

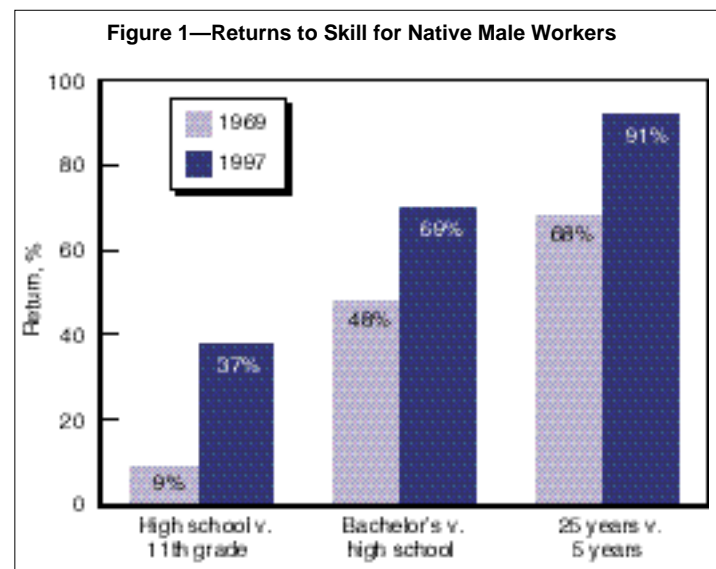
Income Inequality in the Golden State: Why the Gap Has Widened Between Rich and Poor

In 1996, PPIC published the most comprehensive report to date on income inequality in California. In *The Distribution of Income in California*, Deborah Reed, Melissa Glenn Haber, and Laura Mameesh show that income inequality has risen sharply in the state over the past two decades and that it has grown faster in California than in the nation as a whole. The growing gap between the rich and the poor in California results not only from rising income among the well-off but also from a substantial decline in income among those in the mid- to lowest levels of the income distribution. Between 1969 and 1997, real (inflation-adjusted) wages for male workers grew 13 percent for those in the 90th percentile of the income distribution and fell by about 40 percent for those in the 25th percentile (that is, the percentile at which 25 percent of workers have lower earnings and 75 percent have higher earnings).

Because this trend has persisted and has been relatively unresponsive to economic upturns, it appears unlikely that the situation will correct itself through economic growth. However, if policymakers are to address the problem, they must first understand its underlying causes. That is the purpose of a follow-up study by Deborah Reed, *California's Rising Income Inequality: Causes and Concerns*. The study identified two leading causes of the widening income gap in California: rising returns to skill and immigration.

Effects of Returns to Skill

Returns to skill measure the difference in earnings between more-skilled and less-skilled workers. In the study, skill was defined in terms of years of schooling and years of work experience. Figure 1 shows how returns to skill have changed over time for U.S. born, male California workers. (The study focused on male earnings because trends in male wages reveal labor market realities generally, without the complicating effects of rising labor force participation, as in the case of female wage trends.) In 1969, a native male with



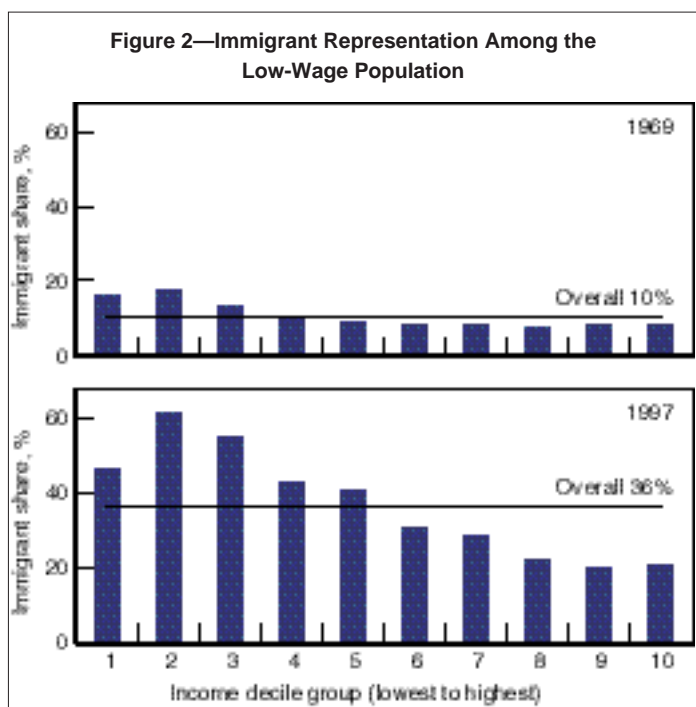
In 1969, a worker with a high school diploma earned 9 percent more than a similar worker who had no diploma. By 1997, the difference had increased fourfold, to 37 percent.

a bachelor's degree earned almost 50 percent more than a similar worker who had only a high school diploma. By 1997, the return to a bachelor's degree had increased to nearly 70 percent. The returns to experience have also grown over the past 30 years. In 1969, a native worker with 25 years of experience earned 68 percent more than a native worker with five years of experience, and by 1997 he was earning 91 percent more.

Like the increase in income inequality, the change in returns to education results more from falling wages for men at the bottom of the distribution—in this case the education distribution—than from increases for men at the top. Between 1969 and 1997, mean weekly wages for native males with 15 years of labor market experience and no high school diploma declined by one-third, falling from \$750 to about \$500. Mean wages for similar native males with a bachelor's degree remained fairly stable at about \$1,200.

Effects of Immigration

Immigration contributed to rising income inequality in the state because the proportion of immigrants in the state's male workforce has grown substantially and has grown most at the bottom and lower-middle of the income distribution. Figure 2 shows the proportion of immigrants in the male workforce for each of 10 equal wage categories, ranging from the lowest 10 percent of male weekly earnings to the highest 10 percent. The horizontal line over the bars represents the share of immigrants in the overall male workforce. If immigrants were evenly divided across all 10 income categories, the bar would rest evenly on top of all 10 income bars; but as the figure shows, the lowest income groups have the largest proportion of immigrants. In 1969, immigrants accounted for 10 percent of the overall male workforce and close to 15 percent of the workers in the three lowest wage groups. Between 1969 and 1997, the share of immigrants in the male workforce rose to 36 percent, but this growth was concentrated in the lower half of the wage scale. This growing overrepresentation of immigrants in the bottom categories has contributed strongly to rising income inequality in California.



Between 1969 and 1997, immigrants grew from 10 percent to 36 percent of California's male workforce. Much of this growth occurred at the lower end of the wage scale.

Summing Up the Causes

Of the factors examined in this study, rising returns to skill and immigration account for 44 percent of the rising income inequality in California. The study found slight effects for two other factors: Changes in native education, age, and race (6 percent) and changes in industrial structure (4 percent).

Taking into account all of the factors examined, the analysis explains about 54 percent of the growth in the state's income inequality. Other causal factors could not be observed in the data. These factors include such things as the individual characteristics of people (for example, basic skills and special training) and the individual characteristics of jobs (for example, scope of responsibilities).

Policy Considerations

This study makes it clear that the poor in California have been losing income ground steadily, in good economic times and bad, since the late 1960s. Given the trends and the causes the study has identified, it seems reasonable to anticipate continuing substantial income inequality in the state's future. This likelihood raises concerns about the well-being of the poor, about equal opportunity, and about social consequences. The absolute well-being of the poor becomes a major issue when real male earnings at the 25th percentile have dropped by 40 percent over three decades. As incomes at the median level and below continue to slide, should we be more concerned about equal opportunity? If the earnings of the lower half are dropping inexorably as the earnings of the top rise, what will that do to the social fabric?

The study suggests several policy directions related to the major identifiable causes of income inequality. Given the finding that rising returns to skill increased inequality not so much because the wages of college graduates rose but because the wages of workers with a high school diploma or less fell so sharply, it is not surprising that most of the policy suggestions involve education and training—improve the opportunity to finish high school and enter college, improve K–12 education and training for those who do not go to college, and actively promote the economic progress of immigrants and their children through education and training. Finally, it is important that national and state leaders consider how policies focused on promoting growth and economic efficiency (for example, technological change and international trade) may affect income inequality.

This research brief summarizes a report by Deborah Reed, California's Rising Income Inequality: Causes and Concerns. The report may be ordered by calling (800) 232-5343 [mainland U.S.] or (415) 291-4415 [Canada, Hawaii, overseas]. The full text is also available on the Internet (www.ppic.org). The Public Policy Institute of California is a private, nonprofit organization dedicated to independent, nonpartisan research on economic, social, and political issues affecting California.