
PULLING APART

*A State-by-State Analysis
of Income Trends*

Jared Bernstein

Elizabeth C. McNichol

Lawrence Mishel

Robert Zahradnik

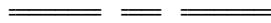
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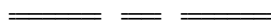


Jared Bernstein is a labor economist with the Economic Policy Institute. He has researched and authored studies in the areas of low-wage labor markets, minimum wage, income and wage inequality, poverty and education. He is co-author of *The State of Working America*.

Elizabeth C. McNichol is Director of the Center on Budget and Policy Priorities' State Fiscal Project. She oversees the Center's state work on state fiscal issues, which includes developing alternatives for long-term structural reform of state budget and tax systems, encouraging low-income tax relief, and improving methods for considering budget priorities.

Lawrence Mishel is Vice President of the Economic Policy Institute. He has done extensive research in the areas of income distribution and poverty, labor markets, industrial relations, technology and productivity, education, wages, unions and collective bargaining. He is co-author of *The State of Working America*.

Robert Zahradnik is a policy analyst with the Center on Budget and Policy Priorities' State Fiscal Project. His work focuses on state and local budget and tax issues.



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Center on Budget and Policy Priorities
820 First Street, NE, Suite 510
Washington, DC 20002
(202) 408-1080
www.CenterOnBudget.Org

Economic Policy Institute
1660 L Street NW, Suite 1200
Washington, DC 20036
(202) 775-8810
www.epinet.org

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Executive Summary

Despite the strong economic growth and tight labor markets of recent years, income disparities in most states are significantly greater in the late 1990s than they were during the 1980s. The average income of the lowest-income families grew by less than one percent from the late 1980s to the late 1990s — a statistically insignificant amount. The average real income of middle income families grew by less than two percent, while the average real income of high-income families grew by 15 percent.

The small growth in the incomes of low-income families over the last decade was not enough to make up for the decline in incomes during the previous decade. Nationwide, from the late 1970s to the late 1990s, the average income of the lowest-income families fell by over six percent after adjustment for inflation, and the average real income of the middle fifth of families grew by about five percent. By contrast, the average real income of the highest-income fifth of families increased by over 30 percent.

The trend has been widespread. Income disparities between the top fifth of families and families at the bottom and the middle of the income distribution grew substantially in almost every state over the past two decades.

While the national trend toward increasing inequality has received widespread coverage, less attention has been focused on how this trend has varied by state. This analysis examines trends in income inequality in each of the 50 states over the past two business cycles.

Income Inequality Increased In All States But Four Over the Last Two Decades

In 46 states, the gap between the incomes of the richest 20 percent of families and the incomes of the poorest 20 percent of families is wider than it was two decades ago.

Data Used in This Report

This report is based on before-tax income data for families — two or more related individuals residing together — from the Census Bureau’s March Current Population Survey public use files. All figures are expressed in 1997 dollars and have been adjusted for inflation. The report compares “pooled” data from the three most recent years for which data were available — 1996, 1997, and 1998 — to pooled data from the late 1970s and the late 1980s. The purpose of pooling these data was to increase the sample size of the data and hence their precision. Comparisons between the three time periods chosen are appropriate because they are similar points in the business cycle. (The late 1970s and late 1980s were the peaks of the previous two economic expansions and the late 1990s are the highest point of the current expansion for which state data are available.)

- In 18 states high-income families got richer while the poor got poorer. In 31 states the incomes of high-income families grew faster than the incomes of low-income families.¹
- In all but two states in the nation, the average income of families in the top 20 percent of the income distribution grew, after adjustment for inflation, between the late 1970s and late 1990s. In 31 states, the incomes of the upper fifth of families jumped by over 30 percent over the past two decades.
- Incomes of the poorest fifth of families, however, declined in 18 states between the late 1970s and the late 1990s. In some states, the decline was very steep. In 11 states, the incomes of families in the bottom quintile of the income distribution dropped by more than 10 percent. In four states — Arizona, New Mexico, New York, and Wyoming — the poorest fifth of families experienced a decline in income of *more than 20 percent*.

The differences in income growth since the late 1970s between high- and low- income families are seen to be even more pronounced when families in the top five percent of the income distribution are compared to the bottom fifth.

- In the eleven large states analyzed, the incomes of the top five percent of families increased by 35 percent or more between the late 1970s and the late 1990s. By contrast, in ten of these eleven states the incomes of the bottom fifth of families either declined or grew very little between the late 1970s and late 1990s.²

¹ In the remaining state — Alaska — the income of low-income families grew at a faster rate than the income of high-income families.

² An analysis of the average income of the top five percent of families was conducted for eleven large states that have sufficient observations in the Current Population Survey to allow the calculation of reliable estimates of the average income of the top five percent of families. These states are California, Florida, Illinois, Massachusetts,

- In the eleven large states analyzed, the increases in the average income of families in the top five percent of the income distribution ranged from \$58,000 to over \$111,000. In three states — New Jersey, New York, and Pennsylvania — the increase was larger than \$100,000. By contrast, the largest increase in average income for the bottom fifth of families in these states was only \$1,300. In New York, for example, the average income of the top five percent of families grew by \$107,880 while the average income of the bottom 20 percent dropped by \$2,900.

Middle-income families also lost ground. In 45 states, the gap between the average income of middle-income families and the average income of the richest 20 percent of families widened.

- The average income of families in the middle fifth of the income distribution fell in 11 states between the late 1970s and the late 1990s. In all but three of these states, the average income of the top fifth of families increased. In the other 39 states, the average income of the middle fifth of families increased modestly, but did not keep pace with the income growth of the top fifth of families.

Gap Between High-Income Families and the Poor and Middle-Class is Wide

The resulting disparities between the incomes of high- and low-income families are substantial.

- In the United States as a whole, the poorest 20 percent of families had an average income of \$12,990 in the late 1990s, while the average income of families in the top 20 percent of the income distribution was \$137,490, or more than 10 times as large. There were nine states — New York, Arizona, New Mexico, Louisiana, California, Rhode Island, Texas, Oregon, and Kentucky — where the average income of the richest fifth of families was more than eleven times as great as the average income of the bottom fifth of families.
- In the late 1970s, there was no state where high income families had average income that was as much as 9.5 times larger than the average income of low-income families. By the late 1990s, 24 states had "top-to-bottom" ratios of 9.5 or greater. The increase in income disparities between the top and bottom fifths of families was greatest in New York, Arizona, Rhode Island, Oregon, California, New Mexico, West Virginia, Kentucky, Connecticut, and Kansas.

The gaps between the incomes of high-income families and middle-income families also were not always as large as they are in the 1990s.

Michigan, New Jersey, New York, North Carolina, Ohio, Pennsylvania, and Texas.

- In the late 1970s, there was not a single state where the average income of families in the top quintile of the distribution was as much as 2.7 times as great as the average income of families in the middle quintile. By the late 1990s, there were 39 states where the gap was this wide.
- In the late 1990s, the gap between high-income and middle class families was the widest in 12 states — Arizona, New Mexico, New York, Oregon, Texas, California, South Dakota, Rhode Island, Florida, Kansas, Mississippi, and Louisiana — where the average income of the richest fifth of families was at least three times as large as the average income of the middle fifth of families.

The Economic Prosperity of the 1990s Has Not Been Shared Equally

The long-term trend toward increasing inequality has continued over the past decade despite the economic growth of recent years. In only a handful of states was progress made toward reducing income inequality between the late 1980s and the late 1990s.

- Since the late 1980s, income inequality has increased in most states. In two-thirds of the states, the gap in incomes between the top 20 percent of families and the bottom 20 percent of families grew between the late 1980s and the late 1990s. In 15 states, the average income of families in the bottom fifth of the distribution fell while the incomes of those in the top fifth grew.
- By contrast, the gap in income between the top 20 percent of families and the bottom 20 percent narrowed significantly in only three states — Alaska, Louisiana, and Tennessee.

Since the late 1980s, the incomes of very high income families — the richest five percent of families — grew dramatically while the incomes of the poorest families declined or stagnated.

- In nine of the 11 large states analyzed, the average income of the poorest fifth of families declined or grew very little since the late 1980s, while the incomes of the top five percent of families grew by more than 15 percent. In five of these states — Michigan, New York, Ohio, Pennsylvania, and Texas — the incomes of the top five percent grew by more than 30 percent.
- The greatest increase in average income for the poorest families in the 11 large states was \$1,490 in Michigan. The increases in the average income of the top five percent of families ranged from \$32,690 in Illinois to \$67,680 in Pennsylvania.

Families in the middle of the income distribution have fallen farther behind upper-income families in most states over the past decade.

- In close to three-fourths of the states, the ratio of the incomes of the top fifth of families compared to the middle fifth of families increased between the late 1980s and the late 1990s. Income disparities between the top and middle fifths of families increased most in Arizona, followed by Oregon, South Dakota, Rhode Island, Kansas, New York, Connecticut, New Hampshire, Nevada, and Maryland. By contrast, the top to middle ratio did not decline significantly in any state.
- On average in the United States, the share of income held by the middle fifth of families fell from 17.2 percent to 16.2 percent of total income, while the share held by the richest fifth of families increased from 42.1 percent to 45.4 percent of total income. Since the late 1980s, the share of income held by the middle fifth of families has fallen in 44 states. Over the same period, the share of income held by the fifth of families with the highest incomes grew in all but four states.

Causes of Rising Inequality

Researchers have identified several factors that have contributed to the large and growing income gaps in most states. The growth of income inequality is primarily due to the growth in wage inequality. Wages at the bottom and middle of the wage scale have been stagnant or have declined over the last two decades. The wages of the very highest paid employees, however, have grown significantly. Several factors have contributed to increasing wage inequality including globalization, the decline of manufacturing jobs and the expansion of low-wage service jobs, immigration, and the weakening of labor market institutions — the lower real value of the minimum wage and fewer and weaker unions. These factors have led to an erosion of wages for workers with less than a college education — approximately the lowest-earning four-fifths of the workforce.

In the last few years, persistent low unemployment, an increase in the minimum wage and fast productivity growth have fueled real wage gains at the bottom. As a result, there has been a lessening of wage inequality at the bottom while the gap between middle- and high-wage workers continues to grow. However, even the recent wage growth for low-wage workers has not been sufficient to counteract the two-decade long pattern of stagnant or declining wages.

Besides wages, the other major source of income is investment income such as dividends, rent, interest and capital gains. Since investment income primarily accrues to those at the top of the income structure, recent expansions of investment income have led to greater income inequality. (This report captures only some of the effects of these investment income trends because the income measure used in this report includes only a portion of investment earnings. It does not include income from capital gains.)

Another factor that explains some of the increased income inequality is the increase in the number of families headed by a single person. These families generally have lower income than two-earner families.

Government policies — both what governments have done and what they have not done — have contributed to the increase in wage and income inequality over the past two decades in most states. For instance, deregulation and trade liberalization, the weakening of the social safety net, the failure to have effective labor laws regulating the right to collective bargaining, and a minimum wage that has declined in real terms have all contributed to growing wage inequality. In addition, changes in federal, state and local tax structures and benefit programs have, in many cases, accelerated rather than moderated the trend toward growing inequality emerging from the labor market.

States Can Choose a Different Course

One consequence of the nation's prolonged economic recovery is that tax revenue has been growing at a faster rate than originally projected in most states, leaving states with surplus revenues. The strong economy also has played a part in reducing public assistance caseloads in many states. As a result, the current economic expansions provide state budget-makers with the resources to mitigate some of the growing inequality through state policies.

States have long played a major role in the establishment of labor market policies such as rules governing the formation of unions, the design of the unemployment insurance system, and the establishment of state minimum wages, all of which affect income inequality.

The minimum wage, for example, has a direct bearing on individual earnings. The value of the federal minimum wage has fallen considerably since the late 1970s. One way that policymakers could help reverse or moderate the decline in wages for workers at the bottom of the pay scale would be to enact a higher minimum wage. Ten states have compensated for the decline in the value of the federal minimum wage by establishing higher state-level minimum wage standards.

Since the 1970s, unemployment insurance protection has eroded as a result of both federal and state-level cutbacks. The proportion of jobless workers receiving unemployment insurance benefits has declined in recent years. These cutbacks have affected both middle- and low-income families. Efforts to strengthen the unemployment insurance system both at the national level and in many states are warranted in order to broaden the receipt of unemployment insurance among unemployed workers.

Changes in programs that provide assistance to low-income families have contributed to the increase in income inequality and will likely continue to exacerbate the trend towards increasing inequality in the coming years. In the typical state, cash assistance benefits for a

family of three with no other income fell 40 percent between 1975 and 1996, after adjusting for inflation. In addition, in every state, receipt of cash assistance has declined dramatically. Studies indicate that between one-half and three-quarters of former welfare recipients are employed shortly after they leave the rolls. However, significant barriers to obtaining and keeping steady work remain for many families, and these barriers are likely to retard income gains for the lowest income fifth of families.

There are a host of options state policymakers can consider to strengthen their social safety nets including the provision of supportive services such as transportation, child care, and health insurance coverage to low-wage workers. States can also provide intensive case management and a range of services to help current and former welfare recipients to maintain their present employment, move into better jobs, or obtain the education and training needed for career advancement.

The analysis presented here uses pre-tax income. It does not reflect the effects of tax policies that influence the distribution of post-tax income. Nevertheless, federal and state tax policies influence how much income families have to spend and how disposable income is distributed. The overall effect of the federal income tax system is to narrow income inequalities. In recent years, expansions in the earned income tax credit have helped to increase the after-tax income of low-income families with children. However, the tax system more generally has become less progressive over the past two decades; changes to the federal tax code made in 1997 exacerbated this trend.

While the federal tax system as a whole remains progressive, nearly all state tax systems are regressive. States rely more on regressive sales taxes and user fees than on progressive income taxes and, therefore, take a larger percentage of income from low- and middle-income families than from the wealthy. In the past few years, when many states have sought to cut taxes, nearly all have chosen to make the vast majority of the cuts in their progressive income taxes, rendering their tax systems even more regressive.

In order to narrow the gap between high- and low-income families, states can institute tax reforms that are progressive in nature and improve the after-tax distribution of income. For example, states can increase their reliance on income taxes rather than sales taxes by cutting sales tax rates rather than income tax rates. States can also make their income tax systems more progressive by enacting tax credits targeted to low-income taxpayers or by raising personal exemptions or standard deductions. Another way to lessen the negative impact of state tax systems on the poor while cutting taxes is to exempt food from the sales tax base. One direct way that states can use tax policies to raise income from work for their poorest residents is to enact state earned income tax credits.

State policies constitute only one of a range of factors that have contributed to the increasing disparities in incomes over the past decade. If low- and middle-income families are to

stop receiving steadily smaller shares of the income pie, state as well as federal policies will have to play an important role.

Table A

<p><u>Ten States where Income Inequality Between the Top and the Bottom Was Greatest, 1996-98</u></p>	<p><u>Ten States where Income Inequality Between the Top and the Middle was Greatest, 1996-98</u></p>
<p>New York Arizona New Mexico Louisiana California Rhode Island Texas Oregon Kentucky Virginia</p>	<p>Arizona New Mexico New York Oregon Texas California South Dakota Rhode Island Florida Kansas</p>
<p><u>Ten States where Income Inequality Between the Top and the Bottom Grew Most, 1970s - 1990s</u></p>	<p><u>Ten States where Income Inequality Between the Top and the Middle Grew Most, 1970s - 1990s</u></p>
<p>New York Arizona Rhode Island Oregon California New Mexico West Virginia Kentucky Connecticut Kansas</p>	<p>Arizona Oregon Rhode Island Kansas New York West Virginia California South Dakota New Mexico Kentucky</p>
<p><u>Ten States where Income Inequality Between the Top and the Bottom Grew Most, 1980s - 1990s</u></p>	<p><u>Ten States where Income Inequality Between the Top and the Middle Grew Most, 1980s - 1990s</u></p>
<p>Rhode Island Oregon Arizona New York Connecticut Kansas New Mexico Washington California Montana</p>	<p>Arizona Oregon South Dakota Rhode Island Kansas New York Connecticut New Hampshire Nevada Maryland</p>

I. Introduction

The U.S. economy continues to experience a prolonged period of economic growth. By November of 1999, the unemployment rate had dropped to 4.1 percent, the lowest rate since the early 1970s. Despite the current economic expansion, the long-term trend in the distribution of growth raises some troubling and ongoing issues. The incomes of the country's wealthiest families have increased substantially over the past two decades, but middle- and lower-income families have seen their incomes stagnate or fall. This trend of rising inequality in the United States as a whole has been well documented by Census Bureau and Congressional Budget Office data and by a large number of analysts. Few analyses, however, have focused on how income inequality has changed within the different states and regions of the country.

This report examines trends in the distribution of income from the late 1970s to the late 1990s in each of the 50 states. The analysis finds that in the vast majority of states, the gap between the incomes of the highest-income families and the incomes of middle-class and poor families has grown substantially over the period.³

The report also finds that even the economic expansion of the past several years has not altered the long-term trend. Rather, an analysis of the changes in income inequality since the late 1980s (a period comparable in the economic cycle to the current period) shows that in two-thirds of states, the gap between high-income and low-income families continued to grow over the past decade. Moreover, the gap between high-income and middle class families increased since the late 1980s in close to three-fourths of states.

³ Families with incomes that fall in the bottom 20 percent of the income distribution are referred to as "poor" in this report. The vast majority of these families have incomes below the official poverty line.

One consequence of the nation's prolonged economic recovery is that tax revenue has been growing at a faster rate than originally projected in most states, leaving states with surplus revenues. The strong economy also has played a part in reducing public assistance caseloads in many states. As a result, the current economic expansions provide state budget-makers with the resources to mitigate some of the growing inequality through state policies.

Why Growing Income Inequality is a Problem

As this report demonstrates, inequality has grown in virtually every state in the United States since the 1970s. This growing divide between the rich and the poor and the middle class deserves the attention of policymakers and the public.

The strong economic growth of recent years results from the contributions of people in all walks of life, from laborers to corporate executives. It is a problem when everyone does not share in the resulting prosperity.

The United States was built on the ideal that hard work should pay off, that individuals who contribute to the nation's economic growth should reap some of the benefits of that growth. And for many years, they did. Over the past two decades, however, the benefits of economic growth have been skewed in favor of the wealthiest members of society. If everyone's income grew along with the economy but the incomes of some grew a little faster than others, that would be far less of a problem. But since the late 1970s, the incomes of the poor have actually fallen or stagnated in most states and the incomes of the middle class have increased only slightly, while the incomes of the wealthiest grew rapidly. It is not that the poor and middle class are simply getting a slightly smaller share of the growth; it is that virtually all of the growth is going to the top end.

Continuing growth in income inequality could also undercut the basis of the much-heralded changes made to the welfare system in recent years. Current policy is based on the assumption that a job is the first step to self-sufficiency and to moving out of poverty. When former welfare recipients can only find jobs that do not pay enough to lift a family out of poverty and the real incomes of the poorest families decline over time, the underpinnings and future success of policies that encourage work are called into question.

The decline in the incomes of the poorest families is particularly disturbing. Research has shown that poverty can have a substantial effect on child and adolescent well-being. Children who grow up in families with incomes below the poverty line have poorer health, higher rates of learning disabilities and developmental delays, and poorer school achievement. They are far more likely to be unemployed as adults than children who were not poor.⁴

⁴ See, for example, Greg Duncan, Jeanne Brooks-Gunn, eds. *The Consequences of Growing Up Poor*. New York: Russell Sage Foundation, 1997.

Moreover, there is evidence that income inequality in and of itself — not simply the decline of the incomes of the poor — results in problems for society. For example, there is a considerable body of research linking income inequality to poor health outcomes. A number of papers at a recent conference on income inequality sponsored by the Federal Reserve Bank of New York discussed the association between higher levels of inequality and poor schools, substandard housing, and higher levels of crime victimization.⁵

- The impact of inequality on public health in particular has received considerable attention from researchers. A recent article on income inequality summarized this research as follows: “Demographers and public health researchers have found mounting though controversial evidence that greater inequality can boost mortality rates and contribute to poor health. Countries and communities with above-average inequality have higher mortality rates than countries or communities with comparable incomes and poverty rates but lower inequality.”⁶

While numerous studies have documented this link between income inequality and poor health, the causes of this link are not entirely clear.⁷ A leading explanation is that individuals who feel their income and social status are below what they expect based on their observation of the status of others experience high levels of stress. There is a well-documented link between stress and poor health.

- Income inequality can have a direct effect on adequacy of housing. Economic growth can lead to more demand for housing and consequently to higher housing prices. When the incomes of the poorest families are falling even as the economy grows, they are less likely to be able to afford adequate housing leading to increased homelessness.
- In the United States, increased disparities in income have led to geographic disparities as wealthier families move to the suburbs. Because school systems depend heavily on local funding, this has led to increased disparities in the quality of schools. Poor schools make it harder for poor children to acquire the skills they need to succeed.

⁵ Timothy Smeeding, “General Commentary,” *Federal Reserve Bank of New York Economic Policy Review*, September, 1999.

⁶ Gary Burtless, “Growing Income Inequality: Sources and Remedies” in Henry J. Aaron and Robert D. Reischauer, eds. *Setting National Priorities, The 2000 Election and Beyond*. Washington, DC: Brookings Institution Press, 1999.

⁷ See, for example, Ichiro Kawachi, Sol Levine, S. Michael Miller, Kathryn Lasch, and Benjamin Amick, *Income Inequality and Life Expectancy - Theory, Research and Policy*, Society and Health Working Paper Series No 94-2, 1994.

A widening gulf between the rich and the poor and the middle class can reduce social cohesion, trust in institutions including government, and participation in the democratic process. Growing income inequality in the United States has widened discrepancies in political influence — a particular problem given the heavy dependence of candidates for office on private contributions. This may have contributed to the growth in the number of Americans who feel that their elected officials do not care much about the views of ordinary citizens.

In addition, as the divide grows among families at differing income levels, there is less contact and familiarity with the problems faced by families in different economic circumstances. For example, it can be difficult for an upper middle-income family living in a suburban neighborhood to understand the lack of decent housing available to poor families. Similarly, wealthy families with the resources that allow access to private schools for their children can lose sight of the need to support public schools. As a result, support for the taxes necessary to finance government programs declines.

The failure to invest in programs that meet the health and housing needs of families at all income levels, that provide education and training for children and that provide supports for low-wage workers can have long-term impacts on the future economic growth of the country.

Government at all levels has an important role to play in pushing back against the growth of income inequality. Improvements to state government policies can affect the trend towards growing income inequality. State and local tax policies also can serve to mitigate the effects of increased inequality. Through policies such as raising the minimum wage, strengthening unemployment insurance, implementing a wide range of supports for low-income working families, and reforming regressive state tax systems, state and federal lawmakers can help moderate the growing income divide.