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Politics, Public Policy, and Inequality: A Look Back at the Twentieth Century

Howard Rosenthal

Brown University and Princeton University*

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1. Introduction

For at least a century, the United States has enjoyed unbridled prosperity. True, there have been significant interruptions in the upward course of per capita growth, most notably the Great Depression. While we could not always answer positively to Ronald Reagan's famous 1980 presidential debate question, "Are you better off now than you were four years ago"[1], most of us are unambiguously better off than our grandparents were 50 years ago or their grandparents 50 years earlier.

The distribution of prosperity has, unlike the aggregate, not followed a monotonic path. The broad outline of what happened is easy to summarize. Inequality in income and wealth decreased for much of the twentieth century. The decrease in inequality appeared to fit the hypothesis of Kuznets [1955]: as industrialization led a larger fraction of the population to enter high-productivity activities, inequality fell. The fall in inequality, however, has been arrested and reversed. When inequality started to rise depends on which measure one is using but the reversal did not start before the late 60s and was clearly in full bloom before—not after—Reagan took office.

This essay documents that the long-run trend in inequality—decreasing for roughly the first three-quarters of the twentieth century and increasing thereafter—is matched by similar trends in public policy and political polarization, and discusses the implications of these parallel trends. I focus on public policies, such as taxes and minimum wages, that are tied to inequality since they are explicitly redistributive. For example, Lee [1999, p. 979] finds that "almost all of the growth in the wage gap between the tenth and fiftieth percentile is attributable to the erosion of the real value of the federal minimum during the [1980s]." Estate taxes become more onerous for the first three-quarters of the century before reversing in the late 70s. Top marginal income taxes increase before starting a decline in the 60s. The federal minimum wage takes root in 1938 and increases, in real terms, until the late 60s but then declines precipitously. I later document in more detail how minimum wages and taxes closely track the secular pattern of inequality.

As inequality among Americans fell during the first two-thirds or three-quarters of the twentieth century, Americans also seemed to have grown closer together politically. In 1960, the sociologist Daniel Bell published *The End of Ideology: On the Exhaustion of Political Ideas in the Fifties*. A year later, the political scientist Robert Dahl pointed to a nation moving from oligarchy to pluralism [Dahl, 1961]. Similarly, the new "rational choice" school in political science emphasized tweedle dee-tweedle dum parties focused on the median voter [Downs, 1957] and members of Congress largely concerned with constituency service [Fiorina, 1978] and universalism in pork barrel politics [Weingast, Shepsle, and Johnsen, 1981]. What these authors pointed to was echoed in analyses of roll call voting patterns in the House and Senate. Put simply, the fraction of moderates grew and the fraction of extreme liberals and extreme conservatives fell from 1900 to about 1975 [Poole and Rosenthal, 1997; McCarty, Poole and Rosenthal, 1997].

Just as inequality went from falling to rising in the last-quarter of the century, we witnessed a turn around in politics. Keith Poole and I have termed this "The Polarization of American Politics" [Poole and Rosenthal, 1984; Krugman, 2002a, 2002b]. Moderates are nearly extinct. Extreme liberals and extreme conservatives have surfaced, particularly extreme conservatives in the Republican Party. What, more precisely, are the changes in partisan positions that underlie polarization? The Republican Party in Congress moves from a very conservative position in 1900 to a substantially more moderate position in the 1970s before rebounding to 1900 conservatism in 2000. The Democratic Party becomes more moderate until the 1950s and then drifts, relatively slowly, to a more liberal position. The net effect of these changes is that the differences between the parties—polarization—narrow until the 70s and then expand.

My main focus—stimulated by the parallel trends in economic inequality, political polarization, and public policy—is on how politics and economic inequality relate and are coupled by economic policy. There is, in this respect, an abundance of alternative hypotheses about the rise of inequality. The list includes greater trade liberalization, increased levels of immigration, declining rates of trade unionization, the fall in the real minimum wage, a decline in progressive taxation, technological change increasing the returns to education, the increased rates of family dissolution and female headed households, the aging of the population, pure racism, America's federal political system, gridlocked national politics, and the absence of proportional representation in elections (See Atkinson, 1997, for an overview of some of these topics; see also, Alesina, Glaeser, and Sacredote, 2001.)

Most of the factors listed above are either directly political or potentially affected by public policy. Technological change, however, would appear to respond to many forces that are independent of government policy. Similarly, decline of marriage is universal throughout the Western world. The roots of this may be just as much in technological changes that affect work in the household and in changes in lifestyle as changes in incentives produced through welfare and other public policies. Nonetheless, politics and public policy remain the focus of this essay.

An important aspect of the increase in inequality is that it has indeed taken place during a period of substantial economic growth. Although the quadrupling, from 1970 to 2000, of the proportion of the population that is incarcerated [Western, Kleykamp, and Rosenfeld 2003] suggests that many African-American males may not be better off than their grandparents,[2] by and large the increase in inequality is not a matter of pauperization. While there is debate as to whether the lower end of the income distribution is somewhat worse off or has remained relatively stable in economic status, it has pretty clearly not gotten much worse off. Moreover, a substantial segment of the lower tail consists of immigrants who are much better off than they were in their nations of origin. At the same time, at the middle and the top end of the income distribution, voters have become much richer. This is not just because the growth rate of income at each centile has been increasing in the centile. The poor eligible to vote increasingly vote less than the rich. In addition, non-voting legal and illegal immigrants tend to be poor. Another factor, but quantitatively less important than immigration, arises from growth in the number of incarcerated Americans and ineligible ex felons. (See Macdonald and Popkin, 2001 on both criminals and immigrants in voter turnout.).

Prosperity, immigration, and criminal justice policy combine to mute the political response to inequality. This chapter proposes an account of the political and institutional forces likely to blunt a movement toward redistributive economic policies. Rising wealth and incomes have created a sizeable constituency with a vested interest in the status quo, while the growing share of non-citizens and disenfranchised ex-offenders reduces the political power of the poor. As I discuss below, these shifts in the electorate take place in the context of institutional features of the American political system which give economic policies a kind of "stickiness," particularly given the polarization discussed above. Once established, economic policies which affect the distribution of income tend to be slow to change.

The essay proceeds as follows. A theoretical overview of the political economy of inequality is provided in section 2. This section also briefly applies the theoretical perspective to an understanding of events in the twentieth century. In section 3, I make some international comparisons. I highlight how the Great Depression, World War II, and the 1960s represented exceptional events for the United States. I suggest how politics might be relevant to differences in inequality across nations. In section 4, I document how politics in the United States has become polarized. In section 5, I link the political polarization to outcomes in income and wealth inequality and immigration. In section 6, I argue that increases in aggregate income and wealth and in immigration are acting to mute any political response to inequality. In section 7, I show how changes in public policies on taxes and minimum wages correspond to the changes in inequality and political polarization. This section also emphasizes how old age insurance taxes follow an entirely different pattern from taxation that is explicitly redistributive. I then conclude.

2. The Political Economy of Inequality

Theoretical Overview

This essay attempts to tie together the complex social phenomena of inequality, public policy, and political polarization. I start with a theoretical perspective that draws from formal models in political science and economics.

Politics as Liberal-Conservative Competition

A basic premise is that public policy throughout the twentieth century was largely (but not entirely, because of race[3]) a matter of political competition over a single, liberal-conservative dimension. In particular, in this theoretical overview, I am assuming that the 435 members of the House of Representatives fall along a liberal-conservative continuum with the most liberal representative in position 1, the median representative in position 218, and the most conservative in position 435. Similarly, the 100 senators can be ranked from 1 to 100. In the 107th Congress that served in 2001-02, the five most liberal senators were Feingold, Dayton, Corzine, Wellstone, and Boxer; the five most conservative were Ensign, Smith, Nickles, Gramm, and Kyl.[4] More information about how liberal-conservatism is measured is provided in Section 4. The liberal-conservative cleavage captures the debate over income and estate taxes and minimum wages.

American Institutions, Gridlock, and Sticky Policies

This cleavage interacts, in turn, with the presence of checks and balances in the American political system. For starters, new legislation requires either passage in both Houses of Congress and the president's signature or, in the case of a presidential veto, passage by two-thirds majorities in both Houses of Congress. Policy change can also be impeded by the filibuster in the Senate. In addition, congressional committees have substantial power that enable them to structure or impede legislation. In particular, if a House committee has jurisdiction over a bill and wants to block it, it may be necessary to obtain a two-thirds vote for a discharge petition that would bring the bill to the floor. The upshot here is that no single individual is decisive in the policy process. The United States is not like the United Kingdom where a single parliamentary election can easily lead to substantial policy change. In the United States, a number of veto agents or pivots (Krehbiel, 1998, Brady and Volden, 1998) must be on board to engender legislative change. A large coalition must be created to defeat the status quo and change policy. In a nutshell, legislation in the United States tends to be very sticky.

There are several examples of sticky legislation for policies that are central to this essay.

1. Goldin (1994) documents how presidential vetoes withheld restrictive immigration legislation until the 1920s even though congressional majorities had favored it for several decades. The restrictive immigration laws of the 1920s remained largely intact for 45 years, until the Immigration Act of 1965. Although Congress subsequently passed compromise immigration bills, the liberal 1965 policy essentially prevailed for the rest of the century.
2. The maximum estate tax rate remained fixed at 77% from 1940 through 1976 while the minimum estate subject to tax remained, in nominal dollars, fixed at $60,000 from 1942 through 1976.
3. Minimum wages changed more frequently but, because they are also defined in nominal dollars, the real value of the wage can erode sharply when, as happened from 1981 through 1989, no increase is enacted over a relatively long period.
4. Economic regulations adopted in the New Deal remained in effect for decades. Transportation and telecommunications were deregulated only in the late 1970s and 1980s. The separation of commercial and investment banking and other aspects of the Glass-Steagall Act remained in effect from 1933 until the passage of the Gramm-Leach-Bliley Act in 1999.
5. Welfare as an entitlement, known as AFDC, was initiated by the Social Security Act of 1935. The basic system remained in place and was extended until, over 60 years

later, the passage of the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996.

The power that institutions give to the status quo is important in assessing empirical studies of inequality. Because legislative adjustments are infrequent and non-discrete, the typical continuous responses embodied in econometric models will be inappropriate. In short, the lumpiness of politics makes it all the more difficult to understand the interactions of the slew of factors, listed above, that affect inequality.

Overcoming the force of status quo policies—gridlock for short—typically requires both a dramatic change in economic or social conditions and strong majorities. (For an opposing view, see Mayhew, 1991.) A recent example of a social shock changing policy is 9/11 leading to the USA Patriot Act. The terrorist attacks moved the status quo on civil liberties and privacy to the left on the liberal-conservative continuum. Existing constraints on law enforcement appeared to be too liberal. A more conservative policy became possible. (The policy can be safely interpreted conservative in that of the 66 House votes against the act, 62 came from Democrats, largely on the left wing of the party.[5])

The stickiness is especially likely to be overcome when the shocks lead to change that is favored by a party that controls both the White House and has majorities in Congress. The New Deal is, of course, the most pronounced example. The shock of the Depression changed how the status quo in economic policy mapped onto the liberal-conservative dimension while the huge Democratic majorities made passing new programs easy. (The Democrats had an 82-16 edge in the Senate at one point.) The important policy changes of the 60s discussed above occurred during unified Democratic government, with majorities reinforced by the Goldwater debacle of 1964. Similarly, the double-digit inflation before the 1980 election changed the status quo and led a Democratic controlled House to concede the Reagan tax cuts of 1981, although as soon as inflation dropped, the Democrats declared later Reagan budgets “dead on arrival”.[6]

The blocking of major policy change in the Reagan era once the inflation shock had passed[7] illustrates the stickiness of policy in times where there are no great shocks and where political competition produces more even results than the huge majorities of the Depression era. The possibilities for gridlock are further accentuated by political polarization. Institutions that lead to *Pivotal Politics* [Krehbiel, 1998] or *Revolving Gridlock* [Brady and Volden, 1998] interact with polarized politics to further restrict policy change.

Let me illustrate this point. With George W. Bush in the White House, a normal bill requires not only his assent but also support of the liberal-conservative median in the House. Moreover, the bill would also have to avoid a filibuster in the Senate. To get the necessary 60 votes for cloture, the bill would have to be acceptable to the filibuster pivot. This is senator 41 in the ranking. (Johnson of South Dakota and Feinstein of California tied for this spot in the 107th Senate.)[8] The Republicans will not be able to move any policy in a more conservative direction without the consent of this filibuster pivot. The other side of this coin is that Democrats cannot make more liberal policies without the agreement of majorities that would override a presidential veto. In the Senate, an override requires support from senator 67 (DeWine of Ohio in the 107th Senate) in the liberal-conservative lineup. So no change is possible for any policies that fall in the gap between the filibuster pivot in the Senate and the veto override pivot in Congress. As moderates disappear, the pivots are more likely to be quite conservative or quite liberal. As politics become more polarized, this gap or "gridlock zone" becomes larger.[9]

The import of sticky politics is that trends in inequality can persist for a long time. If the New Deal enacted policies that reduced inequality, inequality was likely to fall for some time, even after preferences might have shifted in favor of a less egalitarian society. Similarly, the high degree of inequality at the beginning of the twenty-first century can be expected to persist—absent a devastating shock to the system, such as a Depression-like economic event. Persistence is all the more likely in the presence of polarized politics and an enlarged "gridlock zone". Federal legislation that would deal with inequality is highly unlikely.

The Political Economy of Redistribution

In contrast to the political science of legislation, with its emphasis on gridlock and the persistence of the status quo, the economics of redistribution largely relies on models where the individual with median income dictates policy. The basic insight was developed by Foley (1967). Income distributions are skewed; that is, average income is above median income. Being below average, the median income voter should support redistribution. In fact, if taxes are proportional to income and redistribution is identical (lump-sum) for all, only the minority with incomes above the average would oppose redistribution. So simple majority rule should lead to redistribution.

Foley's basic insight has been tempered by subsequent work that emphasized restraints on redistribution that would result from diminished labor supply (Romer, 1976, 1977; Roberts, 1977), simple deadweight loss (Meltzer and Richard, 1981; Bolton and Roland, 1997), expectations of upward mobility (Benabou and Ok, 2001) and credit market imperfections (Benabou, 2000). Nonetheless, in median voter democracies, some redistribution can be expected to occur. Redistribution, however, might be absent because the majority rule model is simply inappropriate. One factor making the model inappropriate is that the median voter may, as indicated in section 5, have an income much higher than that of the median individual in the income distribution. The other is that political institutions are distant from simple majority rule and, as indicated above, gridlock can block policy change.

The Impact of Inequality on Policy Formation

When policy change does occur, the nature of the change can be shaped by the inequality present in society. If the top half of the income or wealth distribution has a lot to lose, its members can be expected to fight hard to protect gains and to seize the opportunity to reverse or limit redistribution when in power. The dramatic increase of real income and wealth in the last half of the century and a dramatic increase in the fraction of the population invested, directly or indirectly, in equities (Duca and Savings, 2003) may underpin the regressive tax policies of the Bush administration. Conversely, when inequality is high and incomes are low or falling, a unified left government may be more inclined to press for redistributive taxation of wealth and income, minimum wages, and income insurance programs.

Coalitions that reduce inequality can, however, still be built under conservative governments. As Goldin (1994) stresses, the restriction of immigration in the 1920s responded not only to nativist and southern concerns with the distribution of political power but also to labor concerns about low wage competition from immigrants. The Republican sponsored laws of the 1920s are likely to have increased wages at the low end and stimulated black migration to the north (Collins, 1997), at the expense of those denied entry. From a broader perspective, the rich can make redistributive concessions to the poor to secure the participation of the poor in wars (Ticchi and Vindigni, 2003) or to avoid a revolution by the poor (Acemoglu and Robinson, 2002). Avoidance of revolt or at least unrest does seem to have been an underpinning of the Great Society program.

Programs to reduce inequality might be tempered by two factors. First, I conjecture that, for a given level of inequality, redistribution becomes less likely at very high levels of per capita income. The basic logic is that at high levels of societal income the rich and middle classes rely on self insurance and have less demand for redistributive social insurance. The middle classes become more risk acceptant. Second, who votes affects redistribution. A perhaps unintended consequence of the largely unskilled immigration of the past thirty years is that poverty is concentrated among immigrants who have no voting rights. The lower turnout, in general, of the poor combines with immigration and the overall increase in income to reinforce the effect of gridlock at blocking public policies that would reduce inequality.

Other Events

Other events, particularly swings in technology, the business cycle, wars, social unrest, and racial politics, are somewhat independent and distinct from the trends in political polarization, public policy, and income inequality that are emphasized here. Some of these changes have direct effects on inequality. Racial biases in hiring may trap low income African-Americans. Technological change that generates increasing returns to education will have a direct effect on inequality that may not be compensated by changes in public policy. The changes also have indirect effects through their influence on the political process by shifting the control of government and public policies. Thus, the Depression and World War II combined to produce high marginal tax rates that were persistent in the post-war period.

Applying the Theoretical Framework

Let me, very speculatively, apply the theoretical perspective just developed to the unfolding of the twentieth century. In the first half of the century, inequality may have been decreased by a combination of technological factors of the Kuznets variety, the severe tightening of immigration in the 1920s, anti-competitive incumbent protection measures brought about by the Great Depression, and very high marginal tax rates on incomes and estates justified by war finance.[10] The huge congressional majorities enjoyed by the Democrats in much of the period from the 30s to the 70s permitted passage of policies that may have contributed to lowering inequality. These policies, given the status quo bias in American politics, were likely to persist for a very long time.

By 1950, however, the aggregate economy was at an all-time peacetime high in terms of per capita output. (In contrast, per capita output in continental Europe and Japan remained well below its prewar highs.) As time progressed, pressure built for changing government policy in a direction that would promote competition and risk-taking via deregulation and that would place more reliance on self-insurance and less on social insurance.

These pressures continued in the 60s when the top half of the income distribution was earning much more in real terms than during the Roosevelt years. Memory of the Great Depression had faded for some and was non-existent for others. Moreover, the Democratic party turned away from issues of general social welfare and toward issues—race, gender, sexual preference, immigration from outside northern Europe—that were based on ascriptive characteristics of individuals (Gerring, 1998). In promoting these anti-discriminatory measures, the party lost its dominance in the South. Among southern voters, conservatives, most notably well-to-do southerners[11], switched to the Republicans. In the House of Representatives, African-Americans became concentrated in the left wing of the Democratic Party. As such, race ceased to be a distinct issue dimension in American politics and became embedded in the liberal-conservative conflict over redistribution.

The political pressure against egalitarian, redistributive policies came to the fore in the last quarter of the century. Perhaps the first marker was the anti-tax movement that led to the passage of Proposition 13 in California in 1978. During this last quarter-century, technology, globalization, and increased immigration may all have contributed to worsening income inequality. Nonetheless, new conservative strength both blocked compensating policy responses and, when given the opportunity, reduced the support for existing programs.

The parallel trends in inequality, public policy, and politics seem less explicable in terms of other factors. Race does appear related to the current absence of redistribution in the United States (Alesina, Glaeser, and Sacredote, 2001) and to the absence of public spending in local communities (Alesina, Baqir, and Easterly, 1999; Alesina and La Ferrara, 2000, 2002). The claim that welfare expenditures in the United States are low because of race has been made by many authors including Myrdal (1960), Quadagno (1994), and Gilens (1999). But it is hard to see racism as hardening in the last quarter of the twentieth century when inequality increased. Racism and racial tension seem to have been at least as rife when inequality fell. Recall the lynching and race riots in the first half of the century and the urban riots of the 1960s. Similarly, unionization has been declining since the 1950s, well before inequality worsened, and trade liberalization has been ongoing since the 1930s. So my focus in the rest of the essay will be on minimum wages, taxes, and immigration and how these policies relate to inequality.

3. Some International Comparisons

Many observers have noted that income inequality in continental Europe and Japan is not as severe as in the United States, with Britain being something of an intermediate case. It is, therefore, important to ask what are the major distinctions in the historical experience of the industrialized nations. I emphasize trends in aggregate economic experience, the 1960s, and institutions in contrast to an older literature that roots "American exceptionalism" more in the organization of labor and the absence of Socialist and Communist parties (Lipset, 1996, Sombart, 2001). In a nutshell, I argue that the Great Depression may have allowed the United States to parallel other nations in the decline of inequality for most of the twentieth century while the economic expansions of the first half of the century may have set the seed for the current increase in inequality.

There were indeed dramatic differences in the pattern of aggregate growth between the United States and the six other major industrial nations that formed the G-7 (Canada, France, Germany, Italy, Japan, and the United Kingdom). Over the course of a century, all seven nations did incredibly well. Maddison (1995, pp. 194-197) presents time series on GDP per capita in terms of 1990 Geary-Khamis dollars. In 1900, all G-7 nations were below $4700 and two, Italy and Japan, were below $1800. By 1990, all had passed $15600. The path of growth, however, was substantially different across these societies. The European nations involved in World War I all took a substantial hit. The United States and Japan did not. Germany never recovered until the advent of the command economy of Nazism. Germany did not surpass its 1913 GDP per capita until 1934.Here, I highlight contrasts in economic growth during the Depression and then during World War II.

The Great Depression

The United States was particularly hard hit by the collapse of the 1930s. The US did not surpass its 1929 level of GDP per capita until 1940. The public policy effects of the Depression in the United States were not just the introduction of social insurance and progressive taxes. The Depression furthered anti-competitive regulation in the form of the Motor Carrier Act, The

Banking Act of 1933 (Glass-Steagall), the Civil Aeronautics Act, Federal Communications Act, the Wagner Act which strengthened unions, agricultural price supports and marketing boards, taxicab regulation at the local level, etc. These were all reversals of capitalism, that as Rajan and Zingales [2002, 2003] have argued, were part of a worldwide response that cushioned incumbents from the shock of especially bad times. Incumbent protection coupled with progressive taxation is likely to preserve incomes at the low end while blocking the entrepreneurial creation of new fortunes and performance based compensation at the high end.

War

World War II, however, represents the big distinction between the United States and the other major industrialized nations. On the one hand, the war led to tax policies with very high marginal rates. Inertia carried these policies forward for many years. On the other, the United States did not suffer the physical destruction and economic disruption that befell countries, including G-7 members France, Germany, Italy, and Japan that were defeated and occupied at one point in the war. Those countries had complete economic collapses. At the end of the war, per capita GDP in France in 1943, 1944, and 1945 was below the 1900 level. The 1946 and 1947 levels in Germany similarly fell behind the comparable figure for 1900. The Italian GDP per capita in 1945 was below that for 1905 while Japan in 1945 lagged behind the 1911 level. Per capita output in the UK in 1945 exceeded that at the time of Dunkerque. But output soared the most in the United States. By 1945, the US had more than doubled the 1938 level of output.

Clearly, the aftermath of World War II could be expected to have a great differential impact on how nations organized politically and implemented policies with respect to redistribution and social insurance. [For example, did old age pensions in Europe have to be provided by the state because private firms had no capacity to provide them and individual savings had been wiped out in the war?] Piketty (2001) has argued that wartime wage policies within France and the destruction of wealth during two wars established a political lock in of redistributive policies that have kept income inequality from rising there. In this respect, it is interesting that Britain and the United States are the major industrial nations with the greatest degree of inequality by the end of the century.[12] Britain, as indicated above, is intermediate between the United States and Europe in the impact of the war; it is intermediate with respect to inequality. It is the only European nation where elections could result in implementing and sustaining "reforms", first under Margaret Thatcher and then under Tony Blair.

There are two further distinctions between the United States and other nations that may relate to the rise of inequality in the last quarter of the twentieth-century. These are the civil rights and immigration legislation passed in the 1960s and American institutions.

The 1960s.

After World War II, there were dramatic difference in the pattern of economic growth between the United States and nations recovering from the war.. There were also unique policy changes in the United States that occurred in the 1960s, including the Voting Rights Act of 1965 and the Civil Rights Act of 1964. These policies capped a process that broke apart the old Democratic coalition of white southerners and northern non-Protestants.

From the end of Reconstruction to the mid 1930s, southern Democrats represented the left wing of the Democratic party and were the force behind legislation, such as railroad regulation in the 1880s (Poole and Rosenthal, 1993) and corporate taxation in the 1910s (Brownlee, 1996), that had a redistributive aspect—from northern whites to southern white. Starting in the 1930s but most emphatically after the passage of civil rights legislation in the 1960s, the southern delegation in Congress moved substantially to the right and became hostile to redistribution.[13] Similarly, southern voters, including whites, once solidly Democratic are now split heavily along income lines (McCarty, Poole, and Rosenthal, 2002). In other words, the enfranchisement of African-Americans in the South shifted the policy debate from one of North-South or urban-rural redistribution among whites to one of white-black or rich-poor redistribution. The connection of redistribution to race may have made Americans relatively unfavorable to redistribution. (See the previously referenced work by Alesina and coauthors.)

The 1960s also featured the development of affirmative action policies based on ascriptive characteristics of individuals. These policies reflect a shift, as mentioned previously, in Democratic Party platforms from an emphasis on general welfare to ascription (Gerring, 1998). A recent theoretical model by Austen-Smith and Wallerstein (2003) suggests why race may now be linked to an increase in inequality even when it did not seem to be consistent with the fall in inequality earlier in the century. The distinction arises from the post 60s availability of affirmative action as a social policy. In their model, there is neither, racial discrimination in employment nor prejudice among voters. But they demonstrate, within the context of the model, that there will be less redistribution when there are two policy instruments—affirmative action and redistribution—than when redistribution is the only policy instrument.

In addition to civil rights legislation, the 1960s also featured the passage of the Immigration Act of 1965, which opened the United States to substantial legal immigration for the first time in over four decades. This immigration may well have exposed the domestic poor to wage competition (Borjas, 1999; Bean and Bell-Rose, 1999) and, moreover, caused the lower income brackets to become less represented in the voting population.

Institutions

As outlined in the previous sections, the United States has institutions that support gridlock and make policies sticky. Institutions, it can be suggested, helped lock in New Deal type policies. They also may make it difficult to respond to the current increase in inequality. On the other hand, the institutional story should be taken with some caution. In addition to the institutional structure for legislation, the United States has another important difference with respect to at least some continental European nations. It does not have politicized national labor organizations capable of organizing mass protests. If the United States can have gridlock in its national legislature, Europe can have it in the streets.

Inequality and Politics

I now turn to some comparative evidence on inequality.

In Figure 1, I show the percent of total income that accrues to the top one-tenth of one percent of families in the United States, Britain, and France. The data, based on tax returns, is reproduced from Piketty and Saez (2003). Early in the twentieth century, one family in one thousand accounted for 8 percent or more of family income in all three countries. By the late 60s this share had fallen dramatically to around 2 percent in all three countries. Without the data from the last quarter-century, it would be hard to find a role for politics—there were a mixture of left, right, and Facist regimes in the three countries—and easy to see support for the Kuznets notion of rising industrialization leading to a drop in inequality.

The divergence occurs in the last two decades. The share of the rich holds at 2% in France but increases to over 3% in Britain and to 6% in the United States. It is easier to see the role of politics than of technology from this point on. Bartels (2002), on the basis of regression analysis for 1948-2000, argues that Republican presidents are associated with the growth of income inequality and Democratic presidents with its reduction. The Bartels story doesn't say much about the general fall in inequality in the first half of the century, but politics does appear to have bite in the last half.

In the United States, Ronald Reagan took office in 1981. Concurrently, the Republican vote share and, with a lag, seat share for the House of Representatives was increasing (Duca and Savings, 2002). Consequently, for the last 20 years of the century, the Republicans controlled either the Presidency or both houses of Congress for all but two years (1993-94). Starting with Nixon in 1969, the Republicans exercised the same level of control for all but six of the last 32 years of the century. This is precisely the period where inequality reverses.

In Britain, Margaret Thatcher took office in 1979. The conservatives remained in power in Britain until Tony Blair took office in 1997, near the end of the Piketty-Saez series. In contrast, Francois Mitterand brought the Socialists to power in France in 1981 and retained the presidency until 1995. The Socialists also controlled the legislature for most of this period. When the right briefly controlled both the presidency and the parliament, from 1995 to 1997, "reforms" were blocked by massive labor disruptions. Similarly, reforms proposed in Italy by Berlusconi in 1994 were blocked by strikes; Berlusconi was forced from office. Helmut Kohl's 16 years in office in Germany were perhaps facilitated by a realization that reforms were not consistent with maintaining political power.

The data presented by Piketty and Saez are largely echoed, for shorter time series of Gini coefficients presented by Atkinson (1997). He indicates that the Gini coefficient of household income rose sharply in Britain after 1977. The picture here is somewhat different than that of Piketty and Saez, since Atkinson shows that Gini coefficients rose even more sharply in Britain than in the United States. Income, however, remains substantially more equally distributed in Britain than in the United States. In contrast, the Gini coefficients remained stable in France and Germany and even fell in Italy.

There are two caveats, however, to the simple story that recent trends in inequality are simply the consequence of the politics of the 80s and 90s. First, Atkinson shows that the Gini coefficients for Sweden and Japan increased about the same degree as in the US. Although the Social Democrats did not hold office continuously in Sweden, it is hard to argue that there was a Reagan-Thatcher type switch there. Similarly, Japan went away from complete LDP control in the 1990s. The other side of the coin is that Atkinson also shows that, like France, inequality did not increase in Germany and Italy. In Germany, the right governed, with Helmut Kohl, from 1982 to 1998. The Italian case is more mixed but certainly not one of a Mitterand type left-wing government. Second, as I show later on, in the United States, many of the important policy changes that would be associated with an increase in inequality were initiated before the election of Reagan. Similarly, figure 1 shows that inequality in Britain began to increase before Thatcher's election.

Putting these results together, I suggest that technological and market forces are pushing toward increased inequality. So are "reforms" pushed by some business interests—weaker unions, deregulation, free trade, and privatization—that would benefit from these forces. The "reforms" are more likely to be pushed when the right has political power. Indeed, causality may be reversed. If inequality is produced by large increases in income in the top half of the income distribution, conservative or right governments may be as much the consequence of inequality as its cause. I argue this point in section 6.

The right, on the other hand, may not always be able to implement "reforms". Powerful labor movements can block change from ever being put on the legislative table or veto change through strikes and mass demonstrations. The power of labor unions may be what ties together the lack of an increase in inequality in France, Germany, and Italy. Note that Margaret Thatcher's defining moment with labor was in facing down the coal miners in 1985; Reagan's was firing the air traffic controllers in 1981. In contrast, Chirac and Juppé caved to the 1995-96 strikes.

This comparative discussion highlights the distinctive historical context of the United States, including the social legislation of the Depression, the relative prosperity of the World War II and postwar period, and the civil rights and immigration legislation of the 1960s. These historical events, I argue, are important influences on inequality as well as the associated trends in political polarization and economic policy that I discuss.

4. Polarization

What do we mean by the "Polarization of American Politics"? We all recognize that members of Congress can be thought of as liberals and conservatives. Ted Kennedy is a liberal, Diane Feinstein is a more moderate Democrat, John Breaux even more so, Olympia Snowe a moderate Republican, and Trent Lott is a conservative Republican. The perception of liberal-conservativeness is commonly shared. There is a common perception because there is a predictability of behavior. If I know that Olympia Snowe will fight a large tax cut, I am pretty sure that all or almost all the Democrats will support her position. In fact, for the past quarter-century, we can find a common ordering from liberal to conservative that, on average, will "explain" over 90 percent of all the individual roll call votes cast by legislators. On a given vote, legislators will break into two camps, one liberal and the other conservative. On some votes, with large conservative majorities, the break might come between Diane Feinstein and senators to her right. On closer votes, Olympia Snowe might be at the break point. For any vote, we can find a break point that represents our "explanation".

A statistical method, called DW-NOMINATE (McCarty, Poole, and Rosenthal, 1997) permits assigning numerical values for liberal-conservativeness for representatives that allow us to compare representatives across American history and study polarization.[14] Schickler (2000) has developed an interesting graph that we can use to portray polarization. I reproduce it as figure 2.

Figure 2 contains plots of three liberal-conservative measures against time. The graph in the middle is the position of the median House member, the member who ranks 218 out of the 435 representatives. Not surprisingly, the position of the median member of the Republican House delegation plots out as the top graph, above the overall median in a conservative direction. The median Democrat is the bottom graph.

It can be seen that the median position in the House does not track inequality (figure 1) particularly well. The overall House median is more volatile than either party median. Party ideology changes only slowly but elections can sharply shift the position of the House. This happened frequently before World War I, when elections to the United States House of Representatives reflected a competitive democracy rather than a gerrymandered welfare state for incumbents. Since World War I, there have only been two big shifts: the liberal-move after the 1929 stock-market crash and the conservative move with the "Contract with America" in 1994.[15] The overall volatility bears little relationship to the gradual decline in inequality from 1913 to 1975 shown in figure 2. In particular, the House moved in a conservative direction from 1913 to 1929 and from 1937 to 1948. Conversely, as inequality rose after 1975, the House became more liberal until 1994. Changes in the position of the median Democrat also fail to track changes in inequality

What does track changes in inequality is the position of the median Republican. House Republicans, who were almost entirely northerners before the 60s, moved in a liberal direction until the early 70s and then moved backed to being as conservative as they were pre-1929. (The story for the Senate is similar to that for the House.)

Finally, I get to how figure 2 shows polarization. We can think of polarization as the *difference* between the Republican median and the Democrat median. From 1913 to 1975, as inequality falls, polarization falls. Until 1937, not only did the Republicans become more liberal but also the Democrats became more conservative, as the position of southern Democrats changed. After 1937, the Democrats became more liberal but at a very slow rate. So polarization continued to fall until 1975 because of the more rapid liberal movement of Republicans. In the last quarter of the century, both parties moved, particularly Republicans, to extreme positions. How we measure polarization is robust to alternative definitions. In the remainder of this paper, rather than use the difference between medians I use the average distance between Democrats and Republicans.[16]

It should be pointed out that the changing positions of the Republicans and the increase in polarization are not a simple matter of the changes in southern politics. There would be similar results if we analyzed the roll call votes of just northerners. The trend of House polarization is echoed by a separate analysis of presidents since 1955 done by Keith Poole.[17] The positions of presidents are pegged by having them "vote" on roll calls that *Congressional Quarterly* uses to compute presidential support scores. The basic story is that Reagan and George H. W. Bush appear as far more conservative than Eisenhower and Nixon while Clinton was only slightly more conservative than his predecessors.

Polarization along liberal-conservative lines may be particularly relevant to the study of inequality because redistributive issues typically involve liberal-conservative splits (see, for example, Poole and Rosenthal, 1991 on minimum wage). As the parties move apart on redistributive issues, voters may polarize more along income lines. McCarty, Poole, and Rosenthal (2002) show that partisan identification and presidential vote choice are increasingly stratified by income, with the top income quintile becoming overwhelmingly Republican supporters while the bottom quintile gives overwhelming support to Democrats.

5. Political Polarization, Economic Inequality, and Immigration.

I now show how the trend in polarization matches up with two other major reversals in American society. One is the shift from decline to increase in economic inequality seen in figure 1. The other is the reversal in immigration.

Comparisons of the wage share of the rich in figure 1 and either the position of the median Republican or the difference in the party medians discloses a high degree of congruence. I now show a similar result for the postwar period using two different measures. To measure inequality, I employ the widely used Gini coefficient. To measure polarization, I employ the average liberal-conservative (DW-NOMINATE) distance between Republicans and Democrats. The results are in Figure 3. The correlation, for 1947-2001 is 0.94.

A time-series covering wealth inequality was developed by Edward Wolff (2002a). The fit to polarization for 1927-1990 is not as tight as with the Gini coefficients. The result is shown as figure 4. Wealth concentration into the top one percent declines as polarization declines through the 70s and then, in the first half of the 80s begins to increase as wealth increases. Afterwards, surprisingly, wealth inequality plateaus around 20 percent. More recent work by Kopczuk and Saez (2003), based on estate tax returns from 1916 onwards, shows a similar pattern. These authors find that the share of wealth held by the top 1% oscillates from 35% to 40% until 1929. Afterwards, with the stock market crash and estate taxation, this share falls to the 23%-21% range from 1940 until 1965 when it drops to just under 20% in the late 70s.

Afterwards, wealth inequality increases, but only slightly, to about 22%. Of course, these reports can be biased by the ability of the rich to effectively transfer their estates to their heirs in a way that avoids reporting the wealth. Even so, a basic picture emerges. The long-term decline in the wealth of the rich is at the least halted and perhaps slightly reversed at a point close to when political polarization increases.

The pattern also holds with respect to immigration. The plot of the percent foreign born against polarization is shown in figure 5. The correlation of 0.95 was computed by matching the 13 observations for the decennial census from 1880 through 2000 with the polarization index for the corresponding House. The percent foreign born is not the only way in which immigration might be measured. Bean and Stevens (2003, p. 19) show that the flow of immigration fell dramatically in the 1910s as a result of World War I and fell through the 1920s and 1930s to nearly 0 after the passage of the national origin quota Immigration Acts of 1921 and 1924. Immigration then increased in every decade from the 1940s through the 1990s. Thus, the flow of immigrants appears to have picked up sometime before the change in inequality.

But what of low-skilled immigrants, those with a potential impact on both inequality and polarization? The increase in immigration right after World War II was in large part a flow of refugees. Only in the 60s, centered on the abolition of national quotas in the Immigration and Naturalization Act Amendments of October 3, 1965, did the number of immigrants from Asia and Latin America exceed those from Europe and Canada (Bean and Stevens, 2003, p. 21). Third world immigrants begin to strongly outnumber those from the first world only in the 70s. Similarly, illegal immigration, as proxied by “apprehensions” by the INS, only becomes a major factor in the 1970s (Bean and Stevens, 2003,, p. 24). Consequently, it is plausible that low-skilled immigration became a major factor only in the late 60s and in the 70s, precisely the time period when polarization begins to increase.

6. The Political Implications of Economic Inequality

It is now time to reconcile the continual prosperity of the United States since the Great Depression, marked by an enormous increase in aggregate per capita output, with the increase in inequality from the 1970s onward (figures 1, 3, and 4), and to relate these observations to politics. I contend that economic prosperity, as reflected in growth in the incomes and assets of middle and upper-income voters, weakens the political movement for redistributive policies. This shift is reinforced by the rising prevalence of non-citizens in the population and particularly among the poor.

Levy's *The New Dollars and Dreams* (1998) drew attention to those Americans who had fallen behind at the bottom of the income distribution. But data presented in that study highlight a different point with respect to political implications. Let's characterize the poor as families with under $20,000 in 1997 dollars. Levy shows that, in 1949, 60 percent, a strong majority, of American families fit this definition of poor. At the other end, only about 3 percent had incomes over $60,000. *In 1949 there were, percentage wise, almost no rich Americans*. We were all far from heaven. By 1973, near the time that the inequality curve begins its reversal, the situation had changed dramatically. The poor under $20,000 had fallen to about 19 percent and the relatively well to do above $60,000 had risen to well over 20 percent. This 20 percent that was truly middle class and above would now represent a sizeable segment of the population interested in retaining their wealth. They would be more politically powerful than their numbers would indicate, through actually voting, through making campaign contributions, and through interacting with their representatives. Not surprisingly, in the late 1970s a wave of tax limitation referenda went coast-to-coast from Proposition 13 in California in 1978 to Proposition 2.5 in the liberal bastion of Massachusetts.

By 1996, there had been further dramatic change. A slightly larger fraction of the families had fallen into the poor segment below $20,000, which rose from roughly 19 percent to

21 percent. The top category, however, continued to surge ahead. By 1996 about 32 percent of the population was above $60,000. Even if those families earning the high incomes were putting in more total hours due to female entry into the labor force, the family unit would be likely to resist taxation on either incomes or wealth.

I have made somewhat different tabulations to use data that is closer to the present time and to take an intervening date close to the worst post World War II recession. In figure 6, I look at household income in 1967, 1984, and 2000 in terms of 2000$. A first observation is that real median income is rising through this period. It goes from $31,397 in 1967 to $35,568 in 1984 to $42,148 in 2000. Although incomes may have decreased somewhat at the bottom end, *a majority of Americans were better off* even though inequality was increasing. While the higher the centile in the distribution, the higher the growth rate of income attached to that centile, even the median had real growth

I have also shown percentages of households in 2000$ income categories of $35,000 and above—types at or near the median and above it. The rightmost set of bars shows all households earning over $35,000. The other bars show breakdowns for finer income categories. As shown in the rightmost set, households over $35,000 increased steadily from 42 percent in 1967 to 58 percent in 2000. As shown in the other bars, there was an increase in every category except the bottom category of $35,000 to $50,000. That loss was more than offset by movement into higher income classes. In particular, Americans over $100,000 rose from about 3 percent in 1967 to over 13 percent in 2000. There are now lots of pretty rich households.

Very much the same story emerges if one looks at after-tax incomes. Phillips (2002, p. 128) presents a chart that shows inflation-adjusted annual after-tax income of the two bottom quintiles from 1967 to 1997. The chart also shows the top 5% and the top 1%. The two bottom quintiles have been basically stable—we do not see pauperization. Inequality has grown because the top groups have reaped all the benefits of per capita economic growth. Similarly, even for the carefully chosen period 1977 (before the bad times of the late 70s and early 80s) to 1994 (after the recession of 1991-92 and before most of the boom of the 90s), Phillips shows family income in the middle quintile declining by only one per cent.

The growth in median income, and the much faster growth in high incomes is not a scenario that generates strong political demands for redistribution. Indeed, it is as if economic policy in the United States was successfully solving a maximization problem: let high incomes grow as much as possible subject to not making the median household worse off.

Changes in wealth holdings also show significant growth for households at the upper end of the distribution. It is true that consumer debt as a fraction of income has risen dramatically (see, for example, Phillips, 2002, p. 134). It is also true that mortgage exposure has risen through an increase in the mortgage debt to loan value or debt to equity ratio (Bhacheiva et al., 2003). But a much rosier picture emerges if one considers asset holdings and net worth, particularly of the middle class.

The median net worth of households jumped from $56,900 in 1983 to $71,100 in 1998 (1998$, Bertaut and Starr-McCluer, 2002, p. 186). From 1983 to 1995, the fraction of households owning mutual funds, tax-deferred equity, all types of bonds, and other financial assets all increased (Poterba, 2002, p. 110). (There was a slight decline in directly held equity.) Particularly striking is the jump in households with tax-deferred equity, which went from 19.5% in 1983 to 30.4% in 1995. By 1995, non-housing (e.g. credit card) debt represented less than 10 percent of non-housing assets for all age groups except those 34 and below (Poterba, 2002, p. 115). So many of those indebted could anticipate wealth accumulation during the life cycle. By 1998, citizens in the third wealth quartile had nearly half of their total assets in investments other than their primary residence; their debt, other than mortgage and home equity debt, was less than six percent of their assets (Bertaut and Starr-McCluer, 2002, pp. 196-197.). This quartile is almost certain to contain the pivotal voters.

Duca and Savings (2002) argue that the increase in equity holdings, brought about by 401k plans and lower mutual fund charges, explains the increase in the Republican vote share for the House of Representatives. Americans, far more than the citizens of other industrialized nations [Guiso, Haliasso and Jappelli (2002)], are into stocks. The results in Duca and Savings do not control for the end of the one party system in the South. But later research (John Duca, personal communication) not only confirms this result for the Republican shares broken out by North and South. Moreover, part of the increased Republican support in the South can be attributed to the increase in incomes in the South. The Duca and Savings results suggest that voter sentiment against redistribution drive both the increase in inequality associated with postwar Republican administrations (Bartels, 2002) and Republicans winning elections more frequently since 1968.

The effect of rising incomes in the South illustrates how inequality and politics may be responsive to the unique federal structure of the United States, mentioned in the introduction. When income inequality across families or households in the nation was low, inequality across states, particularly North-South, was high. As regional differences have diminished and overall inequality has increased, within state inequality must be increasing more rapidly than national inequality.[18] Thus state politics can become polarized along income lines. Pennsylvania perhaps represents an illustration of the process. For years after World War II, Pennsylvania had always had either one very liberal senator (Guffey or Clark) or one very conservative one (Edward Martin). By 1969, however, both of Pennsylvania's seats were in the hands of moderate Republicans, first Hugh Scott and Richard Schweiker and later John Heinz and Arlen Specter. The moderation closely follows the national path for House Republicans shown in figure 2. This moderate representation began to unravel when Heinz was killed in a plane accident in 1991. Heinz was replaced by Harris Wofford, a liberal Democrat who was then beaten by Rick Santorum, a conservative Republican. It is likely that when Pennsylvania's other senator, the moderate Arlen Specter, leaves the Senate, his replacement will not be a moderate. (In the 107th Senate, Specter was 53rd on the liberal-conservative scale while Santorum was tied for 85th.)

If the rapid increase in within-state inequality may find an echo in Santorum type conservatism, offsetting advocacy for the poor may be less forthcoming. Reinforcing this expectation, those with low incomes are disproportionately non-citizens, as shown in figure 7. The figure is based on research by Christine Eibner. She used the November 1998 CPS to compute the cumulative family income distribution for voters, non-voters, and non-citizens. Both citizenship and voting are notorious for being over reported. It is not clear how over reporting is correlated with income, but the bias is unlikely to overwhelm the import of her results. Median family income in 1998 for the entire sample of 74,631 was near $38,000. For voters it was much higher, $45,000. Reported income for non-voters had a lower median of about $34,000. For non-citizens, the median was only about $25,000. The median voting citizen takes in nearly twice as much as the median non-citizen. These results suggest one factor that militates against public policies that would reduce inequality. Those who vote have relatively high incomes. Those who are ineligible to vote have relatively low incomes. Moreover, immigrants, regardless of citizenship status, are typically substantially better off than in their country of origins, Their advocacy for redistribution may be tempered by this relative evaluation of their economic attainment.

Thus the political implications of immigration, which militate against redistributive politics, reinforce the economic consequences of immigration. Bean and Bell-Rose (1999, p. 13) summarize recent research on immigration::

> …the most authoritative assessment of immigration's economic consequences has been carried out by the National Research Council…The Council reached two major conclusions: Immigration exerts a positive effect on the U.S. economy overall but only a small adverse impact on the wage and employment opportunities of competing native groups; and immigration benefits high-skilled workers and the owners of capital but not low-skilled workers or those who do not own capital. … recent immigration … appears to have exerted negative effects on the economic situation of African Americans. …. This

> is perhaps not surprising given that … benefits [of immigration] were concentrated among the highly skilled and the owners of capital, both of which groups include disproportionately fewer African Americans than whites.

The Bean and Bell-Rose summary stresses small losses at the bottom and big gains at the top of the economic hill. This finding is consistent with the evolution of the overall income distribution that I noted above—stability or slight retrogression of real incomes at the bottom and large increases at the top. To the extent that low-skilled immigration has contributed to the increase in inequality, public policy, expressed in the abandonment of discriminatory national quotas and limited attention to illegal immigration, has been a driving force.

The economic effects of immigration summarized by Bean and Bell-Rose do not substantially differ from the summary presented by Borjas (1999). Borjas draws a strong policy implication from the data—admit more high-skilled immigrants and fewer low-skilled immigrants. Such a proposal would not only have a potential direct economic effect—through raising wages at the bottom—but also an indirect political effect. As current immigrants become naturalized while the flow of new immigrants is reduced, the income distribution of voters would come to more closely resemble the overall income distribution.

7. Public Policies Affecting Inequality

Immigration policy is one policy that in a perhaps unintended way contributed to the worsening of economic inequality. Other policies might be thought of contributing to income inequality directly. I will focus on minimum wages, estate taxes, and income taxes, largely because I can report long time series of these policies. These policies reverse in a manner that parallels the reversals in inequality and in politics.

Federal minimum wages were introduced in 1938. The real value of the minimum wage follows a saw tooth pattern. The saw teeth reflect the fact that the wage is not indexed to inflation. When the current nominal wage is in the gridlock zone, the real wage will decline. The Democrats attempted to index minimum wages in the 60s and the 70s. On September 15, 1977 an amendment sponsored by Phil Burton of California to index the wage for five years failed by the relatively narrow margin of 232-191.[19] The vote was strongly along liberal-conservative lines, with moderate Democrats joining Republicans to defeat the amendment. Had Burton succeeded, the minimum wage might be far higher than today in real terms. It may have been as difficult to pass deindexation as it is now difficult to pass meaningful increases. Since the wage is not indexed, deflation may help to reduce inequality if minimum wages are, as Lee (1999) argues, an important factor in determining wage inequality.

The sawteeth, however, only are temporary interruptions in an upward trend that persists until 1968, at the very end of Lyndon Johnson's Great Society. This is shown in figure 8. Minimum wages initially failed to cover large categories of workers, largely as a matter of concessions to Southern Democrats. Figure 8 also shows that coverage was expanded at the same time as the basic minimum wage was increasing. The post-war period was indeed one of generous increases. Although the largest increase occurred in the Truman years, there was a real increase even under Eisenhower, a Republican president.

The big change occurred when Richard Nixon took office. Even though there was some increase post-Watergate, minimum wages did not even recover half of the losses in the first six Nixon years. Increases in minimum wages were voted under President Carter, but they were quickly eroded by the high inflation at the end of his four years. In Carter's last year in office, 1980, real minimum wages were actually less than in Ford's last year, 1976. The Reagan years saw much further erosion of the minimum wage. The "kinder, gentler" increase accepted by George H. W. Bush restored very little of the losses. Bill Clinton was then barely able to better the Bush restoration.

Politically, the reversal in the minimum wage chart is consistent with an end to Democratic dominance in American politics that, as noted previously, can probably be dated from the Nixon election in 1968. But it is also possible that preferences on minimum wages have changed for individual legislators. Poole and Rosenthal (1991) did an admittedly crude calculation of preference shifts by comparing the votes of senators who had voted on minimum wages in both 1977 and 1989. They found that the real wage these senators would support had fallen by about 15-20% from 1977 to 1989. The decline in their support might reflect the academic debate over the employment effects of minimum wages but it might also reflect a shift in preferences of increasingly better off citizens. Both a shift in these preferences and an overall shift to Republicans would be consistent with an electorate that is increasingly tilted toward the well to do by declines in turnout and by immigration.

The real minimum wage today is no higher than it was in the 1950s. But since real wages have generally risen, this wage is less and less a binding constraint on employers. It should be noted that 9 states currently have higher minimum wages than the federal minimum of $5.15. The highest of these wages is $7.15 in Alaska, still substantially below the real value of the federal minimum in 1968. The minimum wage in California, the most populous state, is $6.75.[20] Lee (1999) exploits the cross-sectional variation induced by state minimum wage laws to conclude that the fall in real minimum wages in the 1980s was a major source of wage inequality. The reduction in inequality in the 50s and 60s could, conversely, reflect the increase in real minimum wages during this period. But changes in the minimum wage obviously cannot account for all of the long-term trends in inequality: there was no minimum wage in the United States before 1938, yet, as figures 2 and 5 indicate, inequality fell during this period.

Thus we should also consider taxation. The story is clearest for the estate tax. It is difficult to reduce complex tax codes to single numbers. I focus on two series for the estate tax. The first is the maximum estate tax rate—how much the super-rich would have to pay without giving away or sheltering their wealth. The second is the maximum estate without tax liability, that is, the minimum taxable estate. Both series are shown in figure 9. To make the series comparable with each other and with the various inequality graphs, I have graphed 1.0 – the maximum tax rate.

The influence of partisan politics is even clearer for estate taxes than for minimum wages. The first taxes were introduced under unified Democratic government during World War I. More estates were subject to tax until a unified Republican government in 1926 both lowered the tax and increased the minimum estate subject to tax from around $500,000 to $1,000,000 (in 2002$). Taxes were increased and the minimum decreased when the Democrats took control of the House in the 1930 elections. Taxation of the wealthy increased in the Roosevelt years until the maximum estate tax rate reached 77 per cent in 1940. Rates then remained unchanged for 37 years until 1977. During this time, inflation eroded the minimum until, by 1976, estates under $250,000 were subject to tax. (The failure to increase the minimum for so many years resembles the failure of California to adjust real estate taxes during the real estate price boom that preceded the passage of Proposition 13 in 1978. The lack of adjustment meant a broader base for an anti-tax movement.)

Estate taxes then reverse with legislation in 1976 (effective for 1977) passed under the Ford presidency. The reduction in rates and the increase in the minimum were minor. The phased in minimum adjustments failed to outstrip inflation in the Carter years. Reagan did substantially lower taxes on large estates. His bill, which would have eventually lowered the top rate to 50 percent, was aborted when the Tax Reform Act of 1986, enacted in a time of large deficits, temporarily increased the rate from 55 percent to 60 percent. Clinton's legislation in 1993 made 55 percent, not 50 per cent, permanent. Moreover, the minimum again decreased as the result of inflation. The minimum was stabilized, but not substantially increased, after the Republicans took control of Congress in the 1994 elections. Finally, a unified Republican government made drastic changes in 2001.

The picture just given, of gradual change from Ford through Reagan followed by a "big bang" with Bush 43 is misleading to some degree. A generous exclusion, of about $1,000,000 in

1998$, for a closely held business was introduced in 1977.[21] In 1986, the marital deduction was increased from 50% to 100%. (See Carroll, 2002, p. 393.) "Family Limited Partnerships" for limiting estate taxes began to me mass-marketed, apparently in the late 1980s.[22] In other words, when one considers features of the tax other than maximum rates and minimum taxable estates, the changes in the 70s and 80s were more substantial.

A somewhat different story pertains to top minimum federal income tax rates, shown in figure 10. Marginal tax rates are increasing in the period of decreasing inequality. The Kennedy tax cuts, however, led to a decrease in marginal tax rates before the turn around in inequality. As inequality has grown, however, top marginal tax rates have continued to fall.

Wolff (2002b, p. 28) provides marginal rates on constant 2000$ incomes of $135,000, $67,000 and $33,000 from 1947 to 2000. The story here is more in accord with the pattern I found for estate taxes. These marginal rates were fairly steady throughout the period of declining inequality after World War II. In 1980, the marginal rates on $135,000, $67,000 and $33,000 were 59% 49% and 28% respectively, consistent with strong progressivity in taxation. By 1991, the three marginal rates were nearly equal, 31%, 28%, and 28%, respectively.

The picture of income taxes drawn from marginal rates is echoed by the effective rate on the top one percent by income. The effective rate adjusts for shelters and other gimmicks used to reduce taxes. Carroll (2002, p. 393) presents data for various years from 1963 to 1995. The effective rates on the rich move upward from 24.6% in 1963 to 27.8% in 1977 and then decline to 19.2% in 1985. Pressures to reduce the deficit thereafter led to an upward trend, but, by 1995, after the Clinton bill of 1993, the effective rate had reached only 23.8 percent, still slightly below the 23.9 percent during 1980, Carter's last year in office. Phillips (2002, p. 96) presents effective rates for those earning more than $1million from 1948 to 1970. These peaked in 1955-1960 at 85.5% and then declined to 66.9% in 1965. Philips also shows rates with FICA tax included for 1977 onward. These declined during the Carter years from 35.5% in 1977 to 31.7 % in 1980. Under Reagan, the rate dropped further, to 24.9% in 1985 before rebounding to 26.9% in 1988.

In summary, the three public policies of minimum wages, estate, taxes, and income taxes are all characterized by the following:

- Consistent with the trend in inequality in the twentieth century, redistributive policies are first strengthened and then relaxed.
- The dates of a move away from redistribution are somewhat different—early 60s for marginal tax rates, late 60s for minimum wages, and mid 70s for estate taxes and effective tax rates on the rich. Importantly, however, all, like the tax revolts at the state level, precede the election of Ronald Reagan. One might say that, by analogy to Andrew Jackson riding a wave of democratization to the presidency, Reagan rode a wave of anti-government sentiment.

Social security, an extremely important public expenditure, has not suffered the same fate as minimum wages for the poor or taxes on the rich. The data are presented in figure 11. Social security is financed by a tax, which, unlike the estate tax and the income tax, is openly regressive. Earnings above the cap are untaxed. Moreover, the tax is just a payroll tax; income from capital is untaxed. This tax, however, has grown. In an anti-tax era, Congress has supported, as evidenced in the figure, an increase in the maximum real amount a wage earner can pay into the system. This has been accomplished by both raising the tax rate and the cap. At the same time, notwithstanding the perpetual "crisis" in social security, the maximum real amount a worker gets out of social security has risen dramatically. Social security is formally called Old Age Insurance and was, somewhat misleadingly, sold to the public in that guise. While the payments are mildly redistributive to lower wage earners, it is largely a middle class program that is not supported by taxes on high incomes or capital. So far, in distinction to high taxes on the rich, social security taxes are being maintained. Similarly, Medicare has grown as inequality has grown. Medicare taxes, originally capped at the same earnings level as social security taxes, had higher caps instituted effective in 1991 and became totally uncapped in 1994. Because of the great variance in health care outcomes, health care consumption is far riskier than the rest of old age consumption. Again, we see demand for a government program that offers broad insurance in old age as against earlier in the life cycle. In line with the uncapping of the Medicare tax, there is now only political debate about extending Medicare (to cover prescription drugs) whereas the debate about social security turns around retrenchment or privatization.

8. Conclusion

Although economic inequality fell about equally in the United States, France, and Britain in the first 70 years of the twentieth century, over the last thirty years the United States has followed an exceptional path with inequality rising much more sharply there than in other developed nations. These long-term patterns pose a challenge to simple explanations of American inequality, and motivate this political and institutional inquiry. In the United States, I find that trends in economic inequality over the last century match closely with changes in political polarization, immigration, and many redistributive policies. Of economic policies that might affect inequality, estate taxes track this pattern for the entire century as do minimum wages, from their inception in 1938. Income taxes on the rich follow a slightly different pattern, starting a downward trend in the early 60s. This essay lays out these trends and develops a speculative account of how they relate, noting the complex and reciprocal relationships between economic policies and the constituencies they both create and reflect.

This account is grounded historically in the economic and political history of the century. Although the Great Depression may have played a role, the origin of the striking differences between the United States and most other developed countries may have been World War II, which greatly enhanced the economy of the United States but led to widespread destruction elsewhere. The base present at the end of the war created the opportunity for growth to create a large class of well-to-do and left this class, unlike its counterpart in Europe, without much support for redistribution or social insurance. The "free market" orientation of a large segment of the population may have been buttressed by the spread of equity ownership in the last two decades of the century.

In addition, the current increase in conservatism and polarization follows the push by the Democrats in the 1960s to allow increased immigration and to end discrimination against African-Americans. This led to the realignment of the South into a two-party system favorable to the Republicans. Furthermore, immigration has caused the income distribution of citizens to diverge from the income distribution of all households. The political changes have been substantial. Democrat control of the presidency and Congress was pervasive from 1932 to 1968 but sharply broken thereafter. One result has been major policy shifts in minimum wages, income taxes, and estate taxes.

This essay provides a sobering view of the prospects for change in current economic policies and thus in economic inequality itself. On the one hand, the widening economic disparity between the rich and rest of the population could generate a movement for redistribution. On the other hand, American political institutions, now compounded by increasing polarization, make economic policy difficult to change. As long as prosperity continues for voters in the middle to upper segments of the income distribution, we are unlikely to see a major shift in favor of sharply redistributive policies.

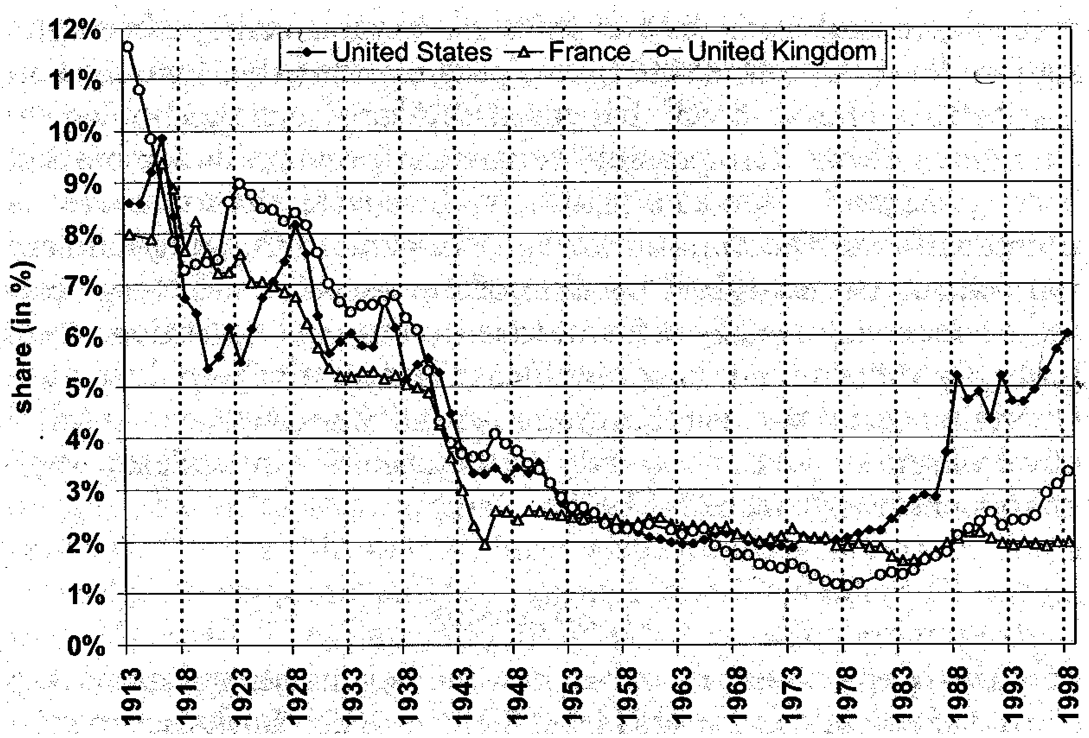

Figure 1.
Top 0.1 Percent Income Shares in the United States, France, and the United Kingdom, 1913-1998.
Reproduced from Piketty and Saez (2003). See source for details of computation.

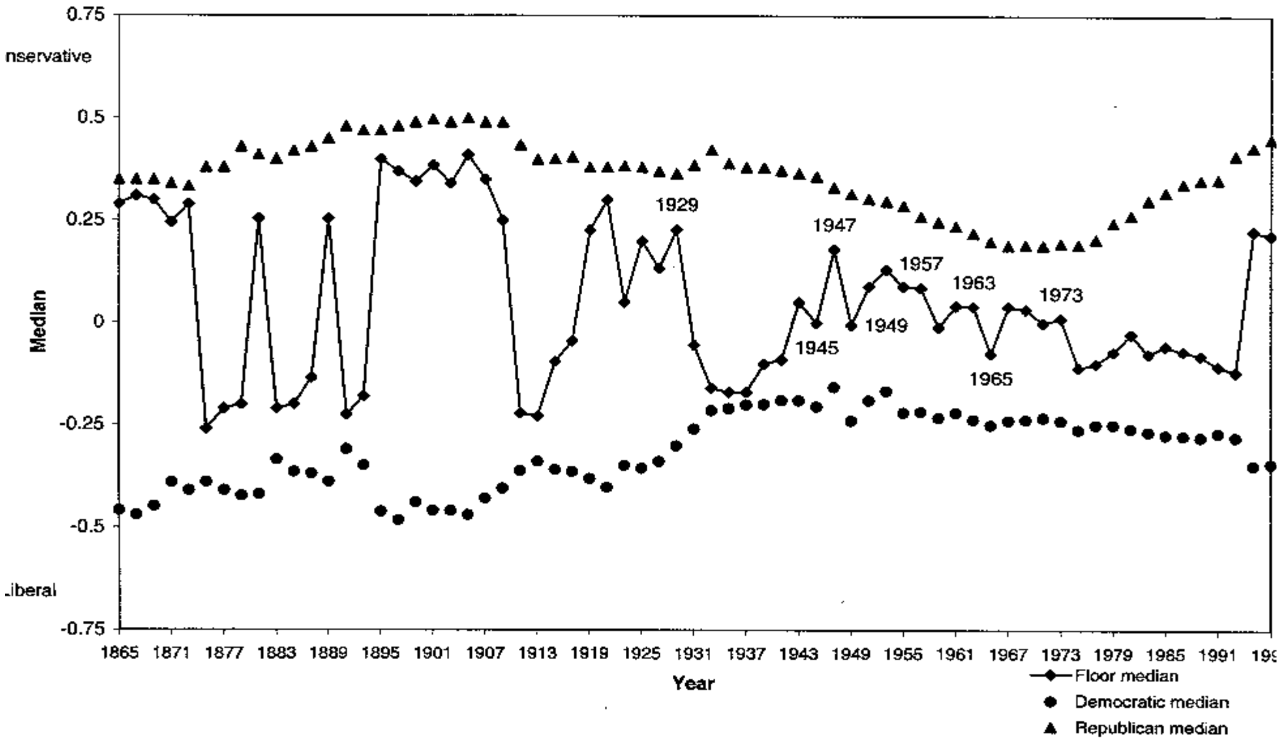

Figure 2.
Floor and Party Medians, House of Representatives, 1865-1997.
The medians are computed using first-dimension DW-NOMINATE scores. Reproduced from Schickler (2000).

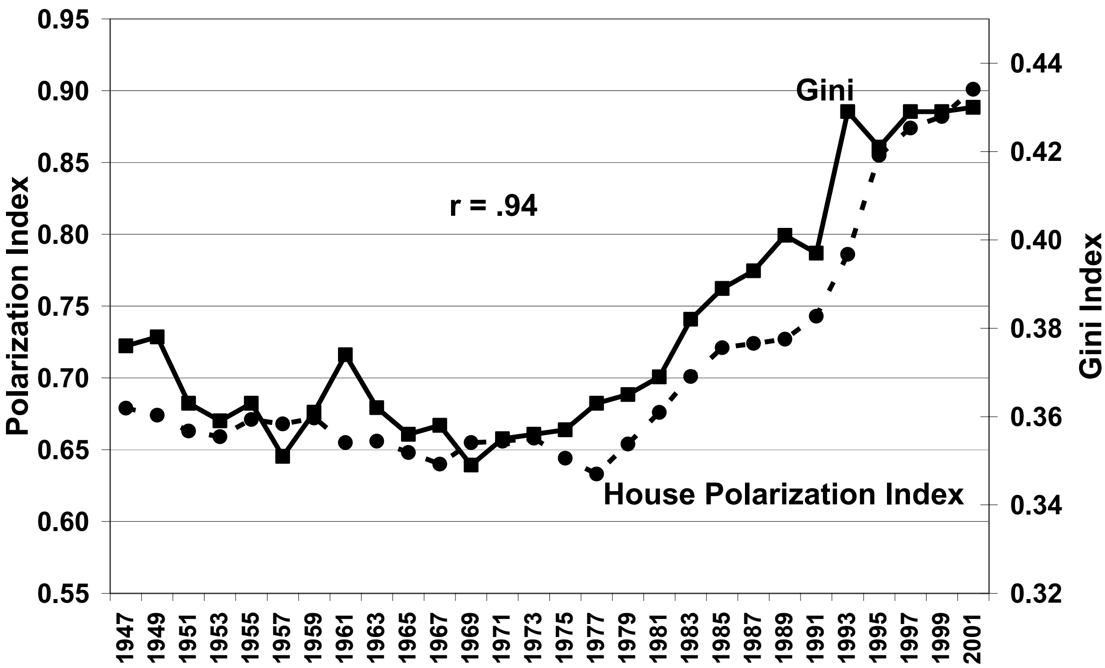

Figure 3.
Income Inequality and Political Polarization, 1947-2001.

Source: Gini index, U.S. Census (2002), Polarization, Computation of Average DW-NOMINATE distance between Republicans and Democrats by Keith T. Poole. There is one data point for each two-year Congress. The Gini index value is for the first year of the Congress. For example, the first data point is polarization for the 80th House, 1947-48 and the Gini value for 1947.

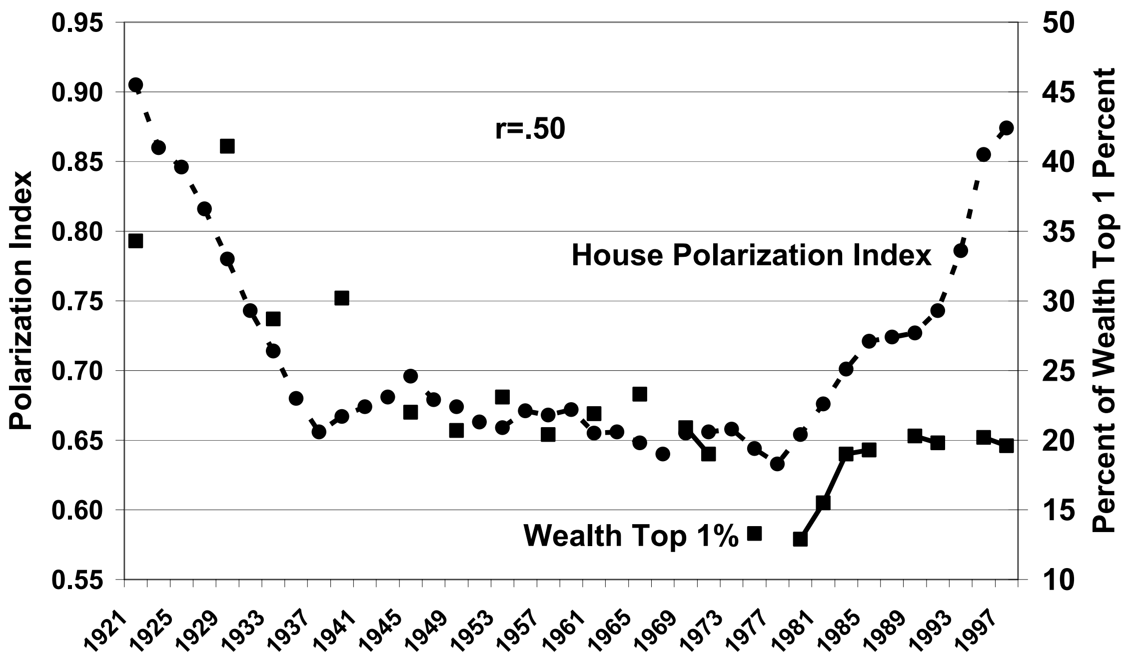

Figure 4.
House Polarization and Percentage of All Wealth Held by Wealthiest 1%, 1921-1997.

For polarization source, see figure 3. Wealth source is Wolff (2002a, table A-1, pp. 82-83.) Wolff does not provide a wealth measure for every year.

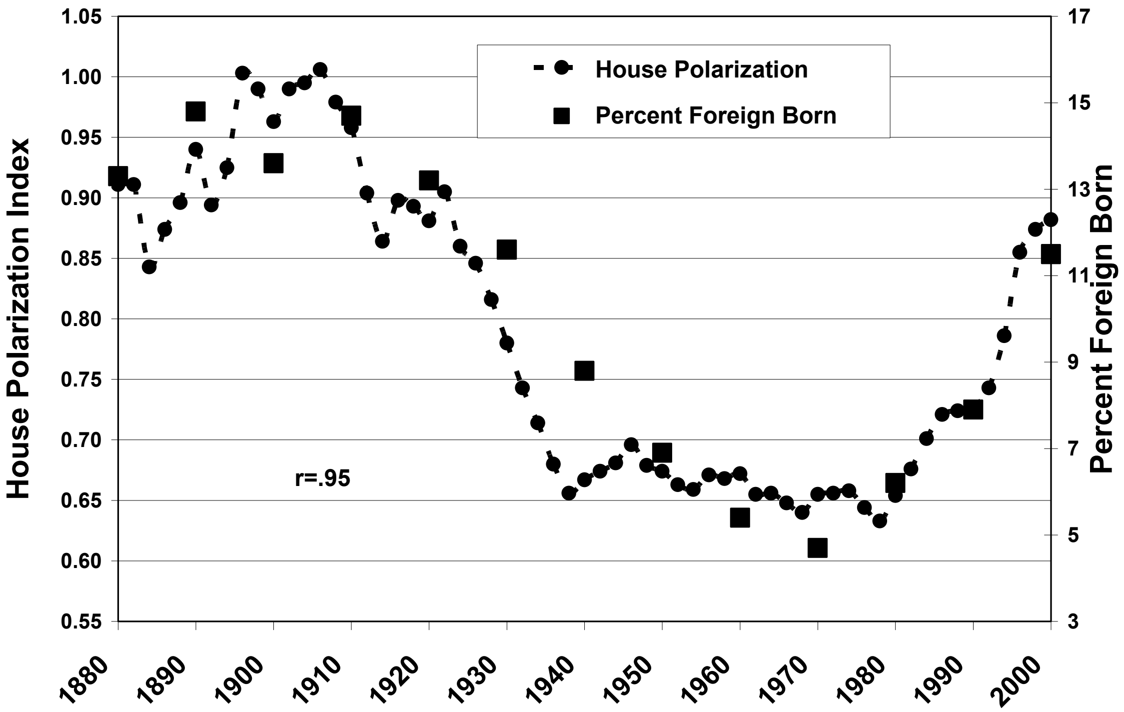

Figure 5.
Percent Foreign Born and Political Polarization, 1880-2000.
Source for polarization: see figure 3. Source for percent foreign born: U.S. Census, various years. Each percent foreign born corresponds to a decennial census. The corresponding polarization point is for the Congress that began service in the year preceding the census.

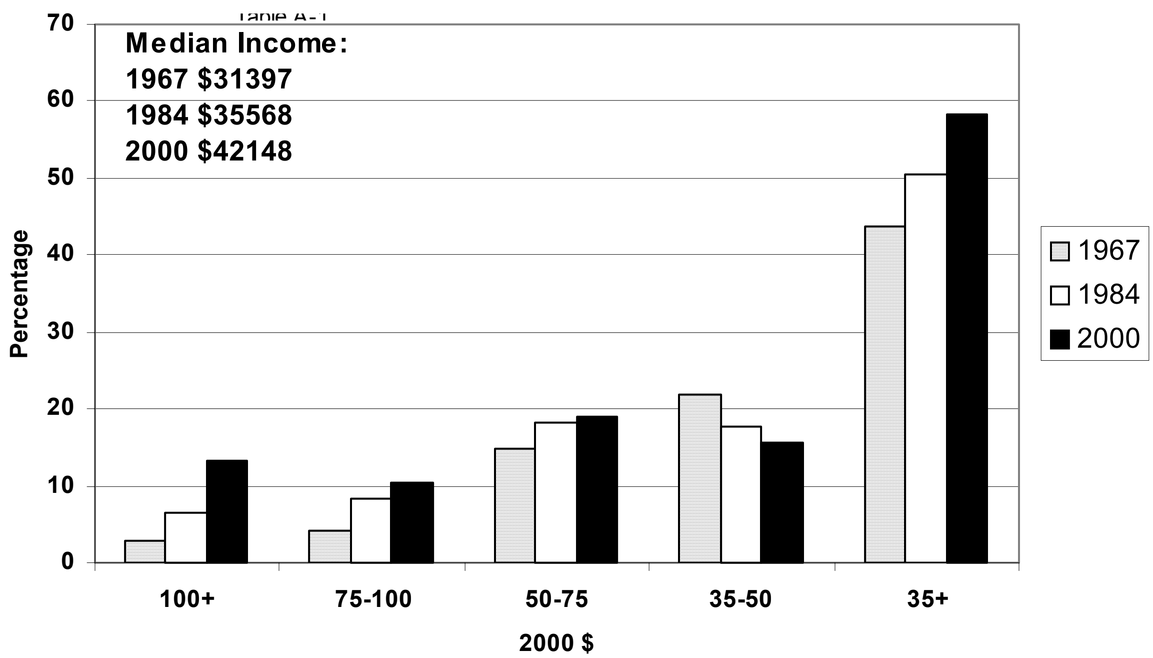

Figure 6.
Household Income in 2000$
Source: U.S. Census Bureau, Money Income in the United States, 2000, Table A-1.

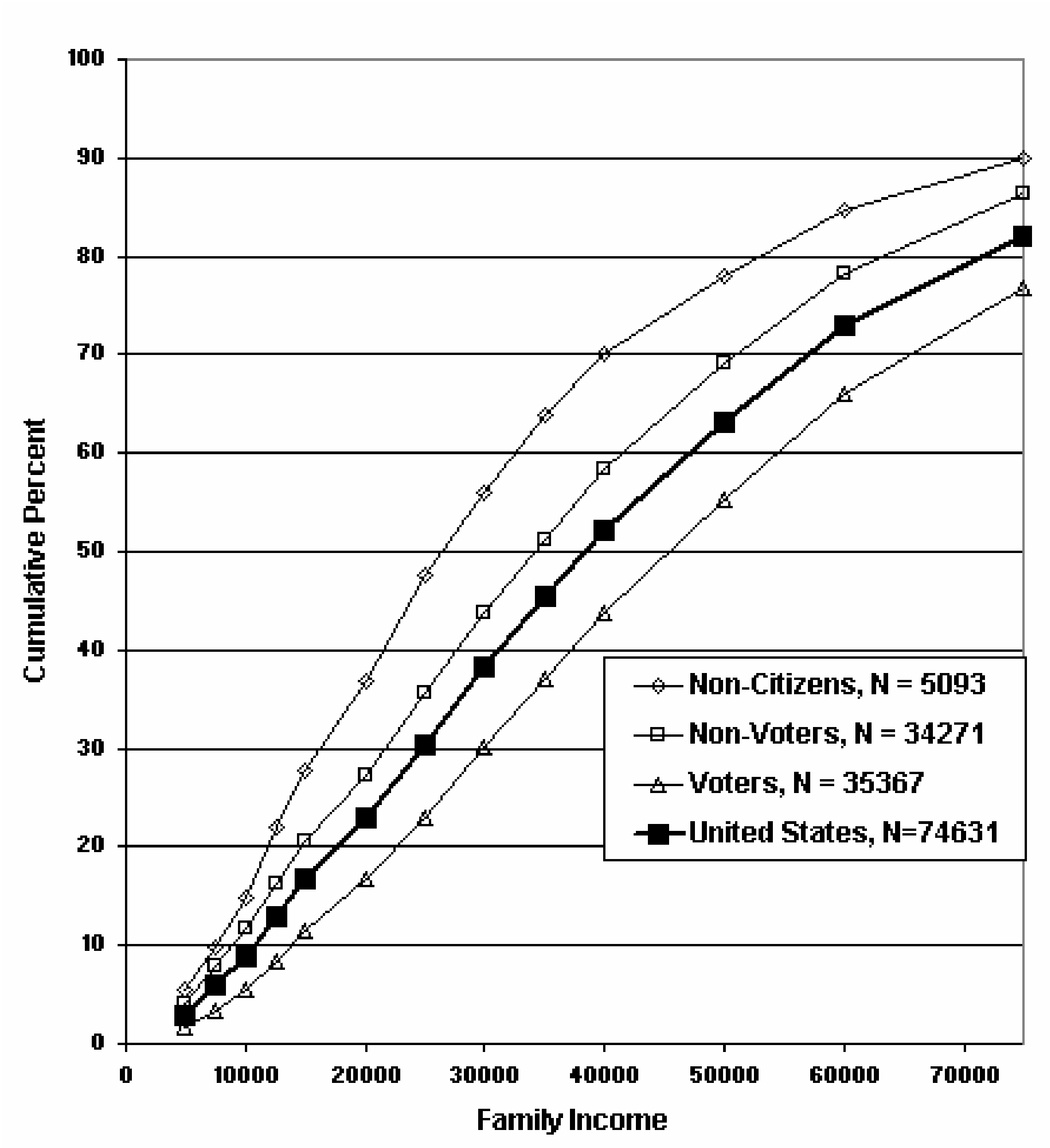

Figure 7
Family Income by Citizenship and Voter Turnout in 1998.

Source: Christine Eibner from November, 1998 Current Population Survey. The points plotted correspond to the upper end points of the 14 income categories used in the survey.

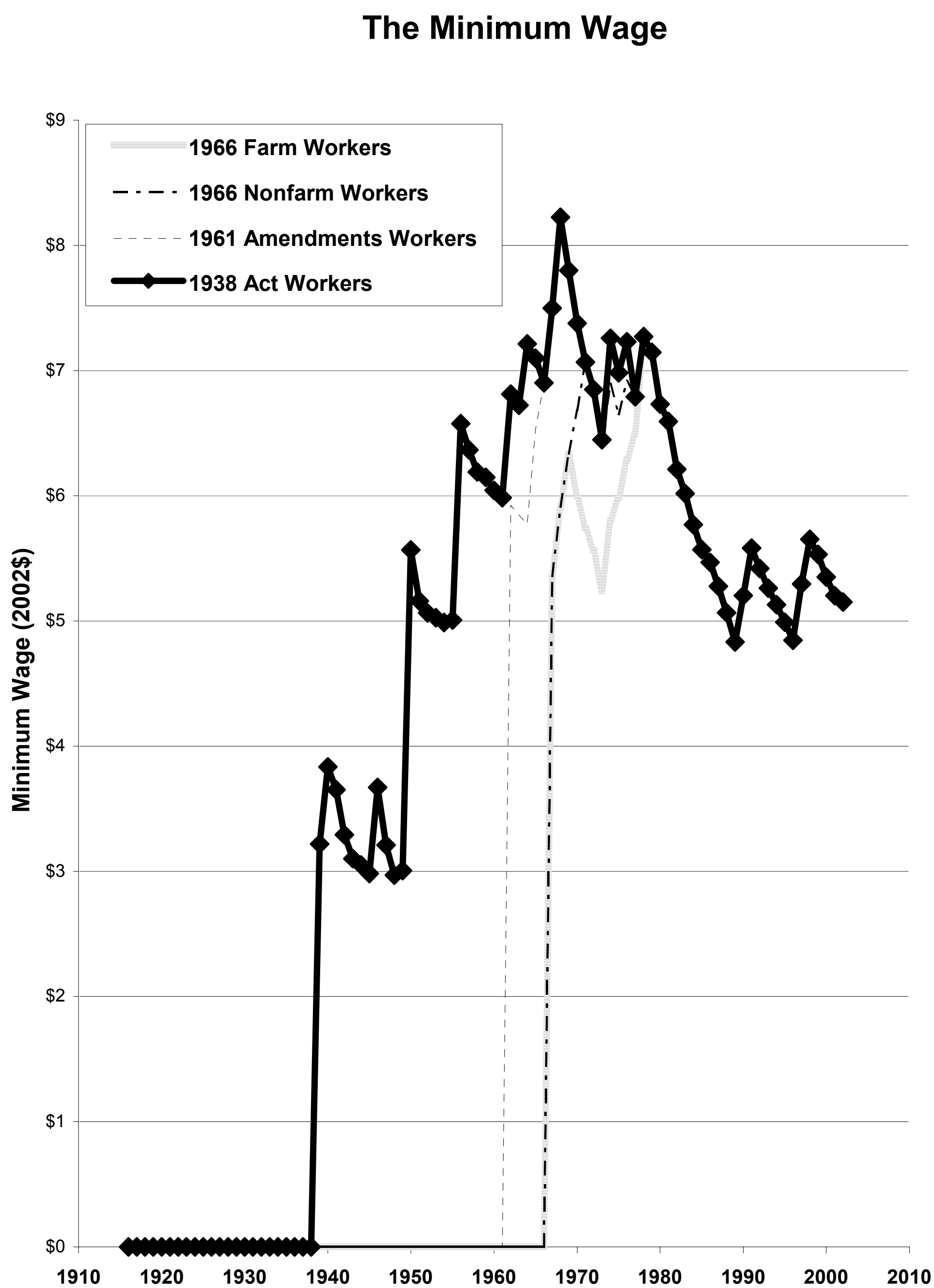

Figure 8.
Real Minimum Wages (in2002$)

Source: Department of Labor, http://www.dol.gov/esa/minwage/chart.pdf. Deflator: CPI-U.

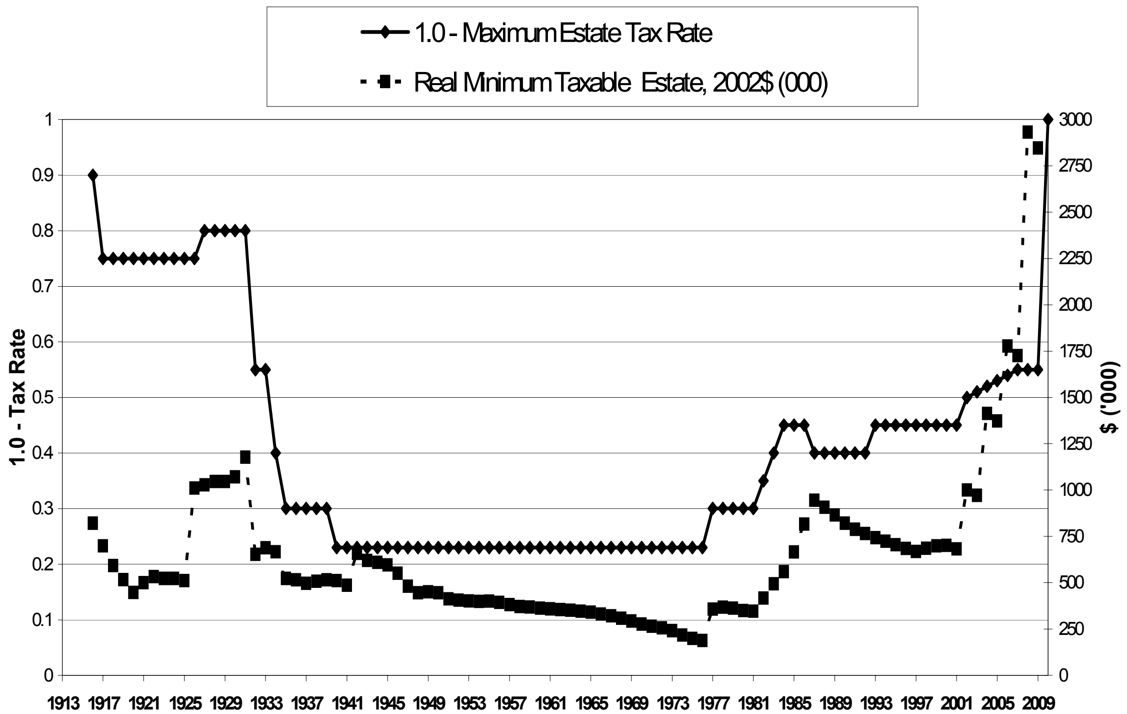

Figure 9
Estate Tax, 1916-2010

Source: Miller, Monson, Peshel, Polacek & Hoshaw, San Diego, CA. Web page http://www.estate-plan.com/pdf/Art_History_Tax.pdf, 2002. Deflator:CPI-U

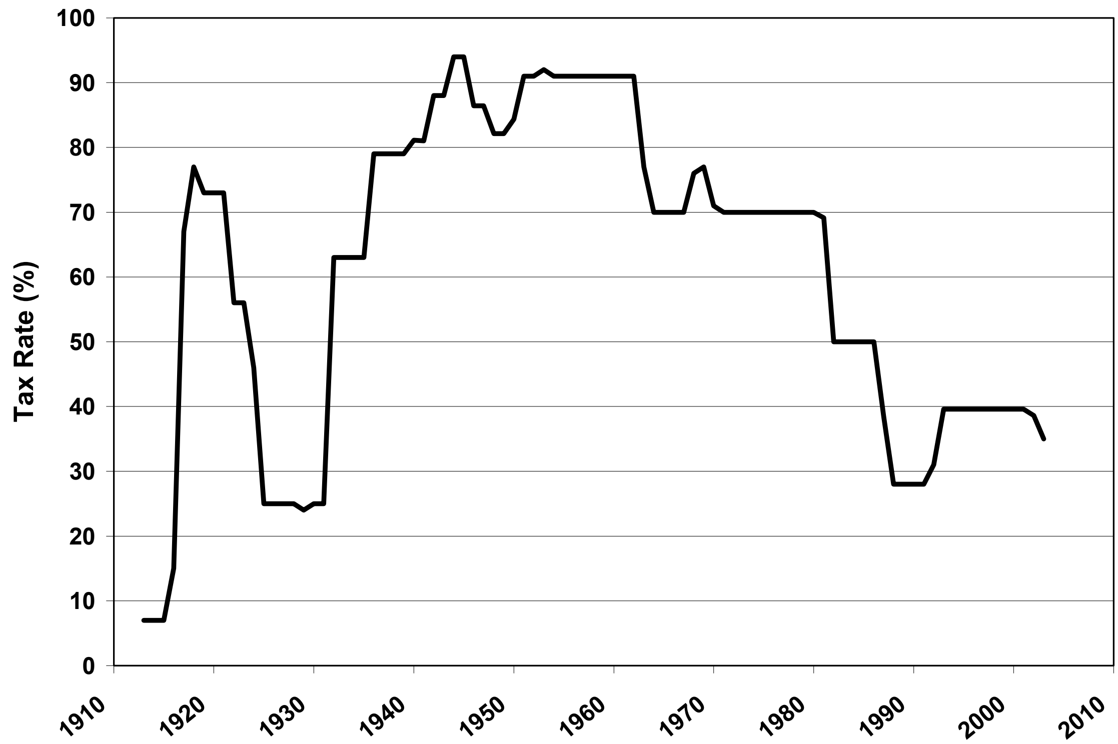

Figure 10/
Top Marginal Tax Rates, Federal Income Tax, 1916-2003

Source. 1916-1969, various sources. 1970-2003, 1970-2000 Urban-Brookings Tax Center, **www.taxpolicycenter.org**.

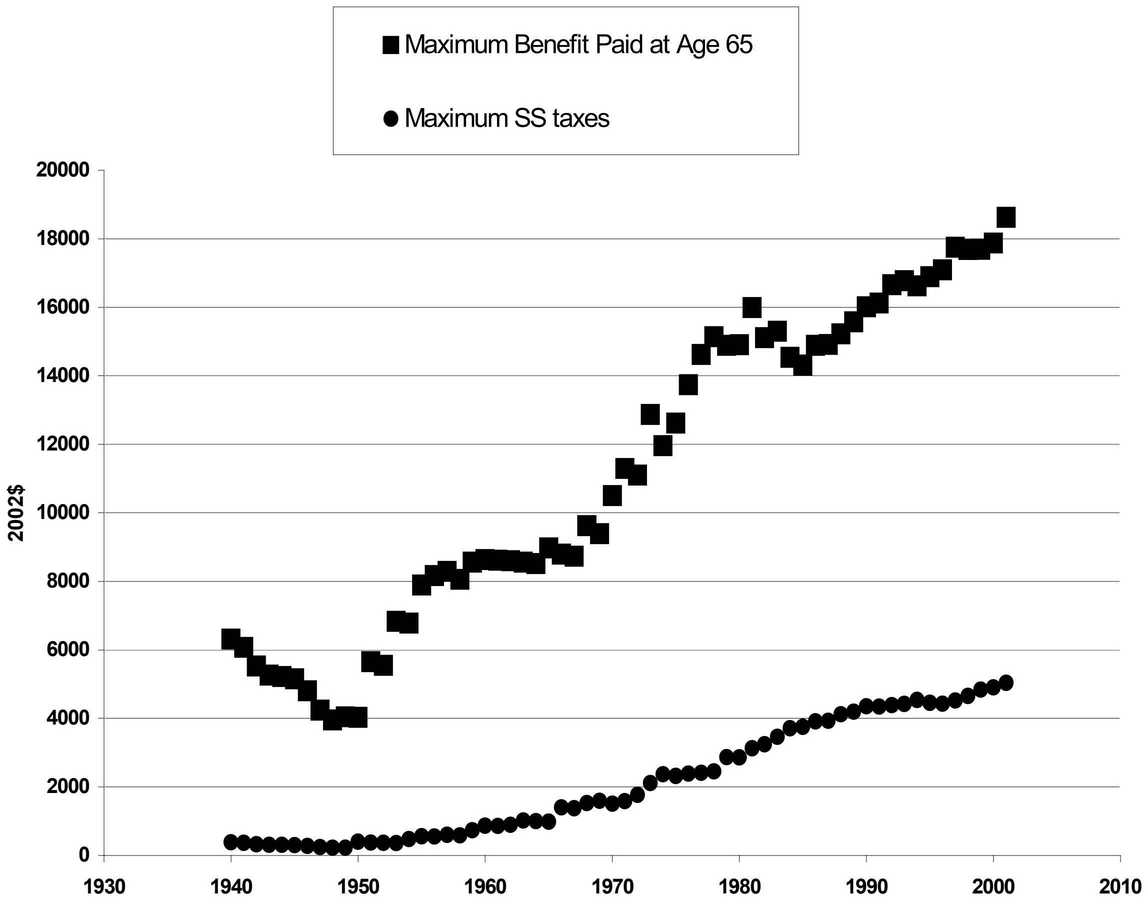

Figure 11

Social Security Benefits and Taxes

Source: Social Security Administration. 2002. *Social Security Bulletin. Annual Statistical Supplement*. Table 2.A3, p. 83 and Table 2.A28, p. 116. Downloadable at http://www.ssa.gov/policy/docs/statcomps/supplement/2002/supp02.pdf Deflator: CPI-U.

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U. S. Census Bureau (2002); "Table F-4. Gini Ratios for Families, by Race and Hispanic Origin of Householder: 1947 to 2001 (Families as of March of the following year)"; Published 30 September; http://148.129.75.3/hhes/income/histinc/f04.html

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Endnotes

[1] Quoted at http://www.cnn.com/ALLPOLITICS/1996/debates/history/1980/index.shtml. A video clip of Reagan making the statement is at http://www.cnn.com/ALLPOLITICS/1996/debates/history/1980/regan.carter.debate.mov.

[2] On the other hand, incarceration does not relate to inequality in any simple way. Incarceration rates showed relatively little variation during the fall of inequality in the first three-quarters of the twentieth century. Consider the rates in three years of relative prosperity, 1929, 1949, and 1969. The rates per 100,000 for these years were 98, 109, and 97 respectively. Source: Sourcebook of Criminal Justice Statistics Online URL: http://www.albany.edu/sourcebook/1995/wk1/t623.wk1, Table 6.23. I thank Bruce Western for pointing me to this source.

[3] See Poole and Rosenthal (1997) for a more detailed discussion of the dimensionality of congressional politics.

[4] Rankings taken from http://voteview.uh.edu/SEN107.htm.

[5] Vote results taken from the Thomas web site of Congress at http://clerk.house.gov/cgi-bin/vote.exe?year=2001&rollnumber=398

[6] The expression is found in countless sources, such as Jacqueline Calmes "Special Report: Congress and OMB Controlling the Budget Process: Stockman Left as His Legacy Enhanced OMB Involvement", *Congressional Quarterly Weekly Report,* Sept. 14, 1985, p. 1809

[7] For a detailed study of how divided government deflected policy change in the Reagan era by preserving Conrail as an independent company, see Baldwin and Bhattachyara (1991).

[8] Rankings taken from http://voteview.uh.edu/SEN107.htm.

[9] The theory of how policy formation in one dimension is affected by the status quo was developed by Romer and Rosenthal (1978, 1979), extended to Congress by Denzau and Mackay (1983), and embedded in the theory of pivotal politics by Krehbiel (1998). Brady and Volden (1998) illustrate how the theory applies to gridlock.

[10] There is probably no single factor that can explain the fall of inequality from 1913 through the 1960s. The fall, for example, of the income share of the rich (figure 1) from 1913-1933 would seem to be greater than that which would be produced by the very limited federal income and estate taxation of the period (figures 11 and 12). Similarly, there was no dramatic increase in inequality following the Kennedy tax cuts of the 1960s. A federal policy of importance for wage inequality in recent years, the minimum wage, did not exist before 1938. The limited impact of federal policies fiscal and wage policies prior to the New Deal suggests important roles for immigration and technology.

[11] See McCarty, Poole, and Rosenthal, 2002.

[12] See, for example, Atkinson (1997).

[13] The changing position of southern Democrats can be seen graphically in animations that show on http://voteview.uh.edu/default_nomdata.htm.

[14] Jordan Ellenberg (2001) has presented a very accessible introduction to the method on *Slate*. A more extensive non-technical discussion is Poole and Rosenthal (1997, ch. 2)

[15] Recent work by Lewis and Poole (2003) shows that the standard error of the overall median is on the order of 0.04 for the Senate. The standard error for the House would be even smaller. Consequently, a move like that following the 1994 elections would be statistically significant at a very high level.

[16] These distances are based on the two-dimensional DW-NOMINATE scaling (McCarty, Poole, and Rosenthal, 1997). They, thus, unlike the difference in medians, avoid any possibility that the changes in polarization are due simply to the rise and fall of the race issue.

[17] Posted at http://voteview.uh.edu/default_recpol.htm.

[18] Paul DiMaggio drew this point to my attention.

[19] Information found in the Voteview database available at voteview.uh.edu.

[20] Minimum wage data from U.S. Department of Labor Employment Standards Administration Wage and Hour Division, published May 13, 2003 at http://www.dol.gov/esa/minwage/america.htm.

[21] On the other hand, the Generation Skipping Tax was introduced, something that made estate tax more onerous for very rich families.

[22] The late 1980s is indicated by http://www.falc.com/flp/flp.htm.