Assembly Committee on Accountability and Administrative Review:

An Oversight Hearing on the State's Role In Addressing Income and Wealth Inequality

December 7, 2011

BACKGROUND PAPER

Trend Toward Greater Inequality

During the first half of the last century, economic growth in the United States resulted in relatively broadly shared prosperity. According to the California Budget Project, "average inflation-adjusted incomes for families in each of the bottom four fifths of the distribution doubled or more than doubled between 1947 and 1973."[i] But since the 1970s, gains have accrued disproportionately to the top of the income distribution, thereby widening inequality.

From 1979 to the beginning of the Great Recession (2007), the people in the top one percent received 36 percent of all gains in household income.[ii] This is equivalent to a 50 percent increase in average income of the top one percent. During the same period, households in the lowest four fifths saw decreases in their inflation-adjusted income of 7.3 to 19.5 percent.[iii]

To provide some context for this discussion, data from the Franchise Tax Board indicate that middle-income households in California had incomes between $26,103 and $45,376 in 2009.[iv] The top 10 percent had incomes of at least $126,077, and the top one percent had incomes of $400,635 or greater.

To be sure, the good news is that the California economy grew during the last few decades. But what are the implications for our state when only a relative few benefit, and the majority are worse off than before? In 2010, 5.8 million Californians lived in poverty (15.8 percent), including 2 million children (22 percent).[v] For a two-parent family with two children that means living on an income of $22,000 per year or less.[vi]

One might wonder if other nations or states are experiencing more broad-based economic prosperity. Income inequality is greater in the United States than in any of the other nations in the wealthiest "Group of Eight," and greater than all but two of the 34 nations which form the Organisation for Economic Co-operation and Development. Among the 50 US states, California has the seventh widest gap between rich and poor.[vii]

Growing National Interest in Inequality

On September 17, 2011, a group calling themselves Occupy Wall Street (OWS) began to demonstrate in a park located in Manhattan's Financial District. The protesters refused to vacate the park at night and began to erect tents. Since then, similar demonstrations have materialized in as many as 100 cities across the United States.[viii] In California, "occupy" protests have developed in Sacramento, Oakland, Los Angeles, San Francisco, San Jose, San Diego, and on some college campuses. In most cities, local authorities initially allowed the protests to proceed peacefully. But in recent weeks, there have been incidents in which protesters were forcefully removed from public spaces.

The amorphous nature of these protests makes it difficult –if not impossible– to obtain official statements, positions or goals of what has become a national movement. That said, there is enough information available to discern the major themes expressed by OWS participants and their supporters. The idea behind the movement's slogan, "We are the 99%," is their contention that the wealthiest one percent of US residents manipulate democratic and economic institutions to the detriment of the remaining 99 percent of residents. As evidence, they cite the growing inequality of wealth and income within the US population.

OWS protesters express a range of goals, but the most specific include the elimination of corporate personhood and the need for campaign finance reform to remove the influence of money in politics.[ix] Public opinion research shows both, that many Americans share the frustration expressed by the OWS protesters, and that Americans as a whole are closely divided between OWS supporters and opponents.[x] The OWS movement has sparked a national conversation about inequality and the role of government in addressing it, which extends far beyond those inclined to camp out in public parks.

Public opinion research shows that Americans are split with regard to whether or not the nation is divided into "haves" and "have-nots." Soon after the beginning of the OWS demonstrations, 45 percent of Americans thought this was the case, while 52 percent did not.[xi] But two months later, another poll showed that 60 percent of Americans support government action to reduce income inequality.[xii] Interestingly, only 44 percent of the latter respondents said they identified with the OWS movement, although a majority of all respondents supported the movement's goals.

Polls show views in California are similar to those across the nation. A recent Field Poll shows that 46 percent of Californians identify with the OWS movement, while 49 percent do not.[xiii] But more relevant to policymakers, is the fact that a majority (58 percent) agree with the underlying reasons for the protests, while only 37 percent do not. In this hearing, the Committee will engage experts in a constructive discussion on some of these concerns.

Income versus Wealth

When discussing inequality, income and wealth are both useful concepts, but they are not interchangeable terms. As used by the committee, *income* refers to household income as calculated for tax purposes. Income is a valuable measure of economic activity occurring within a specific period of time, such as earnings per year. *Wealth* refers to the total value of assets, including, for example: savings, trusts, inheritance, investments and property. Wealth is more important than income in determining long-term economic security, because it allows families to weather financial crises such as unemployment or illness. Wealth also allows families to invest in the economic future of their children and subsequent generations.

During the last few decades, inequality of wealth was even greater than inequality of income. For example, the 10 percent of US households with the highest incomes received nearly half of all income (47.1 percent) in 2007, while the 10 percent of US households with the greatest wealth had nearly three-quarters (73 percent) of total wealth.[xiv]

Causes of Inequality

The traditional explanation for growing economic inequality in the United States is composed of various factors including a technological revolution in the 20th century, increased competition from other nations, and the disappearance of low-skilled jobs. In *Winner-Take-All Politics*, Hacker and Pierson advance an alternate argument that growing inequality is the result of the failure of our political system to address the needs of the middle and working classes. For example, they describe the absence of a government response to the eroding value of minimum wage as a "passive-aggressive" form of government policy.[xv]

Some economists argue that there is little government can do to impact inequality, because inequality is largely driven by differences in how much people earn before government taxes and benefits come into play. Hacker and Pierson describe how governments can and do shape capitalist systems —and therefore how much people earn— by regulating minimum wage, labor unions, corporate governance, enforcing contracts, determining who has standing in the courts, etc.[xvi]

Specific reasons cited by Hacker and Pierson for growing income inequality throughout the past thirty years include: decreased tax rates on the richest Americans, the declining influence of labor organizations, skyrocketing compensation for corporate executives, and the creation of new financial products.[xvii] The housing crisis which began in 2006 has exacerbated wealth inequality and dealt the hardest blow to those families least able to recover.[xviii]

Policy Options

Given the interdependence of the California economy with the economies of other US states, and the national and global economies, it may seem that state policymakers have little ability to affect the gaps in wealth and income inequality. But the state also regulates many of the factors listed above which affect income.

Analysis conducted by the California Budget Project indicates that higher education still provides a mechanism to move people out of the lowest rungs of the income distribution. During the past 30 years, "the value of a bachelor's degree increased considerably… Workers with four-year degrees made strong hourly wage gains, while the earnings of workers with lower levels of educational attainment lost purchasing power."[xix] Economic mobility, especially dramatic changes, may be less common than most Americans believe. Almost half of California adults who grow up in low-income families have low incomes themselves.[xx] But the rate of those who grew up in low-income households and graduated from college that go on to live in poverty as adults, is just 16 percent.

The presenters gathered from the worlds of political science, economics and public opinion research will provide the Committee with more specific policy options. *The goals of this hearing are:*

- To examine how state and national government policies might exacerbate wealth and income inequality,
- To identify the societal impact of inequality, and
- To identify policies the state could implement to ameliorate any negative effects of inequality.

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[i] *A Generation of Widening Inequality*, California Budget Project. November 2011.

[ii] This calculation by Hacker and Paulson accounts for the value of employer-sponsored health insurance, federal taxes and government benefits.

[iii] Franchise Tax Board.

[iv] This range represents the middle fifth of the income distribution.

[v] Small Area Income and Poverty Estimates, US Census Bureau.

[vi] Based on US Census Bureau Poverty Threshold; exact figure is $22,113 per year.

[vii] US Census Bureau data from 2010.

[viii] Figure provided by OWS proponents, http://occupywallst.org/about/.

[ix] Occupy Wall Street Public Opinion Project, November 29, 2011.

[x] Pew Research Center for the People and the Press, September 29, 2011.

[xi] *No Consensus About Whether Nation is Divided into Haves and Have-Nots*, Pew Research Center. September 29, 2011.

[xii] *Six in Ten Support Policies Addressing Income Inequality,* ABS News/Washington Post Poll. November 9, 2011.

[xiii] *California Voters About Evenly Split in their Identification with the Occupy Protest Movement, but a Majority Agrees with the Underlying reason for the Protests*, The Field Poll. November 29, 2011.

[xiv] Economic Policy Institute.

[xv] Winner-Take-All Politics, Hacker and Pierson, p. 53.

[xvi] Winner-Take-All Politics, Hacker and Pierson, Ch. 2.

[xvii] Winner-Take-All Politics, Hacker and Pierson, Ch. 2.

[xviii] *The State of Working America's Wealth, 2011: Through volatility and turmoil the gap widens*, Sylvia Allegretto. March 23, 2011.

[xix] *A Generation of Widening Inequality*, California Budget Project. November 2011.

[xx] Low-income here refers to those in the bottom fifth of the income distribution. Data from Pew Charitable Trust.