Why Is Income Inequality Increasing?

7 ▮ Martina Morris and Bruce Western

Inequality in Earnings

Trends and Implications

Ironically, as some sociologists were debating whether social classes had finally withered away (e.g., Clark and Lipset 1991), earnings inequality in the United States quietly started to grow again. Median income declined and the distribution of income grew markedly more unequal during the last three decades of the twentieth century, reversing a long trend of earnings growth and equalization. Writers in economics and the popular press described, analyzed, and debated this new trend. Sociologists, on the other hand, were, and to a large extent remain, remarkably silent about it. We have continued to address trends in the earnings "gaps" (by gender and race) or focus on poverty alone, leaving the broader trends—stagnation in earnings levels and growing polarization in earnings distributions—to others. We have continued to study how people are allocated to positions in the earnings distribution, rather than the structure of those positions. If the structure had been stable, a narrow focus on allocation might be justifiable. But this has been a period of pervasive economic restructuring, and the impact on earnings distributions both within and between groups has been profound. Sociological theory provides a rich framework for understanding the broad changes now underway, and we offer this essay as a challenge to the field to critically evaluate the evidence and provide a sociologically informed response.

According to Simon Kuznets (1955), inequality should not be rising in the late twentieth-century United States. The Kuznets curve predicts that economic development has an inverted U-shaped relationship to inequality. Inequality first rises as capital is concentrated in the hands of investors, then falls as economic development generates widespread prosperity. For much of this century, in fact, inequality followed the Kuznets path. Earnings inequality peaked on the eve of the Great Depression, then began a long secular decline.[1] Postwar prosperity was marked by a rise in median earnings and stability in earnings inequality. The annual income of the median worker more than doubled from 1950 to 1970, with those at the bottom of the earnings scale making even greater progress. It was, as many observed in chastened hindsight, a rising tide that lifted all boats. These trends reversed in the early

This is a commissioned chapter that draws heavily on material in a previous publication (Martina Morris and Bruce Western, "Inequality in Earnings at the Close of the Twentieth Century," *Annual Review of Sociology* 25, pp. 623–657. Copyright © 1999 by Annual Reviews, www.AnnualReviews.org. Reprinted by permission of Annual Reviews).

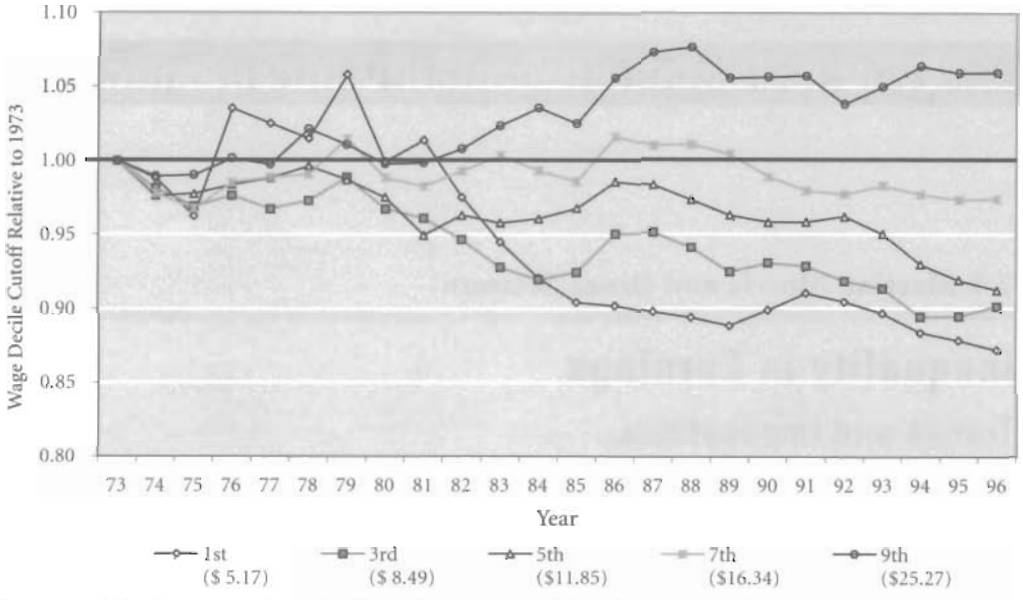

Figure 1. The lines trace the real value of wages at each decile relative to the value in 1973. Sample is all workers, from the CPS Outgoing Rotation Group File. The data can be obtained online at http://www.epinet.org/datazone/data/orghourlyxoffs_all.xls. For more analysis of these data see Bernstein and Mishel (1997).

1970s. Median earnings stabilized in 1973 and then began to decline. In 1980, earnings inequality began to rise rapidly. The net result of these two trends was that by the early 1990s, nearly 80 percent of workers earned less than their counterparts in the 1960s.[2] Although there appeared to be a small uptick in median wages in the last years of the 1990s, it will take decades to make up the losses.

Data from the Current Population Survey (CPS) show these trends in terms of hourly wages (Figure 1).[3] Each line in the figure represents the dollar value of the wage decile cutoff indexed to its value in 1973. The line for decile 1, for example, represents the relative wage earned by the worker at the tenth percentile of the wage distribution over time. If we follow it across the graph, we can see that workers in this decile saw their real wages rise slightly from the mid-1970s to the beginning of the 1980s, fall precipitously during the 1980s, and continue to decline at a lower rate during the 1990s. By 1996, wages for these workers had fallen about 13 percent in real terms (and by 20 percent if the sample is restricted to men). Wages at the median (fifth decile) stagnated through most of the 1970s and 1980s, then fell sharply in the 1990s, losing a total of about 10 percent over the two decades. Only those at the top (ninth decile) experienced some wage gains, a rise of about 5 percent, with most of the increase coming in the late 1980s.

Comparative data suggest that among industrialized countries, only the United Kingdom experienced a similar growth in wage inequality. In France, Germany, and Italy, the earnings ratio of the first to the fifth decile among men declined or remained stable. And while British wage inequality grew, it was driven by gains at the top, not losses at the bottom.[4] The broad stagnation of living standards coupled with a collapse of wages at the bottom is thus a peculiarly American disease, at least among the industrialized democracies.

So the American story since the 1970s is not that the rich got richer and the poor got

poorer, but that virtually everyone lost ground, and those at the bottom lost the most. Although mean trends differ by race and sex, all groups experienced a rise in within-group inequality. This leads to a set of research questions that breaks out of the usual "wage-gap" framework and begins to address the general issue of changes in labor market dynamics. We review below supply-side, demand-side, and institutional accounts of change.

Supply-Side Accounts

On the supply side, the labor force expanded by more than 44 million workers from 1950 to 1980, a 70 percent increase. The baby boom, rising women's labor force participation, and growing immigration all increased the share of workers with little work experience, tenure or education. Although a rising supply of "unskilled" workers seems like a natural explanation for falling wages at the bottom of the distribution, the evidence suggests little role for most of these supply-side changes:

1. The baby boom generation, born between 1946 and 1964, entered the workforce from 1964 to 1982, a period when earnings of low-wage workers held relatively steady. The dramatic decline in wages at the bottom occurred during the entry of the subsequent "baby bust" cohort, which should instead have benefited from the shrinking labor supply.
2. From 1950 to 1994, the fraction of women working for pay increased from 34 percent to 59 percent. Despite this increase in supply, women's wages rose at every decile of the distribution. Occupational segregation also remained high, indicating the persistence of largely separate labor markets for men and women and suggesting that the impact of women's entry on men's wages was probably small.
3. Immigration, and in particular the rapid influx of Asians and Latin Americans following the 1965 Amendments to the Immigration and Nationality Act, is the one supply-side effect that finds some support in the data. Studies find a substantial impact of immigration on the rise in the wage differential between high school dropouts and graduates.

On the boundary between supply and demand explanations lies the debate over the role of education and "skill." Despite a rising supply of workers with a college education,[5] their relative wages began to rise in the mid-1980s. This came to be called a "rise" in the college premium, but it was almost entirely driven by the *collapse* in the earnings of high school graduates and dropouts. Initially, the growth in the education wage gap was attributed to a trade-induced decline in domestic demand for high school–educated workers driven by the relocation of manufacturing to less-developed countries. However, conflicting findings led to the rise of an alternative hypothesis: a rising demand for skill driven by "skill-biased technological change." The proponents of this argument claim that computerization of the workplace and other technological advances increased the demand for high-skill workers well beyond the increase in supply. One study reported that computer use at work raised earnings by as much as 19 percent. Critics countered with an analysis showing that the use of pencils and "sitting while working" had similarly strong effects. Despite the continuing weakness of the empirical evidence, skill-biased technological change remains the dominant explanation among labor economists for the increase in earnings inequality.

Demand-Side Accounts

The structure of the labor market also changed substantially during the postwar

boom years. Restructuring took two forms: continuing decline in manufacturing employment leading to the rise of a "service economy" and an increase in market-mediated employment relations that featured outsourcing, subcontracting, and temporary, contingent, and part-time work contracts. The trend toward growing employment in the service sector and shrinking employment in manufacturing has continued almost linearly since the 1940s, and by the mid-1990s the service sector accounted for more than 80 percent of total employment. Service sector jobs have traditionally paid less, offered fewer benefits, and relied more on part-time employment. Still, there was no sharp increase in deindustrialization in the 1970s or 1980s that would account for the sharp changes in earnings during these decades. In addition, inequality is growing within the sectors, not simply between them, and declines in manufacturing wages were also substantial. So the simpler versions of the deindustrialization thesis have been discarded.

The "good jobs–bad jobs" debate has therefore been refocused in recent years, noting that high- and low-road employment strategies are being used together, not only within industries, but even within firms. This shifts attention to the trends in the system of employment relations often referred to as the "internal labor market." Cost reduction became an important basis of competition during the 1970s, and internal labor markets became a prime target because they are inflexible and expensive to maintain. The wave of "downsizing" that took place during the late 1980s and 1990s heralded this change. Still, the size of the shift to market-mediated employment is unclear. One study finds that contingent work rose from about 25 percent of employment in 1980 to 35 percent by the end of the decade. Other estimates have been more conservative, ranging from 5 percent to 17 percent of the labor force by the end of the decade. Although the shift to market-mediated employment may not be as rapid or revolutionary as some scholars have suggested, the rise in job instability is well documented now, and it has been linked to the declining wages of workers who are not college educated.

Institutional Accounts

Market explanations have dominated research on rising inequality, but supply and demand are clearly mediated by institutional constraints. Relatively fewer studies have examined the role of institutional changes, and those that have focus chiefly on the minimum wage and unions. Both appear to explain part of the decline in wages at the bottom of the distribution. The federal minimum wage was frozen at $3.35/hour from 1980 to 1990. Although less than 10 percent of the working population typically makes the minimum wage, one estimate attributes about 17 percent of the growth in the gap between the wages of college graduates and high school dropouts to the freeze. The 1990 increase is estimated to have reduced the previous decade's growth in wage inequality by about 30 percent. The decline in unionization may also have played a role. In 1970, unions represented about 27 percent of all wage and salary earners in the United States; by 1993 only 15 percent. When a job change is accompanied by the loss of union status, the wage penalty is on the order of 20 percent after controlling for other worker characteristics. Some studies suggest that the decline in union density may account for about 20 percent of the overall rise in male wage inequality and as much as 50 percent of the rise for male blue-collar workers. As with other potential explanatory factors, however, there is also evidence of increasing earnings inequality among union members.

An increasingly "globalized" economy provides the context in which all of these trends have emerged. Imports from less developed countries (LDCs) are typically produced by low-skill labor, and LDC imports increased

by 75 percent between 1978 and 1990. Low-wage imports may be an important cause of declining demand for low-skill U.S. workers, but here again the empirical evidence is mixed. Capital mobility may also raise inequality by diverting investment to countries with low-wage labor, thus reducing labor demand in higher-wage countries. In contrast to the theory, however, spending on new plants and equipment overseas by U.S. multinationals has been a declining proportion of total U.S. economic activity.

The Future of Inequality

What does the future hold for earnings inequality in America? That will depend in part on the underlying causal factors and in part on the public response to the current trends. As the review above suggests, the trends are at least now well documented, but there is little consensus on the causal forces. What is clear is that the simplistic Kuznets curve cannot adequately represent the trends in contemporary inequality, if, indeed, it ever was adequate. Local earnings dynamics increasingly reflect the intersection of national political forces and the growing global reach of capital. At the most basic level, it is a question of whether markets or politics will have the upper hand in earnings determination. If market forces dominate, we would expect that the lower and middle classes will continue to lose the benefits of unionization, internal labor markets, and minimum wage laws, thus producing an increasingly bipolar society as the inequality-reducing institutional reforms of New Deal capitalism erode. Under this scenario, the United States is not becoming like Western Europe, which is likely to bear the continuing imprint of its more deeply institutionalized welfare capitalism, but rather like South America and Eastern Europe, with their (sometimes militarily enforced) laissez-faire systems.

The relocation of manufacturing jobs to less-industrialized and lower-wage countries has led some to predict that the United States and other highly industrialized countries will evolve into homogeneously high-skill (and, presumably, low-inequality) labor markets.

However, this view could only be seen from an ivory tower. Over 80 percent of the U.S. labor force is already employed in the service sector. If this sector holds the clues to our future, then wage stagnation and polarization will clearly continue. Many of the lowest paid, least challenging jobs—cashiers, sales persons, truck drivers, receptionists, and information clerks—are in the service sector. They will never be exported. These particular jobs are also in the top 10 in terms of projected employment growth, led, at number one, by cashiers.

Cross-national variation in earnings inequality, however, makes it clear that distributional trends are not driven by a single logic of, say, capitalist development or post-industrialism. Other countries face similar pressures from global markets and structural change, but have maintained a level of equality that is unknown in the United States. The difference is in politics, not markets. It is possible, therefore, to use political institutions to reverse the trends in wage decline and polarization. To the extent that rising inequality in U.S. earnings can be traced to institutional change—and these are the explanations with the most consistent empirical support—inequality is likely to persist. Institutional change tends to be slow, and trends in institutional change are reversed even more slowly. The prospects for a reversal in declining union organization, for example, are dim. Job growth in the nonunion sector of the economy is so rapid that the maintenance of current levels of private sector unionization would require organizing efforts unprecedented in the postwar period. Despite the massive redistribution of income and wealth to those at the top, there seems to be little political support for institutional changes that would reverse these trends.

Why is it, then, that the decline and polarization of earnings has occasioned so little political response among the population at large? There are many possible reasons. One is that most people now rely on two incomes to support a family, so that individual earnings losses are masked by income pooling. Another is the explosion of consumer credit, which makes it possible for many to buy what they can no longer afford. Finally, political apathy may be one of the by-products of a high level of inequality. As those at the bottom of the income distribution feel increasingly remote from the mainstream, alienation from politics grows, election turnout declines, and the public sphere shrinks to include just the affluent. The constituency for redistribution vanishes. In this scenario, graphically detailed by Massey in his provocative 1996 presidential address to the Population Association of America, the persistence of high inequality seems especially likely. The analysis may seem bleak, but it is supported by research that shows that political participation, political information, membership in voluntary associations, and a host of other indicators of political efficacy depend closely on income. The rise in inequality could thus become self-sustaining.

Sociology clearly has an important role to play in understanding the recent trends in economic inequality. It is not just a question of earnings, but of fundamental changes in politics, markets, and life chances. The current earnings trends challenge us to rethink our disciplinary perspective and reintegrate our theoretical and empirical agenda, or else lose the heart of our field to other disciplines.

NOTES

1. Here and throughout, detailed keys to the literature are provided by Morris and Western (1999). Other summaries of the literature include Levy and Murnane (1992) and Danziger and Gottschalk (1993; 1995). Comparative trends in earnings inequality are described in OECD (1996, ch. 6).

2. The precise figure depends on the measure used to adjust for inflation, and this is a hotly contested issue.

3. There are at least four different measures of economic well-being that can be examined here: hourly wages, annual earnings, household total earnings, and wealth. All show the same basic pattern, with pronounced rises in inequality. We show hourly wages here because they do not confound labor supply components, such as hours worked and income pooling, with labor pricing. Wages thus better represent the job structure.

4. Inequality does appear to be on the rise in post-socialist economies, although the quantitative evidence here is less reliable. The forces making for such change are, at least on the surface, very different than those at work in the United States, except insofar as one understands them as proceeding from "marketization" in its various forms (e.g., de-unionization, deregulation of wages).

5. About 25 percent of the 25–34-year-old population had a four-year college degree in 1995.

REFERENCES

Bernstein, Jared, and Lawrence Mishel. 1997. "Has Wage Inequality Stopped Growing?" *Monthly Labor Review* 120:3–16.

Clark, Terry N., and Seymour M. Lipset. 1991. "Are Social Classes Dying?" *International Sociology* 6:397–410.

Danziger, Sheldon, and Peter Gottschalk, eds. 1993. *Uneven Tides: Rising Inequality in America*. New York.

Danziger, Sheldon, and Peter Gottschalk. 1995. *America Unequal*. Cambridge: Harvard University Press.

Kuznets, Simon. 1955. "Economic Growth and Income Inequality (Presidential Address)." *American Economic Review* 45:1–28.

Levy, Frank, and Robert Murnane. 1992. "U.S. Earnings Levels and Earnings Inequality: A Review of Recent Trends and Proposed Explanations." *Journal of Economic Literature* 30: 1333–81.

Massey, Douglas S. 1996. "The Age of Extremes: Concentrated Affluence and Poverty in the Twenty-First Century." *Demography* 33:395–412.

Morris, Martina, and Bruce Western. 1999. "Inequality in Earnings at the Close of the Twentieth Century." *Annual Review of Sociology* 25:623–57.

Organisation for Economic Cooperation and Development (OECD). 1996. *Employment Outlook*. Paris: OECD.