

Poverty and Inequality

The Political Economy of Redistribution

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Chapter 1 - Introduction

Jon Neill , *Western Michigan University*

In the early 1970s, the War on Poverty appeared to be near a successful conclusion. In 1960, 18.1 percent of American families were living in poverty. But by 1973, the poverty rate of American families had fallen to 8.8 percent. Over this thirteen-year period there was an equally impressive reduction in the percentage of families living near poverty. The percentage of families below 125 percent of the poverty level dropped from 25 to 12.8 percent. During the 1960s, inequality also declined significantly, at least by some measures. In 1960, the top quintile of families earned 41.3 percent of aggregate income while the bottom quintile earned 4.8 percent, for a ratio of income shares of 8.6. By 1970, this ratio had fallen to 7.57.

Unfortunately, the success of the U.S. economy in reducing poverty and inequality did not continue into the next decade. After 1973 the poverty rate rose fitfully, to 10.3 percent in 1980, 10.7 percent in 1990, and 11.7 percent in 1992. Likewise, the near-poverty rate climbed 3 percentage points to 15.8 percent. Changes in the shares of aggregate income received by families at the top and bottom of the income distribution were no less disturbing. Between 1970 and 1980, the top to bottom quintile share rose slightly to 7.98. However, over the next ten years it increased dramatically, to 10.14. In fact, each of the first four quintiles earned a smaller fraction of aggregate income in 1992 that they did in 1980. In total, there was a transfer of 3.1 percent of aggregate income from these four quintiles to the top quintile, with about 74 percent of this transfer going to families in the top 5 percent of the income distribution.¹

In looking for an explanation for this trend, it is perhaps tempting to turn to changing political and social conditions and institutions. Yet while political and social change may have played an important role in reshaping the distribution of income in the United States, income distribution is ultimately an economic phenomenon. After all, income is determined by market forces and the policies that governments adopt to restrain and redirect them. Without a thorough study of the economic events of the past twenty years, it is highly unlikely that this unsettling rise in poverty and inequality can be fully understood.

To answer the question that these unhappy events confront us with, it is necessary to consult economists from a fairly wide range of fields. To begin with, the distributional changes of the past decade and a half must be carefully quantified

and placed in the proper context. For example, it is important to know if these changes were confined to particular regions or subgroups in the United States, and if they were reflective of changes taking place in other industrialized economies. International trade has become a much larger part of economic life, and the U.S. economy is no longer a monolith, largely unmoved by economic developments abroad.

The role of the political process in determining the distribution of income would also seem to be of paramount importance. Although it may be coincidental, the rhetoric and policies of the Reagan-Bush administration constituted a clear repudiation of the social philosophy and programs of the Kennedy-Johnson administration. In any case, one cannot help wondering how it is that, in a democratic society, the top 20 percent of the population would be able to increase its share of aggregate income. This is an interesting public choice question, but the failure of middle- and lower-income families to increase their share of aggregate income may be at least partly due to the intergenerational transmission of economic status.

However important these questions may be, many find the most interesting and provocative aspect of the disfavor which the economy has shown poor and middle income families over the past two decades to be the bounty that it simultaneously created for others. Although the economy did not grow as rapidly during the 1980s as it did during the 1960s, the decade was marked by an impressive growth in real domestic product. Between 1982 and 1990, real GDP increased about 30 percent. But unlike other expansions, this one was not accompanied by less poverty and inequality; the benefits from the expanding economy apparently did not trickle down, as so many had argued would happen.

Of course the relationship between growth and distribution is complicated and obscure. Presumably wages rise rapidly in an expanding economy, more rapidly than other components of income. And since poor and low-income families are typically families for whom wages are the most important component of income, many are pulled out of poverty and into the middle class by the expansion. Thus, the obvious question is: what role did labor markets play in reshaping the distribution of income? A quick look at the wage and salary component of national income reveals that, in real terms, there was only a modest growth between 1980 and 1990, about 26 percent, compared to over 49 percent between 1960 and 1970. In fact, this component grew only slightly more than it did between 1970 and 1980 (22.5 percent), a period that is not usually viewed as a time when the economy was good to wage earners. Moreover, the share of national income generated by wages and salaries continued to decline. This share rose slightly more than 2 percentage points between 1960 and 1970, but fell almost 5 percentage points between 1970 and 1990.

The lecture series that produced the essays in this volume was organized for the purpose of bringing together six well-known economists to learn their views on these and related issues. The lectures were delivered at Western Michigan University during the 1994-95 academic year, at the height of the debate over the need for welfare reform. The points raised by the authors reflect the concerns and hopes of many economists for that endeavor. They also offer a perspective from which to observe and evaluate the impact of the recently passed Personal Responsibility and Work Opportunity Reconciliation Act on the behavior and economic fortunes of low income families.

The essay that opens this collection is by Professor Robert Haveman. What Professor Haveman offers us is a critique of the two proposals that shaped the current debate over welfare reform, the proposal from the Clinton administration and that found in the Contract With America. It is not surprising that both plans emphasize moving welfare recipients off the welfare rolls and into the labor market, since this has been a long-playing theme in U.S. political economy. Even when the War on Poverty was at its height and a guaranteed income was being given serious consideration, many—including liberals such as Robert Kennedy—continued to maintain that finding jobs for the poor, or as Lyndon Johnson put it, turning “tax-eaters” into tax-payers, should be the purpose of the nation’s welfare system.² However, Professor Haveman argues that the labor market today is markedly different from the labor market of the 1960s. Consequently, the prospects for moving significant numbers of people off the welfare rolls and into jobs paying wages that would lift them out of poverty may be more remote and, very likely, not particularly cost-efficient.

The next contribution to this volume is Professor Rebecca Blank’s analysis of the relationship between the incidence of poverty and economic growth. It is often argued that the most effective policies for reducing poverty and inequality are pro-growth policies. The coincidence of rapid growth and a declining poverty rate throughout the 1960s would seem to support this relationship. Yet the 1980s presents a compelling counter-example. Professor Blank evaluates a number of explanatory hypotheses that have been offered, and like Haveman, she sees the labor market as problematic. In her opinion, skill-biased technical progress and the internationalization of the U.S. economy may be the two major reasons for the failure of growth to reduce the poverty rate.

The third and fourth essays, those by Professors John Formby and Timothy Smeeding, address the question of how widespread the rise in poverty and inequality actually was. In his paper, Professor Formby examines the extent of inequality in various U.S. geographical regions over the past three decades using different measures of inequality and definitions of income. His analysis clearly shows that comparisons of regional income distributions are sensitive to the way in

which income is defined, and that while regional income distributions are becoming more similar, this is due to both a decrease in inequality in the South and increased inequality in the Northeast and West. Professor Formby ends his paper with an evaluation of the effect of recent policy initiatives on standard measures of inequality.

In contrast, Smeeding's essay focuses on cross-country comparisons of income distributions. From data that he presents, two facts emerge. First, the United States has more inequality than any other OECD country. Second, though the increase in inequality experienced by the United States during the 1980s was not an isolated event, only a few OECD countries had as large an increase in inequality. This suggests that the safety net in many countries was sufficiently strong to resist the impact of the structural changes that took place, or that proactive policies were effective in preventing inequality from increasing.

The papers by Jere Behrman and Gordon Tullock both speak to the intergenerational dimension of income transfers, though from different perspectives for different ends. Professor Behrman is concerned with the effect of a family's economic status on that of its children. At issue are the principles that guide the intra-household allocation of resources and the claim that the children of high income parents tend to have high incomes themselves. Behrman contrasts the assumptions and implications of two competing models of intra-household resource allocation in the light of recent empirical work to provide insight into how strong the connection between parent and child incomes may be. And although his analysis leads to the conclusion that the economic status of a child's parents plays a large role in determining the child's income, Behrman is quick to emphasize that the importance of education should not be discounted.

The paper that closes this volume raises a number of elusive and disturbing questions. Professor Tullock begins his discussion by asking: what if distribution has a depressing effect on growth? While it may be that the relationship between economic growth and redistributive policies is unclear, there are theoretical reasons to suspect a negative relationship. In Tullock's view, such a relationship presents ethical questions and may explain the apathy of lower-income households toward redistribution. In reminding us that when growth is affected by redistribution, the economic status of future generations must be considered before writing any normative prescription, Professor Tullock's observations are both provocative and insightful.

These six essays offer a wide perspective on poverty and inequality from a group of scholars who have made significant contributions to this important field of research. They certainly are worthwhile reading for anyone concerned about rising poverty and inequality. It is wishful to think that recent developments are

aberrant, that soon poverty and inequality will begin to decline, particularly if government stays the pro-growth course. Thus, if poverty and inequality create the social pathologies that have become commonplace in the United States, as so many argue, a “kinder, gentler” America is not likely to become a reality until this pernicious trend is reversed.

Notes

1. The statistics cited here come from various issues of the *Statistical Abstract of the United States*.
2. Moynihan (1973, pp. 61-63, 130-131).

References

Moynihan, Daniel P. 1973. *The Politics of Guaranteed Income: The Nixon Administration and the Family Assistance Plan*. New York: Vintage Books.