The Top One Percent and Exploitation Measures

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The Top One Percent and Exploitation Measures

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Abstract

With the Occupy Movement that recently took place on Wall Street and in other parts of the globe, a lot of attention has recently been given to growing income inequality. The 2008 United States financial crisis, the Great Recession, and the subsequent weak recovery have brought about a more serious focus on income inequality and the widening income gap between the top one percent and other groups. These events have brought about some social unrest and instability in American society perhaps not seen since the Great Depression. How much has the top 1 percent of households gained in terms of income versus the other 99 percent in the United States over the last 30 years or so? Mainstream economists and other social scientists point to various causes which have been mentioned in many scholarly and popular writings. All of these mainstream factors affecting inequality have been found to be statistically significant in one scholarly study or another. This research paper explores other major concepts to explain income inequality rather than to dispute the findings of other existing research efforts. The empirical findings of this paper support radical arguments that income accumulation of those at the top is not connected to the productivity of capital investment, but rather instead is connected to the declining incomes and exploitation of the rest of the US population despite the rising output per worker of the US workforce over the last 30 to 40 years.

JEL Classification: B51, C50, D33, D63, H53

Keywords: income inequality, rate of exploitation, surplus value, top 1 percent, 99 percent
1. Introduction

Since the September 2011 Occupy Wall Street Movement that spread globally in a short period of time, issues regarding inequality in the US and in other parts of the globe have been gaining momentum in the news media, and in public dialogue and discourse. The income inequality issue may not be easy for everyone to grasp. On the one hand, income inequality can lead to social instability, increasing class conflict and political distrust (Uslaner and Brown 2005). On the other hand, the top one percent income group has contributed increasing tax revenues and has been a big investment source serving as a “trickle-down” engine of economic growth in the United States according to some scholars and writers (Hacker and Peirson 2010; Laffer 2010; Sowell 2012). Against this backdrop, the recent rise in income inequality in the United States has ignited controversial policy debates such as the Buffet Tax Rule (Lowrey 2012). Finally, the income gap between the top one percent and others in America has been widening during recent decades. In fact, a recent Pew Research Center report found an increasing number of US citizens indicating an awareness of greater class conflict between rich and poor — 47 percent indicating this in 2009 yet 66 percent indicating it in 2011 (Morin 2012). Respondents to the Pew survey were about evenly split on the question of whether the rich have their wealth through “hard work, ambition or education” or, on the other hand, by being “born into wealthy families” or having the right connections (Morin 2012).

The cutoff for the income shares of those toward the top of the income scale depend upon whether capital gains are included or not (Saez 2009). Without capital gains, the top 1 percent is estimated to have a family income of slightly less than $400,000 in 2007 according to Saez (2009) or to have a household income of $387,000 for 2010 according to Sentier Research (2012). If capital gains are included, the thresholds are much higher. According to data provided by Saez (2013), for
2008, and when capital gains income is included, the cutoff for the top 1 percent of households is over $1 million.

How the top income and wealth class in the United States attains its success has been studied by various scholars. An upper class of U.S. citizens has probably always existed, but wealth and income concentration in the United States probably did not become a public issue until the rise of big industrialists and robber barons during the Gilded Age around the second half of the 19th century (Hughes and Cain 1994). In modern times, some account for income differences and high earnings for those at the top, and income inequality in general, by noting that higher earning households have higher levels of education than the general population and that an increasing portion of college graduates in the labor force explain greater inequality (Miller, et al. 2010). Others have noted that over the last 30 to 37 years top income groups have benefited more than other income groups from high growth rates in GDP, high returns on wise investments, and the growth of international trade and foreign imports (Dew-Becker and Gordon 2005; Roine, et al. 2009); lower top marginal tax rates for individuals and corporations thanks to the ascendancy of neo-liberal policies in the late 1970s (Roine, et al. 2009); a smaller government presence in the economy with less spending on social programs and infrastructure (Roine, et al. 2009); the growth in the Finance, Insurance, and Real Estate industries (F/I/RE) which lead to big profits for Wall Street executives and big gains for investors while at the same time leading to greater consumer and mortgage debt for households (Foster and Magdoff 2009; Kotz 2003, 2008, 2009; Lapavitsas 2009; McNally 2009; Roine, et al. 2009; Kotz and McDonough 2010; Tabb 2010a, 2010b; Lambert 2011); and the decline of high paying manufacturing employment and in labor union membership as well as the decline in wages and salaries of other income groups, especially those in middle income groups (Bluestone and

This paper adds other variables to this list of possible factors influencing top income shares: two general measures of the Marxian concept of the rate of exploitation (Net Operating Surplus over Private Sector Wages and Net Operating Surplus as a Portion of GDP) and a mainstream/neoclassical economic measurement of the marginal productivity of capital (MPK). Which set of variables has the greater predictive power would be of interest to both radical and mainstream followers of economics and political economy. In the course of writing this paper, no research has been found where these variables have been used to predict an upper income share for the United States, and specifically the shares of those at the top since these income strata derive a greater share of their income from capital gains, dividends, and rents than other income groups (Saez 2013). Finally, in doing research for this paper, only a handful of authors (Amsden 1981; Lambert 2012) have been found to use the concept of a rate of exploitation to predict income inequality, and none has been found so far that uses it explicitly for the United States or for the top shares of an income distribution, much less the top 1 percent.

As shown in Figure 1, the income shares of the top 0.01 to 10 percent mostly declined during and after the Great Depression until the end of the 1970s. Those who see gains to top income groups coming from lower and working classes via decreasing labor wages and salaries despite rising productivity and, hence, greater rates of exploitation would find their views supported if these variables measuring exploitation are found to be linked to top income shares.¹ From 1981 to 2010,

¹ In doing calculations, it was found that the top 10, 5, 1, 0.5, 0.1, and 0.01 percent income thresholds are moderately correlated (r = 0.56 to 0.66) with estimates of wealth concentration in the US from the 1920s to 2007 using Domhoff’s estimates of wealth concentration (http://www2.ucsc.edu/whorulesamerica/power/wealth.html). Wealth is defined as household total assets minus total liabilities. Additionally, as of 2008, Saez’s website (http://elsa.berkeley.edu/~saez/) on inequality and income shares shows that after excluding capital gains the top 10 percent derived around a quarter of its income from entrepreneurial income, interest, rents, and dividends; for the top 5 percent it was around 32 percent; for the
the ratio of Net Operating Surplus to Private Sector Wages and Salaries went from 0.533 to 0.696 whereas the income share of the top 1 percent went from 10.02 percent to 19.77 percent of all income. Figure 2 shows that beginning in 1981, the ratio of Net Operating Surplus to Private Sector Wages and Salaries began to rise sharply after showing a decline in the previous three decades. Those who have followed inequality over the last several decades are probably already aware of these trends, but we want to mention them here to point out why 1981 is a starting point for our analysis.

On the other hand, neoclassical economists and those who subscribe to a marginal productivity of capital (MPK) measurement as explaining greater returns and income going to the top 1 percent would believe that their notions of greater rewards for greater productivity would be confirmed if the MPK variable is found to be a good predictor of top 1 percent income shares. According to this school of thought, those of the top 1 percent are garnering rewards earned through shrewd investments and sound management of business enterprises. Therefore, if a standard neoclassical measure of capital productivity works as a predictor of their income gains, then Marxian notions of labor exploitation as reasons for greater inequality would be weakened.

(Insert Figures 1 and 2 around here.)

This paper proceeds as follows. Section 2 explains the research methods used, Section 3 discusses the results, and Section 4 has concluding remarks that explore the implications of the paper’s analyses.

2. Research Methods
In order to find the relationship between growing income inequality and other important independent variables, we conducted a least squares regression analysis using two regression models, each with a different measure of exploitation. The dependent variable used was the change in the income (including capital gains) share of the top 1 percent from each year from 1981 to 2010 compared to the top 1 percent income share level of 1931 as a base (15.5 percent). For example, the top income share for 1931 was subtracted from the 1985 share of 12.67 percent to yield -2.83, and this in turn was divided by the 1931 income share to yield a value for 1985 of around -18.26 percent. The year 1931 is about the time when the top 1 percent income share began to decline before bottoming out in the 1970s (Piketty and Saez 2003, updated 2010). Using the percentage change in income pinned to a base year shows how the top income class has made a comeback in its share of United States income and also has the effect of smoothing out the pure, positive autocorrelation that exists in the data and allows for avoidance of serial correlation. This was regressed against the following independent variables:

1. Macroeconomic Trends, or Macrotrends. This is an index composed of the following variables:
   a. College Educated as a Percentage of Total Population (United States Census Bureau). The values from decennial census years for US educational levels are used to predict the top income shares.
   b. Trade Union Membership as a Percentage of the Private Sector Labor Force (US Bureau of Labor Statistics). Declining union membership has been linked to less

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2 This is an index created by factor analysis and consisting of the variables below which were found to be highly correlated among one another with most pairings of the variables having correlation coefficients of an absolute value of 0.70 or more, which indicates multicollinearity (Anderson, et al. 2008: 644), and these variables were associated with high variance inflation factors when tried as independent variables in the models. The results of the factor analysis results can furnished by the authors upon request. Since some of the variables were inversely correlated, the reciprocal of some of these variables were used in the factor analysis.
income for lower and middle income groups, and subsequently more income for upper income groups. This variable is highly correlated with manufacturing employment, but is still used as a separate variable because declining union membership has been cited as a factor influencing rising inequality over the last several decades and because not all union membership has been concentrated in manufacturing. Transportation, mining, and other industries have traditionally had high rates of unionization and currently have more union members than manufacturing (United States Bureau of Labor Statistics).

c. Top Marginal Rate Individual Income Tax (Saez 2010). Higher marginal rates cut into top income shares, and so this should be associated with a decline or slower growth in top 1 percent income shares.

d. Finance/Insurance/Real Estate (F/I/RE) Wages and Salaries as a Percentage of all Wage & Salaries (United States Bureau of Economic Analysis). Since revenues and value added for these industries are not available for all years in the series, this variable is used as a proxy to represent the size of these industries in the US economy from 1981 to 2010. As the F/I/RE industries have grown in the US, so have top income shares because of the large profits associated with these industries.

e. Consumer and Mortgage Debt Payment as a Percentage of United States Disposable Income. As wages and salaries stagnated, it has been argued that households borrowed more money to keep up a certain standard of living. The interest and profits earned by financial institutions in turn would have benefitted those who make up the investor class.
2. Government expenditures without Military Spending as Percentage of GDP (United States Office of Management and Budget). This variable should be negatively correlated with top 1 percent income share since greater government expenditures, especially for social programs, outside of defense usually help lower and middle income groups and thereby increase their share of national income and not the income of those at the top.

3. Net Operating Surplus (NOS) as a Percentage of Private Industry Wages and Salaries (United States Bureau of Economic Analysis, Table 2.2A). Private sector net operating surplus is divided by private industry wages and salaries in order to come up with a variable that is somewhat akin to a rate of exploitation variable from Marxian economics as mentioned above.\(^3\) It is hypothesized to have a positive value since higher rates of exploitation should lead to higher top income shares, and is used as a rate of exploitation variable. This variable is hypothesized to have a positive correlation with the change in the top 1 percent income share—a greater rate of exploitation should boost top income shares, and less exploitation should lower top income shares. Wages and salaries are the wages and salaries of private industry workers so that government and non-profit wages and salaries are excluded. However, we make no distinction between productive and unproductive labor as is often done in some analyses using Marxian perspectives.

4. Net Operating Surplus as a Percentage of GDP (United States Bureau of Economic Analysis). Gains in Net Operating Surplus (NOS) as a percentage of GDP would be an indication of greater exploitation if the gains come at the expense of labor. In the next section we show a link between wage stagnation and NOS gains.

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\(^3\) Admittedly, these wages and salaries also include those of managers. Also, BLS data on wages for those who were classified as production workers ended in 2003, and some workers who would be working class (clerical workers, service workers, etc.) would not be included in estimates of production workers. Therefore, aggregate private sector wages and salaries were found to be the best source of data available.
5. Marginal Product of Capital, MPK (United States Bureau of Economic Analysis). This variable is the change in Output/GDP from year to year over the change in fixed assets\(^4\) from year to year for 1981 to 2010. It is used as a simple representation of the neoclassical economic notion of the marginal product of capital in macroeconomics, which is theoretically equal to the rate of return on capital, \(r\). It is hypothesized that if MPK is equal to or approximately equal to \(r\), and if the top 1 percent represents the great bulk of the investor-capitalist class, then higher MPK would mean more and greater returns to those of the top 1 percent, and so this variable should be a predictor of the change in top 1 percent income. Although a few mainstream economists no longer believe this to be a legitimate concept, others still subscribe to it and use the concept in their textbooks, e.g., Mankiw (2012) and Jones (2001) among others.

3. Results and Discussion

Two regression models were developed in order to find which major factors could have contributed to increasing income inequality and increasing income going to the top 1 percent. Among our variable list, some variables, such as the top marginal tax rate had higher values until the 1980s, a time when tax rates were lowered, whereas other variables had lower values until the 1980s and beyond such as the portion of household debt payment as a portion of disposable income.

First, to show some type of exploitation taking place, one could look at what has taken place over the last several decades by comparing the gains in wages and salaries to workers to the gains in worker output per hour or average productivity. From 1981 to 2010, as shown in Table 1, the real

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\(^4\) BEA defines fixed assets as, “Produced assets that are used repeatedly, or continuously, in processes of production for an extended period of time. They consist of equipment and software and structures (including, by convention, owner-occupied housing), but exclude consumer durables” (http://www.bea.gov/glossary/glossary_f.htm, retrieved March 13, 2013).
wages of US business sector workers increased an average of 1.1 percent whereas labor productivity in dollars of output increased an average of 2.1 percent (Bureau of Labor Statistics, Major Sector Productivity). From 1948 to 1980, the average rate of increase in the value of productivity was 2.78 percent and for real wage gains was 2.38 percent, almost a tie. In doing a simple bivariate regression analysis, it was found that when the difference between the output per hour and wage gains is used to predict the changes in net operating surplus (NOS) as a portion of GDP from 1981 to 2010, the difference is statistically significant, has a positive slope, and explains around 19 percent of the variation in the change of NOS over GDP. The Durbin-Watson test shows no autocorrelation present using a test of significance of 1 percent. The bivariate model indicated that 1 percent difference between output per hour gains and wage gains is associated on average with around a 1.2 percent increase in NOS over GDP, which is one of the measures of exploitation used, and NOS is part of the other measure of exploitation used in this paper—NOS/Private Sector Wages and Salaries. Labor captured a smaller share of the rewards of increased output after 1981 when compared to prior periods when wage gains were closer to productivity gains on average (Greenhouse and Leonhardt 2006) and apparently much of the payment for increased output went to surplus value.

(Insert Tables 1 and 2 around here)

In order to find which factors influenced the percentage change in the top 1 percent income share during 1981 to 2010, we conducted multiple regression analyses as shown in Table 2. Reported standard errors are Newey-West standard errors. As the Durbin-Watson test results indicate, there are no signs of autocorrelation present in Model 1 using a test of significance of 5 percent, yet for Model 2, the Durbin-Watson test statistic is inconclusive. As a result, we employ a
more general test of autocorrelation, the Breusch-Godfrey test. The test statistic of 2.088 implies that
the null hypothesis of no autocorrelation is accepted for Model 2.

In Model 1 of Table 2, the variable Macrotrends has a statistically significant relationship
with the change in the top 1 percent income share relative to 1931 share because it encompasses
variables that mainstream economists have put forth as causes of growing inequality over the last 30
years or so, such as the greater percentage of college educated in the labor force, growth in the
F/I/RE sector, declining unionization, declining manufacturing employment, etc. A one unit increase
in this variable results in a 12.5 percent change in the top 1 percent income share on average and
holding all else constant. These factors, when considered collectively, have a big impact on the
fortunes of the top 1 percent. More specifically, in looking at the variables that make up the
Macrotrends index, the top four variables according to the factor loadings (0.903, 0.89, 0.87, and
0.67 respectively) which account for top income gains were the decline in trade union membership,
the decline in manufacturing employment, the increase in the number of college grads, and the
increase in household debt payment. These findings support mainstream assertions regarding
inequality.

Next, the variable that is used as a proxy for social welfare expenditures, Budget without
Military Expenditures, is not statistically significant. At the same time one version of the
Marxian-radical concept of labor exploitation also works well in Model 1 and is statistically
significant and has its hypothesized sign. A 1 percent increase in the share of NOS as a portion of
GDP is associated with a 7.25 percent increase in the change in the top 1 percent share, all else held
constant. The MPK variable does not appear to be a good predictor of top income gains because it is
not statistically significant.
In Model 2, Macrotrends again works well as a predictor of the change in top 1 percent income changes. A one unit increase in the Macrotrends variables is associated with 14.98 percent increase on average in the change in the top 1 percent income share, all other things held constant. In this model, the Budget without Military Expenditures variable is statistically significant. A 1 percent decrease in non-military spending results in a 6.73 percent increase in the change in the top income share. At the same time, the Marxian/radical variable of labor exploitation used (NOS/Private Sector Wages and Salaries) is statistically significant and has its hypothesized sign. On average, a 1 percent increase in the ratio of NOS/Private Sector Wages and Salaries results in an over 1.41 percent increase in the change in the top 1 percent income share, all else held constant. Finally, the MPK variable is again not found to be a good predictor since it is not statistically significant.

To assess how much of the change in the share of top 1 percent income from 1981 to 2010 relative to 1931 that each variable can explain, we took the coefficient of each variable and multiplied it by the change in the value of the variable between 1981 to 2010. The overall change in the dependent variable as a result of changes in NOS/GDP was 21.12 percent, which is the impact of this variable on the change in the top 1 percent income share relative to 1931. For NOS/Private Wages and Salaries Percent, its coefficient of 1.41 was multiplied by 16.29 percent change in the variable to arrive at an overall change of 22.97 percent. This is the amount of the change in top 1 percent income share explained by NOS/Private Wages and Salaries. For the Macrotrends variable, its total change in value over this period was 3.21, and using its coefficient from Model 1, it explains around 40.13 percent of the change in income share. In Model 2, it explains about 48.09 percent of the gain. Given the negative signs of the Budget without Military
Expenditures and MPK variables, one cannot expect them to explain any gains in the top 1 percent income share—only losses, so these results are not discussed.

The Macrotrends variable appears to have a slightly greater degree of impact with regard to the gain in income to the top 1 percent during this time period, yet the two exploitation variables still work well in explaining some of the gain. The MPK variable is not statistically significant and has a negative sign, and so cannot really be used to explain any of the gain.\(^5\)

4. Conclusion

Most of the writings reviewed in developing this paper explained the growth in the income shares of the top income groups by using traditional measurements of manufacturing employment, labor income shares, trade union membership as well as the other macroeconomic variables mentioned above. This paper has found none, however, that used any profitability measures such as Net Operating Surplus or a measure of exploitation, such as NOS/Private Sector Wage & Salaries. Considering these mainstream factors or explanatory variables with a capital share variable (NOS as a portion of GDP) and the NOS/Private Sector Wages and Salaries Percentage variable, the argument that income shares are class and politically derived seems to have some support. There does not appear to be any support for the neoclassical economic view that top income is somehow earned through the productivity of capital, however, given the results found in the two models.

Although the results of this paper support the mainstream factors that are often cited as causes of greater inequality, this papers finds strong statistical support for radical contentions that income share gains to the top 1 percent are extracted from workers and that the marginal product of

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\(^5\) To review some of the diagnostic tests, both models avoid multicollinearity (variance inflation factors less than 5.0 and Pearson correlation coefficients less than an absolute value of 0.70 or 0.80 (Berenson, et al. 2006: 635-636) thanks to the use of the index created by factor analysis, and they also avoid autocorrelation or serial correlation - all tests for autocorrelation either yield Durbin-Watson statistics greater than the upper tail cutoffs for the Durbin-Watson test statistic using significance levels of \(\alpha<0.05\) or a Breusch-Godfrey statistic that lies below the Chi-square cut-off value at \(\alpha<0.05\) (Studenmund 1992: 642-645; Greene 1997: 595-596; Anderson, et al. 2008: 732-736).
capital theory or concept does not hold much validity, especially in trying to justify greater income going to the top strata of United States society. The findings herein also make a contribution to the literature by using different measurements of exploitation to predict successfully the gains and losses of the top 1 percent and put radical concepts and measurements on an equal footing with the mainstream ones in a statistical sense. In most mainstream writings, the concept of exploitation is mostly ignored with the exception of looking at how working class wages have declined and can be used to predict measures of inequality such as Gini coefficients as well as top income shares (Birchfield and Crepaz 1998; Alderson and Nielsen 2002; Minnich 2003). Further research could possibly delve into how the part of investment that goes toward technology or overseas investment impacted top income shares, things not considered in the models, and so this is a limitation of this paper.

A Marxian concept of the rate of exploitation used in this paper appears to have strong statistical validity as well, which supports the contention that the top 1 percent appears to have gained from the surplus generated by workers over the previous three decades. Although not the same as the Marxian concept of surplus value, which is often considered business profits or a simple residual resulting from when wages are subtracted from total revenues, Lee and Jo (2011) argue that with regard to national output/income, there exists a “social surplus”, which is consumption goods, investment goods, and government goods that are socially produced and not just taken as given in an economy and are not determined solely by market forces but also by social structures and social agency. That is, class considerations matter as do political and social ones in producing the goods and services we consume. From 1981 and forward, neoliberal policies have helped to usher in greater imports, less unionization, lower taxes on upper income groups and less spending on social services, and other trends have seen the level of F/I/RE jobs and the number of the college educated
rise as the number of good paying manufacturing jobs has declined. These are all associated to one
degree or another with rising top 1 percent income. Additionally, in conjunction with these policies
and trends, the fact that wage gains have not kept up with productivity gains, and that most
productivity gains have resulted in higher levels of NOS, has caused an increase in the ratio of
profits to private wages and salaries at the expense of greater income to the other 99 percent of the
population. The results of our econometric analysis show that these wage losses and a greater NOS
to private sector wages and salaries ratio is linked to increases in the income share of the top 1
percent. With these things in mind, perhaps it is even more apparent as to how and why the Occupy
Wall Street movement got started and moved across the country and the globe in the fall of 2011.
After 30 years of rising inequality and high levels of exploitation, a mass movement focused on
income distribution issues was perhaps inevitable.

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References


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Figure 1. Top Income Shares

Source: Saez and Piketty (2010)
Figure 2. Net Operating Surplus and Private Sector Wages and Salaries

Source: United States. Bureau of Economic Analysis
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<th>1948 to 1980</th>
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<td>Change in Output per Hour</td>
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**Table 1.** Wage Increases and Output per Hour
Table 2. Regression Results

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<th>Variable</th>
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<th>Coefficients</th>
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<tr>
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<td>Model 2</td>
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<td>Dependent variable: Change in Top 1</td>
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<td>Percent Income Share relative to 1931, 1981-2010</td>
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*p-value < 0.05, **p-value < 0.01