PULLING APART: Ohio

An Analysis of Income Trends

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January 2006

The **Center on Budget and Policy Priorities**, located in Washington, DC, is a non-profit research and policy institute that conducts research and analysis of government policies and the programs and public policy issues that affect low and middle-income households. The Center is supported by foundations, individual contributions, and publications sales.

The Center on Budget and Policy Priorities (CBPP) published the national report, *Pulling Apart: A State-by-State Analysis of Income Trends*, which was written by Jared Bernstein, Elizabeth McNichol and Karen Lyons. This report is a slightly abridged and modified version of that report, tailored for an Ohio audience. We encourage readers to also examine the national report, available at www.cbpp.org, www.epinet.org, or www.policymattersohio.org.

Acknowledgements

The authors wish to thank colleagues at the Center on Budget and Policy Priorities and the Economic Policy Institute who contributed to this report. At the Center, Iris Lav provided thoughtful critiques and helpful suggestions throughout the development of the report. Isaac Shapiro and Arloc Sherman provided critical input on the methodology and substance of the report. The work of former Center staff member Robert Zahradnik on this project contributed greatly to our efforts. Ifie Okwuje provided diligent and thorough research support. We would like to thank John Springer for his excellent editing. Tina Marshall prepared the final document for publication. Sara Williams — the fiscal project's intern — assisted in the preparation of this report. Shannon Spillane, Henry Griggs, Michelle Bazie and Joshua Kaufman provided much appreciated assistance in publicizing this report.

The Center on Budget and Policy Priorities would like to acknowledge the Atlantic Philanthropies, Annie E. Casey Foundation, the Ford Foundation, the Foundation for Child Development, the George Gund Foundation, the William and Flora Hewlett Foundation, The Joyce Foundation, the John S. and James L. Knight Foundation, the John D. and Catherine T. MacArthur Foundation, the Moriah Fund, the Charles Stewart Mott Foundation, the New Prospect Foundation, the Open Society Institute, the Popplestone Foundation, the Public Welfare Foundation, the Charles H. Revson Foundation, the Rockefeller Foundation, the Stoneman Family Foundation, and an anonymous donor for their support of the Center's State Fiscal Project. The Center is grateful to these funders for making this work possible.

The Economic Policy Institute would like to acknowledge the Joyce Foundation, the John D. and Catherine T. MacArthur Foundation, the Charles Stewart Mott Foundation, and the Rockefeller Foundation for their support of EPI's Living Standards Program. The Institute also acknowledges the Ford Foundation, the Charles Stewart Mott Foundation, and the Open Society Institute for their support of the Economic Analysis and Research Network (EARN) program.

At EPI, Danielle Gao was instrumental in the data analysis for the report. Yulia Fungard provided helpful research assistance. Nancy Coleman's, Karen Conner's and Stephaan Harris's hard work to build an audience is much appreciated. We also wish to thank Larry Mishel for his helping us think about measuring income inequality and Jeff Chapman for making this data accessible to our state-level partners.

For the Ohio version of this report, Policy Matters Ohio Executive Director Amy Hanauer contributed information on Ohio to this report and modified and slightly abridged the national report to better meet the needs of Ohio readers.

I. Executive Summary

Income inequality has worsened in Ohio and the United States, both over the past decade and over the past two decades.

Between the early 1980s and the early 2000s, the incomes of the highest-income families climbed substantially, while middle- and lower-income families saw only modest increases in income in both Ohio and the U.S. Low unemployment in the late 1990s led to relatively broad-based wage growth, but this ended in the wake of the 2001 downturn and was not enough to reverse the tide of growing inequality. Real wages for low- and moderate-income families have now begun to decline.

The recession's impact on poor and middle-income families lasted longer than usual, particularly in Ohio which added just 3,600 jobs during 2005, a gain that amounts to less than a tenth of one percent in a job market that includes more than 5 million Ohioans. As of December 2005, Ohio's job levels remained 172,800 jobs (3.1 percent) below the level at the beginning of the recession, more than three and a half years earlier in March 2001.

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 the U.S. and Ohio over the past two business cycles.

Income Inequality Increased in Most States, including Ohio, Over the Last Two Decades

Across the nation, income gaps between the rich and the poor, the rich and the middle, and the very rich and everyone else, have grown substantially over the past two decades:

♦ In 38 states, including Ohio, income growth among high-income families dwarfed that among low-income families between the early 1980s and the early 2000s. The average income of the richest fifth of families increased by $42,884 (57.6 percent), from $74,394 to $117,277. This is roughly an increase of $2,040 a year.

♦ The average income of the poorest fifth of Ohio families increased by $3,186, from $15,030 to $18,216. This is roughly an increase of $150 a year.

♦ The average income of the middle fifth of families increased by $10,305, from $37,387 to $47,692. This is roughly an increase of $490 a year.

♦ Much of the increase for low and middle-income workers can be attributed to increases in hours of work. For example, married couple families with children increased their work hours by more than 16 percent between 1979 and 2002.

♦ The very wealthy (top five percent) had the sharpest income growth. The average income of the richest five percent of families increased by $91,608, from $103,567 to $195,175 in Ohio between the early 1980s and the early 2000s. This is roughly an increase of $4,360 a year.

♦ In the United States as a whole, the poorest fifth of families had an average income of $16,780 in the early 2000s, while the top fifth of families had an average income of $122,150, more than

seven times as much. Ohio earnings in the early 2000s were less unequal, with the top quintile earning $117,300, 6.4 times the bottom quintile earnings of $18,200.

♦ In the early 1980s, there was no state in which the average income of high-income families was as much as 6.4 times larger than the average income of low income families. By the early 2000s, 32 states, including Ohio, had "top to bottom" ratios of 6.4 or greater.

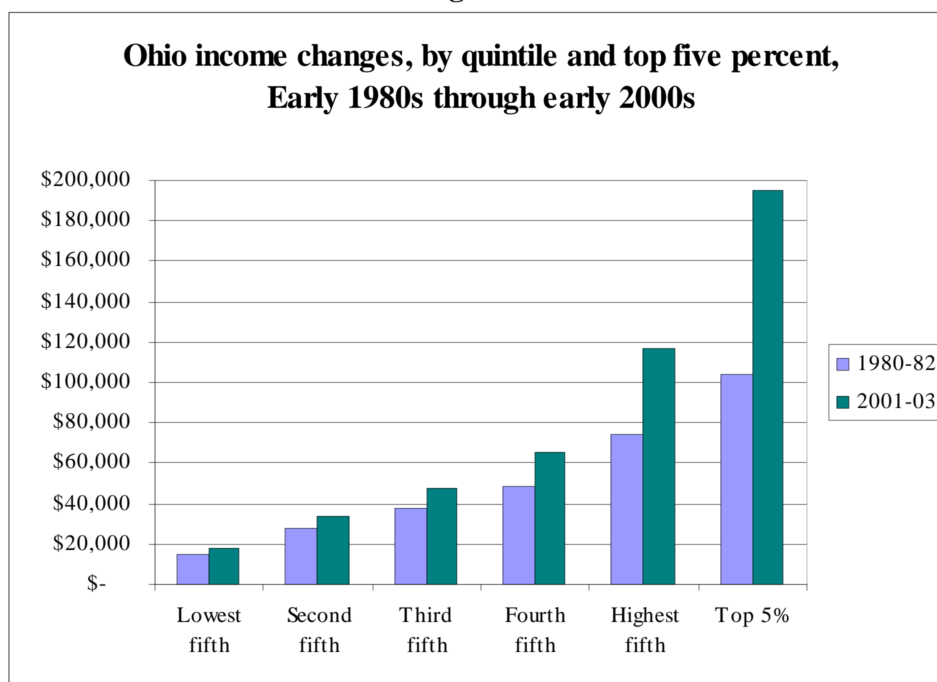
♦ By the early 2000s, the average incomes of the top five percent of families nationally were 12 times the average incomes of the bottom 20 percent. Ohio's top five percent, on average, earned 10.7 times as much as the average family in the lowest quintile.

♦ Similarly, the income gaps between high-income and middle-income families have grown. In the early 1980s, Alaska was the only state in which the top fifth of families earned more than 2.3 times what the middle fifth earned on average. By the early 2000s, the "top-to-middle" ratio was greater than 2.3 in 36 states, including Ohio.

♦ Inequality did not grow as quickly during the 1990s as during the prior decade (or as quickly as it appears to be growing in the 2000s), but income gaps continued to grow in many states including Ohio. In Ohio, incomes grew more among the top fifth than either among the middle or the bottom fifth during this period, and grew more among the top five percent than among any of the quintiles.

Figure A shows graphically the spiking income inequality in Ohio over the past two decades.

Figure A



Source: Economic Policy Institute/Center on Budget and Policy Priorities analysis of CPS data.

Causes of Rising Inequality

The growth of income inequality is primarily due to growth in wage inequality. Wages at the bottom and middle have been stagnant or have grown only modestly for much of the last two

decades while wages of the very highest-paid employees have grown significantly.

Wage inequality stems from long periods of high unemployment, globalization, shrinkage of manufacturing jobs, expansion of low-wage service jobs, immigration, lower real value of the minimum wage and fewer and weaker unions. These factors have eroded wages for workers with less than a college education, who make up approximately the lowest-earning 70 percent of the workforce. Recently, even those with a college education have seen real wage declines, due to bursting of the tech bubble and downward pressure on wages from offshore competition.

Only in the later part of the 1990s was there a modest improvement in this picture. Persistent low unemployment, an increase in the minimum wage, and rapid productivity growth fueled real wage gains at the bottom and middle of the income scale. Yet those few years of more broadly shared growth were not sufficient to counteract the two-decade-long pattern of growing inequality. Today, inequality between low- and high-income families and between middle- and high-income families is greater than it was either 20 years ago or ten years ago.

The expansion of investment income (such as dividends, rent, interest, and capital gains) during the 1990s also increased income inequality, since investment income primarily accrues to those at the top of the income structure.

Government policies 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 certain aspects of the social safety net, the lack of effective labor laws regulating the right to collective bargaining, and the declining real value of the minimum wage have all contributed to growing inequality. In addition, changes in federal, state and local tax structures and benefit programs have, in many cases, accelerated the trend toward growing inequality emerging from the labor market. The large increase in corporate profits has also contributed to growing inequality by depressing wage growth and boosting the incomes of investors.

States Can Choose a Different Course

A significant amount of increasing income inequality results from economic forces that are largely outside the control of state policymakers. Ohio's policies, however, can mitigate the effects of these outside forces. Ohio could implement a state minimum wage, implement a state earned income tax credit (EITC), strengthen its unemployment compensation system, particularly for low-wage workers; strengthen its social safety net, and work to make tax policy more progressive. All of these would do much to restore the more equitable distribution of income that existed for much of the latter part of the 20th century.

I. Introduction

This report examines trends in the distribution of income from the early 1980s to the early 2000s in Ohio and the U.S. These time periods were chosen because they represent similar points in the economic cycle. The early 2000s — the most recent period for which state-by-state data are available — spans the lowest point of the most recent economic downturn. This period was compared to a similar low point in the national economy in the early 1980s. The report finds that the incomes of the country's richest families climbed substantially over the past two decades, while middle- and lower-income families saw only modest increases in income.

This trend of rising inequality has been well documented by data at the national level from the Congressional Budget Office and other sources. Few analyses, however, have focused on how income inequality has changed at the state level in Ohio. This analysis finds that in the vast majority of states including Ohio, the gap between the incomes of the highest-income families and the incomes of middle-class and poor families has grown by a large margin over the period.[1]

The exceptionally low unemployment rates of the late 1990s did yields gains for low-wage workers and relatively broad-based wage growth, but income gaps continued to widen. This broad-based growth ended with the 2001 downturn. Nationally, real wages for low- and moderate-income families grew more slowly in 2002 and the first part of 2003 and then began to decline.

To a greater extent than in past recessions, the highest-income families also saw declines in real income during the 2001 downturn. These declines, which reflected the impact of the drop in the stock market, were short lived. Indications are that since 2002, the incomes of the richest families have rebounded strongly.

In contrast, the downturn's impact on low-and moderate-income families has lingered for longer than is typical. In particular, unemployment has not fallen far enough to generate the pattern of income gains among low- and middle-income families that was seen in the late 1990s. In addition, recent federal tax cuts targeted primarily on wealthy families are helping widen the income gap between the wealthiest families and those with low and moderate incomes.

The growing divide between the rich and the poor and the middle class deserves the attention of policymakers and the public.

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 the benefits of that growth. Over the past two decades, however, the benefits of economic growth have been skewed in favor of the wealthiest members of society. The majority of Americans continue to believe that income

[1] Families with income that fall in the bottom 20 percent of the income distribution are referred to as "poor" in this report. Approximately half of these families have incomes below the official poverty line.

differences are too large and that wealth should be more evenly distributed.[2] Economic forces and government actions, however, have resulted in growing inequality.

This problem is particularly notable in the current economy, as the gap between improvements in productivity (the amount of goods and services generated per hour worked) and real income growth for most families is the largest on record. Most economists consider productivity improvements to be synonymous with a broadly shared increase in living standards. Such was the case between the 1940s and the 1970s: the incomes of families at all levels grew at about the same rate over that period.

Over the last two decades, though, this pattern has changed. Productivity has continued to rise, but the lion's share of the benefits has gone to the richest families. This shows that improving productivity creates only the potential for increased living standards. When the rewards of productivity are channeled upwards, many families fail to benefit from overall economic growth.[3]

Halting and then reversing this trend is the only fair path. A widening gulf between the rich on the one hand and the poor and middle class on the other hand can reduce social cohesion, trust in government and other institutions, and participation in the democratic process.

As the divide grows, families have less contact and familiarity with the problems faced by those in different economic circumstances. High incomes at the top end have helped bid housing prices out of the reach of low- and moderate-income families. Growth in use of private schools has eroded support for public schools and growing economic divisions between communities has meant that wealthy suburban residents have little understanding or concern for needs of poor school districts.

Income inequality can also directly harm to the poor. A recent conference on income inequality sponsored by the Federal Reserve Bank of New York featured several papers which linked higher levels of inequality to poor schools, substandard housing, and higher levels of crime victimization. The impact of inequality on public health has received considerable attention from researchers. A recent article 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."[4] The United States has substantially greater inequality than nearly all other developed nations.

The slow growth 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.

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[2] Leslie McCall and Julian Brash, "What Do Americans Think About Inequality? An Analysis of Polls and Media Coverage of Income Inequality," Demos, May 2004.

[3] This point was recently made in a study by a leading macroeconomist, Robert Gordon, who writes: "Our most surprising result is that over the entire period 1966-2001, as well as over 1997-2001, only the top 10 percent of the income distribution enjoyed a growth rate of real wage and salary income equal to or above the average rate of economy-wide productivity growth. Growing inequality is not just a matter of the rich having more capital income; the increasing skewness in wage and salary income is what drives our results. From Where Did the Productivity Growth Go?, by Ian Dew-Becker and Robert J. Gordon, forthcoming, Brookings Paper on Economic Activity.

[4] 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.

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 than non-poor children. They also are far more likely to be unemployed as adults.[5]

Government at all levels has an important role to play in pushing back against the growth of income inequality. Through policies such as raising the minimum wage, implementing supports for low-income working families, reforming regressive state tax systems, and strengthening unemployment insurance, state and federal lawmakers can help moderate the growing income divide. This report focuses on growing inequality in the states and on policies that states can adopt to mitigate these trends.

Methodology

To assess how families at different income levels in each state have fared over the past two decades, this report measures income inequality at three points in time: the early 1980s, the early 1990s, and the early 2000s. These periods reflect comparable points in the economic cycle — namely, when the economy was in a recession, although the early 1980s recession was deeper than subsequent downturns. All families are ranked by family income (adjusted for family size) and then divided into five groups (or "quintiles"), each containing the same number of persons (not the same number of families). The average income of families in each quintile is then calculated for each of the three time periods.

The data source for this analysis is the Bureau of the Census's March Current Population Survey — a survey of a nationally representative sample of households conducted every year. The survey provides information on family income, which includes not only wages and salaries, but also other sources of cash income such as interest income and cash benefits, including veteran's assistance, welfare payments, and child support income. The starting point is the official Census definition of cash income. This analysis then uses additional Census Bureau data to construct a more comprehensive measure of income. The measure used here accounts for the impact of the federal tax system (including the Earned Income Tax Credit) and the cash value of food stamps, subsidized school lunches, and housing vouchers. Income from capital gains is also included. The incomes shown are adjusted for inflation and expressed as their value in 2002 dollars.

This study is based on three year averages of income data for each of the states. The use of three year averages is necessary in order to have a large enough sample to accurately estimate average income for each of the five income groups for each state.

This Analysis Understates Growth in Inequality

For two main reasons, our results understate the magnitude of growth in inequality over the last two decades. First, the Census Bureau data do not capture trends among the top 1 percent of families. Data from other sources such as the Congressional Budget Office show that the growth in the incomes of the top quintile was especially rapid at the very top of the income scale. Second, this analysis found higher income growth for the bottom fifth than other studies of the last two decades. This results from the starting point for this trend over time — the average incomes for 1980, 1981 and 1982. These were particularly bad years for low-income families as they were hit harder by the economic downturn of the early 1980s than by subsequent recessions. The fact that we're starting our analysis of income growth from this uniquely low base means that we are likely to record particularly strong growth rates for the lowest-income families.

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

II. The Long-Term Trend: The Early 1980s to the Early 2000s

Nationwide and in Ohio, income inequality increased significantly between the early 1980s and the early 2000s. Gaps in income between the richest and poorest families and between the richest and middle-income families have widened across the United States. The incomes of the country's richest families climbed substantially over the past two decades, but middle- and lower-income families saw only modest increases in income. This trend is in marked contrast to the broadly shared increases in prosperity that prevailed between World War II and the 1970s. This chapter examines this long-term (two-decade) trend in income inequality, while trends over the past decade are examined in the next chapter.

To assess how families at different income levels have fared over the past two decades, this report measures income inequality at three points in time: the early 1980s, the early 1990s, and the early 2000s. These periods reflect comparable points in the economic cycle — namely, when the economy was in a recession. All families are ranked by family income (adjusted for family size) and then divided into five groups (or "quintiles"), each containing the same number of persons.[6] The average income of families in each quintile is then calculated for each of the three time periods.

The report first examines the changes in average income for each quintile over time to compare income growth among different income groups. It then examines the ratios of the average income of the highest-income quintile to the middle and bottom quintiles and looks at changes in these ratios over time.

Work Hours

Families across the income spectrum have dramatically increased their work hours over the period covered in this report, even though hours of work declined substantially in the downturn between 2000 and 2002. Much of the growth in income through the year 2000 can be attributed to this growth in work hours. Data on hours of work is not available at the state level, but at the national level, the median two-parent family increased its hours of work by 18.4 percent between 1979 and 2000, to more than 3600 hours a year by 2000. In the recession and its aftermath, work hours declined by 1.8 percent at the median, to 3566 hours, leaving a net increase in work hours over the two decades of 16.2 percent at the median nationally.

Poor married families with children also increased their work hours by a similar 18.9 percent between 1979 and 2000. However, poor families did not work as many hours as median families even at the peak, and poor families were hit harder by the downturn, losing 6.7 percent of their hours in the two years encompassing the 2001 recession nationally. For poor families with children, work hour increases may not make sense, as it is more likely that the cost of child care will exceed the wage available to the second earner. Table 1, below, shows work hours of

[6] Please note that each quintile does not necessarily contain the same number of families. For more information, see the methodology section.

married-couple families with children.

Table 1
Annual hours worked by U.S. husbands and wives (combined)
(age 25-54 with children) by income group, 1979-2000 and 2000-2002

	1979	1989	2000	2002	Hours change 1979-2000	Hours change 2000-2002	Hours change 1979-2002
Bottom fifth	2245	2434	2669	2490	18.9%	-6.7%	10.9%
Second fifth	2810	3179	3372	3276	20.0%	-2.9%	16.6%
Middle fifth	3069	3434	3632	3566	18.4%	-1.8%	16.2%
Fourth fifth	3303	3620	3766	3680	14.0%	-2.3%	11.4%
Top fifth	3384	3697	3780	3717	11.7%	-1.7%	9.8%

Source: The State of Working America, 2004-2005

Single parent families with children also increased their work hours by more than 18 percent between 1979 and 2000, to a total of 1862 hours by 2000.[7] Like two parent families, it is likely that single parent families lost work hours between 2000 and 2002.

Comparing Income Trends Among High- and Low-Income Families

Comparing the income trends of low- and high-income families over the last 20 years shows that while the average incomes of both groups grew, the pace of change for the two groups was markedly different.

Since the deep recession of the early 1980s, the average incomes of the bottom fifth of families have grown in every state except Arizona. In Ohio, the average income of the bottom fifth grew by 21.2 percent. Growth in the incomes of the poorest families is positive news, even if hours increases may be responsible for much of it. However, the magnitude of that growth was small, especially when compared to the jump in the incomes of the richest families.

In every state, including Ohio the incomes of the richest families have grown since the early 1980s; generally, this growth has far outpaced that experienced by the poorest families. In 38 states including Ohio, the income of the top fifth of families grew faster than the income of the bottom fifth of families. In these 38 states, the incomes of the richest grew by an average of $45,800 (62 percent), while the incomes of the poorest grew by only $3,000 (21 percent).[8] In other words, the poorest families — who saw an increase in purchasing power of only $143 per year — have not fared nearly as well as the richest families during this period.

[7] Larry Mishel, Jared Bernstein and Sylvia Allegretto, *The State of Working America, 2004-2005*, Economic Policy Institute.
[8] The average of the poorest families does not include Arizona.

Table 2
Average Ohio Income
Quintiles of Families and Top Five Percent,
Early 1980s through Early 2000s (2002 dollars)*

	Bottom Quintile	Middle Quintile	Top Quintile	Top 5%
Early 1980s	15,030	37,387	74,394	103,567
Early 1990s	15,264	41,736	89,371	138,172
Early 2000s	18,216	47,692	117,277	195,175

* Income is post-tax and includes the value of the EITC, realized capital gains or losses, and the cash value of food stamps, subsidized school lunch, and housing subsidies. See Tables 7 and 8 of the full report for pre-tax income data.

Source: Economic Policy Institute/Center on Budget and Policy Priorities' (EPI/CBPP) analysis of data from the U.S. Census Bureau's Current Population Survey (CPS).

Within the top fifth of families, the wealthiest families enjoyed the largest income growth. The average income of the richest five percent of families grew 85 percent ($92,512) on average between the early 1980s and the early 2000s. In 11 large states where such a comparison is possible, including Ohio, the income of the top five percent of families grew significantly faster than the income of the bottom 20 percent of families, as Table 3 shows.[9]

In Ohio, the income of the top five percent grew by $91,608 or 88.5 percent, while the income of the bottom quintile grew by only $3,186 or 21.2 percent, over the 20-year period. Each year's gain for the wealthiest families substantially exceeded the entire 20-year gain for the poorest families.

[9] The analysis of the changes in the incomes of the top five percent was conducted on these eleven states (and the country as a whole), as they had 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 in the past as well as in the most recent surveys. We were able to calculate the ratio of incomes of the top 5% to the bottom fifth for all states for the early 2000s.

Table 3: Dollar and Percent Change in Average Income of Bottom Fifth and Top 5% of Families 1980-82 to 2001-03 (2002 Dollars)				
	Bottom Fifth		Top 5%	
State	Dollar Change	Percent Change	Dollar Change	Percent Change
11 Large States Where the Income of the Top 5% Grew Faster Than the Income of the Bottom Fifth				
California	1,721	11.4%	87,694	73.3%
Florida	2,460	19.0%	95,555	91.6%
Illinois	3,063	20.5%	88,699	77.0%
Massachusetts	2,752	16.2%	119,517	105.2%
Michigan	3,415	23.5%	102,034	103.3%
New Jersey	3,995	24.4%	152,949	131.9%
New York	1,901	13.4%	104,927	94.4%
North Carolina	2,235	17.7%	85,089	86.7%
Ohio	3,186	21.2%	91,608	88.5%
Pennsylvania	3,381	22.3%	123,590	124.1%
Texas	1,446	10.9%	80,448	65.6%
Total U.S.	**2,664**	**18.9%**	**92,512**	**84.7%**

For all states analyzed, the income of the top 5% grew by a larger percentage than the income of the bottom fifth and this difference was statistically significant.

Source: EPI/CBPP analysis of data from the CPS.

Changes in Income Gaps Between High- and Low-Income Families

Another way to assess changes in income inequality over the last two decades is by calculating the income gap — the ratio between the average family income in the top fifth and the average family income in the bottom fifth — and examining changes in this ratio over time.

Ohio's top quintile earned 6.4 times what the bottom quintile earned in Ohio on average in the early 2000s. For the nation as a whole, the average income of the top fifth of families was 7.3 times as much as the average income of the bottom quintile.

By the early 2000s, the average incomes of the top five percent of families were 12 times the average incomes of the bottom 20 percent nationally. In Ohio, the top five percent of families earned 10.7 times as much as the bottom quintile on average.

Table 3 also compares the top-to-bottom ratios of the early 1980s and early 2000s to see how this gap has changed over time in Ohio. Over the last 20 years the gap in incomes between the top and bottom fifths of families has grown significantly in Ohio and 38 other states. In the past twenty years, the top quintile grew from having 4.9 times the income of the bottom quintile to 6.4 times as much.

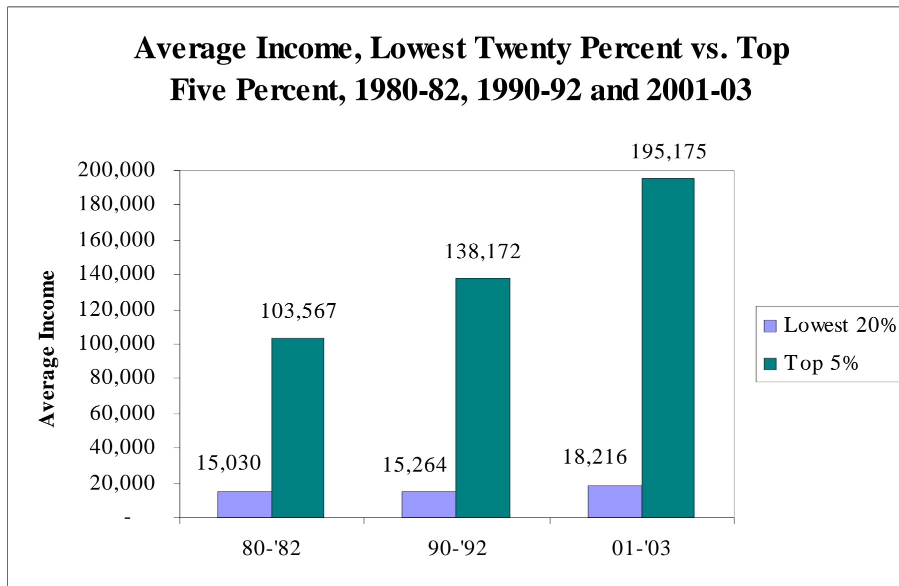
Table 4 Income Ratios in Ohio				
	Top to Bottom	Top to Middle	Top 5% to Bottom	Top 5% to Middle
Early 1980s	4.9	2.0	6.9	2.8
Early 1990s	5.9	2.1	9.1	
Early 2000s	6.4	2.5	10.7	4.1

(Calculated by dividing the average family income of the Top Quintile or Top 5% by the average family income of the Bottom or Middle Quintile)

Source: EPI/CBPP analysis of data from the CPS.

Comparing the changing income gap between the top five percent (instead of the top fifth) of families to the bottom 20 percent of families shows an even more dramatic increase. Among the 11 large states analyzed, all experienced a significant increase in income inequality. In the early 1980s, none of these states had a top-five-percent-to-bottom-20-percent ratio greater than 9.2; by the early 2000s, all of them did. Ohio had the least unequal distribution of income of these states in the early 2000s, but the average income of the top five percent of families was still more than ten times the average income of the bottom 20 percent of families. Figure 1 puts the modest income growth for the bottom quintile in perspective when compared to the skyrocketing growth in income among the top five percent.

Figure 1



Source: EPI/CBPP analysis of CPS data.

In the early 1980s, Alaska had the nation's greatest income inequality, as the income of the top fifth of families was 6.6 times larger than the income of the bottom fifth of families. By the early 2000s, more than half of the states had larger top-to-bottom ratios than 6.6, and the average gap in the nation as whole had risen to 7.3.

While income growth has been very unequal in Ohio and the U.S., Ohio is less inequitable than the rest of the country. This is in keeping with other neighboring states in the Midwest, as

well as the Great Plains, and Mountain states. Inequality is higher on the coasts and in the south.

In terms of income inequality between top and bottom, Ohio ranks 30th in the nation. In income inequality between the top and the middle, Ohio ranks right in the middle at 26th. Our income inequality has grown a bit more quickly, particularly between the top and the middle, in the past decade, but the situation in Ohio is generally better than in many other states. Table 5 shows Ohio's rank in income inequality compared to other states.

Table 5
Ohio Income Inequality Rankings among States

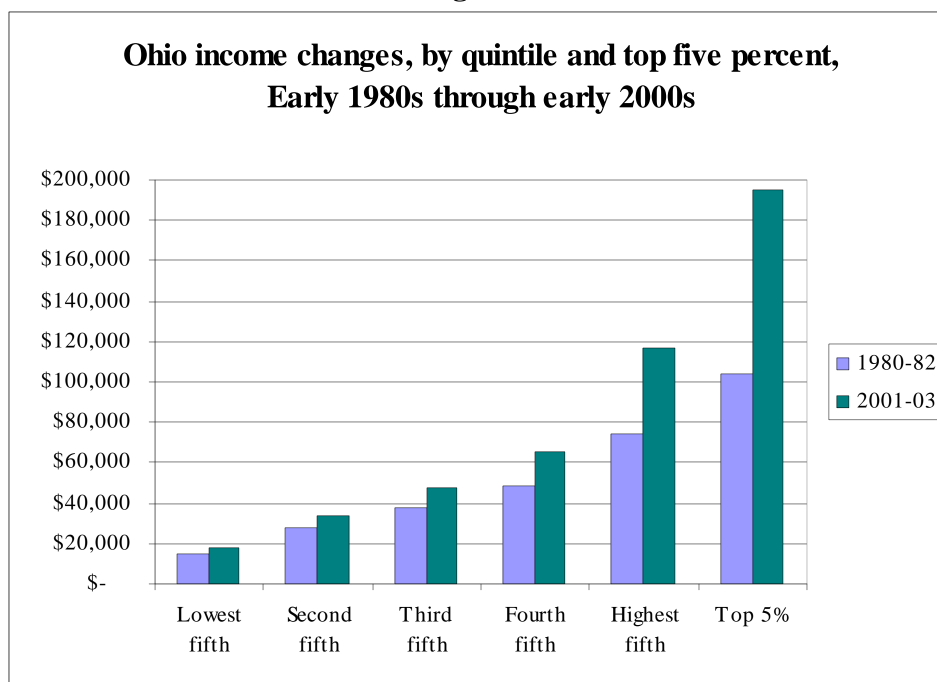
	Top to Bottom	Top to Middle
Early 2000s	30th	26th
Change from early 1980s to early 2000s	28th	22nd
Change from early 1990s to early 2000s	23rd	12th

* Rankings are from largest to smallest, such that 1st signifies the most income inequality or the greatest increase in income inequality.

Source: EPI/CBPP analysis of data from the CPS.

Figure 2, which was also in the Executive Summary as Figure A, shows in dollar amounts the growth in income for each quintile and for the top five percent in Ohio.

Figure 2



Source: EPI/CBPP analysis of data from the CPS.

Comparing Income Trends Among High- and Middle-Income Families

The poorest families were not the only ones that did not fare as well as those at the top of the income distribution. Those in the middle class also failed to match the income growth at the top.

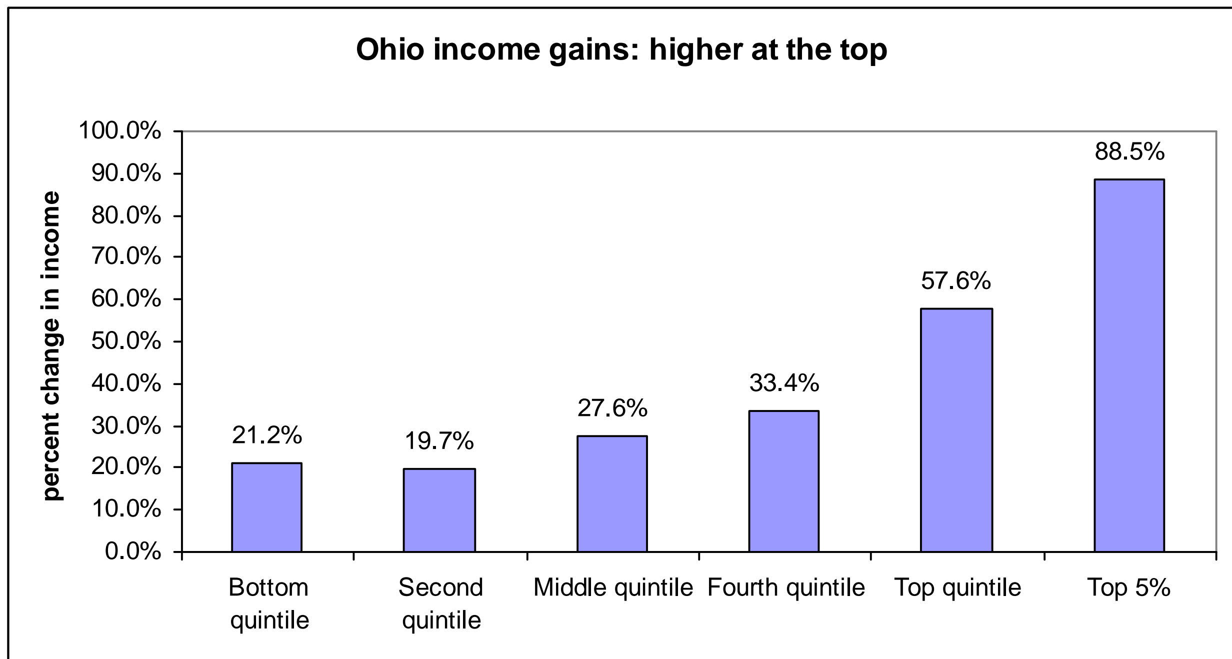
In every state, the average incomes of the middle and top fifths of families increased over the

last 20 years. In 39 states including Ohio, however, incomes grew significantly faster at the top. On average, the incomes of the richest families in these 39 states grew twice as fast as the incomes of the middle fifth — by some 61 percent compared to 30 percent. In Ohio, incomes grew by 57.6 percent among the top fifth on average, compared to 27.6 percent among the middle fifth on average. Thus growth for both the top and the middle was slower than in the nation, but growth was still much steeper for the top.

These income gaps were not always as large. Between the early 1980s and the early 2000s, the income gap between middle- and high-income families grew significantly in 39 states, including Ohio. In the early 1980s, no state had a top-to-middle ratio greater than 2.4; by the early 2000s, more than half of the states, including Ohio, did.

The income gap between the top five percent and the middle 20 percent of families is even wider. In Ohio, the top five percent earn more than four times as much as those in the middle, up from 2.8 times as much in the early 1980s. Figure 3 shows the percent growth in income for each quintile and the top five percent in Ohio.

Figure 3



Source: EPI and CBPP analysis of CPS data.

Without Government Programs the Income Gap Would Be Even Wider

Rather than using the standard Census definition of income in this report, we have adjusted it to account for the impact of the federal tax system (including the Earned Income Tax Credit) and have included the cash value of food stamps, subsidized school lunches, and housing vouchers. Income from capital gains is also included.[10] It was particularly important to make these adjustments to the Census definition of income because of the time period we are analyzing in this report. The bursting of the stock market bubble had a large impact on high income families

[10] These adjustments were made using Census data as well. See the methodological appendix for more details.

in the early 2000s. Changes in federal taxes affected families at both ends of the income scale. Earned income tax credit expansions boosted the incomes of low- and moderate-income working families and federal tax cuts disproportionately benefited the wealthy.

Thus, while after-tax income is the main focus of this report, an examination of income trends using the official Census definition of income shows that government policies — in particular, tax policies — can push back against the widening inequality caused by economic trends. Table 6 shows the top-to-bottom ratio for the early 2000s using the official Census definition of income. On average, the incomes of the top fifth of families were more than ten times greater than the incomes of the bottom fifth – in Ohio the rate was more than nine times as much. That is substantially larger than the top-to-bottom ratio under the definition of income used in this report (i.e., one that includes the effect of federal taxes and near-cash government transfer programs), which was 7.3 on average.

Table 6: Pre-Tax Ratios of Incomes of Top and Bottom fifths of families, 2001-2003 (2002 dollars, Census pre-tax income)

	Rank among states	Average pre-tax income of bottom fifth of families	Average pre-tax income of top fifth of families	Top-to-bottom ratio*
Ohio	30	$17,407	$158,574	9.1
U.S.	n.a.	$15,702	$165,269	10.5

*Calculated by dividing the average family income of the Top Quintile by the average family income of the Bottom Quintile

Source: EPI/CBPP analysis of data from the CPS.

Table 7 shows the pre-tax growth in income for the poorest and richest quintiles of families between the early 1980s and the early 2000s in Ohio and the nation.

The fact that these pre-tax data show larger income gaps than the after-tax data that are the main focus of this report demonstrates that while changes in a number of government policies have served to widen income gaps further, the overall effect of government policies – such as the progressive federal tax structure and supports for low-income families – is to reduce income gaps.

Table 7
Pre-tax dollar and percent change in average income of bottom and top fifths of families, 1980-82 to 2001-03 (2002 dollars, census pre-tax income)

	Bottom fifth		Top fifth	
	Dollar change	Percent change	Dollar change	Percent change
Ohio	$2,687	18.3%	$54,396	52.2%
U.S.	$2,127	15.7%	$58,063	54.2%

Source: EPI/CBPP analysis of data from the CPS.

III. Recent Trends: From the Early 1990s to the Present

Income gaps continued to widen during the 1990s, but the trend towards growing income inequality moderated somewhat compared to the 1980s, as the exceptionally low unemployment rates of the late 1990s brought gains to low-wage workers and relatively broad-based wage growth. This broad-based wage growth ended with the 2001 downturn, however. Real wages for low- and moderate-income families grew more slowly in 2002 and the first part of 2003 and then began to decline.

To a greater extent than in past recessions, the highest-income families also saw declines in real income during the 2001 downturn. These declines, which reflected the impact of the drop in the stock market, were short lived. Indications are that since 2002, the incomes of the richest families have rebounded strongly.

In contrast, the downturn's impact on low-and moderate-income families has lingered for longer than is typical, particularly in Ohio. In particular, unemployment has not fallen far enough to generate the pattern of income gains among low- and middle-income families that was seen in the late 1990s. In addition, recent federal tax cuts targeted primarily on wealthy families are helping widen the income gap between the wealthiest families and those with low and moderate incomes.

In summary, the state results for the 1990s show, at best, a slowing of the growth in inequality compared to the previous decade: inequality grew in fewer states during the 1990s than during the 1980s. However, inequality did continue to grow in more than half of the states, including Ohio.

By the low point of the 2001 recession, therefore, income gaps in the vast majority of states were wider than they had been two decades before. Unfortunately, indications are that even the slowing of the growth of inequality during the 1990s was temporary; widespread growth in income inequality appears to have returned as the economy recovers from the recession.

The state-level family income data analyzed in this report are not available beyond 2002 (actually, pooled data from 2001-2003, centered in 2002). However, a number of national-level wage and income series covering more recent years provide some indication of changes in inequality during the economic recovery that began in 2001. While these data do not address the recovery's impact on inequality in the states, the state patterns should be similar to the national trends shown in these data.

National Income Trends Following the 2001 Downturn

In general, recent national-level data show growing inequality reasserting itself in the 2000s. The decade began with the bursting of stock and high-tech bubbles, both of which were quite

costly to the highest-income families. In place of the capital gains that many high-income families enjoyed in the 1990s, the rapid decline in the value of stocks and bonds of 2001 brought capital losses. These losses led to a decline in the share of national income going to the richest families, and, by definition, an increase in the share of national income going to other groups. But once the stock market "correction" was complete, the factors responsible for growing inequality once again became operative, and the distribution of income and wages appeared to begin widening once again.

Table 8
Real changes in pre-tax family income, 2000-2004, Census Bureau data

Bottom Fifth	-8.3%
Second Fifth	-4.6%
Middle Fifth	-2.6%
Next to Top Fifth	-1.2%
Families in 80th to 95th Percentile	-0.7%
Top 5%	-3.5%

Table 8 shows changes in family income, as defined by the Census Bureau, from 2000 to 2004. (Note that this income measure differs from the measure used elsewhere in this report in that it is pretax, post-cash transfer income, not adjusted for family size.) While incomes fell for the top five percent of families (-3.5 percent), they fell far more for the bottom fifth of families (-8.3 percent), and the magnitude of the decline diminishes for quintiles two through four.

Table 9
Change in real post-tax Household Income, 2002-2003, Comprehensive CBO Data

Bottom Fifth	-1.4%
Second Fifth	0.3%
Middle Fifth	0.7%
Next to Top Fifth	1.6%
Highest Fifth	3.9%
All Quintiles	2.1%
Top 10%	5.1%
Top 5%	6.3%
Top 1%	8.2%

The 2000-2004 time period included both the recession of 2001 and the recovery that began late that year. While the large capital losses associated with the stock market bubble drove inequality down in the first few years of the recovery, there is evidence that this trend began to reverse in 2003. Table 9 shows the most recent year of comprehensive data from the Congressional Budget Office; its income measure more closely resembles the income measure used in this report. (That is, it includes capital gains and losses, as well as the cash value of in-kind benefits, though unlike the measure used in this report, the CBO measure also includes the in-kind value of publicly provided health care.)

These comprehensive data reveal a clear pattern of income inequality, with losses at the low end and gains that increase in magnitude as income increases. In this one-year period, real incomes grew 8.2 percent for the top one percent of households.

Part of this trend toward greater inequality in the 2000s reflects the unequal growth of wages. As discussed earlier, the tight job market of the latter 1990s ensured that wage growth was broadly shared; that pattern prevailed through 2003, as shown in the table below. (Typically, wage trends respond to a slackening of the job market only after a considerable lag.) But by 2003, nominal wage growth began to slow, especially for lower-wage workers and inflation began to accelerate due largely to rising energy costs. The result was falling real wages at the low end of the wage scale, stagnant earnings at the 80th percentile, and growing earnings only at the top. Again, we see a clear pattern of inequality returning to the wage structure.

Real Growth of National Hourly Wages by Percentile, 2000-2005*					
	Wage Percentile				
Annual Growth	10th	20th	Median	80th	90th
2000-03	1.3%	0.7%	1.4%	1.3%	1.3%
2003-05	-1.7%	-0.9%	-0.7%	-0.4%	0.9%
*2005 data are through November.					

In sum, recent national data suggest that the pattern of widening income gaps has returned following a brief interruption during the downturn. The economy is clearly expanding, but wage and income growth is once again accruing largely to families at the top of the income scale.

Do Low-Income Families Move Quickly Up the Economic Ladder?

Income inequality might be of less concern if families have low incomes for only a few years and quickly move into the middle class. For example, if parents are still completing college, income might be very low for a few years, but could increase substantially after graduation.

However, studies of income mobility show that most low-income families have low incomes for many years. Recent studies have found that in the short term, workers in the bottom fifth of the income distribution experience very little income mobility. In the early 1990s, for example, 75 percent of individuals who started in the bottom fifth were still in the bottom fifth one year later.[a]

Income mobility improves somewhat when a longer period of time is analyzed. During the 1970s-1990s, about half of the individuals who started in the bottom fifth had moved up the income ladder after ten years. However, the rest of the individuals remained in the bottom fifth, and many of those who did move up the income ladder did not move far: half of them rose only to the second-lowest quintile.[b]

Race is an important factor in determining which individuals move up the income ladder and how far: studies show that the income mobility of black families is half that of white families.[c]

Researchers have also examined whether income mobility has changed over time. Recent research has shown that income mobility in the United States declined in the 1980s and the 1990s.[d]

[a]Peter Gottschalk,, "Family Income Mobility - How Much Is There, and Has It Changed?" in James A. Auerback, and Richard S. Belous, eds., *The Inequality Paradox: Growth of Income Disparity.* Washington, DC: National Policy Association, 1998.

[b]Larry Mishel, Jared Bernstein, and Sylvia Allegretto; State of Working America; 2004-2005.

[c] Tom Hertz, "Rags, Riches and Race – The Intergenerational Economic Mobility of Black and White Families in the United States", in *Unequal Choices: Family Background and Economic Success,* ed. Samuel Bowles, Herbert Gintis, and Melissa Osborn, Princeton University Press, 2005.

[d]See Daniel Aaronson and Bhashkar Mazumber, "Intergenerational Economic Mobility in the United States, 1940 to 2000," Federal Reserve Bank of Chicago, Working paper 2005-12, November 2005; and Katherine Bradbury and Jane Katz, "Are Lifetime Incomes Growing More Unequal?," Regional Review, Fourth Quarter, 2002.

IV. Causes and Cures: State Policy Options

Income inequality has grown over the last 20 years mainly as a result of economic trends and government policies. In particular, the growth of income inequality is primarily due to the growth in wage inequality.

A variety of factors explain the growth of wage inequality, including long periods of high unemployment, globalization, shrinking manufacturing jobs, expanding low-wage service jobs, immigration, 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, who make up approximately the lowest-earning 70 percent of the workforce. More recently, even those with college educations have experienced real wage declines, due to the bursting of the tech bubble and the downward pressure on wage growth from offshore competition.

Only in the later part of the 1990s was there a modest improvement in this picture. Persistent low unemployment, an increase in the minimum wage, and rapid productivity growth fueled real wage gains at the bottom and middle of the income scale. Yet those few years of more broadly shared growth were not sufficient to counteract the two-decade-long pattern of growing inequality. Today, inequality between low- and high-income families and between middle- and high-income families is greater than it was 20 years or ten years ago.

Government policies — both what governments have done and what they have not done — have contributed to the increase in income inequality over the past two decades in most states. For instance, deregulation and trade liberalization, the weakening of certain aspects of the social safety net, the lack of effective labor laws regulating the right to collective bargaining, and the declining real value of the minimum wage 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 the trend toward growing inequality emerging from the labor market.[11]

Recent state policy decisions have played a role in widening the already growing gaps in the distribution of income. Supports for low-income families such as child care assistance and health insurance were cut during the recent economic downturn, tax actions in good times and bad have increased the regressivity of state tax systems. States can, however chart a different course. States can enact policies that improve the distribution of income, such as raising their minimum wage, widening supports for low-income working families (and improving access to

[11] Many of the effects of changes in federal, state, and local policies are not shown in our data. The impact of state and local taxes, for example, is not reflected in the income figures. The analysis does take into account the impact of federal taxes; however, many of the tax reductions for high-income families were not fully in effect by 2003, the last year of data available for states at the time of this analysis. For more information on the effect of the changes in federal taxes see Larry Mishel, Jared Bernstein and Sylvia Allegretto, *The State of Working America, 2004-2005*, pp. 77-86 and William G. Gale and Peter R. Orzag, "Bush Administration Tax Policy: Distributed Effects," Urban Bookings Tax Policy Center, 2004.

these supports), and reforming their unemployment insurance systems. In addition, states can pursue tax policies that can, in part, offset the growing inequality of pre-tax incomes.

This section gives a brief overview of the factors that researchers have identified as underlying the growth in income disparities. It then examines state policies that could mitigate this trend.

Economic Trends

Increasing income inequality results initially from changes in the wages paid by private employers and from the growth of investment and capital income. Government policies also affect income inequality, both directly (by redistributing income through the tax system and through benefit programs such as welfare) and indirectly (through the rules and regulations they set for the operation of private markets, such as minimum wages, tariffs, and the rules governing the formation of unions). Demographic factors, such as the growth in the number of families headed by a single person, have also played a role.

The growing wage gap is the major factor explaining the growth in income inequality. Wages are a key factor because they constitute about three-fourths of total family income. Wages at the bottom and middle of the wage scale have been stagnant or have declined over much of the last two decades. The wages of the very highest-paid employees, however, have grown significantly. The 1996-2002 period was the only time during the last two decades that real wages grew significantly for workers at all levels, including those at the lower end of the income distribution.

Several fundamental changes in the United States economy have contributed to increasing disparities in the wages paid to low- and middle-income workers relative to highly skilled, highly paid workers. The economy's shift from manufacturing to services has led to an increase in the number of low-paying jobs and a decline in higher-paying jobs for workers with less than a college education. Between 1979 and 2003, employment in manufacturing fell 25 percent, while employment in services rose 115 percent (and employment in retail trade, a sub-sector within services, rose 46 percent). The services and retail trade industries accounted for 79 percent of net job growth between 1979 and 2000. These service sector jobs tend to be lower paid than comparable manufacturing jobs. For example, in 2002, average annual pay for an employee working the equivalent of full time in the retail trade industry was just 55 percent of that of the manufacturing industry.

Increasing international trade also plays an important role in rising wage inequality. As more goods are produced overseas and imported, the number of higher-wage manufacturing jobs available to non-college-educated workers has declined in the United States. In addition, workers in the United States may agree to wage concessions in response to employers' threats of moving production facilities to other countries.[12] Research has generally found that the growth in international trade has played an important role in the decline in relative earnings of non-college-educated workers and can explain about 15 percent to 25 percent of rising wage

[12] Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2004-2005*, Cornell University Press.

inequality.[13]

Labor-market policies have had a major impact on wage inequality. The real value of the minimum wage has declined considerably since its high point in the late 1960s. In fact, the value of the minimum wage dropped 30 percent between 1979 and 1989, after accounting for inflation. Despite legislated increases in the minimum wage in 1990, 1991, 1996, and 1997, the value of the minimum wage in 2005 was still 28 percent less than in 1979. The impact of this reduction in the minimum wage on wage inequality has been, by many accounts, very substantial, especially for low-wage women workers.[14]

In addition, the continued decline in the percentage of workers who are union members has contributed to increased wage inequality. Unions have historically been successful in raising wages and benefits by standardizing compensation across competing employers. Non-unionized workers typically are paid lower wages, have less job security, receive fewer benefits, and are more likely to work part time than union members. Between 1979 and 2003, the percentage of workers belonging to unions dropped from 24 percent to 13 percent. Economic analysis confirms that the decline in union participation during the 1980s contributed to the increase in earnings inequality during that decade.[15]

It has been suggested that increasing technology has fed the growth of wage inequality. Manufacturing has become more automated, so the demand for high-skilled jobs has increased while the demand for low-skilled manufacturing jobs has declined. In addition, new technologies such as personal computers and improved communications have increased the demand for skilled workers in all industries. In theory, these changes should exacerbate wage inequality by placing a premium on highly skilled, high-wage workers over unskilled workers.

However, there is little direct evidence that technological change has affected wage inequality — in part because it is difficult to measure changes in technology.[16] Moreover, technological change that favors skilled over unskilled labor has been going on for many decades, even as the education and skill levels of the workforce have steadily grown.

The issue, then, is whether the pace of technological change has accelerated in recent decades to the point where the demand for skilled workers has outpaced the supply, thereby expanding the wage gap between skilled and unskilled labor. A recent analysis found that the overall impact of technology on the wage and employment structure was no greater in the 1980s and 1990s than in earlier periods, when inequality was not growing; this suggests that technological change has played only a small role in increasing wage inequality.[17]

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[13] Report of the United States Trade Deficit Review Commission, November 2000.
[14] Mishel, Bernstein, and Allegretto, The State of Working America 2004-2005.
[15] See, for example, Richard Freeman, "Is Declining Unionization of the U.S. Good, Bad or Irrelevant?" in Unions and Economic Competitiveness. Armonk, NY: Economic Policy Institute Series, 1992; Richard Freeman, "How Much Has De-Unionization Contributed to the Rise in Male Earnings Inequality" in Sheldon Danziger and Peter Gottschalk, Uneven Tides. New York, NY: Russell Sage Foundation, 1993.
[16] Gary Burtless, "Technological Change and International Trade: How Well Do They Explain the Rise in U.S. Income Inequality?" in James A. Auerback and Richard S. Belous, eds., The Inequality Paradox: Growth of Income Disparity. Washington, DC: National Policy Association, 1998.
[17] Mishel, Bernstein, and Allegretto, The State of Working America 2004-2005.

Finally, immigration has been identified as a potential cause of rising wage inequality. That could happen if the growing number of immigrants increases the supply of low-wage workers, thereby lowering wages at the bottom of the wage scale. The role of immigration in wage inequality is a subject of much research and debate. A recent report by the Congressional Budget Office reviewed the research in this area and concluded, "The arrival of large numbers of immigrants with little education probably slows the growth of the wages of native-born high school dropouts, at least initially, but the ultimate impact on wages is difficult to quantify."[18] The impact of immigration on wage inequality is a larger factor in states like California than in Ohio.

Besides wages, the other major source of income is investments that yield dividends, rent, interest, and capital gains. Since investment income primarily accrues to those at the top of the income structure, any expansion of investment income — as occurred during the 1990s — will lead to greater income inequality.

Between 1979 and 1999, income derived from capital — such as rent, dividends, interest payments, and capital gains — increased as a share of personal income from 18.7 percent to 26.9 percent. Over the same period, total labor income — wages, salaries, and fringe benefits — fell from 75.8 percent of personal income to 71.8 percent.[19] Between 2000 and 2003, the stock market decline resulted in a drop in the share of income derived from capital to 20.8 percent; however, that share remained higher than in 1979 and has begun to resume its growth with the recovery of the stock market.

Higher-income families benefit disproportionately from the increase in the importance of investment income, as this type of income makes up a larger share of their total income. Some 86 percent of all capital gains income is realized by families in the top five percent of the income distribution.[20]

Demographic Trends

Another possible contributor to the growing income gap is changes in the composition of the population. The past two decades have been marked by significant demographic changes: the population has grown steadily older, the education level of family heads has increased, and the share of minorities in the population has expanded. Yet a number of analysts have found that these factors have played a minimal role in increasing income inequality. For example, Lynn Karoly of the RAND Corporation finds that changes in the age and educational make-up of the population have actually reduced inequality[21] and that the increase in the share of the population

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[18] Congressional Budget Office, The Role of Immigrants in the U.S. Labor Market, November 2005.

[19] These figures are based on an Economic Policy Institute analysis of National Income and Product Accounts (NIPA) and Internal Revenue Service (IRS) data.

[20] Urban-Brookings Tax Policy Center, May 2005.

[21] Karoly examined changes in income inequality for subsets of the population with different education levels and different ages. If the composition of the population had shifted towards groups with higher levels of inequality, this would have accelerated the growth in income inequality. Karoly found that the net result of changes in age or education groups was a reduction in inequality. That is, if the age and educational composition of the population had been held constant at the 1975 level, inequality would have been higher in 1993 than the level actually observed.

consisting of minorities has increased inequality by only a small amount.[22]

One demographic trend has had some impact on the rise in income inequality among families.[23] Over the last two decades, the percentage of households composed of single individuals increased from 22 percent to 26 percent, while the percentage of families headed by a woman increased from 14 percent to 18 percent. These trends have reduced incomes at the low end of the income scale because both single individual families and female-headed families are generally lower-income families. This report analyzes the income of families — that is, two or more related individuals — so the changes in inequality reflected here are not the result of the increase in families composed of single individuals, but to some degree they do reflect the increase in families headed by a single woman.

Another significant demographic trend, the increase in husband-wife families in which the wife works outside the home, has lessened income inequality among families. During the 1970s and 1980s, increasing numbers of women entered the workforce, in part to help stem the decline in family incomes that resulted from the fall in average male earnings. In addition, family members increased their hours of work. However, there is a point at which families can no longer increase their work effort to offset declining wages, and the United States may be approaching that limit. In the 1990s, wives' hours of work grew much more slowly than in the 1980s.[24] Between 2000 and 2003, wives' hours of work declined as a result of the weak labor market.

Future Trends in Wage Growth

While this report focuses on past rather than future events, it is relevant to examine the likely path of wage growth in the aftermath of the 2001 recession.

No one can predict with certainty where future wage growth is heading. Nevertheless, there are good reasons to be concerned that the broad-based wage growth of the late 1990s, which led to gains for low- and middle-income workers, has ended. Wages continued to grow into 2002 despite the onset of the recession in 2001, but beginning in 2003, real wages for low- and middle-income workers began to decline, and growing wage inequality has resumed.[25]

The question for the future is whether the conditions that led to shrinking inequality at the end of the 1990s can be replicated in the future. A number of important and related phenomenon occurred in the latter half of the 1990s which helped to boost the incomes of low- and moderate-income families. Economic growth sped up, and productivity and average real wages grew more quickly. This meant that the economic "pie" was growing faster. Yet this by itself does not imply that larger slices will necessarily be cut for low- and middle- income families, i.e., faster growth does not necessarily translate into higher wages. For that to happen, we needed the historically tight labor markets that also prevailed over this period. The move towards full

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[22] Lynn A. Karoly, "Growing Economic Disparity in the U.S.: Assessing the Problem and the Policy Options" in *The Inequality Paradox: Growth of Income Disparity,* Washington, National Policy Association, 1998.
[23] Ibid.
[24] Mishel, Bernstein and Allegretto, *The State of Working America 2004-2005.*
[25] *State of Working America 2004-2005.*

employment in the latter 1990s meant that for the first time in decades, lower wage workers gained the ability to push for a larger share of the growth which took place over the period. In addition, government policies served to increase the wages of low-income workers. The federal minimum wage was increased in 1996 and 1997 providing a short-term increase and the earned income tax credit was expanded. But in the aftermath of the recession, we have left full employment behind and wage inequality has begun to grow again as it did over the 1980s and early 1990s.

Policies to Reduce Inequality

A significant amount of increasing income inequality results from economic forces that are largely outside the control of state policymakers. However, states can adopt policies that mitigate the effects of increasing inequality. By improving the economic well-being of the working poor and assisting in the transition from welfare to work, states can provide economic opportunity for everyone struggling to make ends meet, including workers on the lowest rung of the wage ladder, recent immigrants, and workers who are temporarily unemployed. In addition, state tax systems can be modified so that they moderate rather than exacerbate the growth in the income gap between rich families and poor and middle-income families. Several kinds of policy improvements are discussed below.

Minimum Wage

One way policymakers can help reverse or moderate the decline in wages for workers at the bottom of the pay scale is to enact a higher minimum wage. The federal minimum wage has remained at $5.15 an hour since 1997; after adjusting for inflation, it is lower than in any year between 1961 and 1984. Its purchasing power is about 28 percent below its value at the end of the1970s. In the last few years Congress has considered several bills to phase in an increase in the minimum wage, but it has not enacted any of them.

Because prospects for passage of an increase in the federal minimum wage are uncertain, increases in state minimum wages should be considered. Since 1981, a number of states have raised their minimum wages to offset the decline in the value of the federal minimum wage. As of January 2006, 17 states and the District of Columbia had minimum wages that were higher than the federal minimum wage.[26]

In Ohio, there have been campaigns to raise the minimum wage both at the legislative level and by referendum. Currently, campaigners are gathering signatures to increase Ohio's minimum wage to $6.85 and index it to inflation. A higher minimum wage could serve to reduce income inequality significantly. Each 25-cent increase in the minimum wage would boost the earnings of a full time minimum-wage worker by $520 per year.[27] The majority of minimum wage

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[26] The seventeen states are Alaska at $7.15, California at $6.75, Connecticut at $7.40, Delaware at $6.15, Florida at $6.40, Hawaii at $6.75, Illinois at $6.50, Maine at $6.50, Massachusetts at $6.75, Minnesota at $6.15, New Jersey at 6.15, New York at $6.75, Oregon at $7.50, Rhode Island at $6.75, Vermont at $7.25, Washington at $7.63, and Wisconsin at $5.70. An eighteenth state — Maryland — has adopted a minimum wage of $6.15 as of February 2006. The minimum wage in the District of Columbia is $7.00.

[27] For someone working 40 hours per week and 52 weeks per year at the minimum wage, a 25 cent increase would yield

workers are adults whose earnings contribute substantially to family income. Minimum-wage earners contribute an average of 54 percent of their families' weekly earnings.[28]

One of the principal arguments against raising the minimum wage is the claim that it would price many workers out of the job market. Some argue that an increase in the state minimum wage would result in a loss of jobs to neighboring states with lower minimum wages. These concerns are not borne out by the research. A number of studies have found that increases in state minimum wages did not have a negative impact on employment, even relative to neighboring states with lower minimum wages.[29]

A related way to assist low-wage workers is to enact a living wage ordinance, which typically requires private contractors performing services for a city or other local government to pay their workers a minimum hourly wage that is higher than the minimum wage. These ordinances affect fewer workers than a state minimum wage because they are enacted at the local rather than state level and apply only to employers who receive public funds.

Unemployment Insurance

The incomes of many workers over the course of a year are often reduced because they experience a spell of unemployment. The unemployment insurance system, administered jointly by the federal and state governments, is designed to help workers in such situations. Unemployment insurance replaces a portion of workers' former earnings while they look for new jobs or wait to be called back to their old jobs. The recent recession demonstrated the critical importance of unemployment insurance as a part of the national safety net for low-wage workers.

Unfortunately, unemployed workers are much less likely to receive unemployment insurance benefits than they were a few decades ago. At the end of the recession in 1975, three-quarters of unemployed workers were receiving unemployment insurance benefits.[30] By 2003, that number had declined to only 41 percent.[31] This decline occurred despite the fact that the share of workers who are potentially eligible for unemployment insurance coverage increased from 1975 to 2001. Since unemployment insurance benefits go disproportionately to lower-income workers, the decline in the share of workers who receive these benefits has likely had a substantial impact on income inequality.

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a gross annual wage increase of $0.25 times 2,080, or $520. After payroll taxes of 7.65 percent are deducted, the net gain is $480.

[28] These figures reflect workers affected by the 1996 increase in the minimum wage from $4.25 an hour to $5.15 an hour. They include workers with hourly wages in this range and salaried workers whose hourly wage equivalent (weekly earnings divided by number of hours worked) falls within this range. From Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America, 2004-2005.*

[29] Jared Bernstein and John Schmitt, Making Work Pay: *The Impact of the 1996-97 Minimum Wage Increase,* Economic Policy Institute, 1998; David Card, "Using Regional Variation in Wages to Measure the Effects of the Federal Minimum Wage," *Industrial and Labor Relations Review,* October 1992; Lawrence Katz and Alan Krueger, "The Effect of the Minimum Wage on the Fast Food Industry," *Industrial and Labor Relations Review,* October 1992; David Card, "Do Minimum Wages Reduce Employment? A Case Study of California, 1987-89," *Industrial and Labor Relations Review,* October 1992; and David Card and Alan Krueger, "Minimum Wages and Employment: A Case Study of the Fast Food Industry in New Jersey and Pennsylvania," *American Economic Review,* Volume 84, Number 4, September 1994.

[30] 1975 *Green Book,* Background material and data on programs within the jurisdiction of the Committee on Ways and Means.

[31] Economic Policy Institute calculation.

An Ohio minimum-wage worker who works 37 hours a week every week during 2006 will not qualify for unemployment compensation under new eligibility rules in Ohio. Workers now have to average at least $193 a week over a minimum of 20 weeks, making Ohio's earnings test among the strictest in the nation.[32]

Ohio should broaden its eligibility so that those making at least $100 a week for 20 weeks can qualify for this important safety net, which both helps boost the state during economic downturns and helps moderate the growing inequality discussed here. For more on ways in which unemployment compensation could be changed to better support Ohio workers, see the series of papers on unemployment available at www.policymattersohio.org. [33]

Income Support Programs

Changes in programs that assist low income families also have contributed to the increase in income inequality and will likely continue to exacerbate this trend in coming years.

Among these changes are those in the cash assistance programs serving needy families with children. Since enactment of the 1996 welfare-reform bill, these programs have placed an increasing emphasis on helping families find employment and on reducing the number of families receiving cash assistance. The number of families receiving cash assistance has fallen significantly — much more than the poverty rate. Nationally, the number of welfare cases dropped by more than 57 percent from its peak of 5 million in the early 1990s to 2.2 million in 2000. Studies conducted during this period showed that between half and three-quarters of former welfare recipients were employed shortly after they left the rolls.

For many former recipients who have found jobs, however, the move from reliance on public assistance to reliance on a paycheck has not meant an escape from poverty. A report by the U.S. Department of Health and Human Services released in 2000 reviewed a number of state-level studies and found that welfare recipients who find work earn an average of $2,200 to $3,400 per quarter, or $8,800 to $13,600 per year. By comparison, the poverty line for a family of three in 2000 was $13,738; for a family of four, it was $17,603.[34]

Despite rising poverty, caseloads continued to edge down nationally between 2001 and 2004. For families who continued to receive cash assistance, the value of those benefits fell in the majority of states. In the typical state, benefits for a family of three with no other income fell by more than 18 percent between 1994 and 2003 after adjusting for inflation.

The 1996 welfare-reform bill also imposed stricter eligibility criteria for children in the Supplemental Security Income program, which provides cash assistance to elderly and disabled

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[32] Schiller, Zach, Unemployment Compensation: You must make even more to qualify in 2006, available at: http://www.policymattersohio.org/ucompohio_2006_eligibility_pr.htm

[33] Policy Matters studies on Ohio's unemployment compensation system are available here: http://www.policymattersohio.org/publications.htm#unemployment_compensation

[34] U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation, *A Cross-State Examination of Families Leaving Welfare: Findings from the ASPE-Funded Leavers Studies,* November 2000. (http:aspe.hhs.gov/hsp/leavers99/cross-state00/index.htm#employment).

poor. As a result, thousands of low income disabled children were disqualified from the program. This further reduced the incomes of low income families with children.

In addition, in the early 1990s, many states eliminated or substantially cut their general assistance programs for individuals and families that do not qualify for federal assistance under SSI or TANF. This contributed to income inequality in those states as well. (As noted, this report looks only at families of two or more people, so its findings show the effect of general-assistance cuts on families but not on individuals.)

State policymakers can strengthen their social safety nets to assist both families who leave welfare for work and low-wage workers who have never received cash assistance.[35] Many of these are described on the Center for Community Solutions website at www.communitysolutions.com.

Tax Reform

Virtually all state tax systems, including Ohio, collect a larger share of the incomes of poor families than of high income families. State taxes also generally collect a larger share of the incomes of middle-class families than of high-income families. This widens the after tax income gap, exacerbating the trends in income detailed in this report which include the effect of federal taxes but not state taxes.

Further, many states, including Ohio, have made their tax systems less progressive in recent years. When states raised taxes to meet recession induced shortfalls in the early 1990s, they predominantly raised those taxes that fall most heavily on low- and moderate- income households. When a stronger economy allowed taxes to be reduced, however, much of the benefit was targeted on higher income families. As a result, state taxes appear to have become relatively more burdensome to low- and moderate- income families than they were in the late 1980s.[36] And, early indications are that states are repeating the patterns of the 1990s in the current decade.

When considering tax reductions, Ohio should always turn first to regressive taxes like the sales tax, which disproportionately burdens poor families. When considering tax increases, the progressive income tax should be the first tax considered. Unfortunately, Ohio often does the opposite.

One direct way that Ohio could boost the incomes of its poorest workers is to enact a state earned income tax credit (EITC). The federal EITC is a tax credit for low- and moderate-

[35] For additional information on the policy options summarized below, see Elizabeth McNichol and John Springer, *State Policies to Assist Working Poor Families,* Center on Budget and Policy Priorities, December 2004. Available at http://www.cbpp.org/12-10-04sfp.htm.

[36] Between 1994 and 2001, states lowered personal income taxes, which are the major taxes paid by upper income families, and other progressive taxes by nearly $28 billion, an amount equal to about 6.5 percent of annual state tax revenues. Those reductions far exceeded the increases in progressive taxes states enacted in the early 1990s, which total about 3.7 percent of state revenues. By contrast, the sales and excise tax reductions of the last eight years have totaled just over $1 billion or about 0.3 percent of state tax revenue — just a small fraction of the 4.1 percent of state revenues by which sales and excise taxes were increased in the early 1990s.

income working people that is designed to offset the sizable burden of the Social Security payroll tax on low wage workers, supplement the earnings of low- and moderate- income families, and complement efforts to help families make the transition from welfare to work. Many families with working parents remain poor even when their federal EITC benefits are considered. In addition, low-income families pay a substantial share of their incomes in state and local taxes, particularly sales and excise taxes. Partly as a result of these factors, 17 states plus the District of Columbia have established their own EITCs.[37] State EITCs can boost the incomes of a state's poorest working families and reduce the gap between the state's poorest and richest residents.[38]

V. Conclusion

Over the course of the two decades since the early 1980s, few states have experienced broadly-shared growth. While overall the economy of the United States has grown over the period, most of the benefits of that growth have accrued to families at the top of the income distribution. Lower-income families and families in the middle of the income distribution have increased substantially, thereby widening the gap in income between high-income families and poor and middle-class families.

Even the more broadly shared of the late 1990s growth has not reversed this long-term trend. In well over half the states, families at the bottom and the middle of the income distribution have failed to keep pace with the gains made by the richest fifth of families over the past decade, and consequently, in most states, the gap between high-income families and the middle-class and the poor has widened.

The increase in income inequality has resulted from a number of factors, including both economic trends and government policy. Both federal and state policies have contributed to the increasing gap in income, and both federal and state policies can be used to help mitigate or even reverse this trend in the future.

[37] Colorado, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oklahoma, Oregon, Rhode Island, Vermont, Virginia, and Wisconsin

[38] For more information on state earned income tax credits see "A Hand Up" available at cbpp.org.