

The State of Working Pennsylvania 2008

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Harrisburg, Pennsylvania



The Keystone Research Center

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Overview

A year ago *The State of Working Pennsylvania 2007* warned about a gathering storm on the national economic horizon because of early signs that the housing market bubble had burst.

Since then a hard rain has begun to fall—sinking housing prices and rising mortgage foreclosures have crippled major U.S. financial institutions and forced dramatic attempts by the U.S. Federal Reserve to prevent a large-scale national economic collapse. As this report goes to press in mid-August 2008, financial institutions worldwide remain under severe stress. The national economy most likely entered a recession in January 2008, bringing to an end the economic expansion which began in November of 2001.

The State of Working Pennsylvania 2008 examines the initial impact of the economic slowdown on Pennsylvania and sets this analysis in the context of the economy's performance for the typical Pennsylvania worker during the prior economic expansion. Our main findings: The national economic slowdown has already damaged the Pennsylvania economy; when measured by their hourly wages, most Pennsylvania workers gained no ground during the economic expansion that likely ended in 2007. The economic stagnation experienced by typical Pennsylvania families since 2001 represents a return to the polarizing economic trends that began in the 1970s and that were only briefly interrupted by the shared prosperity of the second half of the 1990s.

Recession?

Since December 2007, the Pennsylvania economy has lost 4,500 jobs, and the number of unemployed people in Pennsylvania has increased by just over 62,000, or 22%. In the same period, the national economy has shed just under half a million jobs, and the number of unemployed has increased by 1.1 million, or 15%.

While no official determination has yet been made that the U.S. economy is in recession, the loss of jobs in Pennsylvania and the continued fragility of credit markets leave little doubt that the economy in the next several years will prove challenging for many Pennsylvania families.

Wage Stagnation Even in Economic Expansion

Even before the economy began to falter, Pennsylvania workers were not doing well. The expansion that began in November 2001 was shorter than the previous two expansions; moreover, it was characterized by slow employment growth. The share of the population employed (the “employment rate”) failed to reach the levels achieved in the strong economy of the late 1990s. Weakness in the labor market since 2001 translated into anemic wage growth that did not even keep pace with inflation.

- The earnings of the typical Pennsylvania worker (the median or 50th-percentile wage earner) in 2007 remained 1.6% below their levels in 2001.
- Even most higher-paid Pennsylvania wage earners—all the way up to 95th percentile earners, who make more than 19 out of every 20 workers—experienced a decline in inflation-adjusted wages from 2001 to 2007.
- Education is no longer insurance against wage stagnation: The earnings of the typical college-educated Pennsylvania worker declined by 8% since 2001.

Since workers were already treading water in an expanding economy, the current, slowing economy and growing inflation rate—5.5% per year¹—mean that the typical worker is likely to lose ground.

Rising Incomes Only at the Very Top—the Return of the Gilded Age

While most workers stood still (or worse) since 2001, the top 1% of Pennsylvania families experienced rapid growth in their incomes.

- The incomes of the richest 1% increased by 31% between 2001 and 2005 (the latest year for which the most detailed Pennsylvania data, provided by the Pennsylvania Department of Revenue, are available).
- The incomes of the wealthiest 0.01% of Pennsylvanians (1 out of every 10,000 taxpayers) rose by 47% over the same 2001 to 2005 period.
- While each group of higher-income taxpayers experienced rapid income growth, the average income of the bottom 90% of Pennsylvania families fell by 4% between 2001 and 2005.
- The top 1% of Pennsylvania earners captured a stunning 79% of all growth in personal income between 2001 and 2005.

Less detailed income data are already available from the the Internal Revenue Service for 2006 (but not yet for 2007). These data suggest that income inequality in Pennsylvania reached a higher point in 2006 than at any previous point since at least 1986, the earliest year for which comparable data are available.

Poof!—Bursting Housing Bubble Evaporates Main Source of Middle-Class Wealth

One of the few bright spots for the typical Pennsylvania family since 2001 was the rapid appreciation of inflation-adjusted housing prices. These increased by 39% between the first quarter of 2001 and the same quarter in 2007. For many Pennsylvania families, this rapid run-up in housing prices added significantly to their net worth. This new wealth also contributed to an explosion in home equity loans, as workers, their paychecks failing to keep pace with the cost of living, borrowed against the rising value of their homes. The collapse of the housing bubble has brought to a screeching halt the rapid appreciation of Pennsylvania housing prices and the ability of homeowners to borrow against the value of their homes to make ends meet.

Since the 1st quarter of 2007, inflation-adjusted housing prices in Pennsylvania have fallen by 4%. Over the same period, housing prices nationally have fallen 7%.

In July 2008, Dean Baker of the Center for Economic and Policy Research (CEPR) projected that, in the United States as a whole, a 10% decline in real housing prices by 2009 will reduce the wealth of the typical U.S. family in the 45 to 54 age cohort by 35%, leaving this cohort with just \$800 more in wealth than similar families had in 1989.² (No data are available on wealth trends for Pennsylvania since the housing bubble burst, but there is no reason to believe the overall trends are different than the national ones.)

¹This 5.5% referred to in the text is the percent change in the seasonally adjusted Consumer Price Index for all urban consumers from July 2007 to July 2008.

²Dean Baker, *The Impact of the Housing Crash on Family Wealth*, Center for Economic and Policy Research, July 2008, online at www.cepr.org

The Failed Promise of Economic Deregulation

In the United States and in Pennsylvania, the stagflation (high unemployment and high inflation) of the 1970s precipitated a three-decade experiment in economic deregulation. Financial markets, labor markets, and individual industries were all deregulated, and policies that protected vulnerable workers (the unemployed, the low-wage earner, the welfare recipient) were all weakened.

The rationalization for deregulation was that policies and institutions that helped rescue the economy from the Great Depression were now obsolete, part of the problem rather than part of the solution. The promise of deregulation was that it would restore prosperity for all, replacing a high “misery index” (defined as the unemployment rate plus the rate of inflation) with a new era of prosperity.

The 2001-2008 period represents the latest evidence on the impact of economic deregulation. The jury is in and, based on a fair reading of the evidence, the jury has reached a unanimous verdict: Our experiment in economic deregulation is a failure. The middle-class is more, not less, miserable. To wit:

- The wages of most workers are stagnant, even though productivity has increased 70% since 1979.
- The concentration of income among the richest 1% is greater than at any time since the 1920s, even while the share of families in poverty, or unable to cover the cost of a basic family budget, has not declined.
- Our financial system is on the brink of a meltdown.
- The survival of millions of people, and possibly the planet, is under threat from the consequences of global warming.

A basic flaw in the deregulatory approach pursued since the late 1970s is that it takes the extreme and ideological view that regulations are bad per se. As Keystone Research Center has emphasized since its founding in 1996, there *is* a need to *update* economic policies and institutions, many of which have not been substantially updated since the 1930s. The reinvention of policies and institutions needs to take place in areas including education and skill development; economic development and the stimulation of key industries; renewable energy and energy efficiency; labor relations and the role of unions; and trade. If we bring our policies and institutions up to date with the economic and social challenges of today’s economy, we can strengthen our competitiveness, expand opportunity and security for working families, and successfully confront environmental challenges, including climate change.

The conclusion of this report outlines in more detail a national agenda for restoring prosperity and opportunity—A New Deal for a New Economy. That section also underscores that Pennsylvania, contrary to some perceptions, is ahead of the curve when it comes to institutional renewal in key areas of economic policy.

In the end, restoring prosperity and opportunity is less a technical problem and more a challenge of political will. Today, with our economy spiraling downward and a presidential election and transition approaching, we as a nation have the best opportunity since the 1930s for a fundamental renewal of our economic policies—a renewal that will serve economic, environmental, and social goals. We cannot afford to miss this opportunity.

Wage and Employment Trends

Recession?

As this report goes to press, the economy is not officially in a recession.³ Already, however, the national economy has racked up a grim list of recent statistics, making the anticipated designation of a recession seem more and more a formality:

- Between December 2007 and July 2008 (the most recent month for which data are currently available), the U.S. economy shed more than half a million private sector jobs.
- The U.S. unemployment rate was 5.7% in July 2008, compared to just 5% in December 2007.
- Inflation-adjusted housing prices, as measured by the widely followed S&P/Case-Shiller Home Price Index, have fallen by 23% nationally from their peak in October 2006.

Since the housing crisis that emerged in 2007, the Pennsylvania economy has performed better than the hardest-hit states, such as California, Florida, Michigan, and Ohio. But Pennsylvania has clearly been hurt by the impact of the financial crisis on the national economy. Moreover, Pennsylvania has also suffered because, contrary to some perceptions, the state did have its own housing price bubble. Following the national pattern, that bubble has now burst:

- Since the first quarter of last year, inflation-adjusted housing prices in Pennsylvania have fallen by 4% (compared to 7% nationally using the same housing price index).⁴
- Private sector payrolls in the state are down by 4,700 jobs (.09%) since December.
- The state unemployment rolls have risen by just over 62,000 since December 2007, an increase of 22%, and the Pennsylvania unemployment rate has risen from 4.4% in December 2007 to 5.4% in July 2008.

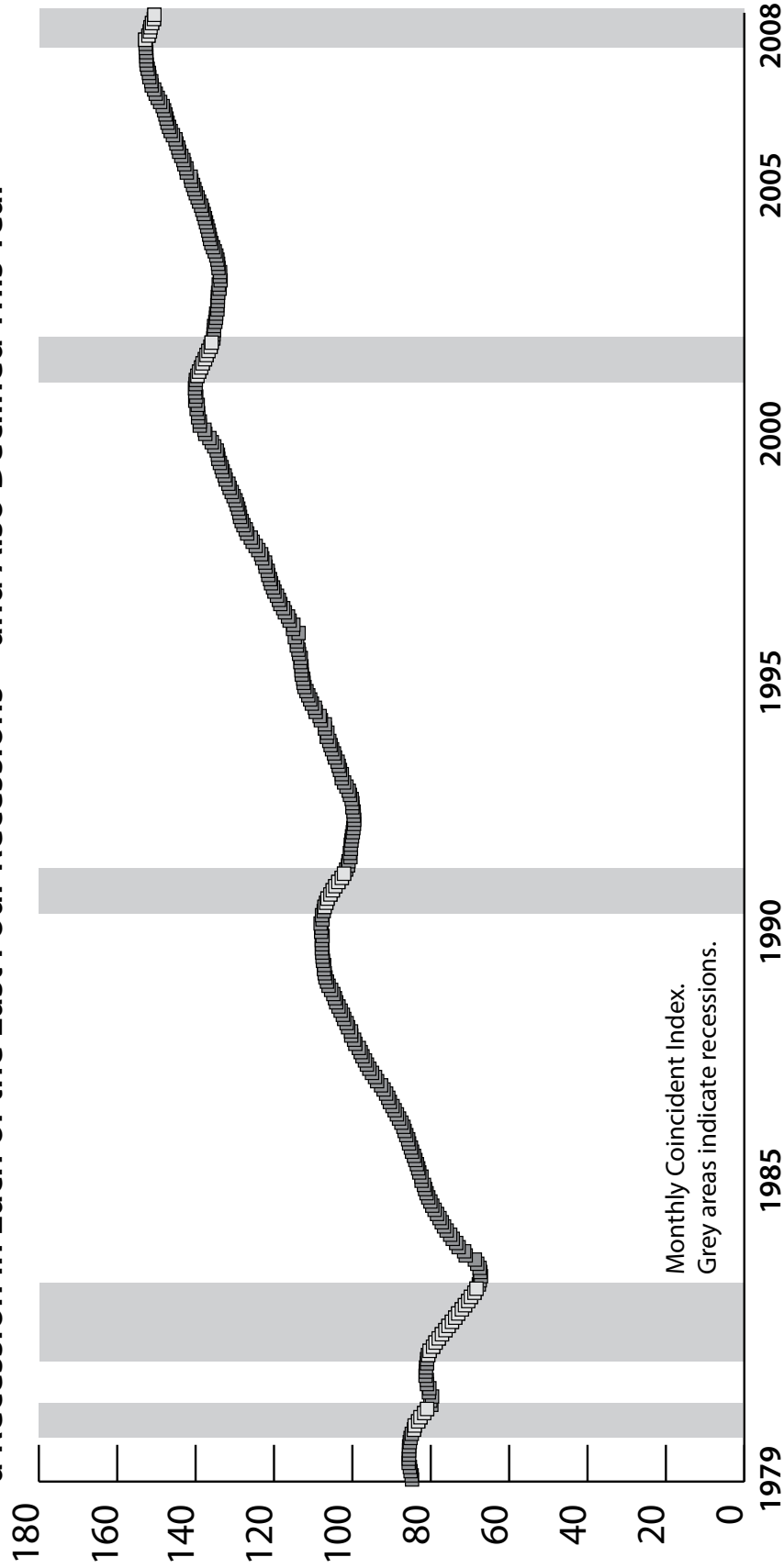
For details on the Pennsylvania housing market, see *A Building Storm: The Housing Market and the Pennsylvania Economy*, available online at <http://www.keystoneresearch.org/housingmarket/index.html>.

Another way to gauge the health of the current Pennsylvania economy is to use an index of economic activity for Pennsylvania maintained by the Philadelphia Federal Reserve Bank. Into this single index (which has the name “the coincident index”), the Reserve Bank folds information on recent trends in employment, wages, hours worked in manufacturing, and unemployment. Since 1979, the only periods in which this Pennsylvania index

³ The Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) is the entity that most economists rely upon to determine the official start and end dates of recessions. (<http://www.nber.org/cycles.html>)

⁴ The housing price figures in this bullet text are based on housing price series maintained by the OFHEO (Office of Federal Housing Enterprise Oversight). The national housing price series most commonly cited in the press, the S&P/Case Shiller Index of housing prices, which shows a much sharper national housing price decline in the last 12 months (20% between May of 2007 and May 2008), is not available for Pennsylvania.

Figure 1. The Federal Reserve Bank of Philadelphia's Pennsylvania Coincident Index, a Measure of the Health of the Economy, Has Declined as the U.S. Economy Entered a Recession in Each of the Last Four Recessions—and Also Declined This Year

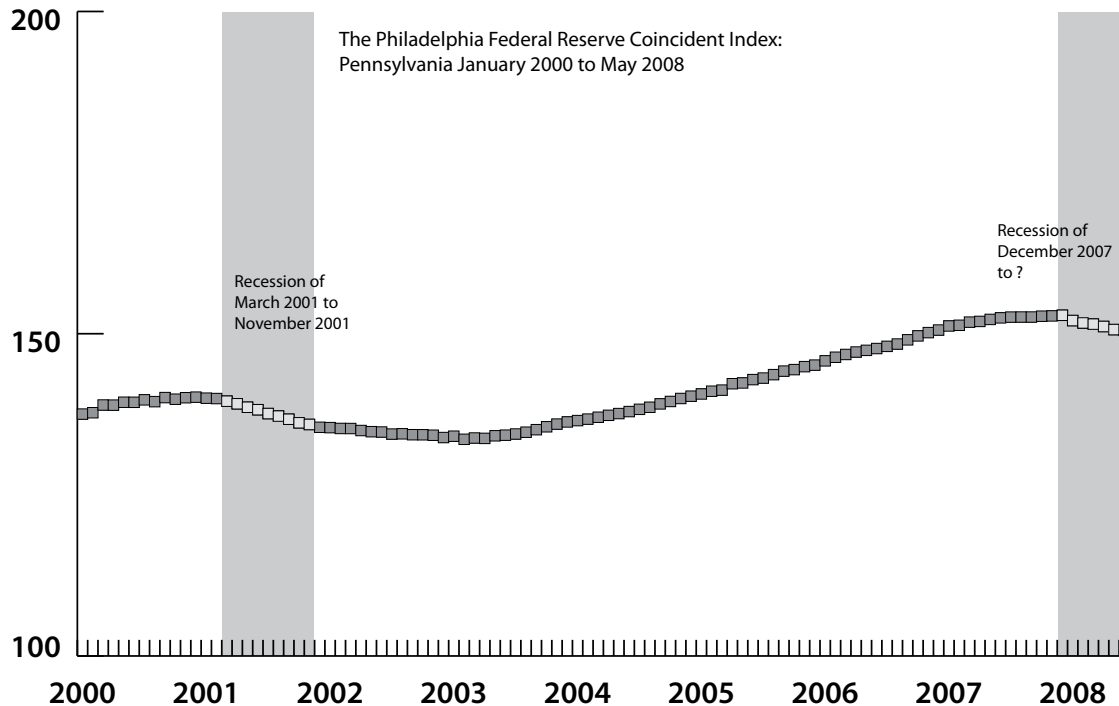


Note. The Federal Reserve Bank of Philadelphia's Pennsylvania Coincident Index is a composite of four state-level variables: nonfarm payroll employment; average hours worked in manufacturing; the unemployment rate; and inflation-adjusted wage and salary disbursements. The grey bars identify the last four national recessions as defined by the National Bureau of Economic Research (NBER) Business Cycle Dating Committee (<http://www.nber.org/cycles.html>).

Source. Keystone Research Center (KRC) analysis of data from the Federal Reserve Bank of Philadelphia. Available online at <http://www.philadelphiafed.org/econ/indexes/coincident/index.cfm>

fell for four or more months in a row were near the beginnings of the last four U.S. recessions.⁵ In 2008, the index has fallen for six months in a row. Based on past experience, this suggests the economy fell into recession at the beginning of this year (Figures 1 & 2).

Figure 2. The Pennsylvania Coincident Index Is Down 1.5% Since December of 2007, Signaling the Pennsylvania Economy Is Likely in Recession



Note. The Federal Reserve Bank of Philadelphia's Pennsylvania Coincident Index is a composite of four state-level variables: nonfarm payroll employment; average hours worked in manufacturing; the unemployment rate; and inflation-adjusted wage and salary disbursements. The grey bars identify the 2001 recession as defined by the National Bureau of Economic Research (NBER) Business Cycle Dating Committee (<http://www.nber.org/cycles.html>) and the likely 2008 recession.

Source. KRC analysis of data from the Federal Reserve Bank of Philadelphia. Available online at <http://www.philadelphiafed.org/econ/indexes/coincident/index.cfm>

Falling Employment Rates and Rising Underemployment

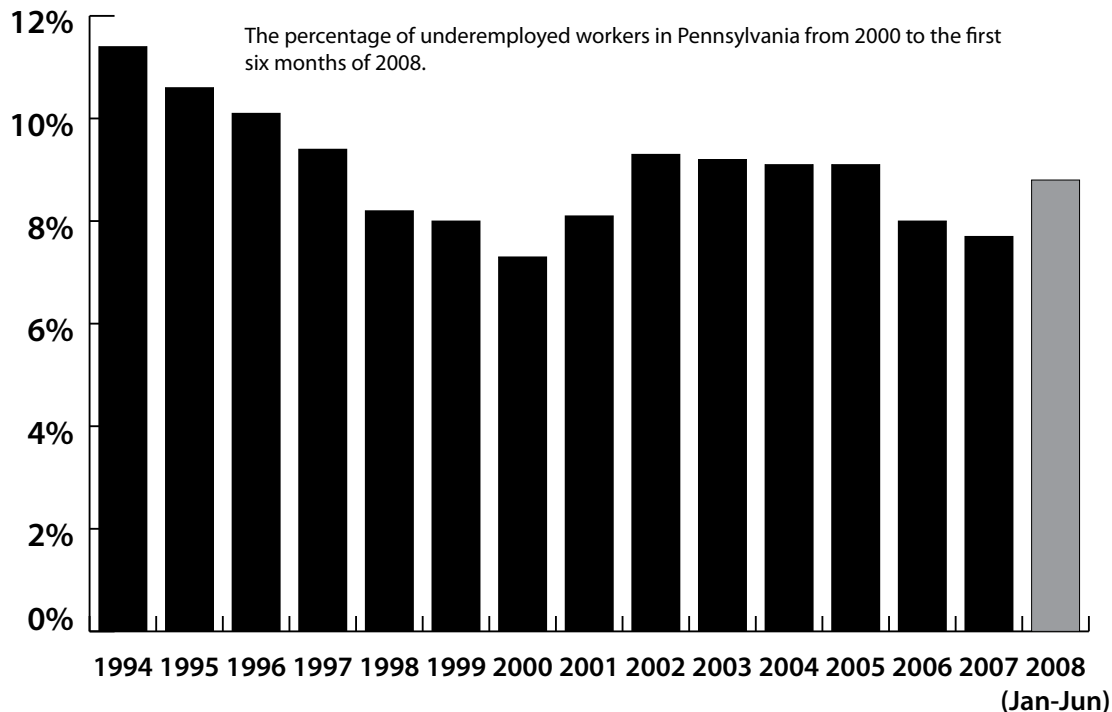
The most comprehensive measures of the health of the labor market are the employment rate—the ratio of employment to population—and the underemployment rate.⁶ Both statistics deteriorated in the first half of 2008.

- Between January and June of 2008 the underemployment rate in Pennsylvania increased to 8.8%, up from 7.9% during the same period in 2007.
- Also illustrating a weakening economy, the employment rate—the ratio of employment to population—in the first six months of 2008 fell to 61.3% from 61.6% in the same period in 2007.

⁵ For a detailed discussion of the performance of the Pennsylvania coincident index in periods of national recessions see Theodore M. Crone, "A New Look at Economic Indexes for the States in the Third District," Federal Reserve Bank of Philadelphia, November/December 2000. Online <http://www.philadelphiafed.org/files/br/brnd00tc.pdf>

⁶ The underemployment rate, officially called by the U.S. Bureau of Labor Statistics the "U-6 measure of the underutilization of labor," is calculated as the sum of the unemployed, those reporting being employed part-time for economic reasons, and marginally attached workers, all divided by the sum of the employed, unemployed, and marginally attached workers. Marginally attached workers are individuals not in the labor force who want, and are available for work, and who have looked for a job sometime in the prior 12 months.

Figure 3. In the First Six Months of 2008, the Underemployment Rate in Pennsylvania Moved Higher



Note. See Footnote 6 for an explanation of how the underemployment rate is defined.

Source. KRC and Economic Policy Institute (EPI) analysis of the Current Population Survey (CPS) Data

- During the last six years of economic expansion, neither the employment rate nor the underemployment rate reached the healthy levels that existed prior to the 2001 recession (Figures 3 and 4).

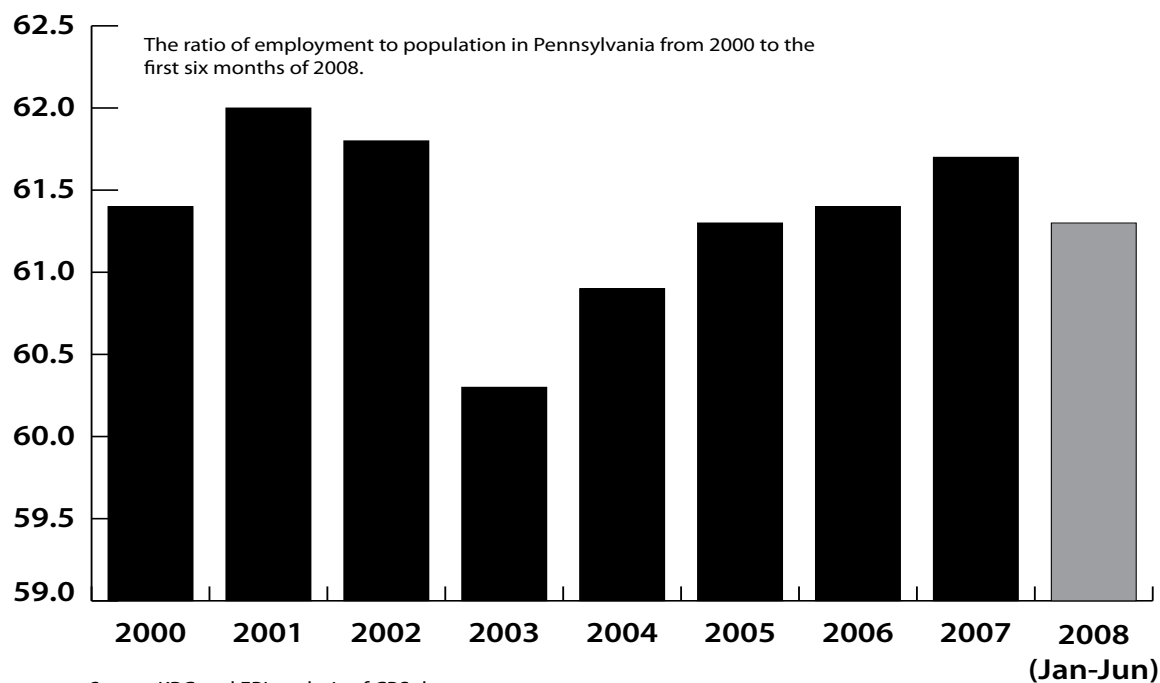
Stagnant Wages

In both Pennsylvania and the United States since 2001, workers throughout most of the earnings distribution saw little or no increase in wages (Figure 5).⁷

Pennsylvania low-wage earners (defined as those at the 10th percentile in Figure 1) earned \$7.87 per hour in 2007, adjusted for inflation, 2% lower than in 2001 (see also Table 1). This indicates that the increase in low-wage earnings following the recent increase in the state minimum wage (an increase analyzed in *The State of Working Pennsylvania 2007*) was not large enough to achieve a rise in low-wage earnings over the full economic expansion.

⁷ While Figure 5 shows workers in the United States gaining more than in Pennsylvania, the differences between the state and the nation are small. Moreover, we know from analyzing data for other periods, including the six years from 2001-2002 to 2007-2008, that the national wage-gain advantage over Pennsylvania is not robust, and depends on exactly which period of time is examined. For that reason, we do not emphasize the U.S.-Pennsylvania differences in wage trends.

Figure 4. The Pennsylvania Employment Rate Declined in the First Half of 2008



Source: KRC and EPI analysis of CPS data

In the middle of the earnings distribution, today's Pennsylvania median hourly wage of \$15.11 per hour is 25 cents lower than its level six years ago (Table 1).

Even higher-wage earners in Pennsylvania have gained little or no ground in Pennsylvania since 2001. In the United States as a whole, the highest-paid fifth of wage earners (from the 80th percentile on up) have seen their wages increase by between 3% and 7% over this period. In Pennsylvania, however, only a tiny group of earners above the 95th percentile has enjoyed substantial wage increases since the 2001 recession.

Education No Protection from Wage Stagnation

A common prescription for countering the wage stagnation America and Pennsylvania workers have experienced in the last several decades is for workers to get more education. While boosting the educational attainment of the Pennsylvania labor force makes sense and could, when combined with other policies, enhance competitiveness and opportunity in the state, having more education has, since 2001, done little to protect workers from losing ground.

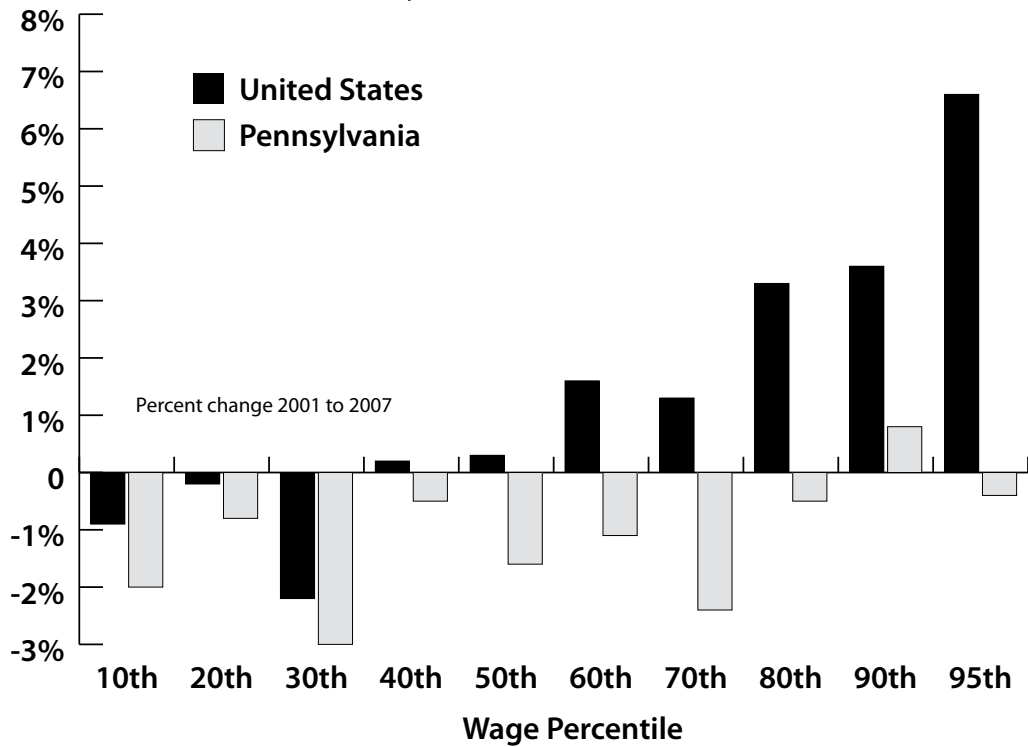
- The median wages of college-educated Pennsylvania workers fell from \$24.36 per hour in 2001 to \$22.42 in 2007—at 8% this is a larger decline than experienced over this period by workers with lower levels of education (Figure 6 and Table 2).
- The median wages of workers with some college education fell by 5%, from \$14.55 in 2001 to \$13.79 in 2007.
- Workers with a high school education fared somewhat better, their wages remaining essentially unchanged (at \$13.10 in 2001 and \$13.08 in 2007).

Table 1. Inflation-Adjusted Change in Hourly Wages From 2001 to 2007 for Each Wage Decile, Pennsylvania and the United States

Percentiles	Inflation-Adjusted Wage (2007 Dollars)					
	United States		% Change	Pennsylvania		% Change
	2001	2007		2001	2007	
10th	\$7.84	\$7.77	-0.9%	\$8.03	\$7.87	-2.0%
20th	\$9.45	\$9.43	-0.2%	\$9.70	\$9.62	-0.8%
30th	\$11.26	\$11.01	-2.2%	\$11.50	\$11.15	-3.0%
40th	\$12.90	\$12.93	0.2%	\$13.12	\$13.05	-0.5%
50th	\$15.05	\$15.10	0.3%	\$15.36	\$15.11	-1.6%
60th	\$17.62	\$17.91	1.6%	\$17.83	\$17.64	-1.1%
70th	\$20.98	\$21.25	1.3%	\$21.01	\$20.51	-2.4%
80th	\$25.38	\$26.21	3.3%	\$25.11	\$24.99	-0.5%
90th	\$33.90	\$35.12	3.6%	\$33.10	\$33.35	0.8%
95th	\$42.70	\$45.52	6.6%	\$41.20	\$41.02	-0.4%

Source. EPI analysis of CPS data

Figure 5. The Inflation-Adjusted Hourly Earnings of Most Pennsylvania Workers Are Lower Today Than in 2001



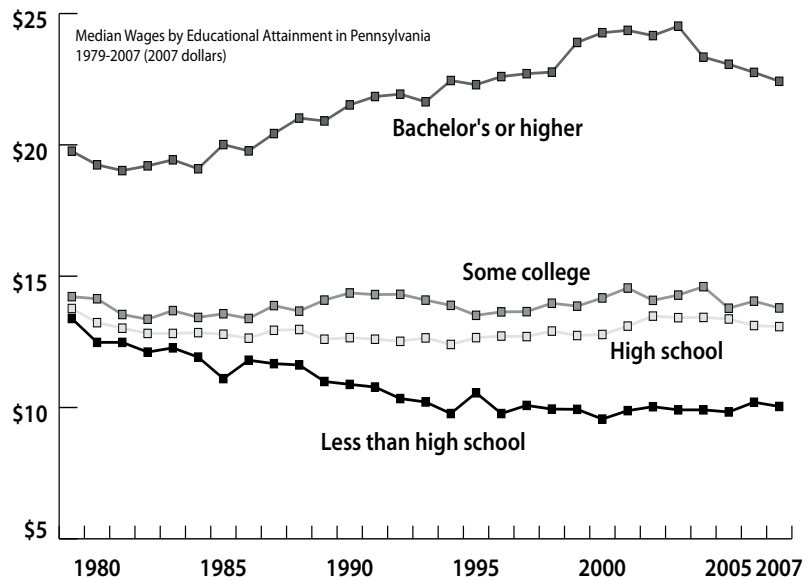
Source. EPI analysis of CPS data

Workers with less than a high school education were the only group to gain some ground between 2001 and 2007. Their wages rose by 1.6% from \$9.88 to \$10.04.

Explanations for rising inequality have often centered on the rapid rise in the wages of college-educated workers since 1979.

Given that, one might expect a slowdown in college earnings to have at least the positive benefit of ameliorating overall wage and income gaps. As noted above and elaborated further below, this expectation has not been borne out. Overall wage and income gaps have grown further even as higher-educated workers have seen their earnings fall.

Figure 6. The Wages of the Typical College-Educated Pennsylvania Worker Have Declined by 8% Since 2001



Source: EPI analysis of CPS data

Table 2. Median Wages by Educational Attainment in Pennsylvania, 1979-2007 (2007 Dollars)

Year	Less Than High School	High School	Some College	Bachelor's or Higher
1979	\$13.39	\$13.77	\$14.22	\$19.76
1989	\$10.99	\$12.60	\$14.09	\$20.91
1995	\$10.56	\$12.66	\$13.51	\$22.29
2000	\$9.56	\$12.78	\$14.17	\$24.27
2001	\$9.88	\$13.10	\$14.55	\$24.36
2002	\$10.03	\$13.48	\$14.08	\$24.16
2003	\$9.91	\$13.42	\$14.28	\$24.52
2004	\$9.91	\$13.43	\$14.60	\$23.34
2005	\$9.83	\$13.37	\$13.78	\$23.07
2006	\$10.20	\$13.12	\$14.05	\$22.76
2007	\$10.04	\$13.08	\$13.79	\$22.42
Percent Change				
1979-2007	-25.0%	-5.0%	-3.0%	13.5%
2001-2007	1.6%	-0.2%	-5.2%	-8.0%
2006-2007	-1.6%	-0.3%	-1.9%	-1.5%

Source: EPI analysis of CPS data

Income Inequality in Pennsylvania

Last year, to document income inequality trends from 1973 to 2004, *The State of Working Pennsylvania 2007* relied on detailed data on the very highest Pennsylvania earners. The data analyzed were more extensive than data available or analyzed for any other state or for the United States as a whole.

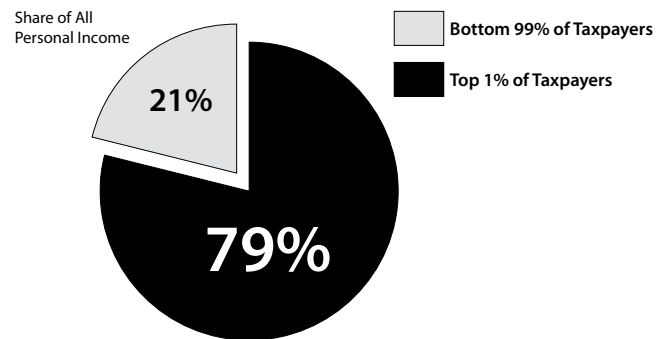
This year, Keystone Research Center obtained similar detailed data on very high Pennsylvania earners in 2005. (See Appendix Table A1 for details on top incomes in 2005.)⁸ We also obtained such data for additional past years, including 2001. This enabled analysis of income inequality trends since the last economic recession in 2001.

Our new and updated numbers reveal a jaw-dropping rise in inequality since 2001, concentrated among the top 1% of Pennsylvania taxpayers.⁹

- Inflation-adjusted total personal income grew in Pennsylvania by 6% between 2001 and 2005: Stunningly the top 1% of taxpayers captured 79% of this income increase (Figure 7).¹⁰
- The average income of the bottom 90% of Pennsylvania taxpayers actually declined by 4% from 2001 to 2005 (Table 3 and Figure 8).
- The average income of the top 1% of taxpayers rose by just under \$250,000 between 2001 and 2005, an increase of 31% (Table 3).

Even the quarter million dollar increase enjoyed on average by the top 1% pales in comparison to the rise in income among the top 1% of the top 1%, the richest 1 out of every 10,000 Pennsylvania taxpayers. The average income of this group rose from \$14.6 million in 2001 to \$21.3 million, an increase of 47%.

Figure 7. The Wealthiest 1% of Pennsylvania Taxpayers Captured Nearly 80% of All Personal Income Growth From 2001 to 2005



Source: KRC analysis of Pennsylvania Department of Revenue (PA DOR) data

⁸ As this report goes to press, the most recent year of taxable income data available from the Pennsylvania Department of Revenue was for the 2005 tax year

⁹ All figures in this section of the report are adjusted for inflation using the CPI-U-RS.

¹⁰ The share of personal income of the top 10% of taxpayers is estimated by dividing the total taxable income of the top 10% of taxpayers by total Pennsylvania personal income reported by U.S. Department of Commerce, Bureau of Economic Analysis (BEA). The income of the bottom 90% of taxpayers is calculated by subtracting the total taxable income of the top 10% of taxpayers from total personal income in Pennsylvania. This assumption guarantees that the total share of personal income of all groups adds to 100%. However it should be noted that total personal income is greater than total taxable income in part because personal income also includes social security, pension income, and the dollar value of transfers and health benefits. This calculation therefore allocates all of the difference between total personal income and total taxable to the bottom 90% of taxpayers. In reality, of course, high-income taxpayers obtain transfers, such as social security and private pensions, and as a result these and any other source of income not considered taxable (which are also included in the BEA personal income data) are being allocated to the bottom 90% of taxpayers. This means that we are understating the share of all income held by the top 10% of taxpayers.

In 2005, 5.8 million Pennsylvania taxpayers (the bottom 90% of taxpayers, or all those making less than \$98,381) earned 65 cents of every dollar of personal income in Pennsylvania (Figure 9). This figure is down 4 cents from 2001, when this group claimed 69 cents of every dollar of personal income (Figure 10).

The next 5% of earners, those falling between the 90th and 95th percentiles, claimed 8 cents of every dollar of personal income in the state, a figure essentially unchanged from 2001.¹¹

The next 4% of earners, those falling between the 95th and 99th percentiles or some 235,000 taxpayers, claimed 12 cents of every dollar of personal income, a gain over 2001 of 1 cent.¹²

The nearly 59,000 taxpayers who earned more than \$343,355 in 2005, the top 1% of taxpayers, earned 15 cents of every dollar of personal income in Pennsylvania, a gain over 2001 of 3 cents.

These data stand in stark contrast to the late 1990s when tight labor markets drove up most incomes, not just those at the top. From 1997¹³ to 2000, when inflation-adjusted total personal income grew by 9% in Pennsylvania, the top 1% of taxpayers captured just 10% of that growth (Figure 11).

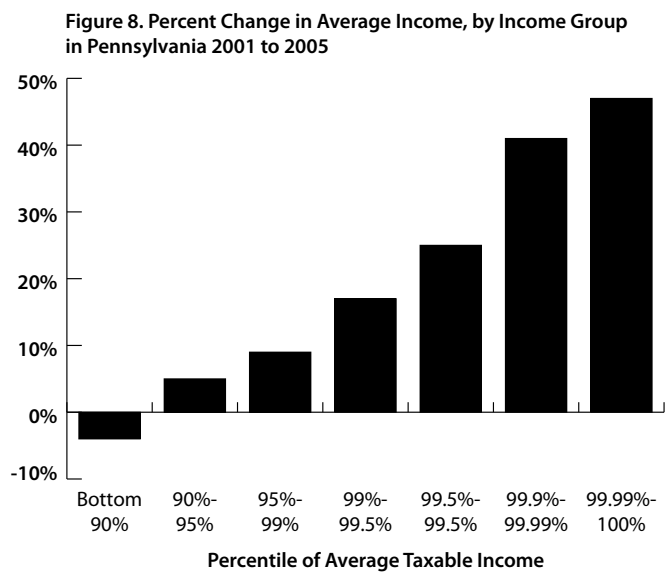
Since income for most families depends on how many jobs they have (and how many hours they work) and on wage levels, given the wage and employment trends summarized earlier, it is unsurprising that the average income of the vast majority of Pennsylvania taxpayers declined by 4% between 2001 and 2005 (Figure 11). Slow job and wage growth in this period translated into slow—in fact, negative—income growth.

What these data do reveal, which other sources have not, is the sharp divergence between the welfare of most Pennsylvanians and that of a tiny minority of the very highest-income taxpayers. As Figure 11 illustrates, the bottom 90% of taxpayers lost ground between 2001 and 2005, while the next 9% made modest gains. But among the top 1% of taxpayers, the gains mushroom for each higher income group. At the pinnacle stand the top .01% of taxpayers who experienced an increase in their average income of 47% between 2001 and 2005—a gain of \$6.7 million dollars.

Table 3. Average Income by Income Group 2001 to 2005

Income Group	2001	2005	Percent Change
Bottom 90%	\$51,251	\$48,986	-4%
90-95%	\$109,995	\$115,108	5%
95-99%	\$179,837	\$196,045	9%
99-99.5%	\$360,350	\$419,820	17%
99.5-99.9%	\$660,406	\$827,152	25%
99.9-99.99%	\$2,135,517	\$3,006,526	41%
99.99-100%	\$14,563,182	\$21,335,316	47%

Source. KRC analysis of PA DOR data

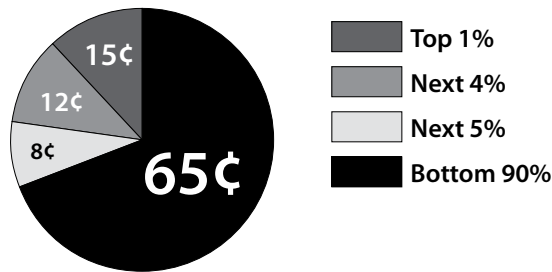


¹¹ Those earning more than \$98,381 but less than \$138,423.

¹² Those earning more than \$138,423 but less than \$343,355.

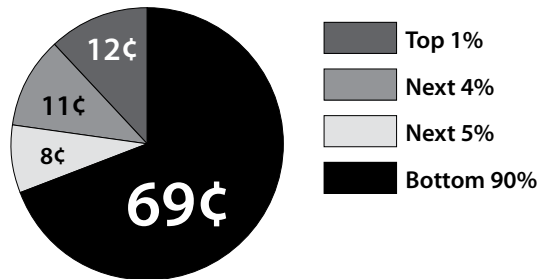
¹³ Because of a change in computer systems, the PA DOR can only provide data on top incomes in Pennsylvania starting in 1997.

Figure 9. In 2005, 15 Cents of Every Dollar of Personal Income Was Claimed by the Top 1% of Pennsylvanians



Source. KRC analysis of PA DOR data

Figure 10. In 2001, 12 cents of Every Dollar of Personal Income Was Claimed by the Top 1% of Pennsylvanians



Source. KRC analysis of PA DOR data

from the IRS. We know that the Piketty and Saez methodology understates top incomes, as we can show by comparing (see Figure 12) actual highest Pennsylvania incomes using less detailed IRS data. We also know that the trends in estimates using IRS data follow the trends in actual Pennsylvania highest incomes (see also Figure 12). From this we conclude that the uptick in 2006 top incomes estimated using IRS data (and seen in Figure 12) will be matched by similar increases in the more detailed Pennsylvania data for 2006 once that data becomes available.¹⁶ Although the Piketty and Saez methodology does understate top incomes, in seven of the eight years for which we have data on the change in actual top incomes, the IRS and DOR data correspond—that is, the increase or decrease in the share of income held by the top 10% of taxpayers in the IRS data parallels the increase or decrease in the income share derived from DOR data.

¹⁴Thomas Piketty and Emmanuel Saez, “Income Inequality in the United States, 1913-1998,” *Quarterly Journal of Economics*, 118 (1), 2003. Updated estimates available at <http://elsa.berkeley.edu/~saez/TabFig2006.xls>

¹⁵ See Estelle Sommeiller, *Regional Income Inequality in the United States, 1913-2003*, PhD dissertation, University of Delaware, 2006.

¹⁶The difference here is not attributable to differences between the definition of taxable income by the DOR and the IRS. The DOR also has published since 1973 summary statistics of Pennsylvania personal income tax filers (data since 1999 is available online <http://www.revenue.state.pa.us/revenue/cwp/browse.asp?A=246&BMDRN=2000&BCOB=0&C=33715>) similar to those published by the IRS. Applying the Piketty and Saez methodology for estimating top incomes to these summary statistics for Pennsylvania yields personal income shares for the top 10% of taxpayers which are nearly identical to those estimated from similar IRS tables. The average annual difference between 1997 and 2005 in the personal income share of the top 10% of taxpayers estimated from IRS data and that derived from summary statistics published by the DOR was 0.3%. By contrast, the average annual difference in the personal income shares of the top 10% estimated from the IRS data and estimated from actual top incomes reported by the DOR was 2.9%.

Preview of Inequality Trends in 2006

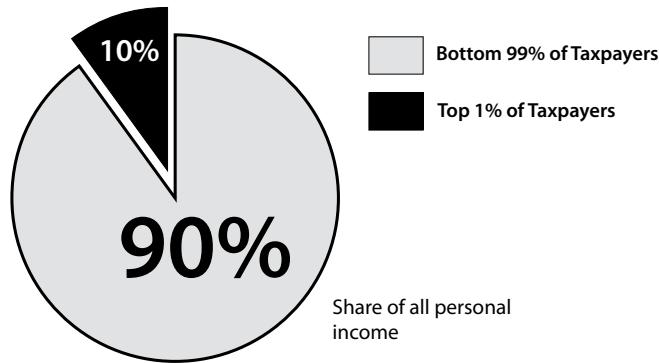
As of the date of this publication in August 2008, 2005 taxable income data is the most recent data available from the PA DOR. However the U.S. Internal Revenue Service (IRS) has already published summary statistics for 2006 federal income tax filers in Pennsylvania. Although this data is not as detailed as that available from the Pennsylvania DOR, it does allow an early look at trends in inequality in 2006.

In examining the 2006 Pennsylvania data from the IRS, we rely on the methodology used by economists Thomas Piketty and Emmanuel Saez, the authors of widely cited estimates of top incomes in the United States between 1913 and 2006.¹⁴ The Piketty and Saez methodology for the United States can be adapted to the state level using published IRS tables on state-level personal income.¹⁵ Lacking detailed data (such as we have for Pennsylvania up to 2005) on the highest incomes, Piketty and Saez estimate the highest incomes by fitting a curve for the entire distribution of income (all the way to the very top) from the data that are available

The increase in inequality in Pennsylvania in IRS data for 2006 took place even though the labor market improved somewhat in 2006, leading to healthier wage growth for some workers. The share of income captured by the top 10% of Pennsylvania families increased in the 2006 IRS data to its highest level at least since 1986.¹⁷

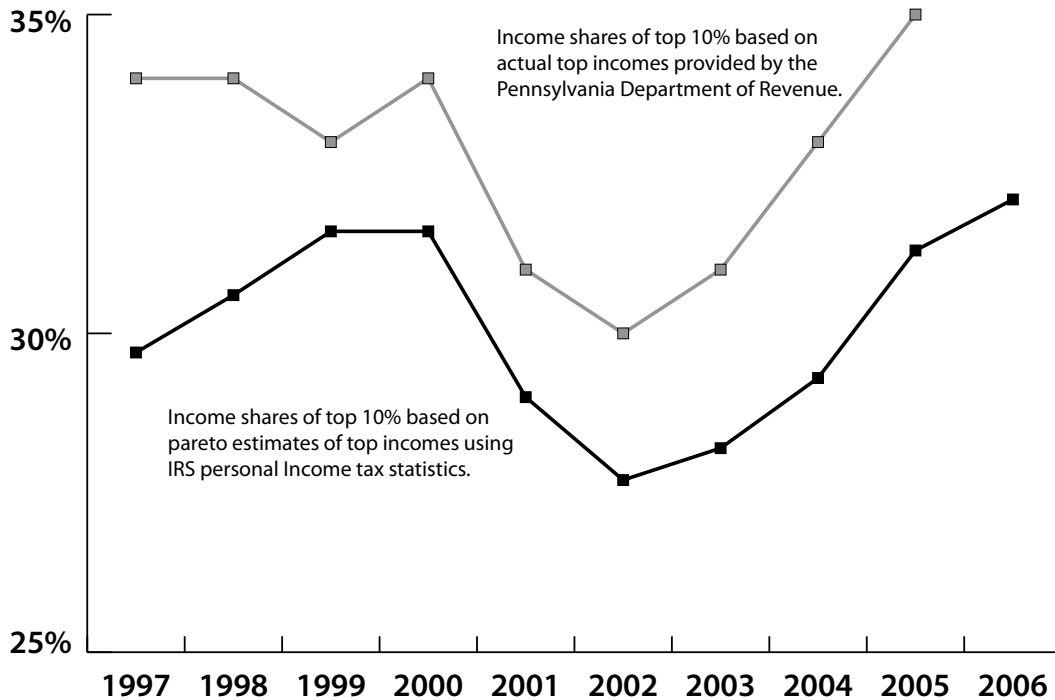
¹⁷ Comparisons of income data from tax returns before 1986 is complicated by the inconsistent treatment of capital gains, whereas prior to 1986 only a fraction of capital gains income was included in adjusted gross income on federal tax returns. Estimates which attempt to remove capital gains income suggest the share of personal income (minus capital gains) of the top 10% of Pennsylvania

Figure 11. The Wealthiest 1% of Taxpayers Captured 10% of All Personal Income Growth in Pennsylvania between 1997 and 2000



Source: KRC analysis of PA DOR data.

Figure 12. Estimates Based on Data From the U.S. Internal Revenue Service Indicate Inequality Reached a New High in 2006



Source: KRC estimates based on U.S. Internal Revenue Service (IRS) and PA DOR data.

Time for a New Economic Approach

This report focuses on a single state but is written in the context of an intensifying debate about the national economy during the 2008 U.S. presidential campaign. For that reason, the thrust of this concluding section of *The State of Working Pennsylvania 2008* addresses national economic policy.

In the national presidential campaign, opinion polls document a high level of concern about our national economy.¹⁸ Based on the data in this report, this concern is easy to understand. Whether one looks at the past year, the seven years since the 2001 recession, or the past 30 years, one sees that the economy has performed poorly from the perspective of the middle class. Moreover, most observers agree that the current economy could spiral down further before it starts to grow again.

At the national level, especially, the thrust of policy during the past 30 years has been deregulation. Financial markets have been liberalized. The impact on the labor market of public policy (e.g., through the minimum wage) and of unions has been weakened. Measured by per capita national spending levels, social programs—such as welfare, unemployment benefits, and employment and training investments—have eroded. Industries have been deregulated (trucking, airlines, and telecommunications circa 1979; energy industries in the 1990s). Finally, trade policy has liberalized the flow of goods, services, and investments across U.S. borders. After this three-decade national experiment, the jury—at least if it’s made up of typical, American middle-class families—is surely in. The verdict: Deregulation has not worked.

After a three decade national experiment, the jury is in—deregulation hasn’t worked, at least from the perspective of typical American families.

So let’s try something different.

Before we do, we should be clear about one starting point: The news from the past three decades is not all bad. This has been a period of enormous technological and organizational innovation. Productivity growth, after lagging far below the rates of the 1940s to early 1970s, picked up substantially in the mid-1990s. In industry after industry, the highest-performing companies achieve levels of productivity, service, quality, and innovation that far outstrip the levels of typical and low-performing companies.

What we call for now is not the reimposition of regulations from the 1960s (even if that were possible), or even indiscriminate reregulation. We call instead for the updating of policies, regulations, and institutions to fit today’s economy. Table 4 outlines key elements of an economic agenda—a “New Deal for a New Economy”—and points the reader to sources where more detail on each element can be found.¹⁹

While many economic agendas come across as a laundry list, our plan represents an effort to create an integrated or “systemic” policy and institutional response to the challenges of the current economy. The combined impact

families in 2006 is at its highest level since the 1940s.

¹⁸ See, for example, Michael Cooper and Dalia Sussman, “Polls Show Tight Race With Focus on Economy,” *New York Times*, August 21, 2008, p. A13.

¹⁹ Since its founding in 1996, Keystone Research Center has framed its economic research and policy analysis with the idea that the nation needs to implement a “New Deal for a New Economy.” A “New New Deal” is an alternative for the same idea that is slightly simpler and shorter, and is also now receiving more currency. It was introduced to recent debates by Paul Krugman in *The Conscience of a Liberal* (New York: W.W. Norton, 2007).

of the specific policies outlined in Table 4 would address four key challenges in the current U.S. economy.

1. Improving productivity growth, innovation, and competitiveness. The U.S. economy faces unprecedented competitive challenges, as indicated, for example, by its gaping trade deficit. Our New Deal for a New Economy would address these competitive challenges by helping to achieve higher rates of productivity growth and innovation. It would do this, in part, through increased investment in skills and in university-industry research and innovation collaboration. It would do this because workforce and economic development policies tied to particular industry clusters, or networks, would accelerate the spread of effective managerial practices that help raise productivity and quality. It would do this finally because some restraints on marketplace competition (e.g., a higher minimum wage, stronger international labor rights and standards) might prompt some businesses (that would otherwise be profitable with low-productivity approaches) to reconsider their business strategy and explore more productive approaches.

2. Expanding opportunity and security. A New Deal tailored to the 21st century would raise wages for low- and middle-wage workers partly through more widespread unionization. These policies would also give more workers the training, education, portable credentials, and career supports necessary to more successfully navigate our more dynamic economy. Such navigation would be accomplished through the strengthening of industry-linked training partnerships, such as now widespread in Pennsylvania, as well as through increased collective bargaining to increase investments in training, education, and career counseling.

3. Ensuring that demand keeps pace with potential output. A New Deal for a New Economy would help ensure that consumer demand, globally and in the United States, keeps pace with the economy's capacity to produce. Comparable to the 1920s within the United States, the recent geographic extension of markets, this time globally, has increased productivity growth but has not produced stable mechanisms for distributing the benefits of that productivity growth. The resulting wage-productivity gap (evident, for example, in China, Mexico, and the United States) creates the risk of an eventual economic crisis because consumption falls short of demand. (This kind of "underconsumption" crisis took place in the 1930s.) So far, the danger of a global shortfall in demand has been avoided through mechanisms such as an expansion of consumer debt, including home equity loans, and through the huge U.S. trade deficit, which enables U.S. demand to sustain growth in China. But these mechanisms are not sustainable. A New Deal for a New Economy should ensure a more equitable wage and income distribution, at home and overseas, and thus produce a more stable and sustainable expansion of consumer demand. Investment in energy efficiency and new energy industries will also provide a boost to global demand over the next several decades.

4. Increasing environmental sustainability. An updated New Deal would, finally, help achieve environmental sustainability. It would do this partly through substantial increases in energy efficiency and renewable energy, but also through the promotion of high-productivity business strategies, which are much more compatible with high environmental standards than low-productivity business strategies. Our next New Deal would broaden social support for sharp cuts in carbon emissions and other pollutants because workers would have greater confidence in their ability to get another good job should they lose one at a polluting facility. Social support for cuts that produce some job loss (as well as lots of job gain) would also result from the overall improvement in security and opportunity (number 2 above) and through specific investments in socializing the cost of worker (and community) transitions from polluting jobs/industries to green and clean ones.

In the end, despite the evidence that the U.S. economy is not currently delivering for the middle class, we remain optimistic. The only limitation on our ability to achieve more successful U.S. and Pennsylvania economies—economies with widespread opportunity for all—is our capacity for social innovation and negotiation.

We have no doubt that a pragmatic mix of market, regulations, and supportive institutions could improve social, economic, and environmental outcomes.

Opportunities for a wholesale updating of policies and institutions to fit current conditions don't come about very often in the United States—perhaps every 35 to 70 years. The stakes linked with our ability as a nation to rise to this occasion are high. On this ability hinge the future of the U.S. middle class and, possibly, the future of our planet.

Table 4. A New Deal for a New Economy
A Holistic Policy Agenda to Promote Competitiveness, Opportunity, and Environmentally Sustainable Growth in the 21st Century

Issue	Policy Specifics	Benefits to Businesses	Benefits to Workers and Families
Invest in skills and career advancement	<ul style="list-style-type: none"> Build training partnerships (spanning multiple businesses in regional industries) that coordinate lifelong learning and career supports for all employed workers Provide universal access to two years of post-secondary education focused on jobs/careers in demand that support a family Provide unemployed and low-wage workers with training, income support, and other support services needed to access careers in demand with a future 	<ul style="list-style-type: none"> Align education and training system with the needs of high productivity businesses Provide businesses with a workforce able to compete in high-wage, high-skill ways Network managers with high-performing businesses, so that they can “see,” “feel”—and more easily adopt—high-productivity organizational practices Embed key occupational groups (e.g., engineers, information technology specialists) in “learning networks” that generate new ideas and spread high-productivity practices 	<ul style="list-style-type: none"> Improve the quality (wages, benefits, supervision, advancement opportunities) of entry-level jobs Provide employed workers, including at the entry level, with ongoing learning opportunities, career counseling, and opportunities to advance—substitutes for the security and opportunity of the old “one-company” career Provide jobless and underemployed workers with sufficient income support, training, career counseling, and other services to reduce economic anxiety
Invest in industries of the future, including renewable energy, advanced manufacturing, and efficient transportation	<ul style="list-style-type: none"> Reorient Manufacturing Extension Partnerships (Industrial Resource Centers in PA) to enabling businesses to adopt high-productivity business strategies and organizational practices Invest in industry cluster collaborations on technology, marketing, and innovation Invest in renewable energy, energy conservation, clean manufacturing, green building, and efficient transportation Create a National Innovation Foundation (NIF) to spur more effective university-industry collaboration to fuel innovation 	<ul style="list-style-type: none"> Help businesses position themselves in non-commodity markets with less price and cost pressure Embed businesses in supportive networks of high-quality suppliers and specialized services Spur innovation and the pace at which businesses can introduce specialized goods and services that command a premium price 	<ul style="list-style-type: none"> Raise national productivity levels and competitiveness, the foundation for higher living standards for workers generally Create a healthier, and sustainable, economy

Issue	Policy Specifics	Benefits to Businesses	Benefits to Workers and Families
<p>Give workers a real option to join unions—strengthen “New Unions for New Economy”</p>	<ul style="list-style-type: none"> • Enact the Employee Free Choice Act (EFCA) • Support innovation to spread “broad-based” unionism, e.g., that spans all employers in regional service industries • Support federal and state legal innovation to facilitate broad-based unionism 	<ul style="list-style-type: none"> • Create more skilled incumbent workforce and a pipeline of qualified new workers • Increase worker retention • Labor-management training collaboration frees employers to focus on other issues • Increases worker/union support for raising workforce quality standards and for improving productivity, quality, and service • Stronger employment security across firms makes workers/unions more amenable to individual employer need to lay off workers (as in the unionized building trades) 	<ul style="list-style-type: none"> • Low-wage, dead end jobs (in janitorial services, direct care, hotels, supermarkets, other retail, office work, etc.) transformed into middle-class jobs with a future • In skilled and professional jobs (most jobs now), new unions held together by workers’ commitment to doing a good job and to those they serve strengthen the meaning workers get from their jobs • Stronger employment security/career counseling sharply reduces economic anxiety • Enough good jobs to go around • Reduced work-family tension • Access to better quality health care and retirement benefits (the former would ideally come from universal health care disconnected from workers’ job status; the latter should supplement new universal retirement accounts)

Issue	Policy Specifics	Benefits to Businesses	Benefits to Workers and Families
<p>Enact a new trade policy that meshes with national efforts to strengthen competitiveness, opportunity, sustainability—“Smart Trade”</p>	<ul style="list-style-type: none"> Require modernization and strengthening of labor (unionization) rights and environmental standards in each trading partner (e.g., EFCA in the U.S.) as condition for enacting/remaining in trade agreements Launch the Americas’ Labor and Environmental Standards initiative to build on creative national efforts to improve compliance and make standards enforcement part of multi-pronged effort to promote high-productivity business strategies Enforce modernized rights and standards through trade Establish hemispheric “structural” funds to invest in infrastructure, education, and job creation through the Americas Explore the need for “inter-bloc managed trade,” at least in the auto industry, to lower the Americas trade deficit with Asia 	<ul style="list-style-type: none"> Facilitate the strengthening of “New Unions for a New Economy” and the benefits to employers of those Help more businesses shift from low-productivity business strategies that lead to violations of labor and environmental standards Help create a politically sustainable and stable framework for high performance businesses to operate for the next generation or more Labor rights will help ensure expansion of global consumption demand over time and prevent “under-consumption” A stepping stone to the creation of stronger global institutions for managing the global macro-economy and financial system and reducing the volatility of the global economy 	<ul style="list-style-type: none"> Facilitate the strengthening of “New Unions for a New Economy” and the benefits to workers of those Relieve low-wage pressure on U.S. workers from trade Relieve low-wage pressure on U.S. workers from immigration (because more opportunities would exist for potential immigrants back in their home) A stepping stone to a less volatile global economy and to a steady expansion of global demand consistent with low unemployment rates
<p>Establish an economic stimulus that helps transition to a New Deal for a New Economy</p>	<ul style="list-style-type: none"> In the first 100 days of 2009, kick-start major investments in the green economy: renewable energy, energy efficiency, clean manufacturing, efficient transportation Invest immediately and substantially in skill upgrading for jobless and underemployed workers, including through the establishment of a new (and permanent) employment security program that gives all jobless workers access to unemployment benefits AND long-term training keyed to jobs in (long-term) demand (“Trade Adjustment Assistance For All”) Invest in the infrastructure of a 21st century economy Revenue sharing for the states 	<ul style="list-style-type: none"> ForeSTALL a deeper and longer economic recession Begin to position American employers ahead of the curve when it comes to confronting the challenge of global warming Begin to provide employers with a world-class infrastructure and a world-class workforce 	<ul style="list-style-type: none"> ForeSTALL a longer and deeper recession Begin to “upskill” jobless and underemployed workers for the jobs of tomorrow Sustain critical state and local services that sustain families in a recession

Appendix

Table A1. Income Thresholds and Average Incomes, All Returns, Pennsylvania 2005													
Percentile of taxpayers by income level		90%	95%	99%	99.50%	99.90%	99.99%						
Minimum income for group		\$98,381	\$138,423	\$343,355	\$531,738	\$1,610,244	\$8,273,108						
Percentile of tax units by income level		Count	Count	Count	Count	Count	Count	Count	Count				
Cumulative percentage of taxpayers		10%	5%	1%	0.50%	0.10%	0.01%						
Average income of taxpayers in each group/range		588,374	\$238,429	294,192	\$361,746	58,837	\$1,024,567	29,418	\$1,629,334	5,883	\$4,838,470	588	\$21,335,316
Percentile of distinct tax units by income level		Count	Count	Count	Count	Count	Count	Count	Count				
Percentage of taxpayers within each group interval		5%	4%	0.50%	0.40%	0.09%	0.01%						
Average income of taxpayers in each interval		294,182	\$115,108	235,355	\$196,045	29,419	\$419,820	23,535	\$827,152	5,295	\$3,006,526	588	\$21,335,316

Note: These results are slightly different than the original 2005 Personal Income Tax (PIT) Booklet due to difference in the overall data population used. The PIT Booklet excludes returns that are suspended at the time of the creation of the booklet.

Source: PA DOR tabulations from the 2005 Annual Personal Income Tax Return Data Set



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