Addressing Widening Income Inequality Community Development

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through

The median annual household income in the U.S. is slightly over $50,000.[1] In contrast, the highest paid CEO in the U.S. earned $84.5 million last year, a factor of roughly 1,700 times the median (and that was for only nine months of work).[2] To compare these two figures and decry income inequality in America is an oversimplification of a highly complex issue. But this comparison hints at a growing divide in our country, where a relatively small group of people controls a relatively large share of the income—the top one percent of Americans control nearly a quarter of all the country's income, the highest share controlled by the top one percent since 1928.[3] The existence of income inequality is accepted as a byproduct of capitalism, where the market rewards individuals for their varying levels of productivity, but how much is too much? And should we be concerned with the apparent rise in income inequality?

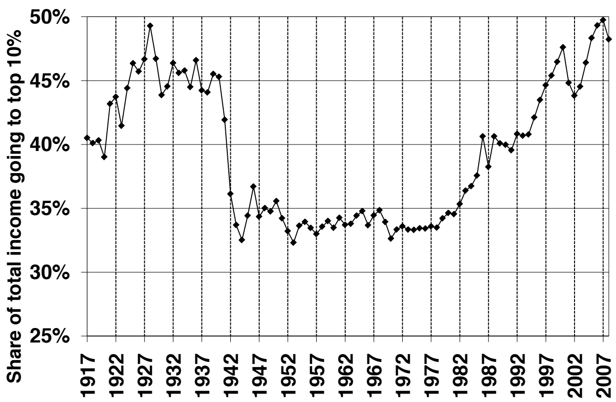
Community development practitioners are all too familiar with the effects of poverty, but less effort has been given to understanding the bigger picture of income inequality. Inequality exacts high social costs across all income groups. Emerging research suggests that crime, teen pregnancy, poor educational performance, drug use, obesity, mental illness, and lower life expectancy are positively correlated with income inequality (regardless of the overall level of income in an area).[4] As Richard Wilkinson and Kate Pickett write in their book, *The Spirit Level*, "The problems in rich countries are not caused by the society not being rich enough (or even by being too rich) but by the scale of material differences between people…What matters is where we stand in relation to others in our own society."[5] In addition, rising inequality has been linked to declining social capital and civic engagement. In his book *Bowling Alone*, Robert Putnam explains, "Community and equality are mutually reinforcing… In terms of the distribution of wealth and income, America in the 1950s and 1960s was more egalitarian than it had been in more than a century… [T]hose same decades were also the high point of social connectedness and civic engagement… Conversely, the last third of the twentieth century was a time of growing inequality and eroding social capital."[6]

Undoubtedly, a highly inequitable distribution of income is most troublesome for those with the least; understanding and addressing inequality is thus an important component of improving the lives of low- and moderate-income (LMI) individuals. The topic of income inequality is notoriously thorny, as it mixes elements of history, politics, economics, and philosophy, but this article aims to untangle some of these issues and consider them through a community development lens.

The Great Divergence

Figure 1 shows the income share of the top decile of earners over the past century, based on income tax data analyzed by economists Thomas Piketty and Emmanuel Saez.[7] From the mid-1920's until the early 1940's, income was highly concentrated among top earners, with the top decile earning roughly 45 percent of total income. However, a drastic shift occurred during World War II. Economists Claudia Goldin and Robert Margo dubbed this period the "Great Compression," in reference to the drastic flattening of the wage structure.[8] According to Goldin and Margo, this period saw a rapid increase in the demand for unskilled labor at the same time that the supply of educated labor was expanding, bringing wages across the labor market closer together. The income share of

Figure 1. *Top Decile Income Share in the U.S., 1917–2008*



Source: Piketty and Saez (2010).
Income defined as market income including capital gains. In 2008, top decile includes all families with annual income above $109,062.

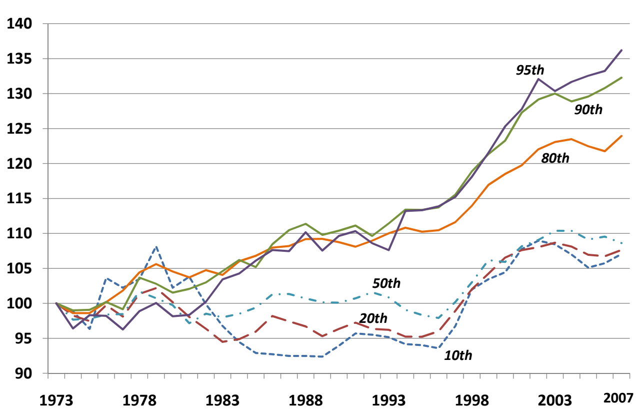
the top decile stabilized around 33 percent following the Great Compression, and with less income concentrated at the top, a strong middle class flourished throughout the 1940's and into the late 1970's. However, the shared prosperity of the midcentury period gave way to a rapid rise in income inequality beginning in the 1980's, a period economist Paul Krugman refers to as the "Great Divergence."[9]

Alternative measures of income inequality support the notion of a Great Divergence. Figure 2 shows the trajectory of real hourly wages for various earners since 1973, demonstrating that those at the top of the earning scale saw their wages rise much more rapidly than those at the bottom. Real hourly wages of those in the 90th percentile, where most people have college or advanced degrees, rose by 30 percent or more, while wages at the 50th percentile and below, where many people have at most a high school diploma, rose by only 5 to 10 percent.[10] Another commonly used tool to examine income inequality is the Gini index, which is a statistical measure of the inequality of a distribution. The Gini index ranges from a value of 0 to 1; when applied to income distributions, the lower the Gini index, the more equal the income distribution; as the index rises, so too does income inequality (a value of 1 would mean that a single person earns all of the income).[11] Figure 3 shows the Gini index for U.S. households over the past forty years and demonstrates that income inequality has been increasing fairly consistently over time. To provide some global context, consider that the most equitable societies (Sweden, Hungary, and Norway) presently rank in the low 0.2s; the U.S., at close to 0.47, is on par with the Ivory Coast, Cameroon, and Jamaica in terms of equitable income distribution.[12]

What Caused the Divide?

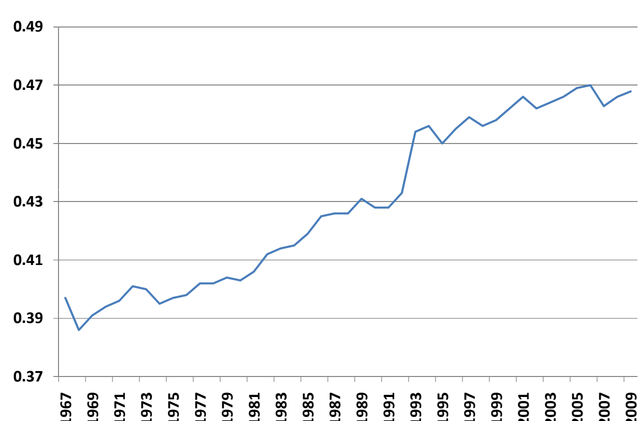
But how exactly did this rise in income inequality come about? The causes of the Great Divergence are wide ranging and interwoven; as a result, there is no singular answer to this question.[13] However, one of the most influential determinants of labor market outcomes and wages is education. Figure 4 shows the differences in the growth of real wages over time by educational attainment. Since 1973, real wages have risen about 20 percent for those with college or advanced degrees, while they have remained flat for high school graduates, and fallen about 15 percent for those with less than a high school education. The U.S. population has increased their overall schooling over the past 30 years, with a greater share of the total population graduating from high school and college; however, much of the increase in schooling since the 1970s is due to the dying out of older generations with comparatively

Figure 2. *Change in Real Hourly Wages for Select Percentiles, 1973–2007 (all workers, normalized 1973=100)*



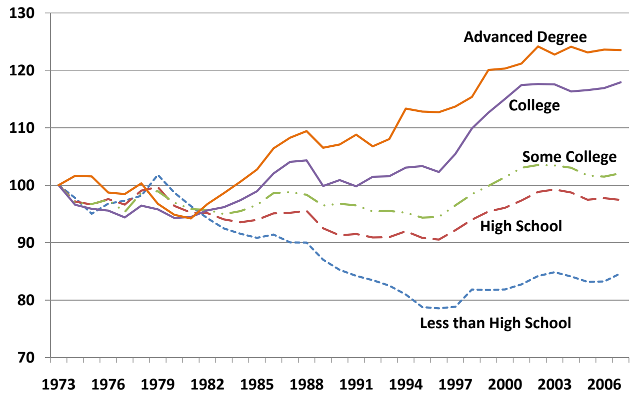
Source: Economic Policy Institute

Figure 3. *Gini Index for U.S. Households, 1967–2009*



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

Figure 4. *Change in Real Hourly Wages by Education, 1973–2007*
(all workers, normalized 1973=100)



Source: Economic Policy Institute

little education, rather than steadily growing educational attainment among younger generations.[14] This slowdown of educational progress across successive generations, coupled with shifting demographics (the aging of the baby boomers and the labor market entry of the smaller baby bust cohorts) has resulted in a relatively smaller supply of skilled labor, relative to previous decades.[15] At the same time, the rise in the use of technology across almost all sectors of the economy has resulted in increased demand for skilled labor.[16] Economists Lawrence Katz and Claudia Goldin argue that the educational system has failed to produce an adequate supply of skilled labor to keep up with the pace of technological change over the past 30 years.[17] In contrast, remember that the Great Compression that took place in the early 1940's was essentially a reversal of this situation, where skilled labor was plentiful at a time when unskilled labor was in demand, flattening wages across the labor market. Today, employers are competing to hire highly skilled workers from a limited pool, creating a wage premium for those with better training and education; the result is the widening income gap across education groups. In addition, consider the impact of educational attainment on employability; in September 2011, the unemployment rate for those without a high school degree was 13 percent, but for those with a bachelor's degree, the unemployment rate was 4.2 percent.[18]

In addition to the decline in educational attainment, researchers have explored other potential causes for the rise in income inequality. One hotly debated topic is tax policy and the redistribution of income. Higher-income households pay more taxes, but also have greater access to special tax breaks; more than 90 percent of the tax savings from preferential tax rates on long-term capital gains and qualified dividends go to taxpayers in the top quintile of the income distribution, as do three-fourths of the savings from itemized deductions.[19] In addition, tax rates for the top earners have fallen since 1980; from the 1940's through the end of the 1970's, marginal rates of 70 – 90 percent were imposed on the highest income bracket, but this figure has since decreased to about 40 percent.[20] However, most of the value of tax credits goes to households in the bottom four quintiles; nearly 80 percent of nonrefundable credits and more than 95 percent of refundable credits benefit those households.[21] Richard Burkhauser of Cornell University argues that the inclusion of transfer income, such as Social Security and TANF, paints a more complete picture of the financial resources available to a household than wages and taxable income alone. Burkhauser finds that after factoring in taxes and transfers, the financial resources available to the bottom quintile of the population increased almost 15 percent from 1979 (the top quintile saw growth of almost 50 percent).[22] The debate around tax policy is highly complex and there is no clear answer about the extent to which it has caused income inequality, but it's clear that public policy plays an important role in addressing income inequality.

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Taking a more international perspective, immigration and globalization are also thought to have an impact on labor markets and wages, and thus inequality. Let's first consider immigration. Despite the popular notion that immigrants reduce wages and opportunities for native workers, research suggests that immigrants expand the economy's productive capacity by stimulating investment and promoting specialization.[23] Economist David Card argues that the impact of immigration on the relative wages of U.S. natives is small, suggesting instead that immigration has affected overall wage inequality because of the concentration of immigrants in the tails of the skill distribution.[24] Card estimates that immigration accounts for just a small share—about 5 percent—of the rise in overall U.S. wage inequality between 1980 and 2000.[25] Globalization, through an increase in international trade and outsourcing of employment across various industries, has also been widely blamed for job losses and depressed wages. The U.S. tends to export goods that rely on skilled labor and to import goods that rely more heavily on unskilled labor, fueling the demand for skilled labor and reducing the demand for less-skilled workers (thereby driving wages even further apart).[26] Imports of manufactured goods from developing countries more than doubled as a percentage of U.S. gross domestic product, from slightly over two percent in 1990 to close to 4.5 percent in 2006.[27] This rapid growth of trade has likely had significant distributional effects, but there is insufficient data to quantify the effect.[28] A recent paper by IMF researchers Jaumotte, Lall, and Papageorgiou supports the notion that trade globalization increases income inequality, but interestingly, the authors conclude that globalization and technological changes increase the returns on human capital, underscoring the importance of education and training in both developed and developing countries in addressing rising inequality.[29]

This is by no means a complete discussion of the causes of income inequality. Other considerations include the decline of organized labor, the fall of the real value of the minimum wage, and the rapid growth of incomes at the very top of the distribution (the so-called superstars, such as athletes, CEOs, and highly compensated finance professionals).[30] But addressing widening income inequality requires us to take the next step beyond identifying causes—we need to think critically about near- and long-term solutions for building financial resources and opportunities for LMI communities.

The Role of the Community Development Field

Federal Reserve Governor Sarah Bloom Raskin recently pointed out that, "Inequality is destabilizing and undermines the ability of the economy to grow sustainably and efficiently."[31] She went on to say:

> *[Inequality] is associated with increases in crime, profound strains on households, lower savings rates, poorer health outcomes, and diminished levels of trust in people and institutions. All of these forces drag down maximum economic growth and are anathema to the social progress that is part and parcel of such growth. These forces also bring people closer to being "scammed" or becoming vulnerable to financial schemes that promise quick and easy fixes. Finding ways to help more Americans safely grow their incomes and net worth in real terms arguably diminishes the destructive influence of income inequality by giving everyone a more secure footing in the economy and the same kind of flexibility and choice available to the more affluent.*[32]

When framed in this way, the role of the community development field in addressing income inequality is clear—to help LMI communities safely grow their incomes and access greater economic security and opportunity. This requires a two-fold approach. The first is to tend to the immediate needs of low-resource households by providing supports that help them earn and keep as much income as possible in the near-term. This includes traditional community development initiatives, such as the provision of affordable housing, access to affordable financial services, workforce development, and efforts to build savings.

The second approach is to address the broader set of factors that influence the long-term earning potential and productivity of LMI individuals, with a particular focus on the next generation of workers. Nobel Laureate James Heckman argues that the best way to create greater productivity and prosperity is to achieve better outcomes for children.[33] This begins with major investments in education and human capital development. As previously discussed, the decline in educational attainment and the undersupply of highly skilled workers is responsible for a fair share of the growth in income inequality. Janet Yellen, former President of the Federal Reserve Bank of San Francisco and current Vice Chair of the Board of Governors of the Federal Reserve System, pointed to the importance of education for addressing inequality, saying, "Improvements in education are an imperative for reducing inequality and an easily justifiable investment, given its high social return."[34] Thus, increasing the scale and effectiveness of educational interventions is more important than ever. Such efforts include early childhood education, increasing high school graduation rates, or asset building programs to increase college affordability. The importance of fostering achievement among low-income children cannot be overstated. A recent report on the wellbeing of American children, by the Annie E. Casey Foundation, concluded, "Children who grow up in low-income families are less likely to successfully navigate life's challenges and achieve future success. The younger they are and the longer they are exposed to economic hardship, the higher the risk of failure."[35]

The community development field can also tackle issues that indirectly impact individual achievement. For example, poor health can significantly impair school and job performance, thereby impacting earnings and opportunities for advancement.[36] The emerging connection between health and community development provides an opportunity for the field to promote better health outcomes among LMI populations, thereby maximizing the earning potential of education and work related activities (to learn more about the Federal Reserve Bank of San Francisco's Healthy Communities initiative, see http://www.frbsf.org/cdinvestments/conferences/healthy-communities). Another example is the impact that "place" can have on an individual's achievement and earning potential. Socioeconomic conditions in very poor neighborhoods are associated with more limited opportunities for residents, including lack of access to high-quality schools, fewer jobs, and social and economic isolation, where residents are physically cut-off from the larger economy and community.[37,38] Community development efforts to address concentrated poverty at the neighborhood level can thus help LMI individuals access important skill building resources and earning opportunities.

While these community development efforts are aimed at those with the least, they have important implications across all levels of the income distribution. Federal Reserve Chairman Ben Bernanke summed it up this way, "The challenge for policy is not to eliminate inequality per se but rather to spread economic opportunity as widely as possible. Policies that focus on education, job training, and skills and that facilitate job search and job mobility seem to me to be a promising means for moving toward that goal. By increasing opportunity and capability, we help individuals and families while strengthening the nation's economy as well."[39] From a community development perspective, addressing widening income inequality is about helping LMI communities reach their full potential, thereby improving their capacity to participate in and contribute to the broader economy. CI

Understanding Both Sides of the Inequality Debate

While almost everyone can agree that poverty is undesirable, the issues surrounding income inequality are much less clear-cut. The debate involves complex issues, but developing an understanding of both sides is an important first step in analyzing the available research and developing potential policy responses. The following is a brief summary of some of the main points of contention in the debate around rising income inequality.

Data methodology

Changes in inequality over time are often reported based on the use of income data from the Census Bureau, which ranks households from highest to lowest income, then divides society into five groups and determines the share of total income received by each quintile.[1] The Census quintiles contain unequal number of persons.[2] Comparison of these quintiles over time shows that wealthier households have experienced greater income gains relative to poorer households. However, critics argue that this approach leads to an overstatement of the problem because the census statistics provide only a snapshot of income distribution at a single point in time and do not reflect that households may move into different income quintiles over time.[3] Thus, a comparison of quintiles over time means comparing incomes of different people at different stages in their earnings profile. However, others argue that the Census data is appropriate for observing trends in income distribution and whether the overall societal distribution of income has changed over time.[4]

Debate also exists about the appropriate definition for household income. The Census Bureau's official definition of income does not include non-cash resources such as subsidies for housing, food, and medical care for low-income households. Some argue that the exclusion of such noncash resources thus overstates the problem of income inequality.[5] However, other studies have found persistent growth in income inequality even after adjusting for alternative income sources, such as transfers and noncash resources.[6]

Efficiency and economic growth

In 1975, Yale economist Arthur Okun introduced the idea of the "leaky bucket," referring to the efficiency loss that occurs when money is transferred through taxation.[7] The problem of the leaky bucket creates an inverse relationship between equality and efficiency, which Okun referred to as "the Big Tradeoff." In addition to the problem of efficiency loss, another traditional argument is that inequality is a byproduct of a well functioning capitalist economy and that unconstrained opportunity encourages innovation and entrepreneurship, and therefore economic growth.[8] However, research over the past 20 years has challenged this assumption, suggesting that inequality and economic growth are inversely related and that inequality may actually "harm" growth.[9]

Consumption and quality of life for the poor

Some argue that consumption is a better indicator of economic well being than income, and that today's lower-income households are able to achieve greater consumption than ever before, suggesting that the gap between rich and poor is not as severe as imagined.[10] For example, the cost of consumer goods such as televisions and microwaves has fallen dramatically over time, allowing more low-income households to purchase them and "keep up" with higher income households. However, critics of this consumption approach argue that while the cost of nonessential consumer goods has fallen over time, the costs of essential items such as housing, transportation, and healthcare have increased over time, making the relative hardship greater.[11]

Endnotes

Addressing Widening Income Inequality through Community Development

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Endnotes

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Ties that Bind: Income Inequality and Income Segregation

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The Polarization of Job Opportunities in the U.S. Labor Market: Implications for Employment and Earnings

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