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IN THIS ISSUE...

Income Inequality, Poverty, and Labor Markets 1-5

Economic Indicators

on the Overall Economy	5
Individual Data Items	6-8
Comparative Regional Data	9
Economic Indicator Trends	10-11
Help Wanted OnLine	15
Business and Employment Changes Announced in the News Media	19
Labor Market Areas:	
Nonfarm Employment	12-17
Sea. Adj. Nonfarm Employment	14
Labor Force	18
Hours and Earnings	19
Cities and Towns:	
Labor Force	20-21
Housing Permits	22
Technical Notes	23
At a Glance	24

In December...

Nonfarm Employment

Connecticut..... 1,690,200
 Change over month +0.28%
 Change over year +1.6%

United States 140,347,000
 Change over month +0.18%
 Change over year +2.1%

Unemployment Rate

Connecticut..... 6.4%
 United States 5.6%

Consumer Price Index

United States 234.812
 Change over year +0.8%

Income Inequality, Poverty, and Labor Markets

By Daniel W. Kennedy, Ph.D., Senior Economist, DOL

A large part of the current political and economic discussion and debate has been centered on the growing concentration of wealth and income over the last 30 years or so. And this trend has accelerated over the current recovery. Another issue is Poverty, a major consequence of extreme inequality. Therefore, addressing the issues of *Poverty* requires an understanding of the broader issue of *Inequality*.¹ With that in mind, the remainder of the discussion will address the 30-year trend of rising Economic Inequality, especially in the U.S., what seems to be driving it, and its connection with labor markets. It will conclude with spotlighting a uniquely American phenomenon that exacerbates the inequality problem: **Urban Sprawl**.

Measuring Inequality

There is a critical measure that will be helpful in gauging the trend in rising inequality over the last 30 years or so. The **Gini Coefficient**, developed by the Italian statistician Corrado Gini in 1912,² is a single

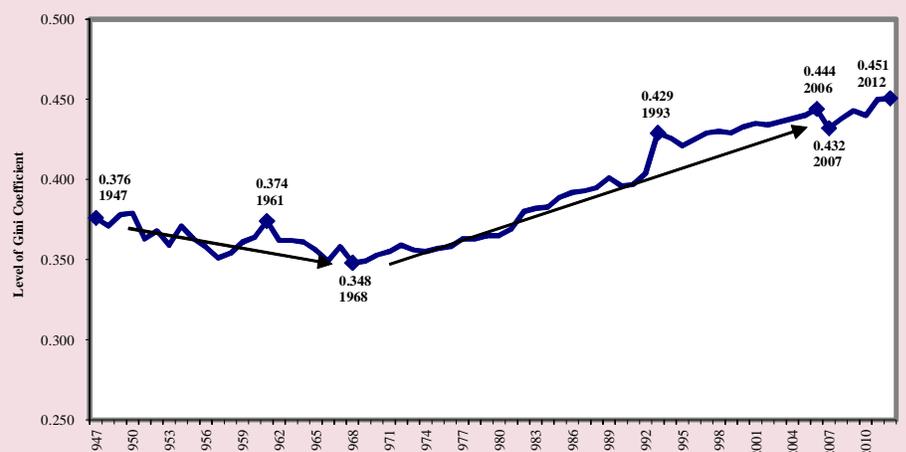
statistic that quantifies the extent of income inequality in a single number that ranges from 0.00 (Perfect Equality), to 1.00 (Perfect Inequality). The Gini Coefficient will be a valuable tool for tracking the changes in income inequality over time, and for cross-sectional comparisons, in what follows.

THE RE-CONCENTRATION OF INCOME: The U.S. and Connecticut

Graph 1 illustrates the Post-World War II trend in the concentration of income. Between 1947 and 1968, the Gini Coefficient for the U.S. declined from 0.376 to 0.348. Then the trend began to reverse and between 1969 and 1982 the Gini Coefficient increased to 0.380, surpassing its 1947 level. The growth in income concentration then accelerated and by 1989, the Gini Coefficient was 0.401, its then highest Post-World War II level. By 1993, it had jumped to 0.429, and after a sharp drop between 2006 and 2007, it reached a new Post-War high of 0.451 in 2012.

Graph 2 presents a longer view of the historical trends in income

GRAPH 1: U.S. Gini Coefficient (All Families): 1947-2012
 (SOURCE: U.S. Census, Table F-4)



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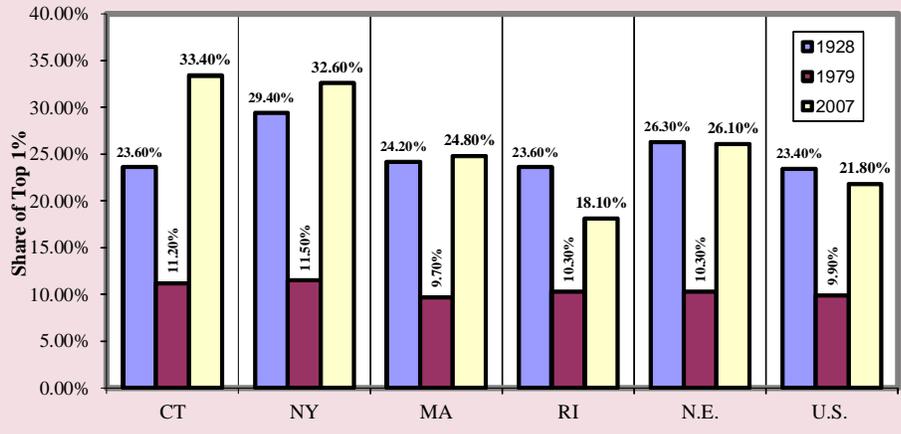
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GRAPH 2: Top 1% Share of Income-CT, Neighboring States, the U.S., and N.E.: 1928, 1979, 2007



concentration for the U.S., Connecticut, New England, and neighboring states. For the first year depicted, 1928, Connecticut’s share of income held by the top 1% was on par with that of the U.S., and not as concentrated as that of New York, Massachusetts, or the New England Region. With the decline in income inequality after World War II, by 1979, the shares of the top 1% had declined considerably. However, the top 1% in New York and Connecticut had more than 11% of each of the two states’ income, while for Massachusetts, Rhode Island, New England, and the U.S., the top 1% had less than 11% of income.

Then, between 1979 and 2007, as the distribution re-concentrated in the U.S., Connecticut’s income became even more concentrated. By 2007, the top 1% had a 33.40% share of Connecticut’s income, even more than the 32.60% share that went to New York’s top 1%. And, it was far above that for Massachusetts (24.80%), New England (26.10%), and the U.S. (21.80%), and more than 15 percentage points more than Rhode Island (18.10%).

So, why should we be concerned about the distribution of income? Is it just envy? Actually, there are significant implications for economic growth when wealth and income become too concentrated. For one thing, there appears to be a connection among income concentration, excessive debt, and slower growth. And driving income concentration is wealth concentration, and some recent research points to **Financialization** as the driver behind the concentration in wealth. In fact, Financialization seems to have

played a significant role leading up to the Great Depression, as well as the period leading up to the Great Recession. Connections between wealth concentration and Financialization, are explored in a 2013 study by the International Monetary Fund (IMF),³ and by Cynamon and Fazzari in their 2014 study.⁴

But changes in the wage structure in labor markets have also played a significant role in the distribution of income. The next section focuses on that connection.

THE LABOR MARKET AND INEQUALITY

The Great Compression was characterized by a reduction in the ratio of the wage in the 90th percentile-to-the 10th percentile from the 1940’s to the 1970’s. After the 1970’s the 90th-to-10th Wage Ratio began to increase again in what has been dubbed *The Great Divergence*. This trend and its reversal are illustrated in Graph 3. Instead of levels, data from Goldin and Margo (1992), covering the period 1940 to 1985, and presented in Graph 3, are in logs, therefore, the 90th-to-10th Log-Difference is presented. The drop in the 90th-10th Log Difference from 1.449 in 1940 to 1.060 in 1950 is quite dramatic. But, after 1950, the trend reverses, and after 1970, the reversal accelerates. By 1985, the 90th-10th Log-Difference, at 1.460, exceeded its 1940 level. And after 1985, wage concentration continued. Two questions are suggested by the trends in Graph 3: (1) What drove The Great Convergence between 1940 and 1950? (2) What drove the reversal, especially after 1970?

The “Great Compression” Gives Way to the “Great Divergence”

Goldin and Margo in their 1992 *Quarterly Journal of Economics* paper noted that “The structure of wages narrowed considerably in the 1940’s, increased slightly in the 1950’s and 1960’s, and then expanded greatly after 1970.”⁵ From 1940 to 1950, wages narrowed by education, job experience, region, and occupation.⁶ Goldin and Margo referred to this as **The Great Compression**. For white men, the 90-10 differential in the log of wages was 1.414 in 1940, but had declined to 1.060 by 1950. By 1985, it had returned to its 1940 level.

The U.S. emerged from the Great Depression and World War II, not only with low unemployment, but the most egalitarian wage structure in the entire Post World War II Era, and it remained intact until the Late 1970’s/Early 1980’s.

Some Explanations of the Great Compression

There are two major periods of programs and policies that appear to play major roles in the Great Compression: those of The Great Depression and those during World War II. During The Great Depression, the *National Industrial Recovery Act* (NIRA), though ruled unconstitutional in 1935, still had an impact by reversing some of the rising inequality of the early 1930’s. Another significant contribution to the compression of wages was the *Fair Labor Standards Act* in 1938, which instituted the Federal Minimum Wage and the 40-hour workweek. During World War II,

wages were controlled under the National War Labor Board (NWLB); also, there were high, war-time, tax-rates, especially on high-income brackets. In addition, there was a high demand for low-skilled workers during the war.

Some Explanations of the Great Divergence

Explanations for the Great Divergence can be divided into two broad categories: Market-Driven Changes and Institution-Driven Changes.⁷ *The Market-Driven* explanations posit that technological progress has been skilled-biased and has favored top earners relative to average earners. For instance, see Gabaix and Landier (2008)⁸ for CEOs as well as Winner-Take-All theories of superstars, such as Rosen (1981).⁹ The key problem with the pure market explanations is that they cannot account for the fact that top income shares have only increased modestly in advanced countries such as Japan, Germany, and France which are also subject to the same technological forces as the U.S.

The Institution-Driven explanations posit that changes in institutions, labor and Financial Market regulations, Union policies, tax policy, and also more broadly social norms regarding pay disparity and in particular tolerance for executive pay, have played a key role in the evolution of inequality (see Bartels 2008¹⁰ and Hacker and Pierson 2010¹¹ for U.S. analysis along those lines). The main difficulty with the institutional-based arguments is that institutions

are multi-dimensional and it is difficult to estimate compellingly the contribution of each specific factor.

Labor’s Declining Share of Income

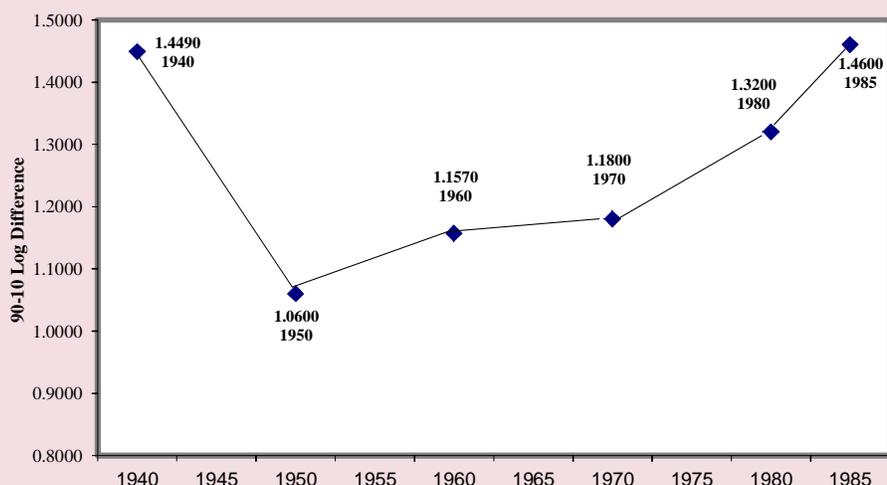
Most of the focus on the growth in income inequality has concentrated on the Personal Distribution of Income, which measures the distribution of income among households, or families. However, there is another perspective on the distribution of income called **The Functional Distribution of Income**, which measures the returns to the factor-inputs, Land, Labor, and Capital, with regard to their contribution to the production of output.

In addition to the growing disparity between the top and bottom wage-earners, labor has also been getting a smaller and smaller slice of the pie. Labor’s share of income has been declining over the last three decades, which has led to a growing interest in the Functional Distribution of Income. Since the 1980’s, labor’s share of national income has fallen around the world, and from Graph 4, which tracks labor’s share of U.S. Gross Domestic Income (GDI) from 1948 to 2013, it has been falling in the U.S. since 1970. This development contradicts the long-standing accepted observation by A.L. Bowley, known as *Bowley’s Law*, which states that labor’s share is remarkably constant in the long run.¹²

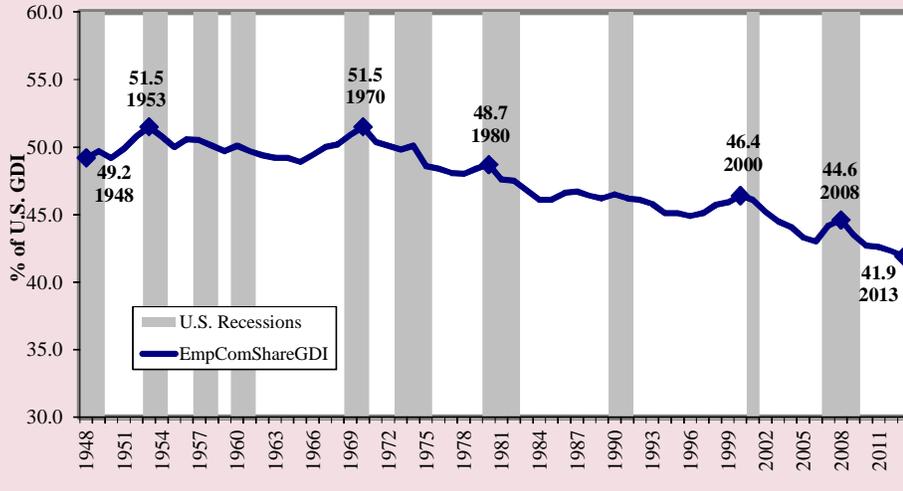
Karabarbounis and Neiman (2013)¹³ found a 5 percentage point decline in the share of global corporate gross value added paid to labor over the last 35 years. They also found that the global labor share has declined significantly since the early 1980s, with the decline occurring within the large majority of countries and industries. They explain the decline in labor’s share as the result of the decline in the relative price of investment goods. Efficiency gains in capital producing sectors, often attributed to advances in information technology and the computer age, induced firms to shift away from labor and toward capital to such a large extent that the labor share of income declined.

On the other hand, when looking at the trend in labor’s share for Continental European and Anglo-Saxon countries between 1960 and 2012, Dühaupt (2013)¹⁴ found two

GRAPH 3: Wage Dispersion (90-10 Wage-Decile Log-Difference): 1940-85



GRAPH 4: Employee Compensation as a Share of U.S. GDI: 1948-2013



broad trends that became apparent: (1) Labor's share fluctuates with the business cycle, increasing during recessions and declining during recoveries and (2) Apart from these short-run fluctuations, there is a long-run, downward trend in labor's share.¹⁵ After the peak years in the late 1970s and early 1980s, Continental European countries exhibited a clear downward trend, whereas the decline in Anglo-Saxon countries was very moderate. However, between 1980 and 2007, U.S. labor's share dropped by 5 percentage points whereby the Canadian share decreased by 2 percentage points. In the UK, the adjusted wage share was relatively stable, only fluctuating alongside the business cycle.¹⁶

In addition to the reasons discussed above, *High-Skilled-Biased Technological change*, which favors high-skilled workers and replaces low-skilled workers and *Deregulation*

and *Liberalization of Labor and Financial Markets*, which resulted in the decline of unions and weakening of labor rights, downsizing, including privatization of the public sector, coupled with the rising size and power of finance,¹⁷ other explanations have been advanced to explain the decline in labor's share of GDI. For instance, Elsby, Bart Hobijn (2013), and Sahin (2013)¹⁸ found Outsourcing as the most significant factor in causing the decline in labor's share.

EXACERBATING THE PROBLEM: Sprawl and the Economic Geography of Income Inequality and Poverty

As noted in the introduction, there is a uniquely American phenomenon that adds another dimension and exacerbates the inequality problem, especially as it relates to the role played by labor markets, and that is **Urban Sprawl**.

To analyze, or even acknowledge this phenomenon, we must turn to an approach to labor markets that introduces **Space** into the analysis.

The Decentralization of Jobs

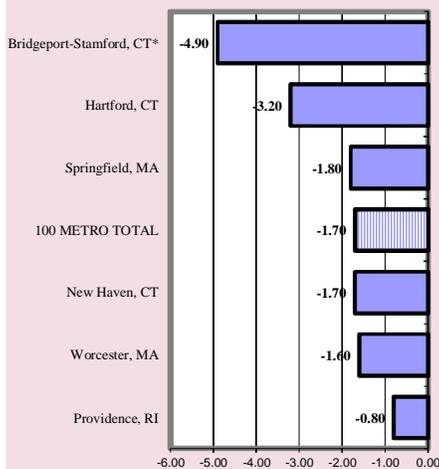
Suburbs are no longer just bedroom communities for workers commuting to traditional downtowns. Rather, many are strong employment centers serving a variety of functions in their regional economies. An investigation by Kneebone (2009) into the location of jobs in the nation's largest metropolitan areas found that nearly half are located more than 10 miles outside of downtowns. Only about one in five metropolitan jobs is located near the urban core, within 3 miles of downtown. Some suburban job growth is undoubtedly occurring in city-like settings, yet a significant share continues to take shape in low density, "edgeless" forms.¹⁹ Although, nearly half of work commutes still originate from, or terminate in, central cities, 39% of work trips are entirely suburban. Some older rail transit systems—which still move millions of daily commuters—capture little of this market because they were laid out when the dominant travel pattern was still into and out of cities before business and commercial development began rapid decentralization. These hub-and-spoke patterns provide dense metropolitan cores with large supplies of suburban workers, but may not serve other parts of metropolitan areas well.²⁰

Spatial Mismatch and the Costs of Transportation

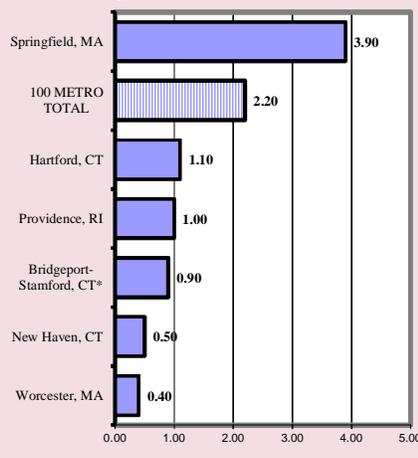
As economies and opportunity decentralize, a *Spatial Mismatch* has arisen between jobs and people in metropolitan America. In some metro areas, inner-city workers are cut off from suburban labor market opportunities. In others, low- and moderate-income suburban residents spend large shares of their incomes owning and operating cars. While owning a car improves chances of employment, a growing body of work quantifies the large combined impact of housing and transportation costs on households' economic bottom lines.²¹

In an analysis of the location of private-sector employment within 35 miles of downtown in the nation's 100 largest metropolitan areas over

GRAPH 5A: Pct-Pt Change in Jobs within 3Mi of CBD: 2000-10



GRAPH 5B: Pct-Pt Change in Jobs Beyond 10Mi of CBD: 2000-10



the first decade of the 21st Century, Kneebone (2013) found that in all but nine of the 100 largest metro areas, the share of jobs located within three miles of downtown declined during the 2000's. Only Washington, D.C. experienced an increase in both the number and share of jobs located in the urban core. At the same time, the share of jobs at least 10 miles from downtown rose in 85 of the 100 MSA's studied, between 2000 and 2010.²²

Job-Sprawl in New England's Mid-Sized MSA's

Graph 5A shows the percent-change in jobs, between 2000 and 2010, within 3 miles of the Central Business District (CBD) of the principal city, or cities, of New England's mid-sized Metropolitan Statistical Areas (MSA's), ranked by greatest to smallest decline. Graph 5B ranks New England's mid-sized MSA's by greatest to smallest percent job-growth beyond 10 miles from the CBD between 2000 and 2010. From Graph 5A, the Bridgeport-Stamford and Hartford MSA's had the largest percent-decline in jobs within 3 miles of the CBD. The Springfield MSA's decline also exceeded the decline for all 100 MSA's studied by Kneebone (2013).²³ However, it was the Springfield MSA that had the greatest percentage of its jobs created beyond 10 miles of the CBD (+3.90%) between 2000 and 2010, and it was the only mid-sized New England MSA that had greater job-growth beyond 10 miles of the CBD than the total 100 MSA's studied (+2.20%).

Bridgeport-Stamford did have significant job-growth between 3 and 10 miles of the CBD (+4.10%, not shown), while middle-ring jobs increased by 2.10% in the Hartford MSA, and Worcester and New Haven both had middle-ring job-growth that exceeded 1% between 2000 and 2010. However, Springfield's middle-ring jobs declined by 2.10% between 2000 and 2010, compared to a 0.50% decline for the 100 MSA's studied.

It appears that though there has been some job-sprawl in New England's mid-sized MSA's over the first decade of the 21st Century, it is the Springfield MSA that has been most negatively impacted. ■

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GENERAL ECONOMIC INDICATORS

(Seasonally adjusted)	3Q	3Q	CHANGE		2Q
	2014	2013	NO.	%	2014
General Drift Indicator (1996=100)*					
Leading	109.5	109.3	0.2	0.2	110.6
Coincident	110.0	109.7	0.3	0.3	109.7
Farmington Bank Business Barometer (1992=100)**	128.0	128.2	-0.2	-0.2	127.6
Philadelphia Fed's Coincident Index (July 1992=100)***	DEC	DEC			NOV
(Seasonally adjusted)	2014	2013			2014
Connecticut	159.88	153.94	5.94	3.9	159.35
United States	161.17	155.76	5.41	3.5	160.69

Sources: *Dr. Steven P. Lanza, University of Connecticut **Farmington Bank ***Federal Reserve Bank of Philadelphia

General Drift Indicators are composite measures of the four-quarter change in three coincident (Connecticut Manufacturing Production Index, nonfarm employment, and real personal income) and three leading (housing permits, manufacturing average weekly hours, and initial unemployment claims) economic variables, and are indexed so 1996 = 100.

The **Farmington Bank Business Barometer** is a measure of overall economic growth in the state of Connecticut that is derived from non-manufacturing employment, real disposable personal income, and manufacturing production.

The **Philadelphia Fed's Coincident Index** summarizes current economic condition by using four coincident variables: nonfarm payroll employment, average hours worked in manufacturing, the unemployment rate, and wage and salary disbursements deflated by the consumer price index (U.S. city average).