

January 26, 2006

THE GROWING GAP

Income Inequality in Massachusetts

Executive Summary

Over the past two decades, incomes for the highest income families in Massachusetts have grown almost five times as fast as those for low income families and nearly twice as fast as those for middle income families. While there have been similar trends across the country, the gap between upper- and lower-income families has grown more in Massachusetts than in forty seven of the fifty states.

This paper – *The Growing Gap* – describes the growth of income inequality in Massachusetts over approximately the last twenty years, discusses the social, economic, and political consequences of inequality, and examines the impact of public policies on the manner in which income is distributed in the Commonwealth. *The Growing Gap* is based on data from the U.S. Census Bureau’s Current Population Survey compiled and analyzed by two independent, non-partisan research organizations based in Washington, DC – the Center on Budget and Policy Priorities (CBPP) and the Economic Policy Institute (EPI). Among its principal points are the following:

- Over the period from 1980-1982 to 2001-2003, families in the top 20 percent of the income distribution in Massachusetts saw their average annual income rise from \$81,522 to \$144,412, an increase of \$62,890 or 77 percent. Families in the top 5 percent of the income distribution enjoyed even larger gains, as their average income soared 105 percent, going from \$113,591 per year to \$233,108 per year, a jump of close to \$120,000.
- Low- and moderate-income families did not fare nearly as well during this span. The average annual income for families in the middle of the income distribution climbed from \$41,612 for 1980-82 to \$58,383 for 2001-03, a difference of \$16,772 or 40 percent. At the same time, families representing the bottom 20 percent of the income distribution in Massachusetts watched their average income rise just 16 percent, from \$16,938 to \$19,690 per year, a change of only \$2,752.
- As a result of the uneven growth in family incomes, income inequality is significantly greater today in Massachusetts than it was at the start of the 1980s. For 1980-82, the ratio of the average income for the wealthiest fifth of families in Massachusetts to the average income for families in the poorest fifth was 4.8:1. That is, the average family at the top of income distribution had an income nearly five times as great as the average family at the bottom of the distribution. By 2001-03, this ratio had grown to 7.3:1; thus, where once the average wealthy family in Massachusetts had the income of roughly five average poor families, it now has the income of more than seven.

- The ratio of the average income for families in the top 5 percent of the income distribution to the average income for families in the bottom 20 percent climbed even more sharply over the course of the last twenty years, suggesting that the gains from economic growth are becoming more and more concentrated in the hands of a relatively small group of families in Massachusetts. For the 1980-82 period, the top 5 to bottom 20 ratio was 6.7:1. It reached 11.8:1 in 2001-03.
- Income inequality grew more in Massachusetts over the last twenty years than in all but two states. The ratio of the average income for the wealthiest fifth of families to the average income for poorest fifth of families in Massachusetts increased from 4.8:1 to 7.3:1 between 1980-82 and 2001-03. Only Arizona and New York experienced greater growth in their top to bottom fifth ratios.
- Due to this comparatively marked rise in inequality, incomes are now less evenly distributed in Massachusetts than in almost four out of five states. The ratio of the average income for families in the top 20 percent of the income distribution in Massachusetts to the average income for families in the bottom 20 percent was the 11th highest in the country for 2001-03.
- Research from a variety of disciplines has demonstrated that income inequality can have dire consequences, not just for individuals and families at the bottom of the income distribution, but for society as a whole. For instance, a review of the findings of various papers presented at a 1999 Federal Reserve Board of New York conference on income inequality notes that “Increased levels of crime, poor health, mortality, poor schools, and poor housing are associated with higher levels of inequality across cities, states, and nations.” In addition: “Social cohesion, trust, and civic engagement all vary negatively with inequality across these same demographic dimensions.”
- Public policies – such as progressive tax policy and a robust minimum wage – can mitigate income inequality and help to ensure that everyone benefits from their contributions to economic growth. For example, tax policies, like a refundable earned income tax credit (EITC), and income support policies, in the form of food stamps or housing subsidies, can help to boost the effective incomes of poorer families.
- For the period 2001-03, the ratio of the average income for the wealthiest 20 percent of families in Massachusetts to the average income for the poorest 20 percent of families was 10.5:1 on a “pre-tax” basis. In other words, before taking into account the effect of tax and other policies, as well as capital gains (or losses), a single wealthy family earning the average income for the top quintile made nearly eleven times what a poor family earning the average income for the bottom quintile did. On a “post-tax” basis, though, that ratio fell to 7.3:1, meaning that tax and other policies helped to shrink the gap between rich and poor considerably.

Introduction

Over the past two decades, incomes for the highest income families in Massachusetts have grown almost five times as fast as those for low income families and nearly twice as fast as those for middle income families. Between 1980-82 and 2001-03, the average income for the wealthiest 20 percent of families in Massachusetts has risen 77 percent, to more than \$144,000 per year, while the average income for families comprising the wealthiest 5 percent has skyrocketed, climbing 105 percent to just over \$233,000 per year. Over the same span, families representing the bottom 20 percent of the income distribution in Massachusetts have seen their average income increase just 16 percent, to \$19,690 per year. While there have been similar trends across the country, the gap between higher and lower income families has grown more in Massachusetts than in forty seven of the fifty states.

Income inequality is, to be sure, a relative measure, comparing two differently situated groups. As such, it differs from absolute measures of need such as the poverty threshold. Income inequality should be no less a cause for concern, however, since, as a phenomenon in its own right, it has been linked to a number of adverse outcomes – higher mortality rates, more crime, less social cohesion, and, potentially, slower economic growth. On a more fundamental level, income inequality – particularly to the degree now seen in Massachusetts – should prompt concern, for it challenges some of our society’s most deeply seated beliefs about shared prosperity and about the value of, and the rewards from, a hard day’s work.

Remedies are available to address these concerns. Public policies can reduce inequality, and by extension, lessen the ills associated with it. In fact, during the last twenty or so years, federal tax and income support policies have reduced inequality considerably – and likely would have had an even more ameliorative effect were it not for the heavily skewed federal tax cuts enacted between 2001 and 2003. The federal tax code’s graduated rate structure, plus features like the Earned Income Tax Credit, have boosted post-tax incomes for families at the bottom of the income distribution and have lowered them for families at the top; food stamps and other income support programs have also effectively raised the incomes of families at the lowest end of the income distribution. In addition, substantial increases in the minimum wage in Massachusetts over the course of the 1990s appear to have helped to slow the growth of inequality in the Commonwealth still further.

This paper describes the growth of income inequality in Massachusetts over roughly the last two decades, discusses the social, economic, and political consequences of inequality, and examines the impact of public policies on the manner in which income is distributed in the Commonwealth. It is based on data from the U.S. Census Bureau’s Current Population Survey compiled and analyzed by two independent, non-partisan research organizations based in Washington, DC – the Center on Budget and Policy Priorities (CBPP) and the Economic Policy Institute (EPI). To permit comparisons over time, CBPP and EPI have pooled the Census data for each state and for the nation as a whole for three separate periods: 1980 through 1982, 1990 through 1992, and 2001 through 2003. Each of these periods represents a similar point in the economic cycle. Except as otherwise noted, all income amounts in this report are expressed in constant 2002 dollars (meaning that all amounts have been adjusted for inflation); are for families (that is, two or more related individuals living together); and are on a “post-tax” basis.

More specifically, “post-tax” income consists of earned income (such as wages and salaries) and direct cash transfers from public programs like Temporary Assistance for Families with Dependent Children (TAFDC), plus capital gains (or losses), the effect of federal tax policies, and the cash value of food stamps, subsidized school lunches, and housing subsidies.

Income Inequality in Massachusetts

Over the course of approximately the last twenty years – from the end of the early 1980s recession to the end of the recent 2001 recession – income growth has been extremely uneven in Massachusetts, as affluent families have seen their incomes grow far more rapidly than poor ones. As Figures 1 and 2 suggest, families in the top 20 percent of the income distribution in Massachusetts saw their average annual income rise from \$81,522 in the 1980-1982 period to \$144,412 in the 2001-2003 period, an increase of \$62,890 or 77 percent. Families in the top 5 percent of the income distribution enjoyed even larger gains, as their average income soared 105 percent between 1980-82 and 2001-03, going from \$113,591 to \$233,108. In contrast, families in the middle of the income distribution experienced far more modest growth, as their average annual income climbed from \$41,612 to \$58,383, a difference of \$16,772 or 40 percent. Over the roughly twenty year span between the early 1980s and 2001 recessions, families representing the bottom 20 percent of the income distribution in Massachusetts have watched their average income rise just 16 percent, from \$16,938 to \$19,690 per year, a change of only \$2,752. In short, from the start of the 1980s to the beginning of the current decade, the average income for the wealthiest 20 percent of families in Massachusetts rose nearly five times as fast as the average income for the poorest 20 percent, while the average income for the very richest 5 percent climbed more than six times as quickly.

As a result of such uneven growth in family incomes, income inequality is greater today in Massachusetts than it was at the start of the 1980s. Income inequality can be measured by comparing the average income for wealthy families to the average income for poor families. Here, two ratios are used to make that comparison: first, the ratio of the average income for families in the top 20 percent of the income distribution to the average income for families in the bottom 20 percent and, second, the ratio of the average income for families in the top 5 percent of the income distribution to the average income for families in the bottom 20 percent. To illustrate, if the average income for a family in the top 20 percent of the income distribution were \$120,000 and the average income for a family in the bottom 20 percent were \$20,000, the ratio of the two would be 6:1. Stated slightly differently, in this situation, it would take 6 families in the bottom 20 percent of the income distribution, each earning the average income for the quintile, to make what one family in the top 20 percent makes in a single year. If the income for the wealthy family were to rise to \$140,000, the ratio would rise as well, to 7:1 in this case. Thus, the higher the ratio, the less evenly incomes are distributed.

Figure 1.

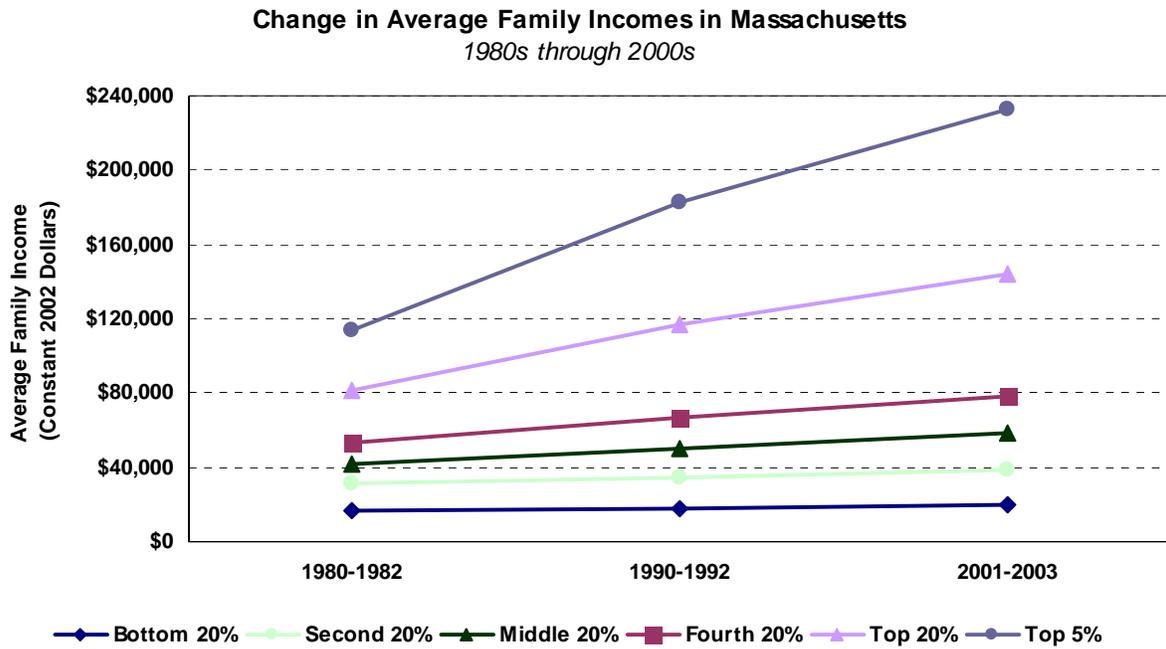


Figure 2.

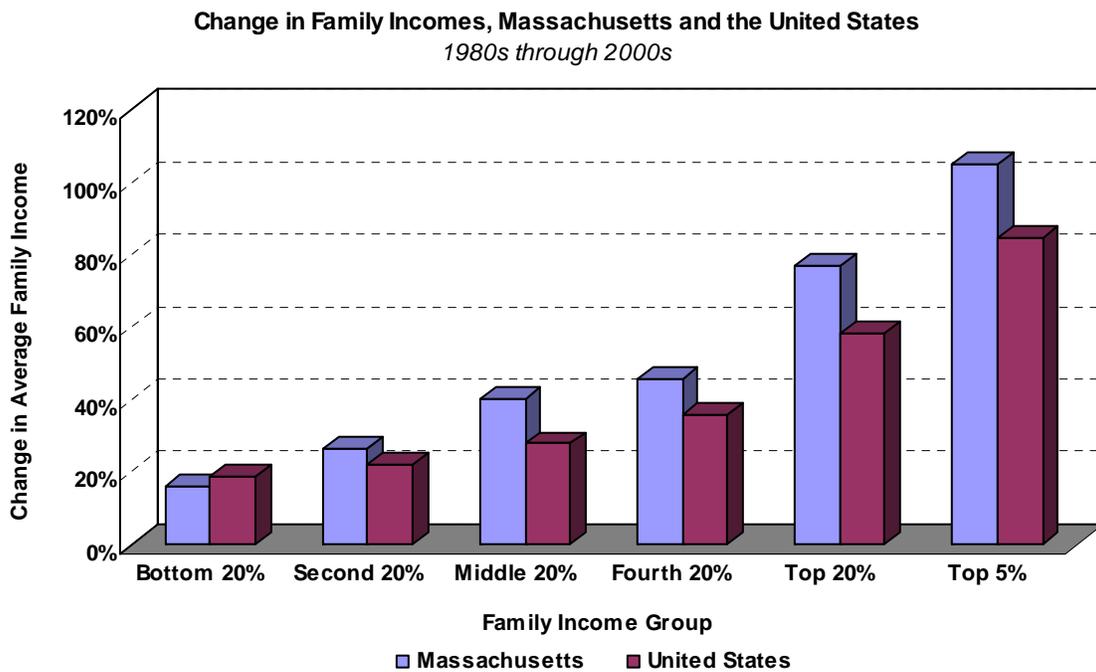
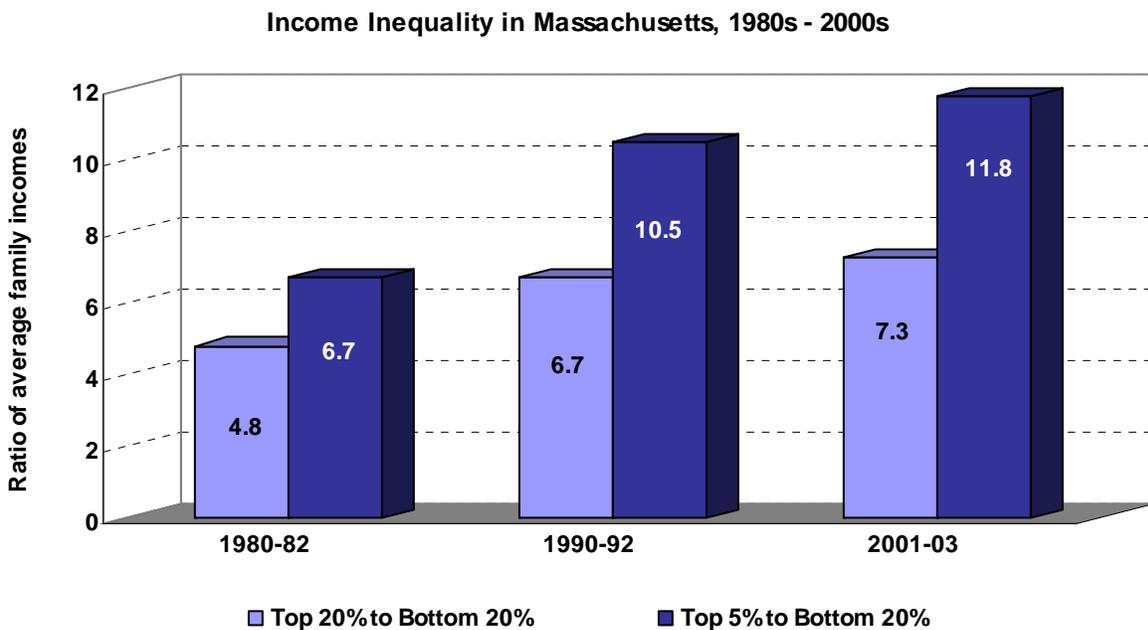


Figure 3 below presents these two ratios for Massachusetts for the 1980-82, 1990-92, and 2001-03 periods. It demonstrates that income inequality has risen steadily since the end of the early 1980s recession. For 1980-82, the ratio of the average income for families in the top 20 percent of the income distribution to the average income for families in the bottom 20 percent was 4.8:1. That is, the average family at the top of income distribution had an income nearly five times as great as the average family at the bottom of the distribution. By 2001-03, this ratio had grown to 7.3:1; in short, where once the average wealthy family in Massachusetts had the income of roughly five average poor families, it now has the income of more than seven.

Figure 3.

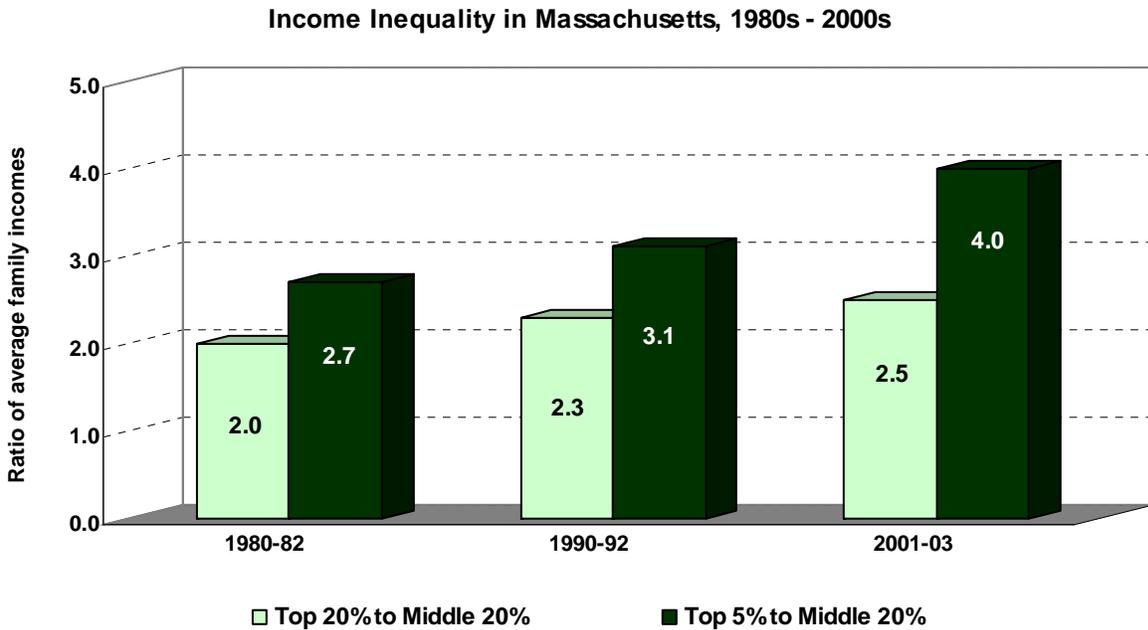


The ratio of the average income for families in the top 5 percent of the income distribution to the average income for families in the bottom 20 percent climbed even more sharply over the course of the last twenty years, suggesting that the gains from economic growth are becoming more and more concentrated in the hands of a relatively small group of families in Massachusetts. For the 1980-82 period, the top 5 to bottom 20 ratio was 6.7:1. It jumped to 10.5:1 for 1990-92 and then continued to expand, until it reached 11.8:1 in 2001-03.

Income inequality may also be measured by comparing the income of an average wealthy family to the income of an average family in the middle class. Figure 4 does so by presenting two additional ratios for the 1980-82, 1990-92, and 2001-03 periods: one, the ratio of the average income for families in the top 20 percent of the income distribution to the average income for families in the middle 20 percent and, two, the ratio of the average income for families in the top 5 percent of the income distribution to the average income for families in the middle 20 percent. It shows that the rift between moderate- and upper-income families in Massachusetts, though not as sizable as the one between low- and upper-income families, has widened perceptibly since the

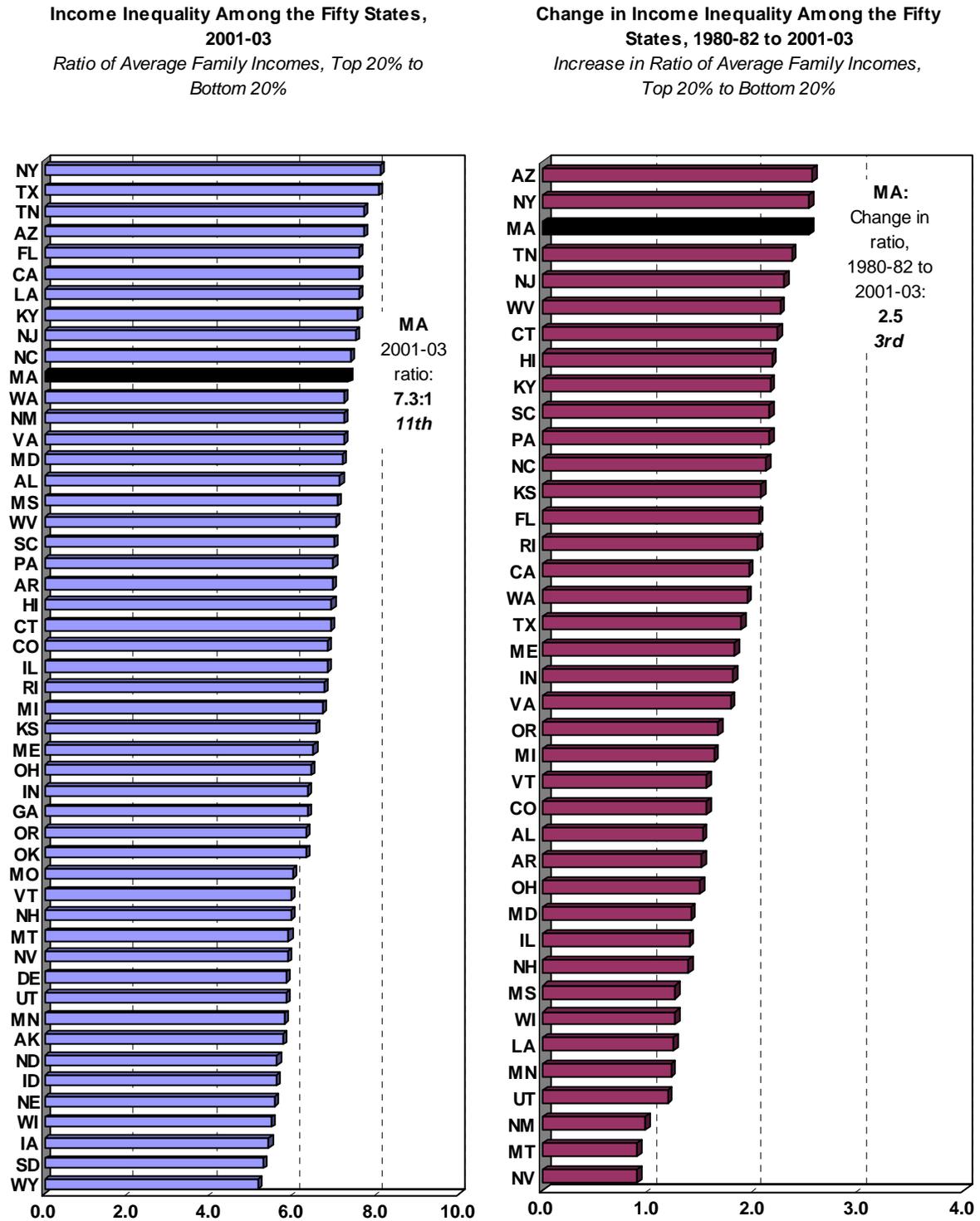
early 1980s. That is, in 1980-82, the ratio of average incomes for the top fifth and middle fifth of Massachusetts families was 2:1. By 2001-03, it was 2.5:1. Similarly, the ratio of average incomes for the very wealthiest 5 percent to the middle 20 percent of Massachusetts families expanded from 2.7:1 in 1980-82 to 4.0:1. This widening rift between the upper and middle classes in Massachusetts reveals, in particular, the disproportionate gains that affluent families have realized in the last twenty or so years.

Figure 4.



On their own, these trends should provoke a number of questions about the economy and the social institutions of the Commonwealth, but, when viewed in relation to the trends in other states, they are even more troubling. Simply put, income inequality grew more in Massachusetts over the last twenty years than in all but two states. As noted above and as depicted in Figure 5, the ratio of the average income for families in the top 20 percent of the income distribution to the average income for families in the bottom 20 percent in Massachusetts increased by 2.5 between 1980-82 and 2001-03, from 4.8:1 to 7.3:1. Only Arizona and New York experienced greater growth in their top 20 to bottom 20 ratios. While most states witnessed a rise in inequality over this time frame, there were eleven states that saw no statistically significant change in their top 20 percent to bottom 20 percent ratios. In addition, while income inequality in Massachusetts may have grown more during the 1980s than the 1990s, it did continue to expand during the latter decade and did so at a rate that was greater than in half the other states during the 1990-92 to 2001-03 period.

Figure 5.



Eleven states experienced no statistically significant change in the ratio of the average incomes for the top and bottom fifths of their respective income distributions between 1980-82 and 2001-03; they are not included in the graph at right above.

Due to this comparatively marked rise in inequality, incomes are now less evenly distributed in Massachusetts than in almost four out of five states. Again, the ratio of the average incomes for families in the top 20 percent of the income distribution to the average income for families in the bottom 20 percent in Massachusetts is 7.3:1 for the 2001-03 period. This degree of inequality is currently the 11th highest in the United States, behind a diverse group of states that includes New York and New Jersey in the east, Florida and North Carolina in the south, and California and Arizona in the west.

Inequality appears to have risen faster in Massachusetts than in most states over the last twenty years both because incomes for the poorest families in the Commonwealth appear to have grown more slowly than for their counterparts in other states and because incomes for the richest families likely expanded much more quickly than for their peers elsewhere across the country. While the average income for the poorest 20 percent of families in Massachusetts rose 16 percent from 1980-82 to 2001-03 – from \$16,938 to \$19,690 – it gained 19 percent nationally – going from \$14,114 to \$16,778. Conversely, the increase in the average income for the top 20 percent of families nationally was 59 percent between 1980-82 and 2001-03, but was 77 percent in Massachusetts. Moreover, the average income for the wealthiest 5 percent of families rose 85 percent nationally – from \$109,195 to \$201,707 – during the last two decades, but climbed 105 percent here in Massachusetts – jumping from \$113,591 to \$233,108. Thus, trends in Massachusetts between 1980-82 and 2001-03 seem to be more extreme versions of the ones that occurred nationally. Across the country, poor families took only very modest steps towards economic security, while affluent ones made substantial strides. In Massachusetts, poor families struggled to plod along, while affluent ones raced ahead.

Looking to the future, in the absence of action on the part of policymakers in Massachusetts, it seems unlikely that the distribution of income in Massachusetts will become more equal in the near term. As noted at the outset, the most recent state by state data on income inequality compiled by the Center on Budget and Policy Priorities and the Economic Policy Institute is for the 2001-03 period. Yet, more recent Census Bureau data on the distribution of hourly wages in Massachusetts (also compiled by the Economic Policy Institute) suggest that the gap between poor families and affluent ones continues to expand. That is, between 2001 and 2004, the hourly wage earned by workers at the 20th percentile of the wage distribution in Massachusetts rose by just 0.7 percent, from \$7.48 to \$7.53 per hour. In contrast, the hourly wage for workers at the 80th percentile grew 5.2 percent, going from \$25.38 to \$26.70 per hour. Moreover, the heavily skewed distribution of federal tax cuts adopted in 2001 and 2003 has almost certainly helped to drive the post-tax incomes of rich and poor families still further apart. According an analysis conducted by Citizens for Tax Justice (CTJ), the poorest 20 percent of Massachusetts residents received 2.5 percent of the federal tax cuts in place in 2001 and 0.8 percent of those in effect in 2003; in 2006, they are expected to receive just 1 percent of the federal tax cuts enacted between 2001 and 2003. At the opposite end of the spectrum, the wealthiest 20 percent of Massachusetts residents received 43.7 percent of the federal tax cuts in place in 2001 and 72 percent of those in effect in 2003; in 2006, CTJ's projections show them receiving 71.6 percent of the tax cuts enacted between 2001 and 2003.¹

¹ *CTJ Issue Brief: The Bush Tax Cuts in Massachusetts*, Citizens for Tax Justice, November 19, 2003.

Consequences of Income Inequality

Income inequality is, to be sure, a relative measure, comparing two differently situated groups. As such, it differs from absolute measures of need such as the poverty rate. Income inequality should be no less a cause for concern, however, as research from a variety of disciplines has demonstrated that, inequality, as a phenomenon in its own right, can have dire consequences. Those consequences are not simply limited to the families and individuals who find themselves at the bottom of the income distribution; they extend as well to society as whole.²

Timothy Smeeding, the Director of Policy Research at Syracuse University, in a review of the findings of various papers presented at a 1999 Federal Reserve Board of New York conference on income inequality, summarized the effects that the uneven distribution of incomes can have, noting: “Increased levels of crime, poor health, mortality, poor schools, and poor housing are associated with higher levels of inequality across cities, states, and nations.” He also observed that: “Social cohesion, trust, and civic engagement all vary negatively with inequality across these same demographic dimensions.”³

Subsequent research helps to illustrate Smeeding’s summation. A 2001 study in the *American Journal of Public Health* determined that: “Individuals living in high-income-inequality states were at increased risk of mortality...compared with individuals living in low-income-inequality states.”⁴ Recent research by Susan Mayer at the University of Chicago indicates that the rise in income inequality has contributed to the growing gap in college enrollment among students from low- and upper-income families.⁵ Robert H. Frank of Cornell University, in an essay in the new book *Inequality Matters*, points to the existence of what he calls “spending cascades,” linked to uneven distributions of income, “in which top earners...initiate a process that leads to increased expenditures on down the line, even among those whose incomes have not risen.” He cites housing markets as particular instances of this effect, arguing that “median house prices depend not only on median incomes, but also on income inequality” – that is, greater degrees of inequality may push up housing prices.⁶ Frank and his colleagues have also found that “areas with higher inequality – specifically, with higher ratios between the income of households in the ninety-fifth and fiftieth percentiles – had significantly higher personal bankruptcy rates, divorce rates, and average commute times.”⁷

The impact of income inequality on commuting times may seem picayune, but income inequality can have more profound effects as well, such as potentially impairing our economy. In a paper presented to the Federal Reserve Bank of Kansas City’s 1998 symposium, “Income Inequality: Issues and Policy Options,” Jason Furman and Joseph Stiglitz, a 2001 Nobel Laureate for economics, argue that:

² The MPBC previously examined this issue in its November 2004 paper, *Keeping It Real: The Effects of Increasing and Indexing the Massachusetts Minimum Wage*; this section draws extensively on that earlier examination.

³ Smeeding, Timothy, “General Commentary,” *Federal Reserve Bank of New York Economic Policy Review*, September 1999, p. 175.

⁴ K. Lochner, E. Pamuk, D. Makuc, B.P. Kennedy, and I. Kawachi, “State-level income inequality and individual mortality risk: a prospective, multilevel study”, *American Journal of Public Health*, Vol. 91, No. 3 (1999), p. 385.

⁵ Jencks, Christopher, “Does inequality matter?,” *Daedalus*, Winter 2002, p. 59.

⁶ Lardner, James and Smith, David A., eds., *Inequality Matters* (The New Press: New York, NY), 2005, p. 141-142.

⁷ *Ibid.*, p. 144.

... there are good reasons to believe that there are adverse economic effects of [income] inequality, some of which may be masked by other trends in the economy, and that there would be economic gains from active policies, both microeconomic and macroeconomic, that explicitly take into account ... increased inequality and try to reverse it. At the very least, the results presented in the first section of [our] paper present a persuasive argument that the reduction in inequality would not have an adverse economic effect. The positive broader benefits [from reducing inequality] make a commitment to such policies all the more desirable.⁸

Perhaps of greatest concern, given the above consequences of income inequality, is that income inequality may well be self-perpetuating. Eric Wanner, the President of the Russell Sage Foundation, in a separate essay in *Inequality Matters*, asks:

...will inequality, once under way, prove difficult to reverse? This might happen if the families who have fallen behind economically also fell behind in other ways that made it more difficult for them, and for their children, to compete with the more advantaged. If, for example, as economic inequality rose over the past twenty-five years, the children of families at the bottom of the income distribution were increasingly likely to live in single-parent families, grow up in distressed neighborhoods, receive substandard child care and health care, attend poor-quality schools, and have less of an opportunity to go to college, then economic inequality might become a self-reinforcing trend. Inequality might also tend to reinforce itself at the other end of the economic spectrum if high-income families become wealthy enough to purchase private substitutes for public goods and withdraw political support for public investments in schools and social insurance systems that benefit the poor.

The Russell Sage Foundation and the Carnegie Corporation are supporting a wide range of research projects to examine this question in depth and, in Wanner's words, the results to date "often point to a pattern of self-replicating inequality."⁹ If this is in fact the case – that inequality begets inequality – then the need to stem and to reverse inequality through public policy is that much more acute, particularly in view of its consequences for individuals, families, and society.

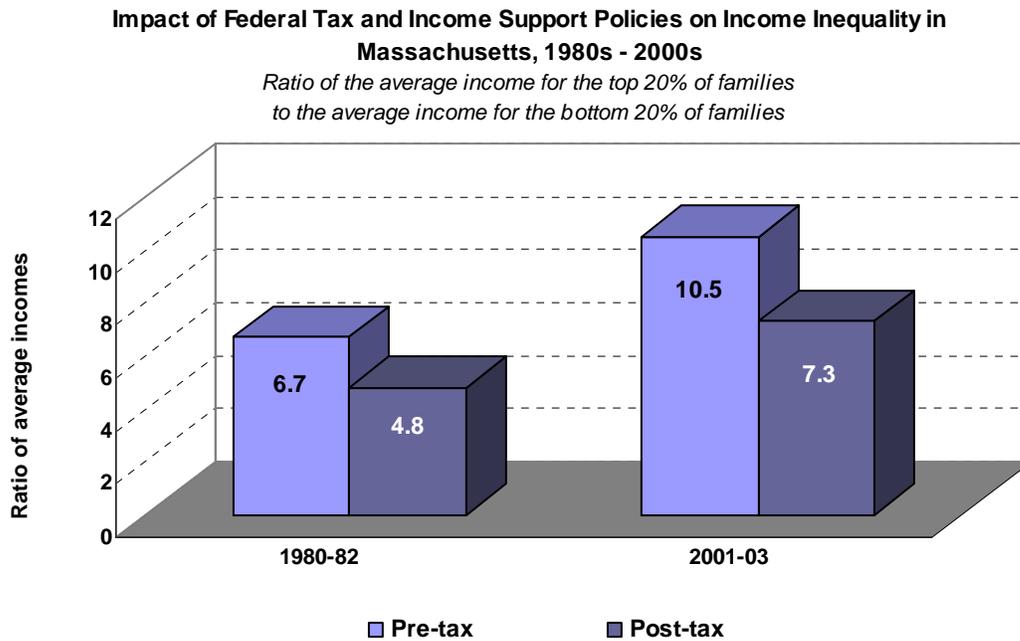
Impact of Public Policies on Income Inequality

Remedies are available to address the ills associated with inequality. Public policies at both the federal level and at the state level can mitigate income inequality and help to ensure that everyone benefits from their contributions to economic growth. Progressive tax policies, such as a refundable earned income tax credit (EITC), and income support policies, in the form of food stamps or housing subsidies, can help to boost the effective – or, as it is referred to here, the "post-tax" – incomes of poorer families. At the same time, progressive tax policies, like the graduated rate structure found in the federal income tax, can shift greater responsibility for taxes on to those wealthy families who have seen their incomes rise the fastest and produce the revenues necessary to finance policies to assist the less fortunate.

⁸ Furman, Jason and Joseph E. Stiglitz, "Economic Consequences of Income Inequality", *Income Inequality: Issues and Policy Options – Proceedings of a Symposium Sponsored by the Federal Reserve Bank of Kansas City* (1998), p. 255; available on-line at <http://www.kc.frb.org/PUBLICAT/SYMPOS/1998/S98stiglitz.pdf>.

⁹ Lardner and Smith, p. 206-207.

Figure 6.



In fact, public policies do not simply hold the potential for reducing inequality. They have actively produced a more even distribution of incomes over the past twenty years than would otherwise be the case – and continue to do so today. Figure 6 shows the ratio of the average income for the wealthiest 20 percent of families in Massachusetts to the average income for the poorest 20 percent of families – a measure of inequality used earlier in this paper – for the 1980-82 and 2001-03 periods and on both a “pre-tax” basis and a “post-tax” basis.¹⁰ It demonstrates that income inequality is much lower on a post-tax basis than on a pre-tax one; hence, while income inequality has clearly risen over the past twenty years, it is well below where it would be in the absence of tax and income support policies – and, as noted previously, would be lower still were it not for the heavily skewed federal tax cuts enacted since 2001.

For the period 1980-82, the ratio of the average income for the wealthiest 20 percent of families in Massachusetts to the average income for the poorest 20 percent of families was 6.7:1 on a pre-tax basis. In other words, before taking into account the effect of tax and other policies, a single wealthy family earning the average income for the top quintile made nearly seven times what a poor family earning the average income for the bottom quintile did. On a post-tax basis, though, that ratio fell to 4.8:1, meaning that tax and other policies helped to shrink the gap between rich and poor considerably. Further, for the 2001-03 period, the ratio of average incomes for the top and bottom quintiles of families in Massachusetts was 10.5:1 on a pre-tax basis, but 7.3:1 on a post-tax basis, again illustrating the ameliorative effect of public policies.

¹⁰ As noted at the outset of this paper, “pre-tax” income include both earned income (such as wages and salaries) and direct cash transfers from programs like Temporary Assistance for Families with Dependent Children (TAFDC), while “post-tax” income consists of “pre-tax” income plus capital gains (or losses), the effect of federal tax policies, and the value of non-cash transfers like subsidized school lunches.

Though not captured in differences between pre-tax and post-tax incomes, wage policies like the minimum wage can also help to combat inequality. For instance, economic research has demonstrated that declines in the real value of the federal minimum wage have contributed significantly to the degree of inequality experienced by low-wage workers, while real increases in the federal minimum have helped to mitigate inequality at the bottom end of the wage distribution. More specifically, David Lee, Assistant Professor of Economics at the University of California, Berkeley found, in a 1999 paper, that “a great majority of the observed growth in inequality in the lower tail of the [wage] distribution is attributable to the erosion of the real value of the federal minimum wage rate during the 1980s.”¹¹ Similarly, in a forthcoming paper in the *American Economic Review*, Thomas Lemieux of the University of British Columbia concludes that:

...large increases in the [federal] minimum wage in 1973-74, 1989-91, and 1995-97 all closely match corresponding declines [in wage inequality among workers with the same education and experience]. By contrast, the three periods where the [federal] minimum wage declined in real terms for failing to be indexed (1981-1989, 1992-1995, and 1998-2003) all correspond to clear increases in residual wage inequality.¹²

Events in Massachusetts appear to mirror these findings. The real value of the Massachusetts minimum wage fell significantly between 1982 and 1992, while, over roughly the same period, the average income for families in the bottom 20 percent of the income distribution were all but stagnant. In 1982, an individual working full-time and earning the Massachusetts minimum wage then in effect – \$3.35 per hour – would have earned \$13,058 (in constant 2002 dollars). By 1992, when the minimum wage was \$4.25 per hour, an individual in the same situation would have earned just \$11,664 (again, in constant 2002 dollars), a decline of 11 percent. Of note, from 1980-82 to 1990-92, the average income for families in the bottom 20 percent of the income distribution in Massachusetts rose just 2 percent in real terms, from \$16,938 to \$17,337. Conversely, between 1992 and 2003, the Massachusetts minimum wage grew substantially. In 2003, it was \$6.75 per hour, having risen 22 percent in real terms since 1992 and producing a full-time salary of \$14,417 in inflation-adjusted dollars. Over nearly same stretch – that is, between 1990-92 and 2001-03 – the average income for families in the bottom 20 percent of the income distribution climbed 14 percent, reaching \$19,690 by the end of the period.

To be sure, simply because declines or increases in the minimum wage appear to correlate with slower or faster income or wage growth does not necessarily mean that the former has caused the latter; for instance, historically robust labor markets during the late 1990s are often cited as a major source of economic gains for low-income families. Nevertheless, these trends – in combination with existing research – would seem to suggest that further increases in the minimum wage could help to combat income inequality.

¹¹ Lee, David, “Inequality in the United States During the 1980s: Rising Dispersion or Falling Minimum Wage?”, *Quarterly Journal of Economics*, 1999, 114(3), 1016.

¹² Lemieux, Thomas, “Increasing Residual Wage Inequality: Composition Effects, Noisy Data, or Rising Demand for Skill?”, forthcoming in *The American Economic Review*, 2006, p. 32, available at <http://www.econ.ubc.ca/lemieux/papers/within.pdf>.

One other instrument available to policymakers seeking to reduce inequality that is not reflected in the differences in pre- and post-tax incomes calculated by CBPP and EPI is state tax policy.¹³ At present, tax policy in Massachusetts exacerbates income inequality. A 2003 study by the Institute on Tax and Economic Policy (ITEP) indicates that, overall, the distribution of state and local taxes in Massachusetts is regressive, as it poses a larger burden on low-income families than on upper-income ones.¹⁴ That is, at the time of ITEP's study, taxpayers in the lowest 20 percent of the income distribution in Massachusetts, on average, paid 9.3 percent of their incomes in state and local taxes, while those comprising the richest 1 percent of taxpayers paid 6.8 percent of their incomes in state and local taxes. Since then, reforms to the corporate excise and other taxes have been enacted that have likely enhanced the progressivity of the Massachusetts tax system; however, those changes are not sufficiently large to alter significantly the overall distribution of taxes.

Further changes in tax policy could improve the fairness of the Massachusetts tax system and, by extension, help to make the distribution of income more even. For example, Massachusetts is one of eighteen states, plus the District of Columbia, that offers its own version of the federal Earned Income Tax Credit (EITC), a refundable personal income tax credit designed both to improve work incentives for low-income individuals and families and to help them make ends meet. If the Commonwealth were to increase the value of its EITC, it would boost the effective incomes of individuals and families at the lower end of the income distribution and would help to shrink the growing gap between rich and poor.

Currently, the Massachusetts EITC is set to equal 15 percent of the federal EITC; according to preliminary data from the Department of Revenue, in 2003, over 303,000 taxpayers claimed the Massachusetts EITC, all of whom, given the parameters of qualifying for the credit, had incomes less than \$37,230 (for families) or \$11,750 (for individuals). The average credit claimed was worth \$231. Of note, five of the states offering their own EITC's – Maryland, Minnesota, New York, Vermont, and the District of Columbia – now offer a credit that is both refundable and greater than 15 percent of the federal EITC, with Minnesota, New York, and Vermont offering refundable credits equal to at least 30 percent of the federal credit. If Massachusetts were to raise its EITC to 30 percent, the value of the average credit would double to \$462.

Importantly, a reduction in Massachusetts' personal income tax rate would make the distribution of effective incomes less equal. Massachusetts has a single – or flat – personal income tax rate. In general, the benefits from a reduction in a flat personal income tax rate would be distributed in proportion to taxpayers' income and, accordingly, would not alter the income ratios discussed above. However, specific features of the personal income tax in Massachusetts, such as the “no-tax” threshold, result in an effective rate that is slightly progressive. Consequently, reducing the personal income tax rate from 5.3 percent to 5.0 percent would benefit upper-income taxpayers more than low-income ones and, therefore, lead to greater income inequality.

¹³ Post-tax incomes calculated by CBPP and EPI reflect only the impact of federal taxes; they exclude the impact of state and local taxes.

¹⁴ McIntyre, Robert S., *et. al.*, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, 2nd Edition*, Institute on Taxation and Economic Policy (Washington, DC), January 2003, p. 58.

Conclusion

More than forty years ago, President John F. Kennedy argued that “a rising tide lifts all boats,” implying that economic growth benefits all those who contribute to it.¹⁵ Yet, over roughly the past two decades in Massachusetts, that rising tide has lifted some boats far more than others. Between 1980-82 and 2001-03, the average income for families comprising the bottom 20 percent of the income distribution in Massachusetts rose just 16 percent, while the average income for families representing the top 20 percent and the top 5 percent climbed 77 percent and 105 percent respectively. As a result, income inequality has grown markedly in Massachusetts over this span; in fact, family incomes are now distributed less evenly here in the Commonwealth than in the vast majority of states.

Economic research indicates that income inequality can have profoundly ill effects, not just for low-income individuals and families, but for society as a whole. Among the adverse outcomes to which inequality has been linked are higher mortality rates, more crime, and reduced social cohesion. Yet, inequality should not be regarded as an unalterable aspect of the modern economy or as a permanent social phenomenon. Public policies – such as progressive tax policy and a robust minimum wage – can help to produce a more even distribution of incomes. Thus, by increasing its own Earned Income Tax Credit or by once again raising its minimum wage, the Commonwealth can begin to turn the tide on inequality and ensure that the gains from economic growth are more widely shared.

¹⁵ Remarks in Pueblo, Colorado, August 17, 1962, *Public Papers of the Presidents: 1962*, p. 626

Appendix Table 1.

Distribution of Income among Massachusetts Families, Early 1980s to Early 2000s

	<u>Bottom 20%</u>	<u>Second 20%</u>	<u>Middle 20%</u>	<u>Fourth 20%</u>	<u>Top 20%</u>	<u>Top 5%</u>
Average Annual Income (in 2002 Dollars)						
1980-1982	\$16,938	\$30,882	\$41,612	\$53,297	\$81,522	\$113,591
1990-1992	\$17,337	\$34,735	\$49,935	\$66,977	\$116,480	\$182,399
2001-2003	\$19,690	\$39,104	\$58,383	\$77,757	\$144,412	\$233,108
Change in Average Income						
1980-1982 to 1990-1992	\$399	\$3,853	\$8,323	\$13,680	\$34,958	\$68,808
1990-1992 to 2001-2003	\$2,353	\$4,369	\$8,448	\$10,781	\$27,932	\$50,710
1980-1982 to 2001-2003	\$2,752	\$8,221	\$16,772	\$24,460	\$62,890	\$119,517
Change in Average Income (Percent)						
1980-1982 to 1990-1992	2.4%	12.5%	20.0%	25.7%	42.9%	60.6%
1990-1992 to 2001-2003	13.6%	12.6%	16.9%	16.1%	24.0%	27.8%
1980-1982 to 2001-2003	16.2%	26.6%	40.3%	45.9%	77.1%	105.2%

Appendix Table 2.

Income Inequality Among Massachusetts Families, Early 1980s to Early 2000s

	Ratio of Average Incomes			
	<u>Top 20% to Bottom 20%</u>	<u>Top 5% to Bottom 20%</u>	<u>Top 20% to Middle 20%</u>	<u>Top 5% to Middle 20%</u>
1980-1982	4.8	6.7	2.0	2.7
1990-1992	6.7	10.5	2.3	3.1
2001-2003	7.3	11.8	2.5	4.0