PULLING APART

A State-by-State Analysis of Income Trends

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The authors are solely responsible for the contents of this report.

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I. Executive Summary

A state-by-state examination of trends in income inequality over the past two business cycles finds that inequality has grown in most parts of the country since the late 1980s. The incomes of the country's highest-income families have climbed substantially, while middle- and lower-income families have seen only modest increases.

In fact, the long-standing trend of growing income inequality accelerated between the late 1990s and the mid-2000s (the latest period for which state data are available).

- On average, incomes have declined by 2.5 percent among the bottom fifth of families since the late 1990s, while increasing by 9.1 percent among the top fifth.

- In 19 states, average incomes have grown more quickly among the top fifth of families than among the bottom fifth since the late 1990s. In no state has the bottom fifth grown significantly faster than the top fifth.

- For very high-income families — the richest 5 percent — income growth since the late 1990s has been especially dramatic, and much faster than among the poorest fifth of families.

Similarly, families in the *middle* of the income distribution have fallen farther behind upper-income families in many states since the late 1990s:

- On average, incomes have grown by just 1.3 percent among the middle fifth of families since the late 1990s, well below the 9.1 percent gain among the top fifth. Income disparities between the top and middle fifths have increased significantly in Alabama, California, Florida, Illinois, Mississippi, Missouri, New Mexico, and Texas. Income disparities did not decline significantly in any state.

The benefits of economic growth were broadly shared for a few years in the late 1990s — the only period in the past two decades for which this was true — but this broad-based growth ended with the 2001 downturn. Once the effects of the recession were left behind, the trend toward greater

Methodology

This analysis uses the latest Census Bureau data to measure post-federal-tax changes in real incomes among high-, middle- and low-income families in each of the 50 states between the late 1980s, the late 1990s, and the mid-2000s — similar points in the business cycle ("peaks").

In order to generate large enough sample sizes for state-level analysis, the study compares combined data from 2004-2006 with data from 1987-1989 and 1998-2000. The study is based on Census income data that have been adjusted to account for inflation, the impact of federal taxes, and the cash value of food stamps, subsidized school lunches, housing vouchers, and other government transfers, such as Social Security and welfare benefits.

Realized capital gains and losses are not included, due to data limitations. *As a result, our results show somewhat less inequality than would be the case were we to include realized capital gains.*

In this analysis, changes in income inequality are determined by calculating the income gap — i.e., the ratio between the average family income in the top fifth of the income spectrum and the average family income in the bottom fifth (or the middle fifth) — and examining changes in this ratio over time. These changes are then tested to see if they are statistically significant.

States fall into one of two categories: (1) those where inequality increased (that is, the ratio increased by a statistically significant amount), or (2) those where there was no change in inequality (the change in the ratio was not statistically significant). It also would be possible for a state to fall into a third category — states where inequality *decreased* by a statistically significant amount. In this analysis, however, no state experienced a decline in income inequality.

inequality quickened, as the incomes of the richest families climbed while those of low- and moderate-income families stagnated or declined.

Specifically, real wages for low- and moderate-income families grew more slowly in 2002 and the first part of 2003 and then began to decline; on average, they are now the same or lower than they were in 2001. The highest-income families also saw declines in real income during the 2001 downturn (due both to the broad sweep of that recession in the job market and to the loss of realized capital gains), but their incomes grew rapidly once they recovered from these losses. The federal tax cuts of the early 2000s, which were targeted primarily on wealthy families, helped widen the income gap between the wealthiest families and those with low and moderate incomes.

An examination of income trends over a longer period — from the late *1980s* to the mid-2000s — shows that inequality increased across the country.

- In 37 states, incomes have grown faster among the top fifth of families than the bottom fifth of families since the late 1980s. No state has seen a significant decline in inequality during this period. Nationally, the richest fifth of families have enjoyed larger average income gains each year ($2,060, after adjusting for inflation) than the poorest fifth of families have experienced during the entire two decades ($1,814).

- Middle-income families have also lost ground compared to those at the top. In 36 states, the income gap between the average middle-income family and the average family in the richest fifth has widened significantly since the late 1980s.

Top 5 Percent of Families Pulling Away Even Faster

The widening income gap is even more pronounced when one compares families in the top 5 percent of the income distribution (rather than the top fifth) to the bottom 20 percent. The higher one goes up the income scale, the greater is the degree of income concentration.

- In the 11 large states analyzed, the average income of the top 5 percent of families rose by more than $90,000 on average. (In three states — New Jersey, New York, and Massachusetts — the increase exceeded $100,000.) By contrast, the largest increase in average income for the bottom fifth of families in these states was only $3,000. In New York, for example, average incomes grew by $108,000 among the top 5 percent of families but by less than $1,000 among the bottom 20 percent of families.

- In the 11 large states for which this comparison is possible, the incomes of the top 5 percent of families have increased by 34 percent to 91 percent since the late 1980s. By contrast, the percentage increase in incomes of the bottom fifth of families in these states ranged from no change to 20 percent over the same period.[1]

Wide and Growing Gap Separates High-Income Families from Poor and Middle Class

The resulting disparities between the incomes of high- and low-income families are substantial.

- In the United States as a whole, the poorest fifth of families have an average income of $18,120, while the top fifth of families have an average income of $132,130 — more than seven times as much. In 22 states, this top-to-bottom income ratio exceeds 7.0. (In the late 1980s, in contrast, just one state — Louisiana — had a top-to-bottom ratio exceeding 7.0.) The states with the biggest increases in income disparities since the late 1980s are Connecticut, Rhode Island, Massachusetts, Alabama, New York, Kentucky, Maryland, Kansas, New Jersey and Washington.

- The average incomes of the top 5 percent of families are 12 times the average incomes of the bottom fifth. The states with the largest such gap are New York, Massachusetts, Connecticut, Mississippi, New Jersey, Tennessee, New Mexico, Alabama, California, and Virginia.

Similarly, income gaps between high-income and *middle*-income families have grown.

- In over two-thirds of states, incomes have grown faster over the past two decades among the richest families than among families in the middle of the income spectrum — more than twice as fast, on average. In the remaining states, incomes have grown at about the same rate for the middle and top fifths of families.

[1] An analysis of the average income of the top 5 percent of families was conducted for 11 large states that have sufficient observations in the Current Population Survey to allow the calculation of reliable estimates of the average income of the top 5 percent of families. These states are California, Florida, Illinois, Massachusetts, Michigan, New Jersey, New York, North Carolina, Ohio, Pennsylvania, and Texas.

- The states with the largest gaps between high-income and middle-income families are Oklahoma, Mississippi, California, New York, Texas, New Mexico, Florida, Arizona, Louisiana, and Virginia.

Causes of Rising Inequality

Several factors have contributed to the large and growing income gaps in most states.

- **Growth in wage inequality.** This has been the biggest factor. Wages at the bottom and middle of the wage scale have been stagnant or have grown only modestly for much of the last two decades. The wages of the very highest-paid employees, however, have grown significantly.

  Wage inequality is growing for several reasons, including long periods of high unemployment, globalization, the shrinkage of manufacturing jobs and the expansion of low-wage service jobs, and immigration, as well as the lower real value of the minimum wage and fewer and weaker unions. As a result, wages have eroded for workers with less than a college education, who make up approximately the lowest-earning 70 percent of the workforce. More recently, wages have been relatively stagnant even for college-educated workers (up only 2.5 percent between 2000 and 2007), in part due to the bursting of the tech bubble, but also due to the downward pressure on wages from offshore competition.

  Only in the later part of the 1990s did this picture improve modestly, as 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 insufficient 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 in the late 1980s or the late 1990s.

- **Expansion of investment income.** Forms of income such as dividends, rent, interest, and capital gains, which primarily accrue to those at the top of the income structure, increased substantially during the 1990s. (Our analysis captures only a part of this growth, as we are not able to include capital gains income due to data limitations.) The large increase in corporate profits during the recent economic recovery has also contributed to growing inequality by boosting investors' incomes.

- **Government policies.** Government actions — and, in some cases, inaction — have contributed to the increase in wage and income inequality in most states. Examples include deregulation and trade liberalization, the weakening 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. 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.

States Can Mitigate the Growth in Inequality

Growing income inequality not only raises basic issues of fairness, but also adversely affects the nation's economy and political system. The country has now entered a new economic downturn — quite possibly a recession — and already there are unmistakable signs that low- and middle-income workers will be hard hit. The uneven distribution of the country's prosperity over the last two decades has left families at the bottom and middle of the income scale ill-prepared to weather this latest downturn. While the recent decline in the stock market is affecting the incomes of the wealthiest families, they have more savings to cushion the impact, and, if the 2001 experience is repeated, their incomes will again bounce back strongly.

A significant amount of increasing income inequality results from economic forces that are largely outside state policymakers' control. State policies, however, can mitigate the effects of these outside forces. State options include:

- **Raise, and index, the minimum wage.** Until Congress acted in 2007, the federal minimum wage had not been adjusted for inflation for almost ten years, and its real value had fallen considerably. Even with the 2007 increase, however, the minimum wage is not indexed to inflation — that is, it will not automatically keep up with the rising cost of living — so its value will begin to erode again after 2009 unless Congress acts. In addition, its value still falls well short of the amount necessary to meet a family's needs, especially in states with a high cost of living. States can help raise wages for workers at the bottom of the pay scale by enacting a higher state minimum wage *and* indexing it for inflation.

- **Improve the unemployment insurance system.** In 2007, the share of unemployed workers receiving benefits was only 37 percent — a sign that the current unemployment insurance system does not reflect the realities of work and family today. The current economic downturn makes it all the more urgent that federal and state policymakers act to make more jobless workers eligible for unemployment assistance by modernizing the system.

- **Make state tax systems more progressive.** The federal income tax system is progressive — that is, it narrows income inequalities — but has become less so over the past two decades as a result of changes such as the 2001 and 2003 tax cuts. Nearly all state tax systems, in contrast, are regressive. This is because states rely more on sales taxes and user fees, which hit low-income families especially hard, than on progressive income taxes. (The income inequality data in this report reflect the effects of federal taxes but not state taxes.)

  Many states made their tax systems *more* regressive during the 1990s. Early in the decade, when a recession created budget problems, states were more likely to raise sales and excise taxes than income taxes. Later in the decade, when many states cut taxes in response to the strong economy, nearly all chose to make the majority of the cuts in their income taxes rather than sales and excise taxes.

  States now appear to be on the brink of another fiscal crisis, and a new round of tax increases is both likely and appropriate if the economy remains weak and the fiscal crisis deepens. Economists recognize that tax increases and other revenue measures, especially if targeted to

high-income taxpayers, can be a reasonable alternative to spending cuts, and can actually be less harmful for a state's economy than big spending cuts.

There are many ways a state can increase taxes in a way that makes its tax system more progressive at the same time. For example, it can reduce its reliance on sales taxes by increasing its income tax on a temporary or permanent basis. If states instead turn to increases in sales taxes or fees to balance their budgets, they can offset the impact on those least able to pay by enacting or expanding tax credits targeted to low-income taxpayers. For example, more states could follow the lead of the 23 states that have adopted state earned income tax credits.

States can also improve the progressivity of their tax systems by *not* enacting at the state level the corporate tax cuts included in the federal economic stimulus package and by restoring state estate taxes eliminated as a result of the phase-out of the federal estate tax.

- **Strengthen the social safety net.** Federal and state changes to programs that assist low-income families have contributed to the increase in income inequality in recent years. While welfare reform efforts in the mid- and late 1990s succeeded in helping more families move to work, they often made it harder for very poor families unable to find jobs or work consistently to get income assistance — and intensive job preparation and training — they need both to make ends meet in the short run and to become employable over the longer period of time.

  States can take steps — such as improving assessment procedures and establishing job preparation programs for those with barriers to employment — that will make their assistance programs more responsive to those at the very bottom of the income scale while maintaining the work-focused nature of the program.

  States can also strengthen their social safety nets by providing low-wage workers with supportive services such as health coverage, child care, and transportation. In addition, they can provide intensive case management and other services to help current and former welfare recipients maintain their current jobs, move into better jobs, or obtain the education and training needed for career advancement.

While these are all useful steps, state policies are only one of a range of factors that have contributed to increasing income disparities over the past decade. If low- and middle-income families are to stop receiving steadily smaller shares of the income pie, federal as well as state policies will have to play an important role.

TABLE A: TOP TEN STATES FOR SELECTED INCOME INEQUALITY MEASURES	
Greatest Income Inequality Between the Top and the Bottom, Mid-2000s	**Greatest Income Inequality Between the Top and the Middle, Mid-2000s**
1. New York	1. Oklahoma
2. Alabama	2. Mississippi
3. Mississippi	3. California
4. Massachusetts	4. New York
5. Tennessee	5. Texas
6. New Mexico	6. New Mexico
7. Connecticut	7. Florida
8. California	8. Arizona
9. Texas	9. Louisiana
10.Kentucky	10.Virginia
Greatest Increases in Income Inequality Between the Top and the Bottom, Late 1980s to Mid-2000s	**Greatest Increases in Income Inequality Between the Top and the Middle, Late 1980s to Mid-2000s**
1. Connecticut	1. Connecticut
2. Rhode Island	2. Oregon
3. Massachusetts	3. Oklahoma
4. Alabama	4. Maryland
5. New York	5. California
6. Kentucky	6. New York
7. Maryland	7. New Jersey
8. Kansas	8. Rhode Island
9. New Jersey	9. Washington
10. Washington	10. Mississippi
Greatest Increases in Income Inequality Between the Top and the Bottom, Late 1990s to Mid-2000s	**States Where Income Inequality Increased Between the Top and the Middle, Late 1990s to Mid-2000s**
1. Mississippi	1. Mississippi
2. Alabama	2. New Mexico
3. New Mexico	3. Missouri
4. Connecticut	4. Illinois
5. Indiana	5. Alabama
6. Illinois	6. Florida
7. South Dakota	7. California
8. West Virginia	8. Texas
9. South Carolina	
10.Massachusetts	

II. Introduction

This report examines trends in the distribution of income from the late 1980s to the mid-2000s in each of the 50 states. These time periods were chosen because they represent similar points in the economic cycle. The mid-2000s — the most recent period for which state-by-state data are available — spans the high point of the most recent economic expansion. This period was compared to a similar high point in the national economy in the late 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.

Moreover, low- and moderate-income families did not share in the most recent economic expansion. The report finds that from the late 1990s to the mid-2000s, the incomes of the poorest families declined and those of moderate-income families barely grew after accounting for inflation.

This trend of rising inequality has been well documented by data at the national level from the Congressional Budget Office and other sources. For example, a recent analysis of Internal Revenue Service data found that by 2006 income inequality in the United States reached its highest level since the early 1900s.[2] Few analyses, however, have focused on how income inequality has changed within the different states and regions of the country. This analysis finds that the growth in income inequality since the late 1980s was not a geographically isolated phenomenon: in the vast majority of states, 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.[3]

[2] See Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States: 1913-1998," *Quarterly Journal of Economics,* February 2003. Updated data available at http://elsa.berkeley.edu/~saez.

[3] Families 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 income below the official poverty line.

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 late 1980s, the late 1990s, and the mid-2000s. These periods reflect comparable points in the economic cycle — namely, when the economy was at the peak of an expansion. 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.[a] 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 veterans 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 value of food stamps, subsidized school lunches, and housing vouchers. Income from capital gains is *not* included, due to limitations of the data.[b] (If capital gains — which go chiefly to high-income households — were included in this analysis, the levels of inequality shown would likely be even greater.) The incomes shown are adjusted for inflation and expressed as their value in 2005 dollars. This income definition is different from the one used in previous editions of Pulling Apart. Thus, the figures in this report cannot be compared to those in the earlier reports.

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 Underestimates Inequality

National data from other sources such as the Congressional Budget Office (CBO) show that the growth in the incomes of the top quintile was especially rapid at the very top of the income scale. The CBO data, which include capital gains and a comprehensive set of other income sources, show that incomes rose nationwide by 41 percent for the richest fifth from 1988 to 2005, and 57 percent for the richest 5 percent, while rising 76 percent for the richest 1 percent.[c] This suggests that, because the Census data preclude analysis of the gains of the top 1 percent, the results in this report understate the extent of growing inequality at the state level.

In addition, average incomes for the highest-income families are understated because the Census Bureau's official measure of income does not include income from capital gains — a source of income that accrues mainly to high-income families.

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[a] The quintiles are constructed to contain an equal number of people rather than families, using an approach similar to method used by the Congressional Budget Office (CBO) to sort households into quintiles. See methodological appendix for details.

[b] The Census Bureau does calculate an estimate of realized capital gains income. We did not include this "imputed" data because changes in the Census Bureau's methodology over time make it an unreliable measure of changes in capital gains income. See methodological appendix.

[c] Congressional Budget Office, *Historical Effective Federal Tax Rates: 1979-2005.* Washington, DC: December 2007.

The gaps between high-income and low- and middle-income families grew dramatically over the last two decades. During that period the benefits of economic growth were broadly shared only for a few years in the late 1990s. This broad-based growth ended with the 2001 downturn. 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, due both to the broad sweep of that recession in the job market and to the loss of realized capital gains.

Since 2001 the incomes of the poorest families and of middle-income families stagnated or declined. The incomes of the richest families, in contrast, grew rapidly once they recovered from the losses noted above. In addition, the federal tax cuts of the early 2000s, targeted primarily on wealthy families, helped widen the income gap between the wealthiest families and those with low and moderate incomes.

More recently, the country has entered into another downturn – quite possibly a recession. The low- and moderate-income families who benefited least from the recent expansion are likely to be hit hard by the current economic slowdown. The downturn of the stock market is also affecting the incomes of the wealthiest families However, high-income families have more savings to cushion the impact. In addition, if the 2001 experience is repeated their incomes will again bounce back strongly.

Why Growing Income Inequality Is a Problem

As this report demonstrates, inequality has been growing across the country since the late 1980s. This growing divide between the rich on the one hand and the poor and middle class on the other 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. Since the late 1990s, the incomes of the country's poorest families have actually declined. Rising income inequality matters not only because it raises basic issues of fairness but, just as importantly, because it adversely affects our economy and political system.

The majority of Americans continue to believe that income differences are too large and that money and wealth should be more evenly distributed.[4] 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

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

1940s and the 1970s: the incomes of families at all levels grew at about the same rate over that period, as the rising tide of national productivity lifted all boats.

Beginning in the 1970s, this pattern 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.[5]

This trend has broad implications. 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. Growing income inequality also has widened discrepancies in political influence — a particular problem given political candidates' heavy dependence on private contributions. This may have contributed to the increase in the number of Americans who feel that their elected officials do not care much about the views of ordinary citizens.

Also, as the divide grows among families at different income levels, families at the upper end of the income scale have less and less contact and familiarity with the problems faced by low- and middle- income families. For example, when income growth is concentrated at the top of the income scale, housing prices can be bid up beyond the reach of low- and moderate-income families, yet an upper-middle-income family living in the suburbs may have trouble understanding the extent of this problem. Similarly, wealthy families that can afford private schools for their children can lose sight of the need to support public schools. As a result, support for the taxes necessary to finance government programs declines, even as the nation's overall ability to pay taxes rises. The failure to invest adequately in programs that educate children, meet the health and housing needs of families at all income levels, and support low-wage workers can dampen the nation's future economic growth.

In addition, there is evidence that income inequality causes direct harm to the poor. For example, a considerable body of research links income inequality to poor health outcomes. Further, a number of papers prepared for a conference on income inequality sponsored by the Federal Reserve Bank of New York found a link between higher levels of inequality and 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."[6] The United States has substantially greater inequality than nearly all other developed nations.

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[5] 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 Ian Dew-Becker and Robert J. Gordon, "Where Did the Productivity Growth Go?," Brookings Paper on Economic Activity, forthcoming.

[6] Gary Burtless, "Growing Income Inequality: Sources and Remedies" in Henry J. Aaron and Robert D. Reischauer, eds.

Income inequality also can have a direct effect on availability and adequacy of housing, as noted above. The unbalanced distribution of economic growth can lead to much greater demand for housing among those at the top end of the income scale which can in turn lead to higher housing prices for all. Most recently, while the incomes of the poorest families grew too slowly to buy into the inflated housing market through traditional means, many ended up in the sub-prime market, where they took on both risky loans and unsustainable levels of debt. When the housing bubble burst and home prices stopped rising, millions of these families defaulted on their mortgages and many are facing foreclosure.

Also, because school systems depend heavily on local funding, increased income disparities have led to increased disparities in the quality of schools, as wealthier families have moved to the suburbs. That makes it harder for poor children to acquire the skills they need to succeed.

Growing income inequality also threatens to undermine the much-heralded changes made to the welfare system since the 1990s. Current welfare policies are based on the assumption that a job will lead to self-sufficiency and to moving out of poverty. When former welfare recipients can only find jobs that do not pay enough to lift a family out of poverty, and when the real incomes of the poorest families grow only slowly (or not at all), the underpinnings and future success of policies that encourage work are called into question.

The recent decline in the incomes of the poorest families is particularly disturbing. Research has shown that poverty can have a substantial effect on children's well-being. 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.[7]

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 a wide range of 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.

Setting National Priorities: The 2000 Election and Beyond, Brookings Institution Press, 1999.

[7] See, for example, Greg Duncan and Jeanne Brooks-Gunn, eds., *The Consequences of Growing Up Poor*, Russell Sage Foundation, 1997.

III. The Long-Term Trend: The Late 1980s to the Mid-2000s

Nationwide, income inequality increased significantly between the late 1980s and the mid-2000s. Gaps in income between the richest families and the poorest families and between the richest families 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 or declines 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.

This chapter 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.

Comparing Income Trends Among High- and Low-Income Families

Comparing the income trends of low- and high-income families over the past two decades shows that while the average incomes of the richest families grew substantially in every state, the poorest and middle fifths of families saw no significant income growth in many states.

Since the late 1980s, the average incomes of the bottom fifth of families grew significantly in 32 states, as shown in Table 1. That income among the poorest families grew in these states may seem like positive news. Unfortunately, in 17 states families in the bottom fifth experienced no significant income growth. And in Connecticut, these families actually saw income decline by nearly $4,500. Furthermore, in states where poor families did experience growth, the increases were small, especially when compared to the income gains of the richest families.

In every state the average incomes of the richest fifth of families have grown since the late 1980s; generally, this growth has far outpaced that of the poorest families. In 37 states, the incomes of the

top fifth of families grew faster than the incomes of the bottom fifth of families. In these 37 states, the incomes of the richest grew by an average of $36,332 (39 percent), while the incomes of the poorest grew by only $1,585 (9 percent). In other words, the poorest families — who saw an increase in purchasing power of only $93 per year — have not fared nearly as well as the richest families during this period. These data span two business cycles. On average, for the nation as a whole, all of the growth in incomes of the bottom quintile occurred during the first period we examined – the 1990s. The poorest families fell behind in the most recent economic expansion.

Within the top fifth of families, the wealthiest families enjoyed the largest income growth. Nationwide, the average income of the richest 5 percent of families grew 60 percent ($82,607) between the late 1980s and the mid-2000s. In the 11 large states where such a comparison is possible, the incomes of the top 5 percent of families grew significantly faster than the incomes of the bottom 20 percent of families (see Table 1A).[8] In three of these states, average incomes of the top 5 percent grew by over $100,000 (more than 70 percent). Meanwhile, the greatest income growth for the bottom 20 percent of families in any state took place in Louisiana, where the average incomes of the poorest families increased only $3,868 (33 percent) over 17 years.

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.

A snapshot of each state's top-to-bottom ratio in the mid-2000s, as well as its corresponding national ranking, is shown in Table 2. In New York, which had the largest top-to-bottom ratio of any state, the average income of the top fifth of families was 8.7 times greater than the average income of the bottom fifth of families. For the nation as a whole, the average income gap was 7.3.

The ten states with the largest income gaps were New York, Alabama, Mississippi, Massachusetts, Tennessee, New Mexico, Connecticut, California, Texas, and Kentucky. In these states the income gap between the top and bottom fifths of families was greater than the national average. For seven of these ten states, this high inequality was driven by the lower-than-average incomes among the bottom fifth of families.

The ten states with the smallest income gaps were Utah, New Hampshire, Idaho, Delaware, Montana, Hawaii, Nebraska, Wyoming, Vermont, and Minnesota. With the exception of Montana, the average income of the bottom fifth of families in all of these states was greater than the national average.

[8] The analysis of the changes in the incomes of the top 5 percent was conducted on these 11 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 5 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 percent to the bottom fifth for all states for the mid-2000s. (See Table 2A.)

TABLE 1: DOLLAR AND PERCENT CHANGE IN AVERAGE INCOMES OF BOTTOM AND TOP FIFTHS OF FAMILIES 1987-1989 to 2004-2006 (in 2005 Dollars)

	Bottom Fifth				Top Fifth		
State	**Dollar Change**		**Percent Change**		**Dollar Change**		**Percent Change**
37 States Where the Incomes of the Top Fifth Grew Faster Than the Incomes of the Bottom Fifth[a]							
Alabama	706		5.6%		33,760	*	42.7%
California	1,926	*	11.8%		39,103	*	36.8%
Colorado	4,532	*	28.7%		49,227	*	53.0%
Connecticut	(4,437)	*	-17.4%		52,439	*	44.8%
Delaware	1,399		7.4%		25,066	*	27.5%
Florida	2,335	*	15.5%		35,953	*	37.9%
Illinois	2,128	*	13.1%		35,541	*	34.7%
Indiana	1,536		9.5%		32,255	*	37.6%
Iowa	2,371	*	14.4%		38,033	*	49.3%
Kansas	734		4.1%		37,756	*	41.9%
Kentucky	930		6.9%		32,329	*	41.4%
Maine	1,872	*	11.4%		26,391	*	29.5%
Maryland	1,808		9.0%		50,673	*	46.6%
Massachusetts	324		1.6%		51,962	*	44.4%
Michigan	1,465	*	8.9%		26,689	*	26.8%
Mississippi	2,665	*	23.1%		38,859	*	49.4%
Missouri	1,745	*	10.9%		32,790	*	34.9%
Nebraska	3,155	*	18.8%		33,196	*	40.0%
Nevada	1,236		6.7%		35,471	*	40.2%
New Hampshire	1,821		8.1%		33,646	*	33.2%
New Jersey	2,194	*	10.4%		54,156	*	44.8%
New York	882	*	5.4%		38,681	*	35.3%
North Carolina	1,474	*	9.9%		30,154	*	34.2%
North Dakota	2,978	*	18.4%		42,933	*	55.8%
Ohio	1,905	*	11.6%		21,933	*	23.7%
Oregon	1,605		9.5%		40,196	*	46.2%
Pennsylvania	1,438	*	8.2%		35,522	*	37.2%
Rhode Island	(992)		-5.0%		43,438	*	43.5%
South Dakota	3,276	*	22.2%		34,769	*	44.1%
Tennessee	867		6.5%		27,638	*	31.9%
Texas	2,657	*	19.8%		32,813	*	35.0%
Utah	2,713	*	14.3%		34,090	*	40.8%
Virginia	3,341	*	19.6%		44,317	*	40.3%
Washington	1,020		5.5%		39,159	*	41.3%
West Virginia	1,466	*	11.7%		30,533	*	41.6%
Wisconsin	1,369		7.3%		31,600	*	35.6%
Wyoming	191		1.1%		21,202	*	24.3%
13 States Where the Incomes of the Bottom Fifth and the Top Fifth Increased at About the Same Rate							
Alaska	3,208	*	17.9%		19,514	*	17.5%
Arizona	813		5.1%		20,454	*	20.3%
Arkansas	3,624	*	30.2%		25,935	*	34.9%
Georgia	2,367	*	16.0%		18,808	*	19.5%
Hawaii	2,468	*	11.8%		24,952	*	22.6%
Idaho	4,141	*	26.6%		30,848	*	38.8%
Louisiana	3,868	*	33.1%		21,119	*	22.9%
Minnesota	5,641	*	31.9%		47,092	*	50.7%
Montana	1,827	*	12.5%		18,083	*	23.7%
New Mexico	1,931	*	15.0%		32,174	*	37.2%
Oklahoma	3,097	*	22.4%		35,453	*	40.2%
South Carolina	839		5.6%		17,058	*	18.9%
Vermont	3,244	*	18.1%		33,958	*	36.7%
District of Columbia	339	*	2.5%		67,905	*	56.3%
Total U.S.	**1,814**	*****	**11.1%**		**35,027**	*****	**36.1%**

* Dollar changes marked with an asterisk are "statistically significant." That is, using statistical methods recommended by the Census Bureau, we calculate with at least 90 percent certainty that — despite the uncertainty inherent in any estimate based on surveys with a limited sample size — the true income change for these groups is greater than zero. For example, in Alabama, we cannot say with 90 percent certainty that the $706 increase in average income of the bottom fifth reflects a true income increase. However, we can say with 90 percent certainty that the $33,760 gain in the income of the top fifth does reflect a true gain.

[a] For the states in this group, the income of the top fifth grew by a larger percentage than the income of the bottom fifth and this difference was statistically significant.

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

TABLE 1A: DOLLAR AND PERCENT CHANGE IN AVERAGE INCOMES OF BOTTOM FIFTH AND TOP 5 PERCENT OF FAMILIES 1987-1989 to 2004-2006 (in 2005 Dollars)							
	Bottom Fifth				Top 5 Percent		
State	Dollar Change		Percent Change		Dollar Change		Percent Change
11 Large States Where the Income of the Top 5 Percent Grew Faster Than the Income of the Bottom Fifth^							
California	1,926	*	11.8%		89,456	*	58.1%
Florida	2,335	*	15.5%		78,587	*	55.4%
Illinois	2,128	*	13.1%		84,730	*	56.9%
Massachusetts	324		1.6%		146,658	*	89.5%
Michigan	1,465	*	8.9%		66,799	*	48.0%
New Jersey	2,194	*	10.4%		155,949	*	90.8%
New York	882	*	5.4%		108,112	*	69.9%
North Carolina	1,474	*	9.9%		72,229	*	57.7%
Ohio	1,905	*	11.6%		44,178	*	34.0%
Pennsylvania	1,438	*	8.2%		80,075	*	58.8%
Texas	2,657	*	19.8%		78,900	*	59.7%
Total U.S.	**1,814**	*****	**11.1%**		**82,607**	*****	**59.8%**

*Dollar changes marked with an asterisk are "statistically significant." The change is known with 90 percent certainty. See the footnote in Table 1 for details.

^ For the states in this group, the income of the top 5 percent grew by a larger percentage than the income of the bottom fifth and this difference was statistically significant.

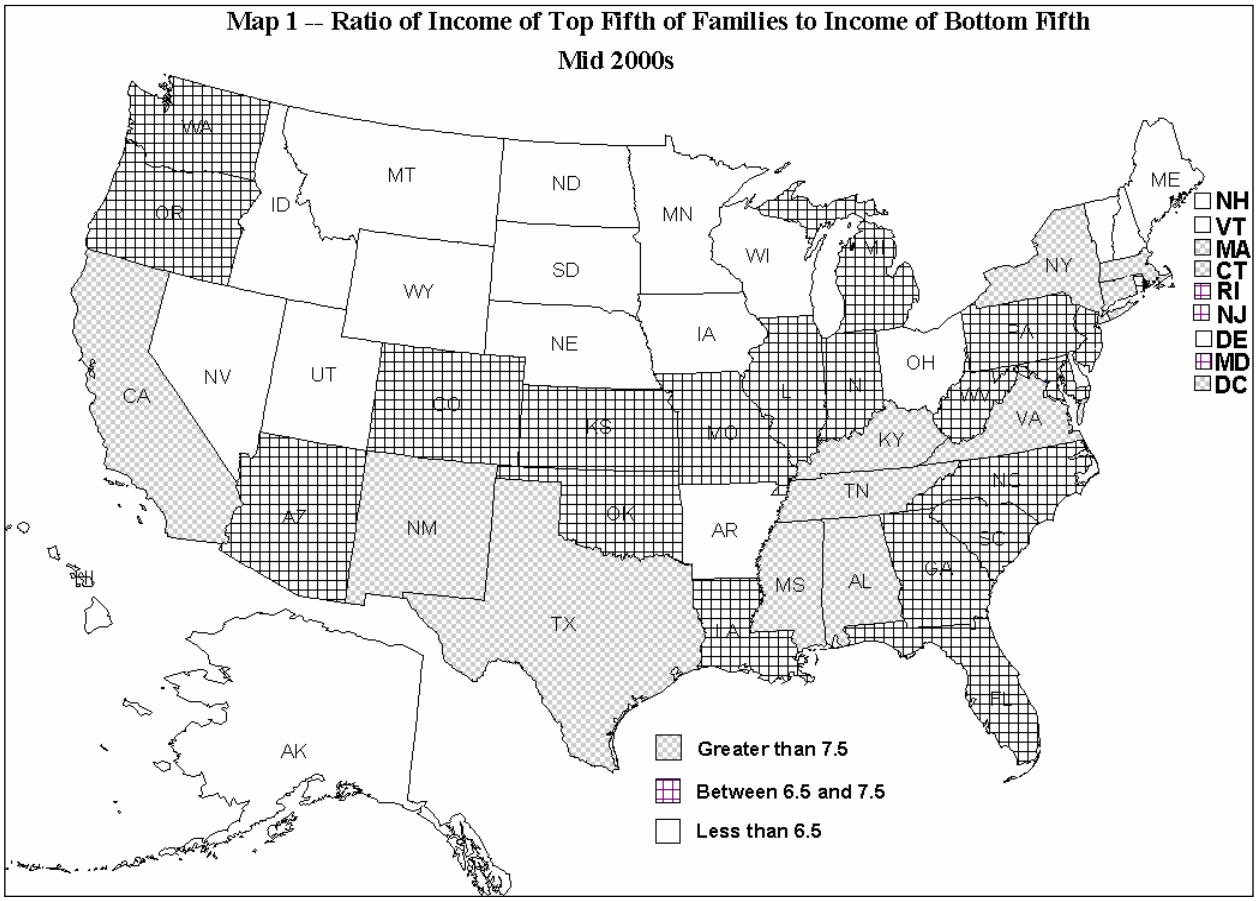
Source: Economic Policy Institute/Center on Budget and Policy Priorities analysis of data from the U.S. Census Bureau's Current Population Survey.

States in the Southeast, Southwest, and on both coasts had greater income inequality, as measured by the top-to-bottom ratio (see Map 1). Income was distributed relatively more equally in the Great Plains and Mountain states.

Table 2A shows the ratios of the incomes of the richest 5 percent of families to the incomes of the bottom fifth. By the mid 2000s, the average incomes of the top 5 percent of families were 12.2 times the average incomes of the bottom 20 percent. The states with the largest such gap were New York, Massachusetts, Connecticut, Mississippi, New Jersey, Tennessee, New Mexico, Alabama, California, and Virginia.

Table 3 compares the top-to-bottom ratios of the late 1980s and mid-2000s to see how this gap has changed over time in each of the states. In 37 states, it has grown larger. That is, over the last 17 years the gap in incomes between the top and bottom fifths of families has grown significantly in 37 states. In the remaining 13 states, there has been no statistically significant change in the income gap. The rank of each state shows how the growth in inequality in that state compares to the growth in inequality in other states.

Nationwide, overall inequality increased significantly between the late 1980s and the mid-2000s. The richest fifth of families had six times the income of the poorest fifth of families in the late 1980s. By the mid-2000s the wealthiest families had 7.3 times the income of the poorest families. In the late 1980s, the income of the top fifth of families was more than seven times larger than the income of the bottom fifth of families in only one state, Louisiana. By the mid 2000s, 22 states had top-to-bottom ratios over 7.0



The five states with the largest increases in income inequality over the last 17 years were Connecticut, Rhode Island, Massachusetts, Alabama, and New York. In the late 1980s, the richest fifth of families in Connecticut had less than five times the income of the poorest fifth of families. By the mid-2000s, the wealthiest Connecticut families had eight times the income of the poorest families. Over the last two decades, the average income of the bottom fifth of Connecticut families *decreased* by $4,437 (from $25,570 to $21,133), while the income of the richest fifth of families *increased* by $52,439 (from $116,939 to $169,378).

Comparing the changing income gap between the top 5 percent (instead of the top fifth) of families to the bottom 20 percent of families shows an even more dramatic increase (see Table 3A). In the late 1980s, the top-5-percent-to-bottom-20-percent ratio was 8.5. By the mid-2000s, the average income of the wealthiest 5 percent was 12.2 times that of the poorest 20 percent of families.

Among the 11 large states analyzed, all experienced a significant increase in income inequality. In the late 1980s, none of these states had a top-5-percent-to-bottom-20-percent ratio greater than 10.0. By the mid-2000s all but one of these states had ratios higher than 10.

TABLE 2: RATIO OF INCOMES OF TOP AND BOTTOM FIFTHS OF FAMILIES 2004-2006 (2005 Dollars)				
State	**Rank**	**Average Income of Bottom Fifth of Families**	**Average income of Top Fifth of Families**	**Top-to-Bottom Ratio***
New York	1	17,107	148,192	8.7
Alabama	2	13,280	112,804	8.5
Mississippi	3	14,205	117,454	8.3
Massachusetts	4	20,609	168,991	8.2
Tennessee	5	14,129	114,396	8.1
New Mexico	6	14,798	118,608	8.0
Connecticut	7	21,133	169,378	8.0
California	8	18,312	145,358	7.9
Texas	9	16,088	126,658	7.9
Kentucky	10	14,318	110,353	7.7
Virginia	11	20,401	154,259	7.6
Rhode Island	12	18,974	143,211	7.5
Illinois	13	18,340	138,011	7.5
New Jersey	14	23,260	175,011	7.5
Florida	15	17,436	130,840	7.5
West Virginia	16	13,941	103,911	7.5
Oklahoma	17	16,909	123,596	7.3
Louisiana	18	15,555	113,499	7.3
Maryland	19	21,952	159,456	7.3
Arizona	20	16,744	121,116	7.2
North Carolina	21	16,436	118,259	7.2
Missouri	22	17,722	126,619	7.1
Michigan	23	17,934	126,264	7.0
Colorado	24	20,341	142,181	7.0
Pennsylvania	25	18,960	130,968	6.9
Oregon	26	18,515	127,248	6.9
Washington	27	19,545	134,090	6.9
Kansas	28	18,807	127,963	6.8
South Carolina	29	15,932	107,378	6.7
Indiana	30	17,635	118,078	6.7
Georgia	31	17,188	115,071	6.7
Arkansas	32	15,628	100,280	6.4
Maine	33	18,302	115,720	6.3
South Dakota	34	18,025	113,623	6.3
Nevada	35	19,730	123,815	6.3
North Dakota	36	19,188	119,804	6.2
Ohio	37	18,337	114,353	6.2
Alaska	38	21,086	130,740	6.2
Iowa	39	18,817	115,187	6.1
Wisconsin	40	20,073	120,440	6.0
Minnesota	41	23,343	139,989	6.0
Vermont	42	21,168	126,504	6.0
Wyoming	43	18,296	108,553	5.9
Nebraska	44	19,919	116,171	5.8
Hawaii	45	23,328	135,525	5.8
Montana	46	16,439	94,444	5.7
Delaware	47	20,367	116,110	5.7
Idaho	48	19,708	110,274	5.6
New Hampshire	49	24,175	134,867	5.6
Utah	50	21,721	117,662	5.4
District of Columbia		14,011	188,541	13.5
Total U.S.		**18,116**	**132,131**	**7.3**

*Rankings based on unrounded numbers.

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

Table 2A: RATIO OF INCOMES OF THE TOP 5 PERCENT AND BOTTOM FIFTH OF FAMILIES 2004-2006 (2005 Dollars)				
State	**Rank**	**Average Income of Bottom Fifth of Families**	**Average Income of Top 5 Percent of Families**	**Top-to-Bottom Ratio***
New York	1	17,107	262,679	15.4
Massachusetts	2	20,609	310,440	15.1
Connecticut	3	21,133	312,954	14.8
Mississippi	4	14,205	205,526	14.5
New Jersey	5	23,260	327,628	14.1
Tennessee	6	14,129	196,083	13.9
New Mexico	7	14,798	203,268	13.7
Alabama	8	13,280	178,770	13.5
California	9	18,312	243,386	13.3
Virginia	10	20,401	270,148	13.2
Texas	11	16,088	211,038	13.1
Rhode Island	12	18,974	246,008	13.0
Missouri	13	17,722	229,088	12.9
Illinois	14	18,340	233,664	12.7
Florida	15	17,436	220,373	12.6
Oklahoma	16	16,909	213,565	12.6
Maryland	17	21,952	269,609	12.3
Kentucky	18	14,318	173,392	12.1
North Carolina	19	16,436	197,331	12.0
Arizona	20	16,744	199,301	11.9
West Virginia	21	13,941	165,619	11.9
Oregon	22	18,515	219,448	11.9
Louisiana	23	15,555	182,113	11.7
Colorado	24	20,341	235,134	11.6
Michigan	25	17,934	205,893	11.5
Pennsylvania	26	18,960	216,216	11.4
Kansas	27	18,807	211,362	11.2
Washington	28	19,545	218,455	11.2
South Dakota	29	18,025	197,902	11.0
South Carolina	30	15,932	172,603	10.8
Indiana	31	17,635	186,532	10.6
North Dakota	32	19,188	199,990	10.4
Georgia	33	17,188	174,387	10.1
Minnesota	34	23,343	236,758	10.1
Nevada	35	19,730	199,958	10.1
Arkansas	36	15,628	157,007	10.0
Wisconsin	37	20,073	198,767	9.9
Maine	38	18,302	180,973	9.9
Vermont	39	21,168	207,541	9.8
Iowa	40	18,817	180,340	9.6
Ohio	41	18,337	174,026	9.5
Alaska	42	21,086	196,633	9.3
Wyoming	43	18,296	167,293	9.1
Nebraska	44	19,919	180,703	9.1
Hawaii	45	23,328	208,750	8.9
Idaho	46	19,708	175,641	8.9
Montana	47	16,439	146,484	8.9
New Hampshire	48	24,175	207,180	8.6
Delaware	49	20,367	172,735	8.5
Utah	50	21,721	175,677	8.1
District of Columbia		14,011	366,631	26.2
Total U.S.		**18,116**	**220,700**	**12.2**

*Rankings based on unrounded numbers.

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

TABLE 3: CHANGE IN RATIO OF INCOMES OF TOP AND BOTTOM FIFTHS OF FAMILIES 1987-1989 to 2004-2006					
State	**Rank of Change**	**Top-to-Bottom Ratio 1987-1989**	**Top-to-Bottom Ratio 2004-2006**	**Change in Top-to-Bottom Ratio[a]**	
Connecticut	1	4.6	8.0	3.4	*
Rhode Island	2	5.0	7.5	2.6	*
Massachusetts	3	5.8	8.2	2.4	*
Alabama	4	6.3	8.5	2.2	*
New York	5	6.7	8.7	1.9	*
Kentucky	6	5.8	7.7	1.9	*
Maryland	7	5.4	7.3	1.9	*
Kansas	8	5.0	6.8	1.8	*
New Jersey	9	5.7	7.5	1.8	*
Washington	10	5.1	6.9	1.7	*
Oregon	11	5.1	6.9	1.7	*
West Virginia	12	5.9	7.5	1.6	*
Tennessee	13	6.5	8.1	1.6	*
North Dakota	14	4.7	6.2	1.5	*
Nevada	15	4.8	6.3	1.5	*
Pennsylvania	16	5.4	6.9	1.5	*
Mississippi	17	6.8	8.3	1.5	*
California	18	6.5	7.9	1.5	*
Iowa	19	4.7	6.1	1.4	*
Indiana	20	5.3	6.7	1.4	*
North Carolina	21	5.9	7.2	1.3	*
Missouri	22	5.9	7.1	1.3	*
Wisconsin	23	4.7	6.0	1.3	*
Florida	24	6.3	7.5	1.2	*
Illinois	25	6.3	7.5	1.2	*
Virginia	26	6.4	7.6	1.1	*
Colorado	27	5.9	7.0	1.1	*
Wyoming	28	4.8	5.9	1.1	*
New Hampshire	29	4.5	5.6	1.1	*
Utah	30	4.4	5.4	1.0	*
Michigan	31	6.0	7.0	1.0	*
South Dakota	32	5.3	6.3	1.0	*
Delaware	33	4.8	5.7	0.9	*
Maine	34	5.4	6.3	0.9	*
Texas	35	7.0	7.9	0.9	*
Nebraska	36	4.9	5.8	0.9	*
Ohio	37	5.6	6.2	0.6	*
Arizona	38	6.3	7.2	n/a	
Hawaii	38	5.3	5.8	n/a	
South Carolina	38	6.0	6.7	n/a	
Vermont	38	5.2	6.0	n/a	
Arkansas	38	6.2	6.4	n/a	
Louisiana	38	7.9	7.3	n/a	
Minnesota	38	5.2	6.0	n/a	
New Mexico	38	6.7	8.0	n/a	
Montana	38	5.2	5.7	n/a	
Idaho	38	5.1	5.6	n/a	
Georgia	38	6.5	6.7	n/a	
Alaska	38	6.2	6.2	n/a	
Oklahoma	38	6.4	7.3	n/a	
District of Columbia		8.8	13.5	4.6	*
Total U.S.		**6.0**	**7.3**	**1.3**	*****

* The changes in the top-to-bottom ratio marked with an asterisk are statistically significant at the 90 percent level of confidence. That is, one can say with 90 percent certainty that the increases or decreases shown in the table are true increases or decreases in income inequality. Those changes that are not statistically significant are listed as n/a.

[a]Change in top-to-bottom ratio may not match calculated difference due to rounding. Rankings are based on unrounded numbers.

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

TABLE 3A: CHANGE IN RATIO OF INCOMES OF TOP 5 PERCENT AND BOTTOM FIFTH OF FAMILIES 1987-1989 to 2004-2006				
State	**Top 5 Percent-to-Bottom Ratio 1987-1989**	**Top 5 Percent-to-Bottom Ratio 2004-2006**	**Change in Top 5 Percent-to-Bottom Ratio[a]**	
California	9.4	13.3	3.9	*
Florida	9.4	12.6	3.2	*
Illinois	9.2	12.7	3.6	*
Massachusetts	8.1	15.1	7.0	*
Michigan	8.4	11.5	3.0	*
New Jersey	8.1	14.1	5.9	*
New York	9.5	15.4	5.8	*
North Carolina	8.4	12.0	3.6	*
Ohio	7.9	9.5	1.6	*
Pennsylvania	7.8	11.4	3.6	*
Texas	9.8	13.1	3.3	*
Total U.S.	**8.5**	**12.2**	**3.7**	*****

*The changes in the top 5 percent-to-bottom ratio marked with an asterisk are statistically significant at the 90 percent level of confidence. That is, one can say with 90 percent certainty that the increases or decreases shown in the table are true increases or decreases in income inequality.

[a]Change in top 5 percent-to-bottom ratio may not match calculated difference due to rounding.

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

Of these 11 states, Massachusetts had the largest increase in income inequality. In the late 1980s, the richest 5 percent of families had about eight times the income of the poorest 20 percent of families. By the mid-2000s, the richest 5 percent had over 15 times the income of the poorest 20 percent of families — almost double the earlier income gap. Over the last two decades, the incomes of the poorest fifth of families in Massachusetts were essentially unchanged[9] — while the incomes of the richest 5 percent nearly doubled, increasing by $146,658 (from $163,783 to $310,440).

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.

As shown in Table 4, the average incomes of the middle and top fifths of families increased over the last 17 years in 49 states (the middle fifth in Connecticut did not experience significant growth). In 35 states, however, incomes grew significantly faster at the top. On average, the incomes of the richest families in these 35 states grew well more than twice as fast as the incomes of the middle fifth — by some 39 percent compared to 15 percent. In many states, the growth was even more unequal.

In the 15 remaining states, incomes of the middle fifth and the top fifth of families grew at about the same rate.

[9] The increase of $324 (1.6 percent) was not statistically significant.

TABLE 4: DOLLAR AND PERCENT CHANGE IN AVERAGE INCOMES OF MIDDLE AND TOP FIFTHS OF FAMILIES 1987-1989 to 2004-2006 (in 2005 Dollars)

	Middle Fifth				Top Fifth		
State	**Dollar Change**		**Percent Change**		**Dollar Change**		**Percent Change**
35 States Where the Income of the Top Fifth Grew Faster Than the Income of the Middle Fifth[a]							
Alabama	8,777	*	25.3%		33,760	*	42.7%
California	4,401	*	9.4%		39,103	*	36.8%
Colorado	12,485	*	28.7%		49,227	*	53.0%
Connecticut	3,103		5.1%		52,439	*	44.8%
Delaware	5,411	*	11.5%		25,066	*	27.5%
Florida	6,825	*	17.0%		35,953	*	37.9%
Illinois	5,926	*	12.5%		35,541	*	34.7%
Indiana	6,760	*	16.2%		32,255	*	37.6%
Iowa	8,599	*	20.7%		38,033	*	49.3%
Kansas	5,775	*	12.9%		37,756	*	41.9%
Kentucky	5,877	*	16.2%		32,329	*	41.4%
Maryland	6,913	*	12.4%		50,673	*	46.6%
Massachusetts	9,186	*	16.2%		51,962	*	44.4%
Michigan	4,186	*	8.8%		26,689	*	26.8%
Minnesota	13,074	*	28.1%		47,092	*	50.7%
Mississippi	7,471	*	23.0%		38,859	*	49.4%
Missouri	6,021	*	14.3%		32,790	*	34.9%
Nevada	7,713	*	18.2%		35,471	*	40.2%
New Hampshire	8,535	*	16.0%		33,646	*	33.2%
New Jersey	8,351	*	14.2%		54,156	*	44.8%
New York	3,984	*	8.3%		38,681	*	35.3%
North Carolina	3,979	*	9.6%		30,154	*	34.2%
North Dakota	9,337	*	22.9%		42,933	*	55.8%
Ohio	4,020	*	8.9%		21,933	*	23.7%
Oklahoma	4,257	*	11.3%		35,453	*	40.2%
Oregon	3,673	*	8.3%		40,196	*	46.2%
Pennsylvania	7,391	*	16.7%		35,522	*	37.2%
Rhode Island	6,744	*	13.6%		43,438	*	43.5%
South Dakota	10,096	*	26.2%		34,769	*	44.1%
Texas	4,528	*	11.3%		32,813	*	35.0%
Virginia	6,703	*	13.3%		44,317	*	40.3%
Washington	5,666	*	11.8%		39,159	*	41.3%
West Virginia	7,744	*	23.3%		30,533	*	41.6%
Wisconsin	6,583	*	14.1%		31,600	*	35.6%
Wyoming	3,719	*	7.9%		21,202	*	24.3%
15 States Where the Incomes of the Middle Fifth and the Top Fifth Increased at About the Same Rate							
Alaska	4,977	*	9.3%		19,514	*	17.5%
Arizona	2,790	*	6.7%		20,454	*	20.3%
Arkansas	8,607	*	27.0%		25,935	*	34.9%
Georgia	4,139	*	9.5%		18,808	*	19.5%
Hawaii	6,652	*	12.2%		24,952	*	22.6%
Idaho	9,714	*	26.5%		30,848	*	38.8%
Louisiana	5,111	*	13.9%		21,119	*	22.9%
Maine	6,927	*	16.3%		26,391	*	29.5%
Montana	5,013	*	13.5%		18,083	*	23.7%
Nebraska	10,823	*	26.5%		33,196	*	40.0%
New Mexico	8,075	*	23.9%		32,174	*	37.2%
South Carolina	4,126	*	10.3%		17,058	*	18.9%
Tennessee	6,613	*	17.8%		27,638	*	31.9%
Utah	10,309	*	25.0%		34,090	*	40.8%
Vermont	8,931	*	19.4%		33,958	*	36.7%
District of Columbia	275		0.6%		67,905	*	56.3%
Total U.S.	**5,784**	*	**13.0%**		**35,027**	*	**36.1%**

*Dollar changes marked with an asterisk are "statistically significant." The change is known with 90 percent certainty. See the footnote in Table 1 for details.

[a]For the states in this group, the income of the top fifth grew by a larger percentage than the income of the middle fifth and this difference was statistically significant.

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

TABLE 5: RATIO OF INCOMES OF TOP AND MIDDLE FIFTHS OF FAMILIES 2004-06 (2005 Dollars)				
State	**Rank**	**Average Income of Middle Fifth of Families**	**Average Income of Top Fifth of Families**	**Top-to-Middle Ratio***
Oklahoma	1	41,857	123,596	3.0
Mississippi	2	39,924	117,454	2.9
California	3	50,981	145,358	2.9
New York	4	52,080	148,192	2.8
Texas	5	44,574	126,658	2.8
New Mexico	6	41,797	118,608	2.8
Florida	7	47,062	130,840	2.8
Arizona	8	44,319	121,116	2.7
Louisiana	9	41,755	113,499	2.7
Virginia	10	57,233	154,259	2.7
Oregon	11	47,685	127,248	2.7
Connecticut	12	63,728	169,378	2.7
Kentucky	13	42,064	110,353	2.6
Missouri	14	48,266	126,619	2.6
Tennessee	15	43,667	114,396	2.6
North Carolina	16	45,432	118,259	2.6
New Jersey	17	67,308	175,011	2.6
Alabama	18	43,445	112,804	2.6
Illinois	19	53,447	138,011	2.6
Massachusetts	20	65,783	168,991	2.6
Colorado	21	55,933	142,181	2.5
Kansas	22	50,410	127,963	2.5
Maryland	23	62,860	159,456	2.5
Rhode Island	24	56,457	143,211	2.5
West Virginia	25	40,976	103,911	2.5
Pennsylvania	26	51,764	130,968	2.5
Washington	27	53,783	134,090	2.5
Arkansas	28	40,533	100,280	2.5
Nevada	29	50,207	123,815	2.5
Indiana	30	48,364	118,078	2.4
Michigan	31	51,758	126,264	2.4
South Carolina	32	44,252	107,378	2.4
Georgia	33	47,782	115,071	2.4
North Dakota	34	50,070	119,804	2.4
Idaho	35	46,309	110,274	2.4
Minnesota	36	59,677	139,989	2.3
Maine	37	49,551	115,720	2.3
South Dakota	38	48,669	113,623	2.3
Ohio	39	49,051	114,353	2.3
Iowa	40	50,043	115,187	2.3
Vermont	41	55,054	126,504	2.3
Utah	42	51,477	117,662	2.3
Wisconsin	43	53,288	120,440	2.3
Nebraska	44	51,633	116,171	2.2
Alaska	45	58,503	130,740	2.2
Montana	46	42,266	94,444	2.2
Hawaii	47	61,130	135,525	2.2
Delaware	48	52,419	116,110	2.2
New Hampshire	49	61,923	134,867	2.2
Wyoming	50	50,674	108,553	2.1
District of Columbia		44,894	188,541	4.2
Total U.S.		**50,434**	**132,131**	**2.6**

*Rankings based on unrounded numbers.

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

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

The top-to-middle income ratios for each state in the mid-2000s are presented in Table 5. Oklahoma had the nation's highest income gap between the top and middle fifths of families: the average income of the top fifth of families was almost three times that of the middle fifth. The other states in the top five were Mississippi, California, New York, and Texas.

The five states with the smallest top-to-middle ratios in the mid-2000s were Wyoming, New Hampshire, Delaware, Hawaii, and Montana.

These income gaps were not always as large. Between the late 1980s and the mid-2000s, the income gap between middle- and high-income families grew significantly in 36 states (see Table 6). The greatest such increase was in Connecticut, followed by Oregon, Oklahoma, Maryland, and California. In the late 1980s, only two states — Louisiana and New Mexico — had a top-to-middle ratio of 2.5 or greater; by the mid-2000s, over half the states did.

Furthermore, the income gap between the top 5 percent and the middle 20 percent of families is even wider (see Table 6A). In the 11 states where the top 5 percent of families could be measured, income inequality between these two income groups increased most in New Jersey, followed by New York and Massachusetts.

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. 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. Changes in federal taxes in the early 1990s and early 2000s 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.

An examination of income trends using the official Census definition of income shows an even sharper divergence in income in any particular year. Table 7 shows the top-to-bottom ratio for the mid-2000s using the official pre-tax Census definition of income. On average, the incomes of the top fifth of families were more than nine times greater than the incomes of the bottom fifth. 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 8 shows the growth in income for the poorest and richest quintiles of families between the late 1980s and the mid-2000s using the official Census definition of pre-tax income. In some 35 states, the incomes of the top fifth grew faster than the incomes of the poorest fifth of families.

TABLE 6: CHANGE IN RATIO OF INCOMES OF TOP AND MIDDLE FIFTHS OF FAMILIES 1987-89 to 2004-06					
State	**Rank of Change**	**Top-to-Middle Ratio 1987-89**	**Top-to-Middle Ratio 2004-06**	**Change in Top-to-Middle Ratio[a]**	
Connecticut	1	1.9	2.7	0.7	*
Oregon	2	2.0	2.7	0.7	*
Oklahoma	3	2.3	3.0	0.6	*
Maryland	4	1.9	2.5	0.6	*
California	5	2.3	2.9	0.6	*
New York	6	2.3	2.8	0.6	*
New Jersey	7	2.0	2.6	0.6	*
Rhode Island	8	2.0	2.5	0.5	*
Washington	9	2.0	2.5	0.5	*
Mississippi	10	2.4	2.9	0.5	*
Virginia	11	2.2	2.7	0.5	*
Kansas	12	2.0	2.5	0.5	*
North Dakota	13	1.9	2.4	0.5	*
Massachusetts	14	2.1	2.6	0.5	*
Texas	15	2.3	2.8	0.5	*
North Carolina	16	2.1	2.6	0.5	*
Kentucky	17	2.2	2.6	0.5	*
Iowa	18	1.9	2.3	0.4	*
Illinois	19	2.2	2.6	0.4	*
Florida	20	2.4	2.8	0.4	*
Colorado	21	2.1	2.5	0.4	*
Missouri	22	2.2	2.6	0.4	*
Nevada	23	2.1	2.5	0.4	*
Pennsylvania	24	2.2	2.5	0.4	*
Indiana	25	2.1	2.4	0.4	*
Wisconsin	26	1.9	2.3	0.4	*
Minnesota	27	2.0	2.3	0.4	*
Michigan	28	2.1	2.4	0.3	*
West Virginia	29	2.2	2.5	0.3	*
Alabama	30	2.3	2.6	0.3	*
South Dakota	31	2.0	2.3	0.3	*
New Hampshire	32	1.9	2.2	0.3	*
Wyoming	33	1.9	2.1	0.3	*
Ohio	34	2.1	2.3	0.3	*
Delaware	35	1.9	2.2	0.3	*
Utah	36	2.0	2.3	0.3	*
Alaska	37	2.1	2.2	n/a	
Arizona	37	2.4	2.7	n/a	
Arkansas	37	2.3	2.5	n/a	
Georgia	37	2.2	2.4	n/a	
Hawaii	37	2.0	2.2	n/a	
Idaho	37	2.2	2.4	n/a	
Louisiana	37	2.5	2.7	n/a	
Maine	37	2.1	2.3	n/a	
Montana	37	2.0	2.2	n/a	
Nebraska	37	2.0	2.2	n/a	
New Mexico	37	2.6	2.8	n/a	
South Carolina	37	2.3	2.4	n/a	
Tennessee	37	2.3	2.6	n/a	
Vermont	37	2.0	2.3	n/a	
District of Columbia		2.7	4.2	1.5	*
Total U.S.		**2.2**	**2.6**	**0.4**	*****

*The changes in the top-to-middle ratio marked with an asterisk are statistically significant at the 90 percent level of confidence. That is, one can say with 90 percent certainty that the increases or decreases shown in the table are true increases or decreases in income inequality. Those changes that are not statistically significant are listed as n/a.

[a]Change in top-to-middle ratio may not match calculated difference due to rounding. Rankings are based on unrounded numbers.

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

TABLE 6A: CHANGE IN RATIO OF INCOMES OF TOP 5 PERCENT AND MIDDLE FIFTH OF FAMILIES 1987-89 TO 2004-06				
State	**Top 5 Percent-to-Middle Ratio 1987-89**	**Top 5 Percent-to-Middle Ratio 2004-06**	**Change in Top 5 Percent-to-Middle Ratio[a]**	
California	3.3	4.8	1.5	*
Florida	3.5	4.7	1.2	*
Illinois	3.1	4.4	1.2	*
Massachusetts	2.9	4.7	1.8	*
Michigan	2.9	4.0	1.1	*
New Jersey	2.9	4.9	2.0	*
New York	3.2	5.0	1.8	*
North Carolina	3.0	4.3	1.3	*
Ohio	2.9	3.5	0.7	*
Pennsylvania	3.1	4.2	1.1	*
Texas	3.3	4.7	1.4	*
Total U.S.	**3.1**	**4.4**	**1.3**	*****

*The changes in the top 5 percent-to-middle ratio marked with an asterisk are statistically significant at the 90 percent level of confidence. That is, one can say with 90 percent certainty that the increases or decreases shown in the table are true increases or decreases in income inequality.

[a]Change in top 5 percent-to-middle ratio may not match calculated difference due to rounding.

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

These pre-tax data show larger income gaps than the after-tax data that are the main focus of this report. This demonstrates that while recent 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: RATIO OF PRE-TAX INCOMES OF TOP AND BOTTOM FIFTHS OF FAMILIES 2004-2006 (2005 Dollars)				
State	**Rank**	**Average Pre-Tax Income of Bottom Fifth of Families**	**Average Pre-Tax Income of Top Fifth of Families**	**Top-to-Bottom Ratio***
New York	1	16,725	189,798	11.3
Mississippi	2	13,785	148,570	10.8
Texas	3	15,410	160,707	10.4
Massachusetts	4	20,990	218,521	10.4
California	5	18,109	184,621	10.2
New Mexico	6	14,513	147,614	10.2
Kentucky	7	13,752	138,588	10.1
Connecticut	8	22,030	216,577	9.8
Rhode Island	9	18,846	183,089	9.7
Oklahoma	10	16,467	156,712	9.5
Alabama	11	15,090	142,989	9.5
Virginia	12	20,907	197,912	9.5
Louisiana	13	15,008	142,039	9.5
New Jersey	14	23,798	225,095	9.5
North Carolina	15	15,986	150,362	9.4
Florida	16	17,583	165,357	9.4
Tennessee	17	15,454	144,875	9.4
Arizona	18	16,309	151,897	9.3
Missouri	19	17,380	160,917	9.3
Maryland	20	22,391	205,644	9.2
Illinois	21	19,400	175,731	9.1
Michigan	22	17,735	160,544	9.1
West Virginia	23	14,475	129,726	9.0
Oregon	24	18,056	161,046	8.9
Kansas	25	18,378	162,625	8.8
Pennsylvania	26	18,900	166,730	8.8
Georgia	27	16,711	147,300	8.8
Colorado	28	20,733	182,090	8.8
Washington	29	19,803	171,550	8.7
South Carolina	30	15,546	134,379	8.6
Arkansas	31	15,037	127,824	8.5
Indiana	32	18,581	150,461	8.1
Maine	33	18,034	145,611	8.1
Nevada	34	19,403	155,664	8.0
Ohio	35	18,093	143,452	7.9
North Dakota	36	19,022	150,556	7.9
South Dakota	37	18,050	141,778	7.9
Alaska	38	21,324	164,468	7.7
Wisconsin	39	19,814	152,283	7.7
Iowa	40	19,367	146,846	7.6
Minnesota	41	23,816	179,083	7.5
Vermont	42	21,535	161,620	7.5
Nebraska	43	20,165	146,626	7.3
Hawaii	44	24,015	172,306	7.2
Delaware	45	20,714	147,957	7.1
Montana	46	16,264	115,939	7.1
Idaho	47	19,631	138,121	7.0
Wyoming	48	19,456	136,831	7.0
New Hampshire	49	25,111	173,092	6.9
Utah	50	21,731	148,037	6.8
District of Columbia		13,971	245,079	17.5
Total U.S.		**18,136**	**168,001**	**9.3**

*Rankings based on unrounded numbers.

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

TABLE 8 : DOLLAR AND PERCENT CHANGE IN AVERAGE PRE-TAX INCOMES OF BOTTOM AND TOP FIFTHS OF FAMILIES 1987-89 to 2004-06 (in 2005 Dollars)

	Bottom Fifth				Top Fifth		
State	**Dollar Change**		**Percent Change**		**Dollar Change**		**Percent Change**
35 States Where the Pre-Tax Income of the Top Fifth Grew Faster Than the Income of the Bottom Fifth[a]							
Alabama	2,501	*	19.9%		41,503	*	40.9%
California	1,232	*	7.3%		44,235	*	31.5%
Colorado	4,605	*	28.6%		62,210	*	51.9%
Connecticut	-5,517	*	-20.0%		60,425	*	38.7%
Delaware	1,186		6.1%		30,478	*	25.9%
Florida	2,180	*	14.2%		43,057	*	35.2%
Illinois	2,712	*	16.3%		40,820	*	30.3%
Indiana	2,138	*	13.0%		42,243	*	39.0%
Iowa	2,480	*	14.7%		48,773	*	49.7%
Kansas	-428		-2.3%		46,757	*	40.4%
Kentucky	225		1.7%		40,839	*	41.8%
Maine	1,166		6.9%		32,891	*	29.2%
Maryland	1,271		6.0%		65,126	*	46.3%
Massachusetts	-235		-1.1%		65,549	*	42.9%
Michigan	923		5.5%		31,916	*	24.8%
Mississippi	2,283	*	19.8%		49,031	*	49.3%
Missouri	1,091		6.7%		38,605	*	31.6%
Nebraska	3,036	*	17.7%		42,033	*	40.2%
Nevada	149		0.8%		41,709	*	36.6%
New Hampshire	1,140		4.8%		41,291	*	31.3%
New Jersey	1,336		5.9%		64,276	*	40.0%
New York	116		0.7%		46,369	*	32.3%
North Carolina	689		4.5%		37,706	*	33.5%
North Dakota	2,076	*	12.2%		54,388	*	56.6%
Ohio	1,205	*	7.1%		24,703	*	20.8%
Oregon	572		3.3%		51,183	*	46.6%
Pennsylvania	806		4.5%		44,372	*	36.3%
Rhode Island	-1,960		-9.4%		56,459	*	44.6%
South Dakota	2,869	*	18.9%		41,952	*	42.0%
Texas	1,815	*	13.4%		38,211	*	31.2%
Utah	1,820		9.1%		43,992	*	42.3%
Virginia	3,072	*	17.2%		54,900	*	38.4%
Washington	497		2.6%		49,007	*	40.0%
West Virginia	1,887	*	15.0%		38,293	*	41.9%
Wisconsin	309		1.6%		38,874	*	34.3%
15 States Where the Pre-Tax Incomes of the Bottom Fifth and the Top Fifth Increased at About the Same Rate							
Alaska	2,946	*	16.0%		18,554	*	12.7%
Arizona	163		1.0%		21,354	*	16.4%
Arkansas	2,942	*	24.3%		34,505	*	37.0%
Georgia	1,533	*	10.1%		22,393	*	17.9%
Hawaii	2,159		9.9%		26,218	*	17.9%
Idaho	3,693	*	23.2%		37,757	*	37.6%
Louisiana	3,275	*	27.9%		24,040	*	20.4%
Minnesota	5,461	*	29.8%		59,547	*	49.8%
Montana	1,392		9.4%		20,855	*	21.9%
New Mexico	1,621	*	12.6%		36,916	*	33.3%
Oklahoma	2,509	*	18.0%		45,197	*	40.5%
South Carolina	257		1.7%		18,449	*	15.9%
Tennessee	2,152	*	16.2%		33,646	*	30.2%
Vermont	2,561	*	13.5%		41,821	*	34.9%
Wyoming	745		4.0%		24,450	*	21.8%
District of Columbia	63		0.5%		88,921	*	56.9%
Total U.S.	**1,345**	*****	**8.0%**		**42,118**	*****	**33.5%**

*Dollar changes marked with an asterisk are "statistically significant." That is, according to a commonly used statistical test, we are 90 percent certain that the change noted (i.e. ,the increase in income) is correct. For example, in Kentucky, we cannot say with 90 percent certainty that the $225 increase in average income of the bottom fifth reflects a true income increase. However, we can say with 90 percent certainty that the $40,839 gain in the income of the top fifth does reflect a true gain. The test is important since this income data is based on samples of the population in each state.

[a] For the states in this group, the income of the top fifth grew by a larger percentage than the income of the bottom fifth and this difference was statistically significant.

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

IV. Recent Trends: From the Late 1990s to the Present

Income gaps continued to widen from the late 1990s to the mid-2000s. Though the economic boom of the 1990s increased real wages among families of all income classes and reduced disparities, the recession that followed had a much more lasting impact on poor families. While incomes among the wealthy rebounded following the 2001 recession, incomes among the poorest and middle fifths of families have stagnated or declined. As a result, the United States is entering an economic downturn with record levels of inequality.

Numerous factors contribute to the recent trend toward widening inequality. (See Chapter V for more detailed information.) Notably, unemployment has not fallen far enough to generate the pattern of income gains among low- and middle-income families that was seen in the 1990s. In addition, the 2001 and 2003 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.

This chapter examines trends in state income inequality during the second half of the period covered in the last chapter: the years between the economic peaks of the late 1990s and the mid-2000s. It then looks at national-level data on income trends following the recession of the early 2000s.

Comparing Income Trends Between High- and Low-Income Families

The economic expansion of the early 2000s appears to have lasted about seven years. Studies of national data show a short period when inequality declined somewhat as the 2001 recession caused the incomes of families at all levels to fall. This was followed by renewed growth in inequality. The relatively short span of this expansion and the fairly recent return to growth for high-income families resulted in smaller changes in income gaps in individual states than in the 1990s. As a result it is harder to discern patterns in many states. This chapter focuses on those states where the results of our analysis were robust enough — either because of the large size of the state or because the trend was especially pronounced — to see statistically significant patterns. The pattern of growing

TABLE 9: DOLLAR AND PERCENT CHANGE IN AVERAGE INCOMES OF BOTTOM AND TOP FIFTHS OF FAMILIES 1998-2000 to 2004-06 (in 2005 Dollars)							
	Bottom Fifth				Top Fifth		
State	Dollar Change		Percent Change		Dollar Change		Percent Change
19 States Where the Income of the Top Fifth Grew Faster Than the Income of the Bottom Fifth^							
Alabama	(2,791)	*	-17.4%		9,906		9.6%
California	255		1.4%		16,772	*	13.0%
Colorado	(1,424)		-6.5%		13,954		10.9%
Connecticut	(1,373)		-6.1%		20,653	*	13.9%
Florida	(4)		0.0%		17,499	*	15.4%
Illinois	(1,588)	*	-8.0%		12,880	*	10.3%
Indiana	(3,117)	*	-15.0%		7,540		6.8%
Massachusetts	807		4.1%		28,369	*	20.2%
Mississippi	(1,314)		-8.5%		22,245	*	23.4%
Missouri	(914)		-4.9%		13,521		12.0%
New Mexico	243		1.7%		27,038	*	29.5%
New York	230		1.4%		14,030	*	10.5%
Pennsylvania	(1,281)	*	-6.3%		8,135		6.6%
South Carolina	(2,228)	*	-12.3%		5,393		5.3%
South Dakota	(1,962)	*	-9.8%		11,887		11.7%
Texas	(287)		-1.8%		10,505	*	9.0%
Virginia	(592)		-2.8%		17,120	*	12.5%
Washington	(852)		-4.2%		14,136	*	11.8%
West Virginia	(1,148)		-7.6%		9,370		9.9%
Incomes of the Bottom Fifth and the Top Fifth Increased at About the Same Rate in the Remaining 31 States and the District of Columbia^^							
Total U.S.	**(459)**	*****	**-2.5%**		**11,044**	*****	**9.1%**

*Dollar changes marked with an asterisk are "statistically significant." The change is known with 90 percent certainty. Among the remaining 31 states and the District of Columbia, differences in dollar changes are not statistically significant at a 90 percent confidence level. See the footnote in Table 1 for details.

^ For the states in this group, the income of the top fifth grew by a larger percentage than the income of the bottom fifth and this difference was statistically significant.

^^Among the remaining 31 states and the District of Columbia, differences in income growth between the top fifth and the bottom fifth were not statistically significant at a 90 percent level of confidence.

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

inequality found in these states is confirmed by recent national data on income distribution from various sources, as noted below.

In 19 states incomes among the top fifth of families increased faster than the incomes of the bottom fifth (see Table 9). The poorest families did not experience income growth in any of these 19 states — and in six of them, these families saw significant declines. In Illinois, for example, the top 20 percent enjoyed 10.3 percent growth in average income from the late 1990s through the mid-2000s. At the same time, incomes of the poorest 20 percent of Illinois families *declined* by 8 percent.

In the remaining 31 states and the District of Columbia, inequality remained at the high levels of the late 1990s.

On average across the 50 states the incomes of the poorest families declined by 2.5 percent between the late 1990s and the mid-2000s. Over that same period the incomes of the richest families grew by 9 percent.

TABLE 9A: DOLLAR AND PERCENT CHANGE IN AVERAGE INCOMES OF BOTTOM FIFTH AND TOP 5 PERCENT OF FAMILIES 1998-2000 to 2004-06 (in 2005 Dollars)							
	Bottom Fifth				Top 5%		
State	Dollar Change		Percent Change		Dollar Change		Percent Change
8 Large States Where the Income of the Top 5 Percent Grew Faster Than the Income of the Bottom Fifth^							
California	255		1.4%		41,988	*	20.8%
Florida	-4		0.0%		39,934	*	22.1%
Illinois	-1,588	*	-8.0%		36,730	*	18.7%
Massachusetts	807		4.1%		87,638	*	39.3%
New Jersey	1,058		4.8%		70,169	*	27.3%
New York	230		1.4%		45,910	*	21.2%
Pennsylvania	-1,281	*	-6.3%		25,674	*	13.5%
Texas	-287		-1.8%		21,676	*	11.4%
Incomes of the Bottom Fifth and Top 5 Percent Increased at About the Same Rate in Michigan, North Carolina, and Ohio^^							
Total U.S.	**(459)**	*****	**-2.5%**		**29,042**	*****	**15.2%**

* Dollar changes marked with an asterisk are "statistically significant." The change is known with 90 percent certainty. See the footnote in Table 1 for details.

^ For the states in this group, the income of the top 5 percent grew by a larger percentage than the income of the bottom fifth and this difference was statistically significant.

^^In Michigan, North Carolina, and Ohio, differences in income growth between the top 5% and the bottom fifth were not statistically significant at a 90 percent confidence level.

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

The incomes of the very richest families — the top 5 percent — grew considerably faster than the incomes of the poorest 20 percent of families in eight of the 11 states where there is sufficient data to make the comparison (see Table 9A). In these eight states, income growth among the richest families ranged from 11 percent in Texas, to nearly 40 percent in Massachusetts. By contrast, among the poorest 20 percent of families in these eight states, income declined significantly in Illinois and Pennsylvania and remained stagnant in the rest.

The largest increase in inequality between the top 5 percent and the bottom 20 percent occurred in Massachusetts: the bottom fifth of families saw no significant increase in income, while the top 5 percent of families saw an increase of 39.3 percent ($87,638).

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

As discussed above, examining income gaps — the average income of the top fifth of families divided by the average income of the bottom fifth of families — can demonstrate changes in income inequality over time.

From the late 1990s to the mid-2000s, the gap between the richest and poorest fifths of families grew significantly wider in 19 states (see Table 10). Mississippi's top-to-bottom ratio grew the most: in the late 1990s, the income of the richest fifth of Mississippi families was 6.1 times the income of the poorest fifth, but by the mid-2000s that ratio had grown to 8.3.

TABLE 10: CHANGE IN RATIO OF INCOMES OF TOP AND BOTTOM FIFTHS OF FAMILIES 1998-2000 to 2004-06					
State	**Rank**	**Top-to-Bottom Ratio 1998-2000**	**Top-to-Bottom Ratio 2004-06**	**Change in Top-to-Bottom Ratio+**	
Mississippi	1	6.1	8.3	2.1	*
Alabama	2	6.4	8.5	2.1	*
New Mexico	3	6.3	8.0	1.7	*
Connecticut	4	6.6	8.0	1.4	*
Indiana	5	5.3	6.7	1.4	*
Illinois	6	6.3	7.5	1.2	*
South Dakota	7	5.1	6.3	1.2	*
West Virginia	8	6.3	7.5	1.2	*
South Carolina	9	5.6	6.7	1.1	*
Massachusetts	10	7.1	8.2	1.1	*
Colorado	11	5.9	7.0	1.1	*
Missouri	12	6.1	7.1	1.1	*
Virginia	13	6.5	7.6	1.0	*
Florida	14	6.5	7.5	1.0	*
Washington	15	5.9	6.9	1.0	*
Pennsylvania	16	6.1	6.9	0.8	*
California	17	7.1	7.9	0.8	*
Texas	18	7.1	7.9	0.8	*
New York	19	7.9	8.7	0.7	*
Alaska	20	5.7	6.2	n/a	
Arizona	20	6.3	7.2	n/a	
Arkansas	20	5.9	6.4	n/a	
Delaware	20	5.9	5.7	n/a	
Georgia	20	6.2	6.7	n/a	
Hawaii	20	6.0	5.8	n/a	
Idaho	20	5.6	5.6	n/a	
Iowa	20	5.6	6.1	n/a	
Kansas	20	6.1	6.8	n/a	
Kentucky	20	7.0	7.7	n/a	
Louisiana	20	7.1	7.3	n/a	
Maine	20	5.8	6.3	n/a	
Maryland	20	6.5	7.3	n/a	
Michigan	20	6.4	7.0	n/a	
Minnesota	20	5.5	6.0	n/a	
Montana	20	5.6	5.7	n/a	
Nebraska	20	5.7	5.8	n/a	
Nevada	20	5.9	6.3	n/a	
New Hampshire	20	5.8	5.6	n/a	
New Jersey	20	6.9	7.5	n/a	
North Carolina	20	6.9	7.2	n/a	
North Dakota	20	5.7	6.2	n/a	
Ohio	20	6.5	6.2	n/a	
Oklahoma	20	6.7	7.3	n/a	
Oregon	20	6.6	6.9	n/a	
Rhode Island	20	6.5	7.5	n/a	
Tennessee	20	7.1	8.1	n/a	
Utah	20	4.9	5.4	n/a	
Vermont	20	6.0	6.0	n/a	
Wisconsin	20	5.8	6.0	n/a	
Wyoming	20	5.5	5.9	n/a	
District of Columbia		11.6	13.5	n/a	
Total U.S.		**6.5**	**7.3**	**0.8**	*****

* The changes in the top-to-bottom ratio marked with an asterisk are statistically significant at the 90 percent level of confidence. That is, one can say with 90 percent certainty that the increases or decreases shown in the table are true increases or decreases in income inequality. Those changes that are not statistically significant are listed as n/a.

+ Change in top-to-bottom ratio may not match calculated difference due to rounding. Rankings are based on unrounded numbers.

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

TABLE 10A: CHANGE IN RATIO OF INCOMES OF TOP 5 PERCENT AND BOTTOM FIFTH OF FAMILIES 1998-2000 to 2004-06				
State	**Top 5 Percent-to-Bottom Ratio 1998-2000**	**Top 5 Percent-to-Bottom Ratio 2004-06**	**Change in Top 5 Percent-to-Bottom Ratio+**	
California	11.2	13.3	2.1	*
Florida	10.3	12.6	2.3	*
Illinois	9.9	12.7	2.9	*
Massachusetts	11.3	15.1	3.8	*
New Jersey	11.6	14.1	2.5	*
New York	12.8	15.4	2.5	*
Pennsylvania	9.4	11.4	2.0	*
Texas	11.6	13.1	1.6	*
Michigan	10.2	11.5	n/a	
North Carolina	10.8	12.0	n/a	
Ohio	10.2	9.5	n/a	
Total U.S.	**10.3**	**12.2**	**1.9**	*****

* The changes in the top 5%-to-bottom ratio marked with an asterisk are statistically significant at the 90 percent level of confidence. That is, one can say with 90 percent certainty that the increases shown in the table are true increases in income inequality. Those changes that are not statistically significant are listed as n/a.

+ Change in top 5%-to-bottom ratio may not match calculated difference due to rounding. Rankings are based on unrounded numbers.

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

Changes in inequality from the late 1990s to the mid-2000s follow no clear regional pattern, although states in the Southeast and Midwest were more likely to face increased inequality. The states in which income gaps grew the most were Mississippi, Alabama, New Mexico, Connecticut, and Indiana.

The income gap between the top 5 percent of families and the poorest 20 percent of families grew in eight of the 11 states where this comparison was possible; in the remaining three states, this gap remained about the same (see Table 10A). The increase was most dramatic in Massachusetts.

In the late 1990s the top 5 percent of Massachusetts families had 11.3 times the income of the bottom 20 percent. By the mid 2000s this ratio had grown to 15.1.

Nationwide, in the late 1990s the top 5 percent had 10.3 times the average income of the bottom 20 percent. This ratio had grown to 12.2 by the mid-2000s.

Comparing Income Trends Among High- and Middle-Income Families

Between the late 1990s and the mid-2000s, income inequality grew not only between low- and high-income families but also between middle-income and high-income families. Income growth among the middle fifth of families stagnated compared to the richest fifth of families from the late 1990s through the mid-2000s. Nationwide, the middle fifth saw their incomes grow by only 1.3 percent while incomes among the top fifth grew by 9.1 percent. The states where there is sufficient data to make the comparison show a similar pattern. In 8 states, the incomes of the top fifth of families grew faster than the incomes of the middle fifth (see Table 11). In Mississippi, for example, middle-income families saw no increase in average income over this period, while families in the top

TABLE 11: DOLLAR AND PERCENT CHANGE IN AVERAGE INCOME OF MIDDLE AND TOP FIFTHS OF FAMILIES 1998-2000 to 2004-06 (in 2005 Dollars)							
	Middle Fifth				Top Fifth		
State	Dollar Change		Percent Change		Dollar Change		Percent Change
8 States Where the Income of the Top Fifth Grew Faster Than the Income of the Middle Fifth^							
Alabama	-1,229		-2.8%		9,906		9.6%
California	1,889	*	3.8%		16,772	*	13.0%
Florida	1,710	*	3.8%		17,499	*	15.4%
Illinois	-1,629		-3.0%		12,880	*	10.3%
Mississippi	-639		-1.6%		22,245	*	23.4%
Missouri	-2,839	*	-5.6%		13,521		12.0%
New Mexico	2,734	*	7.0%		27,038	*	29.5%
Texas	558		1.3%		10,505	*	9.0%
Incomes of the Middle Fifth and the Top Fifth Increased at About the Same Rate in the Remaining 42 States and the District of Columbia^^							
Total U.S.	**649**	*****	**1.3%**		**11,044**	*****	**9.1%**

* Dollar changes marked with an asterisk are "statistically significant." The change is known with 90 percent certainty. See the footnote in Table 1 for details.

^ For the states in this group, the income of the top fifth grew by a larger percentage than the income of the middle fifth and this difference was statistically significant.

^^ Among the remaining 42 states and the District of Columbia, the differences in income growth between the top fifth and the middle fifth were not statistically significant at a 90 percent level of confidence.

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

fifth saw their income rise by more than 23 percent ($22,245). Income inequality between the middle and the top did not decline in any state since the late 1990s.

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

The ratio of the average incomes of the top fifth of families to the average incomes of the middle fifth of families grew significantly in eight states from the late 1990s to the mid-2000s (see Table 12). Mississippi saw the largest increase in income inequality, followed by New Mexico, Missouri, Illinois, and Alabama. Income inequality did not decline significantly in any state.

Income Trends Following the 2001 Downturn

Unlike the richest fifth of families, the poorest families have not fared well since the recession of 2001. Families of all income classes experienced declines in average income during the 2001 recession. However, though the economy had largely recovered by 2005, incomes among the poorest families had not. In the mid-2000s, average incomes among the bottom 20 percent of families were 2.5 percent lower than they had been during the economic peak of the late 1990s. By contrast, in the mid-2000s average incomes among the richest fifth of families were 9.1 percent *higher* than they had been prior to the recession.

Because of data limitations this report cannot analyze changes in inequality in each state for individual years between 2000 and the present. However, a number of national-level wage and income series covering more recent years provide more detail on changes in inequality during the

TABLE 12: CHANGE IN RATIO OF INCOMES OF TOP AND MIDDLE FIFTHS OF FAMILIES 1998-2000 to 2004-06 (Only States Where the Change was Statistically Significant Are Shown)					
State	**Rank**	**Top-to-Middle Ratio 1998-2000**	**Top-to-Middle Ratio 2004-06**	**Change in Top-to-Middle Ratio+**	
Mississippi	1	2.3	2.9	0.6	*
New Mexico	2	2.3	2.8	0.5	*
Missouri	3	2.2	2.6	0.4	*
Illinois	4	2.3	2.6	0.3	*
Alabama	5	2.3	2.6	0.3	*
Florida	6	2.5	2.8	0.3	*
California	7	2.6	2.9	0.2	*
Texas	8	2.6	2.8	0.2	*
Total U.S.		**2.4**	**2.6**	**0.2**	*****

* The changes in the top-to-middle ratio marked with an asterisk are statistically significant at the 90 percent level of confidence. That is, one can say with 90 percent certainty that the increases or decreases shown in the table are true increases or decreases in income inequality. Those changes that are not statistically significant are listed as n/a.

^ In the remaining 48 States and the District of Columbia, changes in the top-to-middle ratio were not statistically significant at a 90 percent level of confidence.

+ Change in top-to-middle ratio may not match calculated difference due to rounding. Rankings are based on unrounded numbers.

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

economic recovery that began in 2001. State patterns should be similar to the national trends shown in these data.

In general, recent national-level data show growing inequality reasserting itself in the mid-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 in 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 set of factors responsible for growing inequality (see Chapter IV) once again became operative, and the distribution of income and wages appeared to begin to widen once again.

The table at right shows changes in family income, as defined by the Census Bureau, from 2000 to 2006. (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 rose by 1 percent for the top fifth of families and by 2.3 percent for the top 5 percent of families, they fell for all other families.

REAL CHANGES IN FAMILY INCOME, 2000-2006, CENSUS BUREAU DATA	
Bottom Fifth	-4.5%
Second Fifth	-3.1%
Middle Fifth	-2.5%
Fourth Fifth	-0.7%
Top Fifth	1.0%
Top 5 Percent	2.3%

The 2000-2006 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 12A: CHANGE IN RATIO OF INCOMES OF TOP 5 PERCENT AND MIDDLE FIFTH OF FAMILIES 1998-2000 to 2004-06				
State	Top 5 Percent-to-Middle Ratio 1998-2000	Top 5 Percent-to-Middle Ratio 2004-06	Change in Top 5 Percent-to-Middle Ratio+	
Massachusetts	3.8	4.7	0.9	*
Illinois	3.6	4.4	0.8	*
New York	4.3	5.0	0.7	*
Florida	4.0	4.7	0.7	*
New Jersey	4.2	4.9	0.7	*
California	4.1	4.8	0.7	*
North Carolina	3.8	4.3	n/a	
Ohio	3.6	3.5	n/a	
Pennsylvania	3.7	4.2	n/a	
Texas	4.3	4.7	n/a	
Michigan	3.7	4.0	n/a	
Total U.S.	**3.8**	**4.4**	**0.5**	*****

The following table 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 after-tax income plus the value of in-kind benefits, though unlike the measure used in this report, the CBO measure also includes capital gains and losses as well as the in-kind value of publicly provided health care.)

These comprehensive data reveal a clear pattern of growing income inequality, with gains that increase in magnitude as income increases. In this one-year period, real incomes grew 20.2 percent for the top 1 percent of households while incomes of families in the bottom four quintiles grew around 1 percent. A recent analysis of Internal Revenue Service data found that the wealthiest families continued to receive the lion's share of income growth between 2005 and 2006.[10] The high growth in incomes of the richest families more than offset the losses of the 2001 recession.

CHANGE IN REAL POST-TAX HOUSEHOLD INCOME, 2004-2005, COMPREHENSIVE CBO DATA	
Bottom Fifth	1.3%
Second Fifth	0.6%
Middle Fifth	0.8%
Next to Top Fifth	0.6%
Highest Fifth	7.4%
All Quintiles	3.9%
Top 10 Percent	9.8%
Top 5 Percent	13.4%
Top 1 Percent	20.2%

The same did not happen for families lower down the income scale. By 2006, Census data shows that inflation-adjusted median incomes remained below 2000 levels.

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 late 1990s ensured that wage growth was broadly shared; that pattern prevailed for a couple of years following the 2001 recession. (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 table below compares the most recent wage data to 2001 levels.) The result was falling real wages at the low end of the wage scale, stagnant

[10] Thomas Piketty and Emmanuel Saez, "Income Inequality in the U.S.: 1993-1998," *Quarterly Journal of Economics*, February 2003. Updated data available at http://elsa.berkeley.edu~saez.

REAL GROWTH OF HOURLY WAGES BY PERCENTILE, 2001-2007					
	Wage Percentile				
Annual Growth	10th	20th	Median	80th	90th
2001-07	-0.6%	0.0%	0.4%	3.5%	3.9%

earnings in the middle, and growing earnings only at the top. Again, we see a clear pattern of inequality returning to the wage structure.[11]

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

[11] Wage percentiles are a summary measure similar to medians. For example, the 80th percentile wage is a relatively high wage. The wages of 80 percent of workers are less than the 80th percentile wage and 20 percent of workers have wages above the 80th percentile.

V. Causes and Cures: State Policy Options

Income inequality has grown over the last two decades as a result of both economic trends and government policies. In particular, the growth of income inequality is mainly due to two factors: the increasingly unequal distribution of labor income and the growth in the stock market, which results in income from interest, dividends, and the sale of capital assets for those who own stocks — mostly those in the highest reaches of the income scale. (Due to data limitations, this study does not include realized capital gains; as a result it underestimates average incomes for high-income families.)

A variety of factors explain the growth of wage inequality, including long periods of high unemployment, globalization, the shrinkage of manufacturing jobs and the expansion of low-wage service jobs, and immigration, as well as 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. Over the 2000s, even those with college educations experienced relatively stagnant real wage growth (up only 2.5 percent between 2000 and 2007). This slow growth was due in part to the bursting of the tech bubble in high-wage industries, but also to the downward pressure on wage growth from offshore competition.

Only in the later part of the 1990s was there broadly shared growth in wages. 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, and they ended with the recession of 2001. Today, inequality between low- and high-income families and between middle- and high-income families is greater than it was at the end of the 1980s or the 1990s.

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.[12]

Recent state policy decisions have played a role in widening the already growing gaps in the distribution of income. In the aftermath of the economic downturn of the early 2000s, supports for low-income families such as child care assistance and health insurance were cut. While some, but not all, of these cuts were reversed, these programs are once again at risk in the current downturn. In addition, tax actions in good times and bad have increased the regressivity of state tax systems.

If they so choose, however, states can chart a different course. States can enact policies that improve the distribution of income, such as raising their minimum wage, maintaining and widening the range of supports for low-income working families and improving access to 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 chapter 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 1989 and 2005, employment in manufacturing fell from 17 percent of all United States jobs to 11 percent of jobs, while employment in service industries rose from 78 percent of jobs to 83

[12] 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. 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, 2006-2007,* Cornell University Press, pp. 67-78 and William G. Gale and Peter R. Orzag, "Bush Administration Tax Policy: Distributional Effects," Urban Brookings Tax Policy Center, 2004.

percent. These service sector jobs tend to be lower paid than comparable manufacturing jobs. For example, in 2006, average hourly pay for an employee working in the services industry was 23 percent less than that of the manufacturing industry.[13]

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.[14] 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 inequality.[15] There is also some recent evidence that expanded trade with very low-wage countries such as China has increased the inequality-inducing impact of international trade.[16]

Labor-market policies have had a major impact on wage inequality. While many states now have their own, higher minimum wage, the real value of the federal minimum wage has declined considerably since its high point in the late 1960s. By 2006, the value was still 31 percent less than in 1979 despite four legislated increases during the 1990s. In 2007, Congress acted to increase the federal minimum wage from $5.15 to $7.25 by 2009. This will restore much of the value eroded by inflation since the 1970s.[17] However, the value is not indexed to inflation — that is, it will not increase automatically as the cost of living increases — thus, its value will begin to erode again after 2009 unless Congress acts. The impact of this reduction in the minimum wage since 1979 on wage inequality has been, by many accounts, very substantial, especially for low-wage women workers.[18]

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 both raising wages and benefits and lowering wage inequality 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 1989 and 2006, the percentage of workers belonging to unions dropped from 16 percent to 12 percent.[19] Economic analysis of the decline in union participation during the 1980s confirms that declining unionization contributes to increased earnings inequality.[20]

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[13] Calculations based on the Bureau of Labor Statistics, *Labor Force Statistics from the Current Population Survey*, various years, http://www.bls.gov/data/home.htm.

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

[15] Report of the United States Trade Deficit Review Commission, November 2000.

[16] See L. Josh Bivens, "Globalization and American Wages, Economic Policy Institute, October 10, 2007. http://www.epi.org/content.cfm/bp196.

[17] Because the most recent data available for this state analysis is from 2006, it does not account for the recent increase in the federal minimum wage.

[18] *State of Working America 2004-2005,* David Lee, "Inequality in the United States During the 1980s: Rising Dispersion or Falling Minimum Wage?," *Quarterly Journal of Economics*, 1999, 114(3), 977-1023.

[19] Bureau of Labor Statistics, *Union Affiliation data from the Current Population Survey*, various years, http://www.bls.gov/data/home.htm.

[20] See, for example, Richard Freeman, "Is Declining Unionization of the U.S. Good, Bad or Irrelevant?" in *Unions and*

Technology also plays a role in wage inequality, though its magnitude is often exaggerated. Historically, the complementarities between highly educated workers and technology-induced skilled demands have led to large wage differences between high- and lower-wage workers. But there is little evidence that this ongoing dynamic increased much over the period in which wage inequality was growing most quickly. Thus, technology has played a smaller role in the *increase* in wage inequality than is often claimed. In fact, one influential recent study argues that technological change has increased labor demand (and relative wages) for both high- and low-wage workers, though not for middle-wage workers.[21]

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."[22]

A number of studies have considered the impact of immigration on wages in California, a state with a large immigrant population. A comprehensive study published in 1999 found that immigration explains between 17 percent and 40 percent of the rise in male wage inequality in the state since the late 1960s.[23] A more recent study of this effect found that "There is no evidence that the inflow of immigrants to California between 1990 and 2004 worsened the employment opportunities of natives with similar education and experience." Further, the study found that while immigration lowered average wages somewhat for more established immigrants — those who entered California before 1990 — it actually resulted in somewhat higher wages for native workers.[24]

Another recent study in a state with many immigrants, New York, found that immigrants have been a significant factor in reducing income inequality there by expanding the number of families in the middle of the income distribution.[25] The impact of immigration on wage inequality will differ depending on the region of the country. The impact will likely be smaller in areas with fewer immigrants, as they make up a smaller share of the workforce and thus have less potential influence on wage levels.

Economic Competitiveness, 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*, Russell Sage Foundation, 1993.

[21] Autor, David H., Lawrence F. Katz, and Melissa S. Kearney,. "The Polarization of the U.S. Labor Market." *American Economic Review*, 96(2), May 2006, pp. 189-194.

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

[23] Deborah Reed, California's Rising Income Inequality: Causes and Concerns. San Francisco, CA: Public Policy Institute of California, 1999.

[24] Peri, Giovanni, How Immigrants affect California Employment and Wages, Public Policy Institute of California, February, 2007.

[25] "Working for a Better Life: A Profile of Immigrants in the New York State Economy," Fiscal Policy Institute, November 2007.

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 2000, income derived from capital — such as rent, dividends, interest payments, and capital gains — increased as a share of personal income from 18.6 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.[26] Between 2000 and 2005, lower interest rates and the stock market decline of the early 2000s resulted in a drop in the share of income derived from capital to 20.9 percent; however, that share remained higher than in 1979.[27] Further, the share of national income growth going to corporate profits during the recent recovery was considerably higher than average.

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 5 percent of the income distribution.[28]

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[29] and that the increase in the share of the population consisting of minorities has increased inequality by only a small amount.[30]

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

[27] This study captures only part of this effect because capital gains income is not included.

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

[29] 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.

[30] 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,* National Policy Association, 1998.

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

As this analysis shows, income inequality has increased substantially in the majority of states over the past two business cycles. In many states, the average income of the poorest fifth of families grew only modestly since the early 1980s.

Some families, however, have low incomes for only a few years and quickly move into the middle class. For example, the parents of a young child may be working part time while finishing college. The family's income might be very low for a few years, but after both parents graduate from college and obtain well paying jobs, the family's income could increase substantially.

Nevertheless, 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. For example, 71 percent of households that were in the bottom fifth in 2001 were still in the bottom fifth two years later.[a]

Income mobility improves somewhat when a longer period of time is analyzed. In a study spanning the late 1960s through the early 2000s, 42 percent of those who started in the bottom fifth remained in the bottom fifth as adults, and two-thirds remained in the bottom two-fifths.[b]

It should be noted that race is an important factor in determining which individuals move up the income ladder and how far; studies show that the upward mobility of black families is half that of white families.[c] Moreover, in a major national study, almost half (45 percent) of black children whose parents were solidly middle class ended up falling to the bottom of the income distribution, compared to only 16 percent of white children.[d]

Researchers have also examined whether income mobility has changed over time. Faster movement up the economic ladder could offset the problems of greater income inequality. On the other hand, if income mobility has remained about the same or declined since the 1970s, then the increases in income inequality over that time would worsen the effects of increasing inequality. This has been the subject of a number of studies in recent years. While there is disagreement, some recent research, including a Federal Reserve Study of intergenerational mobility has shown that income mobility in the United States declined in the 1980s and the 1990s. And, there is widespread agreement that income mobility in the United States has not increased since the 1970s.[e]

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[a] John J. Hisnanick and Katherine G. Giefer, *Dynamics of Economic Well-Being: Fluctuations in the U.S. Income Distribution, 2001-2003*. Washington, DC: U.S. Census Bureau, 2007.

[b] Julia Isaacs, *Economic Mobility of Families Across Generations.* Washington, DC: Economic Mobility Project, 2007, www.economicmobility.org/assets/pdfs/EMP_Across_Generations.pdf.

[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] Julia Isaacs, *Economic Mobility of Black and White Families.* Washington, DC: Economic Mobility Project, 2007, www.economicmobility.org/assets/pdfs/EMP_Across_Generations.pdf.

[e] 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; Katherine Bradbury and Jane Katz, "Are Lifetime Incomes Growing More Unequal?," Regional Review, Fourth Quarter, 2002; and 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.

One demographic trend has had some impact on the rise in income inequality among families.[31] The percentage of households composed of single individuals increased from 20 percent to 25 percent between 1989 and 2004, while the percentage of families headed by a woman increased from 16.5 percent to 18.2 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.[32] Between 2000 and 2004, wives' hours of work declined as a result of the weak labor market.

Future Trends: The Economic Downturn and Beyond

While this report focuses on past rather than future events, it is relevant to examine the likely path of income inequality in the current economic downturn and beyond.

No one can predict with certainty where wage growth is heading. Nevertheless, there are good reasons to be concerned that a return to the broad-based wage growth of the late 1990s, which led to gains for low- and middle-income workers, is becoming ever more elusive. There are already unmistakable signs that low- and middle-income workers — who did not share in the prosperity of the mid-2000s — will be hard hit by the current economic downturn. The most recent economic data show a slowdown in wage growth accompanied by acceleration in inflation — a recipe for declines in real wages. No doubt the drop in the stock market will also result in a decline in the incomes of the wealthiest families, similar to the decline seen in 2002. The combination of these factors could result in a decline in inequality. If it occurs, however, this will represent a decline in real living standards across the income scale and will likely again be temporary.

The more important question is what will happen when the economy begins to grow again. Will the recovery bring the conditions similar to those that led to the shrinking wage inequality of the end of the 1990s, or will it bring a repeat of the growing inequality of the 2000s? A number of important and related phenomena in the latter half of the 1990s 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.,

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[31] Ibid.

[32] Mishel, Bernstein and Allegretto, *The State of Working America 2004-2005.*

productivity grew more quickly in the 2000s than in the latter 1990s, but most families' incomes grew more slowly and poverty increased.

For faster growth to translate into higher real wages and incomes, we need the historically tight labor markets that also prevailed over the latter 1990s. The robust job growth and full employment job market characterizing that period 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 take-home pay of low-income workers. The federal minimum wage was increased in 1996 and 1997 and the Earned Income Tax Credit was expanded.

By contrast, low- and moderate-income wage earners did not fare nearly so well in the economic expansion of the mid-2000s that has just ended. Slow job creation led to stagnating or declining real wages for these workers, even as *high*-income families recovered from the hit their incomes took as a result of the stock market decline and their incomes grew rapidly. Once again, families at the top of the income scale were receiving the lion's share of the growth in the economic pie.

Once the current economic downturn is behind us, there are two paths that future growth can take; one leads to a return to the growing income inequality of most of the last three decades and the other to the shared prosperity of the late 1990s. Federal and state governments have a role to play in pushing towards the goal of shared prosperity.

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. Despite the long-overdue increase in the federal minimum wage in 2007, the need for state action remains.

The federal minimum wage increased from $5.15 an hour to $5.85 in July 2007 and will increase again in 2008 and 2009 until it reaches $7.25 in the summer of 2009. By 2009, its purchasing power will be close to its value at the end of the 1970s. Prior to this increase, the value of the federal minimum wage had not been increased for a decade.

Since 1981, a number of states have raised their minimum wages to offset the decline in the value of the federal minimum wage. By 2007, just prior to the passage of the federal increase, 31 states plus the District of Columbia had enacted state minimum wages that were higher than the federal minimum wage. By September 2009, when the federal increase is fully phased, in the number of states with minimum wages that are higher than the federal minimum wage will have declined to 12.[33]

In order to assist low-wage workers, additional states should consider adopting a minimum wage that is higher than the federal minimum wage. Even the higher federal minimum wage will fall short of the amount needed to meet a family's needs, especially in a state with a relatively high cost of living. In addition, the adoption of a higher state minimum wage can bring these benefits to workers in a more timely way than waiting for the phase-in of the federal provisions.

An additional change that states can adopt to improve on the federal provision is to index their minimum wage for inflation. In 2007, the minimum wages of ten states were adjusted automatically by the amount of the increase in consumer prices. In contrast, the federal minimum wage is not indexed for inflation. After the scheduled increase in 2009, there could be another long period of time before Congress acts to increase the federal minimum wage.

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.[34] Contrary to the popular stereotype, the majority of minimum-wage workers are adults, not teenagers. Minimum-wage earners contribute an average of 54 percent of their families' weekly earnings.[35]

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.[36]

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[33] The 12 states whose minimum wage will be above the federal minimum wage in 2009 are California at $8.00, Connecticut at $7.65, Illinois at $8.00, Maine at $6.50, Massachusetts at $8.00, Michigan at $7.40, Nevada at $7.73, New Mexico at $7.50, Oregon at $8.15, Rhode Island at $7.40, Vermont at $7.85, and Washington at $8.27. The minimum wage in the District of Columbia will be $8.25 in 2009.

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

[35] These figures reflect workers who would have been affected by an increase in the minimum wage from $5.15 an hour to $7.28 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 as well as workers earning just above those amounts. From Mishel, Bernstein, and Allegretto, *The State of Working America, 2006-2007.*

[36] 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

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. In states that have a high level of seasonal unemployment, such as in agriculture or tourism, intermittent unemployment can cause many workers to fall into poverty.

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; frequently it prevents the unemployed from falling into poverty or needing to rely on welfare. The looming recession highlights the critical importance of unemployment insurance as a part of the national safety net for low-wage workers.

Unfortunately, the share of unemployed workers who receive unemployment insurance benefits has been declining. In 2007, the share of unemployed workers receiving benefits was only 37 percent — a sign that the current unemployment insurance system does not reflect the realities of work and family today. In contrast, 42 percent of unemployed workers were receiving benefits in March 2001, when the previous recovery peaked. Since unemployment insurance benefits go disproportionately to lower-income workers, the decline in the share of workers who receive these benefits has likely widened income gaps.

The federal government and a number of states have enacted changes that have made the unemployment insurance program less accessible. For example, when state unemployment insurance costs rose due to a lengthy period of high unemployment in the early 1980s, a number of states reacted by making eligibility rules more restrictive.

There are a number of ways in which states can expand unemployment insurance coverage among low-wage workers. They can extend benefits to workers who have recently joined the workforce by altering their unemployment insurance eligibility rules to allow a person's most recent earnings to be considered in the determination of unemployment insurance benefits. Nineteen states plus DC currently have such provisions.[37] States also can broaden the list of reasons that qualify as "good cause" for leaving a job voluntarily to include such reasons as lack of child care or transportation problems. Permitting workers available only for part-time work to qualify for benefits and

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Industry in New Jersey and Pennsylvania," *American Economic Review*, Volume 84, Number 4, September 1994.

[37] These are Connecticut, the District of Columbia, Georgia, Hawaii, Illinois, Maine, Massachusetts, Michigan, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Rhode Island, Vermont, Virginia, Washington, and Wisconsin.

eliminating restrictions on seasonal workers would also expand the number of workers eligible for benefits.[38]

In addition, states can provide extended benefits during periods of high unemployment**.** When a state's unemployment rises substantially, such as during a recession, the state may qualify under federal rules to pay "extended benefits" beyond the typical 26 weeks to unemployed workers. In 1993 Congress established a new optional formula, or "trigger mechanism," under which states could qualify for the extended benefits program.[39] Adopting this alternate trigger would allow many more states to qualify for extended benefits during an economic downturn than under the standard trigger.[40]

Tax Reform

Virtually all state tax systems 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-income families than of high-income families.

For example, sales taxes place a disproportionate burden on low-income families, largely because lower-income families must spend most or all of their income, while higher-income families do not pay sales taxes on portions of their incomes that are saved and invested. In contrast, the share of income paid under an income tax generally either increases as income increases — in the case of an income tax with graduated rates — or is the same for all income levels. The states' significant reliance on sales taxes and other consumption taxes such as cigarette taxes 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.

Many states have made their tax systems less progressive in recent years. Because states must balance their budgets in good economic times and in bad, states often raise taxes during economic downturns in order to preserve services in the face of falling revenues. When the economy is stronger, states often reduce taxes.

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 during the mid- and late 1990s and again in recent years, 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.[41]

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[38] For more information, see Rebecca Smith, Rick McHugh, and Andrew Stettner; *Between a Rock and a Hard Place: Confronting the Failure of State UI Systems to Serve Women and Working Families*, National Employment Law Project, July, 2003. Available at http://www.nelp.org/iu/initiatives/family/between.cfm .

[39] The federal government pays 50 percent of the cost of these extended benefits.

[40] For more information, see Andrew Stettner, Rebecca Smith and Rick McHugh, "Changing Workforce, Changing Economy: State Unemployment Insurance Reforms for the 21st Century," National Employment Law Project, 2004, www.nelp.org/changingworkforce/MODEL%20REFORMS/Model-Reforms.html.

[41] 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

States appear to be on the brink of another fiscal crisis. As of March 2008, over half of the states are projecting budget shortfalls for fiscal year 2009, which starts in July 2008 in most states. The projected shortfalls are large, totaling at least $39 billion — 9 percent of budgets — in the 22 states that have estimated the size of the gap.

States have three basic options to address these shortfalls: drawing down reserves, cutting spending, or raising taxes. Economists recognize that tax increases and other revenue measures, especially if targeted to high-income taxpayers, can be less harmful for a state's economy that big spending cuts.[42] If the fiscal crisis deepens, as seems likely given current economic forecasts, states will need to turn to tax increases in order to maintain services.

If states again turn to increases in sales taxes and excise taxes now that times are getting tougher, they will increase the regressivity of their tax systems. On the other hand, if states raise income tax rates rather than sales tax rates, after-tax income disparities generally will be reduced.

Another way to lessen the negative impact of state tax systems on the poor is to broaden the sales tax base to include more services consumed by high-income families. In addition, if states choose to raise taxes as the economy declines, they can offset some of the impact of these tax increases on low- and moderate-income families by enacting tax credits targeted to low-income taxpayers or by raising personal exemptions or standard deductions.

Because most state tax systems are tied to *federal* definitions of income and other provisions, cuts in federal taxes often reduce state revenues. When these cuts are in income taxes or the estate tax, conforming to them also makes state tax systems more regressive. States can protect themselves against these revenue losses by removing those linkages to the federal tax code.

For example, the federal economic stimulus package passed earlier in 2008 includes a "bonus depreciation" provision that allows a business to deduct the cost of new equipment immediately rather than over the equipment's useful life. Some 23 states stand to lose $1.7 billion in revenue in the current and upcoming fiscal years from this provision, which is retroactive to January 1, 2008 — unless they act to decouple from it. In 2001-2004, when a similar provision was in effect, more than 30 states decoupled fully or partially, preserving tens of billions of dollars in revenue.[43]

Similarly, the federal corporate tax bill passed in 2004 included a new tax deduction for corporations, known as the Domestic Production Deduction. This deduction reduces state tax collections in states that are linked to the federal corporate income tax. Many states have acted to decouple from this federal provision, and more could follow suit.[44]

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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.

[42] See Nicholas Johnson, "Budget Cuts or Tax Increases: Which is Preferable During an Economic Downturn?," Center on Budget and Policy Priorities, January 8, 2008, available at www.cbpp.org/1-8-08sfp.htm.

[43] For more information see Nicholas Johnson, "New Federal Law Could Worsen State Budget Problems: States can Protect Revenue by Decoupling," Center on Budget and Policy Priorities, February 28, 2008, available at www.cbpp.org/2-13-08sfp.htm.

[44] For more information see Nicholas Johnson, "State Revenue Losses from the Federal 'Domestic Production Deduction' Will Double in 2007," Center on Budget and Policy Priorities, January 2, 2007, available at www.cbpp.org/1-2-07sfp.htm.

In addition, the federal tax cut of 2001 called for gradually eliminating the federal estate tax over ten years, with full repeal in 2010. As a part of these changes, the federal credit for state estate and inheritance tax payments was phased out more quickly, by 2005. At the time of passage of the federal bill, most state estate taxes — known as "pick-up taxes" — were based on the amount of this credit. As a result, they have now been eliminated unless the state acted to retain its tax.

Prior to the 2001 federal tax cuts, states would have received approximately $7 billion in 2007 as a result of the federal credit; over $3 billion of this amount has been retained by the 15 states and the District of Columbia that have "decoupled" from the federal changes. States that have not yet decoupled can restore their estate tax and retain this progressive tax by breaking the automatic connection between the amount of the state estate tax credit in the federal law and the amount of tax an estate owes the state.

State Earned Income Tax Credits

One direct way that states can use tax policies to boost the incomes of their poorest working residents or to offset the impact of a regressive tax increase is to enact or expand a state earned income tax credit. In recent years, several states have created earned income tax credits to build on the strengths of the federal Earned Income Tax Credit. The federal EITC is a tax credit for low- and moderate- 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, over half of the states with a state income tax and one state that has no state income tax — in all, 23 states plus the District of Columbia — have established their own EITCs.[45] 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.[46]

Better Information on the Impact of State Tax Changes

In most states, policymakers consider proposed tax reductions or increases without much information or debate on the impacts of the proposed changes on various income groups. Only a few states have the capacity — in either their executive budget offices or legislative fiscal offices — to analyze these impacts on a routine basis and disseminate this information in a timely manner. Even states that have such a capacity do not necessarily produce and disseminate analyses throughout the legislative session, when critical decisions are being made. Nor is it common for states to analyze the impact on various income groups of tax changes that have already been

[45] State earned income tax credits are in effect in Delaware, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Oregon, Rhode Island, Vermont, Virginia, and Wisconsin. In addition, Washington state recently enacted a state EITC which is not yet in effect.

[46] For more information on state earned income tax credits, see Ami Nagle and Nicholas Johnson, "A Hand Up: How State Earned Income Tax Credits Helped Working Families Escape Poverty in 2006," Center on Budget and Policy Priorities, March 8, 2006, available at http://www.cbpp.org/3-8-06sfp.htm.

enacted. Thus, policymakers in most states do not have access to analytic information describing the impact on families at different income levels of decisions they have made or might make.

In order for state policymakers to fashion tax reforms that reduce rather than increase after-tax inequality, they must have access to consistent, timely information about the distributional impact of their tax systems. Minnesota routinely produces such information, and more recently, Texas and Maine have begun to provide comprehensive information on the impact of their tax systems and proposed tax changes. This type of information can help the public participate in tax debates and help policymakers make informed decisions and help assure that tax policy does not exacerbate income disparities.[47]

Income Support for the Poorest Families

There are a host of options states can consider to strengthen their social safety nets. States can assist low-wage workers by providing key work supports. States can provide housing assistance to low-income families, enabling them to live closer to jobs. States can improve the child care system by providing child care subsidies with affordable co-payments, by improving resource and referral services, and by providing enhanced reimbursement rates to centers that provide care during non-standard hours. States can also expand health insurance among low-wage workers by providing Medicaid coverage to low income working parents.

Intensive case management and a range of supportive services can be provided to help current and former welfare recipients maintain their present employment, move into better jobs, or obtain the education and training needed for career advancement. States can help low-income families obtain work supports such as food stamps, medical coverage, and child care by explaining what benefits these families are eligible for and helping them to apply. In addition, states can help ensure that families receiving Medicaid and food stamps do not inappropriately lose those benefits when they start to work.

Some of the harshest effects of rising inequality are borne by families living in deep poverty, a growing group that includes many children, who are especially vulnerable to its effects. About 40 percent of all poor children have cash incomes below one-half of the poverty line (or $8,040 a year for a family of three in 2006), Census figures show. While welfare reform efforts in the mid- and late 1990s succeeded in helping more families move to work, they often made it harder for very poor families who are unable to find consistent work to get the income assistance and intensive job preparation and training these families need in order to make ends meet in the short run and become employable over a longer period of time.

While every state operates a TANF (Temporary Assistance for Needy Families) cash assistance program to provide income assistance to very poor families, data from the U.S. Department of Health and Human Services show that only about four in ten families with children who meet their state's eligibility requirements for the TANF program actually receive TANF income assistance.[48]

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[47] For more information see Michael Mazerov, "Developing the Capacity to Analyze the Distributional Impact of State and Local Taxes: Issues and Options for States," Center on Budget and Policy Priorities, January, 2002, available at http://www.cbpp.org/1-15-02sfp2.pdf.

[48] U.S. Department of Health and Human Services, *Indicators of Welfare Dependence: Annual Report to Congress, 2007*, http://aspe.hhs.gov/hsp/indicators07/ch2.pdf, page 19.

Researchers have shown that a growing group of very poor single mothers are both jobless and *not* getting assistance from state TANF cash assistance programs.[49]

Many of these "disconnected" single mothers have significant barriers to employment — as do many long-term recipients — including physical and mental impairments that hinder their ability to secure employment without specialized assistance. These same barriers to employment often impede parents' ability to meet TANF program requirements, leading parents either to be unable to get on the program or to being terminated for failing to comply with work and other requirements.

States can take steps to make their TANF assistance programs more responsive to the needs of very poor families while maintaining the work-focused nature of the program. For example, states can:

- improve their assessment mechanisms so they can better identify families with serious problems and then tailor job preparation services for them in ways that match their circumstances;[50]
- develop job preparation programs, working with community and government institutions that specialize in the needs of those with disabilities, for recipients with barriers to employment;
- make it easier for families to apply for TANF benefits initially, waiting until assessments are completed before assigning parents to work activities; and
- review families' circumstances carefully before imposing sanctions or terminating assistance due to a time limit to determine if the family should lose income support.

TANF- and State-Funded Assistance for Low-Income Working Families

Since the enactment of the Deficit Reduction Act in 2006, which made changes in the TANF program, many states have chosen to expand assistance to low-income working families. Some states are allowing working families to continue to receive TANF cash assistance at higher earnings levels, while others have created new "worker supplement" programs that provide assistance to families through a simpler program designed just for working families.

About 14 states have adopted such "worker supplement" programs, and about seven already have begun to implement them. Most of these programs provide a flat grant of cash assistance to families that have recently left basic TANF cash assistance programs and are working.

The amount of the benefit varies, as does the number of months a family can qualify for the aid. For example, Virginia provides working former recipients with $50 per month for up to 12 months

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[49] Rebecca Blank, "Improving the Safety Net for Single Mothers Who Face Serious Barriers to Employment," *Future of Children,* Fall 2007, http://www.futureofchildren.org/usr_doc/7_09_Blank.pdf.

[50] Mathematica Policy Research, Inc., under a contract with the U.S. Department of Health and Human Services, recently released a series of five papers that describe ways in which states can improve their TANF programs for families with disabilities, including improving assessment, partnering with the state vocational rehabilitation agency, developing work programs tailored to the needs of such families, and providing effective supports for recipients with disabilities so they can meet work and other goals. These papers can be found at: http://www.acf.hhs.gov/programs/opre/welfare_employ/identify_promise_prac/index.html.

(for a total of up to $600 per family); Oregon provides $150 per month for up to 12 months; and Arkansas provides $204 per month for up to 24 months.[51]

Vermont has enacted a broader worker supplement program. Its program will provide nutrition assistance (delivered as increased food stamp benefits that happen to be state-funded) to working food stamp households with children, not just former TANF recipients.

Most "worker supplement" programs are financed with state "maintenance of effort" (MOE) funds — the funds that states must spend to qualify for their federal TANF block grant. Certain TANF rules, such as time limits, do not apply when families receive assistance with these *state* funds rather than federal TANF funds. States have developed these programs to help meet multiple goals, including reducing poverty, increasing work incentives,[52] and meeting federal TANF work requirements.[53]

The Federal Food Stamp Program

The Food Stamp Program provides federally funded food assistance to low-income households. Households are generally eligible if they have gross monthly income below 130 percent of the poverty line and meet the financial asset test. The program is a critical support for individuals and families with very low incomes who cannot afford an adequate diet.

Moreover, food stamps serve as an important work support by helping low-wage workers make ends meet. Leaders from across the political spectrum have agreed that a family supported by a full-time, year-round, minimum-wage worker should not have to live in poverty. Such a family, however, will fall short of the poverty line by 25 percent, even after counting the Earned Income Tax Credit, if the family does not receive food stamps.

And because food stamps (unlike the EITC) come to families throughout the year, they can help these families meet monthly expenses. Benefits to these families can be a sizeable portion of their monthly income. In 2007 a typical family of three with a full-time, minimum-wage worker receives $335 a month in food stamps, an amount that constitutes 30 percent of the family's monthly take-home income.

States can take steps to reach more eligible people on the Food Stamp Program. While the Food Stamp Program is a federal program with a national benefit structure, states administer the program. There is wide variation amongst states with respect to what share of eligible people participate in the

[51] For information on design options for a worker supplement program, see Liz Schott, "Using TANF or MOE Funds to Provide Supplemental Assistance to Low-Income Working Families," Center on Budget and Policy Priorities, July 23, 2007, http://www.cbpp.org/5-24-07tanf.htm.

[52] For an overview of the research evidence on the efficacy of providing income support to working families both in reducing poverty and in increasing employment rates, see Charles Michalopoulos, "Does Making Work Pay *Still* Pay? An Update on the Effects of Four Earnings Supplement Programs on Employment, Earnings, and Income,", MDRC, August 2005, http://www.mdrc.org/publications/414/execsum.html.

[53] Providing assistance to working families can help a state meet its federal TANF work participation requirements, which require that a certain share of families receiving assistance with either federal TANF or state MOE funds be working or engaged in a set of welfare-to-work activities for 20-35 hours per week, depending on the age of the youngest child and the marital status of the parent.

program. According to USDA, in FY2005 the Food Stamp Program reached 65 percent of eligible individuals across the United States; Missouri reached 95 percent of eligible people, while Wyoming, at the bottom, only served 49 percent.[54]

The program does less well at reaching working families, with only 57 percent of eligible individuals with earnings participating in the program. Here again, there is huge variation amongst states.

Most states could take steps to connect eligible low-income individuals and families to the Food Stamp Program. Efforts that have proven successful include conducting outreach to potentially eligible households (especially with community based partner agencies), reducing access barriers to the program (such as requirements for multiple office visits and extensive paperwork), expanding the use of telephone interviews, and reducing the share of eligible households who fall off the program when they must renew their benefits.

States can expand who is eligible for the Food Stamp Program. States do have flexibility to set a few key eligibility rules or to leverage slightly larger benefits for eligible households within an array of state options. For example, states may set their own financial asset limit in the program. Households may not participate in the food stamp program if they have financial assets above the food stamp asset limits, which have not been adjusted for inflation for most households since 1986.[55] The steady shrinkage in the value of the asset limits discourages saving and undermines a key path to self-sufficiency.

Fifteen states have set their own food stamp asset policy; 12 of those states have eliminated the asset limit for most or all of their food stamp caseload. As a result, these states have made more low-income households eligible for the Food Stamp Program. States can review their eligibility rules to ensure that they are taking full advantage of all of the rules available to them to expand eligibility and increase benefits.

Child Care and Early Education

Child care assistance programs can help lift the disposable incomes of low- and moderate-income families in both the short and long run. In the short run, they help participating families work and earn more and reduce the high out-of-pocket costs of child care. Child care programs also can help low-income families afford higher-quality care, which can foster healthy child development and improve school readiness and, later, employment outcomes. Because child care subsidies help families afford more stable child care arrangements and reduce the "cost" of working, they have a positive effect on employment rates — research has shown that the availability of subsidies has a positive effect on employment among low-wage mothers.[56]

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[54] "Reaching Those in Need: Food Stamp Participation Rates in 2005," USDA Food and Nutrition Service, October 2007, http://www.fns.usda.gov/oane/menu/Published/FSP/FILES/Participation/Reaching2005.pdf

[55] The Food Stamp asset limits are currently $2,000 for most households, $3,000 for elderly or disabled households.

[56] For a review of this research, see Hannah Mathews, "Child Care Assistance Helps Families Work: A Review of the Effects of Subsidy Receipt on Employment," Center for Law and Social Policy, April 2006, http://www.clasp.org/publications/ccassistance_employment.pdf.

Data from the Census show that, in 2005, families with incomes below the poverty line ($15,700 for a family of three in 2005) spent 29 percent of their cash incomes on child care. Families with incomes between 100 and 200 percent of the poverty line spent 15 percent of their incomes on child care, while higher income families spent an average of just 6 percent..[57] The cost of licensed, center-based care is particularly high. According to the National Association of Child Care Resource and Referral Agencies, the average cost for full-time infant care in a licensed child care center in 2006 ranged from $4,388 in Louisiana to $14,647 in the District of Columbia. (The cost for preschool care was also high — between $3,794 and $10,920.[58]) Without a child care subsidy, many low-income working families are unlikely to be able to afford such a tuition bill for one child, let alone two or more children.

Due to a lack of funding, child care subsidy programs serve only a minority of those eligible for such assistance. Working families that need child care but cannot afford it and do not receive subsidies have few options. Studies of families on child care waiting lists have shown that these parents often are forced to go into debt, to choose lower-quality care, to face untenable choices between paying for child care and other household necessities, and to leave jobs. Expanding child care subsidy programs can both improve low-income families' ability to make ends meet and help them retain employment more consistently.[59]

Extensive research has documented that high-quality early education programs can improve low-income children's educational outcomes.[60] State investments in quality early care and education programs can identify health and developmental issues, link families to necessary supports, and assure that those who care for infants and toddlers have the tools to stimulate early learning and development and ease transitions into the preschool and elementary years. States can work on reducing poverty among children by providing quality early education, but they need to ensure that children who need child care for a full day because their parents are working have access to quality full-day care.

It also is important to note that families' need for child care subsidies does not end when a child enters kindergarten. Families need access to quality, affordable after-school care and, in many cases,

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[57] "Who's Minding the Kids: Child Care Arrangements: Spring 2005," U.S. Census Bureau, http://www.census.gov/population/socdemo/child/ppl-2005/tab06.xls.

[58] "Parents and the High Cost of Child Care," National Association of Child Care Resource and Referral Agencies, http://www.naccrra.org/docs/press/price_report.pdf.

[59] "Valuing Families: The High Cost of Waiting for Child Care Sliding Fee Assistance," Greater Minneapolis Day Care Association,1995; Deborah Shlick, Mary Daly, and Bradford, Lee, "Faces on the Waiting List: Waiting for Child Care Assistance in Ramsey County," 1999; Casey Coonerty and Tamsin Levy, "Waiting for Child Care: How Do Parents Adjust to Scarce Options in Santa Clara County?," 1998; Philip Coltoff, Myrna Torres, and Natasha Lifton, "The Human Cost of Waiting for Child Care: A Study," 1999; "Use of Subsidized Child Care by Philadelphia Families," Philadelphia Citizens for Children and Youth, 1997; Jennifer Gulley and Ann Hilbig, "Waiting List Survey: Gulf Coast Workforce Development Area," 1999.

[60] See, for example, Eric I. Knudsen *et al.*, "Economic, Neurobiological, and Behavioral Perspectives on Building America's Future Workforce," Proceedings of the National Academy of Sciences, July 2006, http://www.developingchild.net/pubs/peer/Economic_Neurobiological_Behavioral_Perspectives.pdf.

before-school care as well as summer activities to ensure that children have developmentally appropriate, safe, and enriching out-of-school experiences.[61]

Fostering Success in the Labor Market

Workers with higher skills have higher employment rates and higher earnings. States can take several steps to improve the skills of their workforce. As noted above, efforts should start with young children through the provision of high quality early care and education. But efforts should not end with children. Effective education and training programs can help low-skilled adults acquire skills in industries and occupations that need workers and that offer the prospect of better wages, opportunities for advancement, and stable employment.

There are several ways states can provide these opportunities for low-skilled adults, including: funding community colleges to develop occupational programs — including certificate granting programs — that begin with remediation for those without the standard prerequisite skills; improving English language and basic skills remediation programs so students can move to occupational training more quickly; revamping financial aid policies to ensure that part-time students (who are balancing work, family, and schooling) are eligible; providing supports, such as mentoring, to help those combining study, work, and child-rearing to help navigate problems that may arise; and creating financial aid packages that help students with not only tuition costs, but also costs for room and board, child care, and transportation.[62]

[61] For more information on quality out-of-school time programs, see "Expanding Learning Opportunities: It Takes More than Time," Afterschool Alliance, September 2007. http://www.afterschoolalliance.org/issue_briefs/issue_expand_learn_29.pdf.

[62] This brief discussion draws on the work of Julie Strawn and Amy-Ellen Duke at the Center for Law and Social Policy. See, "Overcoming Obstacles, Optimizing Opportunities: State Policies to Increase Postsecondary Attainment for Low-Skilled Adults," Center for Law and Social Policy, March 2008, http://www.clasp.org/publications/bbtpolicyoverview.pdf.

VI. Conclusion

Over the two decades since the late 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 seen their incomes grow only slowly. This has widened the gap in income between high-income families and poor and middle-class families.

The trend of growing inequality accelerated during the most recent expansion — the period between the late 1990s and the mid-2000s. On average, the incomes of the families at the bottom of the income distribution declined and the incomes of those in the middle stagnated. In contrast, the incomes of the richest fifth of families climbed over the past decade.

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.

METHODOLOGICAL APPENDIX

The Data Source: Census Bureau Annual Social and Economic Supplement

The data source for this analysis is the Bureau of the Census' Annual Social and Economic Supplement, formerly called the March Current Population Survey (CPS) — a survey of a nationally representative sample of households conducted every year. Each March, approximately 75,000 households (earlier years had smaller samples) are asked questions about their prior year's income (the income data in the 2006 March CPS refers to 2005). The survey provides information on family income from a wide variety of sources, including not only wages and salaries, but also other sources of cash income such as interest income, child support income and cash benefits such as Social Security, veterans' assistance, and public assistance payments.

In addition to cash income, the Census Bureau provides an extensive set of imputations of variables needed to take a more comprehensive look at income trends. These include Census estimates of families' income tax liabilities and credits, payroll taxes, realized capital gains and losses, and the value of cash-like benefits including food stamps, school lunch subsidies, and housing assistance. Other than capital gains, we use these variables to construct the income measure on which we focus most closely: post-tax and -transfer income. We do not, however, include the imputed cash value of publicly-provided health care benefits, like Medicare and Medicaid, because of the lack of a generally accepted method for accounting for medical benefits or expenditures.

Capital gains or losses—the returns or losses from the appreciation or depreciation of capital assets—are largely received by high-income families, so are an important component of income inequality. The Census Bureau does not ask surveyed households directly about capital gains but uses a predictive model to impute capital gains. In prior versions of this report, we included those imputations in our analysis. However, a few years ago, the Bureau began experimenting with a new model to impute capital gains and losses. We found the results to be implausible, yielding levels of gains that are far below prior years' results (and far below administrative benchmarks, such as IRS data). In addition, the results showed an implausibly large surge in capital gains going to low-income households in 2006 (the Census capital gains estimates for families below twice the poverty line were approximately 100 times larger than in the year before). Since these changes appeared to introduce a

large bias into the analysis, we chose to exclude capital gains altogether. Had we been able to include a consistent measure of capital gains, the results in each of our study periods would have shown even greater inequality than they do.

The Census data are affected by other limitations, including underreporting. Surveyed households tend to underreport certain types of income. Some of the most underreported income sources, such as public assistance payments, go disproportionately to the poorest households. Others, such as dividends, go disproportionately to wealthy families. It is unclear how underreporting affects our measures of inequality on balance.

In order to have enough cases to generate reliable estimates of income by quintile by state, we pool data for three consecutive years.

Top Coding

Another challenge with using these data for inequality analysis relates to topcoding. In the data files that the Census Bureau makes available to researchers, income is top-coded (that is, the highest amounts are replaced with capped or average amounts) to protect the identity of the wealthiest Americans. In earlier reports, we used a common method—Pareto imputation—to impute the average value of relevant variables above the top-code ceiling (as discussed below, we again used this method for wage and salary income for the 1987-89 data). But starting with the 1997 data, and thus covering the latter two time periods in our study, Census now provides the actual average values above the topcodes for the key income sources in our study. This enables us to calculate reliable averages for the richest fifth (or 5 percent) of American families, including the top-coded families, without resorting to our own imputations. Note that only a very small share of families, typically fewer than 1 percent, have income levels above the topcode.

We still, however, had to adjust data from our first period, 1987-89, to be comparable to the later years. For interest, dividend, and rental income, our method was to mimic the recent Census approach by estimating average income values for families in the top-coded range. To derive these averages, we used published income tables generated by the Census Bureau from their internal data files, which include values above those on the top-coded public-use files. (The Bureau's internal files are top-coded too, but the topcodes are much higher than in the public use files.) To do so, we first deflated the Census Bureau's current top-code cutoffs for these variables to 1987, 1988, and 1989 dollars. Then, using the micro data for those years, we computed the amount of aggregate income below these cutoffs and subtracted this from the "true" aggregate income levels for each income source derived from published tables. This gave us the aggregate totals above the top-code, which we divided by the number of families with that type of income to obtain average values for top-coded families analogous to those provided by Census for more recent years.

As noted, for wage and salary income, we judged this method to be too crude. For example, the method relies on only one average for everyone with that type of income (whereas, using their internal files, the Census produces about twelve different values, which vary based on gender, work status, and race). We judged this to be acceptable for non-labor income, but not for wage and salary income, where the use of one plug-in would have misrepresented important differences between men and women, as well as differences between states.

Thus, for wage and salary income, we again used the Pareto method based on the assumption that the tails of these distributions follow a Pareto distribution.[63] Since the upper tails of empirical earnings distributions closely follow the general shape of the Pareto, this imputation method is commonly used for dealing with top-coded data. The estimate uses the shape of the upper part of the distribution (in our case, the top 20 percent) to extrapolate to the part that is unobservable due to the top-codes. Intuitively, if the shape of the observable part of the distribution suggests that the tail above the top-code is particularly long, implying a few cases with very high income values, the imputation will return a high mean relative to the case where it appears that the tail above the top-code is rather short.

We made these imputations for both genders across three different geographical areas. For the areas, we sorted the states by share topcoded and divided them into thirds (any finer division would have yielded sample sizes too small for accurate imputation). We then plugged these means (available from authors) into the relevant cases above the top codes.

Assigning Households to Quintiles

For each time period, all families are ranked by income adjusted for family size. Researchers use various methods to make such an adjustment; we choose to follow the practice of the Congressional Budget Office and divide income by the square root of family size. This method creates a so-called "equivalence scale" designed to make incomes across families of different sizes more comparable. For example, with no adjustment a family of four with $40,000 is assumed to be just as well-off as a single individual with that same income level. But with the adjustment, the individual is actually considered to be twice as well off as the four-person family (because $40,000 divided by the square root of 4 is $20,000; while $40,000 divided by the square root of 1 is $40,000 or twice as much).[64] Using these adjusted cutoffs, we then use average income of families in each quintile to calculate the values shown in the report.

Since family size can differ by income level, we structure the analysis such that quintiles each contain the same number of persons, not the same number of families.

The income data presented in this report are adjusted for inflation to reflect 2005 dollars. The adjustment was made using the Consumer Price Index Research Series (CPI-RS). This series adjusts the historical CPI-U from 1978 to 2005 to include improvements made to the CPI over that time period. The CPI-U shows higher inflation than does the CPI-RS across the entire post-1978 time period, however, the difference in the growth rates was largest prior to 1982. The use of the CPI-RS rather than the CPI-U will not affect estimates of income inequality within each time period.

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[63] The Pareto distribution is defined as c/(x^(a+1)) where c and a are positive constants which we estimate using the top 20 percent of the empirical distribution (more precisely, c is a scale parameter assumed known; a is the key parameter for estimation).

[64] A single individual is used in this example for ease of understanding. Note that this study includes only families of two or more persons.

APPENDIX TABLE: AVERAGE INCOMES OF FIFTHS OF FAMILIES IN '87-89 THROUGH '04-'06, BY STATE (2005 DOLLARS)							
	Bottom 20 %				2nd 20 %		
State	**87-'89**	**98-'00**	**04-'06**		**87-'89**	**98-'00**	**04-'06**
Alabama	12,574	16,070	13,280		23,489	31,419	28,184
Alaska	17,878	22,841	21,086		35,509	40,111	39,348
Arizona	15,931	17,513	16,744		29,546	31,402	30,728
Arkansas	12,005	15,975	15,628		22,168	28,392	27,742
California	16,386	18,057	18,312		31,413	32,669	34,500
Colorado	15,809	21,764	20,341		30,975	40,547	38,033
Connecticut	25,570	22,505	21,133		45,168	42,629	43,551
Delaware	18,968	19,932	20,367		35,441	37,815	37,153
Florida	15,102	17,441	17,436		28,235	31,760	31,802
Georgia	14,821	17,359	17,188		29,635	31,473	32,111
Hawaii	20,860	20,730	23,328		38,264	37,936	42,947
Idaho	15,567	18,383	19,708		27,613	30,591	33,091
Illinois	16,213	19,928	18,340		32,977	37,861	36,289
Indiana	16,099	20,753	17,635		29,094	36,995	34,952
Iowa	16,446	19,387	18,817		29,463	34,645	36,797
Kansas	18,074	18,782	18,807		32,849	34,192	34,808
Kentucky	13,388	15,862	14,318		24,866	31,053	28,931
Louisiana	11,687	14,046	15,555		22,738	27,502	28,411
Maine	16,430	18,622	18,302		30,364	34,149	34,752
Maryland	20,145	23,247	21,952		39,331	45,012	42,924
Massachusetts	20,285	19,802	20,609		40,700	39,051	42,320
Michigan	16,469	20,163	17,934		33,920	38,204	35,320
Minnesota	17,703	23,283	23,343		33,773	43,701	43,416
Mississippi	11,540	15,519	14,205		21,093	28,185	25,906
Missouri	15,978	18,636	17,722		29,153	37,045	33,366
Montana	14,613	15,812	16,439		26,019	28,660	30,686
Nebraska	16,765	19,237	19,919		30,082	35,994	37,068
Nevada	18,494	19,525	19,730		31,919	33,880	34,698
New Hampshire	22,353	22,882	24,175		41,068	40,875	45,187
New Jersey	21,066	22,202	23,260		42,585	42,511	45,080
New Mexico	12,867	14,555	14,798		23,251	26,674	28,176
New York	16,225	16,878	17,107		32,341	33,123	33,567
North Carolina	14,961	16,123	16,436		28,048	31,386	31,141
North Dakota	16,210	17,112	19,188		29,747	30,313	34,654
Ohio	16,431	18,446	18,337		31,680	35,511	34,736
Oklahoma	13,812	16,487	16,909		25,514	31,071	30,386
Oregon	16,910	17,952	18,515		31,072	33,633	33,647
Pennsylvania	17,522	20,241	18,960		31,831	36,414	35,589
Rhode Island	19,966	20,247	18,974		36,521	38,127	37,918
South Carolina	15,094	18,160	15,932		27,260	32,807	30,306
South Dakota	14,749	19,987	18,025		27,878	34,758	33,621
Tennessee	13,263	16,337	14,129		24,447	29,734	29,710
Texas	13,430	16,374	16,088		26,323	30,130	30,076
Utah	19,008	22,747	21,721		32,326	39,375	38,186
Vermont	17,924	18,849	21,168		33,002	35,433	39,492
Virginia	17,060	20,992	20,401		34,599	37,935	38,517
Washington	18,525	20,397	19,545		34,194	38,556	37,477
West Virginia	12,476	15,089	13,941		23,386	27,460	27,972
Wisconsin	18,704	20,553	20,073		34,949	38,630	37,372
Wyoming	18,105	18,116	18,296		33,154	32,533	35,562
District of Columbia	13,672	14,709	14,011		28,392	28,961	28,170
Total U.S.	**16,303**	**18,575**	**18,116**		**31,067**	**34,597**	**34,450**

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

APPENDIX TABLE: AVERAGE INCOMES OF FIFTHS OF FAMILIES IN '87-89 THROUGH '04-'06, BY STATE (2005 DOLLARS) CONT'D							
	Middle 20 %				4th 20 %		
State	**87-'89**	**98-'00**	**04-'06**		**87-'89**	**98-'00**	**04-'06**
Alabama	34,668	44,674	43,445		48,602	61,504	61,303
Alaska	53,525	57,632	58,503		74,608	75,364	78,649
Arizona	41,529	44,547	44,319		56,962	62,494	63,209
Arkansas	31,925	38,616	40,533		44,344	52,793	55,924
California	46,580	49,092	50,981		62,860	69,236	74,396
Colorado	43,449	55,042	55,933		60,759	74,056	76,979
Connecticut	60,624	62,520	63,728		75,862	84,250	86,248
Delaware	47,008	52,417	52,419		61,704	71,622	72,108
Florida	40,236	45,352	47,062		56,098	62,402	67,092
Georgia	43,643	46,209	47,782		59,319	62,953	67,061
Hawaii	54,477	56,391	61,130		71,835	77,226	82,432
Idaho	36,595	44,429	46,309		49,985	58,176	62,438
Illinois	47,522	55,076	53,447		63,076	72,492	73,378
Indiana	41,604	49,695	48,364		54,678	63,403	65,553
Iowa	41,444	48,198	50,043		53,041	62,822	66,048
Kansas	44,635	49,358	50,410		57,806	66,416	68,675
Kentucky	36,186	44,646	42,064		50,122	63,105	60,816
Louisiana	36,644	39,465	41,755		52,020	58,332	61,428
Maine	42,624	46,110	49,551		56,035	62,260	65,667
Maryland	55,948	63,661	62,860		71,747	81,528	86,319
Massachusetts	56,597	58,686	65,783		74,777	78,456	89,275
Michigan	47,573	55,042	51,758		63,263	72,266	71,256
Minnesota	46,603	59,613	59,677		61,268	75,177	77,623
Mississippi	32,453	40,563	39,924		46,142	57,444	58,426
Missouri	42,245	51,105	48,266		56,375	65,126	65,660
Montana	37,253	40,935	42,266		49,552	55,067	56,179
Nebraska	40,810	49,202	51,633		52,929	65,627	67,412
Nevada	42,494	48,016	50,207		56,754	65,776	66,368
New Hampshire	53,388	58,433	61,923		66,944	74,757	79,913
New Jersey	58,957	61,454	67,308		75,743	82,995	90,638
New Mexico	33,722	39,062	41,797		46,360	54,928	59,993
New York	48,097	50,378	52,080		65,903	70,925	73,098
North Carolina	41,453	45,754	45,432		55,230	63,470	62,651
North Dakota	40,733	43,590	50,070		51,082	58,165	64,471
Ohio	45,031	51,517	49,051		59,412	67,710	68,209
Oklahoma	37,600	42,346	41,857		53,874	59,880	58,915
Oregon	44,012	47,856	47,685		54,385	63,965	67,457
Pennsylvania	44,374	51,556	51,764		59,080	69,513	71,110
Rhode Island	49,713	56,229	56,457		64,711	75,202	78,544
South Carolina	40,126	45,888	44,252		54,220	63,063	59,640
South Dakota	38,573	45,762	48,669		48,914	60,704	63,967
Tennessee	37,054	43,268	43,667		51,193	59,780	60,686
Texas	40,046	44,016	44,574		56,676	63,214	64,197
Utah	41,168	52,020	51,477		54,926	67,756	67,455
Vermont	46,123	48,520	55,054		59,492	63,482	71,268
Virginia	50,531	56,301	57,233		71,026	75,330	80,439
Washington	48,117	52,496	53,783		62,566	70,567	74,291
West Virginia	33,232	37,671	40,976		45,558	54,226	55,507
Wisconsin	46,706	53,576	53,288		60,614	70,643	69,512
Wyoming	46,955	44,865	50,674		60,313	58,782	66,190
District of Columbia	44,619	43,782	44,894		65,839	72,362	76,175
Total U.S.	**44,650**	**49,785**	**50,434**		**60,078**	**67,791**	**70,256**

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

APPENDIX TABLE: AVERAGE INCOMES OF FIFTHS OF FAMILIES IN '87-89 THROUGH '04-'06, BY STATE (2005 DOLLARS) CONT'D							
	Top 20 %				Top 5 %*		
State	**87-'89**	**98-'00**	**04-'06**		**87-'89**	**98-'00**	**04-'06**
Alabama	79,043	102,898	112,804		n/a	n/a	178,770
Alaska	111,226	130,396	130,740		n/a	n/a	196,633
Arizona	100,662	109,796	121,116		n/a	n/a	199,301
Arkansas	74,346	93,817	100,280		n/a	n/a	157,007
California	106,255	128,587	145,358		153,929	201,397	243,386
Colorado	92,954	128,227	142,181		n/a	n/a	235,134
Connecticut	116,939	148,725	169,378		n/a	n/a	312,954
Delaware	91,044	117,766	116,110		n/a	n/a	172,735
Florida	94,887	113,341	130,840		141,786	180,439	220,373
Georgia	96,262	108,034	115,071		n/a	n/a	174,387
Hawaii	110,574	125,380	135,525		n/a	n/a	208,750
Idaho	79,426	103,654	110,274		n/a	n/a	175,641
Illinois	102,470	125,131	138,011		148,934	196,934	233,664
Indiana	85,822	110,538	118,078		n/a	n/a	186,532
Iowa	77,153	108,210	115,187		n/a	n/a	180,340
Kansas	90,207	113,819	127,963		n/a	n/a	211,362
Kentucky	78,025	111,817	110,353		n/a	n/a	173,392
Louisiana	92,381	99,178	113,499		n/a	n/a	182,113
Maine	89,329	108,609	115,720		n/a	n/a	180,973
Maryland	108,783	151,725	159,456		n/a	n/a	269,609
Massachusetts	117,029	140,622	168,991		163,783	222,802	310,440
Michigan	99,576	129,236	126,264		139,094	206,060	205,893
Minnesota	92,896	128,163	139,989		n/a	n/a	236,758
Mississippi	78,595	95,209	117,454		n/a	n/a	205,526
Missouri	93,830	113,099	126,619		n/a	n/a	229,088
Montana	76,362	89,160	94,444		n/a	n/a	146,484
Nebraska	82,975	108,863	116,171		n/a	n/a	180,703
Nevada	88,344	114,974	123,815		n/a	n/a	199,958
New Hampshire	101,221	132,432	134,867		n/a	n/a	207,180
New Jersey	120,854	153,184	175,011		171,680	257,459	327,628
New Mexico	86,434	91,571	118,608		n/a	n/a	203,268
New York	109,511	134,162	148,192		154,567	216,769	262,679
North Carolina	88,104	111,658	118,259		125,102	174,819	197,331
North Dakota	76,872	97,679	119,804		n/a	n/a	199,990
Ohio	92,421	119,705	114,353		129,848	187,734	174,026
Oklahoma	88,143	110,212	123,596		n/a	n/a	213,565
Oregon	87,052	118,860	127,248		n/a	n/a	219,448
Pennsylvania	95,446	122,832	130,968		136,141	190,541	216,216
Rhode Island	99,773	131,855	143,211		n/a	n/a	246,008
South Carolina	90,321	101,986	107,378		n/a	n/a	172,603
South Dakota	78,854	101,736	113,623		n/a	n/a	197,902
Tennessee	86,758	116,129	114,396		n/a	n/a	196,083
Texas	93,846	116,153	126,658		132,137	189,362	211,038
Utah	83,573	111,528	117,662		n/a	n/a	175,677
Vermont	92,546	113,200	126,504		n/a	n/a	207,541
Virginia	109,942	137,139	154,259		n/a	n/a	270,148
Washington	94,930	119,954	134,090		n/a	n/a	218,455
West Virginia	73,378	94,541	103,911		n/a	n/a	165,619
Wisconsin	88,840	118,226	120,440		n/a	n/a	198,767
Wyoming	87,351	99,588	108,553		n/a	n/a	167,293
District of Columbia	120,636	170,952	188,541		n/a	n/a	366,631
Total U.S.	**97,104**	**121,087**	**132,131**		**138,093**	**191,658**	**220,700**

*n/a signifies that the state did not have sufficient observations in the Current Population Survey to allow for the calculation of reliable estimates of average income.

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