Applied economics professor Jay Coggins of the University of Minnesota

Does income inequality retard economic growth, reduce competitiveness?

A Civic Caucus Focus on Competitiveness Interview

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Present

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Summary

Economic inequality in Minnesota and the United States continues to grow, says Jay Coggins of the University of Minnesota. He co-authored a 2013 Growth and Justice report that makes the case that those at the very top of the income scale are pulling away in income growth, while middle-class income stagnates and poverty rates increase. Coggins argues that current levels of income inequality threaten overall economic growth, both nationally and in Minnesota.

Minnesota is richer in income than the national average and has less income inequality than the U.S. as a whole, according to Coggins. But that advantage is slipping. He notes that there are counties in Minnesota where inequality is as high as in Mississippi, which is among the most unequal states in the country. Minnesota's state and local taxes are more regressive than federal taxes, but less regressive than most other states' taxes.

Coggins argues that part of the job and skills mismatch problem that helps contribute to income inequality is due to inadequate financial support for the preK-12 school system. And he contends that the corporate world could help the middle 80 percent of people (by income) by once again paying for on-the-job training for its employees.

Coggins and his report co-authors conclude that increases in inequality are not inevitable. They recommend development of an "Economic Inequality Impact Assessment" to determine the economic inequality impact of new government policies, legislation or regulations before they go into effect.

Biography

Jay Coggins is a Distinguished University Teaching Professor in the Department of Applied Economics at the University of Minnesota, where he joined the faculty in 1995. He is also policy fellow at Growth & Justice , a research and advocacy organization whose mission is to make Minnesota's economy simultaneously more prosperous and fair. He is co-author of the 2013 Growth & Justice report *Widening Economic Equality in Minnesota: Causes, Effects, and a Proposal for Estimating Its Impact in Policymaking.*

Before coming to Minnesota, Coggins was on the faculty at Montana State University and the University of Wisconsin-Madison.

Coggins' expertise includes agricultural policy, air and water pollution, common property resources, environmental policy and regulation, and poverty and welfare. His current research includes studies on market-based pollution control, option value of natural resources, equity-respecting economic policy and dynamic policy analysis. Among his recent publications are papers appearing in the following publications: *Journal of Environmental Economics and Management, Public Choice, Social Choice and Welfare, and the International Economic Review.*

He received his PhD in Agricultural and Applied Economics from the University of Minnesota in 1989, where he also earned an M.S. degree in 1985. He holds a B.S. in Animal Science from the University of Wisconsin-River Falls.

Background

Jay Coggins is co-author, with Thomas Legg and Dane Smith, of *Widening Economic Inequality in Minnesota: Causes, Effects, and a Proposal for Estimating Its Impact in Policymaking* , a 2013 report of Growth & Justice , a research and advocacy organization whose mission is to make Minnesota's economy simultaneously more prosperous and fair.

The report makes the case that economic inequality in Minnesota and the United States continues to widen, as those at the top pull away in income growth, while middle-class income stagnates and poverty rates increase. The authors support the view that, due to inequality increases over the last 30 years, current levels of income inequality have crossed a threshold, so that the inequality threatens overall economic growth. Comparing measures of economic inequality among counties and among selected high-income countries, they conclude that recent and future increases in inequality are not inevitable and that we could reduce inequality in the future.

The authors recommend development of an "Economic Inequality Impact Assessment," a systematic assessment of a new policy's economic inequality impact. This assessment would then be required at all levels of government in Minnesota before passage of economically significant legislation, implementation of new regulations affecting inequality, or other policy decisions that could further exacerbate inequality. The inequality assessment would be similar to Environment Impact Statements required before decisions are made on pending development projects or policies with possible negative environmental effects.

Discussion

The richest people in the U.S. and in Minnesota are getting richer and richer. According to Jay Coggins of the University of Minnesota, data from the World Top Incomes Database, which is based on Internal Revenue Service (IRS) tax-return data going back to 1913, shows that the top 10 percent of income-earners have achieved only modest income gains over the past 30 years. But the top one percent of income-earners are pulling away from the rest of the top 10 percent; the top 0.1 percent are pulling away from the rest of the top one percent; and the top 0.01 percent are pulling away from the rest of the top 0.1 percent.

Coggins said French economist Thomas Piketty's book on wealth inequality, *Capital in the Twenty-First Century* (2014), shows his concern about the effect of this inequality on the future of democratic, capitalist societies. Piketty points out that the level of economic inequality is, in Coggins' words, "an unsustainable situation that could lead to very bad outcomes geopolitically."

Income inequality in the U.S. has risen from 1967 to 2011. An important and widely used measure of inequality, the Gini coefficient , shows that income inequality has increased by roughly 14 percent over that time period. Meanwhile, the share of all income flowing to the richest one percent of Americans has more than doubled since 1978, from nine percent then to over 22 percent in 2013.

Wealth inequality nationally is even greater than income inequality . The richest one percent owned 24 percent of U.S. wealth in 1978, but by 2013 that share had risen to 40 percent.

Since 1979, Census data show that the people who've benefited the most in income growth rate are the richest in income, while the bottom 20 percent are actually worse off.

Economies with less income inequality grow faster; as income disparity grows, the overall economic performance (measured by growth in GDP) is degraded.

The U.S. has higher income inequality than most other *developed* countries, but inequality is much higher in *developing* countries than in the U.S. Coggins commented that Brazil and China have terrible problems with inequality, even though the average income in China is growing rapidly.

There is evidence that inequality in the U.S. is keeping the middle class stagnant and dragging down GPD.

Minnesota is richer in income than the national average and has less income inequality than the U.S. as a whole. Coggins said the measure of inequality shows that Minnesota has less net income inequality than the nation as a whole. Even so, there are counties in Minnesota where inequality, measured by the Gini coefficient, is as high as in the state of Mississippi, among the most unequal states in the country.

Poverty in Minnesota is below the national average. According to the report, in 2011, 15 percent of all Americans, or a record 46.2 million, lived below the poverty line. That compares to 10 percent of all Minnesotans, or about 500,000, living below the poverty line. Poverty rates both nationally and in Minnesota declined from 1995 to 2000, but have increased since then.

Minnesota compares favorably to the country as a whole in income, inequality and poverty, but the advantage is slipping . Minnesota's median household income remains higher than the national average, but much of that relative standing has disappeared since 2000. The state's median income is declining and inequality is rising both absolutely and relative to other states. Over the last 10 years, Minnesota has fallen from ninth lowest to 13^{th} lowest in income inequality. Our poverty rate has worsened from third lowest to 11^{th} lowest.

Compared among states nationally and among counties in Minnesota, income inequality is highest where median household income is lowest. Coggins pointedout that there is a lot of poverty in many northern Minnesota counties, partnered with high levels of inequality. But he agreed with an interviewer that many Minnesota counties with strong agricultural economies have moderate to high incomes and less inequality.

Adjusted for inflation, U.S. median household income has risen by about eight percent over the last 30 years and has actually fallen since 2000. Median income in Minnesota has risen more, by about 19 percent. But the drop since 2000 has been greater as well.

The standard explanation for why inequality has gone up, globalization and skills-based technological changes, does not explain why the U.S. stands almost alone among developed countries in its rapid raise in inequality.

When taxes and transfers are taken into account, income inequality in many countries is generally lower. Coggins said after taxes and transfers, though, income inequality in the U.S. "hardly budges," while it decreases significantly in France. He noted that the U.S. federal income tax is progressive, while all other U.S. taxes tend to be regressive.

The total effective tax rate in 2009 in the U.S. (including all federal, state and local taxes together) starts at 16.0 percent for the lowest 20 percent in income and keeps going up to 28.5 percent for the 60^{th}-to-80^{th} percentile income group. Then the effective tax rate going through the highest 20 percent in income flattens off somewhat, with the rate reaching 31.6 percent for the 95^{th}-to-99^{th} percentile income group. The effective tax rate then actually decreases to 30.8 percent for the top one percent income group.

Minnesota state and local taxes are more regressive than federal taxes and most other states' taxes are more regressive than Minnesota's; Washington State is the most regressive. Coggins said after state deduction of the federal income tax, the share of family income going to pay state and local taxes in Minnesota is 8.8 percent for the lowest 20 percent income group. It increases a bit to 9.6 percent for the 20^{th} to 40^{th} percentile income group and stays at that same level for the 40^{th}-to-60^{th} percentile group and the 60^{th}-to-80^{th} percentile group. The rates then start falling for the top 20 percent of income earners, reaching 6.2 percent for the top one percent income group.

For nonelderly taxpayers in Washington State, the share of income going to state and local taxes (after state deduction of the federal income tax) actually declines across the board as income levels increase, from 16.9 percent for the lowest 20 percent income group to 2.8 percent for the top one percent in income. There is no state income tax in Washington.

Several economists have recently proposed alternative solutions to economic inequality.

- **Thomas Piketty, author of the 2014 book *Capital in the Twenty-First Century* , proposes an internationally coordinated tax on wealth** . "Everyone else hates it," Coggins said, "both on the right and the left."

- **In his book *The Price of Inequality: How Today's Divided Society Endangers Our Future* (2012), American economist and Columbia University Professor Joseph Stiglitz recommends curbing excesses at the top and helping everybody else.** Coggins said Stiglitz "sees graft everywhere" and wants to rein in the financial sector, limit CEO pay and restore a meaningful estate tax. Stiglitz wants to help those not at the top, especially poor people, by improving access to education, strengthening social protection programs and removing barriers to unionization. He says improving the ablity of poor people to take risks will lead to a more vibrant economy.

- **Dean Baker, co-founder and co-director of the Washington, D.C.-based Center for Economic and Policy Research , recommends reducing the rents those at the top receive from government interventions and helping those at the middle and bottom of the economic ladder.** Coggins said Baker favors helping those at the middle and the bottom with a higher minimum wage and the reform of labor laws.

At least one study suggests inequality could affect the long-term competitiveness of Minnesota. Coggins noted that a 2010 PhD dissertation by Ramaprasad Rajaram at the University of Georgia looked at the effects of income inequality and poverty on economic growth, using 1980 and 2000 Census data from 3,072 U.S. counties. He found that counties with lower poverty rates in 1979 grew significantly more quickly in per capita income over the next 20 years. Similarly, the counties with less inequality in 1979 grew significantly more quickly than those with higher income inequality in 1979. He also found that the counties that grew more quickly between 1979 and 1999 had lower poverty rates and lower overall inequality at the end of the period.

Changes in corporate governance have led to sharp increases in CEO-to-worker compensation ratios since 1990, reaching a peak of 411.3-to-one in 2000. "It used to be unseemly to take this much money from the company," Coggins said.

Part of the job and skills mismatch problem stems from not enough financial resources going into the preK-to-12 school system. "I don't think we're doing enough to financially support our schools," Coggins said. "We're cutting off our nose to spite our face."

The corporate world could help the worker shortage and the middle 80 percent of people (by income) by reverting to paying for on-the-job training of its new and existing employees. Coggins said companies around the country no longer think they should have to take responsibility for training smart people for jobs and he wondered why that has changed.

Immigration turns out to have little effect on inequality and wages. Coggins said when immigrants come into an area, there is downward pressure on wages for immigrants already here, but little pressure on wages of Minnesotans who've been here longer. There is little effect on inequality.

We need to figure out how to create an environment where the right mix of jobs is available. Coggins asked whether we generate a better economy by producing a better-trained crop of students, which will make us more competitive, or by inducing people to create good jobs, causing the economy to grow and produce enough money to afford to fund the schools to get our students trained. "I think we have to do them simultaneously," Coggins said. "What policies can we adopt as a state to make those things happen?"

Using public funds or tax breaks to attract businesses and jobs to various communities or to the state can hurt the quality of schools, roads and other public services. "We give them tax breaks that hurt schools' budgets," Coggins said.

There are steps state government can take to assure more jobs in the middle and a better match between workers and opportunities.

1. Do more to protect people at the bottom from the risks they face. "That involves public services," Coggins said, "such as making sure people have health care, so one unfortunate incident doesn't devastate them; making sure single moms have access to affordable childcare; and generally protecting people from the risks endemic to the bottom.

2. Increase funding to schools. "I really regret that we're not spending more on schools," he said. "There are not enough resources. The dollars per pupil are down and the demands placed on schools are up."

The share of the economy (GDP) going into labor (i.e., compensation) is at a record low, while corporate profits are at a record high. Coggins said corporate profits now make up more than 10 percent of the economy. "Labor compensation and corporate profits have been diverging for about 12 years," he said. "The trend is pretty steady now. I don't understand why."

A number of policy recommendations for reducing inequality are aimed at people in the middle 80 percent of income. Coggins said it would help "an awful lot of people" if labor unions were allowed to be more effective, without right-to-work laws all over the country; if the minimum wage were higher; and if school funding were higher. He said those measures are aimed at the middle 80 percent.