Chapter 1
Introduction: Issues and Scope of Book

1.1 RECENT TRENDS IN LIVING STANDARDS

In this section, the author presents his *own* views about the development of the U.S. economy over the last 50 years. Please note that other researchers may differ in their opinions about these recent developments in U.S. living standards. A number of new terms are also introduced here. These will be formally defined in the ensuing five chapters. However, this section may serve as a way of motivating readers to delve more deeply into the subject matter of this book.

1.1.1 Income and earnings stagnate while poverty remains unchanged

The early years of the twenty-first century have witnessed a struggling middle class despite robust growth in the overall U.S. economy. During the first part of the George W. Bush administration, from 2001 to 2005, the economy (GDP in real dollars) expanded by 14 percent despite a brief recession in 2001, and labor productivity (real GDP divided by full-time equivalent employees) grew at an annual pace of 2.2 percent. Both figures are close to their post-World War II highs for similar periods.

Despite the booming economy, the most common metric used to assess living standards, real median family income (the income of the average family, found in the middle of the distribution when families are ranked from lowest to highest in terms of income), actually *fell by 3 percent*.[1] From 1973 to 2005 its total percentage gain amounted to 6 percent. In contrast, between 1947 and 1973, median family income almost exactly doubled (see Figure 1.1).

Mean (or *average*) family income likewise doubled between 1947 and 1973 and then increased by 21 percent from 1973 to 2005. This is less than the increase over the preceding quarter-century but greater than the rise in median family income. The disparity between the two reflects rising inequality since the early 1970s (see below).

Another troubling problem is poverty. Between 1959 and 1973, there was great success in reducing poverty in the United States, with the overall poverty rate declining by more than half, from 22.4 to 11.1 percent (see Figure 1.2). After that, the poverty rate has stubbornly refused to go any lower. After 1973, it trended upward to 15.1 percent in 1993, then fell back to 11.3 percent in 2000, only slight above its low point, but then rose again to 12.6 percent in 2005.

Another indicator of the well-being of lower income families is the share of total income received by the bottom quintile group (20 percent) of families (see Figure 1.3). Their share rose from 5 percent in 1947 to 5.7 percent in 1974, its high point. Since then it fell off rather sharply to

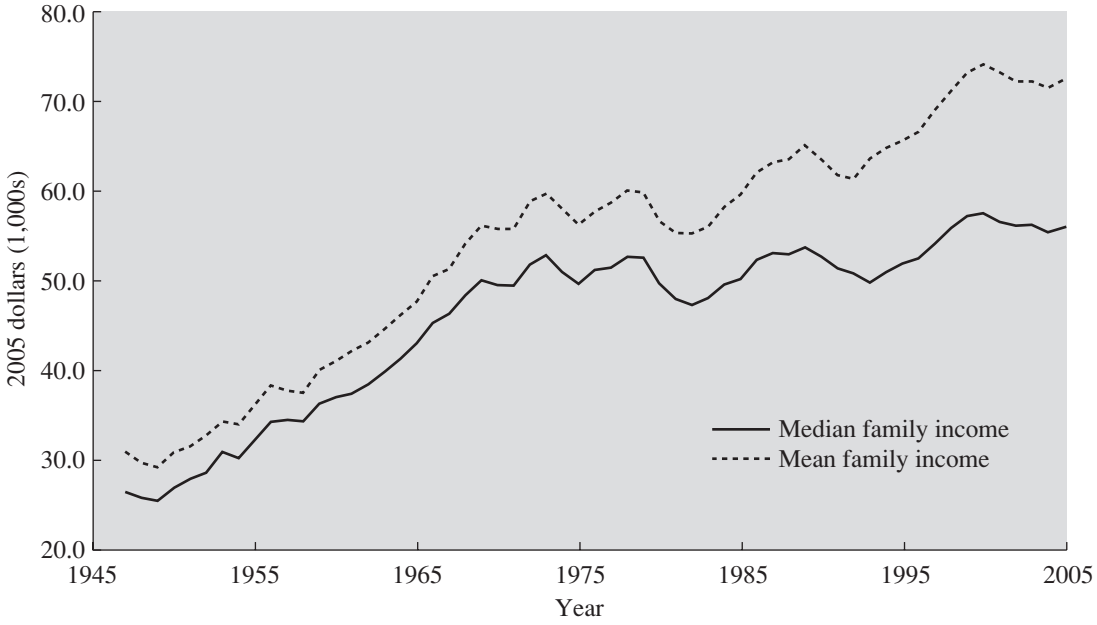

Figure 1.1 Median and average family income, 1947–2005 (2005 dollars, CPI-U adjusted)

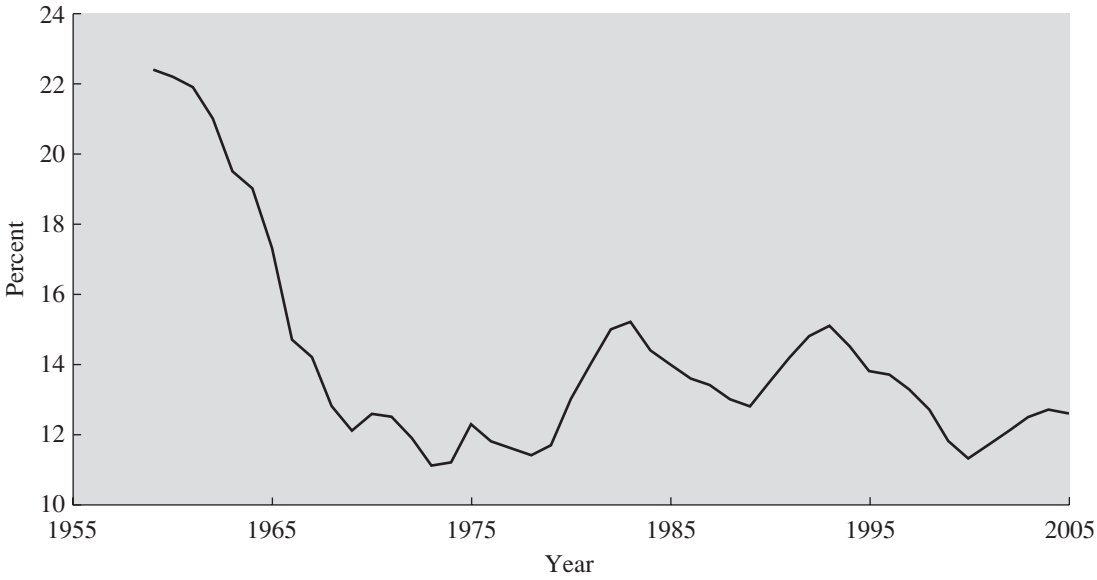

Figure 1.2 The official U.S. poverty rate, 1959–2005

4 percent in 2005. A related statistic is the mean income of the poorest 20 percent of families (in 2005 dollars), which shows the *absolute* level of well-being of this group (the share of income shows the *relative* level of well-being). Their average income more than doubled between 1947 and 1974 but then gained almost *nothing more* by 2005.

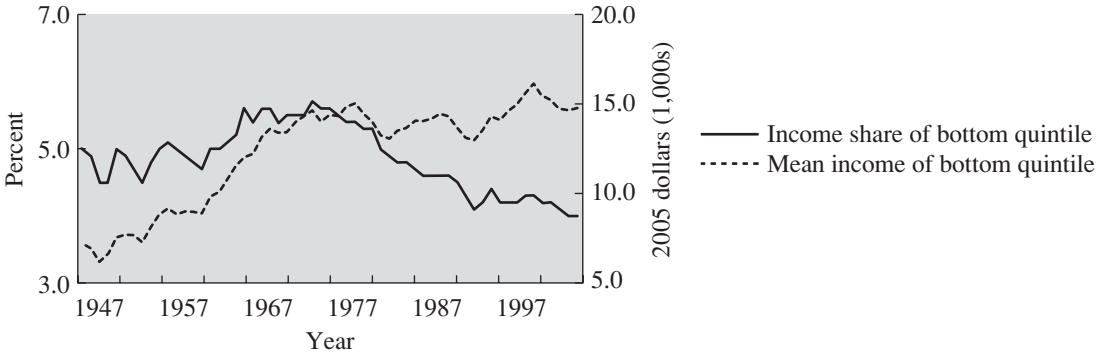

Figure 1.3 The share and mean income of the bottom quintile, 1947–2005

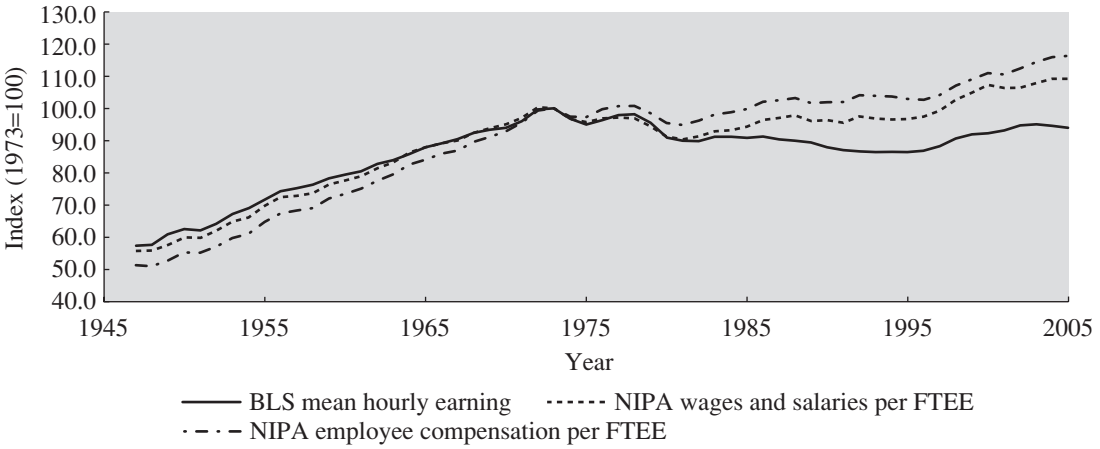

Figure 1.4 Labor earnings indices, 1947–2005 (1973=100)

The main reason for stagnating family incomes and recalcitrant poverty is the failure of wages to rise significantly. From 1973 and 2005 real wages were *down* by 6 percent (see Figure 1.4).[2] This contrasts with the preceding years, 1947 to 1973, when real wages grew by 75 percent. Indeed, in 2005, the hourly wage was $16.11 per hour, about the same level as in 1966 (in real terms).

Two other measures of worker pay are shown in Figure 1.4.[3] The results are fairly consistent among these alternative series. Average wages and salaries per full-time equivalent employee (FTEE) grew by 2.3 percent per year from 1947 to 1973 and then by only 0.3 percent per year from 1973 through 2005; and average employee compensation per FTEE increased by 2.6 percent per year during the first of these two periods and then by 0.5 percent per year in the second.

Despite falling real wages, living standards were maintained for a while by the growing labor force participation of wives, which increased from 41 percent in 1970 to 57 percent in 1988.[4] However, since 1989, married women entered the labor force more slowly and by 2005 their labor force participation rate had increased to only 61 percent, and with it occurred a slowdown in the growth of real living standards.

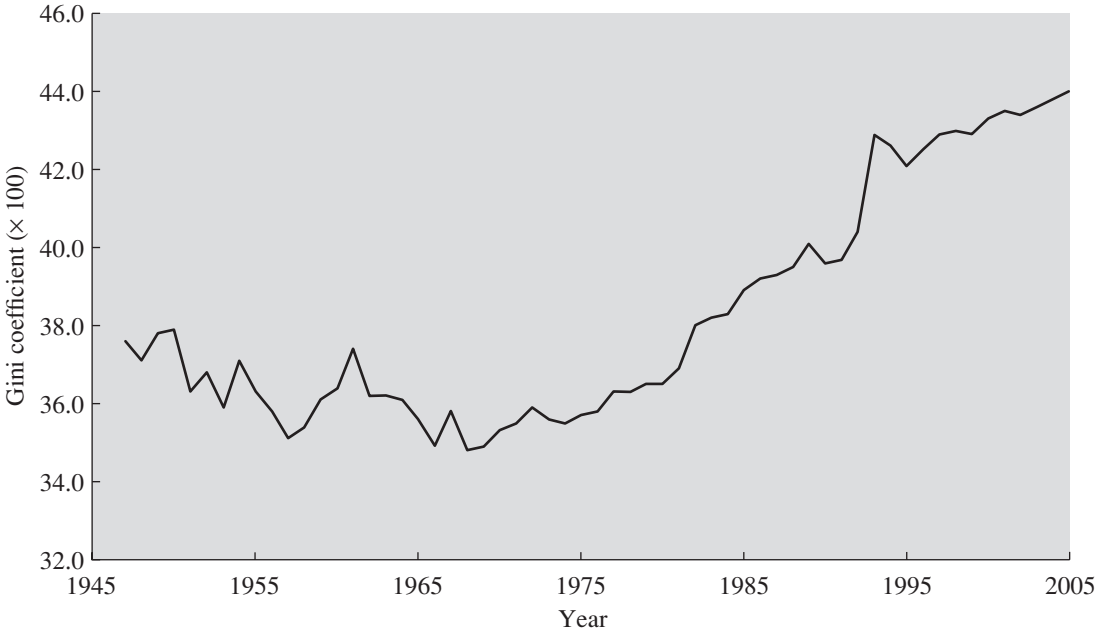

Figure 1.5 Income inequality trends, 1947–2005 (Gini coefficient × 100)

1.1.2 Inequality rises sharply

The United States has also experienced sharply rising inequality since the late 1960s. We will first look at the Gini coefficient for family income (see Figure 1.5). The Gini coefficient is the most widely used measure of inequality and ranges from a value of zero to one, with a low value indicating less inequality and a high value more. Between 1947 and 1968, the Gini coefficient generally trended downward, reaching its lowest value in 1968, at 0.348. Since then, it trended upward, reaching a value of 0.440 in 2005.[5] Historically, this represents an extremely large surge in income inequality.

A second index, the share of total income received by the top 5 percent of families, has a similar time trend. It first declined from 17.5 percent in 1947 to 14.8 percent in 1974 but then rose sharply to 21.1 percent in 2005, its highest value in the postwar period (see Figure 1.6).[6] A third index is the ratio of the average income of the richest 5 percent of families to that of the poorest 20 percent. It measures the spread in income between these two groups. This index generally dipped between 1947 and 1974, from 14.0 to 10.4, and then almost doubled to a value of 20.7 in 2005.

Figure 1.7 shows another cut on family income inequality, based on "equivalent income." Equivalent income is based on the official U.S. poverty line, which, in turn, adjusts family income for family size and composition (the number of individuals age 65 and over, the number of adults, and the number of children in the family unit). A figure of 3.0, for example, indicates that the income of a family is three times the poverty line that would apply to their family size and composition. The series begins in 1967 and ends in 2001.[7]

From the standpoint of inequality, the most telling result is that between 1973 and 2001, equivalent income grew faster the higher the income level. The differences are quite marked.

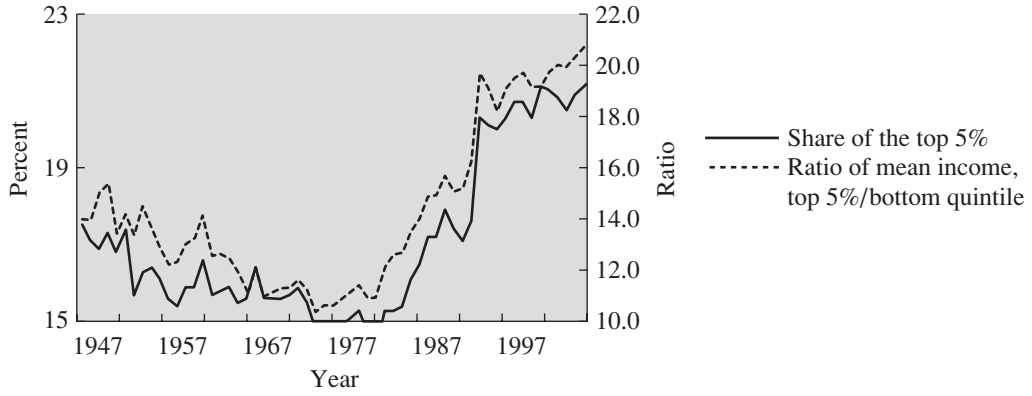

Figure 1.6 Income shares of the top 5 percent and bottom quintile, 1947–2005

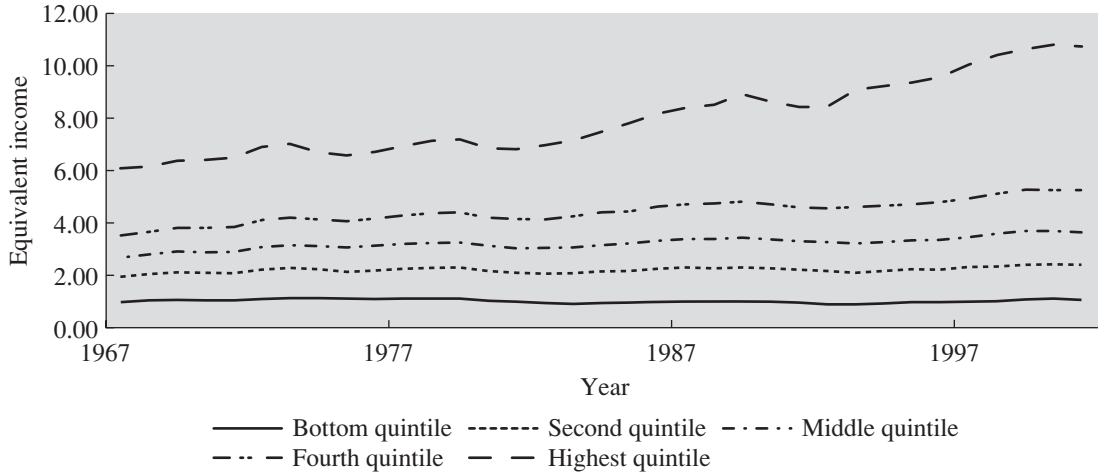

Figure 1.7 Trends in equivalent income by income quintile, 1967–2001

Equivalent income increased by 53 percent among families in the highest quintile, 25 percent in the fourth quintile, 16 percent in the middle quintile, 5 percent in the second quintile, and a *negative* 5 percent in the bottom quintile.

1.1.3 Middle-class debt explodes

Another dimension of well-being is household wealth. Wealth is a stock measure and indicates the value of assets owned by a household (such as housing and real estate, a business, bank accounts, money market funds, stocks, bonds) less outstanding debt (both mortgage and consumer debt). Wealth is an indicator of well-being independent of the direct financial income it provides. There are three reasons. First, owner-occupied housing provides services directly to their owner. Second, wealth is a source of consumption, independent of the direct money income it provides, because assets can be converted directly into cash and thus provide for immediate consumption needs. Third, the availability of financial assets can provide liquidity to a family in times of economic stress, such as occasioned by unemployment, sickness, or family break-up.

Median household wealth grew rapidly in real terms from 1983 to 2001, rising by 24 percent.[8] Much of this increase can be traced to the booming stock market of the late 1990s in the United States. However, from 2001 to 2004, it actually fell by 1 percent, despite the robust real estate market. Mean real wealth, on the other hand, skyrocketed by 65 percent from 1983 to 2001 and then rose by another 6 percent from 2001 to 2004. Here, too, the divergence in these two series indicates rising wealth inequality. Between 1983 and 2004, the Gini coefficient for household wealth climbed from 0.80 to 0.82 and the share of the richest 5 percent from 56 to 59 percent.

Nowhere is the middle-class squeeze more vividly demonstrated than in their rising debt. There are two ratios that are typically used. The first, the ratio of debt to net worth, jumped from 37 percent in 1983 to 62 percent in 2004. Middle-class households, experiencing slow growth in incomes, expanded their debt in order to maintain their consumer spending (see Chapter 5 for more discussion of household wealth).

1.1.4 What has happened to tax rates?

Trends in marginal tax rates of personal income tax are explained here, since these also affect the well-being of families (see Figure 1.8).[9] The first series is the top marginal tax rate (the marginal tax rate faced by tax filers with the highest income). Back in 1944, the top marginal tax rate was 94 percent! After the end of World War II, the top rate was reduced to 86.5 percent (in 1946). Even in 1960, it was still at 91 percent. This generally declined over time, as various tax legislations were implemented by Congress. It was first lowered to 70 percent in 1966, then to 50 percent in 1983 (Reagan's first major tax act), and then again to 28 percent in 1986 (the Tax Reform Act of 1986). After that, it trended upward to 31 percent in 1991 (under the first President Bush) and then to 39.6 percent in 1993 (under President Clinton), but by 2005 it was down to 35 percent (under President George W. Bush).

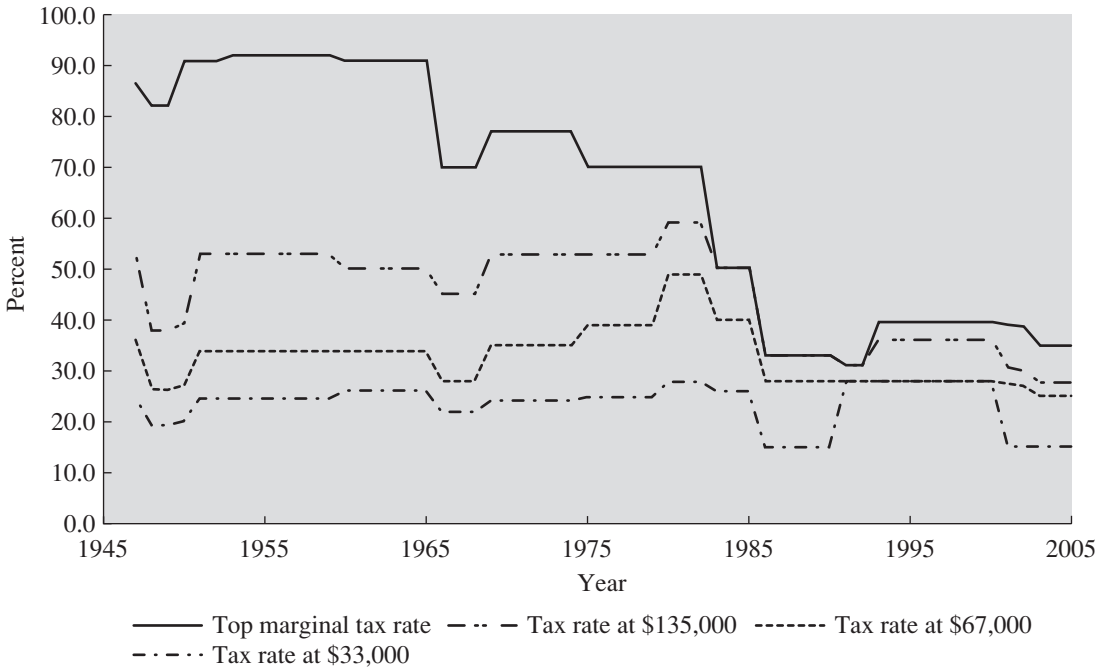

Figure 1.8 Marginal tax rates, selected income levels, 1946–2005 (1995 dollars)

The second series shows the marginal tax rate faced by filers with an income of $135,000 in 1995 dollars. This income level typically includes families at the ninety-fifth percentile (the top 5 percent). This series generally has the same trajectory as the top marginal tax rate. The last two series show the marginal tax rates at $67,000 and $33,000, respectively, both in 1995 dollars. The time patterns are quite a bit different for these than the first two. The marginal tax rate at $67,000 (about the sixtieth percentile) was relatively low in 1946, at 36 percent, generally trended upward, reaching 49 percent in 1980 and then declined to 25 percent by 2005. The marginal tax rate at $33,000 (about the thirtieth percentile) was also relatively low in 1946, at 25 percent, but it actually increased somewhat over time, reaching 28 percent in 1991, and then dropped to 15 percent from 2001 onward.

All in all, tax cuts over the postwar period have generally been more generous for high income taxpayers, particularly those at the top of the income distribution. From 1946 to 2005, the top marginal tax rate fell by 60 percent, the marginal rate at $135,000 by 47 percent, the marginal rate at $67,000 by 31 percent, and the rate at $33,000 by 39 percent.

1.1.5 Rising profits is the key

Where did the increased output go after the early 1970s if median income grew so slowly? To understand this, we must consider the relation between productivity and earnings. In particular, the historical connection between labor productivity growth and real wage growth appears to have broken down after 1973.

From 1947 to 1973, average real worker compensation (a broader concept than wages, including social insurance and fringe benefits) grew almost in tandem with the overall labor productivity growth (see Figure 1.9).[10] While the latter averaged 2.4 percent per year, the former ran at 2.6 percent per year. Labor productivity growth plummeted after 1973. The period from 1973 to 1979, in particular, witnessed the slowest growth in labor productivity during the postwar period, 0.5 percent per year, and the growth in real employee compensation per worker actually turned negative during this time. From 1979 to 2005, the U.S. economy experienced a modest reversal

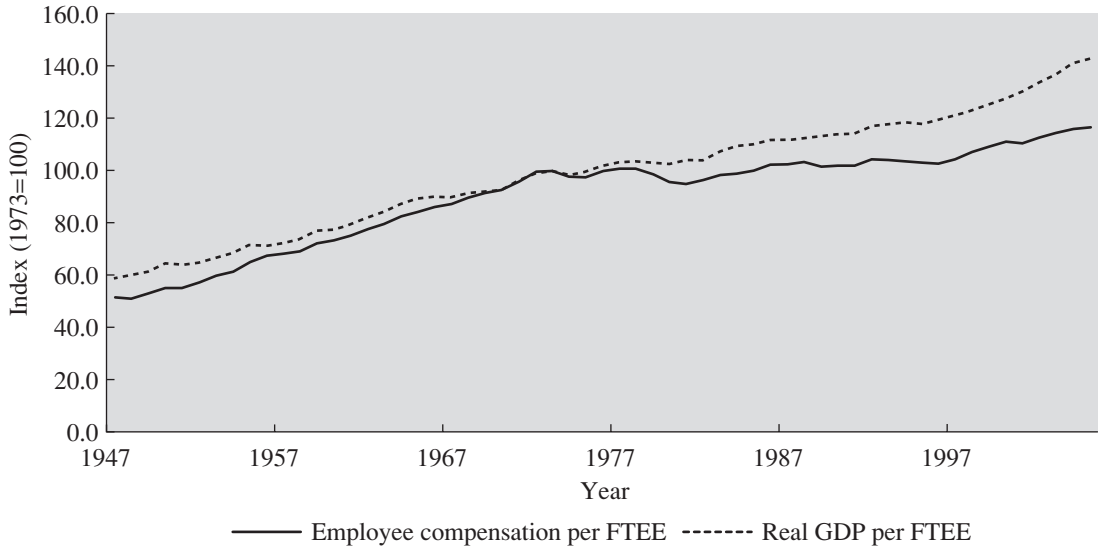

Figure 1.9 Real labor earnings and labor productivity, 1947–2005 (1973=100)

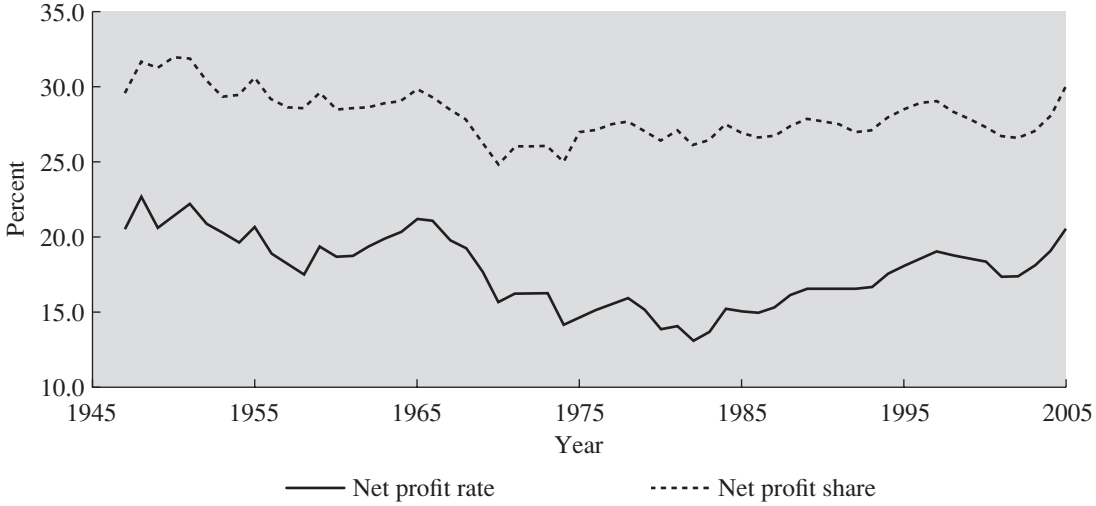

Figure 1.10 Trends in the net rate of profit and the net profit share, 1947–2005

in labor productivity growth, which averaged 1.3 percent per year, while the growth in real employee compensation per worker (full-time equivalent employee) ran at 0.6 percent per year.

If productivity rose faster than earnings after 1973, where did the excess go? The answer is increased profitability in the United States. The basic data are from the National Income and Product Accounts of the U.S. Bureau of Economic Analysis (BEA). For the definition of net profits, I use the BEA's definition of total gross property-type income, including corporate profits, interest, rent, and half of proprietors' income.[11] The net rate of profit is defined as the ratio of total net property income to total private net fixed capital. The net profit rate declined by 7.5 percentage points between 1947 and its low point in 1982 (see Figure 1.10). The trend then reversed itself and the net profit rate climbed by 7.4 percentage points from 1982 to 2005. By 2005, the net profit rate was almost back to its postwar high of 23 percent in 1948.

Figure 1.10 also shows trends in the net profit share in national income, which is defined as the ratio of total net property income to net national income. The net profit share fell by 4.8 percentage points between 1947 and its low point in 1970 (see Figure 1.10). The trend then reversed and the net profit share rose by 5.3 percentage points from 1970 to 2005. By 2005, the profit share was pretty close to its postwar high. The results show that the stagnation of labor earnings in the United States since the early 1970s translated into rising profits in the economy.

1.1.6 Yet schooling has continued to rise

One of the great success stories of the postwar era is the tremendous growth in schooling attainment in the U.S. population. This is documented in Figure 1.11.[12] Median years of schooling among all people 25 years and over grew from 9.0 years in 1947 to 13.7 in 2005, with most of the gain occurred before 1973.

Trends are even more dramatic for the percentage of adults (age 25 and over) who completed high school and college (see Figure 1.12). The former grew from 33 percent of all adults in 1947 to 86 percent in 2005. Progress in high school completion rates was as strong after 1973 as before. The percent of college graduates in the adult population soared from 5.4 percent in 1947 to 28.3 percent in 2005. In this dimension, progress was actually greater after 1973 than before.

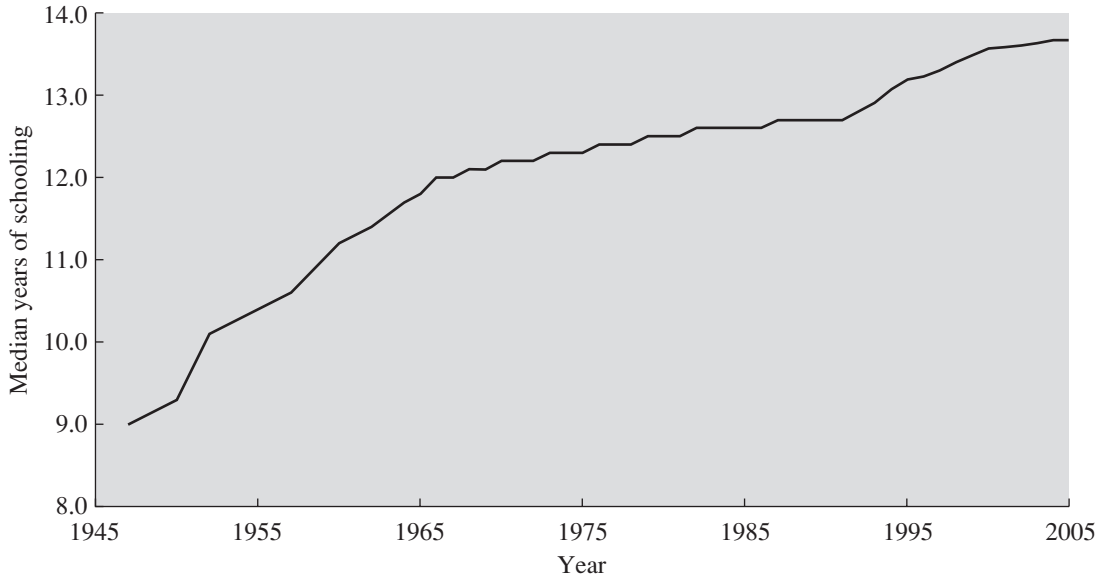

Figure 1.11 Median years of schooling completed by people 25 years and over, 1947–2005

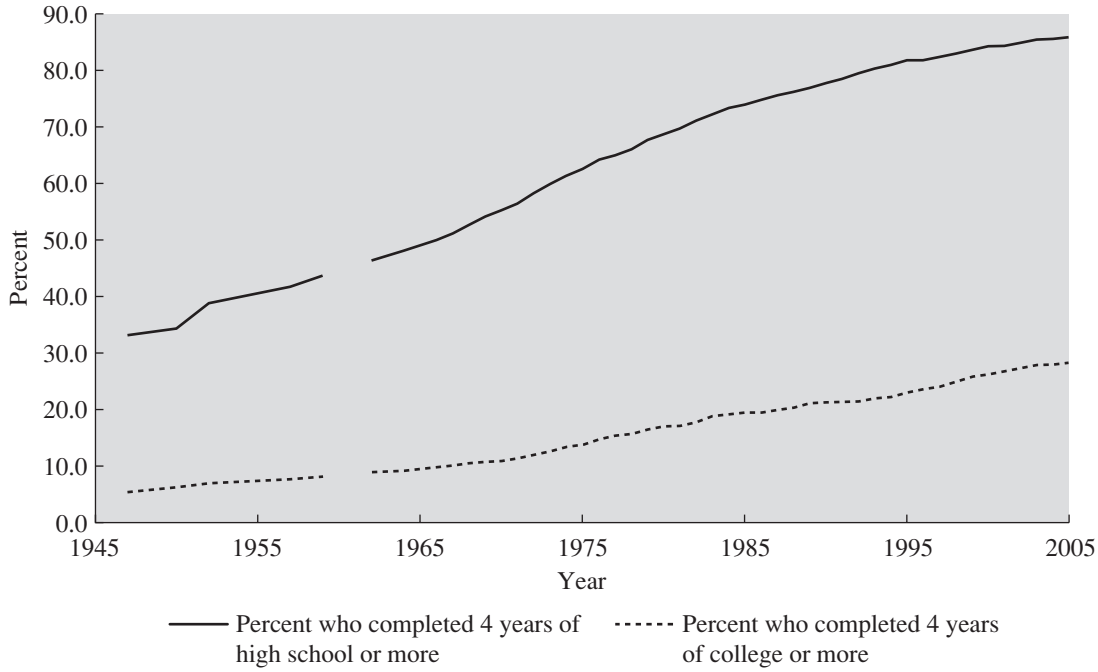

Figure 1.12 Percent of people 25 years and over with a high school and college degree, 1947–2005

Figure 1.13 Ratio of mean annual earnings between college graduates and high school graduates by gender, 1975–2005 (includes all workers 18 years and over with earnings)

However, as noted in Section 1.1.1, real hourly wages grew strongly between 1947 and 1973 and then actually *declined* from 1973 to 2005. Yet, educational attainment continued to rise after 1973 and, indeed, in terms of college graduation rates even accelerated. The growing discordance between wages and schooling constitutes a real paradox from the vantage point of standard economic (human capital) theory, which posits a direct and positive association between schooling attainment and wages (see Chapter 8 for a formal treatment of human capital).

Rising inequality of family income stems in large measure from changes in the structure of the labor market. One indication of the dramatic changes taking place in the labor market is the sharp rise in the returns to education, particularly a college degree, which occurred during and after the 1980s. This trend is documented in Figure 1.13.[13] Among males, the ratio in annual earnings between a college graduate and a high school graduate surged from 1.50 in 1975 to 1.92 by 2005. For females, the ratio also climbed sharply, from 1.45 in 1975 to 1.79 in 2005.

Among men, the increase in the return to a college degree relative to a high school degree was due, in part, to the stagnating earnings of high school graduates (see Figure 1.14). Between 1975 and 2005, their annual earnings in constant dollars gained less than 4 percent, while the earnings of men with a bachelor's degree (but not further schooling) increased by 22 percent. The biggest increase in earnings occurred among males with an advanced degree (master's or higher), who saw their annual incomes grow by 32 percent. Among males who did not graduate high school, earnings plummeted by *11 percent*.

Another indicator of the country's success in education is the dramatic decline in the inequality of schooling in the United States. According to the human capital model, there is a direct and proportional relationship between earnings inequality and the variance of schooling (see Chapter 8). If the dispersion of schooling declines, so should earnings inequality.

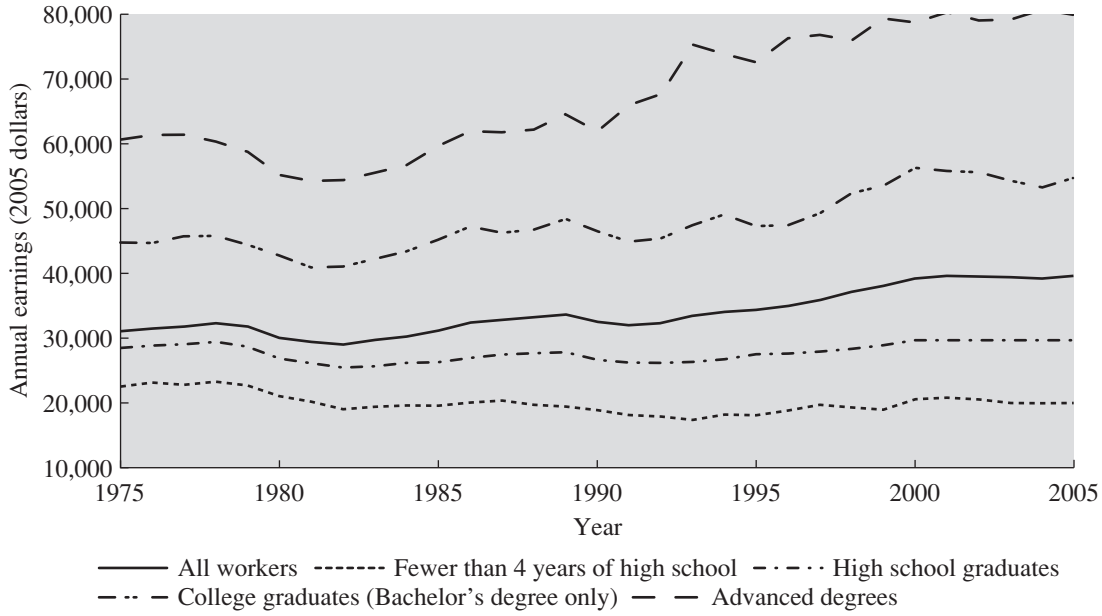

Figure 1.14 Mean annual earnings by educational attainment level, 1975–2005 (2005 dollars)

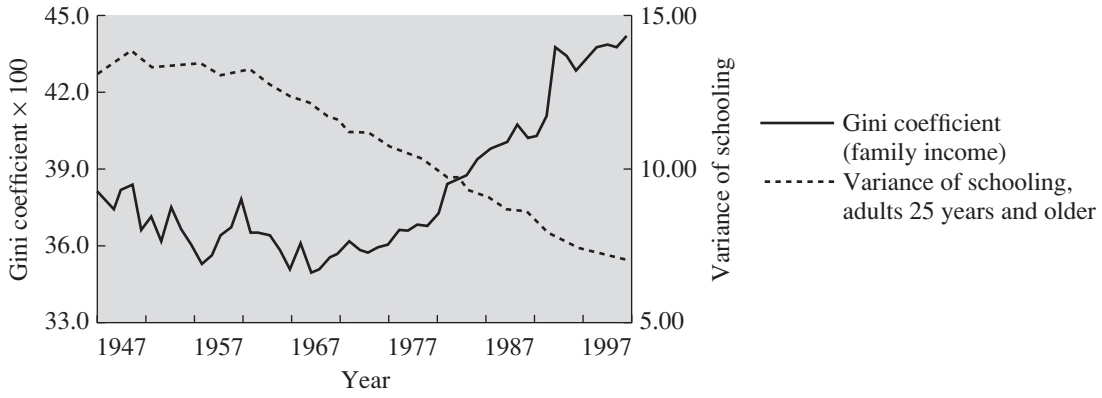

Figure 1.15 Family income inequality and the variance of schooling, 1947–2000

Yet, as shown in Figure 1.15, while income inequality has risen since the late 1960s, the variance of schooling of adults 25 years and older (computed from CPS data) trended sharply downward since 1950. In fact, the variance of schooling fell by almost half from 1950 to 2000 (from 12.5 to 6.9).[14] The simple correlation between the two series is, in fact, *negative*, −0.78. This finding leads to another paradox – namely, the growing discord between the inequality of income and the inequality of human capital.

1.1.7 Some conclusions

The last quarter of the twentieth century and the first few years of the twenty-first century saw slow growing earnings and income among the middle class in the United States. In addition, the

poverty rate failed to decline further and income inequality climbed substantially. In contrast, the early postwar period witnessed rapid gains in wages and family income for the middle class, in addition to a sharp decline in poverty, and a moderate fall in inequality. The "booming 1990s and early 2000s" did not bring much relief to the middle class, with median family income growing by only 4 percent between 1989 and 2005. Personal tax rates generally fell over the postwar period but more for the rich than the middle class. In sum, the U.S. middle class has not prospered very much since the early 1970s.

The stagnation of living standards among the middle class over the years from the mid-1970s to the mid-2000s is attributable to the slow growth in labor earnings over this period. While average earnings (employee compensation per FTEE) almost doubled between 1947 and 1973, it gained only 16 percent from 1973 to 2005. This happened despite substantial progress in educational attainment. Moreover, in spite of notable success in reducing educational disparities within the U.S. population, the inequality of income not only failed to decline but actually rose sharply since the early 1970s. These results suggest a growing disconnect between earnings and schooling.

The main reason for the stagnation of labor earnings appears to derive from a shift of national income away from labor and towards capital, particularly since the early 1980s. Over this period, overall profitability rose substantially, almost back to postwar highs. While business gained from rising profits, workers did not experience much progress in terms of earnings.

1.2 CAUSES OF RISING INEQUALITY

The turnaround in inequality during the 1980s, 1990s, and early 2000s is particularly puzzling in light of the strong economic growth during the Reagan, George Bush, Clinton, and George W. Bush years. Normally, income inequality lessens during periods of prosperity and rises during economic downturns. Except for the 1981–1982, 1991–1992, and 2002 recessions, these two and a half decades were ones of general prosperity, with stable economic growth. Moreover, the U.S. economy also experienced a reversal in productivity growth over recent decades. The period from 1973–1979 witnessed the slowest growth in labor productivity during the postwar period. However, productivity growth recovered to about 2 percent per year from 1980 to 2005, which is quite close to its twentieth-century average.

Another anomaly is the pattern of real wage growth. Historically, the average real wage moved in line with average labor productivity. As we saw in Section 1.1.1, real wages remained virtually unchanged during the years from 1973 to 2005. This is understandable during the 1973–1979 period, when productivity was almost at a standstill, but not during the ensuing years, when productivity growth picked up.

The recent rise of inequality in light of sustained economic growth in the United States has spawned a considerable amount of literature. Why is inequality rising in this country? Is it also rising in other countries, and, if so, to the same degree? Much of the rest of this book will return to these issues when we look at the various factors that affect income inequality. It is, perhaps, useful at this point to mention the major factors that have been considered in these studies.

1.2.1 Skill-biased technology change

Perhaps the leading argument is that the period from 1980 to 2005 witnessed a major technological revolution led by widespread computerization and the consequent penetration of information technology into the whole economy. This change has skewed the income distribution by placing a high premium on college-educated and skilled labor while reducing the demand for semi-skilled and unskilled workers. One important piece of evidence is that the rate of return to a

college education (the wage premium paid to a college graduate relative to a high school graduate) approximately doubled over the decades of the 1980s and 1990s (see above and Chapter 8).

1.2.2 The shift to services

One of the notable changes in the composition of the labor force during the postwar period is the shift of jobs from goods-producing industries to services. The share of employment in services grew from 43 percent in 1950 to 74 percent in 2003. All of the employment growth during the 1980s and 1990s occurred in the service sector. Some have argued that the dispersion of earnings is greater in services than goods-producing industries because of the greater mix of professional and managerial jobs with relatively low-skilled clerical and manual work (see Chapters 7 and 9).

1.2.3 Declining unionization

The proportion of the work force represented by unions peaked in 1954, at 25.4 percent, and at 34.7 percent as a fraction of the nonfarm labor force. After 1954, the trend was downward, and by 2006, only 12 percent were union members. Part of the reason for the decline in union representation is the de-industrialization that has occurred over the last couple of decades, because manufacturing industries in particular have had high unionization rates. Unions have historically negotiated collective bargaining agreements with narrow wage differentials between different types of jobs. This is one reason why the dispersion of earnings in manufacturing has tended to be lower than that of service industries. As a result, the decline in unions has led to widening differentials in the overall wage structure (see Chapter 9).

1.2.4 Globalization

The increasing trade liberalization of the 1970s, 1980s, and 1990s has been cited as another factor. Imports into the U.S. economy have grown from 5.5 percent of GDP in 1970 to 14 percent in 2003, while the share of exports grew from 5.5 to 9.5 percent. According to standard trade theory, as trade increases, there is a growing tendency of factor prices – particularly, wages – to equalize across countries. This can take the form of rising wages among our trading partners as well as declining wages in our own labor force. As imports of manufactured products produced in low-income countries such as Indonesia, China, Thailand, Mexico, and Brazil increases, downward pressure is placed on the wages of unskilled and semi-skilled workers in U.S. manufacturing industries. This process explains both the falling average real wage of U.S. workers (see above) as well as the increasing gap between blue-collar workers and professionals who work in industries such as law, medicine, education, and business services that are well shielded from imports (also see Chapter 9).

A related aspect of globalization is increasing immigration into the United States. The share of foreign-born workers in the U.S. labor force grew from 11 percent in 1996 to 15 percent in 2006.[15] Insofar as foreign-born workers tend to be, on average, less skilled and less educated than native-born workers, immigration has increased the *relative* supply of low-skilled workers and therefore has helped to increase the wage gap between high-skill and low-skill employees in the United States (see Chapter 11 for more discussion).

1.2.5 Downsizing and outsourcing

Another suspect is the corporate restructuring that has taken place during the 1980s and 1990s. This process has taken two forms. First, permanent employees have gradually been replaced by part-time, temporary, and "leased" employees. Second, a number of important corporate functions

such as maintenance, cafeteria services, legal services, and data processing that were traditionally performed by in-house employees have been outsourced (substituted for) by purchasing these operations from other companies. Both processes have reduced the relative number of permanent employees in large corporations. Corporate employees have traditionally enjoyed high wages, high benefits, job security, career-ladder type jobs, and good working conditions. This set of job characteristics is referred to as an internal or primary labor market. In contrast, wages tend to be low in secondary jobs found in part-time employment and small businesses. The shift of employment out of the primary labor force to the secondary labor market may have been another factor accounting for rising income inequality (see Chapter 9).

1.2.6 Public policy changes

The social safety net that has provided some degree of income maintenance to the low income population has gradually frayed during the 1980s, 1990s, and early 2000s. Welfare benefits have been falling in real terms (the average benefit in 1993 was down by 45 percent from 1970, before the change in the welfare system), and the percent of unemployed workers who receive unemployment compensation has also declined. Moreover, the minimum wage fell by 43 percent in real terms between its peak in 1968 and 2005. This has helped put downward pressure on the wages of unskilled workers and may account, in part, for the growing wage disparities between the unskilled and skilled workers and the decline in the average real wage since 1973 (see Chapter 15).

In contrast, changes in the tax code over the last two decades appear to have generally favored the rich over the middle class and the poor. As we saw in Section 1.1.4, the Tax Act of 1981 and the Tax Reform Act of 1986 lowered the tax rate paid by the rich (the top marginal tax rate) from 70 percent in 1980 to 28 percent in 1986, though it since rose to 39.6 percent in 1993 and then fell again to 35 percent in 2005. The biggest increase in taxes has been from the social security tax, which primarily affects middle-class tax payers. However, some changes in the tax code have hurt the rich, including a tightening of tax loopholes, and some changes have benefited the poor, particularly the introduction of the Earned Income Tax Credit. Overall, however, it appears that the redistributional effects of the tax system – that is, the degree to which the rich are taxed more heavily than the poor – have lessened since the beginning of the 1980s. We shall analyze these changes more closely in Chapter 16.

1.3 GENERAL DESCRIPTION OF THE TEXTBOOK

Is the standard of living still rising in the United States? Is inequality increasing or declining? Has poverty in this country attenuated or is it growing? What groups have fared well and what groups have done poorly? Is race and gender discrimination still a problem today? How unequal a country are we in comparison to other industrialized countries? Should we be concerned about inequality and poverty in our country? What factors are responsible for inequality? What role has public policy played? What is happening to the status and well-being of U.S. citizens relative to citizens in other countries? How are people in developing countries faring in the international race to achieve economic growth? What factors cause poverty to persist and what policies are successful in breaking the cycle of persistent poverty? How are racial and gender wealth gaps perpetuated and what forces have been responsible for altering the economic success or failure of women and African Americans? These and related questions will provide the general focus of the textbook.

This is organized into four parts. Part I treats the definition and measurement of income, wealth, inequality, poverty, and mobility and presents a statistical portrait of each. Part II investigates

some of the factors responsible for poverty and inequality. These include the role of labor force participation and labor markets in explaining differences in earnings among individuals as well as savings and bequest behavior. Part III explores the role of race and gender discrimination in accounting for differences in income and poverty rates. Part IV considers the effect of public policy in both reducing inequality and alleviating poverty. Here, it should be noted that discussion of public policy is not confined to Part IV but occurs throughout the textbook, particularly in Chapters 13 and 14 on discrimination.

Chapter 1 introduced the subject of inequality and poverty by presenting an overview of recent trends in living standards, inequality, and poverty in the United States. It also includes the plan of the textbook. Chapter 2 discusses how income and, more generally, the standard of living, are measured. Basic concepts of national income accounting are discussed, as well as the measurement of personal income and alternative measures of personal well-being. The definition of factor shares and the role of household production are also highlighted. Historical trends for the United States are discussed. International comparisons of per capita income, as well as the United Nations' Human Development Index, are also presented. The last part investigates various explanations of the distribution of income between factors (the wage and profit share).

Chapter 3 develops basic measures of income inequality, and presents a statistical overview. Standard measures of inequality are developed, including the coefficient of variation, the Gini coefficient, the Theil entropy index, and the Atkinson index (the latter two for advanced students). Particular attention is accorded to the rise in U.S. income inequality in more recent years. International comparisons are also included, which indicate that the United States is the highest in terms of income concentration in the industrialized world. The Kuznets curve and the world distribution of income are also discussed.

Chapter 4 presents a broad overview of issues in poverty. Three basic concepts of poverty are developed – absolute, relative, and subjective poverty lines. More recent issues in the measurement of poverty are canvassed, such as including noncash government benefits in the definition of family income and the use of consumption expenditure data to measure poverty incidence. Trends in poverty rates are discussed, which show declining poverty from 1960 to the early 1970s and a cyclical movement after that. The poverty data also show a much higher incidence of poverty among minorities than among white Americans. Particular attention is also played to the changing composition of the poor in the United States, such as the "feminization of poverty", its rising incidence among children, and the development of an "underclass." International comparisons are also presented, which generally indicate a much higher incidence of poverty in the United States than other industrialized countries.

Another major factor in accounting for differences in family well-being is household wealth. Chapter 5 first introduces the concept of household wealth. Important methodological issues are then discussed, including the definition of wealth, the role of retirement income, and the availability of data sources. The next section presents evidence on long-term time trends in household wealth concentration in the United States and several European countries. More recent trends in U.S. wealth inequality are emphasized. The composition of household wealth is considered next, including trends in homeownership rates. Several economists have proposed composite measures of income and wealth as a better indicator of well-being than income alone, and several alternative measures are presented.

An important dimension of well-being that is often overlooked is mobility. In Chapter 6, two types of mobility are discussed. The first, lifetime mobility, concerns the degree to which an individual's (or family's) relative position in the income distribution changes over time. This may serve as an important offset to rising income inequality if lifetime mobility has risen as well. The second, intergenerational mobility, concerns the degree to which an individual's

relative rank in the income distribution is correlated with that of his (or her) parents'. Intergenerational mobility reflects the fluidity (or lack thereof) of the class structure of a society. Statistics on mobility in income, earnings, and wealth will be presented. Evidence will also be presented on changes over time in both lifetime and intergenerational mobility in the United States as well as comparisons with other advanced countries.

Part II canvasses alternative explanations for both the existence of and change over time in both inequality and poverty. The first group of chapters looks at the role of the labor market as a source of income differences among individuals. Chapter 7 introduces concepts of the labor force, employment, and unemployment. It discusses trends in labor force participation patterns (who works and who does not), the composition of employment (the decline of manufacturing and the shift to services), and unemployment patterns (particularly by demographic characteristic). This chapter also discusses causes of unemployment, including frictional unemployment, structural unemployment, and demand-deficient unemployment.

Chapter 8 introduces the human capital model, with its emphasis on the role of both schooling and on-the-job training in the determination of relative earnings. It then summarizes empirical work in the human capital tradition, which shows that schooling and experience play a major role in the determination of relative earnings. The value of a college education is highlighted. The recent rise in the returns to education, experience, and skills are also given emphasis, as well as explanations for this occurrence. The next section treats the role of ability as a factor in determining wages and salaries and summarizes empirical work on the effect of ability on earnings. Other interpretations of the schooling–earnings relation are also considered, including job screening, the role of family background and schooling as a socializing mechanism. The contribution of human capital variables to overall earnings inequality is analyzed at the end of the chapter.

Chapter 9 surveys institutional factors accounting for differentials in labor earnings. The role of unions is discussed. After a brief history of the trade union movement in the United States and trends in union membership, the chapter considers the economic role of unions. The first section of the chapter concludes with an analysis of whether unions have been effective in raising their members' earnings. The second part looks at the role of both internal labor markets and segmented labor markets in explaining earnings differences. Are there rigidities in wage structures within organizations (internal labor markets)? Are there really well-defined segments in the labor market? Do these barriers help explain the persistence of earnings differences between certain groups?

The third section of Chapter 9 looks at structural explanations for inequality in earnings. It first considers the role of industrial mix in earnings inequality and then analyzes industry differences in wages and salaries. Do some industries pay more than others and why (efficiency wage theory)? It also looks at occupational wage differences – particularly, their increasing spread in recent years.

The accumulation of household wealth depends not only on income but also on savings behavior, capital appreciation, and gifts and inheritances. Moreover, wealth is the direct source of property income, which is an important factor in accounting for disparities in family income. Chapter 10 considers some of the factors accounting for differences in wealth among families. The first of these is the role of age. Since individuals work only part of their life, they have a strong incentive to accumulate wealth for their retirement years. The standard model of this is the lifecycle model, which is extensively discussed. Other factors, such as gifts and inheritances and capital appreciation, also play a role in wealth accumulation, and these too are treated in Chapter 10.

As noted above, the last 30 years in the United States have been characterized by a sharp increase in income inequality, and particularly inequality in labor earnings. Chapter 11 (optional)

surveys the various explanations that have been put forward to explain the rise in earnings inequality. These include: (i) skill-biased technological change, favoring highly educated over less educated workers; (ii) growing international trade, which has caused the relative wages of low-skilled workers to fall; (iii) the shift of employment to services, which are characterized by a greater dispersion of earnings than goods producers; (iv) declining unionization, which has widened wage differentials between different types of jobs within an industry; (v) a declining minimum wage in real terms, which has put downward pressure on the wages of low-skilled jobs; (vi) corporate restructuring and downsizing in the 1980s and 1990s that may have widened earnings differentials within firms; and (vii) the role of education and ability.

Another major factor that explains differences in earnings and income between groups in our society is discrimination. This topic is covered in Part III. Chapter 12 discusses what discrimination means and how it is measured. Alternative models of discrimination are presented: taste for discrimination; statistical discrimination; the stereotype model; the Marxian model; and the overcrowding model of occupational segregation.

Chapter 13 considers evidence on trends in racial discrimination. Have blacks and Hispanics gained on (non-Hispanic) whites in terms of wages, employment patterns, education, family income and wealth, and poverty incidence over the postwar period? It considers the principal factors in explaining changes in the economic status of black families, including migration from the South, gains in education, and changes in black family structure. The role and effectiveness of anti-discrimination government programs are also treated.

Chapter 14 considers gender discrimination. Has the female/male wage gap declined since the end of World War II, and have women made gains in penetrating traditionally male occupations? This chapter discusses the major factors in explaining changes in the gender wage gap, including the sharp rise in female labor force participation rates, human capital differences, and occupational segregation. It also investigates the effectiveness of anti-discrimination programs, with particular attention paid to issues of comparable worth.

Have government programs made a difference on inequality and poverty in the United States? Part IV considers the role of public policy on poverty and income inequality. Chapter 15 focuses on the low-income population. It begins with a brief history of the social welfare system and the development of income maintenance programs in the United States. It then considers, in succession, how the unemployment insurance program, the social security system, and the welfare system function. The chapter also discusses manpower programs, the minimum wage statute, and housing programs. It ends with an overall assessment of whether these programs have been effective in reducing poverty in the United States.

Chapter 16 begins by raising the issue of why social equity may be an important social concern. It then looks at the redistributional effects of government tax and expenditure policy. Is the tax system progressive, regressive, or neutral? What are the relative magnitudes of the different government transfer programs and have they made a significant dent on inequality? What groups benefit from government expenditures and what are the distributional consequences of them? The chapter also discusses the negative income tax and the earned income tax credit and presents statistics on the extent of taxation in the United States in comparison with other advanced economies.

NOTES

1 *Source*: U.S. Census Bureau, *Detailed historical income and poverty tables from the March Current Population Survey 1947–2005*, available at http://www.census.gov/hhes/www/income/histinc/histinctb.html. Figures are in 2005 dollars unless otherwise indicated. The standard consumer price index – the CPI-U – which the U.S. Bureau of Labor Statistics (BLS) has been computing since 1947

is used to convert to 2005 dollars since this is the standard consumer price index used by the U.S. Census Bureau for the period from 1947 to the present.

Another deflator that is sometimes used is the personal consumption expenditure (PCE) deflator from the National Income and Product Accounts (NIPA). This deflator is based on price changes using product weights derived from household consumption in the NIPA. This deflator generally shows a smaller rise in consumer prices over time than the CPI-U. However, I follow here the convention of the U.S. Census Bureau and use the CPI instead of the PCE deflator.

2 These figures are based on the BLS hourly wage series for production and nonsupervisory workers in private, nonagricultural industries. *Source*: U.S. Council of Economic Advisers, *Economic Report of the President, 2007*. This is the most widely used wage series. The BLS converts nominal wage figures to constant dollars on the basis of the consumer price index (CPI-U).

3 These two are the NIPA wages and salaries per full-time equivalent employee (FTEE) and employee compensation (the sum of wages and salaries and employee benefits) per FTEE. Both series are deflated to constant dollars using the CPI-U price index. *Source*: http://www.bea.gov/national/index.htm.

4 *Source*: U.S. Census Bureau, *Statistical Abstract, 2007*.

5 *Source*: U.S. Census Bureau, *Detailed historical income and poverty tables from the March Current Population Survey 1947–2005* (see note 1). These figures are based on unadjusted data.

6 I use the term "postwar" to refer to the time period after World War II (1946 and after).

7 *Source*: U.S. Census Bureau, *Detailed historical income and poverty tables from the March Current Population Survey 1947–2005* (see note 1). The average income-to-poverty ratios are computed by dividing the mean income of families in each quintile (as ranked by family income) by the mean poverty threshold of the families in that quintile.

8 *Source*: Federal Reserve Board's *Survey of Consumer Finances*, which is done every three years starting in 1983 to 2004 (the last year currently available).

9 The marginal tax rate is the additional amount of taxes paid on an additional dollar of income. Rates quoted here are for married couples, filing jointly. *Source*: http://www.irs.gov/.

10 Results are shown for employee compensation per FTEE. *Source*: U.S. Bureau of Economic Analysis, National Income and Product Accounts, http://www.bea.gov/bea/dn/nipaweb/SelectTable.asp.

11 The definition excludes the capital consumption allowance (CCA) – that is, depreciation of the fixed capital stock.

12 *Source*: U.S. Census Bureau, *Detailed historical income and poverty tables from the March Current Population Survey 1947–2005* (see note 1). Adults refer to persons 25 years and over in the noninstitutional population (excluding members of the Armed Forces living in barracks).

13 The figures are for annual earnings, which are not adjusted for hours worked or the experience level of the workers. *Source*: U.S. Census Bureau, *Detailed historical income and poverty tables from the March Current Population Survey 1947–2005* (see note 1) for the data in Figure 1.13, as well as the next three figures.

14 Because of a change in the educational attainment categories used by the U.S. Census Bureau, it is not possible to update the variance of schooling series beyond 2000.

15 *Source*: Migration Policy Institute, http://www.migrationinformation.org/USFocus/display.cfm?ID=638.