

Exploring Increasing Income Inequality in the United States: A Public Choice Approach

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Abstract

In this article, we present some exploratory analysis of a common measure of income inequality in the United States. That measure is the Gini coefficient, and we explore how, and why, it has increased over the 50-year period in the United States from 1967 to 2017. Our hypothesis in doing so is that rising U.S. income inequality is due, at least in part, to growth in efforts by individuals, groups and even large companies in the United States to use government, with its power to compel, to bend the income distribution in their favor—an activity that public choice economists refer to as rent-seeking. When compared with some simple measures that proxy rent-seeking activity, such as the number of licensed lawyers and the number of registered political action committees, our analysis suggests that the U.S. Gini coefficient rises, a move that indicates increasing income inequality, over time with similar cycles in rent-seeking activity.

Keywords

U.S. income inequality, Gini coefficient, public choice economics, rent-seeking activity, lobbying, political action committees

Introduction

In his essay on the redistribution of income, Lee¹ asserts that most people are certain that the U.S. government helps the poor by transferring income to them. The fact that there are *some* government programs that are aimed at assisting low-income individuals and families serves as a kind of confirmation bias that promotes such certainty.² However, an objective examination of government's many transfer programs reveals that most income redistribution by government is not from the rich to the poor, but instead is from the relatively unorganized (i.e., the common taxpayer) to the relatively organized (e.g., labor unions, financial services providers, etc.), whose interests are represented by lobbying groups.³ Thus, what

typically occurs in the United States is a redistribution of income from those below the top of the income distribution to those at or near the top of that distribution.

Lee's⁴ earlier observations are supported by the evidence. When considering federal programs such as Medicare and Social Security, individuals who are in the top 10% of all income earners receive approximately the same percentage of federal transfers as those in the bottom 50%.⁵ Even when Social Security is excluded, the top 10% collect

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approximately two thirds of the government transfers received by the bottom 50%. Moreover, people with higher levels of income have longer life expectancies and will collect government benefits over more years relative to low-income earners.⁶ High-income earners also receive a large proportion of the federal government's tax expenditures, in the form of exclusions, deductions, credits and other tax breaks. The Congressional Budget Office estimates that more than half of tax expenditures go to those in the highest quintile of income earners, while 17% of these expenditures go to the top 1%.⁷ In addition to benefits for wealthy individuals, the federal government spends nearly \$100 billion annually on subsidies to corporations, much of which goes to large companies.⁸ State and local governments also offer billions of dollars in corporate subsidies to large corporations, such as the \$3 billion in cumulative tax breaks that New York City planned to give Amazon to open a new headquarters in Long Island City.⁹

What Lee¹⁰ describes above, and what is supported by the evidence, is generally encompassed in the public choice economics concept of rent-seeking activity, which, given the government's power to compel, occurs when individuals and groups seek to employ government in ways that provide benefits to themselves, but which come at the expense of others.^{11,12} Put differently, the theory of rent-seeking suggests that individuals, interest groups and private business interests will devote real resources, such as campaign contributions and other overt forms of political support, to lobbying within the political process in order to secure governmentally-granted privileges.^{16,17} That this process bends the distribution of income in the United States toward those at the top is likely an unsurprising result to public choice scholars.

In this article, we present some exploratory analysis of a common measure of income (in)equality in the United States. That measure is the Gini coefficient, and we explore how, and why, it has increased over the 50-year period in the United States from 1967 to 2017. Our hypothesis in doing so is that rising U.S. income inequality is due, at least in part, to rent-seeking.

When compared with some simple measures that proxy rent-seeking activity, such as the number of licensed lawyers and the number of registered political action committees, our analysis suggests that the U.S. Gini coefficient rises, a move that indicates increasing income inequality, over time with similar cycles in rent-seeking activity.

Income Inequality in a Rent-Seeking Society

Rising income inequality is a reoccurring theme in major newspapers and on cable news in the United States. Data from the U.S. Bureau of the Census supporting this reporting are presented in Figure 1. This figure tracks movements in a commonly used measure of income inequality—the Gini coefficient—in the United States over the 50-year period in the United States from 1967 to 2017. In the early portion of the time series, this measure is relatively stable, beginning at 0.386 in 1967 and pausing at 0.398 in 1977. However, in the late-1970s, the U.S. Gini coefficient series begins a notable rise, continuing until about 1991, when it stood at 0.428. At this point the trajectory increases quite dramatically, rising to 0.454 in 1993, at which point it resumed its previous climb until the most recent year, 2017. By the end of the series, the U.S. Gini coefficient reaches a peak of 0.482, up 25% from its starting point in 1967.

Consistent with this Gini coefficient series, the middle class in the United States seems to be shrinking, particularly in urban areas. In cities such as Chicago, neighborhoods that once were predominantly middle class are being supplanted by high- and low-income earners, creating an economically polarized city.²³ The maps in Figure 2 show the change in Chicago's neighborhoods between 1970 and 2017. In 1970, over half of the city was inhabited by middle-income earners. By 2017, only 16% of the city's residents were middle income. Some of this economic polarization has been accompanied by racial change. Much of the city's population in low-income areas is African American or Latino, which is partially the result of dynamic migration patterns and

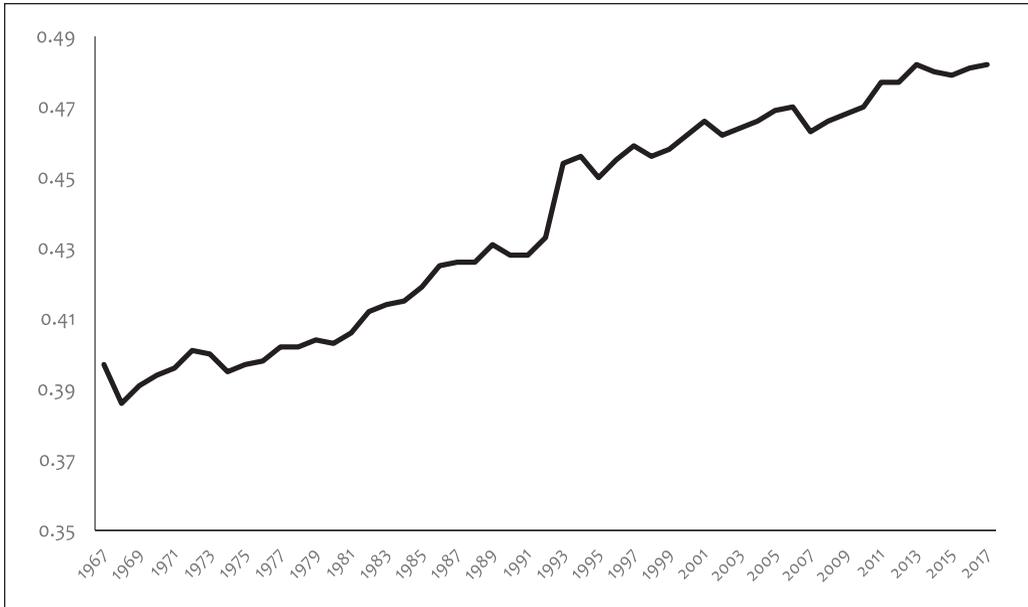


Figure 1. U.S. Gini coefficient, 1967 to 2017.
Source. U.S. Bureau of the Census.

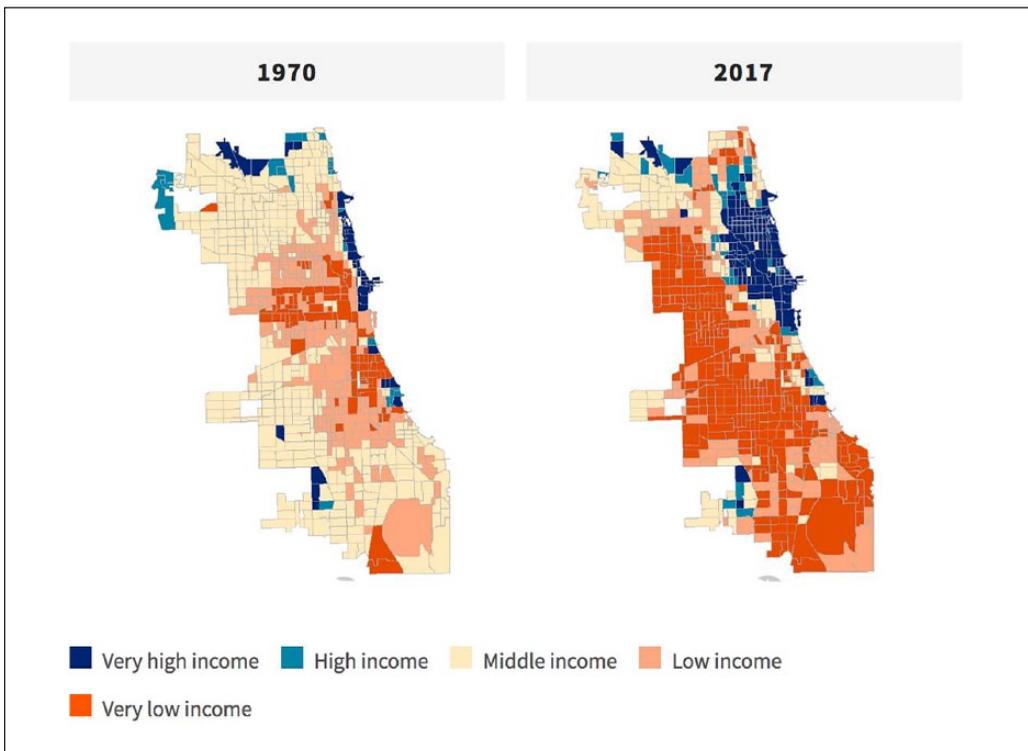


Figure 2. Average income in Chicago neighborhoods, 1970 and 2017.
Source. Lutton.²⁶

Table 1. Granger Causality Tests.

Null hypothesis	Observations	F-statistic	Probability
<i>Lawyers</i> does not Granger cause <i>Gini</i>	49	4.450	.017
<i>PAC</i> does not Granger cause <i>Gini</i>	32	1.913	.167

White flight to the suburbs. Even so, in the high-income areas, middle-class families have been squeezed out because of increases in housing costs and the conversion of multi-family homes into single-family residences.²⁴ Furthermore, these trends in Chicago are consistent with changes in other metropolitan areas around the United States.²⁵

In this essay, we contend that much of the disappearance of the U.S. middle class is the result of decades of rent-seeking activity. Quantifiable proxies for rent-seeking activity in the United States have been used previously in empirical public choice studies. Some very basic examples are useful for this essay. Two such examples are the number of licensed lawyers and the number of political action committees (PACs). Reliable data on the number of lawyers in the United States, dating back to 1878, are available from the American Bar Association (ABA). In terms of the series analyzed in this study (i.e., 1967-2017), the number of lawyers in the United States rose from a low of 310,736 in 1967 to a high of 1,335,963 in 2017, representing an average growth rate of about 2.9% per year. Although the number of lawyers is a crude measure of rent-seeking activity in a country, most lobbyists in the United States have ties to the legal profession, and any increase in the number of lobbyists, and lobbying activity (rent-seeking activity), should be reflected in the ABA time series.²⁷

The number of registered PACs likely represents a more appropriate simple measure of rent-seeking activity over time in the U.S. As Sobel²⁸ points out,

Interest group activity manifests itself throughout the political process. Political action committees (PACs), for example, spend millions of dollars each year lobbying, donating to political campaigns, and providing legislators with free trips, meals and recreation. In return,

legislators draft new legislation, sponsor bills and vote for bills that may be favorable to the interest groups. (p. 220)

Reliable data on the number of registered PACs in the United States are available from the Federal Elections Commission (FEC). However, annual time series data for this variable cover a smaller time period, from 1974 through 2007. According to FEC series, the number of registered PACs rose from a low of 608 in 1974 to 4,234 in 2007. This particular series peaked at 4,268 PACs in 1988.

In order to test our public choice hypothesis, that income inequality in the United States increases in response to growth in rent-seeking activity, we first perform separate Granger causality tests for each rent-seeking data series.²⁹ This is essentially a test of whether the lags of one variable enter into the equation for another variable.³² If so, a causal relationship exists between the two variables, such that one variable can be said to “Granger cause” the other.³³ In each of the cases examined here, the null hypothesis states that the rent-seeking series does *not* exhibit a causal relationship to the Gini coefficient series. Here, the Gini coefficient series is referred to as *Gini*, the ABA (lawyers) series is referred to as *Lawyers*, and the FEC (PACs) series is referred to as *PAC*. Results of these tests are reported in Table 1. The first Granger causality test, which employs 49 observations, rejects, at the 98.3% level of confidence, the null hypothesis that *Lawyers* does not Granger cause *Gini*. Thus, it supports our contention that rent-seeking activity promotes increasing income inequality in the United States. The second Granger causality test, which employs 32 observations, fails to reject, at traditional levels of significance, the null hypothesis that *PAC* does not Granger cause *Gini*.

What to do with the mixed results presented in Table 1 regarding income inequality in the United States? Perhaps this is a good occasion to follow Kennedy's³⁵ advice, which is based on formalization in Leamer³⁶ and Attfield,³⁷ to consider significance level as a sliding scale that is inversely related to sample size. As Kennedy³⁸ notes, Leamer³⁹ "would also argue that genuinely interesting hypotheses are neighborhoods, not points." In the second test, one can state, at the 83.3% level of confidence, that *PAC* Granger causes *Gini*. Given that this result stems from a time series that is about one third smaller than that used in the first test, which strongly supports the rent-seeking hypothesis, these two tests appear to describe the same neighborhood.

In order to more formally explore the robustness of our conclusions, we undertook traditional regression analyses of the three data series described above. In the first test, we regress the Gini coefficient series, or $Gini_t$, on the natural logarithm of the observations in $Lawyers_t$, referred to here as $\ln Lawyers_t$, and the lagged value (one year) of each observation in the Gini coefficient series, which is expressed as $Gini_{t-1}$.⁴⁰ The first of these two variables, $\ln Lawyers_t$, tests the rent-seeking hypothesis of increasing income inequality. As such, it is expected to be positively related to $Gini_t$. The second variable, $Gini_{t-1}$, is included to capture any inertia in the dependent variable, $Gini_t$. It is expected to be positively related to $Gini_t$.

The results of the first regression are presented in Table 2. The two regressors, $\ln Lawyers_t$ and $Gini_{t-1}$, are jointly significant in explaining $Gini_t$.⁴¹ They also account for more than 98% of the variation in $Gini_t$. The second of the two regressors, $Gini_{t-1}$, is positively signed and significant at better than the 99.9% level of confidence, suggesting that any movement in U.S. income inequality tends to continue. The first of the two regressors, $\ln Lawyers_t$, is positively signed and significant at the 99.8% level of confidence, thus supporting the rent-seeking hypothesis that increasing income inequality in the United States is at least partly due to rent-seeking activity at federal, state and local levels.

Table 2. OLS Results.

Variable	Coefficient	t-ratio	Probability
Constant	-0.115	-3.10	.003
$\ln Lawyers_t$	0.016	3.30	.002
$Gini_{t-1}$	0.774	11.16	.000
nobs	50		
F-statistic	1,378		.000
R ²	0.983		
Durbin h	0.312		.378

Table 3. OLS Results.

Variable	Coefficient	t-ratio	Probability
Constant	0.002	0.15	.879
$\ln PAC_t$	0.004	1.94	.062
$Gini_{t-1}$	0.926	22.82	.000
nobs	34		
F-statistic	499.7		.000
R ²	0.970		
Durbin h	0.038		.485

For the second test, we regress the Gini coefficient series, $Gini_t$, on the natural logarithm of the observations in PAC_t , referred to here as $\ln PAC_t$, and the lagged value (one year) of each observation in the Gini coefficient series, which again is expressed as $Gini_{t-1}$. The first of these two variables, $\ln PAC_t$, tests the rent-seeking hypothesis of increasing income inequality. As such, it is expected to be positively related to $Gini_t$.

The results of the second regression are presented in Table 3. The two regressors, $\ln PAC_t$ and $Gini_{t-1}$, are jointly significant in explaining $Gini_t$.⁴² They also account for 97% of the variation in $Gini_t$. The second of the two regressors, $Gini_{t-1}$, is positively signed and significant at better than the 99.9% level of confidence, again suggesting that any movement in U.S. income inequality tends to continue. The first of the two regressors, $\ln PAC_t$, is positively signed and significant at the 93.8% level of confidence, thus supporting the rent-seeking hypothesis that increasing income inequality in the United States is at least partly due to rent-seeking activity at federal, state and local levels.

Conclusion

As Americans grapple with growing income inequality, they are also becoming more aware of the increase in lobbying, political action committees and “dark money” contributions. Many of the donations to interest groups and PACs come from wealthy individuals and large corporations. During the 2018 election cycle, more than 20% of the donations to super PACs, totaling \$59.7 million, came from 10 wealthy individuals.⁴³ The growth of interest groups and PACs represents an increase in rent-seeking behavior, and the findings in this article indicate that an increase in this behavior is positively correlated with increases in the Gini coefficient. Evidence also suggests that many of the benefits of such rent-seeking behavior at the federal, state and local levels go to wealthy individuals and large corporations.

These results indicate that one possible way to reduce income inequality may be to limit the growth and activities of political action committees and lobbying groups in the United States. However, contrary to conventional wisdom that new federal campaign finance laws will accomplish this, public choice economists would argue that further limitations on governments’ power to confer privileges, such as income transfers from middle-income taxpayers to those at the top of the income distribution, represent the most, if not the only, effective prescription. American workers should consider that campaign finance laws are written by the legislators who must abide by them. As such, these laws will tend to be opaque, and covered in the types of loopholes that keep incumbents in office.

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Notes

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