An Analysis of the Impacts of Economic Growth on Income Inequality

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Introduction

An era of industrialization, a rise in monopolistic “captains of industry,” along with a surging disproportionate wealth distribution at never-before-seen levels–this was the Gilded Age of the 1920s. The coinage of the term “gilded” refers to the “golden” and luxurious life of industrial leaders contrasting with the overlooked, destitute conditions of the working class at the turn of the twentieth century. This income inequality has held continuity into the present day, even though the American economy has grown dramatically over time with increased industry diversification and employment opportunities. This result may strike one as odd, however, because if there is more money circulating in the economy, why is this additional supply not flowing into the hands of citizens in various classes and demographics? Why does it tend to flow to one specific demographic? This may even lead some to ask what the impact of economic growth is on income inequality.

Firstly, it is important to become familiar with the many terms that economists use to describe and measure economic growth and income inequality. Economic growth is most commonly measured in terms of gross domestic product (GDP) and gross national product (GNP). GDP refers to the total production of goods and services within a country’s borders, regardless of who owns the means of production. Furthermore, GDP is more commonly placed in real terms, or adjusted for inflation, rather than in nominal terms, or not adjusted for inflation. On the other hand, GNP refers to the total value of all the final products and services owned by a country’s residents, regardless of where the means of production are located. For instance, if a large clothing company owned by a U.S. millionaire does production overseas instead of in the US, its profits still contribute to the GNP of the U.S. The Gini index, also known as the Gini coefficient, is commonly used to measure a nation’s inequality as a whole, considering the distribution of wealth among a population. Understanding this, some economists and sociologists have considered the general trend and contrast between economic growth and income inequality levels during certain periods. As shown by the Gilded Age, economic growth has been associated with greater income inequality. Simultaneously, however, times of lower economic growth, like the early 1980s with rising inflation, the 2008 financial crisis, and the COVID-19 pandemic, had still seen rises in income inequality, with today’s inequality levels being as high as those of the Gilded Age, when the top 1% of households earned 20% of the national income (Saez). These comparisons revealed that there had to be another factor causing such disproportionate outcomes; they could not have been caused by economic growth alone. After compiling and analyzing data concerning the socioeconomic aspects of income inequality, it became clear that there is no one-way relationship between economic growth and income inequality. They are so interrelated that you cannot say one is the cause of the other. Rather, there is a consistency in which when more money enters the economy, regardless of phases of rapid or stagnant growth, income inequality increases when the distribution or redistribution of that circulating money is unequal. Factors that have tipped this disparity in favor of a wealthier demographic largely include historical social ills, federal tax policies, and lack of federal relief and welfare programs for lower-earning households.

Historical Social Ills Presenting Barriers to Minorities

Historical social ills, both racial and economic, in times of both rapid and slow economic growth, have prevented more equal distributions of circulating wealth from reaching the hands of minority groups. One of the key indicators of the U.S. economy's performance is the purchasing value of the dollar. However, when this value decreases and general prices begin to increase in a process called inflation, the demographics that tend to struggle the most are those of Black and Hispanic ethnicities. It is not a coincidence that these specific demographics are also the lowest-earning households in the U.S. and have been consistently discriminated against under systemic racism. In analyzing the history of specifically African Americans in an economic light, Matthew Johnston, a writer for Investopedia and professor of macroeconomics, explicitly states that "[t]here is a cross-state relationship between the Gini coefficient of land inequality in 1860 and the Gini coefficient of income inequality in 2000." Here, Johnston identifies the direct relationship of how the system of slavery prevented African Americans from having the means or opportunity to purchase land at a time when land and property, rather than investments and goods, were considered signs of wealth. Subject to systemic racism, African Americans could not hold any political power or voice, and thus could not change laws that prevented their demographic from owning land or even borrowing loans to purchase land. They were given access to virtually nothing due to their second-class status as slave property. Only a handful of slaves could manage to save enough money–if they received any, that is–to buy their way to freedom. On the other hand, White plantation owners in the South and White manufacturers in the North during the 1800s were able to prosper off of each other, gradually accumulating wealth in the early stages of the US. However, even after African Americans finally gained freedom and U.S. citizenship in the 1860s, almost a century after the country's founding, the perpetuity of racism in the form of sly, notorious Jim Crow laws, delayed the ability to economically mobilize and gain corporate representation (Siripurapu). Such laws included preventing Blacks from buying their own land, leading to the development of sharecropping, a system in which Blacks promised to give a share of their harvest in return for land and tools. However, this still did not equate to capital and furthered the Black-White income gap. While further analyzing the impacts of race on the wealth disparity beyond the 1800s and into the 1930s, Anshu Sirapurpu from the Council of Foreign Relations makes sure to acknowledge the (now illegal) policy of redlining, which prevented Black Americans from obtaining mortgages. This perpetuated further inequality in the form of "housing segregation and a disparity in home ownership, which is a major source of wealth." Here, Sirapurpu effectively points out that in a time when home ownership became the major indicator of wealth, Black Americans were set up to legitimately be lower-class citizens by being excluded from even considering housing opportunities. These effects are blatantly reflective of slavery restricting African Americans from accessing land when land itself was an indicator of wealth, placing White households at an advantageous and comfortable place to naturally become the country's top earners. This pattern flows into data taken by our economists today, as compiled by Inequality.org, where statistics show that to enter the top 10% of earners in their racial group, White families must earn $117,986, about twice the standard for Black families and 1.5 times the standard for Latino families (Ciluffo and Kochhar). This means that gaining some form of a lifestyle up to par with White Americans would take an additional amount of effort and time for past and present Black Americans.

The racial gap is just as wide for those of Hispanic-Latino descent, shifting perspective to the demographic economically affected by past policies on immigration and overall low wages.

Due to American gains in Texas and Mexico against the Mexican and Spanish governments, the U.S. opened its borders more freely to Latin America in the 1800s, resulting in floods of job-seeking immigrants looking for temporary work to support their livelihoods back home. This continued for decades, later gaining federal support in the 1942 Bracero Program, which allowed millions of these temporary laborers to gain seasonal labor contracts and work legally in the United States. However, increased use of machinery led to the sudden deactivation of this program in the 1960s, leaving a “lasting effect [that] included a large amount of undocumented…laborers in the U.S…[and] cheap labor from Mexico for the program's entire duration” (Johnston). Lack of citizenship for undocumented immigrants meant restrictions on education, insurance eligibility, and starting businesses, all of which are means of attaining social mobility. On top of these setbacks, Mexican laborers, who comprised a large demographic of Latino Americans, were considered “cheap labor,” as stated by Johnston. It is clear that these laborers and their descendants only gained income through low-paying, low-skilled jobs, while skilled labor was reserved for mainly White Americans with higher educations. However, in an interview with Pew Research Center sociologist Ziyao Tian, Tian addresses that as time has progressed, this domestic, low-skilled, cheap labor has been replaced by outsourced human capital and machinery, increasing unemployment and stagnating wage increases for many of these Latino American laborers. In fact, the Bureau of Labor Statistics saw a 5% unemployment rate for those of Hispanic or Latino ethnicity, being the second highest unemployed demographic in the U.S. just slightly below African Americans reaching a 5.3% unemployment rate as of January 2024. In comparison, those who identify as White experience a 3.4% unemployment rate, and further increasing the disproportionate rates is the 2.9% unemployment rate of those of Asian descent. Ultimately, historical social ills have caused detriment to the past and present economic livelihoods of Black and Hispanic Americans, perpetuating disproportionate distributions of wealth and causing further obstacles for these very demographics trying to overcome income inequality today.

Tax Policies

Tax policies such as income tax, marginal tax rates, and tax breaks that continue to favor the economic elite’s control over their wealth contribute to unequal wealth distributions in the US, regardless of whether those distributions occur in times of economic growth or slowdowns. The income tax we still use today was introduced in 1913, just following the Gilded Age. Representing the era that came before it, this policy had a facade of its own. Marketed as a way to bring wealth equality and promote equity for the lower classes, the income tax imposed on only the wealthiest was truly just to compensate for the lowering of tariffs and “did little to level the playing field between the rich and poor” (Johnston). Thus, whatever income managed to accumulate from the tax went directly to supply the needs of the government and was never redistributed to the communities who needed it most. This failure can be further analyzed in data depicting that in early 1928, America’s top 0.1% earned over two-hundred and five times the average income of the bottom 90%, and in 2007, the top 0.1% earned an even greater two-hundred twenty times the average incomes of the bottom 90% (Saez). With income tax failing to narrow the country’s wealth disparity not only today but also in the 1900s, a strong issue that has arisen is the need to cap the highest-earning incomes through marginal tax rates, an additional tax paid for every additional dollar earned as income. While explaining the effectiveness of these marginal tax rates, Johnston evaluates how by the time “the marginal tax rate was raised to 15% [significantly higher than its original 7%]...the top 1% share of income

began to drop, reaching a low of about 15% of total income [in the U.S.] in 1923." Here, Johnston shows a trend in which higher marginal tax rates encourage top earners to not accumulate an income above a certain level to avoid paying the additional tax, thus allowing for less money to be concentrated into the hands of an elite class. This government-issued reverse incentive effectively allowed for a descent in income inequality levels. The same relationship between marginal tax rates and income inequality applies to times when marginal tax rates are lowered. As Inequality.org researchers state in their analysis of the impact of the marginal tax rate on the economic divide, "Between 1979 and 2019, the richest 0.01 percent of households had a cumulative income growth rate of 507 percent…in 1979 [the marginal tax rate] was 70 percent, compared to just 37 percent today." Because the marginal tax rate had significantly been cut to almost half of what it was in 1979, the top 0.01% of households have been able to keep a larger portion of their income today than in years past, consequently allowing for the concentration of wealth to grow in the favor of their group alone. However, since the government imposes these additional tax policies on only higher-earning brackets, should these policies not be harming lower-earning households anyway? Looking in relative terms, the income tax and marginal tax rates imposed on exclusively the wealthy were only a very small proportion of the elite's total income, still leaving thousands, if not millions, for each high earner to spare. In contrast, any type of tax for the lower classes takes out a heavy percentage of their earnings. Applying this concept to more recent times, Inequality.org reports that the minimum wage is only 2.5 times greater than it was in 1988, almost forty years ago. In 2021 alone, real worker wages dropped 2%, while corporate profits (based on the S&P 500, one of the key indicators of the U.S. market's performance) soared to over 16%. Where is this additional profit going? It is going to the hands of the country's top-earning households, rather than lower-earning workers. How will policymakers today ensure that the redistribution of money in the U.S. economy reaches the needs of differing classes? This pattern perpetuates the fact that policies concerning tax breaks continue to support the wealthy. Explaining what it takes to stay in the top 1% of U.S. earners, financial writer and educator Mark Cussen reveals that "[t]he [top] 1% own more than 50% of…equity shares…[and] may get even richer if they…reinvest the money in investments that cater to rich investors." Here, Cussen illustrates the statistics in which stock ownership (following the general idea of high risk, high reward) allows for the wealthy to gain even more wealth through the highs of the volatile market. Even when there are economic slowdowns and these stocks lose value, the wealthy not only have enough money as a fallback, but they can also reinvest into equity ventures, like hedge funds, that double their investments. These investments are often unrealized gains, meaning they are simply profits based on increases in the share's value and are not taxed until they are realized, or sold. Being naturally exclusive to the wealthy based on starting price, only the wealthy can buy such large, profitable investments in the first place, while middle and lower classes receive the majority of their income from taxed wages and salary. These lax tax policies further the economic divide as wealthier demographics can retain most of their assets, giving only a small percentage of their large and often untaxed incomes, while taking out larger percentages of smaller but more commonly taxed incomes from the middle and lower classes.

Union Movements and Welfare Relief Programs

Federal policy again factors into income inequality by not redistributing the economy's increasing circulation toward union movements and welfare programs that have been proven to support lower-income households in economic endeavors. As compiled by Inequality.org's

report on the relationship between union presence and inequality by gathering data from the U.S. Bureau of Labor Statistics, it is shown that as unions decline, inequality becomes more extreme. For instance, when union membership was at its highest in 1945, with 33% of laborers involved with some union, the top 1% income share was 13%. However, today, union membership is at a low, with about 10% of laborers involved in unions, and the top 1% income share being 21.8%, reflective of Gilded Age levels. Although it is important to note that correlation does not equal causation, it is evident that there is some negative correlation between unions and income inequality. As shown throughout history, those in unions reaped the benefits of higher wages and a voice to propose legislative change and safer working conditions, including a limit on the hours one can work. Not only did laborers succeed in providing themselves with a path to income equality, but at some points in history, government funding towards relief and welfare programs also worked on behalf of workers. Directly supplementing the lowest-earning households and individuals through insurance, housing aid, food stamps, and more, welfare and relief programs successfully released the burden of affording basic necessities for struggling households. In fact, in 2016, the U.S. experienced a 12% drop in poverty levels with federal assistance implemented, with some of these programs including Medicare and Medicaid, Supplemental Nutrition Assistance Program (SNAP), and Trade Adjustment Assistance (TAA), a program for those unemployed due to increased imports (Rosen). Here, the federal government allocated the funds taken from the wealth of middle and higher-class citizens through tax and redistributed that wealth to what was necessary for lower-class demographics, like low-wage workers, recently unemployed populations, or non-health-insured families, thus boosting the lower-class and minimizing the inequality gap. However, according to Inequality.org, even though the trend of the income share for the top 1% has increased to its highest levels, poverty rates have relatively stayed the same, meaning that the wealthy are consistently keeping, or as some say “hoarding,” a considerable amount of their income, and whatever the government does receive from taxes only slightly funds welfare programs. Some condone this “hoarding” due to the implications of welfare programs. It is certainly true that government assistance in the form of physical goods, like food stamps through SNAP, acts as a “soft” credit, something akin to what many people know as in-kind donations, and this safety net allows for individuals and households to then focus on building income for non-subsistence expenditures that may boost their standards of living, such as the ability to move to a better neighborhood. Government assistance in the form of direct financial aid, however, such as TAA, not only diverts funds from other investments that may improve the country’s overall quality of life, such as technology and infrastructure, which in turn would create new jobs, but, as Foundation for Economic Education (FEE) economist Howard Baetjer Jr. points out in an article, may “diminish…self-sufficiency, since it leads more people to accept unemployment and production, since the productive potential of those people is not turned into goods.” This alternative perspective opens the question of whether or not income inequality can be reduced through immediate and direct financial distribution, which decreases poverty but also self-sufficiency, or through a longer-term process of distributing economic opportunities among lower classes, such as investing in jobs or funding more accessible higher education. What matters most is that the chosen path of distributing wealth effectively evens the playing field. The economists and policymakers of today and the future can look to the statistics of the past to determine the best methods.

Conclusion

Through the analysis of historical socioeconomic factors forming roots in the Gilded Age and leading up to present-day income inequality levels, it is clear that there is no direct relationship between economic growth and its impact on income inequality. Rather, the relationship is more nuanced and complex and is based on a variety of factors that have favored wealth distribution in the U.S. towards the hands of the economic elite. Such factors that have tipped this distribution in favor of the wealthy majorly include historical social ills, both racial and economic, federal tax policies, and lack of federal relief and welfare programs for lower-earning households. Will truly impactful change begin with the next generation of policymakers? This answer begins with one behavior: taking notice of the patterns and situations of different socioeconomic backgrounds around oneself. It is a social responsibility for citizens to stay informed on these issues and to use their analysis to participate in the democratic process, no matter what age that citizen is. Change begins now, and the examination of whether current policies are effective in helping those in need can move the fight to end income inequality in the right direction and give hope that the gap will be minimized in the future.

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