Why is inequality growing?

by Robinson G. Hollister, Jr.

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The changing income distribution

In 1959 Robert Lampman predicted a decline to 10 percent of the population in poverty in the 1977–87 decade,[1] and by 1969 the percentage in poverty was already down to 11 percent. At that time Lampman's prediction looked quite good. However, post-1973, the situation began to deteriorate. Poverty rose sharply during the 1981–82 recession and even after a long expansion by 1987 we were back up to 13.5 percent of the population in poverty.

Lampman had conditioned his forecasts on sustained economic growth. In fact we had a period of sustained, long-term growth and a stable income distribution prior to 1973. Subsequently we've had very slow economic growth and increasing inequality.

The puzzle before 1973 was really why the income distribution was in fact so stable. Since 1973, however, the puzzle is, Why is the size distribution of income changing so much? And, in particular, why is inequality growing?

Possible causes of the growth in inequality

The complexity of the analysis quickly escalates and we get into the very broad issues: the role of productivity and causes of the productivity slowdown; the issues of "deindustrialization" and the quality of jobs; and, of course, in the post-1980 period, increasing international competitiveness. Danziger and Gottschalk title one of their articles on this subject, "Do Rising Tides Lift All Boats?"[2] But of course the tide hasn't been rising very much in the last decade, so really it seems to me that the relevant question is, Does a stagnant pool necessarily mean the small boats must sink? That is, when there is a slowdown in growth does it necessarily have to hurt the poor relatively more? Some of my favorite explanations thus far are the following.

First of all, there is demographic change. In the late 1970s we had an extraordinary growth in the labor force due to the rising labor force participation of women and the necessity to absorb the baby boom, whose numbers entering the workforce reached an all-time peak in size in 1979. The labor markets need time, to some degree, to adjust their institutions to such large influxes of different types of workers, and, indeed, it appears to me that the markets were adjusting pretty well for most of these groups, with perhaps the exception of black youth.

A second factor seems to be the shifting location of employment: the regional shifts from North Central to South and Southwest, but perhaps more important from the central city to the suburban fringe. This is the famous "spatial mismatch hypothesis."[3] The evidence seems to be mounting now that there was a substantial movement of employment from the city center to the suburban fringe and that residential segregation inhibited the mobility response of low-income people, making it difficult for them to follow the jobs to the suburban fringe. In this process inequality increases. On top of these two processes which were interacting—that is, the demographic change and the shifting location of employment—we had, of course, the macro shocks and macro policies in response to them of the late 1970s and early 1980s. My views on this go back to some work that John Palmer and I started in the late 1960s regarding the unemployment-inflation trade-off.[4] That work has been continued by Joe Minarik, Alan Blinder, and Rebecca Blank.[5] We concluded that inflation did not hurt the poor, and if anything in post-World War II periods of fast-rising prices, the poor had done better simply because these were periods of tightening labor markets. Not only was unemployment lower, but also part-time workers moved to full-time work and skill differentials narrowed. Somewhat to my surprise, this relationship seems to have held up even during the late 1970s and early 1980s.

I think in our propensity for separating long-term growth from business cycles in our analysis, we tend to forget about or to diminish the importance of macroeconomic policy. I think that most of us, on reflection, agree that tight labor markets and macroeconomic policy fostering those tight labor markets are the most important governmental policies affecting the extent of poverty. And in this regard, of course, the big crash of 1981–82, brought on by tight monetary policy, plays a major role in the increasing inequality. Indeed, my view has been that Paul Volcker has been the villain of the Western World, not only from the point of view of the low-income population in the United States but of course from the perspective of all those Third World countries that suffered even more from the worldwide recession he brought on with tight monetary policy. One would like to see greater emphasis on the role of macro policies in such a way that rather than simply looking at the peak-to-peak long-term growth, one worries about how the peaks are reached and what difference that makes.

The final factor in this configuration of inequality-increasing factors is the growth in female-headed families. The broader cultural trends appear to have increased the number of households headed by women; delay in the age of marriage and increased divorce rates and lower rates of remarriage have appeared not only in the low-income population but all across the income distribution. However, one can see the first three factors I talked about—that is, demographic change, the shifting location of employment, and the macroeconomic policies—may have interacted to play a role in increasing and making more permanent the roles of women as household heads. Where there are fewer employed males, as William Julius Wilson reminds us, there is a greater likelihood of female heads, of divorce, and of lack of remarriage.[6] And when male unemployment is concentrated in the central cities, it may create a cultural situation in which households headed by women become more accepted both as a necessity and as a norm. And, of course, the macroeconomic policies, by generating the low employment prospects, both for the men and for the women who head families, contribute greatly to creating female-headed families and certainly to increasing inequality.

Issues for the future

Does it continue to be useful for us to analytically separate business cycles and economic growth for the purpose of poverty policy analysis? The division tends to lead us to lose sight of the central importance of macro policy, and it tends to make us neglect the possibilities of, say, an incomes policy as an alternative to inducing a large-scale recession as a way of dealing with upward pressure on the price level. But in any case, as analysts we need to address the question of how we can shape macro policies, which are necessary in response to exogenous shocks, in such a way that they will do less damage to the low-income population.

Second, as Lampman has reminded us, as the population configuration changes, institutions have to be reshaped and adjusted. And so, for example, with the continuing increase in the labor force participation of women, the whole issue of child care requires important analysis and shaping of institutions. Similarly, with respect to Social Security, the growing relative size of the elderly population has kept issues of the shape of the system in the political forefront, with rumblings of intergenerational conflict heard in the media. We have all noted that reduction in poverty among the elderly has been the signal, if not the single, accomplishment of social policy in the 1970s and 1980s. Of course the Social Security System should not be declared outside the bounds of reform, but my own view is that, whatever the changes, it is crucially important to keep the replacement ratio at its present high level, to not let poverty among the elderly rise again. In addition, we need to be looking at changes in labor markets and housing that will smooth the currently abrupt transitions from the prime working and family-raising years into the retirement years and thereby lessen the burden carried by the income maintenance system.

A third broad area of long-term interest is economic growth, international competitiveness, and the quality of the labor force. We hear increasingly about the mismatch between, on the one hand, technology and competitiveness (which sharply raise the literacy and numeracy requirements for employment) and, on the other hand, an increasing proportion of the population who suffer from inadequate education and training in the impacted central cities. Robert Solow concluded, based on his work in the 1960s on structural unemployment, that fear that automation was making large segments of the population "unemployable" was largely unfounded.[7] Today I am a bit skeptical about the conclusions once again emerging that technology is going to make a large portion of our labor force unemployable. I think these arguments and the data and methods of analysis they are based on require much more careful attention. This is not a Panglossian suggestion that nothing need be done, but a concern, based on past experience, that a headlong rush, in the name of a technological imperative, into wide-ranging "literacy testing" and broad educational reform in order to make our labor force more competitive can leave the poor screened out, unserved, labeled "unemployable." We need to be much clearer about changing employment conditions and what needs to and can be done to reshape institutions so that those at the low end of the income distribution won't fall even further behind. Surely such careful analysis would be in the tradition of Bob Lampman's great works.■

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1 "The Low Income Population and Economic Growth," Study Paper No. 12, Joint Economic Committee, Congress of the United States, December 16, 1959, p. 24.

2 *American Economic Review*, 76 (May 1986), 405–410. Also available as IRP Reprint no. 548.

3 See, for example, Keith R. Ihlanfeldt and David L. Sjoquist, "The Impact of Job Decentralization on the Economic Welfare of Central City Blacks," *Journal of Urban Economics*, 26 (1989), 110–130.

4 Robinson G. Hollister, Jr., and John L. Palmer, "The Impact of Inflation on the Poor," in *Redistribution to the Rich and the Poor*, ed. Kenneth Boulding and Martin Pfaff (Belmont, Calif.: Wadsworth, 1972).

5 Rebecca M. Blank and Alan S. Blinder, "Macroeconomics, Income Distribution, and Poverty," in *Fighting Poverty: What Works and What Doesn't*, ed. Sheldon H. Danziger and Daniel H. Weinberg (Cambridge: Harvard University Press, 1986).

6 *The Truly Disadvantaged: The Inner City, the Underclass, and Public Policy* (Chicago: University of Chicago Press, 1987), pp. 83–106.

7 See Solow's paper in this issue of *Focus*.