

Chapter 12

Persistent Poverty and Rising Inequality

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People are generally interested in economic inequality for two somewhat independent reasons: First, income inequality is deeply connected to poverty, and poverty is of moral concern because of the deprivations and suffering associated with it. Second, inequality is also associated with concentrations of income and wealth among elites, and this also seems to many people to be undesirable, both because of the unfair advantages this often represents and because of the power such concentrations of wealth confer on the rich.

In this chapter we will look at both aspects of inequality, although we will give more attention to poverty. We will begin with a broad empirical sketch of patterns of poverty, wealth and inequality in the United States. This will be followed in section two with a discussion of alternative explanations of persistent poverty in contemporary America, which we will refer to as the “blame the victim” and “blame society” approaches. Section three will then discuss the principle social structural processes which contribute to rising inequality, persistent poverty, and high concentrations of wealth and income at the top in the United States today.

I. FACTS ABOUT POVERTY AND INEQUALITY IN AMERICA

We will examine three clusters of facts about poverty in the United States: comparisons with other countries; trends in poverty rates over time; and the racialized character of poverty in America.

Perhaps the most striking fact about poverty in America is that the United States has by a considerable margin the highest rate of poverty among all the developed capitalist economies (Figure 12.1).¹ The figures are especially disturbing for children, where the poverty rate in the United States is 3-4 times greater than in many European countries (see Figure 2.3 in chapter 2). Much of this difference across countries is directly attributable to public policies. Figure 12.2 calculates two child poverty rates across countries, the first based on household income *before* taxes and income transfer payments from government programs and the second based on household income *after* taxes and transfers. Before taxes and transfers, the child poverty rate in the United States around 2000 was 26.7%, not very different from the rates in Sweden (23.4%) and France (28.7%). These are the child poverty rates based on the income households earn in the market. The picture is completely different after taxes and transfers. The poverty rate among children in the United declines only slightly, from 26.7% to 22.4%, whereas in Sweden it drops to 2.6% and in France to 7.9%. Our first general observation, then, is that poverty rates are very high in the United States compared to other economically developed countries, and to a significant extent this is the result of public policies rather than simply the “natural” functioning of the market.

¹ In international comparisons, the standard definition of “poverty” is a household income that is less than 50% of the national median. This is also called *relative* poverty, since it defines poverty relative to the median standard of living in a country. This is generally considered a much more reliable measure for comparative analysis than “absolute poverty” defined by a “poverty line”, since the cost of living are so different in different countries.

-- Figure 12.1 and 12.2 about here --

Some people may be inclined to dismiss these observations because they are based on “relative poverty” measures rather than some absolute poverty line. After all, it is sometimes pointed out, people whose income is half of the median income in the United States today nevertheless have higher income than people living at the median fifty years ago.² Two comments on this: First, the quality of life one can obtain from a given amount of income depends in significant ways on cultural standards, not just on some absolute level of consumption. It really does matter for one’s economic well-being if one is unable to participate in the mainstream standard of living of a society, and this is the situation for people whose income is less than half of the median. Secondly, there is very strong evidence that high levels of relative poverty are harmful to people beyond the simple fact of the poor having low income relative to prevalent social standards. A good example is the relationship in rich countries between levels of relative poverty and health. Figure 12.3 shows the relationship between the child poverty rate and the mortality rate among children younger than five years in 21 rich countries. While this chart does not prove that a high rate of relative poverty contributes to higher infant mortality, the strength of the association is strongly consistent with this interpretation.

-- Figure 12.3 about here --

Our second set of observations concerns change in poverty rates over time within the United States. For this analysis we will use the official U.S. poverty line as the basis for defining the poverty rate. It is, of course, very problematic to define a specific absolute threshold below which one is “poor”. The basic idea is to define an income level above which it is possible to have adequate nutrition, housing, clothing and other basic necessities. The problem is that the notion of “necessities” is heavily influenced by cultural norms and social expectations, rather than simply technical or biological considerations. This is one of the reasons why in international comparisons poverty is generally defined relative to a country’s median income rather than by some absolute level of income. In any case, in our analyses within the United States we will follow the standard convention of using the official government poverty line as the criterion for poverty. In 2009 for a single person the poverty line was \$10,830 and for a family of four, \$22,050.

In terms of the official poverty line, poverty rates both for children (Figure 12.4) and for adults (Figure 12.5) declined sharply in the 1960s in the wake of new government programs directed at poverty reduction. Since then, poverty rates among children have fluctuated up and down depending upon market conditions and changes in public policy. In 2007 the poverty rate for children under 6 years of age stood at just over 20%, a full 5% higher than it had been at its low point in 1969. Poverty rates for adults 18-64 have also risen slightly since the early 1970s, from a low of 8.3% in 1973 to 10.9% in 2007. If we look at extreme poverty – the percent of the poor who are living at less than one half of the official poverty line – the upward trend is even more dramatic (Figure 12.6). In 1976 around 28% of the poor lived in extreme poverty. By 2005 the figure was 43%. This rise in poverty rates and the rates of extreme poverty occurred in spite of the fact that the per capita gross domestic product – a measure of the overall wealth of the United States – more than doubled in period from the early 1970s to 2007. The United States is

² The median income for all families in 1947 (using constant 2006 dollars) was \$23,235 while in 2006 it was \$59,407.

therefore not simply a very rich country with high levels of poverty; it is a rich country in which increasing wealth since the early 1970s has not resulted in any reduction of poverty.

-- Figures 12.4 12.5, 12.6 about here --

Another aspect of changes in poverty in the closing decades of the twentieth century concerns the spatial distribution of poverty. Two things should be noted here. First, in terms of the regional distribution of poverty, in the 1960s and earlier the poverty rate in the South was much higher than in the rest of the United States (Figure 12.7). In 1969 the overall poverty rate in the South was 18%, whereas in the other regions of the country it was between 8% and 10%. By 2007 the rate in the South had declined to 14% and in the other regions risen to 11-12%. At the beginning of the 21st century, poverty is a widespread national phenomenon, not something concentrated in a specific region of the country. Second, before the 1960s poverty was especially acute in rural areas and small towns (figure 12.8). Even in 1969 it was still the case that poverty rates in non-metropolitan areas were nearly 50% higher than in central cities. This is no longer the case: poverty in nonmetropolitan areas has slightly declined since the 1960s and risen in the central cities, so that in 2007 central city poverty rates were slightly higher than those outside of metropolitan areas.

-- Figures 12.7 and 12.8 about here --

Our final set of observations about poverty concerns its connection to race. We will discuss this further in chapter 14. For now it is sufficient to note the dramatic difference in poverty rates across different racial categories (Figure 12.9). In 2005, a quarter of all African Americans and just over a fifth of Hispanic Americans lived below the poverty line compared to only a tenth of whites. Race and poverty are clearly closely linked. However, two things are important to note about this connection. First, the *disproportion* in poverty rates among African Americans compared to whites has declined over this period: in 1973 the poverty rate among African-Americans was 3.7 times greater than among whites; by 2005 this had declined to 2.3 (Figure 12.10). Second, even though poverty rates remain much higher among African-Americans and Hispanics than among white Americans, it is nevertheless still the case that the majority of poor people in the United States are white. In 2005, 57.3% of people living below the poverty line were white, 21.5% were African-American and 21.2% were Hispanic. This runs counter to the widespread belief that poverty is mainly a problem of minority communities. Poverty is an American problem that disproportionately affects African Americans and Hispanics, but affects millions of white Americans as well.

-- Figures 12.9 and 12.10 about here --

While poverty is certainly the most salient moral issue linked to economic inequality, it is not the only reason to study inequality. Inequality also matters because of the way it concentrates resources, advantages and power at the top of the distribution relative to the middle. As we saw in Figure 9.2 in chapter 9, in the quarter century after WWII all income strata experienced roughly the same annual rates of growth in income – about 3.5%/year. Since that time, the rate of income growth was much higher at the top of the income distribution than at the bottom or the middle. Figure 12.11 looks at the inequality generated by the top of the distribution over a much longer period, 1917-1998. This trajectory over time is sometimes called “the great U-turn”. Prior to the Second World War people in the top 10% of the income distribution earned between 40% and 45% of all the income earned in the United States. This dropped precipitously in the early 1940s and stayed around 33% for over three decades. Then, beginning in the late 1970s and

accelerating the in the 1980s, the income share of this top group increased sharply, reaching 42% by the late 1990s.

-- Figure 12.11 about here --

The top decile is certainly an extremely privileged category. On closer inspection, however, the real growth in income inequality in the United States in the last decades of the 20th century was actually driven by fantastic increases in income in the top 1% of households. This is shown in Figure 12.12. This figure presents the ratios of the average household income of people in different income strata at three points of time. Three ratios are presented in the figure. The 50:20 ratio is the ratio between the average income of people in the middle quintile (which is almost exactly the same as the overall median income) and the average income of people in the bottom quintile.³ This is a measure of how much inequality there is between the middle and the bottom of the income distribution. The 95-99:50 ratio is the ratio of the average household income of people in the 95-99th percentiles (i.e. those just below the top 1% of the income distribution) to the average household income of people in the middle. And finally the 99:50 ratio is the ratio of the average household income of the top 1% of households (the 99th percentile) to the middle. What Figure 12.12 shows is that the first of these ratios does not change at all in the period 1979-2000. The second ratio changes a little, indicating a modest increase in the degree of inequality between the middle of the income distribution and the 95-99th percentile. The real action, however, is in the ratio of average income of people in the top 1% of the income distribution to people in the middle. In 1979 the average income of people in the top 1% was 10 times that of people in the middle of the distribution. This increased to 15 times greater in 1989 and over 25 times greater in 2000. The overall increase in levels of inequality in the United States at the end of the 20th century is clearly driven by the extremely rapid increase in income among the very richest Americans.

-- Figure 12.12 about here --

One final set of data will complete our statistical portrait of inequality in America: inequality in wealth. Income is defined as the *flow* of money a person has available over a given unit of time; wealth is a *stock*, the amount of money and other assets that one owns at any given moment. Wealth takes many forms. For most people, the primary form of wealth is home ownership. When a person buys a home, usually they take out a loan (a mortgage), and their wealth consists in the difference in the value of the home and the amount they owe on the loan. This is called “home equity”. As they pay off the loan over time and as the value of the home increases because of the market for houses (assuming, of course, that home prices are increasing), their equity in the home increases, and thus their wealth increases. Other forms of wealth include savings; investments in stocks, bonds and other financial instruments; real estate other than one’s home; and many other things. A person’s “net worth” is the difference between the value of all of these assets and whatever debts a person has. Financial net worth is the difference between the value of financial assets and debts.

Wealth in the United States is distributed much more unequally than income. Figure 12.13 indicates the percentage of all household income, net worth and net financial assets that go to the

³ The middle quintile of an income distribution includes everyone from the 40th to the 60th percentile in the distribution. The median of the whole distribution – the 50th percentile – is close to the average income in this group since the income distribution within the middle quintile will be fairly symmetrical around the mid-point.

top 1% of households, the next 90% and the bottom 90%. In the case of income, the bottom 90% of households get a little under 60% of total income while the top 1% of households get about 18% of all income. That is a disproportionate share, to be sure, but it is nothing like the disproportion for overall wealth and financial assets: the net worth of the top 1% accounts for 33% of all wealth and 42% of financial assets. For the bottom 90% of households the corresponding figures are 29% and 19%. If we convert these into ratios of average wealth at the top and bottom of the distributions, the average net worth of the top 1% is about 100 times greater than the average net worth of the bottom 90% of the U.S. population, and the average net financial assets of this tiny group at the top is 200 times greater than the average of the bottom 90% (see Figure 12.14).

II. EXPLANATIONS OF PERSISTENT POVERTY: *BLAME THE VICTIM* AND *BLAME SOCIETY*

In both the scholarly literature and popular discussions about poverty it is possible to distinguish two broad ways of explaining poverty in the United States. The first of these is sometimes referred to as “Blame the victim.”⁴ The idea here is pretty simple and intuitive: You look around and see that some people are poor and others are not. Indeed, it is easy enough to find examples of adult siblings from the same family, one of whom is poor and the other has a steady well-paying job. So, if two people come from the same origins and face more or less the same opportunities and only one is poor, then surely there must be some difference between them that explains their different fates. The explanation for why people are poor, the reasoning goes, must lie in some flaw within poor people, not in the social system in which they live, and the solution to poverty, therefore, must be to somehow change the person, not the society.

Once you decide that the central explanation for poverty lies in the qualities of poor people, there are many different specific causal processes that could be at work. For example, one theory of poverty which once was quite popular, but now is generally not given much credibility among social scientists, is that poor people are generally genetically inferior to the non-poor. The most common version of this view identifies intelligence as the key issue: the poor have deficits in the genes that affect IQ. Such views were once particularly strong in discussions of poverty that linked poverty to race, but occasionally still resurfaces. As recently as the 1990s in their notorious book *The Bell Curve*, Richard Herrnstein and Charles Murray argue that genetic deficits in intelligence are a central explanation for the high poverty rates among black people in America.⁵

There is one version of the blame the victim theory of poverty that remains quite influential. In this version, the deficit within poor people is identified as psychological dispositions closely connected to “culture”. As a result, this explanation for poverty is sometimes referred to as the “cultural of poverty” thesis. The key idea here is that poor people have a distinctive pattern of cultural values which creates difficulty in delaying gratification and planning for the future. They don’t save. They have difficulty controlling their impulses – for sex, for immediate pleasure, for anger, for obeying the law. The anthropologist Edward Banfield popularized this perspective in

⁴ The term was coined by Ryan, William in his book *Blaming the Victim* (New York: Vintage, 1976)

⁵ Richard Herrnstein and Charles Murray, *The Bell Curve* (New York: The Free Press, 1994). This book has been thoroughly attacked by social scientists for serious methodological flaws. See, for example, Claude S. Fischer, et. al. *Inequality by Design: cracking the bell curve myth* (Princeton: Princeton University Press, 1996).

his study of poverty in Puerto Rico in the 1950s. He wrote that poverty is explained by “the existence of an outlook and style of life which is radically present-oriented and which therefore attaches no value to work, sacrifice, self-improvement, or service to family, friends or community.”⁶ These attributes may come from adaptations to past discrimination of a community, or they may come from other sources; but once they are inculcated inside of the person, they are hard to change. They become internalized psychological dispositions which get transmitted inter-generationally in an endless cycle of persistent poverty.

Blaming the poor for their poverty remains a popular way of understanding poverty in part because this provides explanations which do not threaten those with privilege. Poverty in the midst of plenty is a deeply disturbing fact of contemporary American society, and people with stable jobs and good incomes feel a need to justify their advantages. The most painless way to do this is to believe, if only vaguely, that the poor are somehow unworthy. While this is never fully convincing, especially because of the problem of children who cannot be seen as deserving to be poor, nevertheless it reduces the moral pressure on the middle class and the wealthy to take seriously the problem of changing institutions to eliminate poverty.

The alternative general approach to explaining poverty can be referred to as “blame society.” While of course there may be some specific individuals who are poor and remain poor because of their personal attributes, mostly the poor are not very different from others in motivations, preferences, hopes, and aspirations. Indeed, many poor people work incredibly hard, patching together a number of badly paying jobs in order to barely meet basic needs. The most important causes of poverty, the argument goes, lie in the rules of the game and power relations of society, not the internalized cultural characteristics of poor people.

Consider the core psychological issue raised in the culture of poverty thesis: the problem of delayed gratification and impulse control. Is it really true that in general poor people suffer from an inability to delay gratification whereas middle class and rich people do not? Credit card consumerism in the middle class is profoundly present-oriented. Many middle class people, as we saw in the chapter on consumerism, accumulate large credit card debts paying exorbitant interest rates because they want things now and are unwilling to save. William Ryan, in his book *Blaming the Victim*, reports the following research that bears directly on the problem of whether or not poor people in general have more difficulty in delaying gratification than more affluent people: Children were given the choice of getting one Hershey candy bar immediately or two the following week as a reward for completing a task. In the experiment, this promise

was either kept or not kept. When the experiment was repeated this was the only factor that differentiated between those who chose immediate gratification and those who chose to delay. Class and race were *not* related to delay. Those who had experienced a broken promise were the ones – not unsurprisingly – who were not willing to delay and therefore risk another disappointment. . . . The situational variable, then, rather than class affiliation, determined the ability to delay.⁷

⁶ Edward Banfield, *The Unheavenly City Revisited* (Boston: Little, Brown, 1974), p. 87.

⁷ William Ryan, *Blaming the Victim* (New York: Vintage Books, 1976), p. 133, reporting research by S. Miller, F. Riesmann and A. Seagull, “Poverty and Self-Indulgence: a critique of the non-deferred gratification pattern,” in *Poverty in America*, edited by L. Ferman, J. Kornbluth and A. Haber (revised edition: Ann Arbor: University of Michigan Press, 1968).

Or think about another issue that is often seen as characteristic of the culture and dispositions of the poor: an amoral attitude towards social norms and crime. Do the poor really differ from the middle class or the rich all that much on these dimensions? A significant proportion of “respectable” wealthy people cheat on their taxes. There are frequent scandals of a rich person being nominated for a high political appointment whose appointment falls apart when it is revealed that they “failed” to pay all of their taxes. Why do sophisticated wealthy people who can easily afford to pay their taxes and hire professional accountants and lawyers to make sure that they do not make “mistakes” still cheat on their tax payments? The answer is pretty simple: they do so because they think that they can get away with it. The resulting theft comes to orders of magnitude more than property theft by the poor: in 2002 the total economic loss from property theft (burglary, larceny-theft, and motor vehicle theft) was estimated to be somewhere around \$16.6 billion (in 2002 dollars) while the total amount of cheating on taxes in 2001 was estimated to be over \$300 billion.⁸ Even if some of this underpayment of taxes was simply due to errors, not deliberate cheating, tax cheating would still be vastly greater than property theft. If one adds to tax cheating the other kinds of corporate fraud that wealthy elites commit – think of the Enron scandal, for example – the disparity between the magnitude of theft by the rich compared to the poor grows even larger. It is hardly surprising, of course, that an executive in a large corporation or a prominent politician would never consider robbing a convenience store but is happy to steal from the public by cheating on taxes, padding expense accounts or cooking the books of a corporation, but this is really much more a function of the opportunities they face rather than of their character or moral values.

This, then, is the central thesis of the social explanations of poverty: *Circumstances of people across classes and economic conditions vary much more than values and personalities.* There are plenty of poor people and rich people with problems of impulse control, anger management and willingness to delay gratification, but these traits have very different consequences for their behavior and lives because of the circumstances in which they act. This is not to say that the experience of poverty has no impact on psychological states and dispositions of people to behave in particular ways, but simply that the most important difference between the poor and the rest of the society is the character of opportunities and circumstances they encounter, not their inherent attributes, personalities, or values.

There are some explanations for poverty that blur the distinction between blame the victim and blame society. For example, probably the most popular explanation for poverty in the United States among scholars centers on deficits in education among the poor. This explanation clearly identifies a social cause of poverty: the American school system fails to provide decent education for poor people. The “No Child Left Behind” legislation in 2001 saw as one of its goals remedying this deficit by holding schools accountable, closing bad schools, and in other ways reducing the educational achievement gap between children of middle class families and poor families. The educational deficit explanation, therefore, definitely identifies failed institutions as a central problem. Nevertheless, this explanation for poverty also embodies some of the aspects of the blame the victim approach to poverty, for the reason the failed educational system is seen

⁸ The tax cheating estimates come from the Internal Revenue Service “tax Gap estimates” reported on the IRS website, identified as: IR-2006-28, Feb. 14, 2006. The property theft estimate is from the Federal Bureau of Investigation, *Crime in the United States, 2002: Uniform Crime Reports*. Washington, DC: U.S. Department of Justice, 2003.

as generating poverty is still because of the way this shapes a particular attribute of poor people – in this case their “human capital” or skills.

While the claim that poor people generally lack marketable skills may be completely accurate, this is not an adequate or complete explanation for the fact that they are poor. Having little education only explains poverty given the social environment in which the person lives, and this must also be part of the explanation for poverty. Or, to make the point in a slightly different way: explaining why particular people are poor is not the same as explaining the level poverty itself. This idea can be clarified by thinking of an entirely different kind of example: the way grades in a class are distributed to students.⁹ Suppose a really nasty professor has a terrible grading curve where in a class of 20 students only one A and two B’s are given, and everyone else gets a C or less. At the end of the semester Mary gets the A, and John and Melissa get the two B’s, and George, among others, get a C. Now, if you ask the question, “why did Mary get an A?” it may well be the case that she was smarter, worked harder, studied more than anyone else in the course and had more knowledge of the material. And why did George get a C? He didn’t have good study habits and didn’t know as much. But surely this seems to miss the real process at work here: the real explanation lies in the social process through which the “rules of the game” were created and the power structure – the all-powerful mean-spirited professor – created those rules. If the power structure was different and students could vote on the grading curve, then there would be less “grade poverty” in the class. Explaining why a particular person gets a poor grade, in short, is not the same as explaining why there are so many poor grades in the class.

In the case of economic poverty, of course, the process by which the rules of the game are created and maintained are much more complicated than in the grading curve example. Nevertheless, it remains the case that the fact that low skills and limited education result in poverty depends upon the rules of the game through which jobs are created and income is distributed. In the United States there are many important needs that are not adequately met through the market economy and for which good education is not needed and the required skills could be fairly easily acquired: public infrastructure is crumbling, bridges need to be repaired, homecare services for the elderly need to be provided, buildings need to be retrofitted for energy conservation, afterschool program in central cities need to be expanded, and so on. The fact that there are not many above-poverty level jobs for people with relatively low education is as much the result of public policies around creating such jobs as it is a result of the low skills themselves. And furthermore, even apart from the problem of the weak public commitment to creating adequately paying jobs for everyone, public policies could do a great deal to alleviate poverty through more generous programs of publicly subsidized housing, income support, and other forms of income redistribution. None of this implies, of course, that lousy education for poor children is not a serious problem and a form of injustice. “Equal opportunity” is a fundamental value and an essential aspect of fairness. Nevertheless, poverty in a rich society does not simply reflect a failure of equal opportunity to acquire a good education; it reflects a social failure in the creation of sufficient jobs to provide an adequate standard of living for all people regardless of their education or levels of skills.

⁹ This example comes from Alan Garfinkle, *Forms of Explanation*. (New Haven: Yale University Press, 1981).

III. SOCIAL STRUCTURAL CAUSES OF INEQUALITY AND POVERTY IN AMERICA

Saying that inequality and poverty are to be explained mainly by social processes is only the first step in an analysis. What remains to be elaborated are the specific social causes operating to generate specific patterns of inequality.

We will approach this problem by discussing three kinds of inequalities generated within a capitalist market economy:

- 1) Inequalities generated through *exclusion from labor markets*: i.e. between the stably employed labor force and marginalized categories of people.
- 2) Inequalities generated *within labor markets*: i.e. between well paid workers and badly paid workers.
- 3) Inequalities generated through non-labor market income: i.e. between wealthy and nonwealthy individuals.

If we want to sort out the causes of overall economic inequality within the United States, we need to look at the social processes that determine each of these.

1. Marginalization: the problem of acute poverty

“Marginalization” refers to a situation in which a person is, through one mechanism or another, unable to get access to the necessary means to acquire a basic livelihood. In developing countries this is an acute problem: landless peasants leave rural areas for the city and are unable to find stable paid work. They live in shanty towns and eek out a marginal existence in various ways: as scavengers in refuse dumps, as street vendors, as informal day laborers, and so on.

In the United States marginalization occurs because of the mismatch between the distribution of skills in the population and the distribution of jobs in the economy. This mismatch in recent decades has intensified because of the decline of manufacturing. Heavy industry, relying largely on manual labor, used to be a good source of employment for people with limited education. Much of the work was unskilled or semiskilled, and in any case many of the skills needed in the more skilled jobs were learned on the job rather than in school. The rapid deindustrialization of America beginning in the 1970s destroyed those kinds of jobs.

Marginalization in the contemporary American economy is generated by the lack of good employment for people with low or outmoded skills and low education. This is not, as we have already stressed, just a problem of inadequate skill formation; *it is equally a problem of inadequate job creation*. Some people argue that the problem of acute poverty could be solved by a dramatic improvement in education for the poor, giving everyone the knowledge and skills needed to compete effectively in the high tech, information economy. Improving education, of course, would be a very good thing, but it would not completely solve the problem of marginalization. Regardless of the effectiveness of the system of education, not everyone will acquire the knowledge and skills needed for stable good paying jobs in the high tech sectors of the market economy. And even if it were the case that everyone could acquire such skills, there is no guarantee whatsoever that increasing the supply of people with these skills would generate the necessary number of jobs requiring those skills.

2. Inequalities *within* labor markets: the working poor and large wage inequalities at the top of the earnings distribution.

The second source of economic inequality occurs among people with stable employment. Two issues are particularly important here: First, increasingly since the late 1970s there has been a dramatic increase in inequality at the top of the pay scale, especially among managers in corporations and professionals. Second, large numbers of jobs in the American economy only pay poverty-level wages. This is referred to as the problem of the “working poor”. Figure 12.15 shows the trends in real hourly wages of male and female workers at the 20th percentile from 1973-2005. The horizontal line in this figure shows the wage level for a full-time worker needed to bring a family of four above the official “poverty line”. At no time during this period were wages of female workers at the 20th percentile sufficient to do this, while for male workers at the 20th percentile their wages hovered just below or above this level. Taken together, the escalation of high pay at the top of the labor market and the continued existence of large numbers of badly paid jobs at the bottom generates very high levels of overall earnings inequality generated within American labor markets.

-- Figure 12.15 about here --

The two most common explanations for why earnings inequality within the paid labor force has increased since the 1970s center on technological change and globalization. The argument goes like this: Because of the rapidity of technological change in the last quarter of the 20th century, particularly in information technologies, high education and technical skills have become much more valuable to employers and as a result the inequality between skilled and unskilled and between the highly educated and less educated has increased. This occurred precisely in the period where international competition also increased. As a result American firms were increasingly involved in competition with low wage foreign producers, and this put downward pressure on less skilled jobs. The combination of the effects of globalization on the wages of low-skilled workers and technological change on the wages of highly educated workers generated the dramatic increase in overall earnings inequality.

Technological change and globalization certainly contributed to rising inequality, but they do not provide an adequate explanation of the magnitude of either the level of inequality in earnings in the United States or the degree to which it has increased. Empirical research on this issue indicates that at best the effects of these two processes on increasing inequality are modest.¹⁰ Rapid technological change and increasing global competition since the 1970s characterize all developed capitalist economies from Sweden to France to Japan to the United States. Yet, in some of these countries earnings inequality has changed hardly at all over this period, and in none of them is the level of poverty and inequality as high as in the United States.

We want to emphasize two other, interconnected processes that have played a particularly important role in the United States: the decrease in government regulation of labor markets, and the increase in competition within labor markets.

In all labor markets in capitalist societies, people with high levels of education, skills and talents will generally be paid more than people with low skills and education, but the degree of

¹⁰ A good overview of this research can be found in Lane Kenworthy, "Inequality and Sociology." *American Behavioral Scientist* 2007, 50: 584-602 and Martina Morris and Bruce Western, "Inequality in Earnings at the Close of the Twentieth Century." *Annual Review of Sociology* 1999, 25: 623-657.

inequality associated with this universal association depends on other institutional features of the labor market. Specifically, we need to understand the institutional processes through which wages are connected to jobs and jobs are filled by people. Imagine two kinds of systems through which wages are linked to jobs and people:

1. *Intense individualized competition.* In this system, people in the labor market are constantly bidding against everyone else for jobs and earnings. There is continual jockeying around, with employers lowering and raising wages as they compete for employees, and employees constantly looking for new jobs which offer high wages. There are no effective minimum wage rules, so employers pretty much pay what market forces allow. Employers can hire and fire, promote and demote employees without significant restrictions imposed by government or by organized labor. Employees are continually evaluated according to their “merit” relative to other employees, and their pay adjusted accordingly. Individuals make individual employment bargains with their employers; labor unions play no role in the process.

2. *A labor market governed by rules which dampen competition.* Employees are governed by employment contracts which make it difficult for employers to fire workers or lower wages. Wages are partially based on seniority rather than intense individual competition and continual performance evaluation. Workers have high job security and thus employers have to seek ways of forging stable cooperation and productivity improvements among the existing workforce, rather than continually looking for “better” workers. Unions support wage rules which reduce wage spread and the government imposes significant constraints on employers pay policies, especially through a high minimum wage. Collective bargains dominate the employment relation rather than individual deals.

The first of these systems generates much greater wage inequality than does the second, both because of the ways in which it pulls down wages at the bottom of the labor market and because of the way it pulls up the earnings of people at the top of the labor market. While no actual society can be considered a pure example of one or the other of these, the United States is the closest to the first type of labor market of any of the developed capitalist countries, and if anything since the 1970s has moved closer to the competitive labor market model.

There are a number of reasons why the deregulation of labor markets and the intensification of competitiveness within labor markets will tend to escalate inequality in earnings:

First, the constant adjusting of pay upwards and downwards as people compete for jobs leads to a greater spread of earnings over time. Success in intense competition tends to generate cumulative gains over time because early success acts as a signal to other employers about the desirability of a particular employee. In a complementary manner, “failure” in a labor market – for example, losing one’s job – acts as a negative signal even if the failure was not under the person’s control. There are always winners and losers in market competition, but in weakly regulated markets with high stakes competition, the consequences of winning and losing tend to cumulatively intensify overall inequality.

Second, in certain labor markets competition takes the form of what Robert Frank has called “winner-take-all” competitions.¹¹ A winner-take-all market is one in which very small

¹¹ Robert H. Frank and Philip J. Cook, *The Winner-Take-All Society: Why the Few at the Top Get So Much More Than the Rest of Us* (Penguin, 1996)

differences in performance generate big differences in pay. This is like in the Olympics in which the gold medal winner of a race receives all of the fame and fortune, even though the difference between first and second place may be only hundredth of a second. While true winner-take-all markets in which there is a single winner are rare, many labor markets for high paying jobs have some of the features of such markets: corporations are prepared to pay enormous salaries for people they consider to be the “stars” in particular fields. This tends to ratchet up the salaries at the top of the pay scale, particularly when the competitive arena expands from local to regional to national and even international arenas. To the extent that labor markets become more like winner-take-all competitions, overall earnings inequality within those markets will increase.

Third, one of ways that competition can be muted is through social norms which define what kinds of behavior in the market are acceptable. Is it acceptable for an upper manager in a firm to be constantly on the lookout for higher pay in another firm, or is it expected that managers display real loyalty to the corporation for which they work? Does jumping from firm to firm to increase one’s pay indicate healthy ambitiousness or a lack of commitment to the future of the firm in which one is working? In the decades around the middle of the 20th century there were fairly strong norms – informal rules and expectations – within corporations that held managerial salaries in check. Writing in 1967 the economist John Kenneth Galbraith wrote that “Management does not go out to ruthlessly reward itself – a sound management is expected to exercise restraint... There are few corporations in which it would be suggested that executive salaries are at a maximum.”¹² Managers and executives were expected not to constantly try to maximize their personal gain, but to act on behalf of the interests of the corporation for which they worked “in accordance with accepted canons of behavior”.¹³ Managers and executives in corporations were still well paid, but the norms and expectations of the era kept their salaries somewhat in check. Beginning in the 1970s and accelerating in the 1980s those norms disintegrated, particularly for the top leadership of large corporations. The dramatic rise in the salaries at the very top, in turn, tended to pull up salaries of managers in tiers below the top. In many corporate settings by the end of the century, not moving from job to job was seen as an indicator either that there must be something unsatisfactory with the quality of one’s work or that one lacked competitive drive.

These changes in norms concerning behavior and earnings have also occurred within the professions, not just in corporate hierarchies. Pay for professors in American Universities has traditionally been governed by a combination of seniority rules, academic rank, and merit pay. Professors who publish a lot and have strong academic reputations receive merit pay increases, but equally professorial rank and seniority were important in determining salaries. Since the 1970s “playing the market” has become an additional powerful force in determining faculty pay. In some universities Deans explicitly tell faculty members that if they want a pay increase they need to get an outside offer from another university, which then generates a “retention offer”. The result is that it now happens not infrequently that high profile professors, with no serious intention of leaving their university, seek outside offers simply to trigger a bidding war between universities. This can sometimes lead to fantastic pay increases of 100% or more. In the past

¹² John Kenneth Galbraith, *The New Industrial State* (Princeton: Princeton University Press, 2007, originally published 1967) p.146.

¹³ John Kenneth Galbraith, *The New Industrial State*, p. 151

such behavior would have been viewed as quite disreputable. The social norms which dampen market competition in academic labor markets have clearly weakened.

Increased competitiveness, tendencies towards winner-take-all markets, and weakening social norms that dampen income maximizing strategies have all had particularly important effects on increasing inequality at the top of the earnings distribution. The decline of government regulation of low wage labor markets and the virtual collapse of the union movement has especially harmed the bottom of the labor market. The most obvious form of this deregulation is the destruction of an effective minimum wage as described earlier in chapter 9. This directly has allowed the wages in low-wage jobs gradually decline, not just for minimum wage jobs themselves but for jobs paid just above the minimum wage whose pay scales are pegged to the minimum wage. Economists have estimated that wages in roughly the bottom 11% of jobs are directly affected by the level of the minimum.¹⁴ Other forms of government deregulation of low wage labor markets include lax enforcement of workplace regulations, which have allowed a growth of sweatshops in some cities, the increasing employment of illegal immigrants often paid below the minimum wage, and an extremely hostile stance by the government towards labor unions. All of these have the effect of keeping wages at the bottom of the labor market low and thus increasing the distance between the bottom and the top in the distribution of earnings.

3. Wealth Inequality

Economic inequality is not simply the result of earnings inequalities generated through paid employment; it is also generated by inequalities in wealth. Wealth inequality, as we saw in Figures 12.13 and 12.14, is much more unequally distributed than the earnings inequality. In the last decades of the twentieth century, there was a significant increase in the diffusion of financial assets and home ownership in the American population: home ownership rates increased (at least until the crash of housing market in 2008) and more people owned at least some stocks than in the past. Yet this did not result in any reduction of overall inequality of ownership of wealth. Three processes in the economy reinforced wealth inequality.

First, inequality in labor market earnings itself contributes to inequality in wealth since people with high labor market earnings are in a much better position to use some of their earnings for investments in wealth-generating assets than are people with more modest earnings. The fantastic rise in employment earnings at the high end of the labor market has allowed well paid professionals and corporate managers to turn surplus earnings into investments of various sorts.

Second, as we briefly discussed in chapter 9, since the 1970s there has been a dramatic change in the character of the American economy that some analysts have called “the financialization of the American economy.” This is a complex process, but basically it means that beginning in the late 1970s until the financial crisis of 2008, the American economy shifted from an economy within which profits were mainly being generated in production and trade to an economy in which most profits were being generated within the financial sector through the buying and selling of assets of various sorts rather than directly through the production of goods and services.

¹⁴ For estimates of the spillover effects of minimum wages, see Alan Manning, *Monopsony in Motion*. Princeton: Princeton University Press, 2003.

This financialization of the economy was to a significant extent the result of the decisive deregulation of the financial sector that occurred in the 1980s and 1990s and the increasingly speculative character of investments within that sector. Speculation refers to a strategy of investment in which a particular asset is purchased not mainly because of the flow of income that will be generated by that asset – for example, dividends from buying a stock in a company or rent from buying an apartment building – but rather from the expectation that the value of the asset itself will increase over time. When speculation becomes particularly intense, the result is often what is called a “speculative bubble”. This is a situation in which the price people are prepared to pay for a particular asset gets increasingly out of line with what might be thought of as its “real” economic value, and the price keeps getting bid up by the expectation that the price in the future will continue to rise. When, eventually, people begin to realize that the price in the future is likely to decline they abandon the assets and the bubble bursts. What deregulation of the financial sector did was open up a wide range of new strategies for this kind of financial speculation without any meaningful supervision. The result eventually was the financial crisis of 2008. But until that happened, enormous amounts of money were made in the financial sector. These gains were overwhelmingly captured by the wealthy.

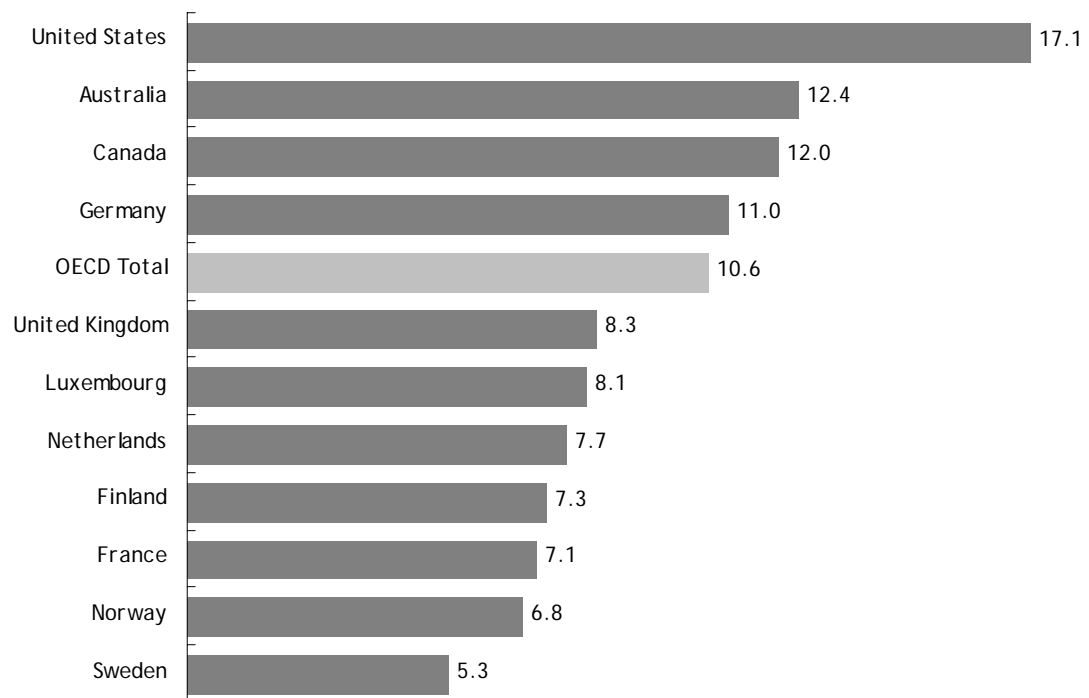
The third process which reinforced wealth inequality concerns the change in the relationship between productivity growth and wage growth since the 1970s (see figures 9.5 and 9.6 in chapter 9). Prior to the 1980s there was a rough correspondence between the growth of labor productivity – how much value people produced per hour of labor – and the growth of hourly wages. Since around 1980, this correspondence has largely disappeared: there has been considerable growth in labor productivity in the economy while hourly earnings remained quite stagnant. What this means is that an increasing portion of the economic value created by the increased productivity was going to owners of assets rather than to the producers themselves.

There have thus been three significant economic shifts in this period all of which reinforce inequality of wealth: earnings inequality has increased dramatically creating much more discretionary income in the upper tiers of the earnings distribution which can be invested in wealth; income has shifted from the people doing the work in the economy to those owning assets; and profits have shifted from sectors which actually produce goods and service, to the financial sector.

The financial crisis that began in 2008 has destroyed trillions of dollars in financial assets, and while real human suffering from the crisis has been felt largely by people who have lost their jobs and houses as a result of the crisis, the decline in the stock market and the collapse of a number of powerful financial institutions has heavily hit the wealth of people at the top. In the short run, at least, this will result in a reduction of wealth inequality.

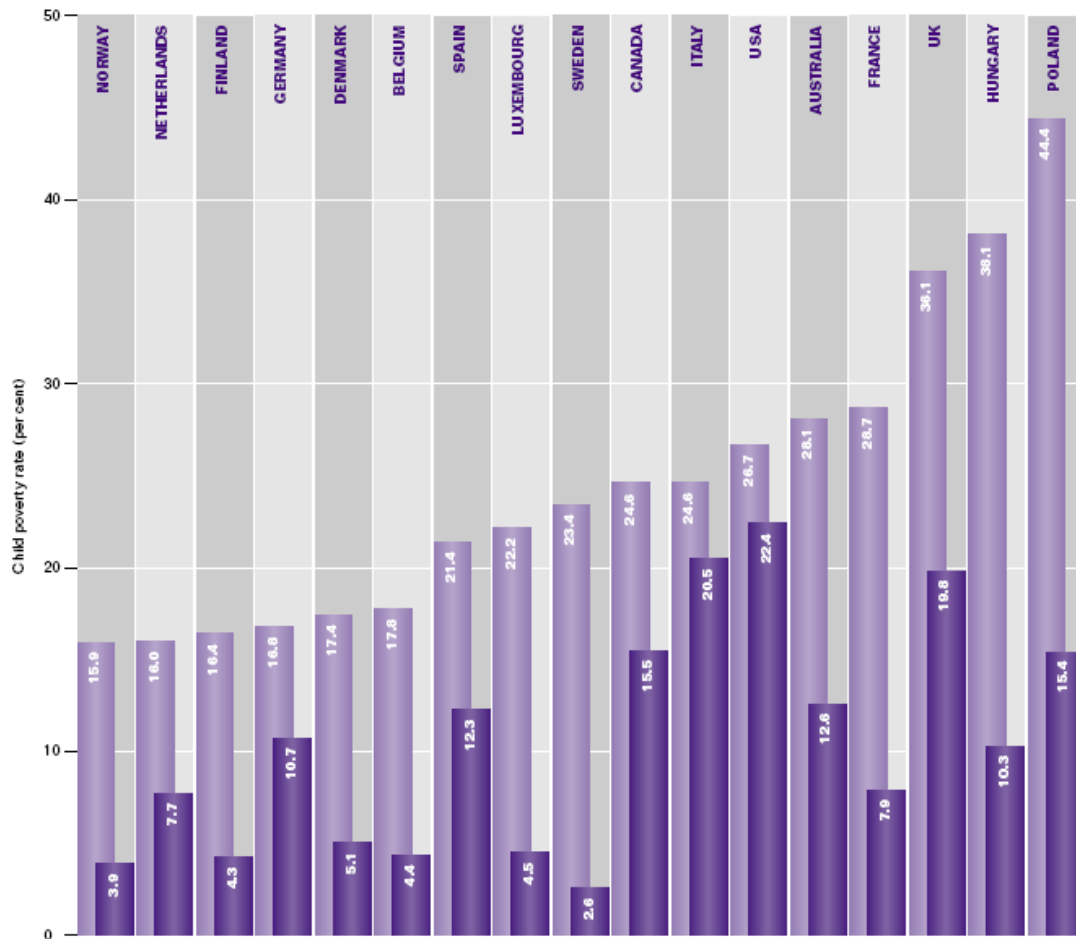
FIGURES FOR CHAPTER 12

Poverty Rate in Selected OECD Countries
(less than half of current median income, after taxes and transfers), mid-2000s



Source: OECD.Stat, "Poverty Measure: Headcount ratio after taxes and transfers"

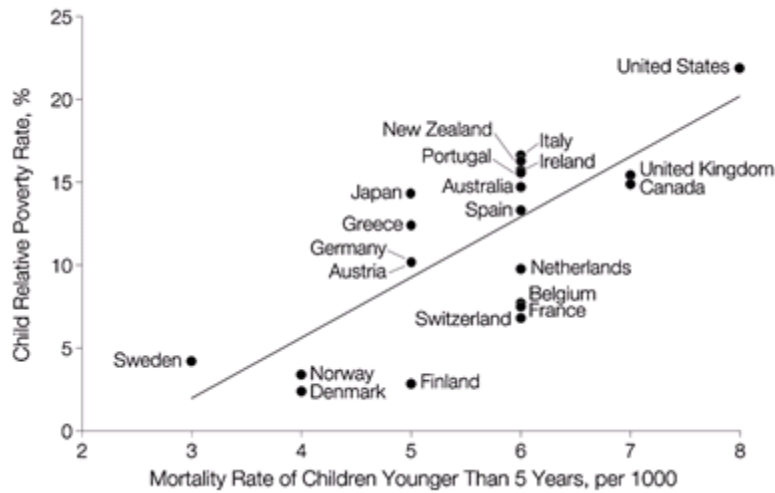
Figure 12.1
International comparison in Poverty Rates among wealthy countries



Note: The taller bars show the poverty rates based on household income *before* taxes and transfers while the lower bars show the rates *after* taxes and transfers. The poverty line in both cases is defined as 50 percent of the median income after taxes and transfers.

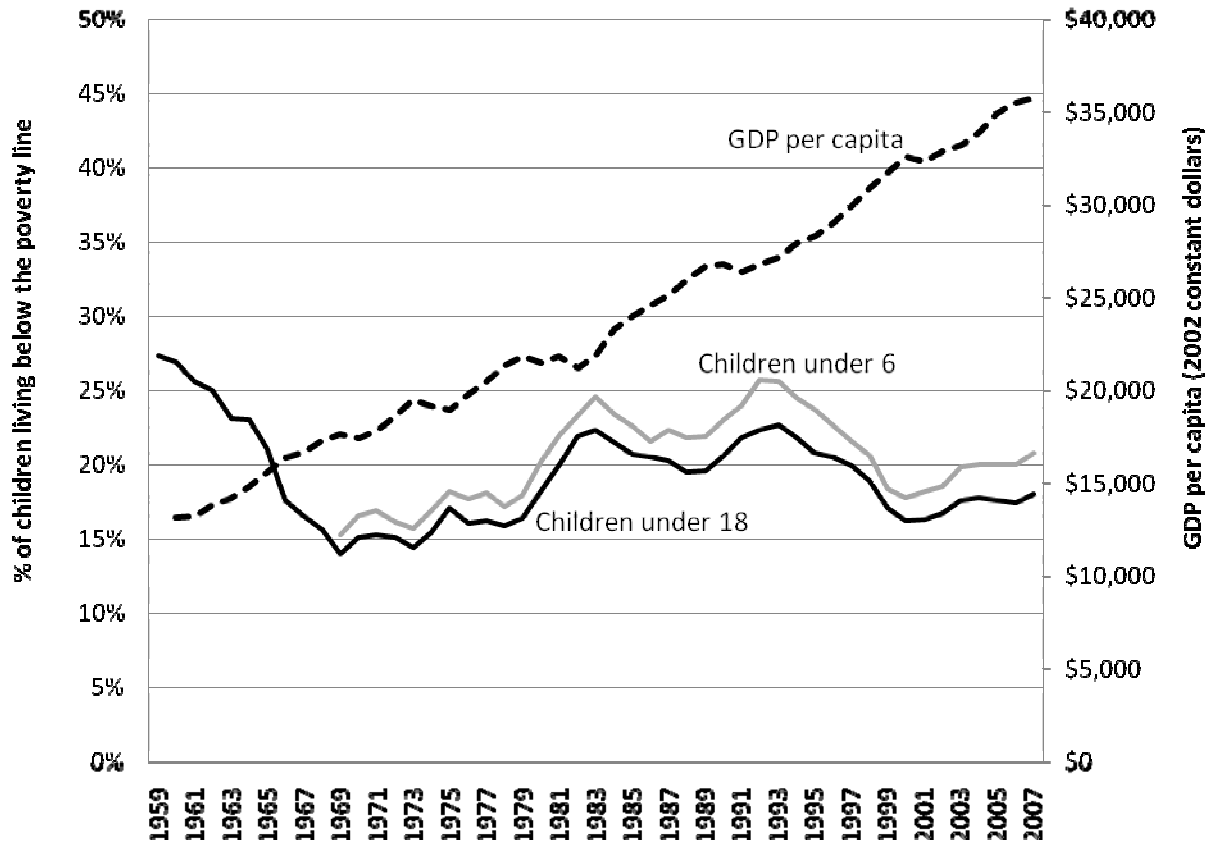
Source: *The league table of child poverty in rich nations*, (Florence, Italy: UNICEF Research Center, 2000)

Figure 12.2
International comparisons of child poverty rates before and after taxes and transfers



Source: Eric Emerson, "Relative Child Poverty, Income Inequality, Wealth, and Health," *JAMA*. 2009;301(4):425-426.

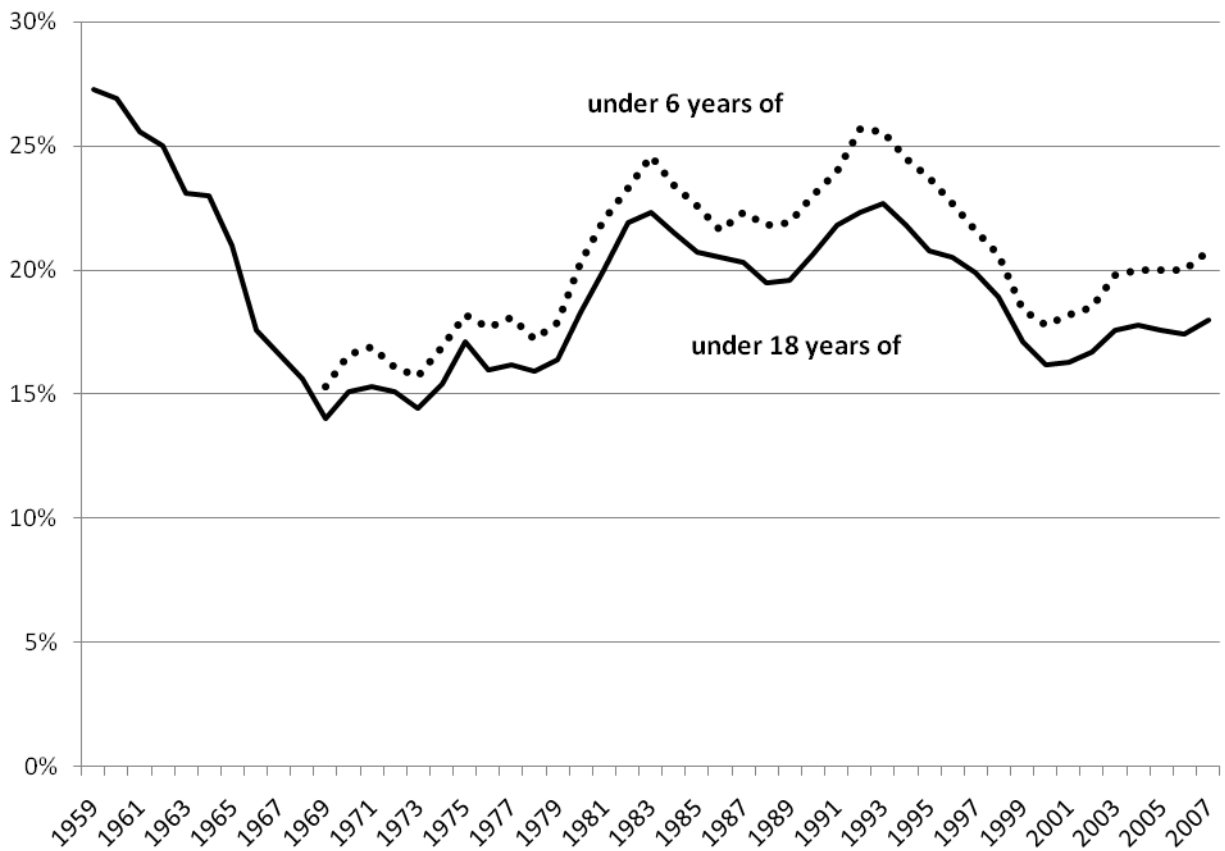
Figure 12.3
The Relationship between Relative child Poverty and under age 5 mortality in high income OECD countries



Note: "Poverty Rate" is defined as the percentage of children living below the official poverty line
 Source: U.S. Bureau of the Census, Current Population Survey, Annual Social and Economic Supplements.

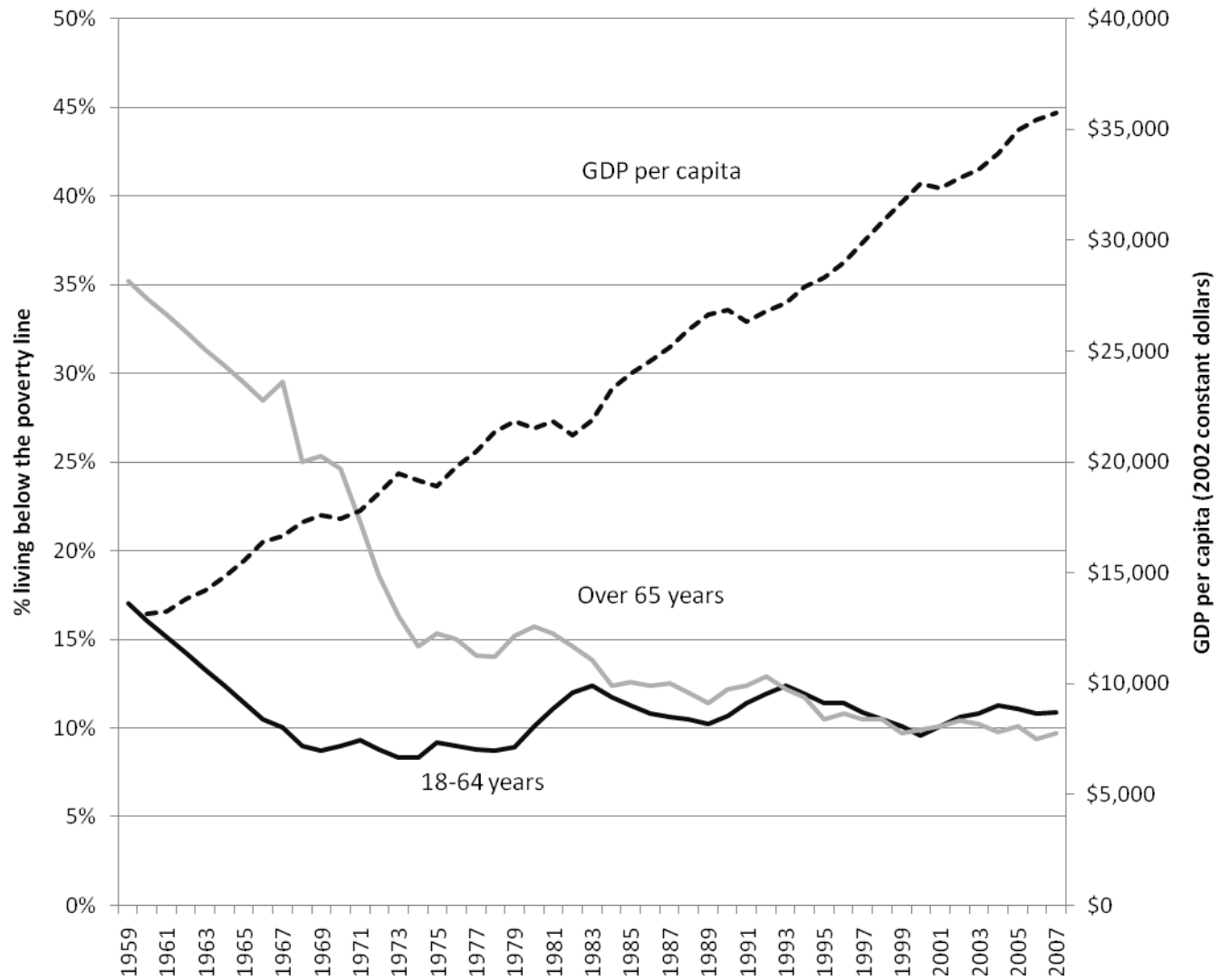
Figure 12.4 Poverty Rate among children, 1959-2007

Percent living below the poverty line



Note: "Poverty Rate" is defined as the percentage of children living below the official poverty line
 Source: U.S. Bureau of the Census, Current Population Survey, Annual Social and Economic Supplements.

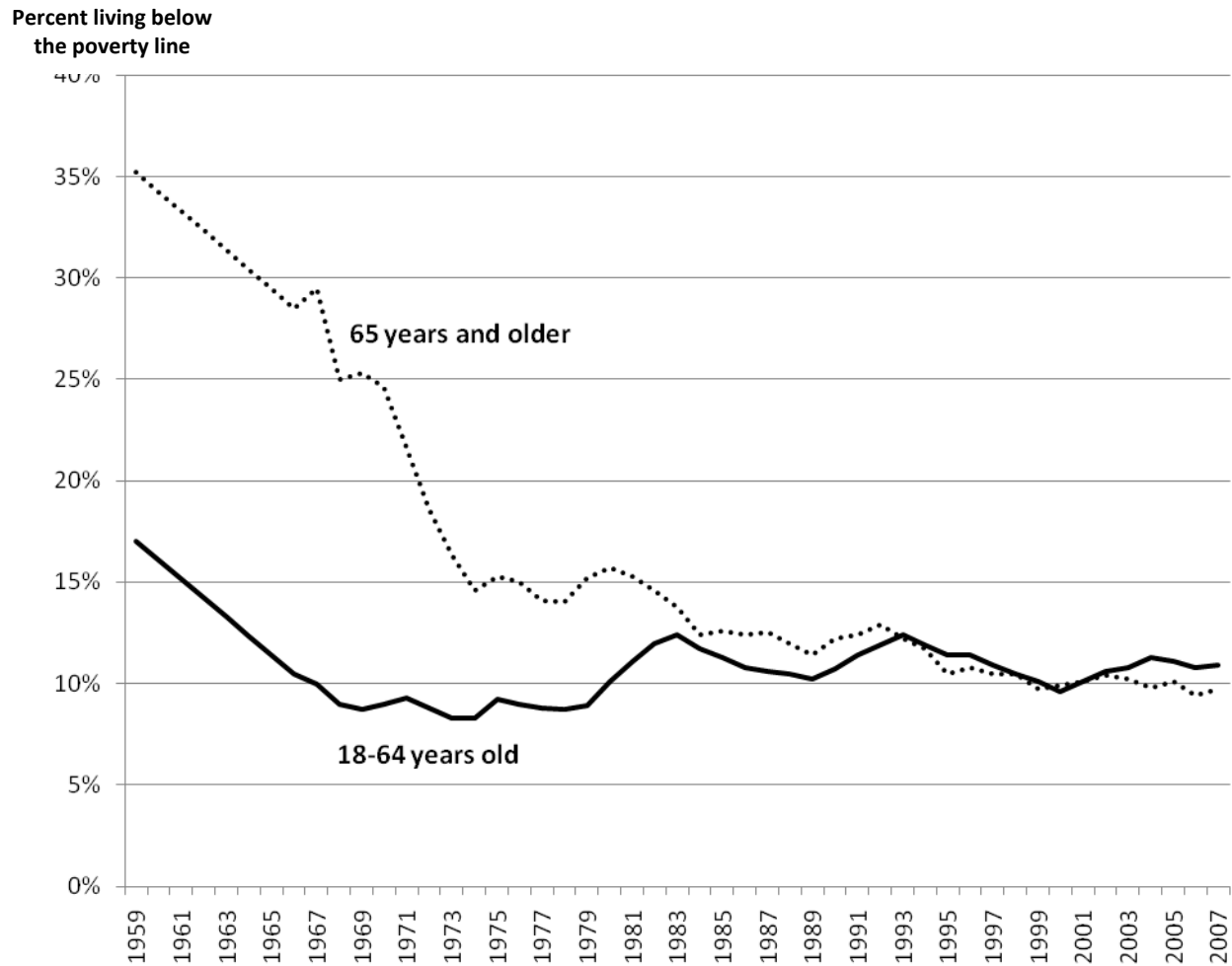
Figure 12.4 Poverty Rate among children, 1959-2007
 [Alternative graph without the GDP line]



Notes: "Poverty Rate" is defined as the percentage of people living below the official poverty line. The data for 1960-1965 are interpolated.

Source: U.S. Bureau of the Census, Current Population Survey, Annual Social and Economic Supplements.

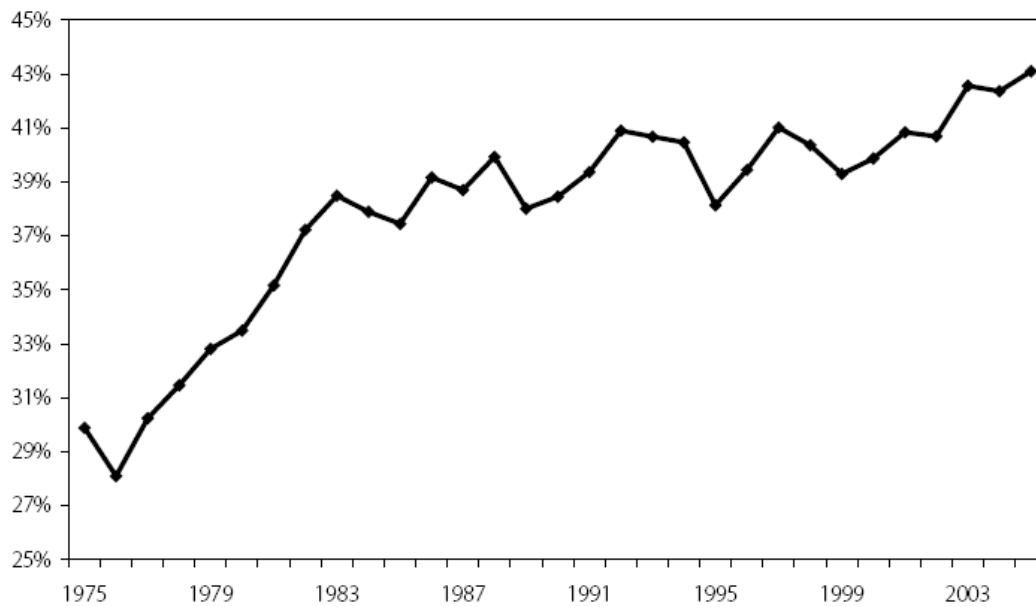
Figure 12.5 Poverty Rate among Adults, 1959-2007



Notes: "Poverty Rate" is defined as the percentage of people living below the official poverty line. The data for 1960-1965 are interpolated.

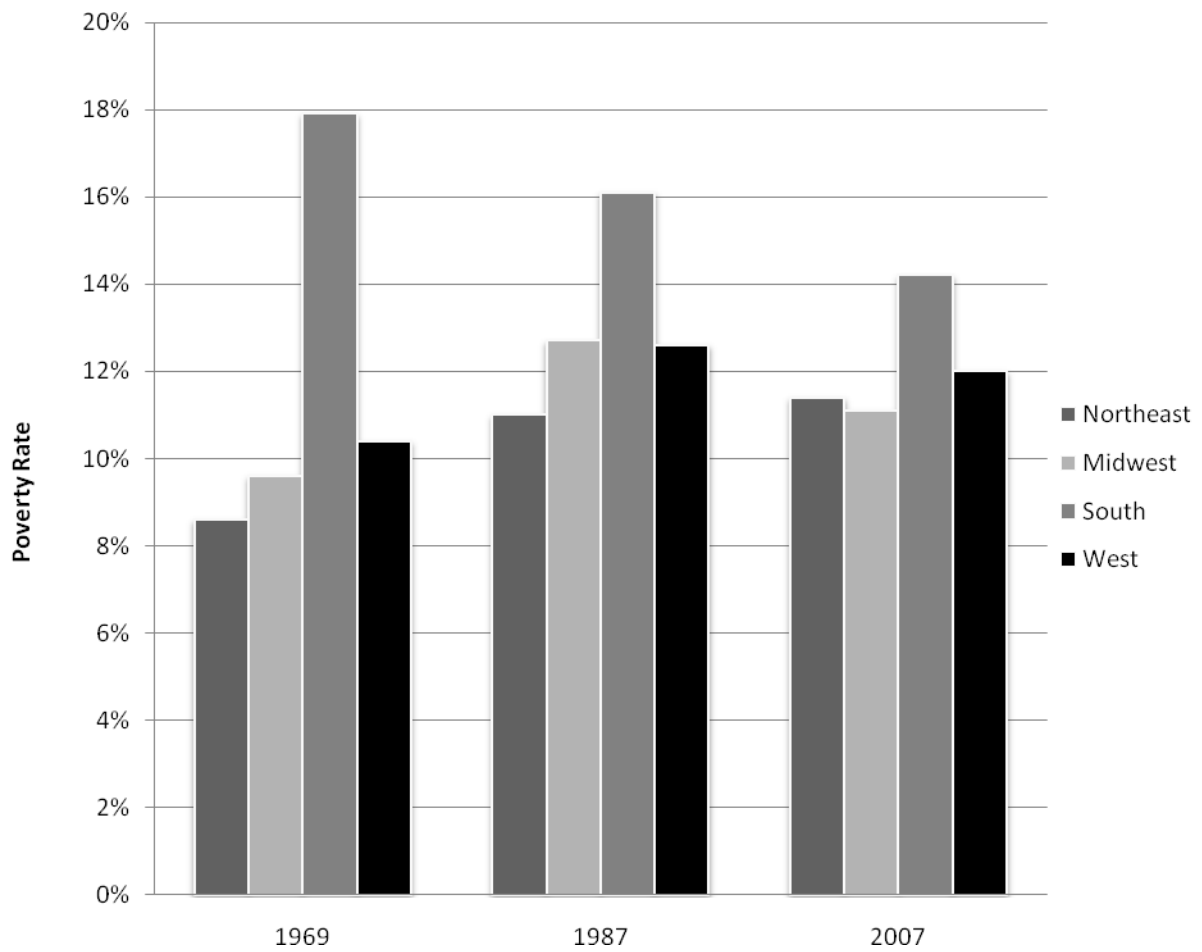
Source: U.S. Bureau of the Census, *Current Population Survey, Annual Social and Economic Supplements*.

Figure 12.5 Poverty Rate among Adults, 1959-2007
 [alternative graph without the GDP line]



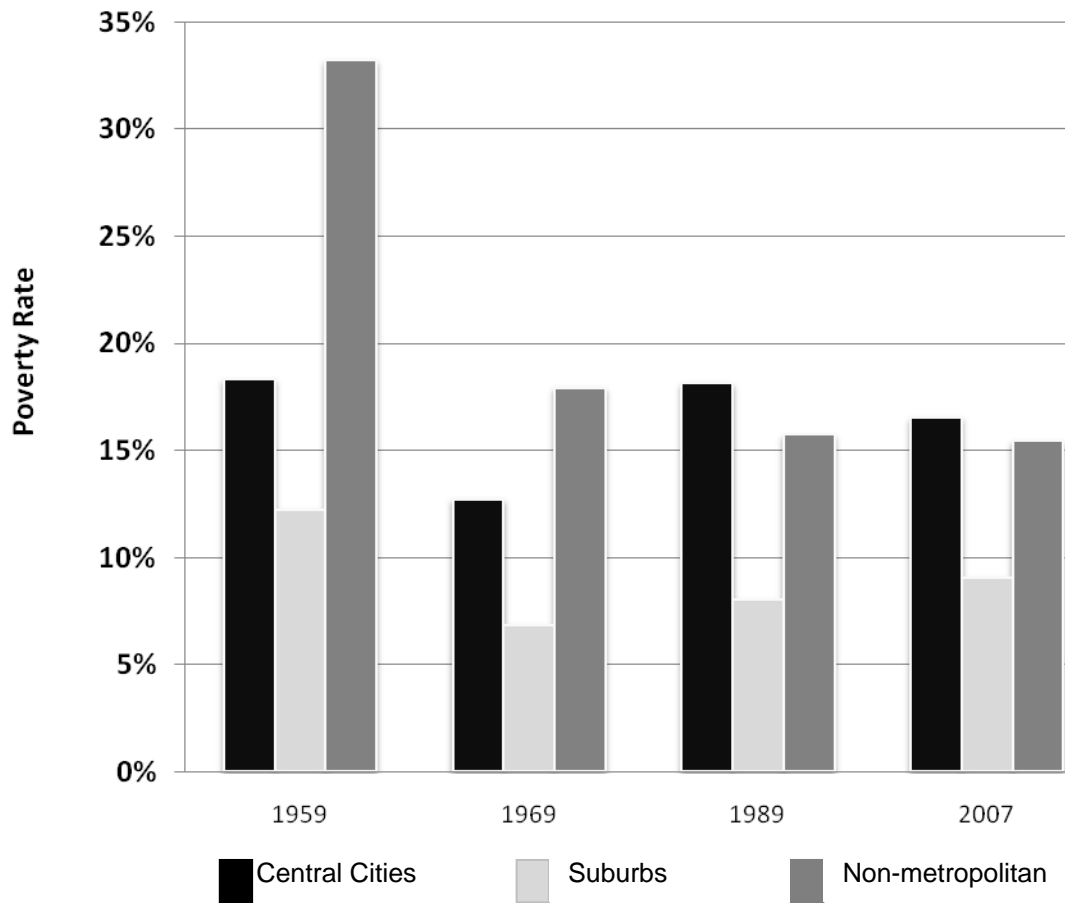
Source: Figure 6D from Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2006/2007. An Economic Policy Institute Book*. Ithaca, N.Y.: ILR Press, an imprint of Cornell University Press, 2007.

Figure 12.6 Percent of the poor below one half of the poverty line, 1975-2005



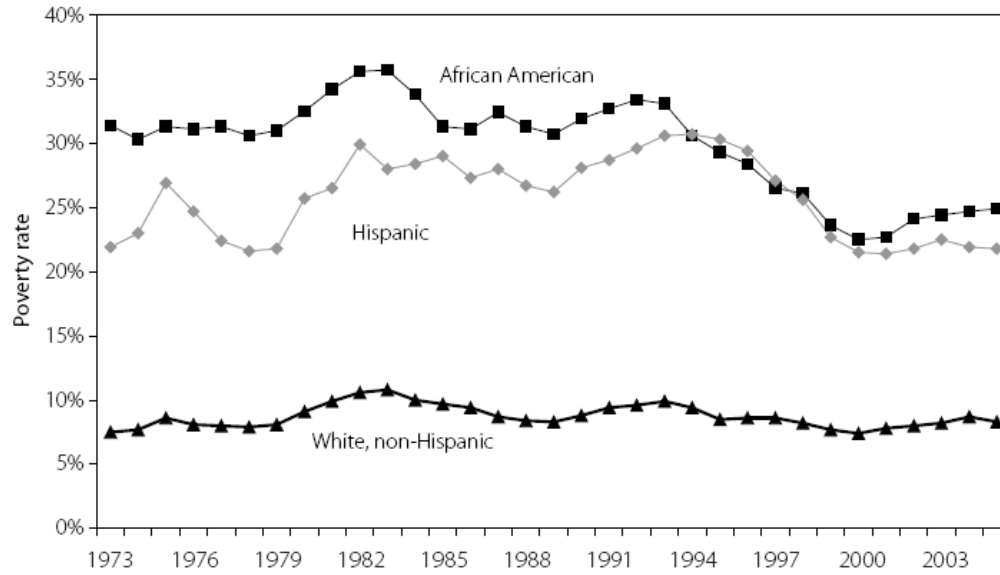
Source: U.S. Bureau of the Census, Current Population Survey, Annual Social and Economic Supplements.

Figure 12.7 Poverty Rates across regions, 1969, 1987, 2007



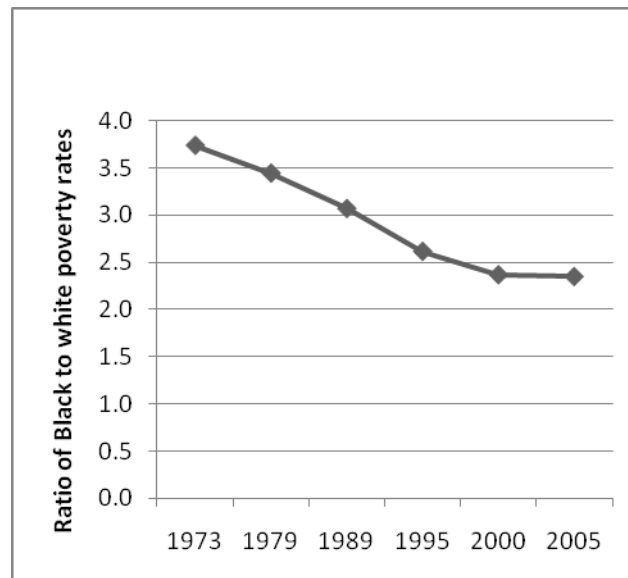
Source: U.S. Bureau of the Census, Current Population Survey, Annual Social and Economic Supplements.

Figure 12.8 Poverty Rates in Central Cities, Suburbs and non-Metropolitan areas
1959, 1969, 1989, 2007



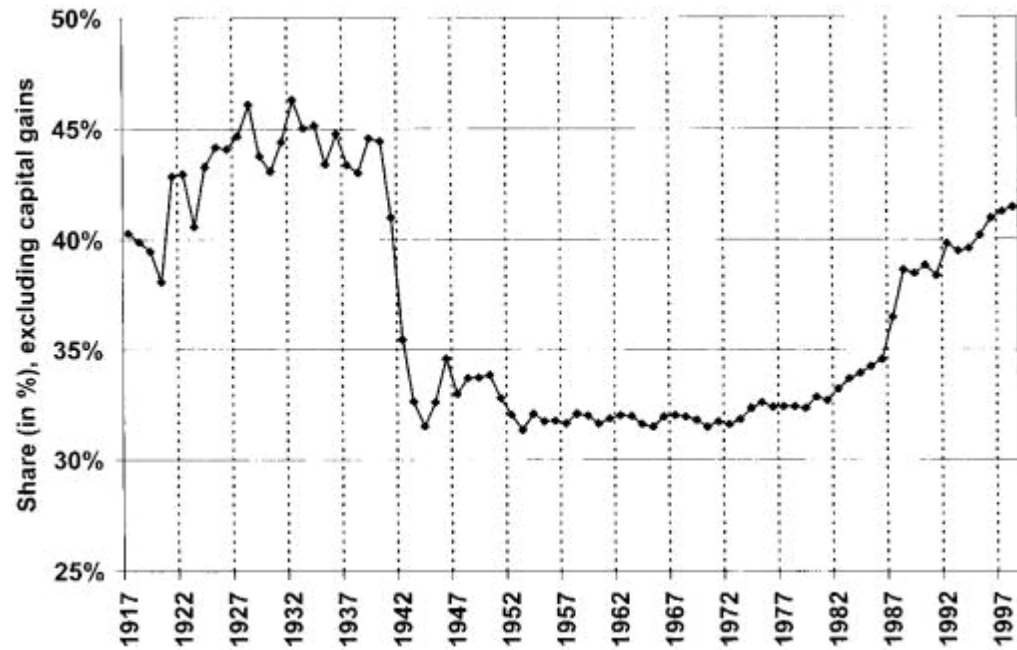
Source: Figure 6B from Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2006/2007. An Economic Policy Institute Book*. Ithaca, N.Y.: ILR Press, an imprint of Cornell University Press, 2007.

Figure 12.9. Poverty rates by race and ethnicity, 1973-2005



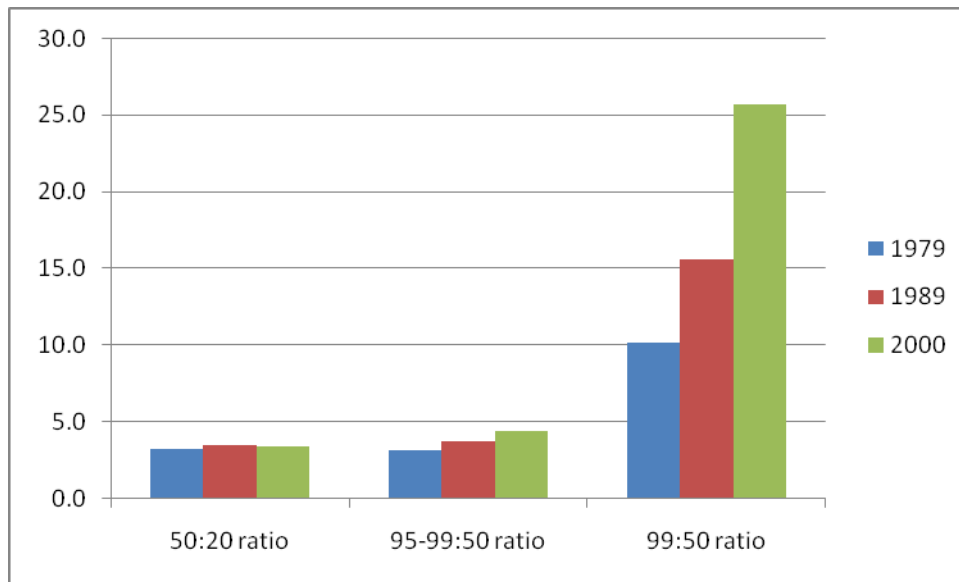
Source: calculated from Table 6.2 in Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2006/2007. An Economic Policy Institute Book*. Ithaca, N.Y.: ILR Press, an imprint of Cornell University Press, 2007.

Figure 12.10
Ratio of Black to White Poverty rates, 1973-2005



Source: Thomas Piketty and Emmanuel Saez, "Income Inequality in The United States, 1913–1998", *The Quarterly Journal of Economics* Vol. CXVIII February 2003 Issue 1, pp.1-41

Figure 12.11
The Top Decile Income Share, 1917–1998



Source: Calculations based on Table 1.11 from *The State of working America 2006.2007*

Note:

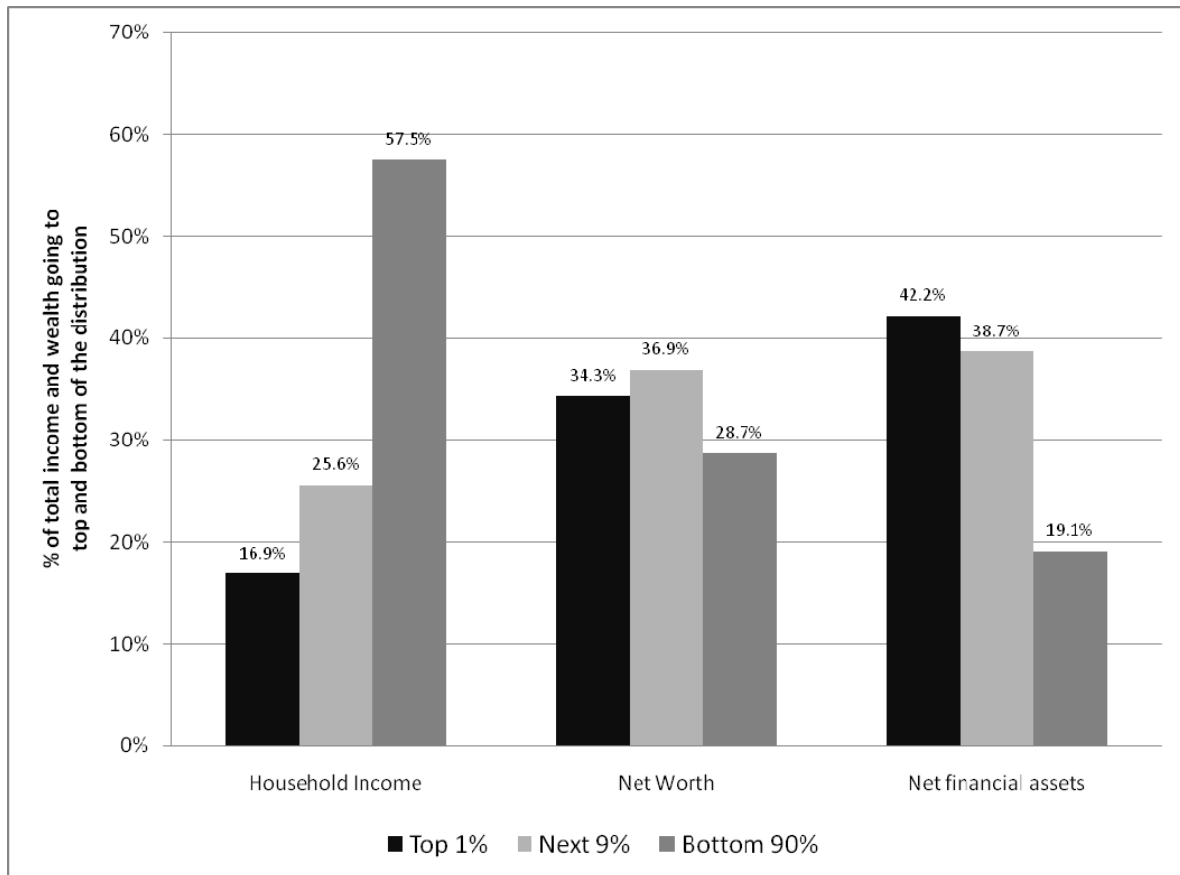
These are ratios between the *average* household income within income groups. The average income of the middle quintile is very close to the median income since the income distribution *within* the middle quintile is not very skewed.

50:20 ratio = The ratio of the *average* family income in the middle quintile to the average family income in the bottom quintile

95-99:50 ratio = The ratio of the *average* family income of people in the 95-99th percentiles to the average family income in the middle quintile

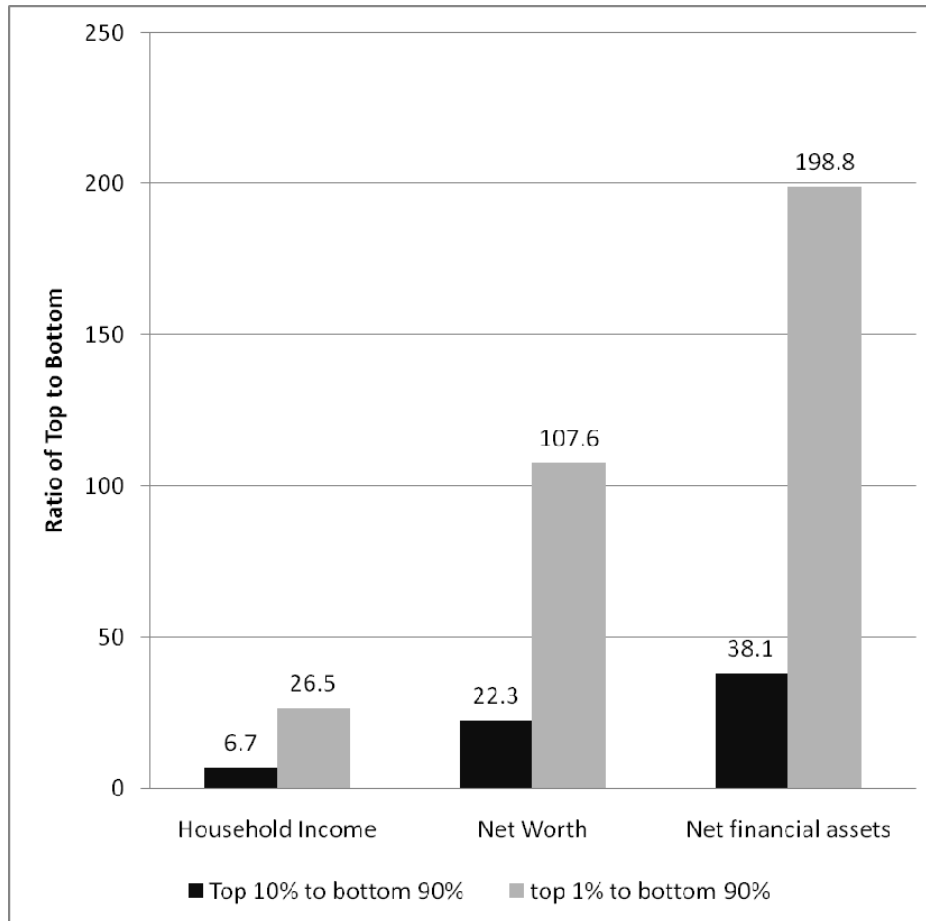
99:50 ratio = The ratio of the *average* family income of people in the 99th percentile to the average family income in the middle quintile

Figure 12.12
Ratios of income between different income strata, 1979, 1989, 2000



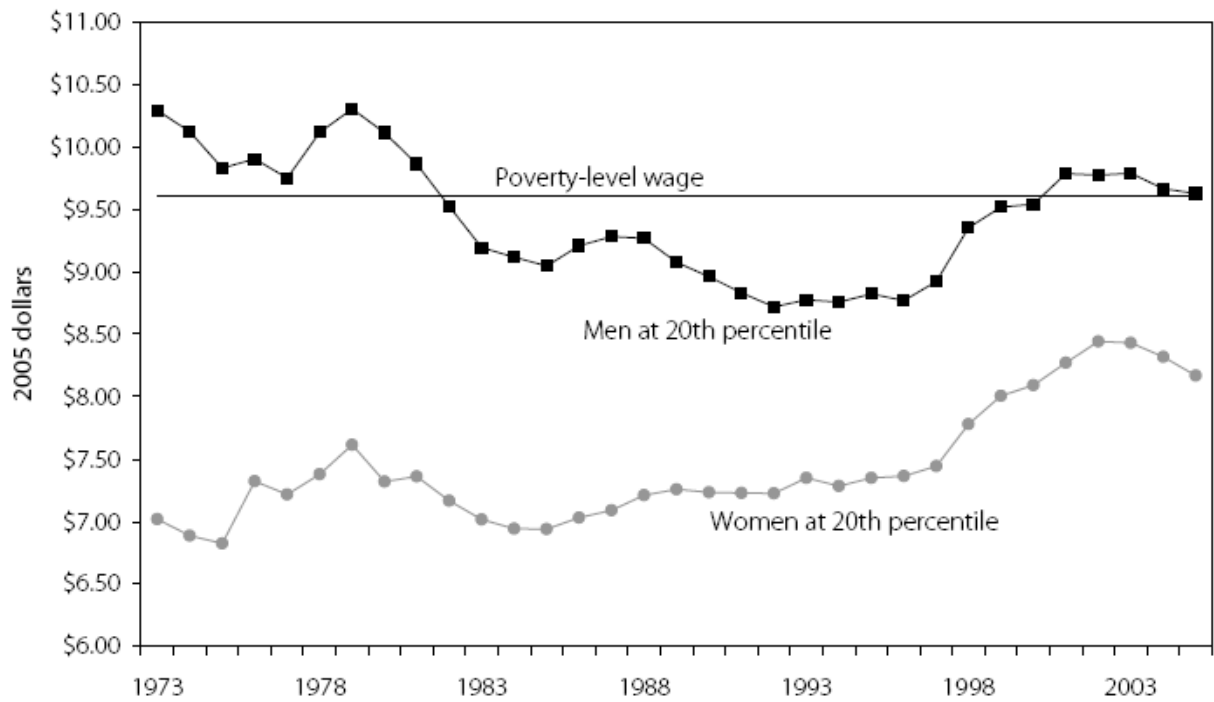
Source: Table 5.1 from Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2006/2007. An Economic Policy Institute Book*. Ithaca, N.Y.: ILR Press, an imprint of Cornell University Press, 2007.

Figure 12.13
Distribution of Household Income and Wealth, 2004



Source: calculations from Figure 12.

Figure 12.14
Ratios of average income and wealth of households at the top of the income and wealth distributions to average income and wealth at the bottom.



Source: Source: Figure 6L in Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2006/2007. An Economic Policy Institute Book*. Ithaca, N.Y.: ILR Press, an imprint of Cornell University Press, 2007.

Figure 12.15
Real hourly wages of low-wage workers, 1973-2005