Rising American Inequality: New Facts and Interpretations

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“Of Course” Inequality Has Increased, but. . .

- Has the increase been steady and inexorable?
- Are there signs that the rise of inequality has ceased? Could it reverse on its own? Could a new set of policies turn it around?
- Does the rise of inequality at all levels of the income distribution have the same time pattern?
  - No, the bottom 95% behaves differently than the top 5%
  - Different timing and different hypotheses for the top and the bottom
The Paper is Divided into Two Parts

- The first part examines the latest data and assesses hypotheses that are data-related.
- The second part summarizes some of the most interesting recent research that has emerged in the past year or two.
  - In part this is a sequel to my two survey papers with Ian Dew-Becker:
    - Short version (2007 in Brookings)
    - Long version (2008 NBER WP)
The Overall Conclusion
About Timing

- There is a political chronology of the increase of inequality.
- At the 90th percentile and below, the big increase was in the era of Reagan and Bush I.
  - No increase in the Clinton era.
  - What happened in the era of Bush II?
- Above the 95th percentile, the increase was continuous from 1975 to 2000 but not after.
  - The top 1% share will be much lower in 2009 than in 2006-07.
The Misleading Growth Gap: Median HH Income vs. Productivity (1975-2006)
Why Is the Standard Comparison Misleading?

- Average Persons per Household has declined at 0.41 percent per year.
- PCE Deflator has increased 0.14 percent per year slower than CPI-RS.
- GDP Deflator has increased 0.12 percent per year slower than PCE defl.
- What matters is productivity in the total economy, not in the NFPB sector.
The Step-by-Step Transition (1975-2006)
Labor’s Share of Domestic Net Factor Income

- Labor’s share has only a peripheral connection with inequality
- Labor’s share could remain constant yet inequality could increase by a shift of labor income from low-paid to high-paid
- Yet the 2000-05 decline in labor’s share added to the widespread laments about the weakened position of labor
- These commentators ignored the cyclical behavior of labor’s share
Figure 1. Labor’s Share, 1960:Q1 – 2008:Q3

Employee Compensation with Labor
Portion of Proprietors' Income

Employee Compensation
Need to Correct for the Business Cycle

- Ten-year moving averages of the labor share data show minor changes
- A central theme of my recent research; the productivity growth trend has an influence on labor’s share
  - When the productivity trend slows down (as in 1965-80) labor’s share increases
  - The opposite occurs in 1990-2005
- Main decline in share occurred in 1980s, not in this decade
Figure 2. Labor’s Share: 10-Year Moving Average

Employee Compensation with Labor
Portion of Proprietors' Income

Employee Compensation
Rising Inequality in the Bottom 90 Percent

- We look at the timing of changes in two ratios, 90-50 and 50-10.
  - Multiplied together they give 90-10

- Hypotheses
  - Decline of unions
  - Rise of imports
  - Rise of immigration
  - Decline of real minimum wage
90-50-10 CPS Ratios, 1973-2007

The graph shows the 90-50-10 CPS Ratios from 1973 to 2007. The x-axis represents the years from 1973 to 2003, and the y-axis represents the percentage. The graph includes three lines: 90-10 (red), 50-10 (green), and 90-50 (blue). The ratios show fluctuations over the years, with 90-10 generally increasing, 50-10 fluctuating, and 90-50 decreasing and then increasing again.
Timing and Hypotheses

- Sharp increase 50-10 ratio 1979-86
  - Consistent with unionization for males
  - Consistent with minimum wage for females
- Steady rise in 90-50 ratio 1979-2007
  - Consistent with skill-biased technical change
  - Demand for college graduates declined after 1990
- Autor-Katz-Kearney polarization hypothesis
- Both ratios increased 2004-07, ending previous plateau
Rising Inequality at the Top: Three Groups

- #1 Superstars (entertainment and sports), market-driven by audience magnification
- #2 Lawyers, investment bankers, other market-driven professionals
- #3 CEOs. Active debate: market vs. managerial power
  - Notice clear correlation with stock market after 1982, especially 2000-2006
Top Income Shares, 1927-2006

- Percentiles 96-99
- Percentiles 91-95
- Top 1 Percent
Sources of Income,
Share of Top 0.1 percent
1916-2005

1916
1921
1926
1931
1936
1941
1946
1951
1956
1961
1966
1971
1976
1981
1986
1991
1996
2001

Salaries
Business Income
Capital Income
Capital Gains

0%
1%
2%
3%
4%
5%
6%
7%
8%
9%
10%
Ratio to Average Pay of CEO Pay, Average of Top 100 and Rank 100 CEO
Conclusion about Pay at the Top

- CEO share strongly correlated with stock market, supports Gabaix-Landier
- But still a role for managerial power
  - Why are stock options so generous?
  - Why are stock options less important in other countries (illegal in Japan until 1997)
Share of Top 0.1%, U.S. vs. U.K. vs. France, 1916-2006
Other Themes in our Previous Surveys

- **Consumption inequality**
  - Data problems prevent clear conclusions

- **Two opposite effects, rich vs. poor**
  - Price indexes rise less for poor, the Wal-Mart effect vs. top-end services
  - Life expectancy is rising much faster for the well-educated. Education spills over not just to income but to health

- **Geographical inequality, the super-star bicoastal cities**
New Papers Surveyed
Here: Bottom 90 Percent

- Burkhauser et al. (2008). Previously unavailable CPS top-coded data suggest inequality has increased much more slowly since 1993 than between 1979 and 1993
- Ottaviano and Peri (2008) on immigration. No impact on native workers, substantial effect on previous immigrants
  - So immigration matters, but not in the way usually portrayed
- Autor-Dorn (2008) on unskilled service workers
Top Incomes

- Frydman and Saks, executive compensation since 1936
- Complete change in behavior since mid-1970s
  - Previously no response to macro fluctuations or stock market
  - Strong correlation since mid-1970s with market capitalization
- Why? Changes in social norms? Contrast with corporatism and union power in Germany and elsewhere
The Health Aspect: Differential Growth of Life Expectancy

- Mera, Richards, and Cutler (2008)
  - Channel from low education to life expectancy comes from smoking and obesity
- Cutler et al. (2008).
  - Causation flows from education to both income and health
  - Poor health contributes to income inequality
- Insufficient emphasis on disparities of access to health care
Geographic Inequality

- New BEA data series on price differences across states
  - Totally eliminates 20% differential between New York State and national average
- Moretti (2008). Educated people move to expensive cities. Cuts in half the rate of return to college education
  - Taxation: Federal taxes based on nominal incomes, high state income taxes in highest income states
Conclusions Part 1: Facts and Hypotheses

- The slow growth of median HH income has been exaggerated
- Labor’s share is not declining
- Different time paths of inequality <90 and >99 suggest different hypotheses
- Increased inequality stopped growing by 1990 for 50-10, slow continued growth for 90-50, no growth since 2000 for top 1%
Conclusions #2: Policy

- Don’t try to regulate pay at the top, much of it is market driven
- Tax the hell out of it (Obama too timid)
- For the bottom 90 percent
  - Spend much more on education starting with pre-school and college access
  - Don’t interfere with free trade or immigration
- Policies can turn around inequality at the bottom. The stock market is taking its toll on inequality at the top