What Has Happened to the Quality of Life in the Advanced Industrialized Nations?

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I. Recent trends in living standards in the United States

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INTRODUCTION

The media have been aglow with reports of the booming economy and rising prosperity in the United States since the early 1980s. Indeed, the run-up in stock prices between 1995 and 2000 created the impression that all families were doing well in terms of income and wealth. This, however, was certainly not the case. As I shall demonstrate, most American families have seen their level of well-being stagnate over the last quarter-century.

Despite this recent boom, the last quarter of the twentieth century witnessed some disturbing changes in the standard of living and inequality in the United States. Perhaps the grimmest news is that the real wage (average hourly wages and salaries of production and nonsupervisory workers in the total private sector, adjusted for inflation) has been falling since 1973. Between 1973 and 1993, the real wage declined by 14 per cent, though it has since risen by 7 per cent from 1993 to 2000, for a net change of −8 per cent. Changes in living standards have followed a somewhat different course. Median family income, after increasing by 13 per cent in real terms between 1973 and 1989, fell back to its 1979 level in 1993, though it has since grown by 17 per cent between 1993 and 2000 (US Bureau of the Census 2002a). Despite falling real wages, living standards were maintained for a while by the growing labor force participation of wives, which increased from 41 per cent in 1970 to 57 per cent in 1988 (US Bureau of the Census 2002b). However, since 1989, married women have entered the labor force more slowly and by 2000 their labor force participation rate had increased to only 61.2 per cent, and with it, occurred a slowdown in the growth of real living standards.

Another troubling change was the turnaround in inequality witnessed in the United States over the last quarter of the twentieth century. Inequality in the distribution of family income, which had remained virtually unchanged since the end of World War II until the late 1960s, has increased sharply since then. What makes the rise in inequality particularly worrying
is that not only has the relative share of income fallen among the bottom half of the income distribution but so has their absolute income as well. The poverty rate, which had fallen by half from a postwar peak in 1959 (the first year the poverty rate was computed) to 1973, has since risen.

The main source of the rising inequality of family income stems from changes in the structure of the labor market. Among male workers alone, wage disparities widened between the high-paid workers and the low-paid ones. Another indication of the dramatic changes taking place in the labor market is the sharp rise in the returns to education—particularly a college degree—that occurred during the 1980s and 1990s.

Current policy discussions in the United States and other advanced industrial countries have emphasized the need for better education of the labor force and the importance of the school-to-work transition. The underlying theme is that more education, more training, apprenticeship programs, and, in general, more skill creation will lead to a more productive labor force and hence higher wages and faster economic growth. Moreover, presumably, a more equal distribution of income will emerge from a more equal distribution of human capital.

There has now accumulated abundant evidence that individual workers benefit in the job market when they receive additional training and education. But it is much less clear that living standards will increase and economic inequality decline if the government enhances opportunities for Americans to improve their job skills. Indeed, this chapter will explore the reasons for this by investigating two other underlying paradoxes: (i) even as educational attainment has increased in recent decades, real wages have still fallen; (ii) As educational opportunities have improved for a broader swath of the US population, economic inequality has not fallen but rather has increased.

The chapter will attempt to weigh whether government investment in education and training would be more or less effective at alleviating economic inequality and strengthening the US economy than direct subsidies to workers who are falling behind. Improved educational and training opportunities are essential for society for several reasons: (i) education provides benefits that transcend the job market, particularly a more knowledgeable citizenry for a democratic society (this was the original rationale for public education in the United States); (ii) more schooling and higher skills lead to more satisfying work opportunities; and (iii) investment in training made by firms lowers worker turnover.

However, the evidence the chapter will explore seems to show that such initiatives will not substantially alleviate inequality or bolster income. Confronting the inequality challenge may require direct subsidies to those at the bottom and tax relief for those workers in the middle who also have been falling behind. Labor law reform aimed at promoting unionization may also prove necessary to improve living standards for most workers.

**RECENT TRENDS IN INCOME, POVERTY, AND EARNINGS**

As shown in Figure 1.1, 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) grew by 25 per cent in real terms between 1973 and 2000 (US Bureau of the Census 2002a). In contrast, between 1947 and 1973, median family income more than doubled. Mean family income likewise doubled between 1947 and 1973, but then increased by 43 per cent in the succeeding 37 years. This is less than the increase over the preceding century but greater than the rise in median family income. The disparity between the two series is due to differences in trends between the mean and median: While mean and median incomes rose at about the same pace before 1973, mean income grew at a much faster rate than median income after 1973. The discrepancy stems from rising inequality since the early 1970s (see below).

Another issue concerns the use of the new CPI-U-RS price index. As noted in note 2, the CPI-U-RS deflator incorporates quality and other adjustments. However, the adjustments are made only for
Figure 1.2 Poverty rate and share and mean income of the bottom quintile, 1947-2000

1978 to the present. The CPI-U index is used for years prior to 1978. As a result, the CPI-U-RS shows a much slower rate of inflation after 1973 than the CPI-U. 288 versus 238 per cent. If we use the CPI-U deflator, then median family income grew by 9 per cent between 1973 and 2000, in comparison to the 25 per cent growth rate on the basis of the CPI-U-RS deflator.

Another troubling change is with regard to poverty. Between 1959 and 1973, there was great success in reducing poverty in America, with the overall poverty rate declining by more than half, from 22.4 to 11.1 per cent (see Figure 1.2). After that, the poverty rate generally trended upward, climbing to 15.1 per cent in 1993, but it has since fallen back to 11.3 per cent in 1998, still above its low point in 1973.4 Another indicator of the well-being of lower-income families is the share of total income received by the bottom quintile (20 per cent) of families. At first, their share fell, from 5.8 per cent in 1947 to 4.7 per cent in 1961, but then rose rather steadily over time, reaching 5.7 per cent in 1974. Since then it has fallen off rather sharply, to 4.3 per cent in 2000.

A related statistic is the mean income of the poorest 20 per cent of families (in 2000 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, from $600 to $127,000 (both in 2000 dollars), but then rose only by 12 per cent, to $142,000 in 2000. The difference in post-1974 trends between this series and the share of income of the bottom quintile, which fell sharply, is that mean income was rising in the general population after 1974.

Figure 1.3 Labor earnings indices, 1947-2000 (1973 = 100)

The main reason for this turnaround is that the real hourly wage (average wages and salaries of production and nonsupervisory workers in the total private sector, adjusted for inflation) has been falling since 1973. Between 1973 and 2000, the BLS real hourly wages fell by 8 per cent (see Figure 1.3). This contrasts with the preceding years, 1947 to 1973, when real wages grew by 75 per cent. Indeed, in 2000, the hourly wage was $14.08 per hour, about the same level as in 1968 (in real terms).5

Other measures of worker pay are shown in Figure 1.3. The results are quite consistent among these alternative series. Average wages and salaries per FTE grew by 2.3 per cent per year from 1947 to 1973 and then 0.5 per cent per year from 1973 through 2000. Average employer compensation per FTE increased by 2.6 per cent per year during the first of these two periods, and 0.4 per cent per year in the second, and the sum of employee compensation and half of proprietors’ income had an annual gain of 2.7 per cent in the first and 0.4 per cent in the second.6 CPS mean earnings for year-round, full-time workers grew at an annual rate of 2.7 per cent from 1960 to 1973, and by 0.9 per cent from 1973 through 2000.

The United States has also witnessed a “disappearing” turnaround in inequality over the last quarter century. Figure 1.4 shows different indices measuring economic inequality in America. The first series is the Gini coefficient for family income. The Gini coefficient ranges from a value of zero to one, with a low value indicating less inequality and a high value more. Between 1947 and 1998 it generally trended downward, reaching its...
Figure 1.4 Income inequality trends, 1947-2000

The lowest value in 1968, at 0.348. Since then, it has experienced an upward trend, gradually at first and then more steeply in the 1980s and 1990s, culminating at its peak value of 0.439 in 2000.

The second index, the share of total income received by the top 5 per cent of families, has a similar time trend. It fell gradually, from 17.5 per cent in 1947 to 14.8 per cent in 1974 and then rose after this point, especially in the 1990s, reaching its highest value in 2000, 20.8 per cent. The third index is the ratio of the average income of the richest 5 per cent of families to that of the poorest 20 per cent. It measures the spread in income between these two groups. This index generally declined between 1947 and 1974, from 14.0 to 11.4, then trended steadily upward, reaching 19.7 in 1998, and then declined slightly to 19.1 in 2000.

Figure 1.5 shows another cut in family income inequality, based on "equivalent income". Equivalent income is based on the official US poverty line, which, in turn, adjusts family income for family size and composition (the number of individuals of any 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.

It is of interest to compute the trend in the equivalent income index of the middle quintile with that of median family income. The former rose by 18.0 per cent from 1967 to 1973 and by 16.8 per cent from 1973 to 2000. In comparison, median family income increased by 16.7 per cent in the first period and by 25.0 per cent in the second. The difference in growth rates after 1973 reflects the difference in price indices. Whereas the calculation of equivalent income is based on the CPI-U deflator (as is the computation of the poverty rate), CPS median family income is indexed by the CPI-U-RS deflator (see appendix). Indeed, as indicated above, median family income grew by only 9 per cent in real terms between 1973 and 2000 if the CPI-U deflator is used. The faster increase in equivalent income than median family income deflated by the CPI-U price index over the 1973-2000 period is consistent with the fact that average family size fell over the period. It is also of note that the annual growth of equivalent income slowed down for each of the five income quintiles between the two periods. In the case of the middle quintile, the annual growth rate was 1.20 per cent in the 1967-73 period and 0.25 per cent in the 1973-2000 period.

From the standpoint of inequality, the most telling result is that between 1973 and 2000, equivalent income grew faster the higher the income level. The differences are quite marked. Equivalent income increased by 54 per cent among families in the highest quintile, 26 per cent in the fourth quintile, 17 per cent in the middle quintile, 8 per cent in the second quintile, and a negative 0.9 per cent in the bottom quintile.

I also show trends in marginal tax rates of the personal income tax, since this also affects the well-being of families (see Figure 1.6). The first series is the top marginal tax rate (the marginal tax rate faced by the richest tax filers). Back in 1944, the top marginal tax rate was 94 per cent! After the end of World War II, the top rate was reduced to 66.5 per cent (in 1946), but during the Korean War it was soon back to 92 per cent (in 1953). Even...
in 1960, it was still at 91 per cent. This generally declined over time, as tax legislation was implemented by Congress. It was first lowered to 70 per cent in 1966, then raised to 77 per cent in 1969 to finance the war in Vietnam, then lowered again to 70 per cent in 1975, then to 50 per cent in 1983 (Ronald Reagan's first major tax act), and then again to 28 per cent in 1986 (through the famous Tax Reform Act of 1986). Since then, it has trended upward, to 31 per cent in 1991 (under President George Bush) and then to 39.6 per cent in 1993 (under President Bill Clinton).

The second series shows the marginal tax rate faced by families with an income of $135,000 in 2000 dollars. This income level typically includes families at the 95th percentile (the top 5 per cent). This series generally has the same trajectory as the first, decreasing in 1966, rising in 1975, falling in 1983 and 1986, and then increasing in 1991 and again in 1993.

The last two series show the marginal tax rates at $67,000 and $33,000, respectively, both in 2000 dollars. The time patterns are quite a bit different for these than for the first two. The marginal tax rate at $67,000 (about the 60th percentile) was relatively low in 1946, at 36 per cent, generally trended upward, reaching 49 per cent in 1980, before declining to 28 per cent in 1986, where it has remained ever since. The marginal tax rate at $33,000 (about the 30th percentile) was also relatively low in 1946, at 25 per cent, but it actually increased somewhat over time, reaching 28 per cent in 1991 and since remaining at this level.

All in all, tax cuts over the postwar period have been much more generous for the rich, particularly the super-rich. Since 1946, the top marginal tax rate has fallen by more than half (54 per cent), the marginal rate at $135,000 by 32 per cent, and the marginal rate at $67,000 by 35 per cent, while the rate at $33,000 actually increased by 13 per cent.

TRENDS IN SCHOOLING AND EARNINGS

One of the great success stories of the postwar era is the tremendous growth in schooling attainment in the US population. This is documented in Figure 1.7. Median years of schooling among all people 25 years old and over grew from 9.0 years in 1947 to 13.6 in 2000. Most of the gain occurred before 1973. Between 1947 and 1973, median education increased by 3.3 years, and from 1973 to 2000 by only another 1.3 years.

Trends are even more dramatic for the percentage of adults (age 25 and over) who completed high school and college. The former grew from 33 per cent of all adults in 1947 to 84 per cent in 2000. Progress in high-school completion rates was almost as strong after 1973 as before — from 35 per cent in 1947 to 60 per cent in 1973 and from 60 per cent in 1973 to 84 per cent in 2000. The percentage of college graduates in the adult population soared from 5.8 per cent in 1947 to 26.2 per cent in 2000. In this dimension, progress was actually greater after 1973 than before. Between 1947 and 1973, the percentage of adults who had graduated from college rose by 7.2
Figure 1.8 Ratio of mean annual earnings between college and high school graduates by gender, 1975–2000 (includes all workers age 18 and over with earnings).

Figure 1.9 Mean annual earnings by educational attainment level, 1975–2000 (in 2000 US$).

with a bachelor's degree (but not further schooling) increased by 26 per cent. The biggest increase in earnings occurred among males with an advanced degree (master's or higher), who saw their annual incomes grow by 30 per cent. Among males who did not graduate from high school, earnings plummeted by 9 per cent.

Another indicator of the country's success in education is the dramatic decline in the inequality of schooling in this country. According to the human capital model, there is a direct and proportional relationship between earnings inequality and the variance of schooling. From the standard human capital earnings function,

\[ \log E_i = \beta_0 + \beta_1 S_i \]

where \( E_i \) is the earnings of individual \( i \), \( \log \) is the natural logarithm, \( S_i \) is the level of schooling, and \( \beta_0 \) and \( \beta_1 \) are coefficients (see, for example, Mincer 1974). This equation states that labor earnings should rise with years of schooling. It then follows that:

\[ \text{Var}(\log E_i) = \beta_1^2 \text{Var}(S_i) \]

where \( \text{Var} \) is the variance. The variance of the logarithm of earnings is a standard inequality index, used in the economics literature, and this...
Figure 1.10  Family income inequality and educational trends, 1947-2000

The equation indicates that earnings inequality rises at the same rate as that of the variance (or dispersion) of schooling levels among workers.

Yet, as shown in Figure 1.10, while income inequality has risen since the late 1960s, the variance of schooling (of adults 25 years of age or older, computed from CPS data), has trended sharply downward since 1990. In fact, the variance of schooling fell by 46 per cent over the period from 1990 to 2000 (from 12.5 to 6.9). The simple correlation between the two series is, in fact, -0.78. This finding leads to the second paradox of the chapter—namely, the growing discord between the inequality of income and the inequality of human capital.

TRENDS IN PRODUCTIVITY AND PROFITABILITY

Another anomaly arises when we consider the relation between productivity and earnings. In particular, the historical connection between labor productivity growth and real wage growth also appears to have broken down after 1973. In the case of an economy characterized by competitive input markets and constant returns to scale, it follows that wages and labor productivity should grow at exactly the same rate:

$$w = \alpha X/L = \alpha X/L$$

where $Y$ is total output, $L$ is total employment, and $\alpha$ is the output elasticity of labor, which equals the wage share in this special case.
net fixed capital. The net profit rate declined by 7.5 percentage points between 1947 and its nadir, 13.1 per cent in 1982 (see Figure 1.12). It then climbed by 6.0 percentage points from 1982 to 1997, though it fell off by 0.5 percentage points between 1997 and 2000. However, even by 2000, it reached 18.6 per cent, well above its low point in 1982.

Figure 1.12 also shows trends in the net profit share in national income. It rose by 2.4 percentage points between 1947 and its peak value of 32.0 per cent in 1950 and then fell by 7.2 percentage points between 1950 and its low point of 24.8 per cent in 1970. It then generally drifted upward, rising by 4.2 percentage points between 1970 and its next high point of 29.1 per cent in 1997. Since then, it has fallen by 1.7 percentage points between 1997 and 2000, though the net profit share was still above its nadir in 1970. The results clearly show that the stagnation of earnings in the United States since the early 1970s has translated into rising profits in the economy.

HOUSEHOLD WEALTH

As noted in the introduction to the chapter, the media has promoted the idea of people's capital gains - that all families are benefiting from the stock market boom of recent years. In this section, I look at recent trends in household wealth. I use marketable wealth (or net worth), defined as the current value of all marketable or fungible assets less the current value of debts. Net worth is thus the difference in value between total assets and total liabilities or debt. Total assets are defined as the sum of: (i) the gross value of owner-occupied housing; (ii) other real estate owned by the household; (iii) cash and demand deposits; (iv) time and savings deposits, certificates of deposit, and money market accounts; (v) government bonds, corporate bonds, foreign bonds, and other financial securities; (vi) the cash surrender value of life insurance plans; (vii) the cash surrender value of pension plans, including individual retirement accounts (IRAs), Keogh, and 401(k) plans; (viii) corporate stock and mutual funds; (ix) net equity in unincorporated businesses; and (x) equity in trust funds. Total liabilities are the sum of: (i) mortgage debt, (ii) consumer debt, including auto loans, and (iii) other debt.

I first look at long-term trends in average wealth on the basis of the Federal Reserve Board's Flow of Funds data (Board of Governors of the Federal Reserve 2002). Average household wealth, after surging by 42 per cent over the 1947-73 period, gained only another 10 per cent between 1973 and 1995, though it added an additional 28 per cent from 1995 to 2000, mainly because of the stock market boom of the late 1990s (Figure 1.13). The total gain from 1973 to 1998 was 30 per cent. This compares to a 43 per cent increase in mean family income over the same period.

Trends in wealth inequality, as measured by the share of total personal wealth owned by the richest one per cent of households, are displayed in
Figure 1.14 Income and wealth inequality trends, 1947–1998

Recent trends in living standards in the United States

Table 1.1 Mean and median wealth and income, 1983–1998 (thousands of 1998 dollars)

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<tbody>
<tr>
<td>1. Median</td>
<td>54.6</td>
<td>58.4</td>
<td>49.9</td>
<td>48.8</td>
<td>48.7</td>
<td>11.1</td>
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<tr>
<td>2. Mean</td>
<td>212.6</td>
<td>243.6</td>
<td>236.8</td>
<td>218.8</td>
<td>270.3</td>
<td>27.1</td>
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<tr>
<td>3. Net worth (CI)</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>a. Zero or negative</td>
<td>15.5</td>
<td>17.9</td>
<td>18.0</td>
<td>18.5</td>
<td>18.0</td>
<td></td>
</tr>
<tr>
<td>b. Less than $500k</td>
<td>25.4</td>
<td>27.6</td>
<td>27.2</td>
<td>27.8</td>
<td>27.2</td>
<td></td>
</tr>
<tr>
<td>c. Less than $1M</td>
<td>29.7</td>
<td>31.8</td>
<td>31.2</td>
<td>31.9</td>
<td>30.3</td>
<td></td>
</tr>
<tr>
<td>B. Income (n)</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Median</td>
<td>34.2</td>
<td>38.0</td>
<td>35.6</td>
<td>36.4</td>
<td>38.9</td>
<td>13.8</td>
</tr>
<tr>
<td>2. Mean</td>
<td>41.6</td>
<td>48.0</td>
<td>45.1</td>
<td>48.1</td>
<td>51.9</td>
<td>24.7</td>
</tr>
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</table>

Notes:


Between 1989 and 1998, one means for the slow growth in median wealth is evident from the third row of Table 1.1, which shows that the percentage of households with zero or negative net worth increased from 15.5 per cent in 1983 to 18.0 per cent in 1998. The share of households with net worth less than $500,000 and less than $1 million (both in 1998 dollars) also rose over the period.

Mean wealth is much higher than the median; $27,000 versus $61,000 in 1998. This implies that the vast bulk of household wealth is concentrated in the richest families. Mean wealth also showed a sharp increase from 1983 to 1989 followed by a rather precipitous decline from 1989 to 1995, and then, largely by rising stock prices, another surge in 1998. Overall it was 27 per cent higher in 1998 than in 1983, and 11 per cent larger than in 1989.5 A comparison with income trends is also provided. Median household income, based on the Current Population Survey, increased by 11.2 per cent from 1983 to 1989 and then by only 2.3 per cent from 1989 to 1998.9 The pattern is similar to that of median wealth, whose growth also slowed down substantially before and after 1989. Mean household income gained 25 per cent between 1983 and 1998, in comparison to a 27 per cent growth in mean household wealth. As with wealth, income grew faster in the 1983–89 period than in the 1989–98 period.
Figure 1.15 provides further details on the 1983-98 period for time trends in CPS median household income and SCF median household wealth. Both show similar dips in the early 1990s. Median household income in 2000 dollars rose briskly between 1983 and 1989, by 13 per cent but then dropped rather precipitously over the next four years, by 6 per cent. It then climbed upward between 1993 and 1998, just exceeding its 1989 peak by 5 per cent. Median household wealth, also in 2000 dollars, first rose by 7 per cent between 1983 and 1989, declined by 6 per cent from 1989 and its low point in 1992, and then surged by 10 per cent from 1992 to 1998.

In Table 1.2, I provide some other indicators of the fortunes of the middle class, as defined by the middle quintile of the income distribution. The first of these is home ownership. Here, there has been some progress. In 1983, 60 per cent of middle-class households owned their own home. This figure rose to 63 per cent in 1989, fell over the subsequent two periods and then climbed to 68 per cent in 1998. The second is with regard to the debt position of the middle class. The debt-to-asset ratio fell slightly from 24 per cent in 1983 to 23 per cent in 1989 and then grew to 25 per cent in 1992 (from the 1991-92 recession). By 1998, it had turned back to 23 per cent. In contrast, the debt-to-income ratio of the middle class increased almost monotonically over the 1983-98 period, from 0.54 to 1.00.

The third indicator is stock ownership. There have been widespread reports in the media that stock ownership has substantially widened in the United States, particularly during the 1990s. There is some truth to these reports. The proportion of middle-class households who own some stock either outright or indirectly through mutual funds, trusts, or various pension accounts increased from 17 per cent in 1983 to 50 per cent in 1998. Much of the increase was fueled by the growth in pension accounts such as IRA’s, Keogh plans, and 401(k) plans, and other retirement accounts. In 1983, ownership of stocks and mutual funds only.

Table 1.2 Wealth holdings of the middle quintile of the income distribution, 1983-1998

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<tbody>
<tr>
<td>A. Households owning homes (%)</td>
<td>60.3</td>
<td>63.3</td>
<td>60.6</td>
<td>62.4</td>
<td>68.0</td>
</tr>
<tr>
<td>B. Households indebtedness</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Debt/assets</td>
<td>0.24</td>
<td>0.23</td>
<td>0.26</td>
<td>0.24</td>
<td>0.23</td>
</tr>
<tr>
<td>2. Debt/income</td>
<td>0.54</td>
<td>0.71</td>
<td>0.86</td>
<td>0.94</td>
<td>1.00</td>
</tr>
<tr>
<td>C. Households owning stock directly or indirectly (%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Any stock holdings</td>
<td>17.2</td>
<td>29.9</td>
<td>35.2</td>
<td>44.3</td>
<td>49.9</td>
</tr>
<tr>
<td>2. Stock worth $5000 or moreb</td>
<td>9.2</td>
<td>18.3</td>
<td>18.7</td>
<td>28.4</td>
<td>34.8</td>
</tr>
<tr>
<td>3. stock worth $10000 or moreb</td>
<td>5.9</td>
<td>1.4</td>
<td>1.3</td>
<td>21.0</td>
<td>27.7</td>
</tr>
</tbody>
</table>

Notes: 
- Includes direct ownership of stock shares and indirect ownership through mutual funds, trusts, and IRAs, Keogh plans, 401(k) plans, and other retirement accounts. In 1983, ownership of stocks and mutual funds only.
- 1998 dollars.

CONCLUSION

The last quarter of the twentieth century or so saw slow-growing earnings, income, and wealth for the middle class, as well as a stagnating poverty rate and rising inequality. In contrast, the early postwar period witnessed rapid gains in wages, family income, and wealth for the middle class, in addition to a sharp decline in poverty, and a moderate fall in inequality. Personal tax rates have generally fallen over time but much more for the rich than for the middle class. In sum, the middle class has been squeezed in terms of income, earnings, and wealth since the early 1970s.

The "boomers' 1990s" has not brought much relief to the middle class. Median household income grew by only 8 per cent between 1989 and 1998 (6 per cent with the CPI-U-RS deflator), while median wealth gained 3.8 per cent from 1989 to 1998. The homeownership rate among the middle-income quintile did expand from 67 to 68 per cent. Household debt as a fraction of assets in this group remained steady at 0.23 but the debt-to-income ratio soared from 0.71 to 1.00. Stock ownership among the middle class grew from 30 to 50 per cent and the share of households with stocks worth $10,000 or more climbed from 1 to 28 per cent. All in all, the standard of living among the middle class, as measured by these economic indicators, did not show much progress in comparison to the early postwar period and even compared to the 1980s. Part of the poor performance is attributable to the sharp drop in income, wealth, and consumption experienced during the 1991-92 recession. Income and wealth recovered after 1993 but not enough to get much ahead of 1989.

The stagnation of living standards among the middle class over the last 30 years is attributable to the slow growth in labor earnings over this period. While average earnings (employee compensation per FTE) almost doubled between 1947 and 1973, they advanced by only 11 per cent from 1973 to 2000. From 1989 to 2000, they grew by 9 per cent. This occurred in spite of substantial progress in educational attainment since the 1970s. Moreover, despite incredible success in reducing disparities of schooling within the American population, the inequality of income has not only failed to decline, but has actually risen sharply over the last three decades. These results suggest a growing disconnection between earnings and schooling.

The main reason for the stagnation of labor earnings derives from a clear shift in national income away from labor and towards capital, particularly since the early 1980s. Over this period, both overall and corporate profitability had risen rather substantially, almost back to postwar highs. The stock market has, in part, been fueled by rising profitability. While the capitalist class has gained from rising profits, workers have not experienced much progress in terms of wages. On the surface, at least, there appears to be a tradeoff between the advances in income and wealth made by the rich and the stagnation of income and wealth among the working class.

What can be done about the stagnating fortunes of the average (working) American? Current policy discussions in Washington have emphasized the need for better education of the labor force and improved training. Education and training are seen to be the key remedies for two major problems that all the economy faces: first, they will lead to higher skills and thus higher-paying jobs and increase the real wage, and second, they will lead to a more equitable distribution of skills in the labor force and thus reduce wage inequality. The results of the chapter seem to cast doubts on the efficacy of this solution.

What should Washington do? I believe that the most effective way to reverse the decline of the real wage and to reduce income disparities is through incomes policy. Among the remedies that I propose are the following.

1. Reduce the minimum wage to its 1968 level. The minimum wage in 2000 was down about a third in real terms, from its peak level in 1968 (when the unemployment rate was only 3.6 per cent). Raising the minimum wage will help increase the wages of the low-wage earners. A more powerful idea is to extend the coverage of "Living Wage" ordinances, which mandate a minimum wage, usually around $10.00 per hour, for city workers and those employed under city contracts. These programs are now in effect in a few dozen municipalities around the country but could be vastly extended.

2. Extend the Earned Income Tax Credit (EITC). The EITC provides supplemental pay to low-wage workers in the form of a tax credit on their federal income tax return. In fiscal year 1999, the EITC provided $29 billion in supplemental aid. An expansion of this credit will further raise the (post-tax) income of low-income families.

3. Make tax and transfer policy more redistributive. A more potent weapon to meet these objectives is to redesign our tax and income support systems so that they transfer more income from the rich to the poor. Tax policy over the last two decades, as shown above, has clearly benefited the rich over the poor (and capital over labor). Comparisons between the United States and other advanced industrial countries (including Canada), which face similar labor market conditions, indicate that tax and transfer policies can be effective in reducing inequality and increasing post-tax income (see, for example, Atkinson et al. 1995).

4. Re-empower labor. The findings presented here and the cross-national evidence compiled elsewhere suggest that one of the principal reasons
for the greater level of inequality in this country and its relatively rapid rise in recent years in comparison to other advanced economies is the low level of unionization in this country (see, for example, Blau and Kahn 1996). This is also a principal factor in explaining declining real wages in the United States. Steps should be taken to help promote unionization in the workplace and expand the power of labor. This can start with reform of existing labor laws. Other work has documented how existing labor law is biased against the establishment of new unions and how notoriously difficult it is the certification process (see, for example, Gordon 1996).

NOTES
1. Over that time period, the S&P 500 composite index increased by a factor of 2.5.
2. These figures are based on the Bureau of Labor Statistics (BLS) hourly wage series (Council of Economic Advisers 1981, 2002). The BLS wage figures are converted to constant dollars on the basis of the consumer price index (CPI-U). The CPI has recently been criticized for overstating the rate of inflation. While this may be true, it is not clear that the degree of bias in the CPI has risen in recent years. As a result, it is likely that the sharp break in the wage series before and after 1993 would still remain even if the bias in the CPI were corrected. The Current Population Survey (CPS) data are defined to constant dollars using the new CPI-U-RS price index. The CPI-U-RS series makes quality adjustments for housing units and consumer durables such as automobiles and personal computers and employs a geometric mean formula to account for consumer substitution within CPI item categories. As a result, the CPI-U-RS deflator is not subject to the same criticisms as the CPS-U series.
3. Figures are in 2000 dollars unless otherwise indicated. It would actually be profitable to one household's income rather than family income. Usually, official US Bureau of the Census series on household income begins only in 1965, whereas family income data are available from 1947 onward.
5. The first series is based on the BLS hourly wage series and refer to hourly wages and salaries of production and nonsupervisory workers in the total private sector. The next three wage series are the National Income and Product Accounts (NIPA) wages and salaries per hour full-time equivalent employee (FTE), employee compensation (the sum of wages and salaries and employer benefits) per FTE, and employee compensation plus half of proprietors' income per person equivalent in production (PEP). The data come from the Current Population Survey (CPS). The first four series are defined to constant dollars using the CPI-U-RS deflator or its design.
6. The reason for including only a portion of proprietors' income is that part of the income of self-employed workers is returns to the capital invested in incorporated businesses. Alternative calculations show that the resulting time trend is quite insensitive to the fraction used in the calculation.
7. The data source for the first three series in Figure 1 in US Bureau of the Census (2002c). These figures are based on unrounded data.
8. It would have been preferable to compute the average incomes of the top 5 percent with that of the bottom 1 percent but figures for the latter are not available.
9. The data are from US Bureau of the Census (2002a). The average income-to-poverty ratios are computed by dividing the mean income of families in each quintile (as weighted by family incomes) by the median poverty threshold of the families in that quintile. It would be useful to be able to compute equivalent income for each family in the sample and then to rank the sample by equivalent income to obtain new 'equivalent income' quintiles; but the underlying data are not available.
10. The data are from US Bureau of the Census (2002a). Adults refer to persons of age 25 years and older in the noninstitutionalized population (excluding members of the Armed Forces living in barracks).
11. The figures are for annual earnings, which are not adjusted for hours worked or the experience level of the workers. The source for the data is Figures 1 and 19 in US Bureau of the Census (2002a).
12. Results are shown for employee compensation per FTE. Results are almost identical for employee compensation plus half of proprietors' income per PEP.
14. Full technical details on data sources and methods can be found in Wolff (2001).
15. The time trend is similar when the wage of vehicles is also included in net worth, since most of the owners are men of descent. By rising by 41 percent between 1981 and 1998, median net worth increased by 25 percent, and the median rent by 28 percent instead of by 27 percent.
16. The statistics here differ from those portrayed in Figure 1, which are based on family income.

REFERENCES


