The Quarterly Review of Economics and Finance 49 (2009) 42–53

Contents lists available at ScienceDirect

The Quarterly Review of Economics and Finance

journal homepage: www.elsevier.com/locate/qref

The short-run impact of the stock market appreciation of the 1980s and 1990s on U.S. income inequality☆

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ARTICLE INFO

Article history:
Received 8 August 2005
Accepted 22 June 2007
Available online 5 August 2008

JEL classification:
D31
E44

Keywords:
Income inequality
Stock market appreciation
PSID
Fixed-effects model
Gini coefficient

ABSTRACT

The paper uses 1980 to 2000 Panel Study of Income Dynamics (PSID) data to study the short-run effect of a stock market appreciation on U.S. household income inequality. Fixed-effects regressions suggest that a stock market appreciation raises the incomes of stockholder households more than non-stockholder households. The Gini coefficients derived from the regressions reveal a perceptible but rather volatile increase that can be attributed to the stock market appreciation, especially for the latter parts of the 1980s and 1990s. When averaged by decade, the stock market appreciation raises the Gini coefficient by about 2% for the 1980s and by 3% for the 1990s.

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1. Introduction

Since the 1970s the U.S. has experienced a trend toward increasing income inequality. The increase in the skill premium resulting from a greater demand for skilled workers along with skill-biased technological change is considered to be a key cause of this trend (Acemoglu, 2002; Berman, Bound, & Griliches, 1994; Krusell, Ohanian, Rios-Rull, & Violante, 1997; Murphy & Welch, 2001). This factor alone may explain about two thirds of the increase in income inequality.

☆ The comments of the anonymous reviewers are greatly appreciated. The content of the paper reflects the personal opinion of the authors and should not be associated with FedEx Services or any of its affiliated companies.

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doi:10.1016/j.qref.2007.06.003

Apart from the skill premium there are a number of other factors that are thought to be influencing the trend in income inequality.[1] The boom in the U.S. stock market is one of them (Clark, 2002; Piketty, 2003; Piketty & Emmanuel, 2001; Smith, 2001; Wolff, 2000). In the past 20 years, the S&P500 stock market index has increased by more than five times. This has raised stockholders' wealth significantly compared to non-stockholders' wealth (Smith, 2001). As wealth is a potential source of income, the rising wealth inequality may also bring about more income inequality. This may be of potential interest for tax policy, for example, the taxation of capital gains. But although there are several studies about the stock market's effect on wealth inequality, there are few on the stock market's effect on income inequality. Yet, from the point of view of public policy and taxation, the income distribution and not the wealth distribution is at the center of attention. The focus on income manifests itself in the fact that the governments of all industrialized countries are primarily redistributing income rather than wealth.

Clark (2002) argues that the recent stock market boom has raised income inequality by causing a real income decline of the poor. Piketty and Emmanuel (2001) and Piketty (2003) find that the secular increase in the income share of the top tenth percentile of households is for the most part a capital income phenomenon. Das and Mohapatra (2003) conclude that the income share of the top quintile of the income distribution grows at the expense of the "middle class" when emerging stock markets are liberalized, while the share of the lowest income quintile remains effectively unchanged.

No research appears to have focused on the effect of the recent U.S. stock market appreciation on income inequality by comparing the income response of households that participate in the stock market with that of households that are not. Also, studies that examine the relationship between stock market growth and income inequality do not always condition on GDP growth. Conditioning on GDP growth is of potential importance in this context because there is substantial evidence that GDP growth decreases income inequality (Beach, 1977; Blank, 1989; Blank & Blinder, 1986; Hirsch, 1980; Thorton, Agnello, & Link, 1978).

The purpose of this paper is to analyze empirically the short-term impact of the U.S. stock appreciations of the 1980s and 1990s on income inequality while accounting for any effect of GDP growth. The paper uses the Panel Study of Income Dynamics (PSID) data. The sample is split into two groups: stockholders and non-stockholders. If the stock market has any role to play in the observed increase in income inequality, then an examination of its differential impact on the incomes of stockholders and non-stockholders is a logical starting point of the investigation.

The remainder of the paper is organized as follows. Section 2 discusses the potential short-run links between income inequality and a stock market appreciation. It sets the stage for the empirical testing strategy. Section 3 introduces the data, the sample selection method, and some evidence on the incomes of stockholders and non-stockholders. Section 4 provides panel data estimates of the impact of stock market growth on the household incomes of stockholders and non-stockholders. It also reports estimates on how much the Gini coefficient of income inequality has been raised by the stock market appreciations of the 1980s and 1990s. Section 5 briefly summarizes the paper and draws some conclusions.

2. Links between stock market and income inequality

A stock market appreciation can affect the income distribution either directly through its impact on the wealth related incomes of stockholders or indirectly through its impact on investment, GDP growth, and the labor incomes of both stockholders and non-stockholders.

The incomes of stockholders can be affected directly by a stock market appreciation if stockholders choose to realize accrued capital gains or if dividend payouts go up. According to Fama and French (2001), the stock market appreciation experienced by the U.S. during the 1980s and 1990s was associated not with higher but with lower dividend payouts. At the same time, however, capital gains realizations increased significantly.[2]

[1] For surveys of the causes of the trend in income inequality see Levy and Murnane (1992), Burtless (1995), and Johnson (1997).

[2] This derives from the figures on capital gains tax receipts (Congressional Budget Office, 2002).

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