GROWING AMERICAN INEQUALITY

Sources and Remedies

BY GARY BURTLESS

Over the past two decades the United States has experienced a startling increase in inequality. The incomes of poor Americans shrank and those of the middle class stagnated while the incomes of the richest families continued to grow. The well-being of families up and down the income scale has increased over the past five years, but the average income of the poorest Americans remains well below where it

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was at the end of the 1970s.

From the end of World War II until the 1970s, the percentage difference in average cash income between well-to-do and middle-class American families generally declined (see figure 1). In the 1980s the gap began to widen noticeably. Better measurement of rich families' incomes accounts for some of the apparent jump in the early 1990s, but the gap between middle- and high-income families almost certainly increased after 1992. The cash income difference between middle-income and poor families followed a similar trend. After narrowing for several decades after World War II, largely because of increased wages and improved Social Security and welfare benefits for the poor, the gap began widening in the early 1970s. The figure suggests that the trend in inequality has not been driven solely by worsening poverty among the poor or by spectacular income gains among the wealthy. It has been produced by growing disparities between Americans at every level of the income ladder.

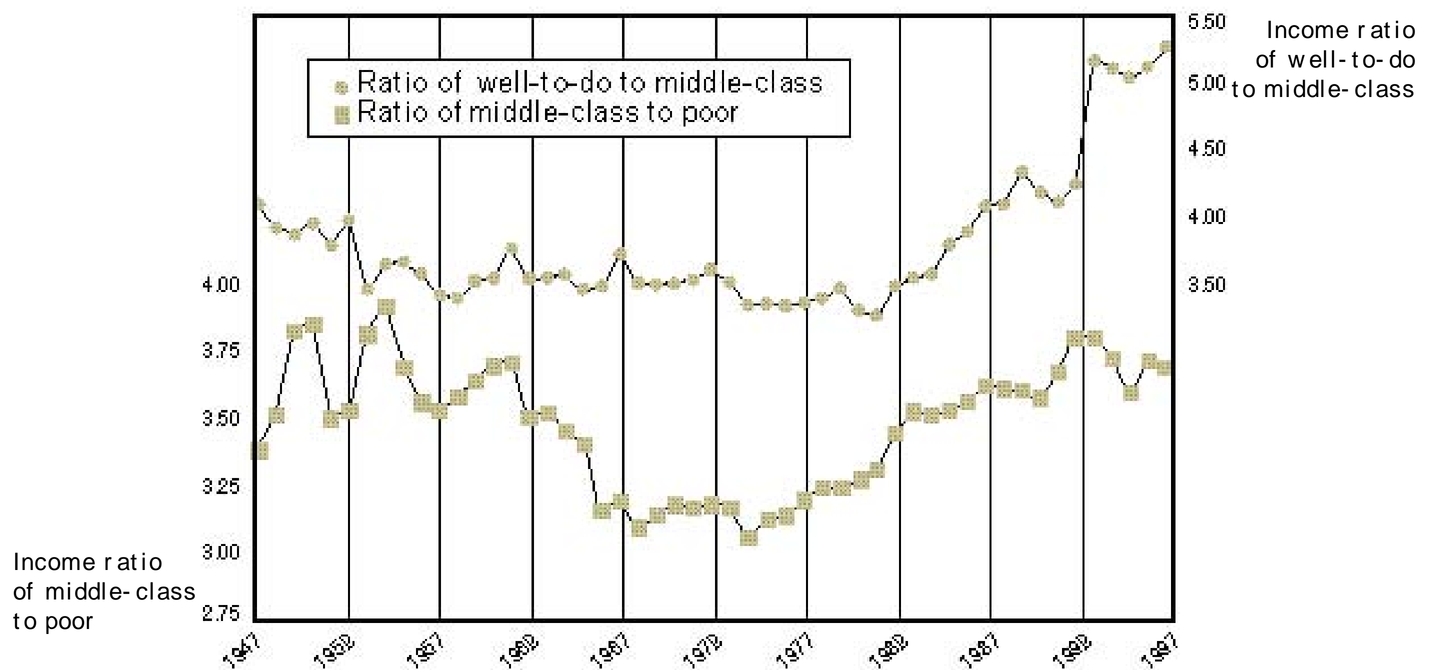
Soaring inequality has not been confined to the United States. Rich nations around the world have seen inequality grow since the late 1970s. But the jump in income inequality has been particularly rapid in the United States—and it came on top of a higher initial level of inequality.

Should We Care?

Many Americans are not terribly concerned about income inequality or about the need for public policies to temper inequality. Although public opinion polls find that large majorities of residents in five European countries and Japan believe the government should guarantee each citizen a minimum standard of living, only about a quarter of Americans agree. By and large, Americans tend to believe that people bear primary responsibility for supporting themselves. U.S. citizens are also more likely to believe their society offers an equal opportunity for people who work hard to get ahead. Given these views, why should Americans be concerned about mounting inequality?

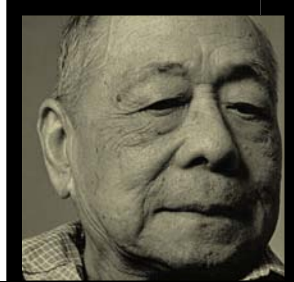
One reason for concern is that growing income disparities may undermine Americans' sense of social cohesion. Even if they are indifferent about the abstract principle of economic equality, most Americans probably believe in the ideals of political and legal equality. But greater inequality has almost certainly produced wider discrepancies in political influence and legal bargaining power. In 1979 the income of an American at the 95th percentile of the income distribution was three times

Figure 1.
Trend in Family Income Inequality: Ratio of Average Incomes of Well-to-do and Middle-class Americans



Well-to-do Americans are those in the top 5 percent of the income distribution. Middle-income Americans are those in the middle 20 percent. Poor Americans are those in the bottom 20 percent.
Source: Author's tabulations of Bureau of the Census P-60 Report data.

the median income and thirteen times the income of an American at the 5th percentile. By 1996 an American at the 95th percentile had an income almost four times the median income and twenty-three times the income of the person at the 5th percentile. The growing income gap between rich, middle-class, and poor and its consequences for the distribution of political influence may contribute to Americans' dwindling confidence that their elected officials care very much about the views of ordinary citizens. According to polling experts Karlyn Bowman and Everett Ladd, in 1960 only a quarter of U.S. respondents agreed with the statement "I don't think public officials care much about what people like me think." By 1996, the share who agreed had climbed to 60 percent.



Inequality may also affect public health. Demographers and public health researchers have found mounting though controversial evidence that greater inequality can boost mortality rates and contribute to poor health. Countries and communities with above-average inequality have higher mortality rates than countries or communities with comparable incomes and poverty rates but lower inequality. According to one public health researcher, low-income Americans have death rates comparable to those in Bangladesh, one of the world's poorest countries, even though absolute incomes, average consumption, and health care spending are much higher among America's poor than they are in Bangladesh. The possible link between public health and inequality may help explain why the United States, one of the world's wealthiest countries, does not have the longest average life span or the lowest infant mortality rate. If the benefits of U.S. income growth after 1979 had been more equally shared, the average health and life spans of Americans, especially poor Americans, might have improved faster than they did.

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Defenders of American economic and political institutions correctly point out that inequality plays a crucial role in creating incentives for people to improve their situations through saving, hard work, and additional schooling. They argue that wage and income disparities must sometimes widen to send correct signals to people to save more, work harder, change jobs, or get a better education. In the long run, poor people might enjoy higher absolute incomes in a society where income disparities are permitted to widen than one where law and social convention keep income differentials small. According to this argument, widening inequality is in the best long-term interest of the poor themselves.

For poor people in the United States, however, the theoretical advantages of greater inequality have proved elusive over the past two decades. Their absolute incomes have not improved; they have declined. Their absolute incomes do not exceed those of low-income residents in countries with less inequality; typically they are lower than those of people in a comparable position in other rich countries. The efficiency advantages, if any, of growing U.S. inequality have not been enjoyed by the poor, at least so far. They have flowed to people much further up the income scale.

Why Has Inequality Increased?

Researchers on income inequality agree on two key facts. Greater family income inequality is closely connected to wider disparities in worker pay—disparities that in turn are associated with rising pay premiums for education, job experience, and occupational skills. In addition, shifts in family composition, specifically the continuing growth of single-parent families and the shrinking fraction of married-couple families, have reinforced the effects of widening wage inequality.

How much of the increase in family income inequality is attributable to rising wage disparities? Both male and female workers saw hourly pay disparities increase over the past two decades, though on average men saw their real earnings fall, while women got a raise. The hourly wage of workers at the 10th percentile fell 16 percent between 1979 and 1997. At the upper end of the pay ladder, wages at the 90th percentile rose 2 percent for men and 24 percent for women. Changes in annual earnings mirrored this pattern. Workers at the bottom of the pay scale saw their yearly labor incomes sink while workers at the top saw their annual pay increase. The gains were especially large among highly paid women.

One way to assess the impact of rising wage disparities on overall income inequality is to calculate how much overall inequality would have changed if wage disparities had remained unchanged. My calculation, using a standard statistical measure of income inequality known as the Gini coefficient, suggests that if male annual earnings disparities had remained unchanged between 1979 and 1996, personal income inequality would have increased about 72 percent of the actual jump. This means that the increase in men's earnings inequality explains about 28 percent of the overall increase in inequality. A similar calculation implies that despite the large increase in pay disparities among women, only about 5 percent of the increase in income inequality can be explained by growing earnings disparities among women. We can combine these two calculations to see what would have happened if male and female earnings inequality had both remained constant after 1979. This third set of calculations suggests that two-thirds of the increase in personal income inequality would have occurred, even without a change in pay disparities. An implication of this finding is that just one-third of the increase in personal income inequality was due to the growth of male and female earnings disparities. Most of the growth was due to some other set of factors.

One factor was the changing American household. In 1979, 74 percent of adults and children lived in married-couple households. By 1996, this share had fallen to 65 percent. Inequality and the incidence of poverty are much lower in married-couple households than in single-adult households. If the percentage of Americans living in married-couple families had remained unchanged after 1979, about one-fifth of the 1979–96 jump in inequality would have been avoided.

Another trend has pushed up income disparities. Women who are married to high-income husbands are increasingly likely to hold year-round jobs and earn high incomes themselves. The increased correlation between husbands' and wives' earnings has widened the income gap between affluent dual-earner families and the rest of the population. If the husband-wife earnings correlation had remained unchanged, about one-eighth of the rise in overall inequality since 1979 would have been avoided. In other words, roughly 13 percent of the increase in income inequality can be traced to the growing correlation between husbands' and wives' earned income.

Policy Response

Though critics of U.S. social policy often overlook the fact, policymakers have not stood still in the face of momentous changes in the income distribution. The direction of policy has shifted noticeably since the early 1980s.

The shift began under President Reagan, who attempted to scale back and reorient welfare programs targeted on the working-age poor. His goal was to make the programs less attractive to potential applicants by cutting benefits or making benefits harder to get. One important policy change, later reversed, was to scale back payments to poor families with a working adult. Reagan thought welfare benefits should be focused on the *nonworking* poor. He expected working adults to support themselves.

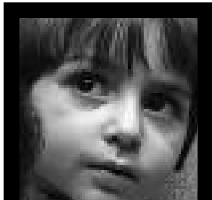
The steep decline in hourly wages of low-skill workers made this view increasingly untenable. Measured in inflation-adjusted dollars, the minimum wage fell more than 30 percent over the 1980s, and wages paid to unskilled young men fell almost as fast. Few breadwinners can support families on wages of $5 or $6 an hour.

Congress and the president responded by reforming tax policy toward low-income families and broadening eligibility for publicly financed health benefits. The Tax Reform Act of 1986 removed millions of low-income Americans from the income tax rolls and boosted the tax rebates low-income workers receive under the Earned Income Tax Credit. The EITC was further liberalized in 1990 and 1993, greatly increasing the credits flowing to low-income breadwinners and their children. Spending on the credit increased eleven-fold in the decade after 1986, reaching more than $21 billion by 1996. The credit, payable to breadwinners even if they owe no federal income taxes, has raised the incomes of millions of families with extremely low earnings.

The EITC is the most distinctive American policy innovation on behalf of the working poor, and sever-

al European countries may eventually adopt a variant of it. While most cash assistance goes to people who do not work, the EITC goes only to low-income people who *do* work. In 1997 the credit provided as much as $3,656 to a breadwinner with two or more dependents. For a parent working full time in a minimum-wage job, the EITC can increase net earnings nearly 40 percent.

The idea behind the credit is to encourage work by increasing the incomes available to low-wage breadwinners who have dependent children. Instead of shrinking as a recipient's earnings grow, the credit rises, at least up to a limit. At low earnings levels the credit increases by 34¢ or 40¢ for each extra dollar earned. Most labor economists who have examined the credit conclude that it has contributed to the sudden and sizable increase in job holding among unmarried mothers.



Congress has also liberalized the eligibility requirements for Medicaid health insurance to include a broad population of low-income children with working parents. Until the late 1980s, working-age families with children were usually eligible for health protection only if the families were collecting public assistance. Children typically lost their eligibility for free health insurance when the family breadwinner returned to work. The Medicaid liberalizations of the late 1980s and early 1990s meant that many children were enrolled in the program even if their parents had modest earnings and were not collecting public assistance.

Some state governments have established new programs to provide subsidized health insurance to members of working-poor families, including the adult breadwinners. Congress passed legislation in 1997 offering states generous federal subsidies to establish or enlarge health insurance programs for the working poor and near-poor.

As U.S. policy has expanded tax and health benefits for the working poor, state and federal policymakers have slashed cash assistance to the non-working poor. General assistance, which provides cash aid to childless adults, has been scaled back or eliminated in several states. Aid to Families with Dependent Children was eliminated in 1996 and replaced with Temporary Assistance to Needy Families (TANF). The new federal program pressures all states to curtail cash benefits to poor parents who are capable of working. The head of each family on welfare is required to work within two years after assistance payments begin. Work-hour requirements are stringent, and states face increasingly harsh penalties for failing to meet them. The law stipulates that the great majority of families may receive benefits for no longer than five years and permits states to impose even shorter time limits. Over a dozen states have already done so.

The new welfare law—and the new state welfare policies that preceded it—helped produce an unprecedented drop in the nation's child welfare rolls. Since peaking in 1994, the number of families collecting public assistance for children has dropped more than 2 million, or 40 percent.

In sum, U.S. policy has become much less generous to the non-working (but working-age) poor, while it has become much more generous to working-poor adults with children. For many low-wage breadwinners with children, the recent policy changes—the increased generosity of the EITC, Medicaid, state-supported health plans, and child care subsidies—have offset the loss of potential earnings due to shrinking hourly wages.

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The reforms are having other economic effects. Poor breadwinners with children have been induced to enter the work force—and stay there. Their entry contributes to the downward pressure on the wages of the least skilled. In effect, public subsidies to the working poor and cuts in welfare benefits to the nonworking poor have helped keep employers' costs low and thus helped fuel employers' creation of poorly paid jobs.

Future Directions

U.S. policies toward low-income, working-age families are not so callous that struggling families have been left wholly on their own to cope with declining wages. But they are not so generous that poor, working-age Americans have shared equally in the prosperity of the past two decades.

Different policies, such as those adopted in Western Europe, would have yielded different results. Some differences, including lower poverty rates and higher wages, make Western Europe a more pleasant place to live, especially for the poor. But others, including high unemployment, are unwelcome. It is not obvious that most Americans, even liberals, would prefer the European approach or approve the policies needed to achieve it.

While the current U.S. policy mix broadly reflects the preferences of U.S. voters, it is haphazard and fails to reach some of those who most need help.Two new policies could aid working-age people who have suffered the worst cuts in hourly pay. The first would assure some of the long-term unemployed a job at a modest wage. The second would make work subsidies more uniformly available and would provide them in a form that most voters approve.

Because public assistance to the nonworking but able-bodied poor is being drastically curtailed, it makes sense to assure at least some poor adults that they will be able to find jobs at a modest wage, however bad the local job market. In some cases this may involve creating publicly subsidized jobs that pay a little less than the minimum wage. It seems particularly important to extend this offer to parents who face the loss of cash public assistance. If voters and policymakers want unskilled parents to begin supporting themselves through jobs, they should assure these parents that some jobs will be available, at least eventually, even when unemployment is high.

For poorly paid breadwinners, it is essential to improve the rewards from working. One possibility is to make a basic package of subsidized health insurance available to all children and young adults. Many Americans regard health insurance for children as a fair and acceptable way to help those in need.

Most health insurance for children is either publicly subsidized through Medicaid or privately provided through employer health plans. When insurance is financed by employers, most of the cost to employers shows up as lower money wages paid to workers. By publicly assuming some or all of the cost of paying for a basic health package for children, we could push employers to boost the wages they pay to insured workers who have child dependents. Such a move would have a greater impact on the pay of low-wage workers, for whom health insurance represents a big fraction of compensation, than on the pay of high-wage workers.

About 15 percent of all children (and nearly a quarter of poor children) have no health insurance. For these children and their working parents, publicly subsidized child health insurance would directly improve well-being and reduce out-of-pocket spending on medical care. It would also greatly increase the reward to work. Parents who do not work qualify for free medical insurance for themselves and for their children under Medicaid. Some lose this insurance when they accept a job that pays modest but above-poverty-level wages. A public health insurance package for *all* children would reduce or eliminate this penalty for accepting a job.

American economic progress over the past two decades has been quite uneven. Families and workers at the top of the economic ladder have enjoyed rising incomes. Families in the middle have made much smaller income gains. Workers at the bottom have suffered a sharp erosion in their relative income position. For some low-income workers, new public policies have helped offset the loss of wages with larger earnings supplements and better health insurance. But many low-wage workers have not benefited from these policies. Humane public policy should try to assure that the most vulnerable Americans share at least modestly in the nation's prosperity. ■