

Rising American Inequality: New Facts and Interpretations

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EPS Session on Inequality:

**Economic, Fiscal, Financial, and Societal
Dimensions**

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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

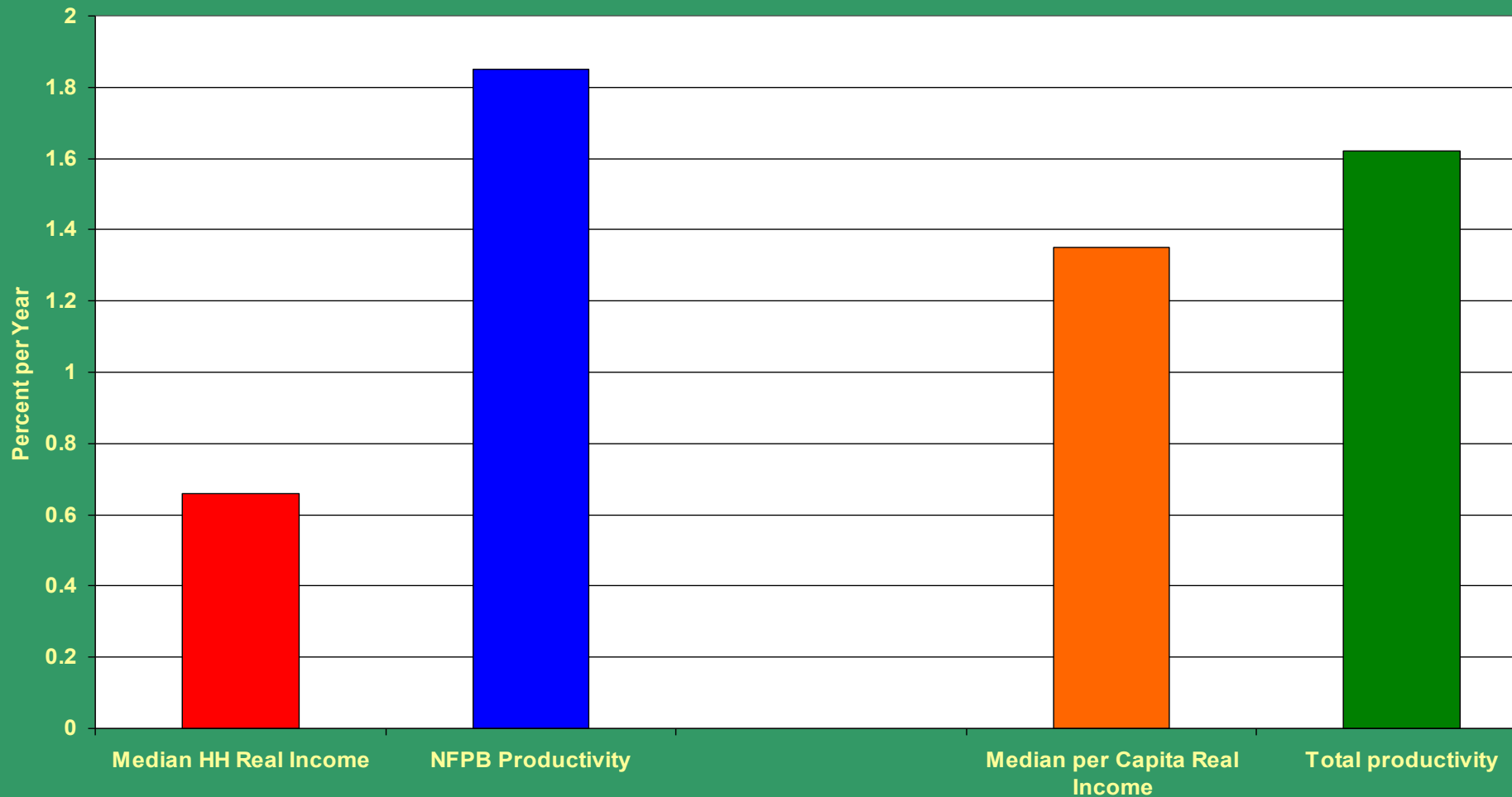
The Paper is Divided into Two Parts

- 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 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

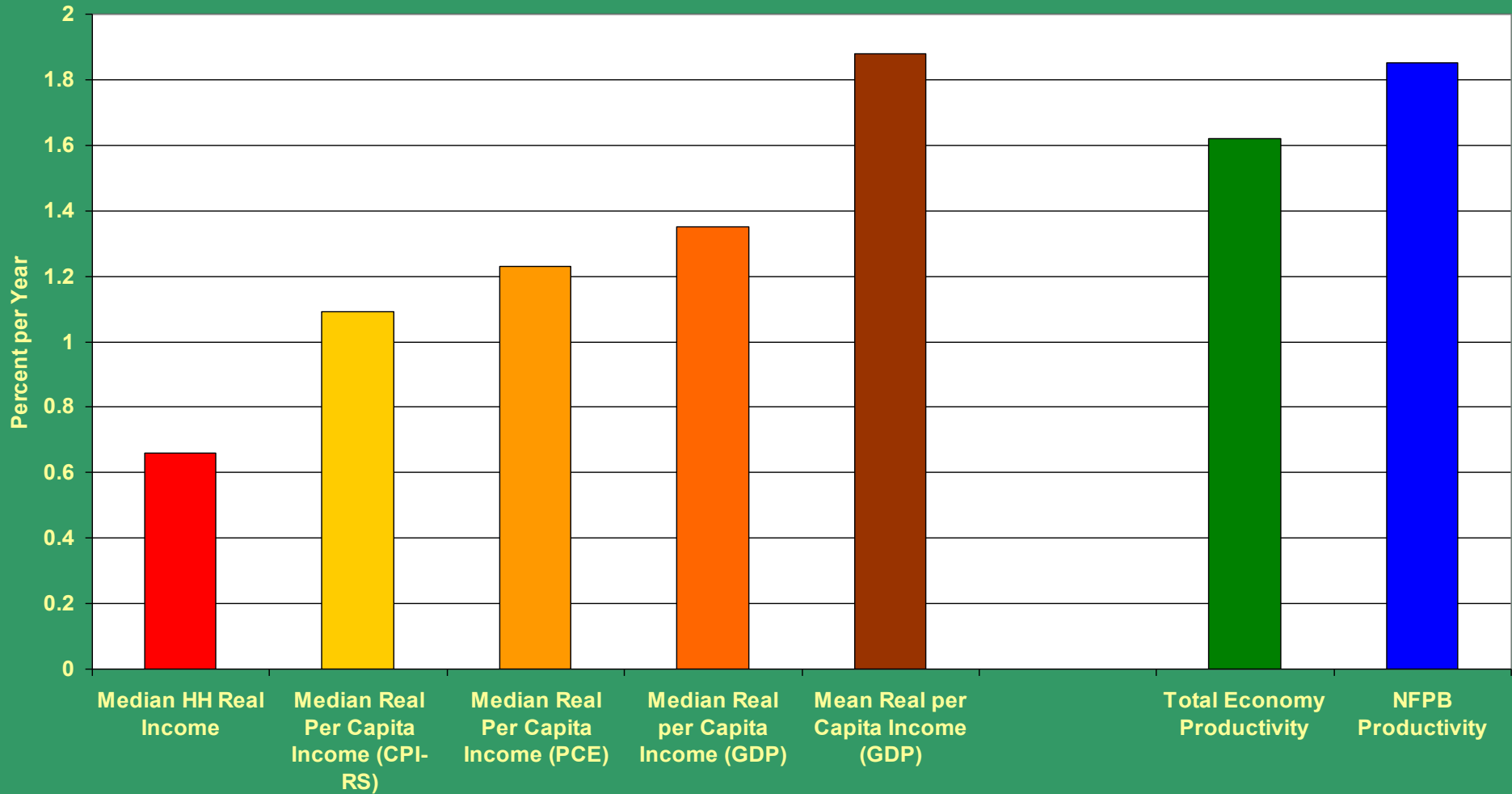
The Misleading Growth Gap: Median HH Income vs. Productivity (1975-2006)



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 def
- What matters is productivity in the *total economy* not in the NFPB sector

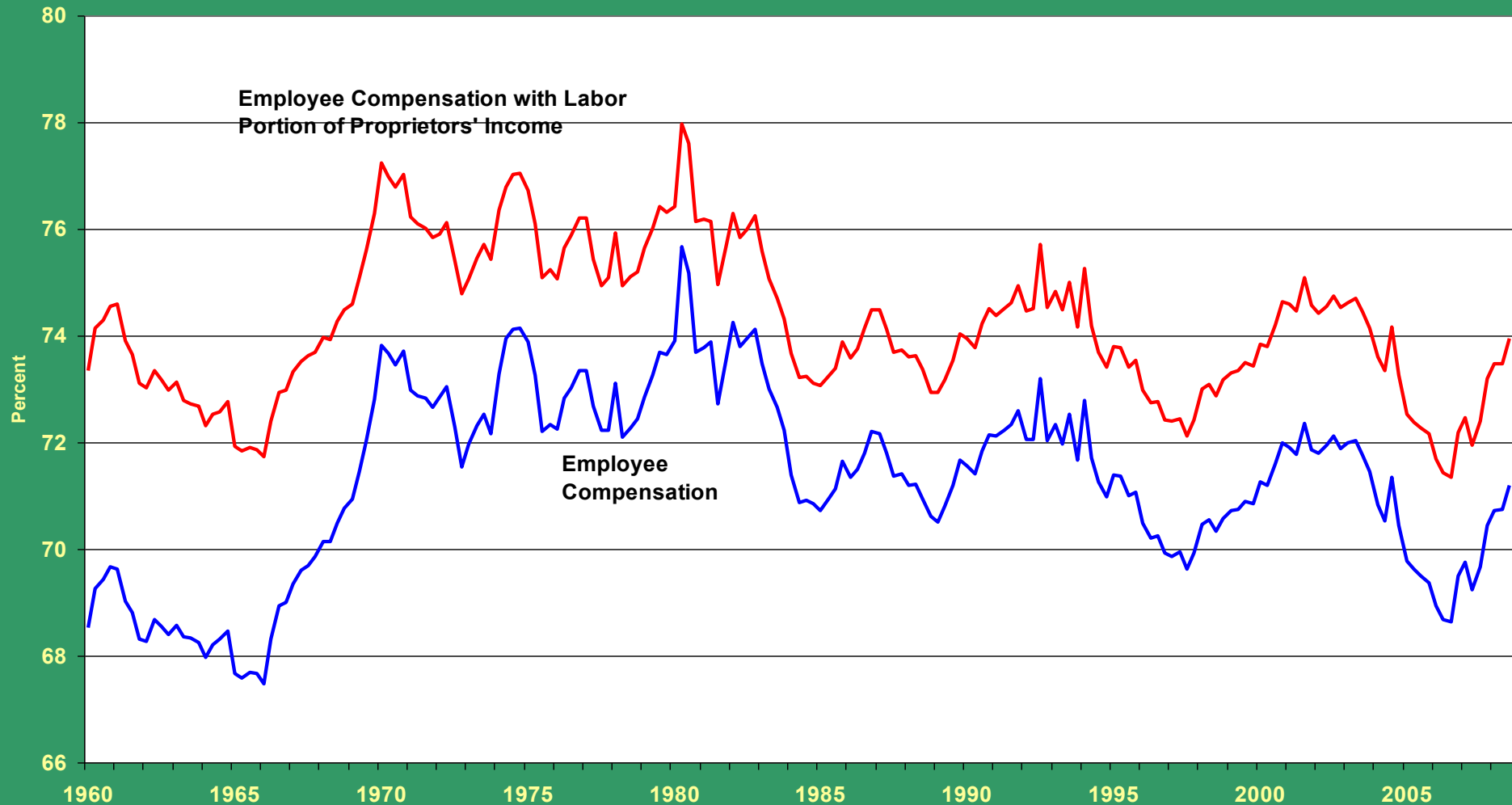
The Step-by-Step Transition (1975-2006)



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

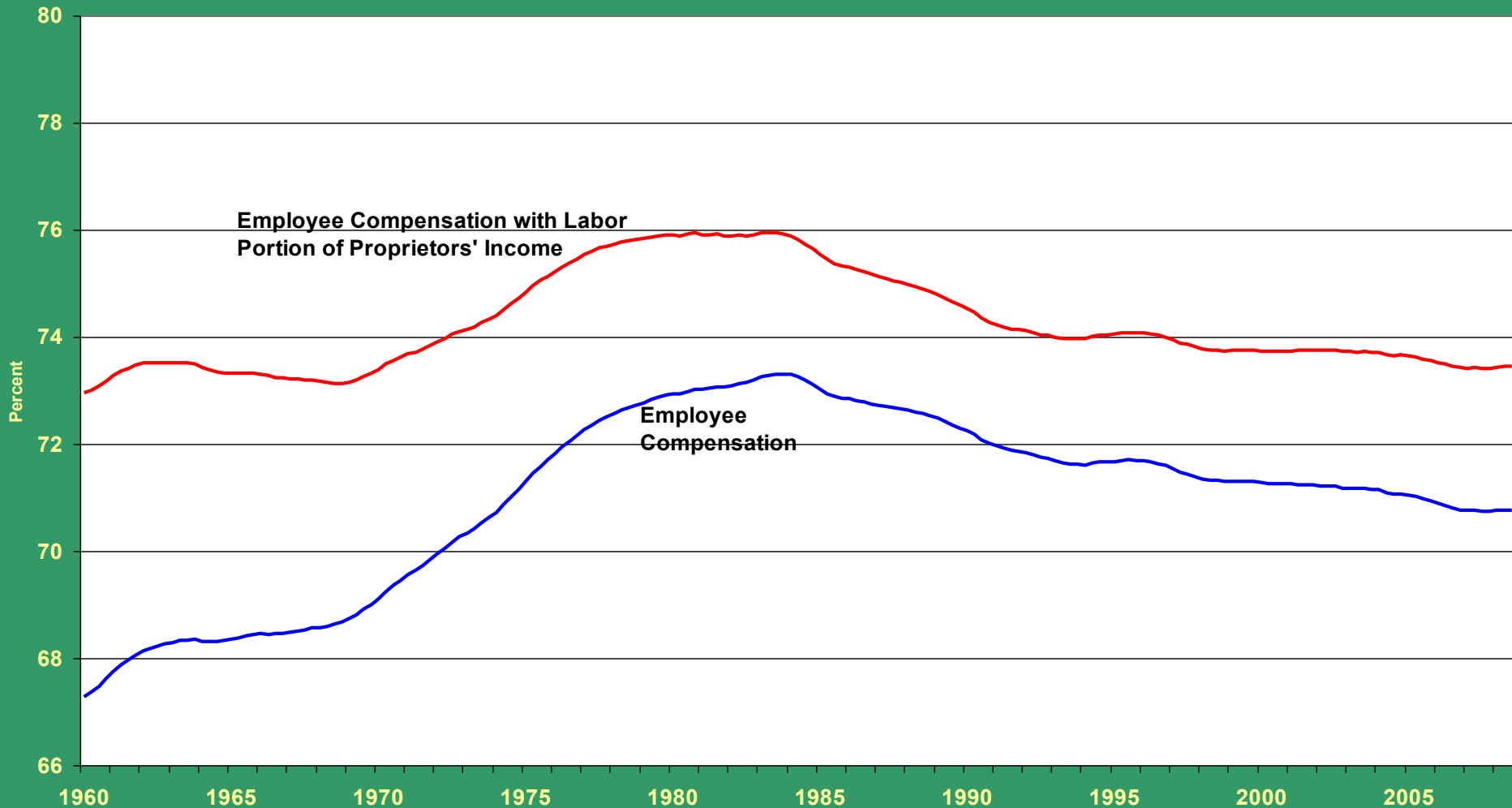
Figure 1. Labor's Share, 1960:Q1 – 2008:Q3



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

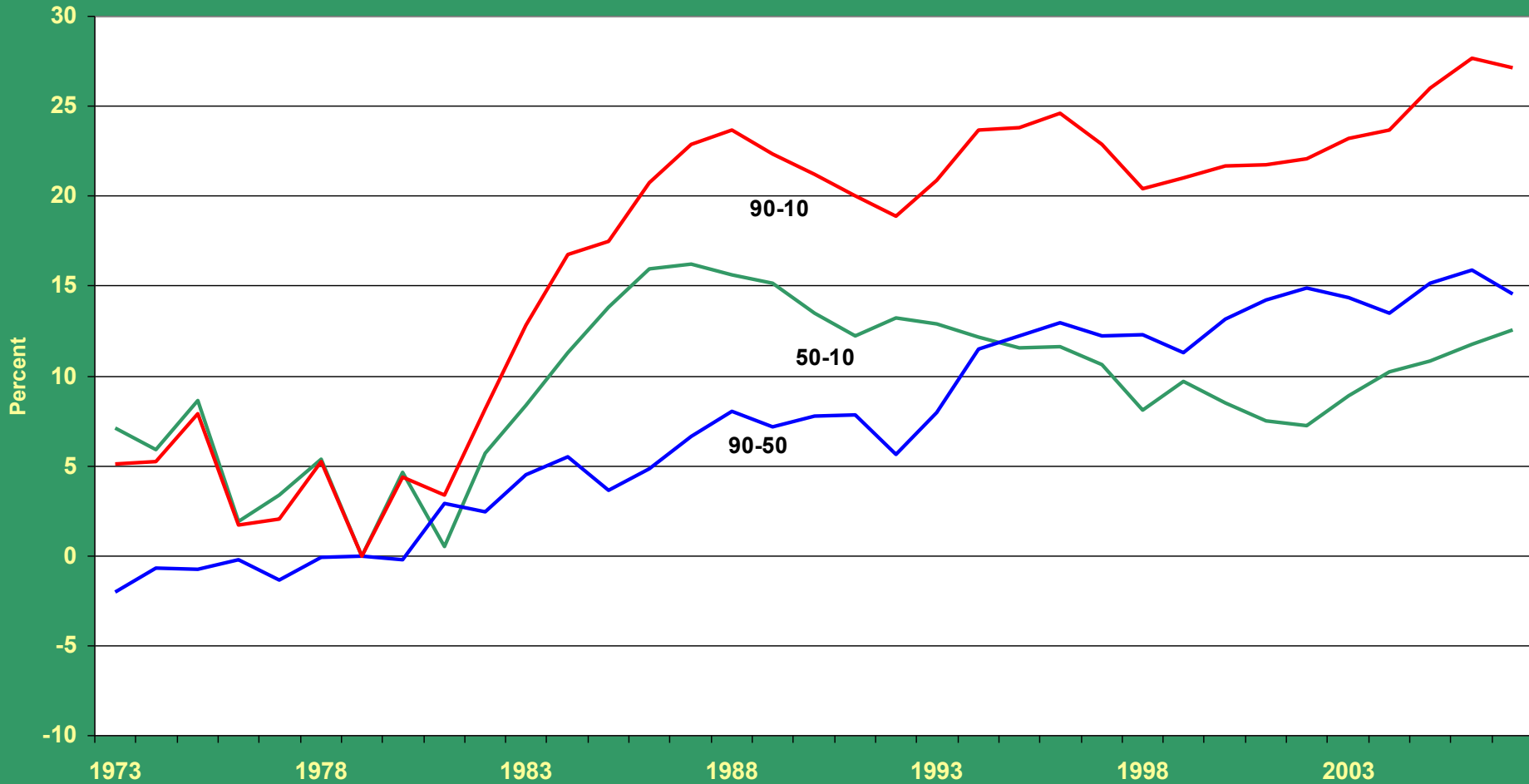
Figure 2. Labor's Share: 10-Year Moving Average



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



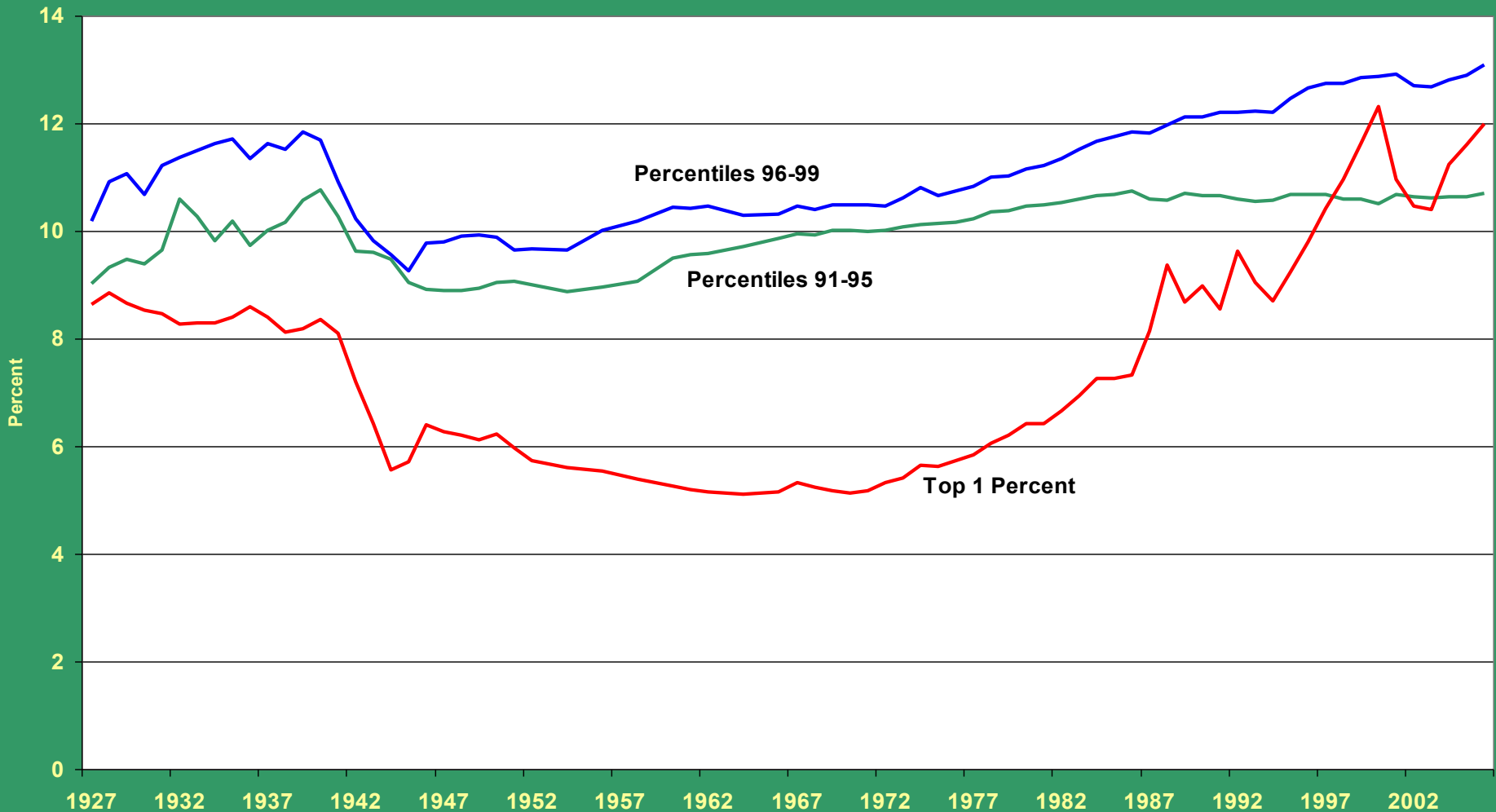
Timing and Hypotheses

- 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

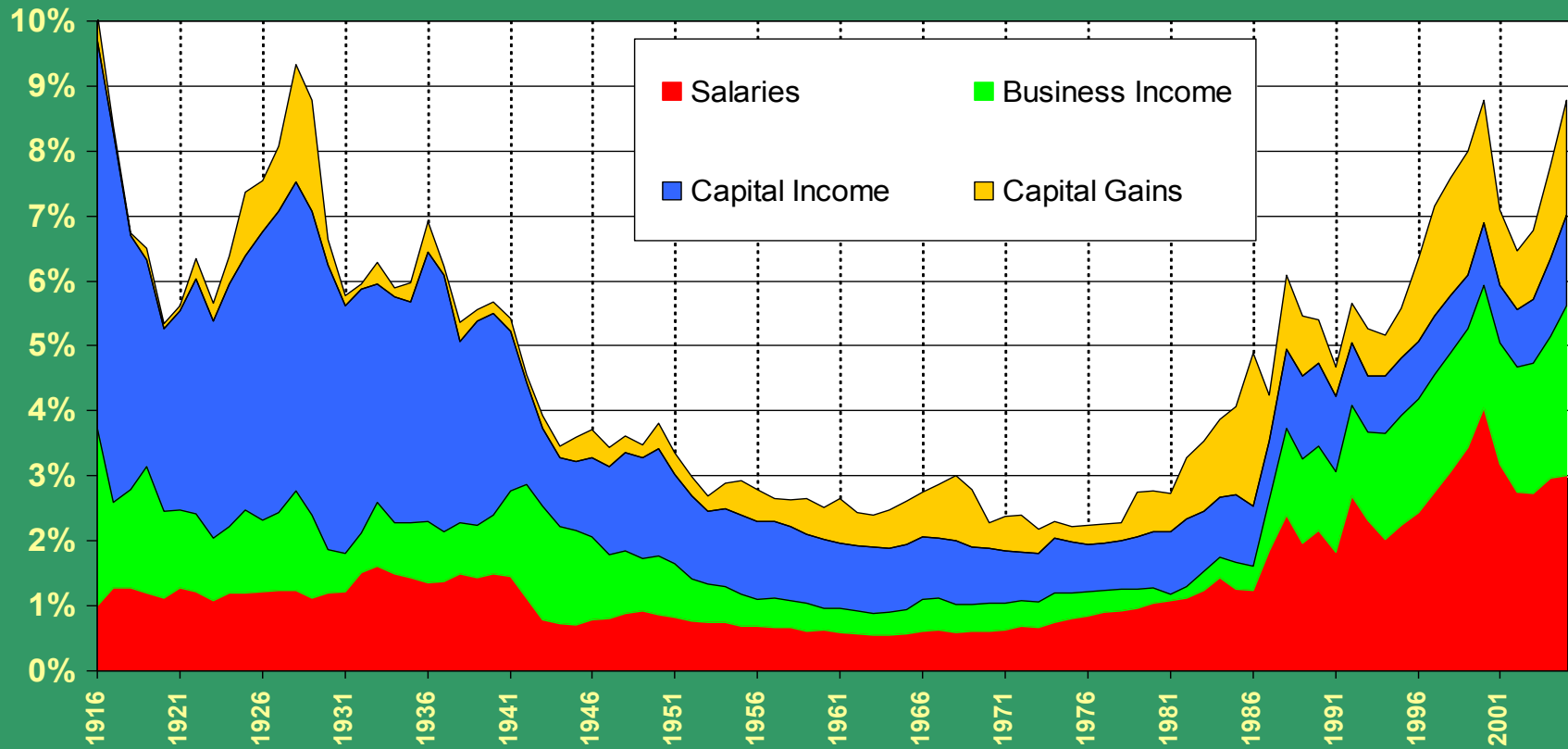
Rising Inequality at the Top: Three Groups

- #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

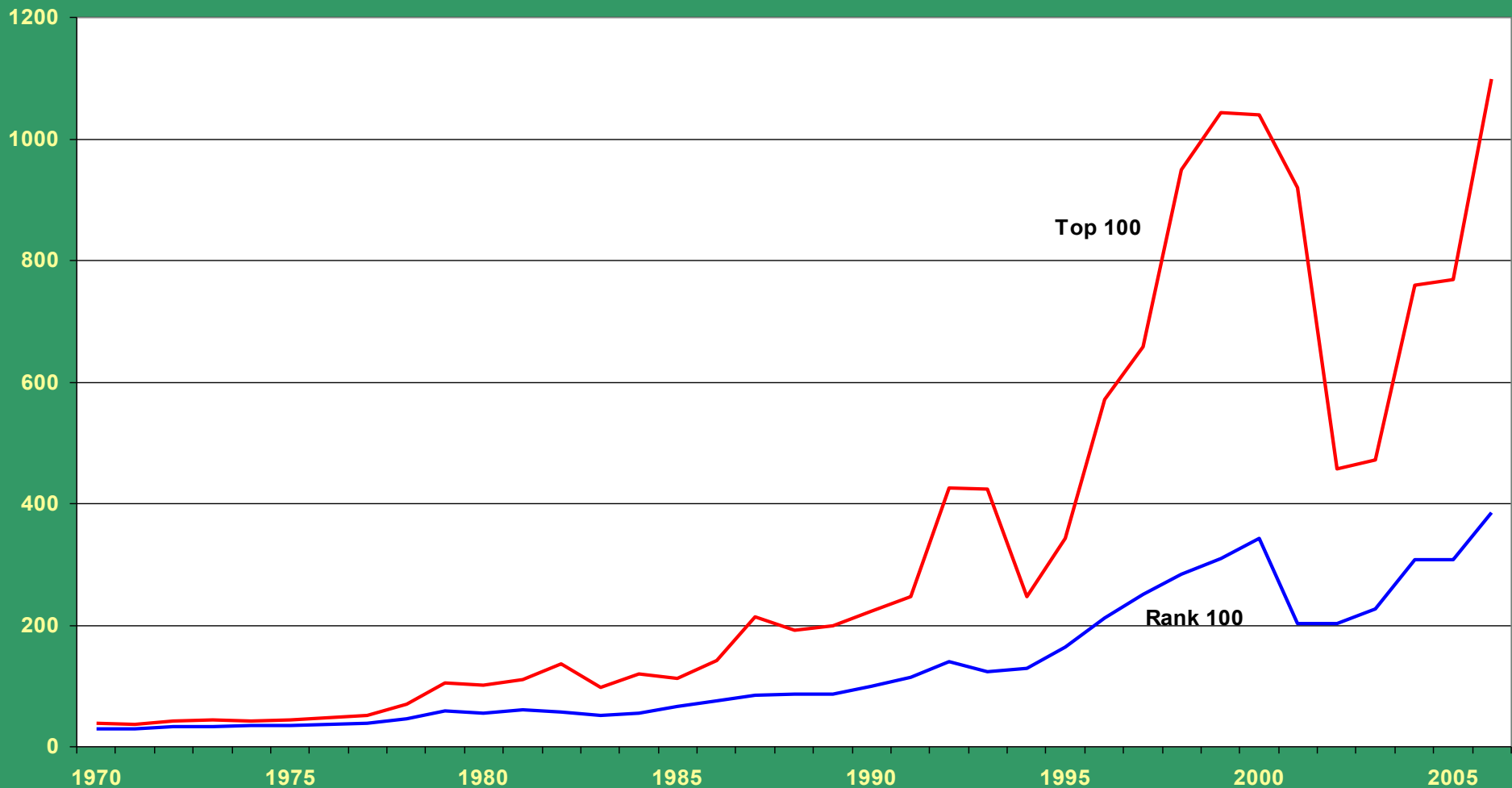
Top Income Shares, 1927-2006



Sources of Income, Share of Top 0.1 percent 1916-2005



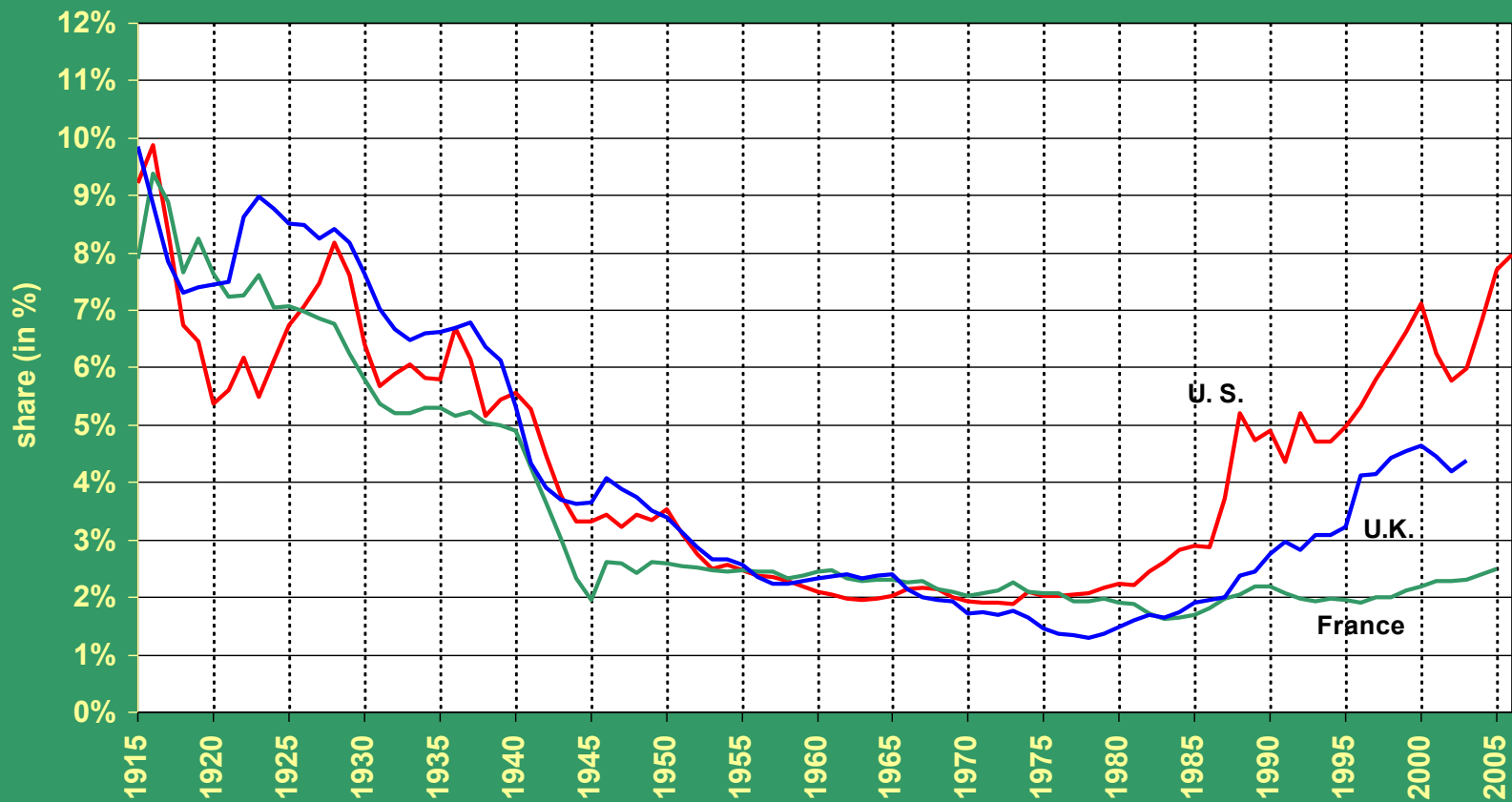
Ratio to Average Pay of CEO Pay, Average of Top 100 and Rank 100 CEO



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