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Explaining Income Inequality

"Who gets what?" is arguably the most important question of political contestation. The answer to this question determines equality and inequality in society. Of course there are many forms of inequality. Political inequality, racial inequality, social inequality, power inequality, and economic inequality, to name a few, have received attention from journalists, pundits, and social commentators, as well as scholars from a variety of academic disciplines (Danziger and Gottschalk 1995, Harris et al. 2004, Johnston 2007, Keister 2000, McCarty et al. 2006, Page and Simmons 2000). While various forms of inequality are almost certainly interconnected, this book explicitly examines one specific form of inequality – economic inequality.

I focus on income distribution as a primary indicator of economic inequality.[1] The amount of inequality present in the income distribution presents an empirical answer to the question of "Who gets what?" I assess the (national) government role, the actions and policies by which government balances – or unbalances – the scales of equality.

[1] The other primary indicator of economic inequality that I considered analyzing is wealth inequality. I elected to focus on income inequality for three primary reasons. First, income is an important determinant of the material goods that people can obtain in the short term while wealth is a better indicator of long-term economic well-being, and politics more commonly focuses on the short term. Second, high-quality data on incomes in the United States are readily available over a long time-span, but wealth data are only available more recently and the data are of much lower quality. Finally, income inequality is the most commonly discussed distributional outcome in recent studies of U.S. politics.

Much of the story of equality and inequality must be a tale of changes in a market economy. But an important and often neglected part of the story concerns government and how policies benefit some people at the expense of others. That is my focus.

When Richard Nixon took the oath of office in 1969, he inherited an economy in which American incomes were more equal than when his predecessor took office, more equal in fact than ever before. While the most reliable data on income inequality go back only to the late 1940s, evidence pieced together by economic historians indicates that after a spike in inequality precipitated by the Great Depression, inequality declined steadily for several decades. Every four-year period brought a new level of equality to American society. It was never to be again. Following the Nixon/Ford presidencies, every new president took control of an economy that was less equal than it had been four years before. How could America trend toward equality for most of the twentieth century and then reverse course?

Equality and Inequality in the World's Richest Country

Despite some recent and dramatic difficulties, there is no doubt that citizens of the United States participate in one of the most prosperous economies in the world. I begin exploring income inequality by providing a detailed look at who has the money in the United States. The goal is to paint a basic picture of economic conditions in the United States and describe how the economic pie is divided.

Economic Prosperity in the United States

How prosperous is the United States? There are several approaches to answering this question. One of them is to compare the United States to other countries around the globe. In Table 1.1, I report the U.S. ranking among OECD countries for several economic indicators. One of the most basic gauges of a country's aggregate prosperity is the total value of goods and services it produces within its borders. By this most rudimentary measure, in the year 2000 the United States was the largest economy in the world. With a GDP of nearly $10 trillion, the United

TABLE 1.1. *Aggregate Economic Indicators in the United States,* 2000

Indicator	**OECD Rank out of 30**
GDP	1 ($9,764 billion)
GDP Growth	6 (6%)
GDP Per Capita (Exchange Rate Method)	4 ($34,575)
Unemployment	5 (4%)
Inflation	9 (2%)

Source: OECD and World Bank.

States' nearest competitor was Japan, with an economy approximately half as large.

The overall size of an economy, however, could be only marginally related to the prosperity of its individual members. China, for example, has a large GDP, but its population is also large. But the United States is also near the top of the heap in GDP per capita and, in addition, has comparatively low rates of inflation and unemployment. In 2000, money and jobs were plentiful and prices were relatively stable. Though the situation has ebbed somewhat in the intervening period, this has been a common description of economic conditions for much of America's recent past.

If we look underneath these highly aggregated numbers, we find that the average American family at the end of the twentieth century clearly enjoyed the material fruits of a strong aggregate economy (see Table 1.2). The median price of a new home was $169,000, Americans owned 2.1 automobiles per household, and they spent more than $4000 annually per household on hotels and restaurants. With a median household income of more than $40,000 per year, the average American household was able to partake of a variety of goods and services that residents of many other countries would consider luxuries. When American households spend more than $100 per year on audio compact disks and more than $700 on alcoholic beverages, it would be hard to argue that the American macro economy is in crisis. While the U.S. economy goes through its ups and downs, Americans generally remain an economically privileged group. The United States undoubtedly has one of the most prosperous economies in the world.

TABLE 1.2. *Consumer Expenditures in the United States,* 2000

Measure	Value
Median Household Income	$41,578
Median Price of New Home	$169,000
% Households with Personal Computer	51%
% Households with Internet Connection	44%
Wireless Phone Subscribers Per Household	0.97
Telephone Lines Per Household	1.79
Automobiles per Household	2.1
Alcoholic Beverages Expenditures Per Household	$711
Tobacco Expenditures Per Household	$677
Hotel and Restaurant Expenditures Per Household	$4138
Compact Disk Expenditures Per Household	$129

Sources: U.S. Census Bureau; Euromonitor (2002).

Big and Small Slices of a Large Economic Pie

The economic pie in the United States is large, but the way it is divided is also important. When we start to talk about politics – who gets what – we are inherently focusing on areas of conflict, and politics is what this book is about. An examination of who gets what in a society points us toward indicators of *relative* rather than *absolute* prosperity. Income inequality is a key indicator of relative prosperity, and it is my focus.

Figure 1.1 presents a rudimentary picture of how economic prosperity is divvied up in the United States.[2] In this figure, I report the

[2] The data here and in the rest of the book come from the March Supplement to the Current Population Study (CPS) conducted by the United States Census Bureau. The CPS is a monthly survey of American households. Each month, approximately 50,000 households are sampled for participation in the CPS, and respondents are interviewed in order to obtain information about the employment status, earnings, hours of work, demographics, and educational attainment of all members of the sampled household over the age of 15. While this monthly survey collects information about wages earned by the various members of the household, it does not provide any more detailed information about the income earned within the household. However, on an annual basis, the CPS asks more detailed questions about income and work experience from the previous year in the Annual Demographic Survey, or March Supplement to the CPS. Beginning in 2003, the Annual Demographic Survey is called the Annual Social and Economic Supplement (ASES).

As far back as 1947, the CPS (it was the April survey in that time) asked respondents about the income from a handful of general sources earned during the previous year by members of the household. In the most recent data, information about income from over 50 separate sources including earnings, wages, tips, and government cash

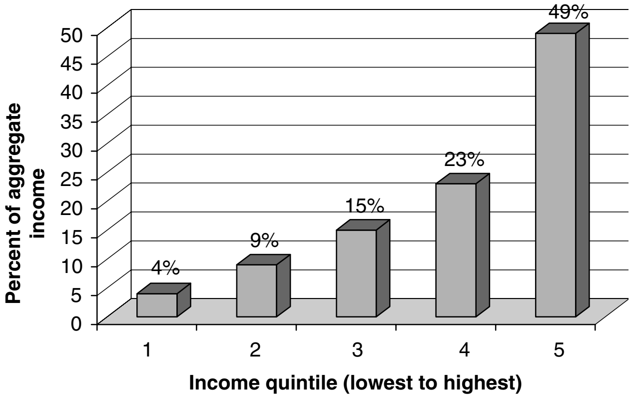

FIGURE 1.1. Share of Household Money Income Held by Each Quintile in the United States, 2000

share of aggregate *money* income held by each income quintile, from poorest to richest.[3] Later in the book I expand the examination beyond the basic money income definition that is the standard reported by the U.S. Census Bureau. This is a good place to start, though, because when the news reports that "median household income rose by 2.3 percent between 1986 and 1987," it refers to money income.[4]

What Figure 1.1 makes crystal clear is that the blessings of economic prosperity in the United States do not fall equally on everyone. Some

benefits is solicited. This makes the March CPS the most comprehensive, consistently available source of household income data in the United States.

3 The household is the unit of analysis utilized throughout this book. One could also examine income inequality across families, or individuals, or even counties for that matter. The decision regarding unit of analysis is not trivial, and households are generally viewed as the most appropriate and inclusive unit of analysis. Analyzing only families, for example, excludes unrelated people living together in a housing unit. Examining individuals raises obvious problems about the inclusion or exclusion of children. Households include families and unrelated individuals and create fairly comparable units of analysis, though important differences across households will always exist.

4 Money income can be thought of as income that comes or could come in the form of a direct cash payment. Specifically, money income includes the following sources: earnings from an employer, unemployment compensation, workers' compensation, Social Security, Supplemental Security Income, public assistance, veterans' payments, survivor benefits, disability benefits, pension or retirement income, interest, dividends, rents, royalties, estates, trusts, educational assistance, alimony, child support, financial assistance from outside the household, and other money income.

have a lot, while others have relatively little. Keep in mind that each income quintile represents exactly the same number of households. The top income quintile, however, received vastly more income than the households in the bottom quintile. In fact, the top 20 percent of households received about 3.25 times as much income as the bottom 40 percent combined, and the richest quintile was, in fact, more than 12 times richer than the poorest quintile of households.

A second way to view the division of the economic pie in the United States is to examine the household income levels at different positions in the income distribution. To make the concept of income inequality more readily grasped, I report the amount of money income received by households at specified points in the income distribution (see Table 1.3). How much income does the household at the 10th percentile (the household richer than 10 percent of other households) make compared to the household at the 95th percentile?

While it may be hard to understand the meaning of the fact that the bottom income quintile receives 4 percent of aggregate income, it should be easy to comprehend that the household at the 10th percentile of the U.S. income distribution earns an income of $10,991.

TABLE 1.3. *Income at Selected Positions in the Income Distribution, 2000*

Percentile	Income	Example Occupations
10th	$10,991	Food Preparation; Teachers' Aide
20th	$18,000	Nursery Worker; Dental Assistant; Security Guard; Bank Teller
30th	$25,030	Food Service Supervisor; Truck Driver; Machine Operators
40th	$32,763	Auto Mechanic; Dental Hygienist
50th	$41,990	Plumber; Technical Writer
60th	$51,565	Architect; Elementary Teacher
70th	$64,002	Financial Manager; Sales-Financial Services
80th	$80,288	Full Professor (Doctoral); Attorney
90th	$109,264	Advertising Executive
95th	$143,500	Family Practice Physician

Note: Listed example occupations approximate average annual income for full and part-time employees at the specified percentile.

Sources: U.S. Census Bureau, Bureau of Labor Statistics, American Association of University Professionals.

Essentially, the household richer than 10 percent of other households makes slightly more than $10,000 each year, including income from government benefit programs that provide cash assistance (like Social Security or welfare). It is probably difficult for many readers to imagine living on around $10,000 (graduate students toiling away as teaching assistants clearly excepted). About 10 percent of households in the United States, in fact, live on that much or less. At the other end of the spectrum, households at the 95th percentile make over $140,000 each year. It seems to be part of the current American mythology that none of us is "rich" or "poor." This is clearly not correct.

This table also lists occupations with wages approximating certain points in the income distribution. An average teachers' aide, for example, earns an annual income approximating the 10th percentile. An average family practice physician, on the other hand, would be at about the 90th to 95th income percentile (even after paying the high malpractice premiums we hear so much about). A full professor at a research university is, on average, richer than about 80 percent of the population.

It should be noted that the occupation listings provide only a rough picture. Many households have more than one income earner, and the occupations listed would put a single earner at the specified point in the income distribution. Imagine, for example, a household comprised of a plumber and a technical writer. This household would be at about the 80th percentile when the earnings are combined. Furthermore, some of the occupations listed at the bottom of the income distribution are there in large part because so many employees in these occupations work part-time. Employees who work less than 40 hours per week push the average annual earnings downward. It is still accurate to say, however, that an average person working in a field in which part-time work is prevalent earns less than an average person working in a field, with comparable hourly wages, in which part-time jobs are less prevalent.

American Inequality in Comparative Perspective

There is a substantial income gap between the richest and poorest Americans. The top 20 percent of households has more than 12 times

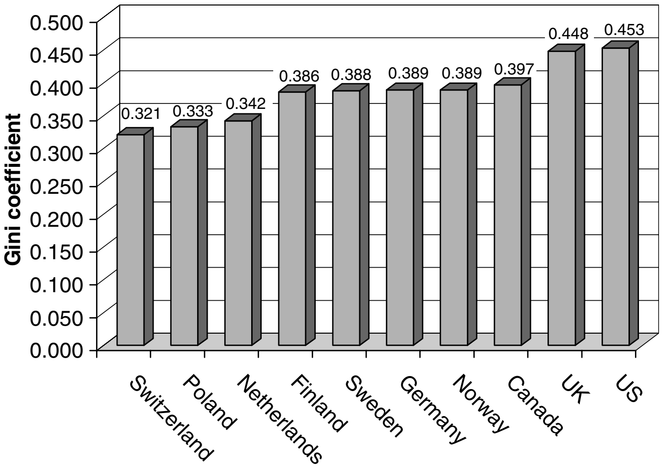

FIGURE 1.2. Income Inequality in Nine Countries

as much income as the bottom 20 percent, and this is undeniably a large discrepancy in terms of absolute size. To this point, however, we have little in the way of context. How substantial is income inequality in the United States in relative terms? One way to gain some perspective on this question is to compare the United States to other countries.[5]

Figure 1.2 shows the Gini[6] coefficient of income inequality in ten countries for which comparable data were available in wave five of the Luxembourg Income Study (LIS) – Switzerland, Poland, the Netherlands, Finland, Sweden, Germany, Norway, Canada, the United Kingdom, and the United States. The data presented here show that the United States has higher levels of income inequality than other developed countries. While I focus here on just the countries available in the most recent LIS data, neither the specific countries available for analysis nor the measure of inequality used dramatically influences this result. Comparative studies of income inequality consistently show that inequality in the United States is among the highest of any developed

[5] Achieving data-comparability in cross-national examinations of income inequality is not easy. In fact, data-comparability problems limited scholarly comparative research on income inequality for decades. Recently, many comparability problems have been overcome, and the highest quality cross-national income data currently come from the LIS.

[6] The Gini ranges from zero to one with higher scores indicating more inequality.

democracy (Brandolini and Smeeding 2006, Gottschalk and Smeeding 1997, Pontusson and Kenworthy 2005). Both our rich and our poor are farther from the middle than in most other developed countries.

TRENDS IN U.S. INCOME INEQUALITY

Thus far we have seen a snapshot of income inequality at the dawn of the twenty-first century. If we wish to understand how political dynamics influence distributional outcomes, however, we must move beyond a cross-sectional snapshot. We need to examine how income inequality has changed over time. Explaining the substantial movement over time of inequality is the primary goal of the book.

To the degree that we can plumb it with the tools of economic history, it is clearly the case that much of the twentieth century was a time of major gains in income equality in the United States. Broken by the Great Depression, the trend until 1973 was toward more income *equality*. A surging industrial economy, the establishment of collective bargaining over wages, and the labor shortages of four wartime periods all helped to establish a society and economy in which the difference between extremes of affluence and poverty was moderate – small by historical standards.

Since 1973 (or some time in the early to mid-1970s) it is equally clear that the trend has reversed. For more than three decades now, most years in America have been less equal than the year before. Moderated by the ups and downs of the economy, the underlying trend is a march toward inequality. The America of the new third millennium is substantially more unequal than its predecessor societies. Perhaps more important, there is no indication in sight that the trend toward greater income inequality has broken. Absent remarkable changes in social and economic organization, it appears likely that the America of decades to come will be one of stark differentials, perhaps one of two societies with vastly divergent economic experiences.

In Figure 1.3, I use a series provided by economic historians (Plotnick et al. 2000) together with modern data on household incomes from the Census Bureau to plot the path of the Gini from 1913 to 2000. The Gini time series displays the pattern just described – a trend toward equality (i.e., smaller values of Gini) disrupted by the turmoil of the Great Depression and then continuing apace until the early 1970s. This

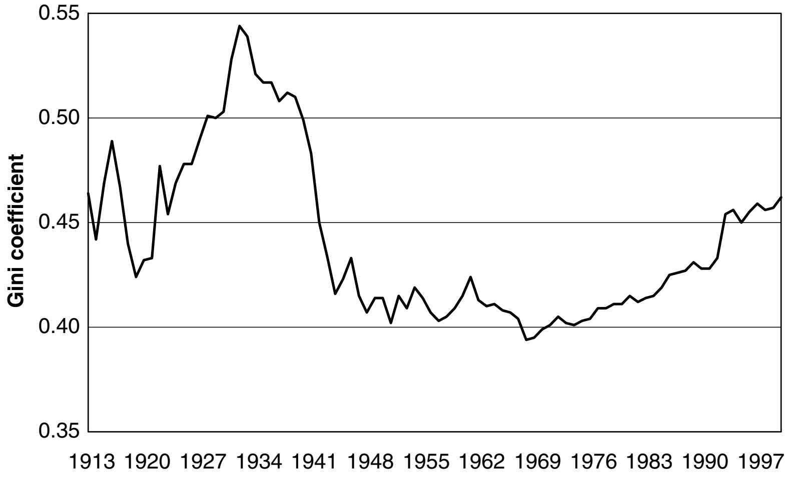

FIGURE 1.3. Gini Coefficient: 1913–2000

is followed by movement in the other direction, a growth of the Gini (and the inequality it represents) from 1973 through the end of the twentieth century.

To get a somewhat different view of the matter, I look simply at how much of the total national income is received by the upper 5 percent of citizens (Figure 1.4). This simple descriptive statistic tells essentially the same story. This highest income group received about a third of all income early in the century. That share steadily declined into the early 1970s to a level a little above 15 percent and then grew to about 22 percent by the century's end. Thus the experience of the richest Americans mirrors that of the whole distribution seen in the summary Gini coefficient. Here, as with the Gini, the arrow points toward a future in which Americans at the top will have an ever greater share of the total income relative to those at the bottom.

The early 1970s was clearly a turning point in the story of equality and inequality in America. So what happened? Who has been winning and losing since this crucial reversal? To answer this question I examine the experience of income classes over time.[7] Figure 1.5 shows how

[7] It is useful to remember that income classes are not really "classes" in the sense of impermeable boundaries. Not only do some people experience social mobility, but many people experience mobility associated with age and life position. Professors, for