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The Contribution of National Income Inequality to Regional Economic Divergence

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One of the core challenges facing the United States today is the growing economic disparities between different parts of the country. Since 1980 the country has bifurcated economically into a handful of booming metropolitan areas and a much larger set of regions of all sizes that have seen their relative incomes decline. As a result, almost a third of Americans today live in a metropolitan area either substantially richer or substantially poorer that the nation as a whole, nearly triple the share that did in 1980.

Growing regional disparities are typically described as resulting from changes to the geographic distribution of high-paying jobs and high-income workers—in particular, the increasing tendency of workers of different education levels to live in different cities from one another.[1]

However, this paper shows that regional divergence results much more from rising income inequality at the national level than from sorting by education. It documents two underappreciated facts about the processes responsible for regional income divergence: that growing disparities are driven primarily by the richest few percent of the population, not the college-educated at large, and that they are due more to changes in how much money these people make than to changes in where they live.

Finding 1: Increasing regional disparities are driven by the richest few percent of the population

First, this paper shows that regional divergence is overwhelmingly driven by the very richest members of society. Previous research has emphasized the role of education in driving divergence, noting that college educated and non-college educated workers are increasingly sorted into different metro areas from one another.

Here I show that most of the effect is driven by a much more select group: the richest few percent of the population. As Figure 1 displays, a full 50% of the divergence in mean family incomes across regions since 1980 is attributable to changes that have happened among the richest 1% of society. Another 25% is driven by the next 9 percentiles, while the poorest 90% of society—a group that includes at least two-thirds of college graduates—has seen only about a quarter as much income divergence as happened overall. This means that increasing regional

[1] See, e.g., Enrico Moretti, *The New Geography of Jobs* (2012); Peter Ganong and Daniel Shoag, "Why Has Regional Convergence Declined," *Journal of Urban Economics* 102 (2017).

disparities are less a function of changes among the college-educated population in general and more a function of changes affecting the very rich.

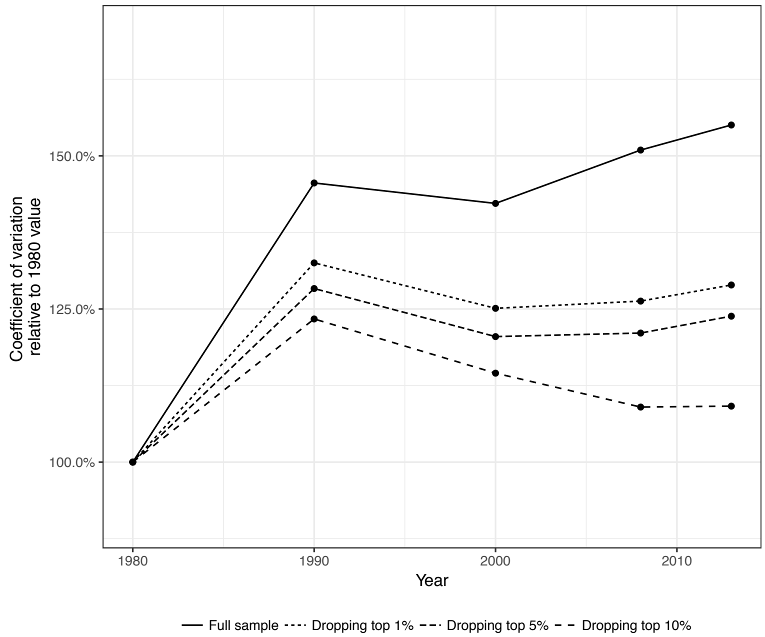

Figure 1. Change in coefficient of variation (population-weighted standard deviation divided by national mean) of mean family income across Commuting Zones since 1980 under simulations that exclude various high income groups. Excluding just the richest 1% of the population reduces the increase in divergence by almost 50%.

Finding 2: Regional income disparities are primarily the consequence of rising national income inequality, not increased income sorting

Second, the paper shows that growing regional income disparities result more from changes to the income distribution—specifically rising income inequality—than from changes in where workers of different income levels live. Many researchers and policymakers have approached regional divergence through the lens of sorting, thinking of it as resulting from changes in the spatial location of different types of workers or industries. This logic suggests that struggling cities should focus on attracting growing industries and high income workers to reboot their economies. But divergence could equally result from changes to the shape of the income distribution—not who lives where, but how much money they make. As the rich have gotten richer over the last 40 years, it's possible that they have dragged the average incomes of the places they live up with them.

To estimate the importance of income sorting and income inequality to the divergence experienced in the United States, I run simulations holding either the amount of sorting or the level of income inequality constant at 1980 levels. Doing this shows that rising income inequality at the national level is a larger contributor to regional disparities than the sorting of people across places by income level. As shown in Figure 2, if there had been no sorting whatsoever, rising inequality would still have resulted in more than half as much divergence as actually occurred. But without the effect of rising inequality, sorting on its own would have produced less than a quarter of the observed divergence. Changes in where workers of different types live matter some, but changes in how much they make matter more.

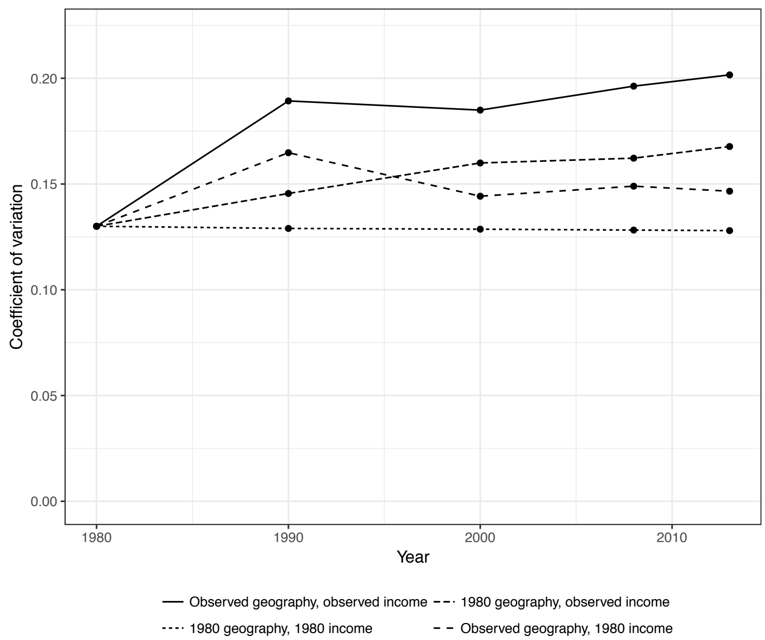

Figure 2. Coefficient of variation in mean family income across Commuting Zones over time under counterfactual simulations holding either income sorting or income inequality at 1980 levels. Rising income inequality on its own accounts for about half of the observed divergence ("1980 geography, observed income"), while increased sorting accounts for less than a quarter ("Observed geography, 1980 income").

Policy implications

Together, these two findings suggest that growing inequalities between regions should be thought of first and foremost as the spatial consequence of rising income inequality in general. As the national 1% have taken a larger and larger share of the economic pie, the regions where they happen to live have seen their incomes pull away from the rest of the country.

Narrowing the disparities between different places will be almost impossible without also reducing the amount of income inequality overall. This means that growing regional disparities should be thought of in large part as a national policy issue, not simply the responsibility of state and local governments. It also means that policies aimed at reducing inequality at the national level will have the beneficial effect of reducing the gaps between places at the same time.