

## General Discussion: The Distribution of Income in Industrialized Countries

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*Chairman: George Shultz*

*Mr. Shultz:* Thank you. Now we will have our discussion.

*Mr. Siebert:* I have two points. First, comparing the data on income dispersion in continental European countries like France, Germany, and Italy, with the U. S. and U.K. data, it is my reading that *rising* income inequality is not a phenomenon of the major continental European countries. So it seems to me that the topic of this conference—rising income inequality—is an Anglo-Saxon phenomenon. The apartment house in Europe (mentioned by Larry Katz) has not changed very much. I have some data in my written comment on Joseph Stiglitz's paper on this issue.

Second, I would like to stress the point made by Mr. Visco and in the Atkinson paper, that the income distribution data we are talking about are a snapshot. There is vertical mobility. Within a five-year period, in the United Kingdom and the United States, more than half of the employees move up one or more quintile of the earnings dispersion. This percentage is somewhat lower in the European countries. So, I think vertical mobility is a very important issue that should be considered before we get into policy conclusions.

*Mr. Katz:* I would like to respond to those two points. First of all, there is no doubt that the rise in inequality is much greater in the Anglo-Saxon countries and that in France and Italy, in particular,

there is no evidence of it. In Germany there is tiny evidence of a growth but most of the other continental European countries actually show some increase in inequality. Second, I completely agree that one should not just focus on the snapshot, but one can do other things. There is a lot of mobility, but one should also realize, if one takes the data in the United States and the United Kingdom and one averages income over 10 years—take average income of every person in the 1980s versus the 1970s. So look at that as a 10-year average in equality; there is about a 40 percent growth in inequality in the United States and the United Kingdom of average incomes, even taking out the year-to-year mobility. So while mobility is important and the total amount of dispersion is much lower, there is a trend in the Anglo-Saxon countries that is much beyond what is significant.

**Mr. Shultz:** I can't resist the comment that income distribution is not the only thing that is stagnant in central European countries. Next comment. Yes.

**Mr. Mishkin:** I have a question: What about the issue of mobility across generations? The reason why I ask this is that, anecdotally in the United States, there has always been a feeling that even though we've had a lot of income inequality, across generations there is a lot of mobility, and that is what produces social stability. So really, the two questions are these: One, what is the research on the United States which indicates whether that is true or not? And two, has there been potentially a change in that? Because that would have very important implications for what happens going forward.

**Mr. Katz:** The evidence on that is the following: It depends on how you want to interpret it. The correlation of permanent—that is five or 10-year averages of income across fathers and sons—is about 0.4 from a number of studies. Earlier studies showed it to be lower. So you can view that as half-empty or half-full. That is, you have sort of an advantage of coming from a wealthy family and in a couple of generations that looks like it goes away. So there is a fair amount of mobility. In terms of trends, if you look at most European countries, that number seems to be pretty similar. There is not evidence today that the United States looks like it has much more intergenerational

mobility. There is some evidence in European countries that the degree of intergenerational mobility has gone up over time. In the United States, for minority groups it has. For whites in the United States, it looks fairly stable. Again, all the stuff is, there are no data on income mobility prior, so it is using occupational status, and once you start going before 1940, it all depends on how you want to rank farmers versus other people. So I think that there is some persistence. All these societies are fairly open and have a lot of intergenerational mobility, but you do have a fair amount of advantage in the next generation coming from a better-off household.

**Mr. Visco:** I would like to add something on the two issues that have been brought up. First, on mobility. We are now doing some research on poverty in emerging nations because this is an issue of interest to a number of member countries, including the United Kingdom. This research is preliminary, but for poverty there is high mobility in the sense that in a given number of years a lot of people move from the lowest quintile upward. But this implies that, at the end of the day, you observe that a large share of the population, one year or the other, ends up being in the lowest quintile. So there is high mobility, but there are a lot of people that experience being poor. And the numbers are striking. More than one-third of the working force in the United Kingdom ended up in this quintile over the last five or six years.

The other thing that is important is with respect to Horst Siebert's comment that in continental Europe the increase in the dispersion of incomes is much lower than has been observed in the Anglo-Saxon countries. (Even if, with respect to Italy, the dispersion has grown substantially after the exchange rate crisis of 1992, and most of the evidence that has been presented by Tony Atkinson does not include this time period.) However, it should be considered that the diffusion of poverty has increased, and this is linked to labor market conditions. So in the analysis of income distribution, I think that it is important to correct for employment rates.

**Mr. Shultz:** Thank you. Over here.

**Mr. Sinai:** If one were to include wealth with income in a wider definition of inequality, either together or as a separate variable to judge inequality, what would the panelists say about inequality in the United States and the Anglo-Saxon countries in Europe viewed this way? What kind of research is available on this question?

**Mr. Katz:** When you look at financial wealth, inequality is much greater than when you look at income. That is, if you look at the dispersion of financial wealth, the share of the upper 1 percent of wealth is massive, relative to the share of income. So if you wanted to get a picture of how much dispersion there is, it is much dispersed and that is true in every country. In terms of the trends, I am not aware of a lot of evidence outside the United States and the United Kingdom. In the 1980s, the trends there are very similar and in the 1990s, in the United States, things are flatter for wealth than income. Over the very long haul, the wealth distribution has become much more equal in the United States and the United Kingdom, if you look over the last 200 years. The recent period has been one of shooting back, but we're not back to where we were 100 years ago.

**Mr. Visco:** An indirect way to look at this thing is to look at the distribution of total market income, and compare that to the distribution of earnings. You observe that in the last year, certainly in the United Kingdom, but I think also in the United States, the dispersion of total income has increased substantially more than the dispersion of earnings. That reflects the incomes of capital that have tended to accrue to persons in the higher quintiles in particular.

**Mr. Shultz:** Way in the back.

**Mr. Darby:** There has been a discussion of the distribution of incomes across all earners or households in the 1970s and 1980s, but I think that is fundamentally misleading because the makeup of the population has changed, in particular, as to households. At the Census we spent a lot of time trying to take account of that. To give you a feeling for the potential magnitude, for at least the United States, in California since 1970, we have gone from 10 percent Hispanic to 30 percent Hispanic. Now, that is mostly not from natural

increase but from immigration of very low human capital workers from just across the border. Their incomes have gone up dramatically as they have come into the United States and, as a result, because their incomes are still much lower than previously poor people in the United States, dispersion has increased. Also, we see many more female-headed families, where there is only one worker. Now I don't know how much of that accounts for the data in other Anglo-Saxon countries, excluding Germany. I would have guessed that Germany's total income distribution became much more unequal when the former East Germanlander rejoined Germany in 1991.

**Mr. Katz:** That is a good point. Sitting in California, you get a slightly extreme view, relative to the rest of the nation. For the United States as a whole, the share of immigrants went from 6.4 percent to 9.7 percent, which is a little smaller than from 10 to 30 percent. I have done all this stuff on a series of papers where you break out the population into immigrant and native and it is true that if you add in the immigrants it does contribute, and in California it has a huge effect. For the United States as a whole, it is modest in its contribution. If you just looked at white U.S. natives, you see a very, very large increase in inequality either of wage earnings or of family income and inequality. Similarly, if you decompose the increase in inequality into family structure, a significant contributor to the increase in inequality, even if you do it per equivalence, is the decline of families headed by two persons. In fact, in the 1970s, the growth of single-female-headed households in the United States is as large a contributor to family income and inequality as changes and dispersion of labor earnings. In the 1980s and the 1990s, that pattern has actually slowed down, and the two most important factors are the growth and dispersion of wages and the increased correlation of incomes of husbands and wives. The family structure change still goes in that direction, but it is not nearly large enough. The other way to see that is if you look only at the population of married couples, households of white natives, and look at inequality, you see a very, very large increase from 1970 to 1990. So Michael's point is right, that does take the raw numbers and it tends to exaggerate their significance, but it doesn't eliminate or even come close to changing the qualitative conclusions about the trends. I am unaware of work on other countries, so I believe that.

**Mr. Budd:** This is really a question for Lawrence Katz. Toward the end of your presentation, you talked about relative increases in the supply of skilled labor, and you particularly used this to explain what happened in Canada and what happened in the United States. In the United Kingdom, which we would agree has an extraordinary increase in inequality, there has certainly been an enormous increase in the number of young people going to universities. I'm not sure whether you count that as increases in skilled labor, but we have had an enormous increase in that.

**Mr. Katz:** The key point is what is the base case. Every single country in the advanced industrial world has become more educated over time. The key question is whether it is accelerating or decelerating. Think of a model, and the way to think of it is to look at the United States. Turn to Table 2 in my handout. The United States is broken into three periods, 1940-1960, 1960-1980, and 1980-1996. What this shows you is the relative gap in earnings between college and non-college workers, which narrowed substantially in 1940-1960; it was pretty flat in 1960-1980; and then you see the growing inequality in 1980-1996. The United Kingdom would look like that. There is a variable called relative supply, which is the growth of the college population. That is very positive in all three periods. The same things would be true in the United Kingdom. What has happened in the United States and the United Kingdom isn't that we've stopped producing highly educated workers, it is that the proportional rate of growth did not continue accelerating. In fact, in the United States, it has slowed down a lot, from 4 percent a year in 1960-1980 to 2½ percent a year in 1980-1996. In the United Kingdom, similarly, you had a very rapid rate of growth in the 1970s. It continued to be rapid in the 1980s and 1990s but not as rapid as the demand shifts. It slowed down a bit. If you did this for France and Germany, that number would be bigger in 1980-1996 than in 1960-1980. So whether the trend is accelerating or decelerating matters because the demand trend is there also.

**Mr. Shultz:** The trend has to slow down.

**Mr. Katz:** Eventually, the trend has to slow down, but if you look at

the college workforce, we are not close to physical saturation. Obviously, if you did this for high school, it would slow down since we are close to saturation there.

**Mr. Heller:** Much of the paper is focused on the relative inequality of income. But we should also look at absolute poverty as a measure. I was wondering whether you would be able to make any generalizations as far as absolute poverty is concerned—people who really don't have enough to eat, people who don't have housing, and other absolute measures, rather than the relative measure. We have all become more affluent over the years, and that includes the poor.

**Mr. Katz:** Measuring absolute poverty is a much, much more difficult issue. In the sense that all the problems that Chairman Greenspan and others have raised about whether we have a consumer price index (CPI) that is accurate, in the sense of whether we actually measure changes in the cost of living, has the quality of housing gone up? If you look at measures of things like working toilets, telephones, VCRs, you would say there are large reductions in absolute poverty. If you ask whether you are more exposed to crime in the United States, outside of the last three years, you would say absolute poverty has gotten a lot worse. If you believe the CPI, we made tremendous progress against poverty through the early 1970s but essentially no progress since. If you believe there is a 1 percent a year bias, then absolute poverty has been declining. Extreme poverty, people living below 50 percent of the line, even if you would adjust for the CPI, there does appear in the United States to be a group completely beyond the safety net that has increased in size, as for example, the visibility of homelessness. But those are very, very difficult measurement issues overall.

**Mr. Shultz:** It has always seemed to me that when you get down to a certain level and you look at the homeless for example, as you mentioned Larry, that you have an entirely different set of things to think about. You have mental illness. You have drug addiction. You have alcoholics. It is a whole different culture and by playing around with economic variables, you are not making contact with it. It has to be gone about and thought about in a different way, I think. Next.

**Ms. Tyson:** I just had an observation, and two questions. The observation is really related to a point Larry made about how the correlation between fathers and sons or intergenerational mobility hasn't changed very much. But if you combine that again with the apartment analogy, then the issue of the social implications of a constant amount of intergenerational mobility with a deterioration, a serious deterioration, at the bottom, it is a little different; the social implications are different than if that were not the case. On the poverty measures for the United States, I was interested in the extent to which the composition of poverty is changing toward children. You mentioned that single-family household formation was becoming less important as a factor behind overall income inequality growth in the 1980s and the 1990s, but is it not still very important as an issue of poverty formation because of children? And then, finally, for OECD, my question is this: A lot of the discussions here have to do with earnings and inequality among men. When you look at the issue of earnings and inequality among women, the data in the United States suggest that there has been an increase in earnings and inequality among women, but it hasn't been as pronounced as among men. Furthermore you haven't seen the sort of falling out of the bottom that you have seen among men, and I was wondering what the observations are like in the other OECD countries?

**Mr. Katz:** In terms of poverty, it is true that the poverty rate of children has increased more than the overall poverty rate in the United States. In particular, the child poverty rate averaged over 20 percent, if you believe our official numbers, in the 1980s, to the mid-1990s where it was sort of in the mid-teens in the 1970s after a huge fall. So clearly, and if you look it is much greater in single-female-headed families, although there has been a large increase among working married-couple families. The biggest shift in the United States is in the poverty rate of the elderly versus that of children. In the 1960s the poverty rate of the elderly was higher than the poverty rate of children in the United States. The poverty rate of children is now three times that of the elderly in the United States. So there has been a huge generational shift in the distribution of the economic distress. I mean, Social Security has done an incredible job of eliminating measured elderly poverty in the United States. We have not done



something like that for children. In terms of women's inequality, in most countries I know of, it has gone up as much as it has for men, but women have gained on men throughout the distribution. So in the United States the gap between the 90<sup>th</sup> percentile woman and the 10<sup>th</sup> percentile woman has increased as much as for men. But the 10<sup>th</sup> percentile woman has basically had a wage increase when you use the CPI, whereas the 10<sup>th</sup> percentile man has had a 25 percent real wage decline over the last 20 years.

**Mr. Visco:** One has also to consider that in the other countries the increase in inequality has been more modest. So the fact that you do not observe a higher dispersion over time for women, this is basically the same thing that you observe for men. The other thing that is interesting concerning poverty is this: There has been an increase in child poverty and it is associated with the fact that poverty is most frequently observed in households with single parents or no working adults. That share has increased substantially over time. And even if the non-employment rate has declined, the share of households without working adults or with single parents has increased.

**Mr. Shultz:** Thank you. We now have to shift gears. I want to thank the panel that is here and invite the next panel to come up. We are going to shift from what has happened to the causes of changing income inequality, and we are going to have an interesting way of going about this. We will start with a presentation by Dennis Snower, then we will take a short coffee break, and then we will have a discussion of his paper and then continue exploring monetary policy effects.