The incidence of the 1990’s expansion on income distribution

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The 1990's expansion has become the longest business cycle expansion in the recent history of the United States and many industrialized countries. The question of how the earnings of this period have been shared among their citizens has been and continues to be the focus of public debate. This paper focuses on the attention of two major questions of this debate: Who gains and who loses from this business cycle expansion? And what were the distributional consequences of government interventions through transfer payments and taxes in this period?

With respect to the first question, the standard view in the literature is that business cycles have potential impacts on both poverty and the distribution of personal incomes. Poverty has traditionally been accepted as countercyclical. Freeman (2001) suggests that the countercyclical behavior of poverty may be related to the fact that unemployment is more concentrated among the poorer less skilled workers. On the other hand, the effect of the business cycle on income distribution has generated more controversy. Since the early papers of Mendershausen (1946) and Kuznets (1953), inequality has been viewed as exhibiting countercyclical patterns. However, Parker (1999) points out that, the rapid growth rates experienced during the last long-lived expansions have to be reconciled with the dramatic rise in inequality. One possible explanation, based on the suggestions of Blank (1988), is that economic growth experienced during the last expansions passes by low-income groups (elderly and female-headed households) and leaves them relatively worse.

If we focus on the cyclical pattern followed by the US poverty and inequality by observing the Gini coefficient and the poverty rate together with the NBER-dated business cycle recessions (shaded areas) during the sample 1954-2003, the poverty rate describes a cyclical pattern, typically rising in recessions and falling in expansions. On the other hand, the Gini coefficient presents an U-shaped pattern and rises almost monotonically since the mid-1970s. Curiously, falls in the Gini coefficient usually coincide with recessionary periods.
In spite of the effects of the business cycles on poverty and inequality described above, government spending may either exacerbate, or mitigate, or even reverse the sign of these relationships. Although public transfer payments and taxes have been assumed to have poverty-reducing and equalizing effects, they may also lead to the opposite effects by, for example, decreasing the labor supply of transfer recipients. In this context, Vitaliano and Mazeya (1989) have found that the top two quintiles lose from the transfer process in the US expansions.

Our paper shows some new lights in the empirical analysis of these two questions. Following Burkhauser, Couch, Houtenville and Rovba (2004), we examine the consequences of the business cycle expansion of the 90’s on income distribution and contribute to the related literature in different ways. First, in contrast to these authors, who compare the distribution of real household disposable income at two consecutive peaks, we focus the analysis on the difference between the through and the peak that marks the 1990’s expansion since we are interested in isolating the effect of this expansion on income distribution. Second, according to Burkhauser and Rovba (2005) we include in the analysis United States, Germany and United Kingdom, but we also examine France, Italy and Spain. Third, we develop an empirical analysis of the households’ income distribution by considering two different definitions of income: Market income and income including the distributional effects of cash transfers and tax system. Therefore, we are able to distinguish in which countries the distributional income changes are just due to business cycle movements and in which ones the changes are due to government interventions. Finally, we try to investigate which sources of the government interventions were the key ones in making the welfare of the population change across the expansion of the 90’s.

Our results hold using both summary measures of inequality and poverty as well as kernel density estimations. We find gains in terms of poverty and inequality from the business cycle expansion in European countries, but not in the United States. Gains in Germany and Italy are motivated by government spending and are not due to the expansionary stage per se. In the case of United Kingdom, government role mitigates the consequences of the expansion with public intervention. The cases of Spain and United States are completely different, because, in spite of being shown the high growth rate during the 90s expansion, these economies were not be able to share equally the gains of the period among their population.