

Policy Approaches to Inequality

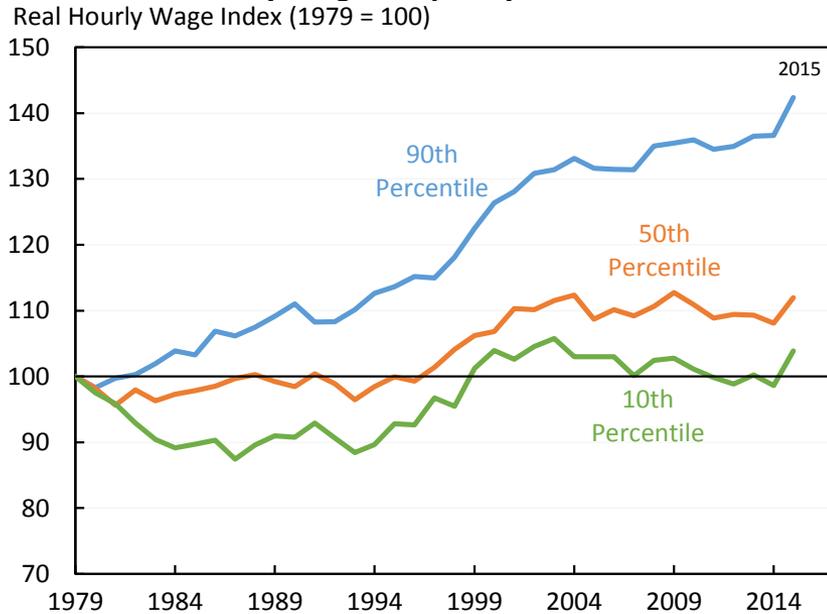
**Sandra Black
Member
Council of Economic Advisers**



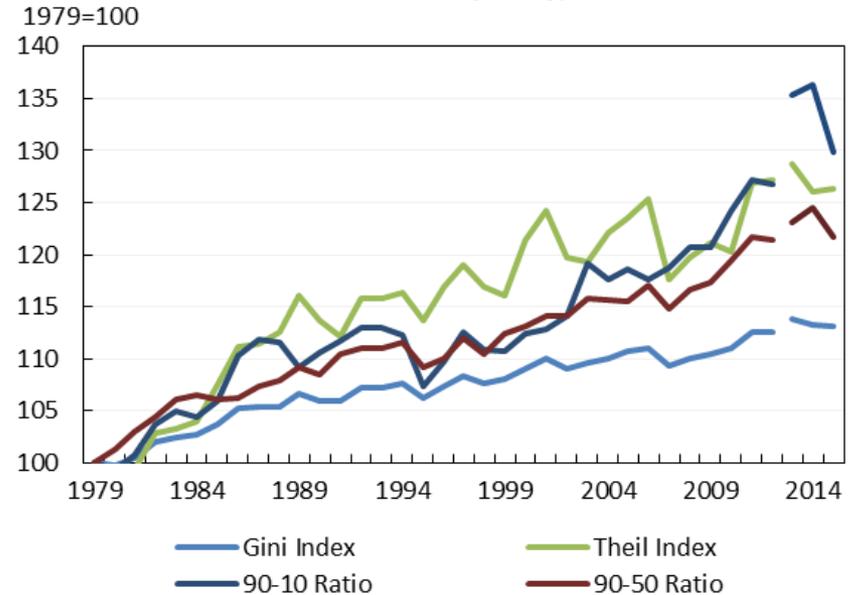
November 17, 2016

Wage and Income Inequality Have Increased Substantially

Hourly Wage Inequality, 1979-2015



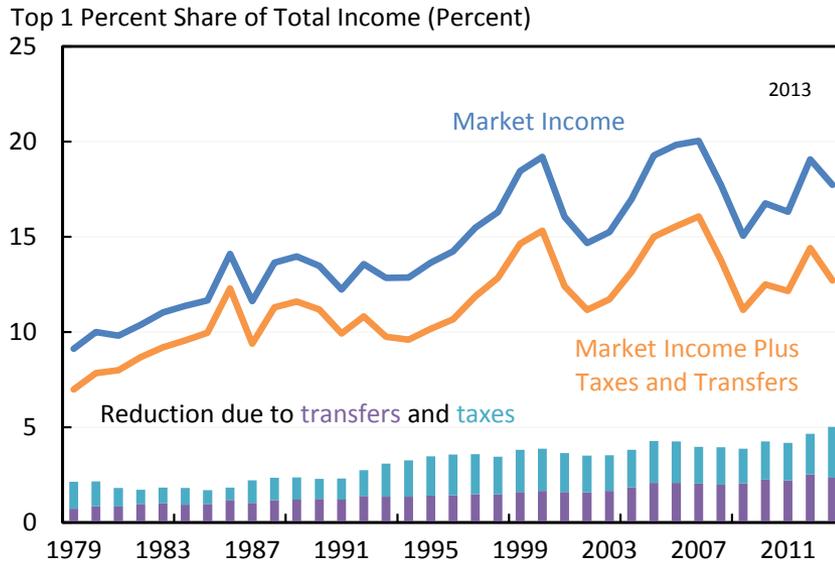
Measures of Income Inequality, 1979 to 2015



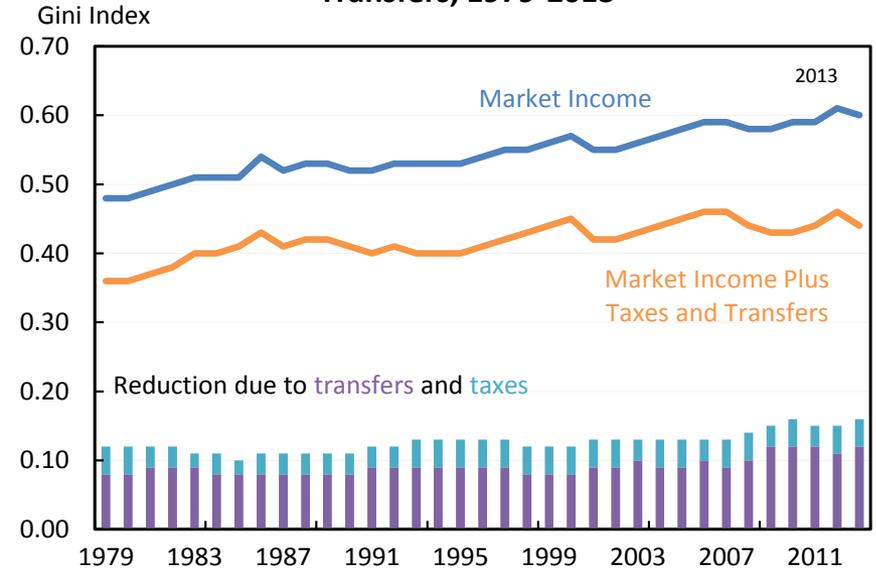
- Between 1979 and 2015, real wages for the highest earnings (90th percentile) grew by 42% while median wages rose by 12% and wages at the 10th percentile rose by just 4%.

Income Inequality Has Increased Even After Taxes and Transfers

Top 1 Percent Share of Income and the Effects of Taxes and Transfers, 1979-2013



Inequality in Market Income and the Effects of Taxes and Transfers, 1979-2013

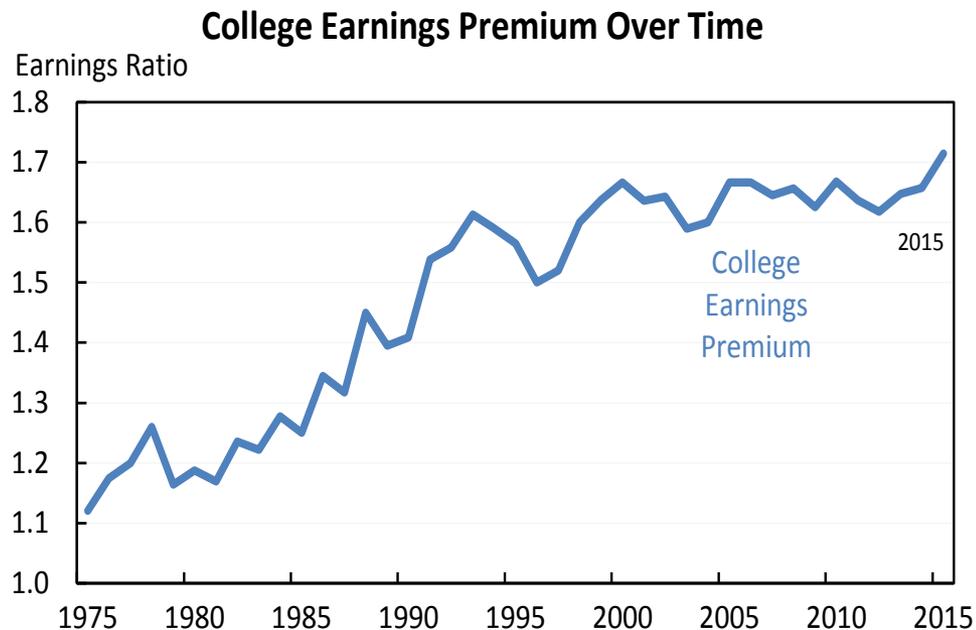


- From the business cycle peak in 1979 to the business cycle peak in 2007, the after-tax-and-transfer income share of the top 1% more than doubled, and the after-tax-and-transfer Gini rose by almost 30%.
- While taxes and transfers reduce inequality at any point in time, they offer only a partial correction that has not kept pace with the growth in market inequality in recent decades.

Causes of Inequality: Competitive and Non-competitive Forces

Competitive market forces caused by shifts in supply and/or demand curves.

- Globalization, skill-biased technological change
- Increasing relative returns to capital and high-skilled labor



- In 2015, the college earnings premium reached a record high. The median full-time, full-year worker over age 25 with a bachelor's degree earned roughly 70% more than a worker with just a high school degree.

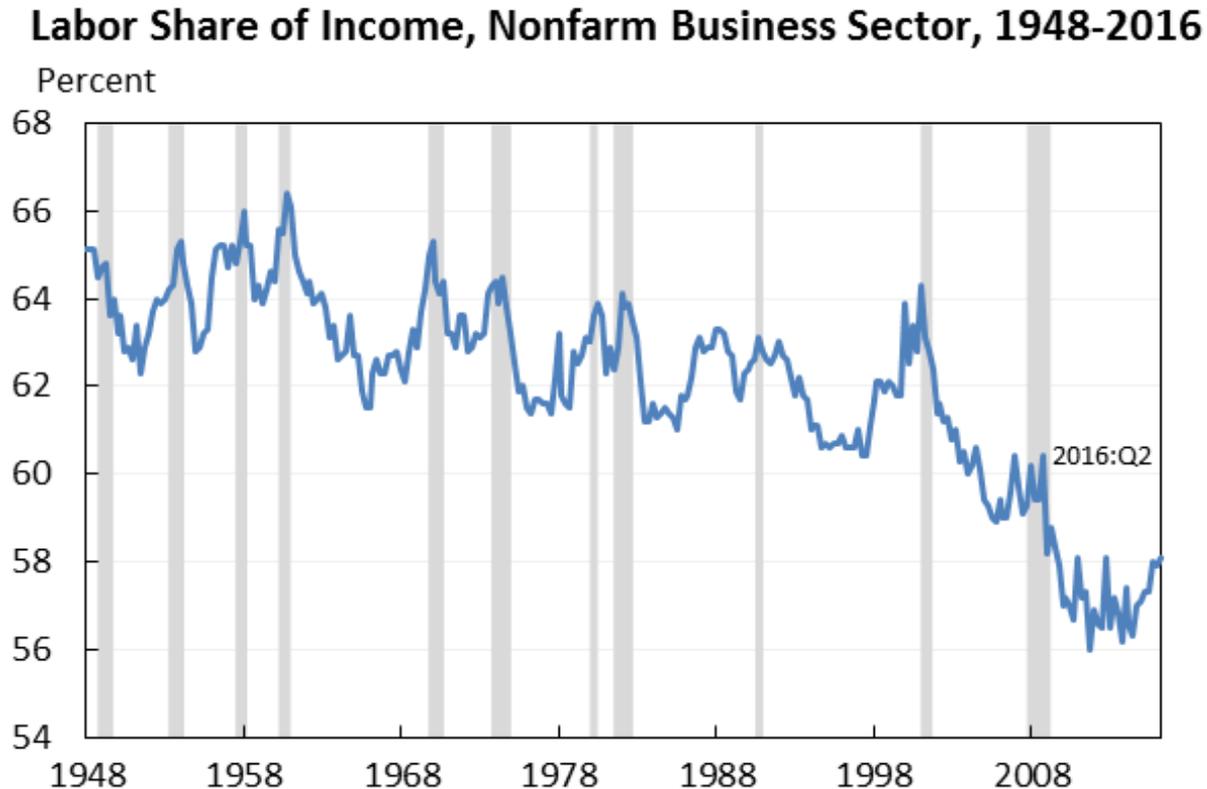
Causes of Inequality: Competitive and Non-competitive Forces

Non-competitive forces: employer monopsony/wage-setting power in labor market.

A shift in the balance of bargaining power toward employers may lead to:

- Redistribution of worker wages to managerial earnings and profits
- Inefficient levels of employment
- Rising disparities in pay among workers with similar skills

Labor's Share of Income Has Been in Steady Decline



- Over the past 15 years, the decline in labor's share of national income accelerated, reaching its lowest level ever since World War II, though there have been signs of reversal since 2014.

Sources of Wage-Setting Power: Search Costs, Frictions

Search Costs and Labor Market Frictions. Competition in the labor market requires that workers be able to switch employers easily in response to changes in wages or working conditions.

Several types of frictions can make job-switching costly, including:

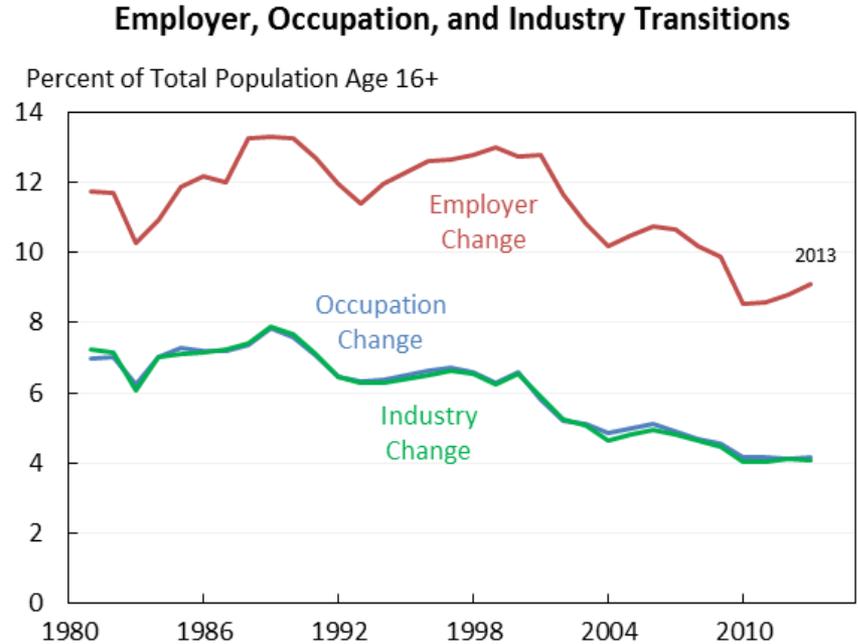
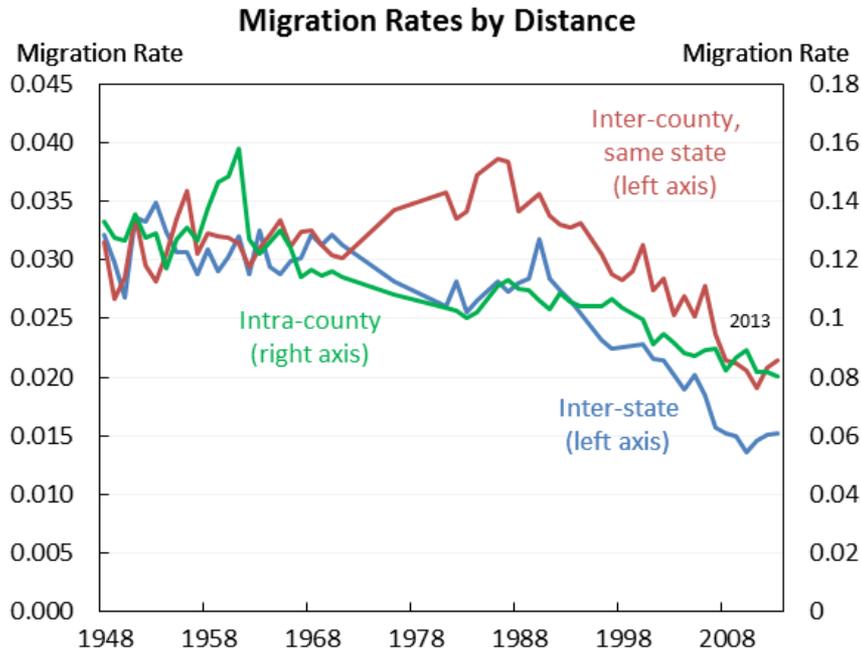
- Information barriers
- Moving costs

Sources of Wage-Setting Power: Employer Behavior

Employer Behavior. Employers can also engage in behavior that limits workers' options and restricts competition.

- **Collusion.** Recent court cases have brought suit against:
 - Silicon Valley employers for “non-poaching agreements” to suppress pay of programmers and engineers
 - Several hospitals for alleged collusion to depress pay of hospital nurses
- **Non-compete agreements**
 - Use extends well beyond cases where plausibly justified by the need to protect trade secrets
 - 1 in 5 workers currently covered (Starr, Bishara and Prescott 2016)
 - Roughly 15% of those earning <\$40K
 - Even in states (e.g., CA) where they are not enforced

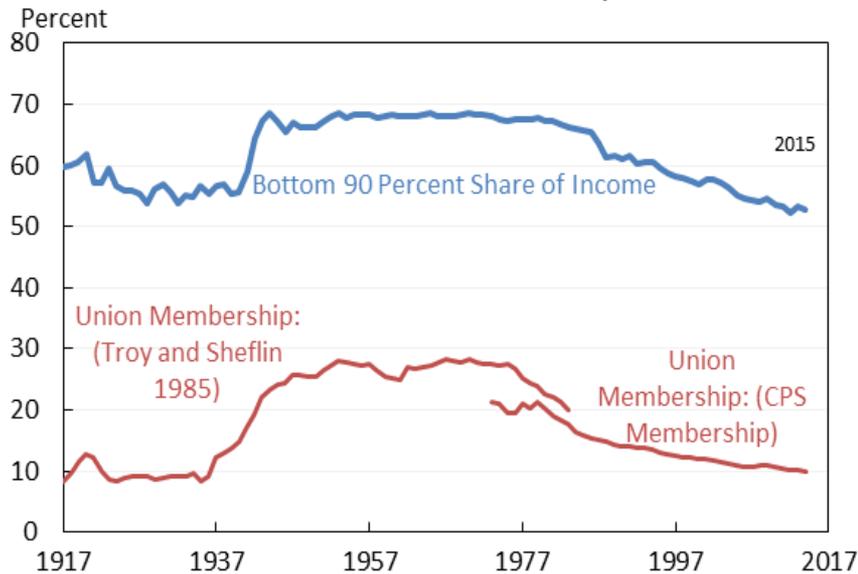
Sources of Wage-Setting Power: Declining Worker Mobility



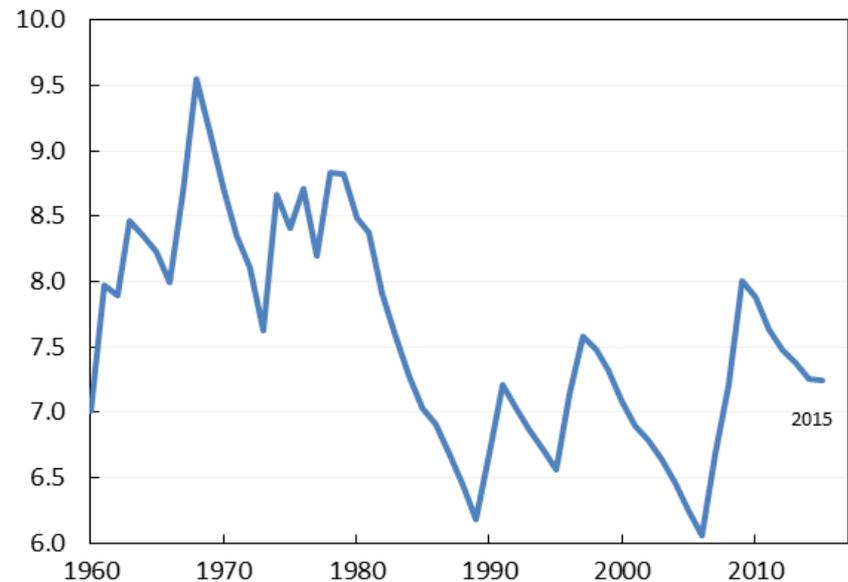
- Long-run declines in various measures of labor market fluidity suggest the U.S. market may be more conducive to monopsony power than in the past.
- Research also shows that wages are less sensitive to current labor market conditions than was true in the past – consistent with an increase in job-switching costs and a reduced ability of workers to renegotiate their wages (Malloy et al. 2016)

Erosion of Worker Bargaining Power Due To Decline in Unionization and Real Value of Minimum Wage

Union Membership as a Share of Total Employment and Bottom 90 Percent Share of Income, 1915-2015



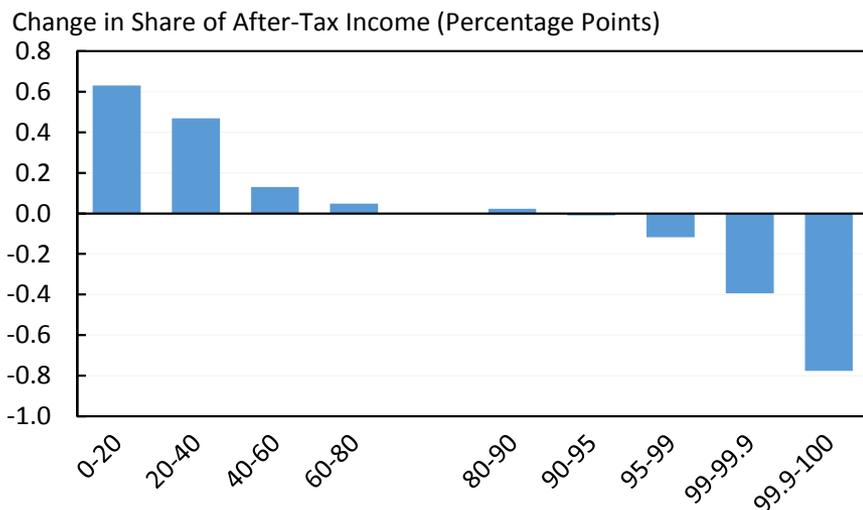
Real Value of the Federal Minimum Wage, 1960-2015
2015 Dollars



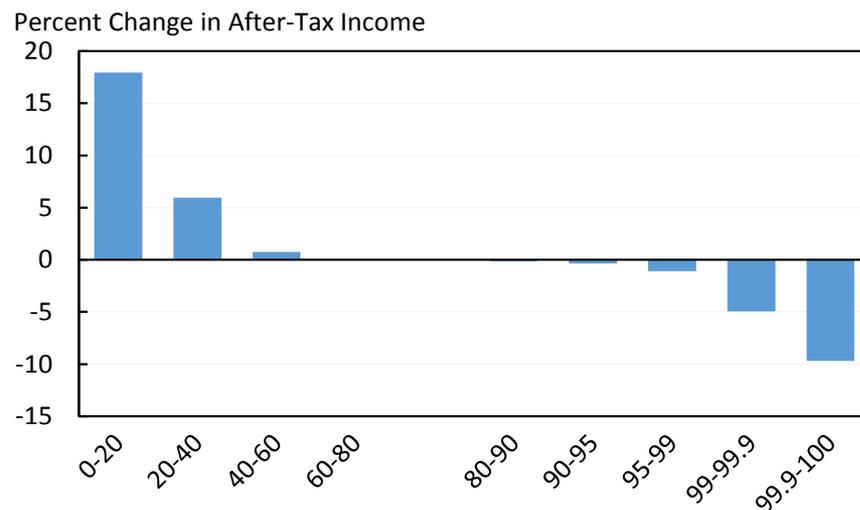
- Employers may be better able to exercise wage-setting power today than in the past due to declines in union membership and in the real value of the federal minimum wage.
- In the past 60 years, union membership fell from 25% to 10% of total employment.
- The real value of the Federal minimum wage has declined 24% since its peak of \$9.55 (in 2015 \$) in 1968.

Changes in Tax Policy and the Coverage Provisions of the Affordable Care Act Have Sharply Reduced Inequality in After-Tax Incomes

**Change in Share of After-Tax Income by Income Percentile:
Changes in Tax Policy Since 2009
and ACA Coverage Provisions, 2017**

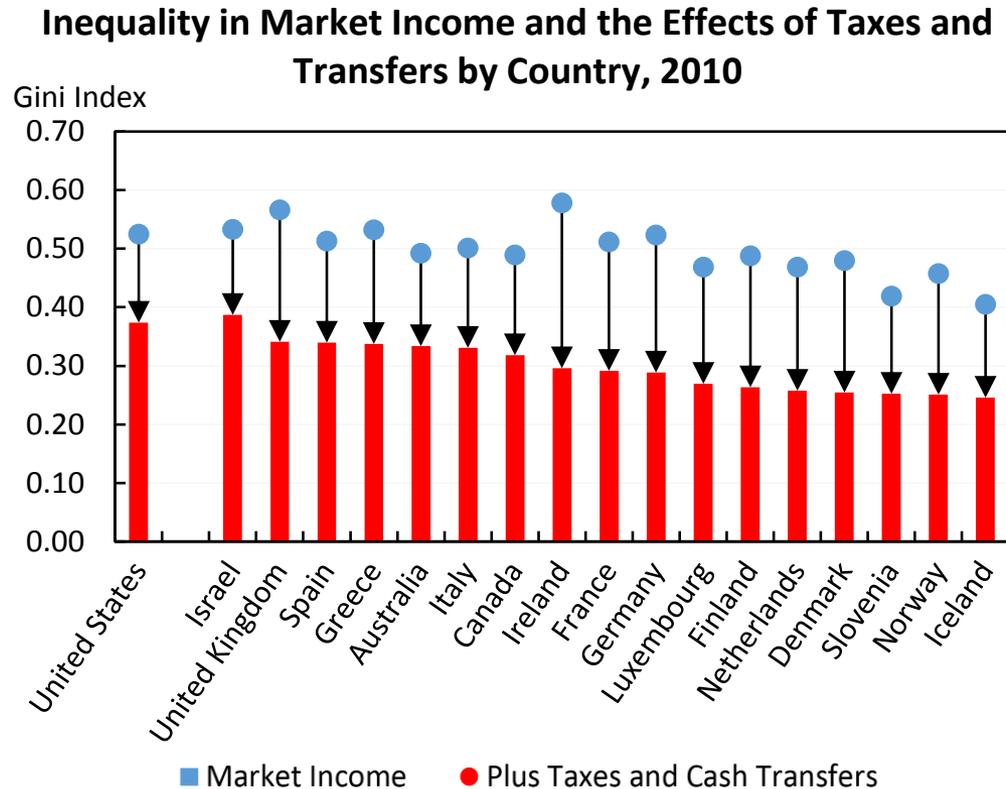


**Change in After-Tax Income by Income Percentile:
Changes in Tax Policy Since 2009
and ACA Coverage Provisions, 2017**



- **Changes in tax policy and the coverage provisions of the ACA will increase the share of after-tax income received by the bottom 99% of families by 1.2 percentage points in 2017 relative to what it would have been under the continuation of 2008 policies. (The income share of the top 1% will decrease by the same amount.)**
- **These policies will boost incomes for families in the bottom 20% by 18%, equivalent to more than a decade of average income gains.**

The U.S. Tax and Transfer System Does Less to Reduce Inequality Than Other Countries' Tax and Transfer Systems



- The US has relatively high inequality of market income compared to other advanced economies—though we are still less unequal than the United Kingdom, Israel, and Ireland.
- We have the highest after-tax-and-transfer inequality of major advanced economies with the exception of Israel.

Multi-Pronged Approach to Promoting Greater Equality in Long Run

- Continued investment in education and skills that boost productivity:
 - Pre-K through college
 - Apprenticeships and job training
- Promotion of competition in labor market:
 - Facilitate independent anti-trust enforcement
 - Reform non-compete laws
 - Improve transparency and worker information
 - Enhance worker mobility through ACA, reform of occupational licensing and land use regulations
- Support for institutions that counter wage-setting power
 - Support workers' rights to collective bargaining
 - Increase the federal minimum wage

Policy Approaches to Inequality

**Sandra Black
Member
Council of Economic Advisers**



November 17, 2016