Poverty, Inequality and Trends in the Labor Market

Hilary Hoynes, University of California Berkeley
Overview

• Since the 1980s we have seen little improvement in poverty despite steady economic growth
• At the same time, inequality is increasing, with more resources for skilled and high income groups
• Here I examine these trends and investigate the causes of poverty and inequality, paying particular attention to the labor market causes
• We conclude by discussing the efficacy of policies to address these concerns
Roadmap

1. Facts on poverty and inequality in the U.S.
2. Linking the trends in poverty and inequality to trends in the labor market
3. Identifying the driving forces of these trends in the labor market
4. Policy solutions
Roadmap

1. Facts on poverty and inequality in the U.S.
2. Linking the trends in poverty and inequality to trends in the labor market
3. Identifying the driving forces of these trends in the labor market
4. Policy solutions
Trends in Official Poverty

Poverty Rate, By Age

- Children
- Age 18-64
- Age 65+

Year: 1960 to 2010
Limitations of official poverty measure

- Income measure is *pre-tax family income*; includes only cash income
  - Does not include Food Stamps (SNAP) or Earned Income Tax Credit (the most important government benefits for low income families!)
  - Not adjusted for work-related expenses
- Not adjusted for *regional variation in costs of living* (e.g., housing)
- Definition of poverty has not changed since measure developed in early 1960s
- Recent *Supplemental Poverty Measure* released by Census; addresses these concerns
New poverty measure shows more improvement, yet poverty remains high and in recent period only fell during strong labor market of late 1990s.
State Child Poverty by State, SPM 2011-2013


Annie E. Casey, Data Snapshot and Kids Count, Feb 2015
Trends in Inequality

• Piketty and Saez have developed a world database for measuring inequality
• Getting data to measure the level and trend in incomes at the very top of the distribution is hard. Standard survey data does not have enough information on these high income earners.
• Piketty and Saez came up with the novel idea of using data from income tax returns to estimate trends in top incomes. This is high quality data that is provided by most countries.
Inequality: The facts for the U.S.

Decomposing the Top Decile US Income Share into 3 Groups, 1913-2013


- **Top 1%** (incomes above $392,000 in 2013)
- **Top 5-1%** (incomes between $165,500 and $392,000)
- **Top 10-5%** (incomes between $116,500 and $165,500)

Decline in top income shares between pre-WWI and post-WW2
“The great compression” period = growth of the middle class

Decomposing the Top Decile US Income Share into 3 Groups, 1913-2013
Post-WW2 and through the 1970s, top income remained low.
Beginning in late 1970s top income share trends steadily up

• The period through the 1970s was similar in the U.S. compared to other countries → suggesting that global factors were responsible

• The upward trend beginning in the late 1970s IS NOT experienced by all countries → suggesting that global factors CAN NOT explain the trend
Greater progressive taxation (higher top MTR) is associated with LESS inequality.
Comparisons across countries shows that:

• Back in the early 1960s the US was on the HIGH end of progressivity of the income tax (and the middle of the pack in inequality)

• Today we have the highest inequality and very low progressivity
Roadmap

1. Facts on poverty and inequality in the U.S.
2. Linking the trends in poverty and inequality to trends in the labor market
3. Identifying the driving forces of these trends in the labor market
4. Policy solutions
The big picture

• Since the mid 1970s, there has been little gain in wages for less skilled workers, especially for men
• Additionally, labor force participation rates are declining for prime age men, and more recently, prime age women
• The implication is stagnant family incomes for the bottom quintile of Americans
• The growth of real wages and the distribution among workers is a crucial factor for determining trends in poverty.
Figure 4C  Cumulative change in real hourly wages of men, by wage percentile, 1979–2011

Source: Authors’ analysis of Current Population Survey Outgoing Rotation Group microdata

EPI, State of Working America.
Figure 4D Cumulative change in real hourly wages of women, by wage percentile, 1979–2011

Source: Authors’ analysis of Current Population Survey Outgoing Rotation Group microdata

EPI, State of Working America.
Declines in labor force participation

Figure 1-9

Figure 1-10

Source: Organisation for Economic Co-operation and Development.
Broadly Shared Prosperity Ended in the Early 1970s, and a Generation of Widening Inequality Began

Percent Change in Average US Family Income (2009 Dollars)

- Bottom Fifth: -5.6%
- Second Fifth: 97.9%
- Middle Fifth: 117.4%
- Fourth Fifth: 104.7%
- Top Fifth: 88.7%
- Top 5 Percent: 74.9%

Income Category

Source: Economic Policy Institute
• These changes in wage and income distribution contribute fundamentally to trends in poverty
• This factor would be putting upward pressure on poverty rates over time; thus the observed trends should be interpreted against this finding.
• But taking a step back, what do we know about why these labor market trends are occurring?
Roadmap

1. Facts on poverty and inequality in the U.S.
2. Linking the trends in poverty and inequality to trends in the labor market
3. Identifying the driving forces of these trends in the labor market
4. Policy solutions
“Returns to Skill” – earnings gap between college and high school degrees

- Rising steadily; doubled between 1979 and 2012
- This trend is also experienced by other countries

Autor, The Hamilton Project.
Rising Skill Premium is explained by demand and supply factors

• DEMAND
  – Over last 100 years innovation has led to reduction in demand for physical labor (technological change)
  – In recent decades the process of machine substitution for routine human tasks has reduced demand for those doing routine tasks (where workers are substitutes) and increased the demand for those who excel in more abstract tasks (where workers are complements)

• SUPPLY
  – Educational attainment increases slowed beginning in 1980s

• Overall if demand for skilled labor keeps increasing AND the supply of skilled labor does not keep up, then the wages of skilled labor increase.
Trends in education

• 1960s/1970s: supply of young college educated increased rapidly relative to high school educated
• Since then educational attainment slowed (though still increasing) especially for men.
• Research by Goldin and Katz (2008) and others shows that more than half of the increase in wage inequality is due to the rising premium to skill (and thus the slowdown in educational attainment)
Fig. 3. The supply of college graduates and the U.S. college/high school premium, 1963–2012. (A) College share of hours worked in the United
Trends more compelling when you look at new labor market entrants

In addition to trends in relative wages, non-college workers are experiencing **absolute reductions** in real wage levels

- What is leading to reductions in real wages for less skilled workers?
  - Technological change (as above)
  - Globalization: Chinese manufacturing gains led to reduction in manufacturing in the US and thus declines in wages in those industries
  - Fall of unions
  - Fall in real value of minimum wages
Fig. 6. Change in real wage levels of full-time workers by education, 1963–2012. (A) Male workers, (B) female workers. Data and sample construction are as in Fig. 3.
The result

- Employment growth is “polarizing” into relatively high-skill, high-wage jobs and low-skill, low-wage jobs [at the expense of middle skill jobs]
FIGURE 1
Smoothed changes in employment by occupational skill percentile, 1979–2007

FIGURE 6
Change in employment shares by occupation in 16 European countries
Occupations grouped by wage tercile: Low, middle, high, 1993–2006

Percentage change in employment shares

“Polarization” – Key forces

1. The slowing rate of four-year college degree attainment among young adults, particularly males

2. Changes in technology, international trade, and the international offshoring of jobs, which affect job opportunities and skill demands

3. Changes in U.S. labor market institutions affecting wage setting, including labor unions and minimum wage legislation
Roadmap

1. Facts on poverty and inequality in the U.S.
2. Linking the trends in poverty and inequality to trends in the labor market
3. Identifying the driving forces of these trends in the labor market
4. Policy solutions
Policy Solutions (Pre-Market)

• Minimum wages
• Promote unionization
• Promote skills: Pre-K, K-12
• Increase college access
• Funded perhaps with higher MTR
The Earned Income Tax Credit: 
*Effective policy given trends in the labor market*

- The EITC is the **main post-market policy** that affects the twin concerns of low employment and stagnant income
Earned Income Tax Credit

- In-work, tax based assistance
- Refundable tax credit for low income families
- Credit varies by number of children (small credit for childless), earnings (and AGI)
The effect of the EITC on employment and income

• THE EITC requires earned income. Research shows that the EITC leads to robust and large increases in employment particularly for single women with children.

• Therefore, the EITC increases family after-tax income through two channels
  – Credit effect: direct EITC payments
  – Earnings effect: incentivized increase in earnings

• Potential to substantively reduce lower tail inequality
Children Kept out of Poverty (2013, In Millions)

Nonelderly Adults Kept Above Poverty (2013, In Millions)

In recent work, I have found that the “static” estimates of EITC underestimate the anti-poverty effects by as much as 50%. The effects on earnings contribute importantly to the reductions in poverty.

Source: Hoynes and Patel (2015)
The Great Recession as a test of the social safety net
Poverty rates rose with unemployment ...

... but the social safety net provided important protection

State Scatterplot of Change in UR against Change in Child Poverty,
Great Recession Period

Source: Bitler, Hoynes and Kuka “Child Poverty in the Great Recession.”
Concluding comments

• Since the 1980s we have seen little improvement in poverty despite steady economic growth
• The main driver for these trends are declines in real wages for low skilled workers
• Against this backdrop, the social safety net makes important improvements in the resources for low to moderate income families
• The broader trends call for renewed attention for human capital investments, from pre-school through college