The Fall and Rise of Income Inequality in the United States

Presented to
MSU Faculty Emeriti Association
February 17, 2017

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The increase in income inequality since the late 1970s is arguably the most important economic story in our lifetime in the United States.
But the *decrease* in inequality in the 1930s and 1940s, which maintained itself until the 1970s, was no less stunning.
One easy way to see the trends is to look at the percentage of income received by the top one percent of households (with incomes above about $440,000 per year in 2015).
Percentage of Income in the United States Received by the Top One Percent of Households, 1913-2015
However, about half of what is happening to the top one percent can be accounted for by the top one-tenth of one percent (with incomes above about $2,000,000 per year).
Percentage of Income in the United States
Received by the Top One Percent and
Top One-Tenth of One Percent of Households, 1913-2015

- Top 1 Percent
- Top One-Tenth of 1 Percent
The Great Convergence of the 1930s and 1940s did not just happen.

It was the deliberate and predictable result of public policies.
Reasons for the Great Convergence

1. Huge increases in educational opportunity.

2. The corporation income tax (1909) and the 16th Amendment to the Constitution (1913) bring progressive income taxation to the United States. The estate tax (1916) brings progressive wealth taxation.
3. The Banking Act of 1933 (the Glass-Steagall Act) makes banking boring.

4. The National Labor Relations Act (1935) makes it much easier for labor unions to organize successfully.

6. During World War II, the National War Labor Board repeatedly rules in favor of wage increases for low-skilled workers.
The Great Divergence that has taken place since the 1970s did not just happen. It is largely due to the slowing or reversal of the policies of the 1930s and 1940s.
1. Education slowed down, and technology sped up.
High-School Graduation Rates in the United States, 1870-1992

2. Financial deregulation made banking exciting.
Index of Financial Deregulation and Relative Wage for Workers in the Financial-Services Sector

Source: Philippon and Reshef (2012)
3. Social norms have changed in ways that exacerbate income inequality.
One-Parent Families as a Percent of All Families with At Least One Child Under Age 18, In the United States, 1950-2016
Average Ratio of Compensation of Chief Executive Officers to Worker Compensation, 1965-2013
4. Unions weakened.
Union Members as Percentage of U.S. Workers, 1930-2016
5. The tax system became less progressive.
Highest Marginal Tax Rate in the U.S. Federal Individual Income Tax, 1913-2016

Marginal Tax Rate, in Percentage Points

Year
7. The increase in immigration was dominated by immigrants with low levels of skill.

It created a large pool of low-skill workers who could not vote.
8. The minimum wage did not keep up with inflation.
The “Great Divergence” of the last 40 years has had a very different character in some parts of the United States than in others.

Source: Ballard and Menchik (2015)
Percent Change in Inflation Adjusted Income, For Households at Selected Points in the Income Distribution, In Massachusetts and the United States, 1976-78 to 2011-13

Source: Ballard and Menchik (2015)
Percent Change in Inflation-Adjusted Income,
For Households at Selected Points in the Income Distribution,
In Alabama and the United States, 1976-78 to 2011-13

Source: Ballard and Menchik (2015)
Political Explanations of the Economic Explanations:

A. Social issues
B. Political organization
C. Electoral institutions
D. Voter ignorance
In my view, race is more important than any of the other explanations.
FIGURE 3.22
Minority Population of Michigan Census Tracts in Detroit Tri-County Area, 2000

SOURCE: U.S. Census Bureau, Census 2000, Summary File 1, Table P4. Michigan Center for Geographic Information.
Michigan, My Michigan
A song to thee, fair State of mine, Michigan, my Michigan.
But greater song than this is thine, Michigan, my Michigan.
The whisper of the forest tree,
The thunder of the inland sea,
Unite in one grand symphony
Of Michigan, my Michigan.