Income Inequality in the United States

Introduction

Income inequality has heightened in the United States over the recent decades, reflecting various factors, including a financial regulation and a globalization change. Globalization can be defined as the process whereby capital, labor, and domestic products become more integrated across all borders. Globalization is an important aspect of the economic force that affects most of the developed countries. There are many controversies concerning the effects of globalization on economies of the countries participating in the international trade (Bertola and Ichino 17-19). Business practices and new technologies accompany the flows of investment capital. Majority of the US large companies rely on international markets as a half of their production is sold in foreign countries and they employ a large percentage of workers from the same countries. By doing so, globalization greatly impacts the economic future of American companies, workers, and families (Herrmann and Pernul 98). This research paper explains in detail the impacts of financial regulations and the effects of globalization on the citizens of the US and offers reasons why income inequality is of concern to the people.

Financial Regulation

The first financial regulation relates to credit controls, such as credit directed towards favored industries and sectors, exceptionally high reserve requirements, ceilings on credit toward other sectors, etc. The second regulation is on interest rate controls: the government openly controls interest rates or there are ceilings and floors, etc. The third regulation considers entry restrictions: restrictions on the involvement of foreign financials, such as licensing requirements, and activity restrictions relating to financial specialization or the creation of international financials (Espinosa-Vega and Yip 243). The fourth regulation considers the responsible supervision and regulation of the financing sector. It encompasses regulatory policies pertaining to a capital regulation, compliance with Basel guidelines, the degree of independence and legal power of the supervisory agency, and the effectiveness of the authorities in imposing the legal framework. The fifth regulation characterizes the policies relating to privatization in the financial sector. The sixth regulation considers the policies' relation to international capital flows, such as restrictions on current-account and capital convertibility and the use of multiple exchange rates. The last regulation documents policies relating to securities markets. Operational restrictions, such as on branching, staffing and advertising, are included here. Establishment of new securities markets is also included in this category (Li and Schaub 267).

Even though the general indicator is labeled as a “financial reforms regulation,” it primarily reflects policies related to the financing sector. In the empirical analysis, the effects each of the seven pillars on income inequality as well as the effect of the aggregate index, which is the sum of the seven regulations, are examined.

Theoretically, different forms of the financing regulation can affect the distribution of income in many ways. For example, more stringent capital requirements and the efficient enforcement of a prudential financial supervision usually aim at reducing a systemic risk and buffering the economy from potential financial crises stemming from this risk. If crises hurt primarily the poor, and assuming that capital regulation succeeds in lowering a systemic risk, then capital regulation should lower income inequality (Littlechild 603). Given that the majority of the literature on the relationship between income inequality and the business cycle seems to agree that a negative correlation exists between the two, then a negative correlation is also expected between the financing regulation and inequality. In contrast, based on the fact that capital requirements hold in both good and bad times and that capital is expensive, more stringent capital requirements may raise financial incentives to lend to "safer" individuals and firms rather than to relatively poor individuals, even if they are creditworthy or will generate income with the capital. This would be true when the financial system and the economy are apprehensive (Stremersch and Verhoef 589).

In its turn, the superior ability to enforce the regulatory initiatives of the abolition of interest-rate and entry requirements, the privatization of financials, the liberalization, and transparency of capital-account transactions should improve financial intermediation services and the screening and monitoring of projects. This would also allow financials to obtain the liquidity to fund good investment ideas from individuals across the full spectrum of the income distribution, yielding a narrower income distribution and lower inequality (Silva and Leichenko 279).

Enhanced privatization, liberalized transactions and looser entry financial requirements would lead to a more efficient and competitive financing sector. That is, a financial market power is usually associated with relationship lending, higher interest-rate margins, and entry restrictions. And these elements constitute barriers for individuals and firms with less collateral or poor credit. Therefore, it is expected that the indices pertaining to the abolition of interest rate controls and entry barriers, enhanced privatization of financials, and liberalization of capital account transactions will be negatively related to income inequality (Hsu, Kraemer, and Dunkle 11).

The potential impact of the liberalization of the securities markets on income inequality seems more difficult to predict. On the one hand, the liberalization of securities markets enhances financial liquidity and increases the volume of lending. In line with the discussion of the potential impact of effective financing supervision on inequality, this would allow individuals at the lower end of the income distribution to have an easier access to lending and capital and to fund their investment ideas more efficiently and at a lower cost. On the other hand, the recent financial crisis has taught us that intense securitization would lead financials to excess risk-taking and a rise in the probability of financial failures. In particular, financials react to downturns by tightening their lending standards, which reduces lending to individuals with lower asset holdings. This would, in fact, widen the distribution of income. In addition, liberalization of securities markets could lead not to funding of projects, but to investments in non-traditional activities. Thus, the overall impact of the liberalization of securities markets on income inequality is ambiguous (Bieling 429).

However, the laws giving supervisors power can be offset by a low level of institutional quality; for example, when government corruption is high or bureaucratic quality is low and/or economic development has not reached an appropriate level. Apparently, this is the case for developing countries that face higher absolute poverty. Thus, it is quite difficult to identify which effects prevail.

Globalization

Globalization in the past two decades has been misunderstood and has been blamed for the world's economic problems. In this paper, globalization is regarded as the process of economic integration between nations, meaning integration of investment (both portfolio and fixed investment), goods and services, free movement of labor force and adoption of common currency. The main agreement that has fuelled the integration is the signing of charters and agreements that abolish cross border restrictions to free up trade restrictions. Opening of foreign investment and the factors mentioned above have resulted into the new phenomenon in globalization (Doussard, Peck, and Theodore 200).

With the United States being more open to investment and trade, the significantly reduced costs of transmitting information around the globe have reduced the costs of companies in managing firms that are located in other states. This has also enhanced the transfer of productions units to other countries where the production will be less costly compared to the mother country. Through this trade process, host countries have taken a comparative advantage to pursue the best use of economic resources. Globalization together with subsidization of tariffs has promoted an international relocation of investments (Amin 218). The third world countries have been given the opportunity to exploit their relative advantage through the division of industry; meaning they can develop labor intensive industries and can take advantage of their comparatively large number of low unit cost labor. The availability of labor intensive goods has been driving the fast economic growth rates that the United States is experiencing for the last two decades. Freeing up the import of the goods to the US has been the source of income inequality with the inevitable resistance by those losing out. A free flow of capital internationally could be the major principle of the recent globalization trend, concerning the shock in economy and the structure of economies that the US is currently facing (Li and Schaub 263).

Income Inequality

For the past two decades, the concerns about the increasing income inequality have become the subject of discussion. In the 1980s, when the theory of globalization started being implemented, economists termed the period as a 'decade of greed' as much high incomes were earned from the financial markets. The increase of income inequality raises questions not only in the US but also in the other high income countries such as the Canada and United Kingdom. Why is globalization raising many concerns in the developed economies?

It is important to differentiate the meaning of income inequality and absolute poverty. These two terms are usually misunderstood. Absolute poverty is the situation whereby individuals do not have access to clothing, food, and shelter to facilitate their mental and physical development, while income inequality is whereby there is a set income level in a particular country and those people that are not reaching it are considered poor. As long as income levels will continue to be drawn, there will always be the presence of absolute poverty. The absolutely poor, as defined by World Bank, are those individuals living under US$1 dollar a day (Yeung 414).

In the United States, income inequality has been constantly increasing. A study conducted by Atkinson indicates that the most significant part of the raise in wage imbalance in the US has been the increase of the top score of income earners as compared to the median, not to the bottom score. Statistics show that real wages in the US concerning the lowest wage earners have been decreasing.

Globalization and Inequality

Globalization has played a major role in changes in income inequality. Most economists have researched on the impacts of globalization on income inequality and in particular in the US. There has been a debate on the widening income gap between the poor and the rich and the increasing rate of unemployment in the United States. These factors have been much contributed by the increased imports of labor intensive goods from the third world countries, which have resulted into the lower demand for low wage labor. Technological advancements such as improvement of information technology have increased the demand for high skilled labor in relation to demand for low skilled labor. These are not the only components that are contributing to income inequality. There are other factors, such as a slower growth in supply of skilled labor force, which has led to the increase in wages of skilled workers as compared to wages of less skilled workers. In addition, the increased immigration of low skilled workers and participation of women has consequently led to pushing down of wages of less skilled workforce (Herrmann and Pernul 101).

It is evident that these factors have contributed to the increasing in unemployment and income inequality in the US. Economists support the advancement in technology as the key driver that has led to a vast economic development in the US. The degree of trade does not emerge to be big enough for the increased trade with the third world countries. Furthermore, average income countries feature for about 80% of the world’s industrial workforce and industrial manufactures consist of about 60 % of their exports. On the other hand, their exports of manufacture goods account for only 2% of the gross domestic product (GDP) of the US, with the GDP comprising 75% of services. These factors alone cannot explain the widening wage inequality. As far as income inequality is concerned, the United States trade with the third world countries skyrocketed in 1990s, while most of the income inequality was during that time and continued to increase to the present day (Doussard, Peck, and Theodore 206).

As Atkinson demonstrates, income inequality in the US is one of the most rapidly increasing among the developed economies. Atkinson advocated that this trend in the US has been due to the shift to work done related in the US. Autor and Katz have explained the difference of income inequality in the US and Canada as a result of the fact that the US is widely dominated by less skilled workers, while Canada has a higher percentage of the educated workers.

Atkinson's research also implies that the same factors driving economies to give more importance to performance-related pay have also led to less willingness to impose high tax rates, thereby making disposable incomes more or less the same as pre-tax incomes. Consequently, in United States, disposable incomes have turned to be more unequal. The move to performance-related pay and reluctance to impose high tax marginal rates could also be forced upon countries because of the greater international mobility of capital and skilled labor. Therefore, there is a pressure for tax rates to be internationally competitive, which is another aspect of globalization.

From the economic view point, an increased flow of unskilled labor and labor intensive goods from the third world countries to developed economies in late 90s has reduced the demand for low skilled labor in high income countries such as the USA, which in turn has widened the income inequality gap among the citizens of the US. Heckscher-Ohlin trade model stipulates that trade will tend to equalize factor payments, leading to greater cross border income inequality in developed economies and increasing income equality in the developing states.

Globalization should not be contributing to income inequality in the US, except where the state is experiencing negative trends as a result of the greater directness to investment and trade. The government should find ways to absorb the negative impacts of integration and globalization. While globalization should be leading to greater income equality in the US through raising the wages of the less-skilled, financial regulation is likely to be the main cause leading to further increases in income inequality.

A second source of anxiety or insecurity may stem from the impact that globalization, immigration, and automation have on the distribution of income in the United States. Under this view, the pressures of the global marketplace and technological change have contributed to a rise in income inequality. For example, a recent research from the Congressional Budget Office found that from 1979 to 2007, the average post-tax individual income for the 1 % of the United States population with the highest incomes rose 275%. For the rest of the top 20%, it rose 65%, but for the bottom 20%, it rose just 18%.

The study also determined that the wealthiest Americans have collected the bulk of the profit gains over the past two decades. This analysis found that the national income of the richest 1 % more than doubled between 1980 and 2008, rising from 8% percent to 18%. The richest 1 % now makes an average $1.3 million of after-tax income compared to $17,700 for the poorest 20% of the U.S. citizens (Silva and Leichenko 280).

The rising income gap may have been wider if lower-wage workers had not increased by more than 20% the number of working hours over the past decade. According to the united economic data, this trend of increased hours of work has probably been linked to incentive policies such as the pay as you earn Tax Credit and a relatively low minimum wage.

The top income recipients tend to be in educational groups, such as those with doctorates and professional graduate degrees in business, law, and medicine. Workers with only high school degrees or less, some college graduates, and non-professionals with master degrees tend to do less well (Espinosa-Vega and Yip 243).

The trend of rising income inequality is a common thing in the United States. Most advanced countries are also seeing the wages of low-skilled workers remain flat or declining over the 20 years with momentous increases in wages of high-skilled workers. Advanced countries with the most unequal distribution of income include the United States, the United Kingdom and Italy. Denmark, Netherlands, and Sweden tend to have less income inequality. In addition, labor income as a share of GDP has fallen, while capital's share has risen. From the mid-1980s to 2006, income inequality in most advanced countries (as measured by Gini coefficients) has increased.

A variety of explanations—trade with developing countries, increases in foreign investment flows, an increase in low-skilled immigration, trade and financial liberalization, skill-based technological change, and changes in regulations and institutions—have been put forth to explain these income trends, where the relative returns to skilled labor and capital are increasing, while the relative returns to unskilled labor are decreasing. However, there is no consensus on what weight each factor actually has, which makes it difficult to find the best policy remedy. However, it is clear that the market, starting over two decades ago, turned strongly against less skilled and less educated workers.

Why Income Inequality is of Concern

Compared with the citizens of other economically developed countries, the US residents seem to have a high easiness for income inequality. The widening gap between the poor and the rich has prompted a continuous public debate about fairness, but there is little debate regarding income distribution problem and what can be done about it.

The principle issue is that low-paid/skilled workers lack the political confidence to raise these issues to the state government. The point is that the US citizens seem to have control of the compelling moral arguments for reducing income inequality, beyond purely serving the self-interest of the poor. Nothing is more suggestive of this ideological theory than the fear of conventional politicians that, by advocating on inequality, they will be perceived as agitating "class warfare between the poor and the rich" (Yeung 408).

Income inequality raises basic social issues that are supposed to be the subject matter of debate and make the government to formulate policies that regulate the impacts of globalization and reforms in the financial regulation acts. Ethical arguments for reducing income inequality follow various forms of principles, which are discussed below:

Fairness: Morally uninformed differences among the citizens arising from the circumstances related to the background of development and growth should not be allowed to create extreme differences in human dignity or basic well-being. In a just society, those with a better economic stability should contribute towards the well being and welfare of those with an inadequate economic status. More so, to the extent that household income helps determine an individual's life chances, fair equality of opportunity depends on providing households with adequate resources to give them fair life chances in prosperity.

Public sympathy and compassion: As citizens, we should simply mind how others are progressing in life. Being at the top as well being among the middle income earners provides the means to be compassionate by improving the material well-being of those at the bottom. Being economically developed does not advocate for being greedy of getting more wealth and undermining the unfortunate in the society (Hsu, Kraemer, and Dunkle 28).

Independent Solidarity: An independent community cannot tolerate too many social classifications levels before it loses its independent nature. This is possibly the most evident in the relationship between political and income influence in the modern US politics. Although the wealthiest candidates do not always win, they are certain that they are recognized.

Desert: The wage that an individual receives should have some connection to what he or she deserves. Opinions based on desert have usually defended market-derived inequality; in the labor market, compensation is a utility of productivity and inferior pay excogitates a smaller contribution to production which the high skilled workforce delivers. However, in our everyday experiences, the low-skilled worker who works hard should be paid as the managers or the CEO's of the companies because the wage paid is not proportionate to the work delivered.

Self-interest: the rich individuals in the society should pay attention to improving the well being of the destitute members of the society or the unskilled laborers rather than serving their own personal interests of becoming more richer and making the less fortunate even poorer.

These ideologies points towards a particular concern for inequality that arises from low incomes, or absolute poverty. The practice of fundamental freedoms and contribution to the social life of an individual normally requires at least a low standard of living. This minimum is absolute and not fixed, but depends partially on the expectations and social standards of an individual. Apprehension about inequality properly takes into account the social safety disposable income and the struggle of the working poor, though it should not overlook the absorption of economic strength at higher levels of income distribution (Stremersch and Verhoef 589).

Conclusion

In conclusion, globalization and financial regulation are important economic forces that can affect the United States. Globalization and financial regulation policies can either promote or harm the economic growth of the US. If these factors are monitored and controlled properly, they can lead to lesser income inequality, but if they are assumed, they can lead to greater income inequality. The state government should set forth policies of ethical business practices in instances where the country has integrated with different states to do business and the banks should have a proper regulation to stabilize the financial market. The government should efficiently manage income equality, since less income inequality will lead to economic development.