Rising Income Inequality Adversely Affects Many Social Systems

The Wage Gap, 2014

In addition to Elizabeth McNichol, Douglas Hall, David Cooper, and Vincent Palacios contributed to the following viewpoint. McNichol is a senior fellow and Palacios is a research associate at the Center on Budget and Policy Priorities. Hall is director of the Economic Analysis and Research Network (EARN), and Cooper is an economic analyst at the Economic Policy Institute.

It is a basic American belief that hard work should pay off—that individuals who contribute to the nation’s economic growth should reap the benefits of that growth. Over the past three decades, however, the benefits of economic growth have been skewed in favor of the wealthiest members of society. Rising income inequality not only raises basic issues of fairness but also adversely affects our economy and political system.

The Negative Effects of Income Inequality

A widening gulf between the richest Americans and those at the bottom or middle of the income scale can reduce social cohesion, trust in government and other institutions, and participation in the democratic process. For example, two-thirds of respondents to a recent Pew Research poll indicated that they believe that there are strong conflicts between the rich and the poor. Growing income inequality also has exacerbated discrepancies in political influence in federal, state, and local government—a particular problem given political candidates’ heavy dependence on private contributions. For example, in the 2008 election, over 70 percent of funding for campaigns for the House of Representatives—which totaled $854 million—came from large donations (over $1,000) or Political Action Committees. This may have contributed to the increase in the number of Americans who feel that their elected officials do not care much about the views of ordinary citizens.

In addition, inequality has negative effects on the nation’s health, housing, and education. As the divide grows between families at the top of the income scale and everyone else, the richest Americans have less contact with everyone else—and thus less familiarity with the problems that typical Americans face. Metropolitan areas with rising income inequality experienced rapid growth in residential segregation by income between 1970 and 2000, according to a 2007 Brookings Institution study.

Because school systems depend heavily on local funding, increased income disparities have led to increased disparities in the quality of schools. As wealthier families have moved to the suburbs, low-income families have become increasingly concentrated in areas with low
housing values. The result is lower property tax collections to support schools and other services. That makes it harder for children in low-income families to acquire the skills they need to succeed.

Segregation by income also reduces support for state taxes, which comprise almost half of funding for elementary and secondary schools. An upper-income family living in the suburbs may have trouble understanding the extent of the problems of schools in low-income neighborhoods. Similarly, wealthy families who can afford private schools for their children can lose sight of the need to support public schools. As a result, support for the taxes necessary to finance government programs declines, even as the nation’s overall ability to pay taxes rises. The failure to invest adequately in programs that educate children, meet the health and housing needs of families at all income levels, and support low-wage workers can dampen the future economic growth of individual states and of the nation.

There is also evidence that income inequality causes more direct harm to people in poverty. For example, a number of papers prepared for a conference on income inequality sponsored by the Federal Reserve Bank of New York found a link between higher levels of inequality and poor schools, substandard housing, and higher levels of crime.

Growing income inequality threatens to undermine efforts to move more families from welfare to work.

The Research on Inequality

The impact of inequality on public health has received considerable attention from researchers. A recent article [by Gary Burtless] summarized this research: "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." The United States has substantially greater inequality than nearly all other developed nations. A recent study found that children in states with higher income inequality were less well-off than those in states with a more even distribution of income.

In addition to the link to overall health, a recent paper that examined differences among countries and among U.S. states found a strong connection between income inequality and social problems such as mental illness, violence, drug abuse, and poor educational performance.

Growing income inequality also widens the gap between housing costs and what households—particularly renters with very low incomes—can afford to pay. High housing costs reduce the disposable income that families have to pay for other essentials, such as
food, transportation, and medical care. They also contribute to housing instability and homelessness, which can have severe and enduring effects on families, particularly young children.

In addition, growing income inequality threatens to undermine efforts to move more families from welfare to work. When low-wage jobs do not pay enough to lift a family out of poverty and when the incomes of the poorest families grow only slowly or not at all, policies that encourage work cannot succeed.

The recent decline in the incomes of the poorest families is particularly disturbing. Research has shown that poverty in childhood has a long and harmful reach. Even modest changes in family income for young children in poor families significantly affect their educational success—and may have a big effect on their earnings as adults. Poverty researchers Greg J. Duncan of the University of California, Irvine, and Katherine Magnuson of the University of Wisconsin found that children in low-income families that received an income boost when the children were under age 6 earned more and worked more as adults.

**The Growing Wage Gap**

The growth of income inequality in nearly every state mainly reflects two factors. The first is that the distribution of labor income (wages and salaries) is becoming increasingly unequal; in other words, the gap between high-wage and low-wage jobs is growing. The second is that investment income has grown faster than wage income. A combination of broad economic trends and state and national government policies has contributed to both of these developments.

The growing wage gap is the primary cause of the growth in income inequality. Wages are a key factor because they constitute about three-fourths of total family income. Wages at the bottom and middle of the wage scale have been stagnant or have declined over much of the last three decades. The wages of the very highest-paid employees, however, have grown significantly.

Wages have eroded for workers at the bottom and middle of the income scale for several reasons, as explained below.

**The Availability of Jobs**

One factor that affects wages is the supply of workers relative to the number of jobs available. When jobs are available but there are relatively few workers, employers must pay higher wages to fill job openings. The unemployment rate is one measure of the supply of workers; a high unemployment rate means that employers will have an easier time of
finding workers, so there is less pressure on them to increase wages. The unemployment rate was higher on average over the last three decades than between the 1940s and the late 1970s. As a result, middle- and low-income workers have generally had much less bargaining power than in that earlier period.

The economy’s shift from manufacturing to services has led to an increase in the number of low-paying jobs and a decline in higher-paying jobs for workers with less than a college education.

The one significant exception to the trend of growing wage inequality highlights the importance of full employment. The later part of the 1990s, a time of broadly shared growth in wages, was also a time of persistent low unemployment. That, plus an increase in the minimum wage, an expansion of the earned income tax credit, and rapid productivity growth, fueled real wage gains at the bottom and middle of the income scale.

Unemployment rates vary significantly from region to region. In 2011, when the national rate averaged 8.9 percent, state unemployment rates ranged from 3.5 percent in North Dakota to 13.5 percent in Nevada. The particular mix of industries in a state and changes in their fortunes can have a large effect on the relative level of inequality and growth in inequality in that state.

International trade also plays an important role in rising wage inequality. As U.S. imports have grown, the number of higher-wage manufacturing jobs available to non-college-educated workers has declined. In addition, workers in the United States may agree to wage concessions in response to employers’ threats of moving production facilities to other countries. Research has generally found that the growth in imports has played an important role in the decline in relative earnings of non-college-educated workers and can explain about 15 percent to 25 percent of rising wage inequality. The effect may be growing. There is also some recent evidence that expanded trade with very low-wage countries such as China has increased the inequality-inducing impact of international trade.

Changes in the U.S. Economy

Several other fundamental changes in the U.S. economy have also helped widen the wage gap. The economy’s shift from manufacturing to services has led to an increase in the number of low-paying jobs and a decline in higher-paying jobs for workers with less than a college education. Between 1979 and 2011, employment in manufacturing fell from 22 percent of all U.S. jobs to 9 percent, while employment in service industries rose from 72 percent of jobs to 86 percent. Many service-sector jobs are lower paid than comparable manufacturing jobs; between 2008 and 2010, for example, average weekly earnings for an employee working in non-manufacturing industries were 20 percent less than in manufacturing industries.
The specific mix of industries in a state will determine how much globalization and the shift to services affect it. States that have relied on manufacturing, such as midwestern states with auto factories or southern states with textile plants, have been hard hit, for example. Similarly, the effects of technological change, discussed below, will differ based on the make-up of a state's economy.

Technology also plays a role in wage inequality, though its magnitude is often exaggerated. Previously, a number of researchers, observing that wages for highly educated workers have risen even as the number of these workers has grown, concluded that technological change has increased the demand for educated workers and thus is a major factor in the growing pay gap between high- and lower-wage workers. But there is little evidence that this dynamic intensified much over the period in which wage inequality was growing most quickly. Thus, technology must have played a smaller role in the increase in wage inequality than is often claimed.

More recent research has found a different, more nuanced relationship between technology and inequality. One influential recent study argues that technological change has had little effect on the wage gap between high-wage and low-wage workers in recent years. The authors argue that since the 1980s, demand for higher-skilled, better-educated workers has driven wage increases at the high end of the wage scale, but wages also grew at the low end of the scale because of the continued demand for workers performing non-routine manual jobs that computers cannot perform. In the middle, however, routine jobs performed by moderately educated workers were more likely to be replaced by technology or outsourced, so these workers' wages fell.

The Decline in Union Membership

The continued decline in the percentage of workers who are union members has also contributed to increased wage inequality. Between 1979 and 2011, the percentage of workers belonging to unions dropped from 23.4 percent to 11.8 percent. By 2011, only 6.9 percent of private-sector workers were union members, compared to 37 percent of public-sector employees.

There is a point at which families can no longer increase their work effort to offset declining wages, and the United States may be approaching that limit.

Unions have historically succeeded in both raising wages and benefits and in lowering wage inequality by standardizing compensation across competing employers. Non-unionized workers typically are paid lower wages, have less job security, receive fewer benefits, and are more likely to work part time than union members. Economic analysis of the decline in union participation during the 1980s confirms that declining unionization contributes to increased earnings inequality.
One factor that has accelerated the decline of unions is the proliferation of state laws that prohibit unions from requiring union membership for all workers covered by a union contract. These so-called "right-to-work" laws are common in the South.

**The Impact of Demographic Changes**

Demographic changes may also contribute to the growing wage gap. For example, the share of households composed of single individuals rose from 22 percent to 27 percent between 1979 and 2010, while the share of families headed by a woman rose from 14.3 percent to 19.6 percent. These trends have reduced incomes at the low end of the income scale because both single-individual families and female-headed families generally have lower incomes. This report adjusts the income of households for the number of members so the changes in inequality reflected here do not result from the increase in families composed of single individuals, but to some degree they do reflect the increase in families headed by a single woman.

Another significant demographic trend, the increase in husband-wife families in which the wife works outside the home, has lessened income inequality among families. During the 1970s and 1980s, increasing numbers of women entered the workforce, in part to help stem the decline in family incomes that resulted from the fall in average male earnings. In addition, family members increased their hours of work. However, there is a point at which families can no longer increase their work effort to offset declining wages, and the United States may be approaching that limit. In the 1990s, wives' hours of work grew much more slowly than in the 1980s. Between 2000 and 2009, wives' hours of work declined as a result of the weak labor market.

Some have identified immigration as a potential cause of rising wage inequality. In theory, inequality would increase if the growth in the number of immigrants increases the supply of low-wage workers, thereby lowering wages at the bottom of the wage scale. The actual role of immigration in wage inequality is much less clear, however. A 2005 report from the Congressional Budget Office reviewed the research in this area and concluded, "The arrival of large numbers of immigrants with little education probably slows the growth of the wages of native-born high school dropouts, at least initially, but the ultimate impact on wages is difficult to quantify." A recent study by economists at the Federal Reserve Bank of Atlanta found only a very small negative impact (0.15 percent) on the wages of documented workers in firms that also hire undocumented workers. They also found that immigration increased wages slightly in sectors where there are opportunities for task specialization and in industries where communication skills are important.

Outside of its effect on wages, if any, immigration has been shown to reduce inequality. For example, a study in a state with many immigrants, New York, found that immigrants have
expanded the number of families in the middle of the income distribution thus reducing inequality.

The potential impact of immigration on wage inequality—whether positive or negative—in a given state will depend in part on the number of immigrants in the state. For example, fewer than 5 percent of Montana and Wyoming residents are foreign-born, compared to over 20 percent of California and New York residents. Where immigrants make up a smaller share of the workforce, they will have less potential influence on wage levels.

**The Impact of Government Policies**

Increasing wage inequality results initially from changes in the wages that employers pay. Government policies, however, also affect income inequality, both directly (by redistributing income through the tax system and through transfer programs such as unemployment insurance and food stamps) and indirectly (through the rules and regulations that apply to private markets, such as minimum wages, tariffs, and the rules governing the formation of unions).

Investment income primarily accrues to those at the top of the income scale, so any increase in investment income as a share of total personal income ... will widen income inequality.

Labor-market policies have had a major impact on wage inequality. The real value of the federal minimum wage has declined considerably since its high point in the late 1960s. By 2011, its value was still 13 percent less than in 1979, despite four legislated increases during the 1990s and three more in the 2000s. The minimum wage is not indexed to inflation—that is, it does not increase automatically as the cost of living increases—so its real value will continue to erode each year unless Congress acts. The impact of this reduction in the minimum wage since 1979 on wage inequality has been, by many accounts, very substantial, especially for low-wage women workers.

Many states now have their own, higher minimum wage, which reduces inequality by raising wages at the bottom of the wage scale....

States also play a major role in delivering safety net assistance, which pushes back against growing inequality by helping low-wage workers move up the income ladder and by shielding the most vulnerable citizens from the long-term effects of poverty.

**The Shift from Labor Income to Capital Income**

Besides wages, the other major source of income is capital income: Investments that yield dividends, rent, interest, and capital gains. Investment income primarily accrues to those at
the top of the income scale, so any increase in investment income as a share of total personal income—as occurred over the last three decades—will widen income inequality.

Between 1979 and 2007, capital income rose as a share of personal market-based income from 15 percent to 20 percent, while labor income (wages, salaries, and fringe benefits) fell from 76 percent of personal income to 71 percent. Further, the share of national income growth going to corporate profits during the recovery from the recent recession was considerably higher than average.

One result of these trends is that the gains of economic growth show up increasingly as capital income such as interest and dividends rather than increased wages, salaries, or benefits. Thus, wage earners benefit less from economic growth than wealthier owners of assets like stocks and investment properties. A recent Economic Policy Institute analysis of the reasons why wage growth has lagged behind growth in the economy (measured by productivity growth) found that almost half of the increase in this gap since 2000 can be explained by the shift in shares of income from labor to capital.

Higher-income families benefit disproportionately from the increase in the importance of investment income, since it makes up a larger share of their total income. In 2012, 87 percent of all capital gains income will go to families in the top 5 percent of the income distribution.

Further Readings

Books


Periodicals and Internet Sources

• Dave Gilson and Carolyn Perot "It’s the Inequality, Stupid," Mother Jones, March/April 2011.
• Ryan Messmore "Justice, Inequality, and the Poor," National Affairs, Winter 2012.


Source Citation


URL

http://ic.galegroup.com/ic/ovic/ViewpointsDetailsPage/ViewpointsDetailsWindow?failOverType=&query=&prodId=OVIC>windowstate=normal&contentModules=&display-query=&mode=view&displayGroupName=Viewpoints&dviSelectedPage=&limiter=&currPage=&disableHighlighting=false&displayGroups=&sortBy=&search_within_results=&p=OVIC&action=e&catId=&activityType=&scanId=&documentId=GALE%7CEJ3010529239&source=Bookmark&u=plan_canada&jsid=6f81335f91a1948fd31d639f57e9eb69

**Gale Document Number:** GALE|EJ3010529239