Almost every culture has some variation on the saying, “rags to rags in three generations.” Whether it’s “clogs to clogs” or “rice paddy to rice paddy,” the message is essentially the same: Starting with nothing, the first generation builds a successful enterprise, which its profligate offspring then manage poorly, so that by the time the grandchildren take over, little value remains.

Much of society’s wealth is created by new enterprises, so the apparent implication of this folk wisdom is that economic inequality should be self-limiting. And for most of the early history of industrial society, it was.
But no longer. Inequality in the United States has been increasing sharply for more than four decades and shows no signs of retreat. In varying degrees, it’s been the same pattern in other countries.

The economy has been changing, and new forces are causing inequality to feed on itself.

One is that the higher incomes of top earners have been shifting consumer demand in favor of goods whose value stems from the talents of other top earners. Because the wealthy have just about every possession anyone might need, they tend to spend their extra income in pursuit of something special. And, often, what makes goods special today is that they’re produced by people or organizations whose talents can’t be duplicated easily.

Wealthy people don’t choose just any architects, artists, lawyers, plastic surgeons, heart specialists or cosmetic dentists. They seek out the best, and the most expensive, practitioners in each category. The information revolution has greatly increased their ability to find those practitioners and transact with them. So as the rich get richer, the talented people they patronize get richer, too. Their spending, in turn, increases the incomes of other elite practitioners, and so on.

More recently, rising inequality has had much impact on the political process. Greater income and wealth in the hands of top earners gives them greater access to legislators. And it confers more ability to influence public opinion through contributions to research organizations and political action committees. The results have included long-term reductions in income and estate taxes, as well as relaxed business regulation. Those changes, in turn, have caused further concentrations of income and wealth at the top, creating even more political influence.

By enabling the best performers in almost every arena to extend their reach, technology has also been a major driver of income inequality. The best athletes and musicians once entertained hundreds, sometimes thousands of people at one time, but they can now serve audiences of hundreds of millions. In other fields, it was once enough to be the best producer in a relatively small region. But because of falling transportation costs and trade barriers in the information
economy, many fields are now dominated by only a handful of the best suppliers worldwide.

Income concentration has changed spending patterns in other ways that widen the income gap. The wealthy have been spending more on gifts, clothing, housing, celebrations and other things simply because they have more money. Their extra spending has shifted the frames of reference that shape demand by others just below them, so these less wealthy people have been spending more, and so on, all the way down the income ladder. But because incomes below the top have been stagnant, the resulting expenditure cascades have made it harder for middle- and low-income families to make ends meet. Despite taking on huge amounts of debt, they’ve been unable to keep pace with community standards. Interest payments impoverish them while enriching their wealthy creditors.

But perhaps the most important new feedback loop shows up in higher education. Tighter budgets in middle-class families make it harder for them to afford the special tutors and other environmental advantages that help more affluent students win admission to elite universities. Financial aid helps alleviate these problems, but the children of affluent families graduate debt-free and move quickly into top-paying jobs, while the children of other families face lesser job prospects and heavy loads of student debt. All too often, the less affluent experience the miracle of compound interest in reverse.

More than anything else, what’s transformed the “rags to rags in three generations” story is the reduced importance of inherited wealth relative to other forms of inherited advantage. Monetary bequests are far more easily squandered than early childhood advantage and elite educational credentials. As Americans, we once pointed with pride to our country’s high level of economic and social mobility, but we’ve now become one of the world’s most rigidly stratified industrial democracies.

Given the grave threats to the social order that extreme inequality has posed in other countries, it’s easy to see why the growing income gap is poised to become the signature political issue of 2014. Low- and middle-income Americans don’t appear to be on the threshold of revolt. But the middle-class squeeze continues to tighten, and it
would be imprudent to consider ourselves immune. So if growing inequality has become a self-reinforcing process, we’ll want to think more creatively about public policies that might contain it.

In the meantime, the proportion of our citizens who never make it out of rags will continue to grow.

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