn the tax resistance that has made it so difficult to restore our crumbling public infrastructure and maintain support for the social safety net, including the Legal Services Corporation.

Most economists celebrate reliance on market prices in the name of efficiency. Many go on to argue that market-determined rates of pay also promote a measure of fairness, rewarding those who work hard and invest in developing their skills. This is all well and good. Yet it is an overreach to claim that market-determined rates of pay are morally just. It is one thing to say that someone who works 10 percent harder, or is 10 percent more skillful, than another should be paid 10 percent more. But in today's winner-take-all marketplace, those who are only 1 percent more talented often earn thousands of times more than their nearest rivals.

Even more troubling, evidence suggests that chance events play a much larger role in market-determined pay now than in the past. There are natural limits on talent and effort, and in markets that attract many thousands of contestants, a substantial number will be close to those limits. Even if luck counts for only a small fraction of total performance, most winners in the highest-paid markets will actually be slightly less hardworking and talented than their rivals, but substantially luckier.[14] That's because the most talented, hardworking contestant will be about as lucky, on average, as her closest rivals, but among those rivals, there will be at least some who are extremely lucky, which is all it takes for one of them to end up in the winner's circle.

Today's growing pay disparities generate additional moral concerns by making it more difficult for low- and middle-income families to achieve basic goals. One of Charles Darwin's most important insights was that life is graded on the curve. The absolute quantity of resources someone has matters less than how what she has compares with her competitors. Only half of all children can attend schools in the top half of the school quality distribution, which, again, are almost invariably those located in more expensive neighborhoods. It's not reasonable to ask parents to set aside their goal of sending their children to the best schools they can. When growing income inequality induces others to bid more intensively for houses in better school districts, most parents see failing to do likewise as an unacceptable option. In their efforts to keep up, other important dimensions of their lives suffer.

The result is difficult to square with anyone's conception of a just society. Most moral systems embrace some version of the golden rule: do unto others as you would have them do unto you. Some people are economically disadvantaged because they are lazy or made foolish choices, but most are struggling through no fault of their own. It is thus no surprise that most people find it painful to witness someone stricken with a serious illness and unable to afford medical care; or that they are similarly troubled by the knowledge that many parents cannot afford to educate their children; or that they recoil from the sight of people having to confront difficult legal disputes without being able to afford a lawyer.

Empathy for people in difficult situations helps explain why most industrial societies provide relatively generous social safety nets for their citizens. These programs typically include state-sponsored public education and universal access to medical care. The same concerns help explain why America created the Legal Services Corporation. But this element of the American social safety net, which was never generously funded, is even more critically short of resources today. The nation can remedy the issue without having to demand painful sacrifices from anyone. Americans should support leaders willing to attack this problem.

ENDNOTES

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13 See Robert H. Frank, Adam Seth Levine, and Oege Dijk, "Expenditure Cascades," *Review of Behavioral Economics* 1 (1–2) (2014): 55–73.

14 See, for example, Frank, *Success and Luck*, chap. 4.