Community Concerns from …
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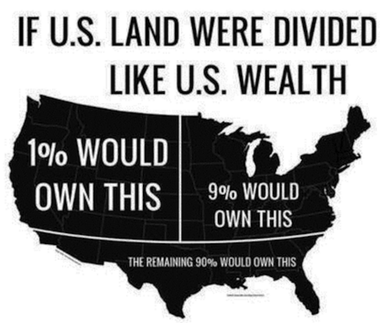
U.S. Income Inequality: Higher Than It Has Ever Been

Economic insecurity remains widespread throughout the U.S., and low- and middle-income workers have seen no significant wage growth over the past decade. Today, one-quarter of American workers make less than $10.90 per hour. A full-time worker earning $10.90 per hour earns $22,672 a year, which for a family of four creates an income below the federal poverty level.

Meanwhile, the top 10% of earners took home 50% of all income in 2012, including the top 1% taking home 24% of the income. That's the highest percent in the last 100 years, when the government began collecting income data. During this same time period, average wages remained flat despite an increase in worker productivity of 15%, while corporate profits increased 13%.

Looking back, between 1979 and 2007, household income grew at a much greater rate for wealthy households:

1. Nearly tripled (increased 275%) for the richest 1% of households.
2. Rose 65% for the top fifth.
3. Only increased 18% for the bottom fifth.



In that same timeframe, since top incomes increased faster, their piece of the pie grew larger. The richest 1% increased their share of total income by 10%, while, on average, the remaining 99% saw their piece of the pie shrink by 1-2%. In other words, even though the income going to the poor improved, they fell further behind when compared to the top 1% or even the top fifth.

History of income inequality in the U.S.

The level of concentration of income in America has fluctuated throughout its history. In 1915, an era in which the Rockefellers and Carnegies dominated American industry, the wealthiest 1% of Americans earned roughly 18% of all income. By 2007, the top 1% account for 24% of all income.

The first era of inequality lasted roughly from the post-civil war era to sometime around 1937. But from about 1937 to 1947, income inequality in America fell dramatically. Highly progressive New Deal taxation, the strengthening of unions, and regulation of the National War Labor Board during World War II raised the income of the poor and working class and lowered that of top earners. Wages remained relatively high because of lack of foreign competition for American manufacturing, lack of low skilled immigrant workers, competition for U.S. workers in general, and strong trade unions. By 1947, more than a third of non-farm workers were union members, and unions both raised average wages for their membership, and indirectly and to a lesser extent, raised wages for workers in similar occupations not represented by unions.

This "middle class society", a product of relatively high wages for the U.S. working class and political support for income leveling government policies, resulted in a relatively low level of inequality which remained fairly steady for about three decades ending in the early 1970s.

The return to high inequality – also referred to as the "Great Divergence" – began in the 1970s. While income growth began to stagnate, productivity continued to climb. Studies have found that income has grown more unequal almost continuously since then, except during the economic recessions in 1990–91, 2001 (Dot-com bubble), and 2007 sub-prime bust.

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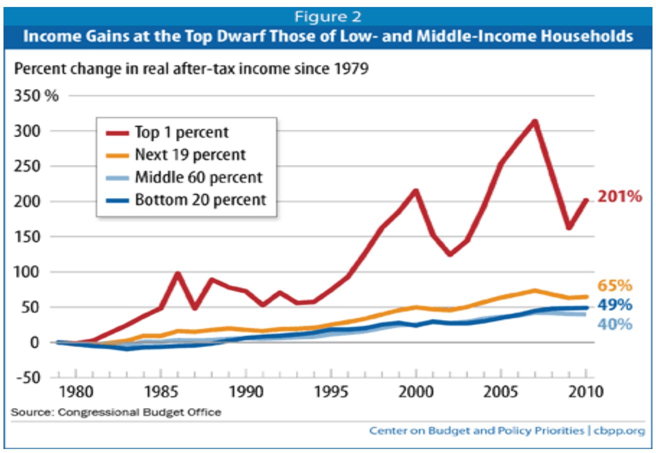
The Great Divergence differs in some ways from the pre-Depression era inequality. Before 1937, a larger share of top earners income came from capital (interest, dividends, income from rent, and capital gains). Post 1970, income of high-income taxpayers comes predominantly from "labor", i.e. employment compensation.

Breaking down the proportion of the increase in income inequality between 1979 and 2007 that came from distribution of pre-tax income and how much from taxes and "government transfers", the Congressional Budget Office data shows that the increase is composed of the following:

- 23% from changes in distribution of "market income" to households (top earners received a larger share of salaries, interest, dividends, capital gains, business income, etc.)
- 6% from changes in "government transfers" (social security, unemployment, the end of AFDC welfare, etc.)
- 4% from changes in federal taxation (overall decline in the average federal tax rate and shift in federal revenues from income taxes to less progressive payroll taxes, etc.)

Of the 23% increase in inequality from changes in pre-tax "market income", 79% came from a shift to top earners in different types of income across the board. A smaller amount (21%) came from a shift from wages and salaries to more concentrated income sources – i.e., interest, dividends, business income, and especially capital gains, which are greater among top earners than income from salaries and wages, which is more common to those with lower income.



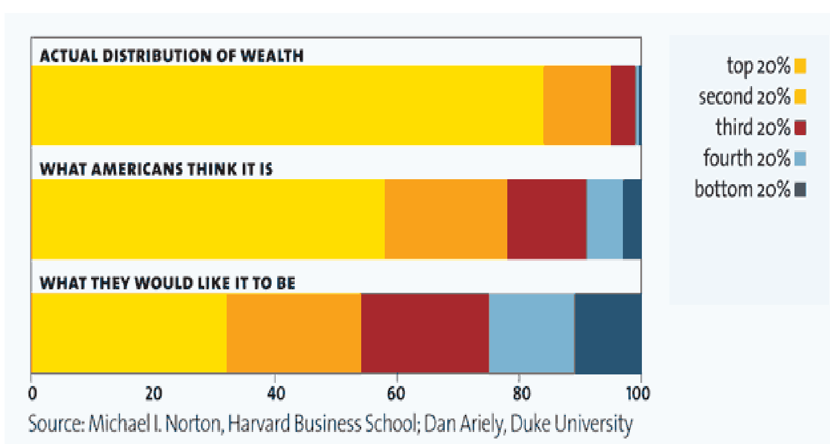
For the last two decades, American workers have been increasingly productive. However, U.S. real average hourly earnings are relatively flat, with today's inflation-adjusted wage equating to about the same level as that attained by workers in 1970. So where have the benefits of the technology-driven productivity cycle gone? Almost exclusively to corporations and their very top executives. The chart to the left shows how the income gains for the top 1% have increased since 1979 and now dwarf those of low- and middle-income households.

Until 2011, the Great Divergence had not been a major political issue in America, though stagnation of middle class income was. In 2009, the Barack Obama administration's White House Middle Class Working Families Task Force convened to focus on economic issues specifically affecting middle-income Americans. In 2011, the Occupy movement drew considerable attention to income inequality in the country.

<u>Where do Americans think the wealth is?</u>

Americans in the upper fifth of the income stream make 16.7 times the income of those in the lower fifth. However, barely half (47%) of Americans think that the rich-poor gap is a very big problem for the U.S.

In 2011, researchers from Harvard University and Duke University conducted a study regarding what Americans think about income inequality in the U.S. The graph to the right shows the actual distribution of wealth in the U.S., what Americans think it is, and what they would like it to be.



<u>Why is income inequality increasing in America?</u>

There are many reasons why this is happening:

1. <u>The U.S. minimum wage has not kept up with rising costs.</u>

In 1970, the federal minimum wage was $1.60 an hour. Today, it's $7.25 an hour. That's a 353% increase over that period of time, which seems like a fair amount until you actually start looking at how prices have increased. The following chart shows the average cost of items in the U.S. in 1970 compared to today:

	Average Cost in 1970	**Average Cost Today**	**Percent of Increase**
Education – one year of tuition at a public university	$1,207	$13,216	994%
Housing – median price of a home sold in U.S.	$23,600	$240,100	917%
Rent – median monthly gross rent in U.S.	$108	$889	723%
Automobile – average cost of a new car	$3,900	$29,217	649%
Gas – average cost of a gallon of gas	$.36	$3.80	956%
Dental Care – average cost of teeth cleaning for an adult	$13.58	$64.00	371%
Bread – average cost of a loaf of bread	$.25	$1.98	692%
Hamburger – average cost of 1 pound of hamburger meat	$.70	$4.68	569%

The minimum wage percent increase of 353%, between 1970 and today, is clearly much lower than the percent of increase that is shown for the items in the chart above. Even if you look at <u>all</u> goods and services of a typical consumer, what cost $1.00 in 1970, costs $6.13 in 2014. This is a 513% increase, which is still well beyond the 353% increase for minimum wage. <u>If the minimum wage had increased by 513%, it would now be $9.81.</u> People earning minimum wage today struggle to make ends meet on a daily basis. With the high cost of tuition and homeownership, obtaining higher education and/or buying their own home is simply out of reach for many of them.

2. <u>The growing education gap.</u>

Attaining a post-secondary degree or certificate has become increasingly important for securing opportunities to get higher paying jobs in the United States in the 21st century. Today, more than 70% of America's young people start some kind of advanced training or education within two years of receiving their high school diplomas. Yet for too many, the journey ends long before graduation day. They become college dropouts.

Until a decade ago, the U.S. led the world in college graduation rates. The current rate of non-completion of educational programs is very alarming. The 2011 "Pathways to Prosperity" study by the Harvard Graduate School of Education shows that only 56% of students who enter America's colleges and universities graduate within six years, while only 29% of students who enter two-year programs complete their degrees within three years. These numbers are worse for minorities and low-income students. Students from low-income families are under-represented in the educational pipeline. In 2010, the immediate college enrollment rate of high school graduates from low-income families was only 52% compared to 82% of high school graduates from high-income families.

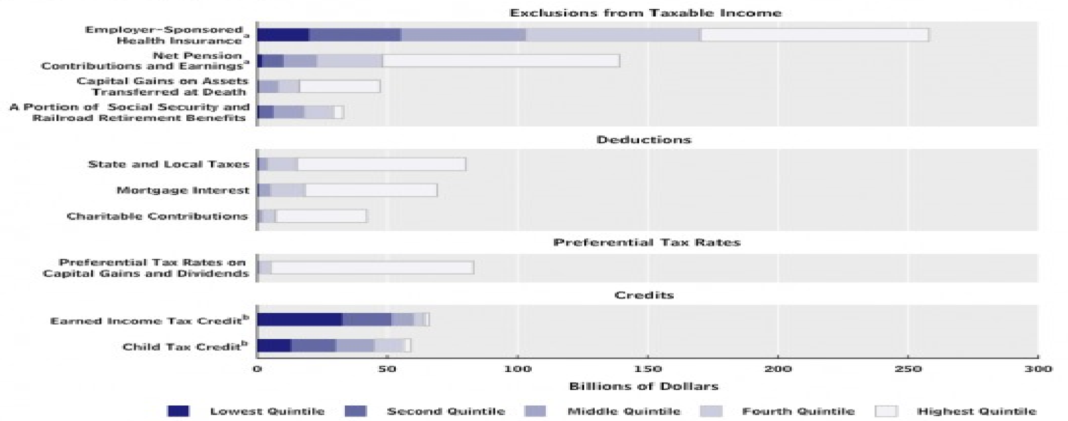
According to the "Pathways to Prosperity" study, reasons students cited for dropping out of school included cost; inability to cope with the competing demands of study, family, and jobs; and not being prepared for the rigors of academic work. Another study done by the Pew Research Center found that financial barriers play a key role in students' decisions to drop out of college. Their report showed that 66% of students had halted their education to support a family, 57% preferred to work and make money, and 48% simply couldn't afford college.

3. <u>The tax code disproportionately benefits the rich.</u>

The United State's tax code includes various tax expenditures, such as exclusions, deductions, credits, and other policies, that allow taxpayers to shield some income from taxation or pay lower rates. The combined effect of these tax expenditures goes overwhelmingly to the benefit of the richest Americans. When President George W. Bush was in office, he dropped taxes on long-term capital gains (stock market earnings), where the wealthy accumulate most of their money, to a mere 15% from 39.6% under President Clinton. President Bush also whittled down the inheritance tax rates. In 2010, the inheritance tax temporarily disappeared completely, costing the nation billions in lost revenue.

In 2013, the Congressional Budget Office looked at the 10 biggest expenditures and found they totaled over $900 billion. Over half of this went to the top fifth of income earners. For a family of four, that means those making $162,800 a year or more. Seventeen percent went to just the top 1% of earners – those families making over $654,000. Meanwhile, a mere 8% went to the bottom fifth of American families. The chart below shows the size and distribution of selected major tax expenditures by income group in 2013:

Figure 5.
Size and Distribution of Selected Major Tax Expenditures, by Income Group, 2013



Source: Congressional Budget Office.

4. Corporations often put profits ahead of workers.

U.S. companies must compete with lower-priced Chinese and Indian companies who pay their workers much less. As a result, many companies have outsourced their high-tech and manufacturing jobs overseas. The U.S. has lost 20% of its factory jobs since 2000. These were traditionally higher-paying union jobs. Less union representation has led to less worker empowerment. Service jobs have increased, but these are much lower paid positions.

During the 1990s, companies went public to gain more funds to invest in growth. Managers must now produce ever-larger profits to satisfy stockholders. Since payroll is usually the largest budget line item, re-engineering has led to doing more with fewer full-time employees and hiring more contract and temporary employees. Immigration also allows those with less power to fill low-paid service positions.

5. The Federal Government has prompted a stampede into stocks by keeping treasury rates low.

To help with recession recovery, interest rates have been kept low. One consequence of this however, has been low treasury rate returns causing a stampede into stocks. The increase in stock prices helped the top 10% of the population, who now own 91% of the wealth in stocks and bonds. Americans in the bottom 50% of the population only own 0.5% of stocks, bonds, and mutual funds. They aren't investing because many of them are just scrapping by. Other investors have been buying commodities, driving food prices up 40% since 2009. This hurts the "bottom" 90%, who spend a greater percentage of their income on food.

What impact does income inequality have on Americans and how can we fix this?

Income inequality in the U.S. is higher than it has ever been, and if something is not done, it is only going to get worse. As the rich get richer, the rest of Americans are getting left behind. Exactly what impact is this having on American people and their families? And what can be done to fix this? In Couleecap's December 2014 Community Concerns paper, we will take a look at how income inequality impacts Americans and provide some possible solutions to this growing concern in our country.

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