Prepared Remarks
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“The Politics of Income Inequality in the United States”
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Thank you Dean Lee for that introduction, and thank you all for being here. I’m honored to be speaking to you tonight about inequality in the United States. I’ve been working on this topic for over ten years now, and I’ll be drawing on my work over this period, as well as some of the best and most relevant research by other political scientists, sociologists, and economists. I also want to acknowledge the work and support of several graduate and undergraduate students here at UT, who have participated in various capacities in the research program that anchors the presentation. I know I have benefitted from their work, and I’m hopeful that they’ve learned a great deal as well.

[CLICK TO NEXT SLIDE]

Alright, so I want to start with a very clear warning. There’s danger ahead in this presentation – real and serious danger. Anytime you’re talking about inequality, it has a good chance to inflame passions on all sides of the debate. But we’re especially unlucky on that front tonight because we’re in the midst of a presidential election. Democrats and Republicans have pretty different views on the issues surrounding economic inequality, and they use vastly different rhetoric when talking about it.

So this is a potentially very dangerous presentation. Predispositions regarding inequality are always prevalent, but our predispositions become even stronger when the parties that we root for disagree publicly. Many of you may not have a clear attachment to a party or even a presidential candidate. But for those who do, if you’re an Obama supporter, you probably have a pretty clear idea what you should think about inequality before you walked through the door. The same is also true of Romney supporters. So there’s no doubt that we have some division in the room on an issue that can inflame passions. But don’t be afraid. One of the best things we can do is take a step back and acknowledge our predispositions. So I’d invite you to do that right now. Acknowledge your predispositions. Try to set them aside for at least the next 30 minutes. My goal, no matter which side you’re on, is not to convert you. My goal really isn’t to present a quote-unquote “side” at all. My goal is to help us think through an important issue with a focus on evidence rather than ideology.

[CLICK THE QUOTE IN]

Finally, I have a request. Given the topic of the evening, I think we would do well to follow Governor Romney’s advice. So please, be very quiet.

[CLICK TO NEXT SLIDE]

The presentation today will be oriented around these three questions, we’ll take each in turn. The first question is about describing the current distribution of income, and coming to grips with how income inequality has changed over time.

[CLICK TO HOW MUCH INEQUALITY]

We’ll look at this question in a few different ways.
First, I just want to show you what the distribution of income looked like in 2010. Part of the fun of this chart (or not) is that each of us can see where our income falls. This is pre-tax income for everyone in your household combined. I’m showing the level of income at various percentiles, so going down the chart, the 20th percentile represents the income level that’s higher than 20 percent of other households, and so on up the scale. So, just under $21,000 makes you richer than 20 percent of American households and poorer than 80 percent of households. At the top end, a little over 180,000 puts you in the top 5%. The pure middle is right around 50,000. In Tennessee, things are a bit different, mainly in that Tennesseans are poorer at every point in the income distribution. Both our poor and our rich are poorer than the country as a whole at similar points in the distribution. Of course, our cost of living is a bit lower in Tennessee as well, but not sufficiently lower to account for these differences.

Here, we get a slightly different picture. In this chart, we divide the U.S., and then Tennessee, into five equally sized groups, called quintiles, and then ask what percentage of total income each of those equally sized groups has. In both the U.S. and Tennessee, the results are similar. The bottom 20 percent of households, or the bottom quintile, has just more than 3 percent of income. The top quintile has more than 50 percent of income, and the top 5 percent has about 22 percent of income. If economic outcomes were perfectly equal, of course, each of those five equally sized groups would have identical shares. So, no surprise here, we have some economic inequality. But there’s economic inequality in every society. How much do we really have? To answer this question we need to begin making comparisons.

The first comparison I want to show you is the United States compared to other countries. This chart looks at data from 28 countries for which I have truly comparable data. The measure here is the ratio of the 90th percentile of income to the 10th percentile of income, so the bigger the bar is, the bigger is the income gap between the rich and the poor. Of the 28 countries, we are more equal than 6 and less equal than 21. So from a cross-national perspective, income inequality is pretty high. But that’s just one form of comparison.

Instead of comparing the U.S. to other countries, now let’s compare us to ourselves in the past. This chart shows the percentage of all income going to the top 1 percent from 1913-2010. We see a notable peak in inequality just prior to the Great Depression. After that peak, inequality declined steadily until the late 1970s. Since 1980, inequality has risen dramatically. By 2009, this measure of inequality was essentially as high as it was just prior to the Great Depression. We currently have a higher level of inequality than we have seen since the 1930s.
We can see here a bit more about how we got where we are. The basic story is that incomes at the middle and bottom of the income distribution grew quite slowly while incomes at the very top absolutely sky-rocketed.

So, whether we compare ourselves to other countries, or to ourselves in earlier times, inequality today is high. But is this a problem?

Answering this question is to some extent purely a matter of opinion, but I also have some data that are helpful in shedding light on the issue. First, I want to present a few simple arguments in support of the viewpoint that concerns about inequality are overblown, and then discuss some evidence that tests the implicit empirical assumptions of these arguments.

Let’s start with the argument that inequality is just about effort, a result of rich people working harder than poor people. This is a reasonable argument, and I think most fair-minded people would conclude that if inequality is purely driven by differential effort, then inequality is not unjust. Let’s look at some data relevant to that argument. This first chart has six lines, representing the annual hours worked in households in each quintile of the income distribution, as well as the top 5 percent. The dark teal line at the bottom represents the hours worked in the poorest quintile, and the orange line represents the hours worked by the richest 5 percent. What do we see here? First, the argument that the rich work harder than the poor is true. While a big reason for the low level of hours worked in the poorest quintile likely has to do with involuntary unemployment, the data are really incontrovertible that work effort is correlated with income. However, the fact that the rich work harder than the poor does not, of itself, support the conclusion that current levels of inequality are fully explained by differential work effort. In order to reach that conclusion, we need to observe a strong positive correlation between the relative work effort of the rich and the rise in inequality. So let’s look for that.

Here, the orange line is inequality, as measured by the ratio of the 95th percentile to the 50th percentile. The gray line is a measure of how much more people in the top 5% worked than people in the middle. The scale for the gray work-effort line is on the left side of the chart. I’ve compressed that scale in order to be able to see variation in relative work effort. At its highest point, the top 5 percent worked about 1.12 hours for every hour that the middle income quintile worked. The comparable number in the most recent data is about 1.1. So not any real change. Remember, if inequality can be explained by differential work effort, we should see inequality rise only when the work effort of the rich goes up relative to the work effort of those in the
middle. That’s not at all what we see here. While inequality was rising, the relative work effort of the rich was essentially flat. So this is pretty strong evidence that work effort is a very weak explanation of inequality. While the rich do work harder than those in the middle and at the bottom, they work no harder relative to those groups now than they did when inequality was much lower.

[CLICK BACK ARROW, THEN DUAL EARNER HOUSEHOLDS]

Another common argument is that inequality can be explained by the fact that lots of women have joined the workforce over the years, combined with the fact that high-income men and women tend to marry each other, and on top of that there is a breakdown of the family among the poor. Under this view, inequality is essentially a result of dual-earner households at the top of the income distribution. Inequality goes up because more households have two earners, and high earners tend to couple. This chart tests this idea. Let’s just focus on the top two lines since the bottom set of lines makes the same point anyway. If rising income inequality is attributable to an increase in two-earner households, we should see these two lines move together. One line is inequality, the other line is the share of two-earner households among the rich. There has been a slight increase in the proportion of high-income households with two earners, but it’s a small increase, just about 1 percentage point. Inequality, on the other hand, has gone up dramatically. Now I will say that if we look at these data over a longer period of time, there’s some correlation between two-earner households and inequality, but most of the increase in two-earner households came before the big increases in inequality, so this probably isn’t a great explanation.

[CLICK BACK ARROW, THEN NEEDED FOR GROWTH]

Finally, a common viewpoint on inequality is that we have to have it in order to spur innovation and growth. I think there’s merit in this argument. Economic rewards certainly help to motivate people, and without unequal economic rewards for outstanding achievement, growth likely would be stymied to at least some extent. But the real question here is how much inequality does a society need to reap the benefits of differential economic rewards? This chart doesn’t answer the question fully, and I’m not sure it’s a question that can be fully sorted out, but the chart provides some helpful clues. What I’ve done here is plot the level of inequality in a country on the x axis and the rate of economic growth on the y axis. What does the chart tell us? Look at the position of the USA. I put orange lines running through that data point. The key evidence is that there are numerous countries in the upper left portion of the plot. These are countries that are lower than the U.S. on inequality and higher than the U.S. on economic growth. Based on this rather simplistic analysis, we can conclude that economic growth could likely be maintained, even if levels of inequality were reduced substantially.

[CLICK BACK ARROW]

Another issue that’s worth addressing is whether there are any potential negative consequences of high inequality. First, and I’ll show just a little data on this point, is social mobility.
An argument that I hear pretty commonly is that in America, the key characteristic of our economy is economic opportunity. People assert that we have a lot of inequality, but that inequality is accompanied by high levels of social mobility. In no other country is a poor person more likely to move up the income scale than in the United States, or so the argument goes. Let’s go to the data. This chart plots 22 countries, looking at a combination of inequality and social mobility. As a country moves to the right on the chart, the country has more inequality, and as a country moves up on the chart, the country has less social mobility. The line represents the correlation between inequality and social immobility. This is a very strong relationship. As inequality increases, social immobility increases as well. What this suggests is that if social mobility is your goal, inequality can get in the way. Why? I think the simplest way to understand this is to think of various positions in the income distribution as stair steps. When inequality is low, the height of each stair-step is pretty small. As inequality goes up, the overall rise of the stairs, as well as the height of each step increases. If social mobility implies the ability to climb the income staircase, that staircase becomes harder to climb as the height of each stair increases.

There are a handful of other potential side-effects when the gap between the rich and the poor becomes quite large. First, based on studies of political participation in the American states, as well as cross-national analysis, higher levels of inequality are associated with lower voter turnout and less political engagement. I’m not yet fully convinced whether inequality causes reduced participation or whether reduced participation causes inequality, but there’s good evidence that there’s a real relationship between these two outcomes. Second, those who study economics and politics by making comparisons across countries are finding increasing evidence that inequality can, at least under certain conditions, retard economic growth. The jury is still out on this argument, but the evidence is growing in its favor. Finally, extreme inequities can generate social unrest. We don’t really have to look a whole lot beyond the Occupy Wall Street movement last year to see this potential in a vivid way. Some would argue that the Tea Party is indicative of this issue as well.

Now I want to move on to the third central question of the presentation: what makes inequality change? One of the most challenging and exciting things about studying this topic is its inherent interdisciplinary nature. It’s exciting because multi-disciplinary questions are almost always big questions in which lots of people are interested. You really do get to connect with big ideas and with really smart people from all over the world with big ideas of their own. So that is truly cool. But, the fact that this question has been approached from multiple disciplines is also quite daunting because it means the questions I’m interested in have already been addressed from several perspectives. That means there’s a ton of work to be done to come to grips with what we know and what we need to find out. When you study inequality, you don’t just have to read what
economists say, you have to read what sociologists and political scientists and policy scholars have to say as well.

[CLICK WHAT MAKES CHANGE]

Over the next several minutes, I’ll talk mainly about ideas – ideas from the three main disciplines that study inequality and are relevant to the question of what makes inequality change over time. As I said, we have a lot of ground to cover, and there’s frankly no way for me to cover it all in the context of a 30 minute presentation. When I’m conducting analysis, I do my best to account for all the arguments that are out there, but tonight, I’m really picking and choosing the most relevant ones. So here goes.

[CLICK ECONOMICS]

Let’s start with explanations of changing inequality that find their home in economics. Three main factors are getting most of the attention in contemporary scholarly debate. The first is skill biased technological change, which means changes in technology that have made those with a college degree ever more valuable employees relative to those without a degree. That sounds a lot like a recipe for rising inequality. But this explanation can’t be the whole story because inequality has risen even among the college-educated.

Deindustrialization and globalization are also at the forefront. Here, the argument is that global competition has depressed the wages of blue-collar workers and depleted the manufacturing sector. While these arguments have merit, again, certainly not a complete story because these global economic changes began to unfold quite a while before American inequality began to increase.

Next up is the rise of the financial sector. The story behind this factor is connected to the idea that the wizards of Wall Street have inflated their incomes through the development of a whole lot of financial tools that don’t really make people better off. Again, this makes some sense but the rise of the finance sector has been steady since the late 1940s. Inequality actually went down for a good chunk of the time that finance was rising.

Then we come to asset bubbles. Here we’re talking about over-valued prices on certain assets, like technology stocks in the 1990s or real estate more recently. How would that influence inequality? The heart of the argument is that it’s the super-rich who benefit most from inflated prices on these kinds of assets. Again, this factor likely plays a role, but we did not see dramatic declines in inequality after the tech bubble burst in the 1990s. And we should have if this is all there is to explaining inequality. Other factors need to be considered.

[CLICK BACK ARROW, THEN DEMOGRAPHICS]

That brings us to demographic explanations coming primarily from sociology. First up is aging. More old people means more retired people, with no earned income. That translates into higher inequality. Next is immigration. It’s not too hard to convince people that an influx of low-skill
immigrants could depress wages at the bottom of the income distribution, thus leading to rising inequality. Moving on, we get to the rise of single-female headed households. This is related to the discussion before of dual-earner households, but is focused on the fact that many, many households in poverty are headed by single mothers. If this type of household becomes more prevalent, then we would expect inequality to rise. Last, we have the decline of unions. Over the past six decades, union membership has gone from around 35 percent to about 7 percent. While unions are far from universally loved, one thing they accomplish is generating higher wages for their workers and more income equality within their membership. So the decline in union members would likely predict greater inequality. As with economic explanations, though, none of these is a silver-bullet answer for rising inequality. Some of them are partial explanations, but they don’t tell the whole story. We also need to pay attention to politics.

[CLICK BACK ARROW, THEN POLITICS AND POLICY]

Those are the explanations we turn to now. Well, this won’t come as a surprise to anyone in the room: Republicans and Democrats don’t agree on very much. Matters of inequality and redistribution are no exception. So how might policy decisions made in Washington affect the path of inequality over time? There are two broad mechanisms. The first is a dirty word in American politics – redistribution.

[CLICK REDISTRIBUTION]

Redistribution, simply stated, is shifting resources from some through various forms of taxation to others through various benefit programs. Redistribution has an undeniable impact on inequality, and it’s a policy arena in which Democrats and Republicans have some pretty fundamental disagreements. To get a handle on the effect of redistribution on inequality, I’m going to take you through a few charts that use income data from 2010 to capture the inequality-reducing impact of tax and transfer programs.

[CLICK TAX CHART]

Starting with taxes. In all these charts a bar that is positive represents a reduction in inequality, so here we see that the federal income tax reduces inequality by about 4.5 percent. A negative bar means that the program actually increases inequality. We see such an effect for both federal payroll taxes and local property taxes. Overall, federal individual taxes reduce inequality by a little over 4 percent, and the total tax system reduces inequality less than half as much, at under 2 percent.

[CLICK BACK ARROW, THEN SS AND MEDICARE]

Moving next to Social Security and Medicare, we see that these programs have substantial redistributive effects. While these are inter-generational transfer programs, they have massive rich-poor redistributional impact as well, together reducing inequality by over 13 percent, dwarfing the effect of the tax system, and all the benefit programs to come in the next slides.
Now we move to the effect of a variety non-means tested programs. These are programs that do not specifically target the poor since there is no income qualification. Instead, the qualification standards are based on factors other than income. All of these programs, from Veterans benefits to unemployment and disability, have modest effects, reducing inequality by between 0 and 1.26 percent.

Here we look at programs that do target the poor. You have to be below an income-threshold to receive these benefits. The effects here are also modest, with Medicaid (known as TennCare in our state) producing the largest reduction in inequality at 1.26 percent. Public assistance is classic welfare, what we most commonly think of when we think of redistribution. The effect of welfare is tiny, and the effect is tiny mainly because we don’t spend all that much money on such programs in the United States.

Finally, in this chart we look at the overall effect of federal-level redistributional programs on inequality. The total effect is more than a 25 percent reduction in inequality. But it’s really important to note that the big drivers of redistribution in our country are programs for the elderly. Programs that aim to help the working-age poor are a drop in the bucket.

When pressed to talk about what policies influence inequality or poverty in the United States, most people are going to mention one of the redistributive programs above, if they can come up with any answer at all. But in recent research, the focus has begun to shift to a second category of policies called market conditioning. What is market conditioning? It’s the difference between how the economy would function without the existence of government, compared to how it functions with the existence of government. So that’s a big set of policies. Pretty much everything in fact. But some of those market conditioning policies might actually influence inequality. I’ll just discuss education specifically. How would the market be different if there were no public schools? Probably, some kids would barely go to school at all, while others would get advanced degrees. Go back a few hundred years and we can see a picture of what that looks like. Since wages are tightly connected to skills, and education helps to generate skills, the market would likely produce much greater inequality in the absence of public education. And there’s a key empirical point in there. When we look for the effects of politics and policy via market conditioning, we look for effects on market income, before the effects of all the redistributional programs we discussed earlier. What my recent work has shown is that the market conditioning mechanism is really important, probably more important than redistribution. I’ve found that market inequality is much more responsive to politics and policy than is redistribution. I would argue that the biggest and most substantively important fight in American
politics, is about how to organize the economy and provide economic opportunity, not about how much to redistribute.

[CLICK BACK ARROW, THEN INSTITUTIONS]

Another set of factors related to politics is the design of American political institutions. One of the fairly unique aspects of our system is how strongly it is biased toward the status quo. We have separated powers and a bicameral legislature. That means that pretty broad agreement has to be reached before policy change can occur. And in the Senate, it’s now essentially the norm that a simple majority cannot pass legislation. The reason that status quo bias connects to inequality goes back to some of the economic and demographic factors we discussed before. Lots of those factors have been pushing in the direction of increased inequality. If the economy is changing and no new policies are enacted to deal with those changes, then inequality will increase. Another way of saying this is that stagnant policy does not produce stagnant outcomes in the midst of a changing economy.

[CLICK TO NEXT SLIDE]

To this point we’ve seen that there are lots of suspects in the search for an explanation of changes in inequality over time. But which factors really matter when all of these explanations are considered side by side? That is the issue to which we turn now.

[CLICK WHICH POLITICAL FACTORS]

We’ll start with this chart that is based on an analysis of data from 1947-2008. In this analysis, I considered all of the explanations discussed earlier and then some, and here are the explanations that survived. This chart presents the effects of each variable using a standard metric so the size of the effects can be compared. A light bar means that an increase in the explanatory factor reduces inequality, a dark bar means that an increase in the explanatory factor increases inequality. So, what are the strongest effects? Union membership and economic growth. As union membership goes up, inequality goes down. So the fact that unions have declined so substantially is an important explanation for rising inequality. On economic growth, more of it means less inequality. Moving on to other factors, globalization, as represented by a measure of trade openness, increases inequality. So do real estate and stock market valuations. But political and policy factors matter, too. Democratic strength in Congress reduces inequality. Increasing the top income tax rate and the capital gains rate reduces inequality. So an important part of the picture is missed here if we ignore politics.

[CLICK BACK ARROW, THEN HOW MUCH]

Finally, we turn to the question of how much of the increase in inequality is attributable to political factors. These results come from a more recent analysis that I’ve done using data from 1947-2010. This is what we’re trying to explain – that dramatic rise in inequality from the late 1970s to today. I take what we know about connections between political factors and inequality,
and look at how those political factors have changed over this period. How much of the increase in inequality can be attributed to political change while controlling for a host of other explanations?

[CLICK PAGE DOWN]

The answer is quite a bit. Essentially, just four political variables explain over 75 percent of the increase in inequality. The fact that the Senate has shifted toward the Republican Party explains about 10% of the increase. Tapping into status quo bias, the fact that polarization in the Senate has increased, alongside the existence of the filibuster, explains about 20%. 45 percent or so can be explained by income and capital gains tax rate reductions. The bottom line is that party politics, public policy, and American institutions all contribute in substantial ways to how inequality has changed over the past three decades.

[CLICK BACK ARROW]

In conclusion, three big takeaway points. First, inequality is high and rising in the United States. Second, some good news. We can affect this outcome through the political process. The policy choices that we make matter. Whether you think inequality ought to be lower, ought to rise even more, or should just be left to its own devices, you can have some degree of influence through the American democratic system. But, that’s not the whole story. There are lots of factors that make policy change hard in the United States, and these factors can prevent your preferences from being translated into policy, especially if policy change is what your beliefs require.
References


