The New American Economy

A Rising Tide that Lifts Only Yachts

The United States is the richest country on earth; the income of the average American household substantially exceeds that of the average household anywhere else. And household wealth, too, is huge by global standards.[1]

But these statistics mask a troubling truth. For three decades, while household income and wealth may have been increasing, it was mostly the wealthiest Americans who benefited from the nation's economic gains. For those at the top of the income ladder, the 1980s and especially the 1990s were a period of rapid income and wealth growth. But for those in the middle class and for the poor, it was a period of stagnation, marked by very modest income gains.

Largely as a result, families with the highest income and wealth in the United States are far better off than their counterparts in other countries or than the average family in the United States. In contrast, the poor in the United States have slightly less purchasing power than the poor in almost every other advanced economy.[2] The gaps between the rich and the middle class and between the rich and the poor are greatest in the United States.

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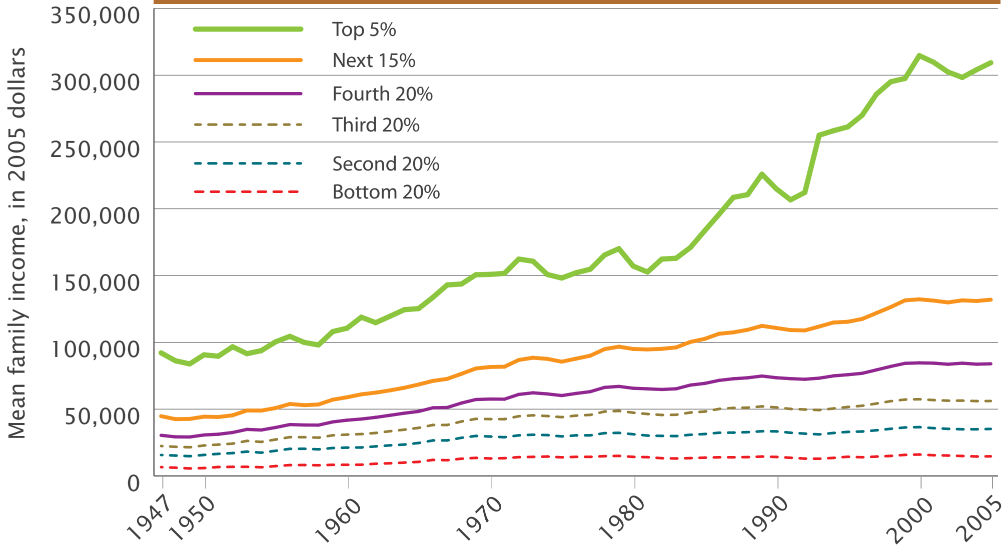
1. Income is defined as wages, salary, interest, dividends, capital gains, and rent received over some period of time, usually a month or a year. Wealth is the value, at some moment, usually the end of an accounting period, of assets—bank accounts, mutual funds, stocks, bonds, real estate, and businesses—minus liabilities—mortgage debt, consumer debt, education debt, and other obligations. High income and high wealth usually go together, but not always. For example, a young person in the entertainment industry might have a high income but low wealth while an old person with a modest income may be wealthy in home equity.
2. Purchasing power is income adjusted for price differences among countries.

Figure 1 shows mean[3] household income for a range of levels, from the bottom 20 percent to the top 5 percent of the income spectrum. The figure shows how income increases since 1980 have become more highly concentrated at the top of the earnings spectrum, in contrast to the pattern of widely shared progress between 1947 and 1979. After about 1980, incomes at the top of the distribution soared: the mean income of the top 5 percent of families increased over that period from about 3.3 times the median income to 5.5 times.[4] In contrast, those in the bottom half earn little more than they did two decades ago, after adjusting for inflation.

Figure 1. The Top Is Peeling Off: Income Distribution, 1947–2005



Source: Current Population Survey, Annual Social and Economic Supplements, Historical Income Tables, U.S. Bureau of the Census, Table F-9, available online at http://www.census.gov/hhes/www/income/histinc/f09ar.html; Table F-2, available online at http://www.census.gov/hhes/www/income/histinc/f02ar.html.

3. "Mean" is defined as the total income of all the households in that income level divided by the number of families in that income level.

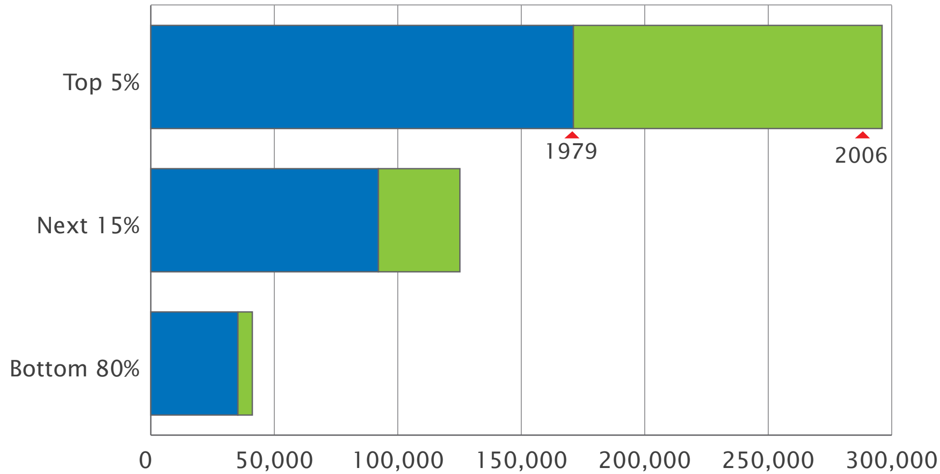
4. "Median" is defined as that level of income that divides the population into two equal halves, with 50 percent of households above and 50 percent below that income.

The Majority of Americans Grow Old Waiting for a Raise

Over the past three decades, the mean income of the top 5 percent of households grew more than four times as fast as the mean income of the bottom 80 percent. Figure 2 shows mean income for three groups of Americans in 1979 and 2005: the top 5 percent, the next 15 percent, and the remaining 80 percent.

The increase in mean income of the top 5 percent ($125,837, represented in Figure 2 by the righthand segment of the top bar) was more than three times as great as the mean 2006 income level of the bottom 80 percent of households.

Figure 2. Mean Income at Various Points in the Distribution, 1979 and 2006



Source: Historical Income Tables, U.S. Bureau of the Census, Table H-2, available online at http://www.census.gov/hhes/www/income/histinc/h02ar.html; Table H-6, availible online at http:// www.census.gov/hhes/www/income/histinc/h06ar.html.

"Them that's Got Is Them that Gets"

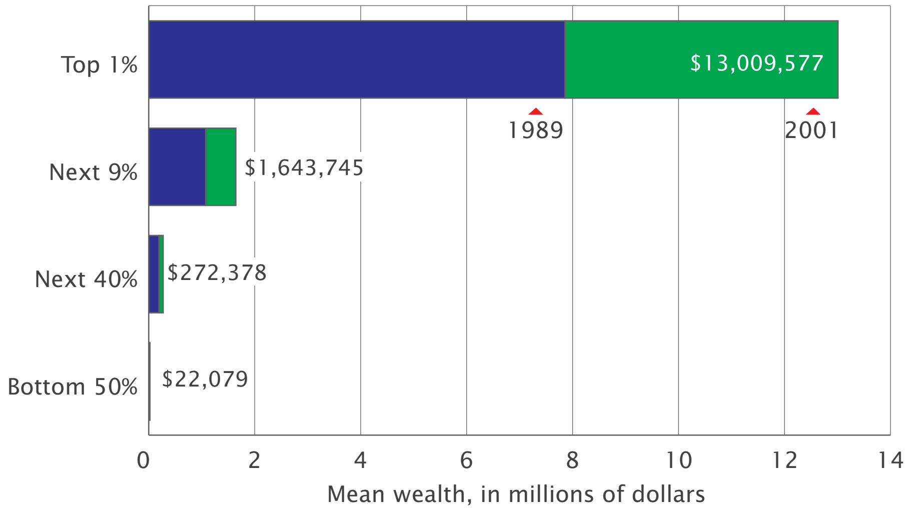
The widening income disparities are small compared to the growing differences in the levels of wealth. The households in the bottom half of the wealth spectrum—which includes many young families with lots of debt— have very little wealth. Even among households nearing retirement, the bottom quarter have almost no private savings or home equity. Figure 3 shows the mean wealth of the top 1 percent, the next 9 percent, the next 40 percent, and the bottom 50 percent in 1989 and 2001 (although reliable data for more recent years is unavailable, these differences have almost certainly widened further).

Wealth in the United States is much more concentrated than income. The top 5 percent of *income* recipients have on average 5.5 times the income of the remaining 95 percent, but in terms of *wealth,* the top 5 percent of households have on average 23 times the wealth of the remaining 95 percent. And the wealthiest families also enjoyed the greatest increases in wealth between 1989 and 2001. In fact, the *increase* in wealth of the top 1 percent over that period ($5,151,836 per household) is three times the 2001 *level* of wealth of the next 9 percent and nearly 40 times the level of wealth of the bottom 90 percent of households.

A family without wealth has no margin for unexpected emergencies. Younger households are particularly vulnerable because most families only accumulate significant financial wealth as they approach retirement. Yet younger families, with children at home, are most in need of some wealth to see them through bad times.

Edward Wolff of New York University has calculated that, among households headed by people between twenty-five and fifty-four years of age, the 40 percent with the least wealth would exhaust all their financial assets (excluding homes) in less than one week if they lost their income.[5]

Figure 3. Mean Wealth at Various Points in the Distribution, 1989 and 2001



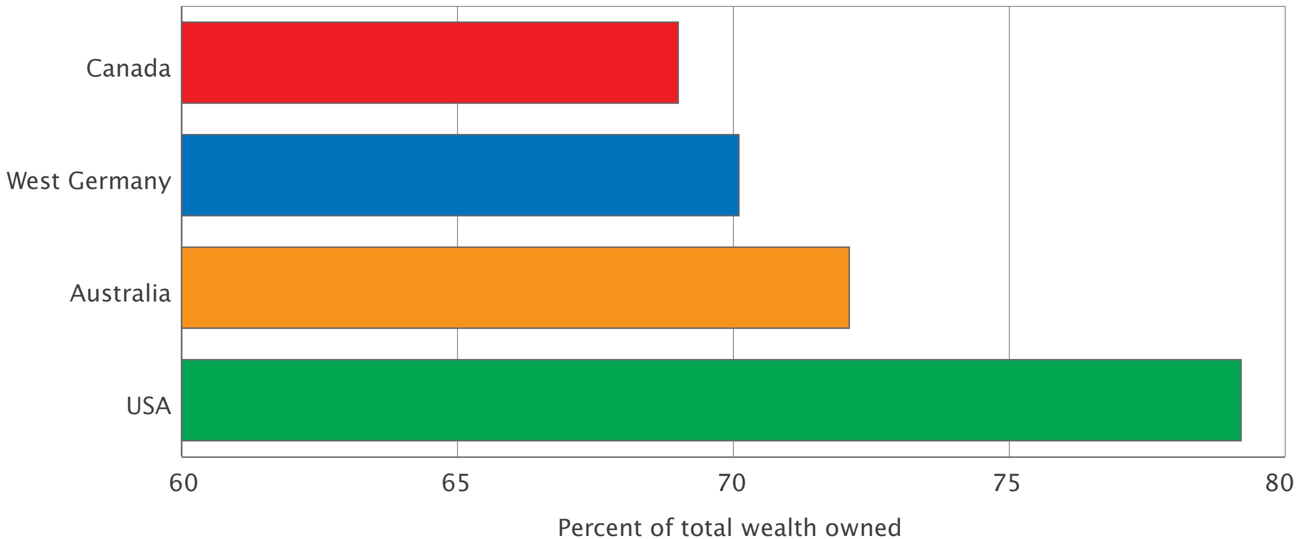
Source: Arthur B. Kennickell, *A Rolling Tide: Changes in the Distribution of Wealth in the U.S.,* 1989–2001, Levy Institute Working Paper 393, November 2003, available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=427720.

5. Edward N. Wolff, "Recent Trends in Wealth Ownership, 1983–1998," in *Assets for the Poor: The Benefits of Spreading Asset Ownership*, ed. Thomas M. Shapiro and Edward N. Wolff (New York: Russell Sage Press, 2001), available online at http://ideas.repec.org/p/wpa/wuwpma/0004047.html.

On Top of the World

In all market economies, wealth ownership is highly concentrated, but the United States leads the pack by a significant margin. The wealthiest 20 percent of households in the United States own nearly four-fifths of household wealth (see Figure 4).

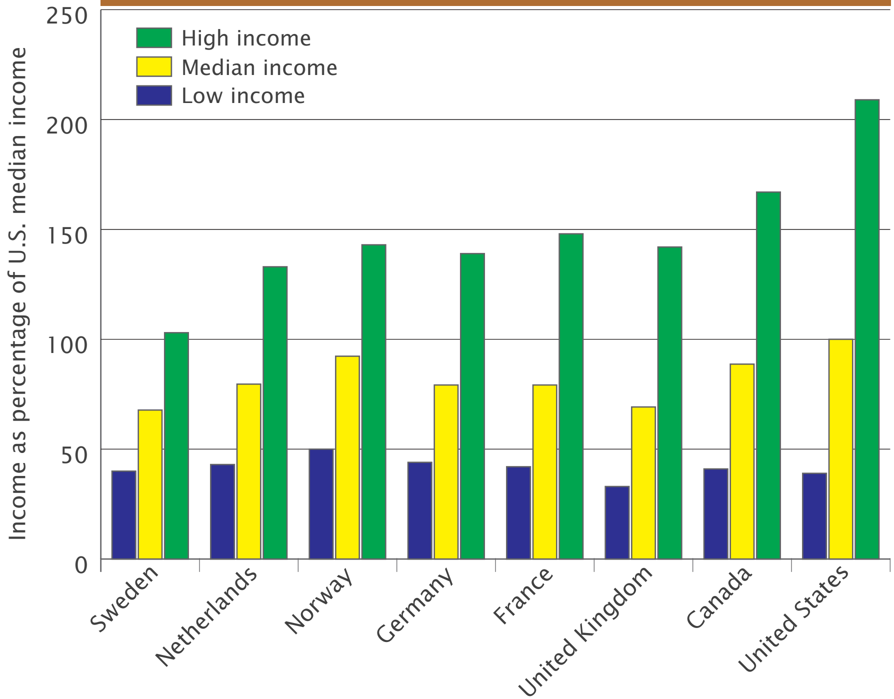
Figure 4. Share of Total Wealth Owned by Wealthiest 20 Percent in Four Countries, Early 1990s



Note: These data are for various years in the early 1990s and are for households with heads aged twenty-five to sixty-four.
Source: Richard Hauser and Holger Stein, *Inequality in the Distribution of Personal Wealth in Germany 1973–1998*, Levy Institute Working Paper 398, November 2003, availible online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=488223.

With respect to income inequality, research using data from the Luxembourg Income Study reveals that, while a family in the United States with the median income is well off by international standards, low-income families here have slightly less purchasing power than the poor in most other advanced economies. Figure 5 shows the mean income of those in the top 10 percent of the income distribution, those in the bottom 10 percent, and the median income for six European countries, Canada, and the United States (all income levels are presented as a percent of the U.S. median income so that they can be easily compared). In Sweden, the country in the figure with the least income disparity, the high-income segment of the population is only a little better off than the U.S. median, yet the poor in Sweden have higher purchasing power than the poor in the United States.

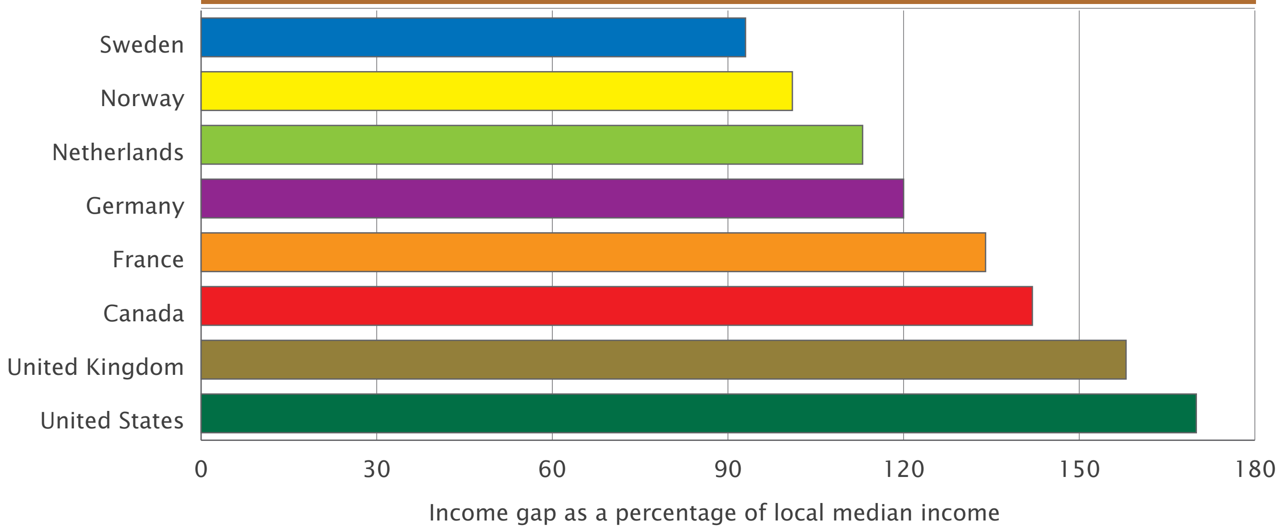
Figure 5. Income at Various Points in the Distribution in the 1990s



Source: Timothy M. Smeeding and Lee Rainwater, *Comparing Living Standards Across Nations: Real Incomes at the Top, the Bottom, and the Middle*, Luxembourg Income Study, Working Paper 266, February 2002, available online at http://www.sprc.unsw.edu.au/dp/DP120.pdf.

At the top and in the middle of the income spectrum, Americans have more purchasing power than those in the top and middle of the distribution in any of these countries. But at the bottom of the distribution, only the poor in the United Kingdom have less purchasing power than the poor in America. In addition, America's poor lag further behind the purchasing power of their middle- and high-income counterparts than anywhere else. Figure 6 shows the gap between the purchasing power of those with high income and those with low income relative to the median income in each of these countries.

Figure 6. The Income Gap Between High- and Low-Income Households in the 1990s



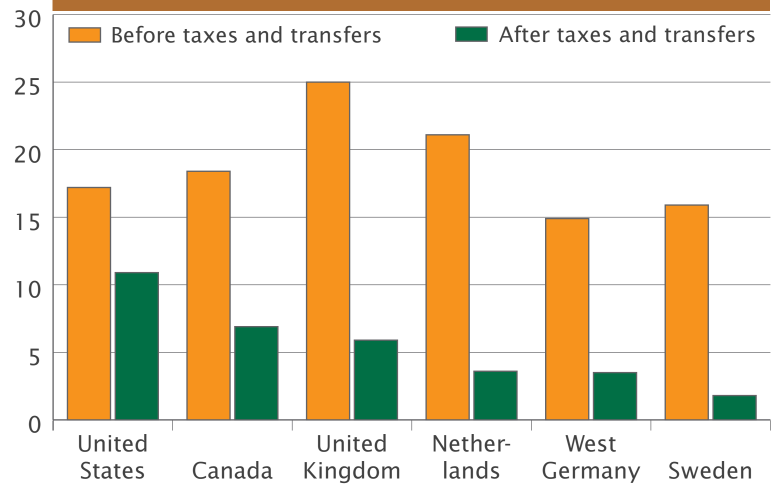
Note: The data for each bar in this figure is calculated by simply taking the difference between the height of the low-income and high-income bars in Figure 5, dividing it by the height of the middle-income bar, and then multiplying by one hundred.
Source: Timothy M. Smeeding and Lee Rainwater, *Comparing Living Standards Across Nations: Real Incomes at the Top, the Bottom, and the Middle*, Luxembourg Income Study, Working Paper 266, February 2002, available online at http://www.sprc.unsw.edu.au/dp/DP120.pdf.

Rather than work against the growing gap between rich and poor, recent tax policy in the United States has aggravated it, with tax cuts disproportionately rewarding those at the top while doing little for the middle class or the poor. Because the United States long has used public policy less than other major countries do to lift families out of poverty, this approach only adds to an already bad situation.

Figure 7 shows the proportion of households headed by persons between 25 and 64 years old that are in poverty, both before and after the effects of public policies are taken into account.[6] When considering only household earnings (before taxes and transfers), the United States does not have an unusual proportion of its population living in poverty. However, as the figure illustrates, after considering the effects of public polcies, the proportion of the population in the United States that remains in poverty is significantly higher than that for other nations.

6. Here poverty is defined as having income of 40 percent of the median or less. This definition is used in many countries. It has the advantage of making international comparisons relatively easy. In the United States, almost exactly the same percentage of the population—10 to 11 percent—falls below the 40 percent cutoff as falls below the official poverty line.

Figure 7. Percent of Population in Poverty Before and After Government Programs



Source: Timothy M. Smeeding, Lee Rainwater, and Gary Burtless, *United States Poverty in a Cross-National Context,* Luxembourg Income Study, Working Paper 244, September 2000. Data are the most recent comparable figures, from the early to mid-1990s, available online at http://www.listproject.org/publications/liswps/244.pdf.

- While 17.2 percent of the U.S. population starts out in poverty, government policy reduces that proportion to 10.9 percent—a reduction of little more than a third.

- Even nations that start out with a higher proportion of their populations living in poverty, the Netherlands and the United Kingdom, for example, use their government policies to lift significantly more than half of these people out of poverty. The United Kingdom, for example, starts out with 25 percent of its population living in poverty but is able to use government policies to reduce that proportion to 5.9 percent.

- The U.S. poverty rate after government policies are taken into account—10.9 percent—is much higher than in any of the other nations illustrated in Figure 7.

As the figure makes clear, other countries do not wait for economic tides to turn, but rely much more than the United States does on active tax and transfer policies to lift families out of low-income status.

Policy decisions affecting income and wealth distributions are complex, both politically and substantively. Some income and wealth inequality is necessary to provide incentives for efficient allocation of time, labor, and capital. But for most Americans, the prospect of these ever-widening income and wealth gaps, coupled with little improvement in the economic well-being of the majority of the population, surely must provoke unease. Is this really the America we want?

Prepared by Matt Homer, Elah Lanis, Jonah Liebert, and Bernard Wasow.

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THE CENTURY FOUNDATION

HEADQUARTERS:
41 East 70th Street
New York, New York 10021
212-535-4441

WASHINGTON, D.C., OFFICE:
1333 H Street, N.W., 10th floor
Washington, D.C. 20005
202-387-0400

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