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Supplement from Marin Economic Consulting on the Root Causes of Inequality and Addressing the Inequality Problem

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The extent of income inequality in any region such as the Bay Area is a result of local, state and national policies, and is exacerbated by economic factors such as technological progress and globalization. And, while local policies alone are largely inadequate to address the issue of extreme inequality, there are a variety of options that can ameliorate the effects. As a supplement to the research brief on Bay Area income inequality, this document provides a discussion of the root causes of inequality and a set of local policy options for addressing it.

These policy options have the potential to raise the fortunes of the Bay Area's lower-income households, allowing those residents to share in the rapidly increasing prosperity of the region.

1. The Importance of Income Inequality as an Issue

A debate over the implications of income inequality in the United States has been brewing over the last few years. This debate is important because history has shown that inequality has meaningful implications for the functioning of an economy as well as political systems. The rise in income inequality in the country, however, has not been a subject of debate – it has been widely accepted by both academics and politicians alike based on a variety of sources covering an array of income and wealth measures. Income inequality nationwide is now at levels last seen during the Great Depression, and is much higher than in most developed nations including most European nations even before taxes and transfers are considered (their inclusion would further increase the gap).[1]

There are both benefits and drawbacks to income inequality, varying by level/extent. One benefit of inequality it is to encourage investments in productive resources. Those with more resources and/or human or physical capital tend to have higher incomes than those with fewer resources. On the other hand, inequality can also be a destructive force. Extreme income inequality may:

1. reduce overall consumption, slowing economic growth;
2. reduce economic mobility[2];
3. reduce resources devoted to societal well-being;
4. be mirrored in inequities in health outcomes, education, and criminal behavior; and

1. Organisation for Economic Co-operation and Development (OECD). Income Distribution and Poverty, by Country. www.oecd.org/els/soc/inequality-and-poverty.htm
2. Economic mobility is the ability of an individual to improve their economic status.

5. foment civil disenfranchisement and unrest.

There is no strict consensus surrounding the point at which increasing inequality generates more of these consequences than it provides benefits. However, a growing consensus is forming around the notion that economies do suffer when inequality levels are elevated, which is currently the case in the United States.[3]

Evidence is mounting that many of these negative influences are becoming significant across the country. Economic mobility (the ability of an individual to improve their economic status) is lower in the United States than in most other developed nations.[4] Economic mobility is highly influenced by government resources dedicated to the "safety net",[5] general infrastructure, and scientific discovery.[6] As the United States grows and becomes more prosperous, the willingness to spend on these items should increase, not decrease. Voter turnout is very low[7] and movements such as Occupy Wall Street are evidence of the civil effects of rising inequality.

2. Background on the Root Causes of Inequality

In a free market, capitalist society such as the United States, some degree of inequality is inevitable. Fundamental economic principles suggest that people will be compensated roughly according to their ability to contribute to economic activity. Those with the skills to contribute to high-value endeavors – which, in the Bay Area, are relatively concentrated to the technology sector -- will have higher incomes than those that contribute in other ways, such as retail sales or in the hospitality sector. In this way, inequality is good and productive, in theory providing the incentives for each individual to contribute economically in a way that makes the best use of their particular skills and abilities.

This ideal view of the markets and capitalism neglects the fact that there are often significant impediments to each individual realizing their full potential. Some have better access to the necessary resources than do others.[8] This access affects outcomes, tilting the playing field in the direction of those with access, regardless of their particular skills and abilities. Rent-seeking behavior, the goal of profiting as much as possible from the resources at one's control, sometimes involving influencing government policies, is another way in which inequality can be skewed beyond its natural level.

In a capitalist system, the owners of resources devote their energies not toward maximizing national economic output but toward maximizing their own incomes. This is not a criticism of the system, but merely a feature that needs to be acknowledged. Where markets are not entirely free but influenced by government intervention, there is scope for those with resources to influence that government intervention so as to bias the outcome in their favor. This influence may seek to generate market power through government activity where there would otherwise be none. It may influence regulations so as to bias the market toward their product and away from competitors. It may influence government policies on the relative position of labor versus capital in the economy generally, influencing the incomes of workers relative to those of the owners of capital.

Also, inequality can result from outside of the economic system of purchasing goods and services, such as through the political process. The political process is generally one in which people vote in their own best interest or according to their particular ideology. This is true whether it is in regards to support of infrastructure improvements or offering or withholding support for government spending, such as spending on public education. Different segments of society

3. Organisation for Economic Co-operation and Development (OECD). Focus on Inequality and Growth, December 2014. http://www.oecd.org/els/soc/Focus-Inequality-and-Growth-2014.pdf
4. Organisation for Economic Co-operation and Development (OECD). A Family Affair: Intergenerational Social Mobility across OECD Countries. Chapter 5, Economic Policy Reforms: Going for Growth, 2010.
5. The safety net includes all government programs designed to safeguard against economic hardship. These include, but are not limited to: the earned income tax credit, food stamps, Medicaid, and Social Security.
6. This includes reduced funding for basic research and development and for programs such as NASA.
7. According to Center for Public Justice, Voter Turnout and Competitive Politics Report from Q3 2000, the U.S. ranks 139th in 172 countries in voter turnout. http://www.cpjustice.org/stories/storyReader$509
8. These resources include primarily education, but also simply information about the benefits of education or of job opportunities.

support public education to varying degrees. For example, a young couple just starting a family may well support public education spending, believing that their children will benefit from the availability of a good public school system. Retirees, however, may choose not to support local education in favor of programs that benefit them. Well-to-do families inclined to send their children to private schools may also withhold support for public schools. To the extent that these latter groups dominate the discourse, the quality of public schools will inevitably suffer.

The example of public education is one where, because of the composition of society, many young children are, to some extent, deprived of a crucial resource with which to achieve their full potential. This also happens when wealthier school districts make a priority of offering broadband connectivity in schools while poorer districts go without.[9]

The concentration of wealth and hence access to the political system in a progressively smaller proportion of population can become a self-reinforcing feedback loop. Those with greater incomes (and likely greater wealth) will have greater access and influence on government action in society, as evidenced by spending on political campaigns. This spending is coming in substantial part from the wealthier groups and individuals our society with the express purpose of promoting their own agenda. Those with less wealth do not have this ability to influence political and ultimately economic outcomes, which therefore enhances the extent of inequality

Simple market forces, such as raising wages among those with more education relative to those with less education can also exacerbate inequality. There is a reasonable consensus that with technological progress and increasing globalization, the returns to education have increased significantly over the course of the last 40 years. Both technological progress and globalization have reduced the demand for less educated and lower skilled (lower income) workers relative to the demand for more educated higher skilled (higher income) workers. As a result, those with more education have seen their incomes rise relative to those with less. As education has a strong relationship to income, increasing the incomes of the better educated relative to the less well educated has the effect of raising incomes among the well to do relative to the less well off, those with less education.

3. Addressing the Inequality Problem

It is not income inequality itself but the degree to which it exists that can be problematic. Inequality generates incentives, which are good for the economy, whereas too much inequality is detrimental to economic growth. The U.S. economy is driven by consumer activity.[10] If all income and wealth were in the hands of one person, there would be significantly less consumption than if income were more evenly distributed throughout the economy. This extreme concentration of income would clear have a dampening effect national economic activity.

But while there is no solution to inequality itself, there are a variety of options for mitigating the issues associated with extreme levels of inequality. Some of the options are easy, while others are more difficult to implement. For example, current redistributive policies are in place in a system of taxes and transfers administered largely, but not only, at the federal level.[11] These policies do significantly affect the incomes and welfare of those with low incomes. In fact, beneficiaries under the current (circa 2007) system of taxes and transfers exist in each of the first four quintiles of the income distribution. The fourth quintile (2nd highest) experienced a 1% increase in income after accounting for taxes and transfers in 2007.[12]

The current system of taxes and transfers does reduce inequality, but to levels that are still historically high and significantly higher than in nearly all other developed nations. At the same time, the system of taxes and transfers does

9. A local non-profit, the Education Superhighway, started by San Francisco's serial entrepreneur Evan Marwell, provides evidence on this gap and is working to close it. www.educationsuperhighway.org/the-connectivity-gap
10. According to the U.S. Bureau of Economic Analysis, nearly the production of consumption goods accounts for roughly 70% of U.S. gross domestic product.
11. These policies include the income tax, the earned income tax credit, food stamps, and other welfare programs.
12. Haskins, Ron, "Absent Major Change, High Wealth Inequality Will Likely Remain the Norm", Brookings Opinion Piece, November 18, 2014.

nothing about the rapidly growing inequality of wealth. Recent studies show that the top 1% of the population collects about 24% of all income, owns 40% of all wealth, holds 50% of all stocks, bonds, and mutual funds, and received 63% of all income gains in recent years. Their wealth is 225 times that of the average American, which is twice what the same figure was in 1983.[13]

The policy options to address inequality fall broadly into five categories:

- Expand redistribution policies (taxes and transfers)
- Provide services to low and moderate income groups
- Enhance education, skills, and opportunity[14] for low-income individuals
- Better inform choices regarding educational attainment, occupation selection and skill acquisition
- Income support policies

A. Expand Redistributive Policies

Redistribution policies are currently in place at the state and national levels. Doing more to reduce the effect of increasing pre-tax and transfer income inequality involves strengthening these policies and increasing either taxes at the top, transfers at the bottom, or both. In today's political climate, expanding redistributive policies seems unlikely. Instead, there is a continued path toward increasing the ability of those at the top to influence political processes in their favor.[15]

B. Provide Services

A second way to offset the effects of increasing income inequality is simply to provide more in the way of services to those at lower levels of the income distribution. This does not always mean serving only those at the lower end, but it does mean implementing policies that provide benefits that disproportionately accrue to those with lower incomes. Healthy San Francisco is one such policy.[16] It provides health care to uninsured residents of the city aged 18-64 who do not otherwise qualify for public health care assistance. The policy is designed to bring universal health care to the city. It is a policy that both benefits low income residents and may lower overall health care costs for city residents.

C. Enhanced Education, Skills and Opportunity

The third way, and arguably a part of the second, is to enhance the education, skills, and work opportunities for those in lower income households. There are a variety of ways in which this can be accomplished, ranging from the quick and easy-to-implement with short run benefits to the time consuming and difficult-to-implement with long term benefits.[17] One such quick and easy-to-implement policy would strengthen workforce development and training programs, which begins by providing more resources to expand the work of each county's Workforce Investment Board (WIB). An example of a more difficult policy with long-term benefits would be a concerted effort to increase the quality of and access to a high quality public education.

D. Better Inform Choices

Given that income inequality measures are based on household income, choices by individuals can help to alleviate extreme levels of income inequality.

13. Stiglitz, Joseph, The Price of Inequality: How Today's Divided Society Endangers our Future, 2013.
14. Opportunity in this context means increased access to quality housing and jobs.
15. The Supreme Court's ruling in the Citizens United case may be evidence of this as it awards corporations a greater role in elections, providing the wealthy with another way of influencing the political process that is not available to the average citizen.
16. HealthySanFrancisco.org
17. Stephen Levy, "2014 Trends Affecting Workforce Development", Joint Venture Silicon Valley, Institute for Regional Studies, 2014.

In particular, making choices regarding education and work starts with information. Imparting job and work information starts in schools with counselors that have sufficient resources with which to do their jobs. It continues with information about work and job options. The WIBs can play an increasingly valuable role in this regard if they are properly funded.

E. Income Support Policies

Finally, policies that serve to increase the incomes of those at the bottom will also serve to offset the ill effects of inequality. A primary candidate among these policies is the minimum wage. Nationally, the minimum wage has been declining because of inflation since 1968.[18] In 1968, the minimum wage adjusted for inflation was $10.69. Today's minimum wage is just $7.25, more than 30% less than it was in 1968. Though the minimum wage would have to be increased significantly to make a dent in measured income inequality, it serves to effect a transfer of income from those that are relatively well off, business owners and consumers, to those in need, ameliorating the effects of excessive inequality.

4. Summary and Local Policy Options

By standard measures, the Gini Coefficient and Income Ratios, inequality in the Bay Area is only slightly higher than inequality in California and the United States as a whole. However, a deeper look at the underlying income distribution reveals that the gaps between high and low income groups in the Bay Area are enormous despite the fact that, at all levels of the income distribution, average incomes are higher in the Bay Area than in the state or nation.

Despite the region's broad reaching prosperity (low income groups are better off in the Bay Area than elsewhere), it remains true that poverty afflicted 11.3% of the region's population, and 13.8% of San Francisco's residents in 2013. In some areas, poverty rates are higher still. Even at the regional level, there are many policy instruments available that will address the joint problems associated with high levels of income inequality and poverty.

Each of the five options listed in the previous section for addressing inequality is available at the regional level. The first option, taxing and redistributing, is more constrained at the local level than the national level, since local governments do not generally possess the legal right to tax and redistribute income. Other forms of taxation are available locally, such as the sales tax or real estate transfer taxes.

Increasing revenues through these taxes and spending on services for low-income residents is one approach for addressing inequality locally. These services provide not only direct assistance, but perhaps facilitate income growth over time, both of which reduce the influence or incidence of inequality. Programs such as Healthy San Francisco provide care to individuals between the ages of 18-64 with low incomes who do not qualify for other public coverage. Even in the presence of the Affordable Care Act, there will remain individuals and families that struggle to make ends meet. Providing assistance in this way can alleviate some of that stress.

Expanding programs to aid the homeless, through efforts such as those undertaken by North Beach Citizens[19], is another way of helping the less fortunate. Providing shelter and aid to the homeless is an extremely controversial topic, but the Bay Area has the resources necessary to do more than it is already doing.

And, many families are able to keep a roof over their heads but still struggle to put food on the table. There are grassroots-level efforts to change this, such as ExtraFood.org in Marin[20] as well as good work by larger organizations like

18. Elwell, Craig K., "Inflation and the Real Minimum Wage: A Fact Sheet," Congressional Research Service, January 8, 2014.
19. North Beach Citizens, www.northbeachcitizens.org.
20. ExtraFood, www.extrafood.org.

Second Harvest Food Bank.[21] But, given the prosperity of the region, much more could be done to provide relief to hungry families and their children.

Item C above was the basis for a report that provides suggestions for enhancing the skills and opportunities for low wage workers. The report, entitled ''Economic Prosperity Strategy, Improving Economic Opportunity for the Bay Area's Low- and Moderate-Wage Workers", focuses on policy and workforce development strategies that promote pathways to middle class, economic growth, and economic security around the Bay Area.[22] These strategies should be taken seriously and given full support.

Also in the category of providing services and enhancing education, skills, and opportunity for low-skilled workers is providing resources for improving the choices that they make. Simply informing them that learning a trade is a path to decent income is beneficial. Too little of this information is available in schools and from the WIBs. Greater regional resources should be devoted to providing this information early on in the education of tomorrow's workers.

More directly, income support through an increased minimum wage is important. Though not uniformly accepted as good policy, and with the potential to slow the economy if ever so slightly, raising the minimum wage locally is an important means for improving the well-being of those in the bottom part of the income distribution.

The San Francisco Bay Area is one of the most prosperous regions in the nation. It has experienced a recovery from the Great Recession that is remarkable. At the same time, the gap in incomes between the wealthiest and the poorest households is staggering. Although experiencing higher incomes on average than many among the least well off in other regions, the cost of living in the Bay Area makes that relative prosperity delusive. This suppliment has highlighted some of the ways the prosperity of the region could be shared. There are surely many others.

Clearly, the Bay Area is an enormously prosperous region, yet the rising tide is not lifting all boats. Given this prosperity, the region not only has the opportunity but also the *ability* to do more for the least fortunate.

21. Second Harvest Food Bank, www.shfb.org.
22. Economic Prosperity Strategy: Improving economic opportunity for the Bay Area's low- and moderate-wage workers. SPUR Report, October 2014. www.spur.org/publications/spur-report/2014-10-01/economic-prosperity-strategy