Winners and Losers
The Era of Inequality Continues

By Sheldon Danziger and Deborah Reed



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Income inequality in the United States has grown substantially in the past quarter-century. Even the long ongoing economic recovery of the 1990s has done little to stem the tide. In the near future, market forces are unlikely to alleviate the hardship for low-income families who have borne the brunt of economic changes. Several public policy reforms, however, could raise the living standards of low-income families and workers.

A Quarter-Century of Growing Inequality

According to Census Bureau statistics, U.S. family income inequality (by numerous summary measures) has climbed almost continuously from a postwar low in the late 1960s. It has been higher during the 1990s than in any decade since the end of World War II. Most industrialized nations have also experienced growing income inequality, but in the United States, where the existing income disparity was greater, the rise has been more rapid. The difference, primarily, is that other countries have been more effective in countering the increased inequality generated by market forces through labor market and tax and transfer policies.

One way to measure inequality is by the relative income gap between the upper and lower "middle class." Figure 1 shows a near-steady rise in the ratio of family income at the 75th percentile to that at the 25th percentile—the "75–25" ratio—from 1973 to 1997. In 1973, an upper-middle-income family had 2.4 times the income of a lower-middle-income family. The ratio increased to a peak of 3.1 in 1993, falling only slightly—to 3.0—by 1997.

During the 1970s, inequality rose because the income of families in the upper middle of the distribution grew faster than the income of those in the lower middle. Between 1973 and 1979, income at the 75th percentile grew 9 percent, from $64,200 to $70,000, while income at the 25th percentile grew 4.5 percent, from $26,300 to $27,500. But during the 1980s and 1990s, incomes for families at the upper middle rose while incomes for those at the lower middle fell. By 1997, family income at the 75th percentile had grown to $80,500 while income at the 25th percentile had fallen to $26,900 (incomes in 1998 dollars, adjusted to represent a family of four).

At the extremes of the distribution, family income fell at the bottom and grew at the top over the past quarter-century. Between 1973 and 1997 the income of families at the 10th percentile fell 7 percent, while income at the 90th percentile grew 38 percent (see figure 2). In fact, inequality increased throughout the distribution, as the size of each bar in figure 2 increases from the lowest- through the median to the highest-income families.

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Changes in inequality can also be evaluated by comparing the share of people who are poor—those living in families below the poverty line—with the share who are "rich"—those living in families with incomes more than seven times the poverty line (about $105,000 for a family of four in 1997 using an alternative price index). Between 1973 and 1997, the share of people who were poor increased 1.2 percentage point to 11.8 percent while the share of those who were rich

FIGURE 1.

Ratios of Family Income and Male Weekly Wages of the Upper-middle Class to Those of the Lower-middle Class

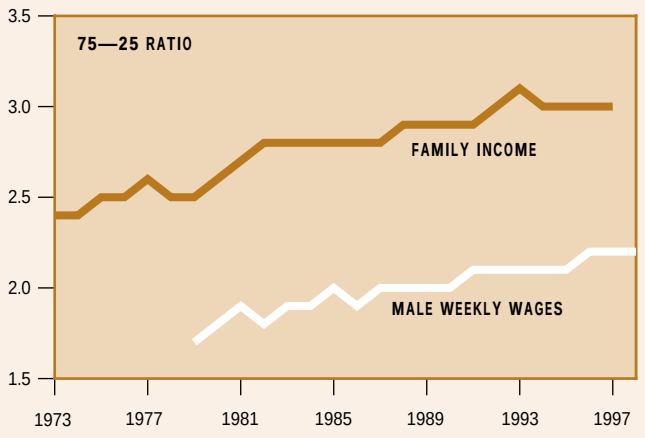
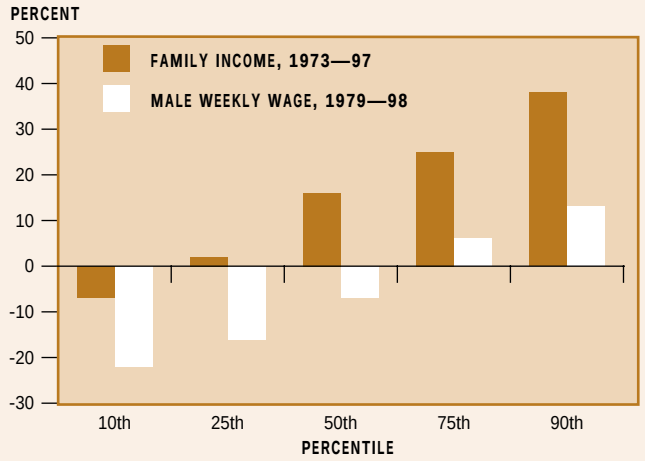


FIGURE 2.

Percentage Change in Real Family Income and Male Weekly Wages



increased 8.1 percentage points to 14.3 percent—yet one more indication that economic growth has raised incomes at the top of the distribution while allowing absolute incomes at the bottom to stagnate or fall.

Despite the Economic Boom, the Gap Remains

Although the robust economic recovery of the 1990s has produced the lowest unemployment and inflation rates in 30 years and has lifted living standards across the income distribution, families below the median have not yet fully recovered from the income stagnation and recessions of the early 1980s and early 1990s. Family income in the lower middle of the distribution remains a few percentage points below its 1989 and 1979 peaks, whereas that in the upper middle has increased a few percentage points since 1989 and 15 percent since 1979. As figure 1 shows, family income inequality fell slightly as the economy recovered from the recession of the early 1990s. But as of 1997, the 75–25 ratio was still higher than it was in 1973, 1979, and 1989, the last three business cycle peaks.

Changes in the distribution of male earnings—the largest single component of family income—account for much of the increased family income inequality. Thanks to the current economic expansion, the wages of men at the bottom of the distribution grew between 1996 and 1998, but weekly wages for full-time male workers at the 10th and 25th percentiles, $300 and $432 respectively, remain more than 6 percent below their 1989 business cycle peak and more than 15 percent below the 1979 peak. The 75–25 ratio for men's weekly wages was just below 2.2 in 1998, slightly under its 1997 peak, but well above the 1979 and 1989 peaks (1.7 and 2.0, respectively; see figure 1).

Male earnings inequality rose during 1979–97 because real earnings fell for workers at the median and below and grew for those at the top of the distribution. Figure 2 shows a decline in men's earnings of 22 percent at the 10th percentile, 16 percent at the 25th percentile, and 7 percent at the median. Over the same period, men's earnings grew 6 percent at the 75th percentile and 13 percent at the 90th percentile.

Why Is Inequality Increasing?

Most economists agree that the main source of growing earnings inequality is the rising value of worker skill. In 1979, for example, the median full-time weekly wage for men with college degrees was 29 percent higher than that for men with high school diplomas only. By 1998, college graduates had a 68 percent edge. During 1979–98, real wages increased 8 percent for male college graduates but fell 18 percent for high school graduates. For women, the weekly wage gap between college and high school graduates increased from 43 percent in 1979 to 79 percent in 1998. The work experience differential increased as well, with earnings of workers with substantial labor market experience growing relative to those of new labor market entrants.

There is some disagreement over the relative importance of various causes of the rising value of skill. Labor-saving technological changes have simultaneously increased the demand for skilled workers who can run sophisticated equipment and reduced the demand for less-skilled workers, many of whom have been displaced by automation. Global competition has increased worldwide demand for the goods and services produced by skilled workers in high-tech industries and financial services. Lower-skilled workers increasingly compete with low-wage production workers in developing countries. Immigration has increased the size of the low-wage workforce and competition for low-skilled jobs. Institutional changes, such as the decline in the real value of the minimum wage and shrinking unionization rates, also moved the economy in the direction of higher earnings inequality.

Developments other than rising earnings inequality also widened the family income gap. In particular, changes in family structure, especially the growing share of female-headed households, increased the number of low-income families. A growing tendency for high-earning men to be married to high-earning women further separates the incomes of dual-earning couples from those of female-headed households.

Implications for the Future

Because growing income inequality arises primarily from long-term structural changes in the labor market that are unlikely to be reversed, U.S. income inequality is likely to remain high in the coming decade.

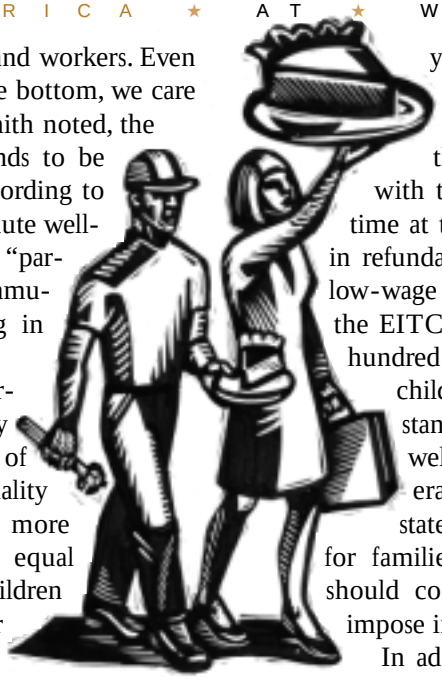
Even an extension of the current economic boom cannot be expected to close the family income gap any time soon. As figure 1 shows, the greatest single year of improvement in narrowing the family income gap was 1993–94. But the income gap in 1997 was still so large that *nine more years* of the unparalleled progress of 1993-94 would be required to return family income inequality to 1979 levels, almost twelve more such years to return it to 1973 levels.

Because the economic returns to skills have increased so much, the labor market now provides incentives for workers and young people to upgrade their skills through education and training. Indeed, the share of high school graduates entering college has already grown in the past few years. But though the resulting growth in the supply of skilled workers may eventually reduce labor market inequality, the adjustment will take years—years during which the wages of less-skilled workers are likely to remain low.

Nor will all workers respond equally to the incentives to improve their skills. Generally speaking, younger Americans are much more likely to undertake substantial investments in education or training programs than are prime-age workers who have been hurt by changes in the labor markets over the past quarter-century and who have relatively few years of work left before retirement. In addition, because of pervasive inequalities in school quality and access, children from the poorest families and from racial and ethnic minorities who are concentrated in the inner cities are likely to respond less than average to the incentives.

Policy Directions

We are concerned about increased inequality over the past quarter-century because of its effects on both the absolute and



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relative well-being of low-income families and workers. Even without a decline in income for those at the bottom, we care about rising inequality because, as Adam Smith noted, the minimum acceptable standard of living tends to be higher the richer the society. Moreover, according to recent Nobel laureate Amartya Sen, the absolute well-being of the poor in terms of their ability to "participate in the standard activities of the community" depends on their relative well-being in terms of resources.

Increases in inequality over the past quarter-century are likely to have made equality of opportunity harder to attain. The children of the poor are increasingly subject to lower-quality education, lower-quality health care, and more dangerous communities. Concerns about equal opportunity are particularly relevant for children from female-headed households and for those who are racial and ethnic minorities because they are far more likely to grow up in poor families.

Many of the economic forces that have contributed to rising income inequality have also brought positive changes in our economy. Technological changes and increased globalization raise the average standard of living by bringing new goods to consumers and producers and by reducing their prices. The rising value of skill provides incentives for people to upgrade their own skills, which can be financially and personally rewarding. Even if it were possible to slow technological changes or adopt protective barriers to trade, we see no reason to attempt to lower inequality by doing so.

The United States has pursued policies to promote free trade and technological advancement in the interest of growth and efficiency; in doing so it has produced winners and losers. Government policies should therefore help reduce the resulting inequalities by aiding the low-income families and less-skilled workers who have borne the brunt of labor market changes.

Reasoned policy in this area must take into account two realities. First, the recent welfare reform experience has shown that the public favors policies that promote work. Welfare reform has dramatically reduced cash assistance for people who are capable of working, but it has offered expanded wage and child care subsidies. Second, education and well-designed training programs can improve the earnings of workers and promote economic opportunity in the long run. These policies, however, are unlikely to substantially improve the well-being of low-income workers in the coming decade. For the short term, policymakers should expand work-oriented antipoverty policies that raise the incomes of the least-skilled workers.

For people who are able to find jobs, the key elements of support are wage supplements and refundable child care tax credits. The Earned Income Tax Credit, substantially expanded in 1993, has done much to offset the decline in real wages for workers at the bottom of the earnings distribution who work year-round and who have children. Almost all low-income families with children are now eligible for substantial credits from the EITC. For example, a single mother with two children who works year-round, full-time at the minimum wage receives about $3,600 in refundable tax credits. But only a small share of low-wage workers who do not have children receive the EITC, and their maximum credit is only a few hundred dollars. Raising substantially the EITC for childless workers would increase their living standards without taking them through the welfare system and would also make the federal income tax more progressive. Several states have already adopted their own EITCs for families with children, something other states should consider, especially those that continue to impose income taxes on the working poor.

In addition, even though the employment rate and earnings of single mothers have increased in the past five years, many single mothers, especially former welfare recipients, with young children are hard pressed to work full-time, year-round because a large portion of their earnings must go to child care. Increasing public subsidies for child care would be particularly beneficial for this group. The Dependent Care Credit (DCC) provides tax relief for families with children, but it is a nonrefundable credit and so benefits only families with positive income tax liabilities. Making the DCC refundable would raise the disposable income of single mothers and other low-income working families who spend substantial sums on child care but do not owe federal income tax. It too would make the federal income tax more progressive.

Finding a job has become more difficult for less-skilled workers over the past quarter-century. In mid-1999, even with the lowest unemployment rate in 30 years, many less-skilled workers are unable to find work. For those who want to work but are unable to find regular employment, transitional public service "jobs of last resort" at wages just below the minimum can provide the basis for a work-oriented safety net. Such "jobs of last resort" are more important than ever now that we have "ended welfare as we know it." During the next recession, many former welfare recipients will find themselves out of work and without recourse to cash assistance because of time limits, sanctions, and other aspects of welfare reform.

Looking Ahead

The good news is that the current economic recovery seems to have slowed the quarter-century trend toward rising income and earnings inequality. The bad news is that inequality is unlikely to return to the level of the late 1970s any time soon, much less to the lower levels of the late 1960s and early 1970s. As this era of inequality continues to unfold, work-oriented policy reforms could, at relatively modest cost, greatly benefit those workers and families most disadvantaged by the structural economic changes that have boosted the fortunes of the rich. ■