Worsening Inequality of Wealth and Incomes

SUMMARY

After years of neglect, political America has awoken to the problems of rising deficits being incurred at all levels of government. Economists and politicians may argue endlessly of causes and solutions. Cut spending, raise taxes, grow the economy all have their place. This essay examines income, wealth, and taxes, not just rates but where those rates have affected income growth.

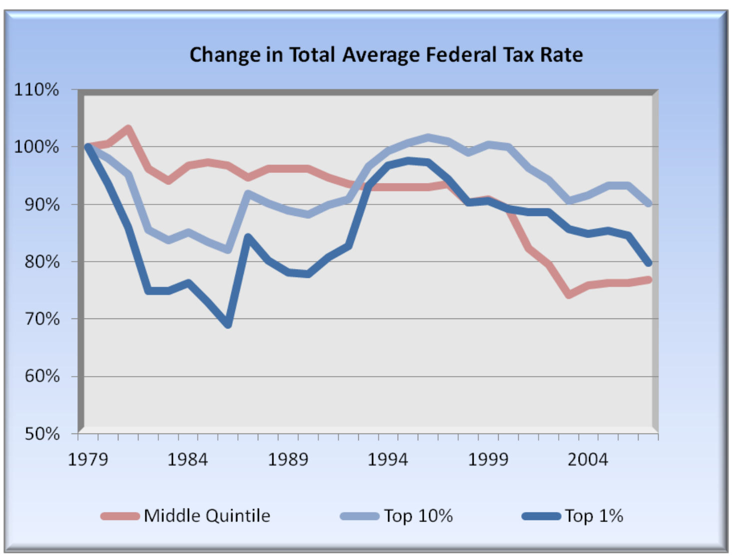
By every measure, U.S. wealth and income has skewed heavily and continues to tilt to the top 1%, approaching an unhealthy situation. A robust middle class will spend more of its earnings than the wealthy and in this country consumer spending constitutes the largest economic component.

METHODOLOGY

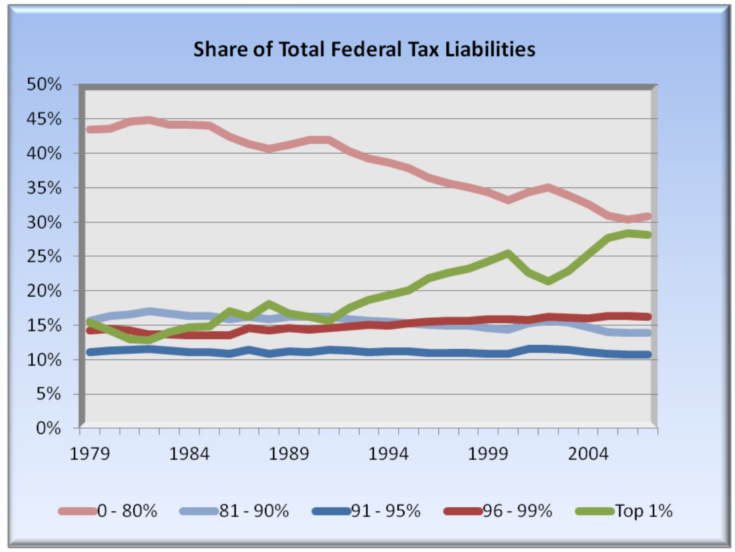
All the data used in this report are derived from government sources. Income and tax data are from Congressional Budget Office (CBO). CBO published tax and income data from 1979 through 2007, dividing data of households into five quintiles (20% each) as well as the top 10%, 5%, and 1%. Wealth data come from the Federal Reserve's 2007 Survey of Consumer Finances Chartbook divided into four quartiles plus top 10%.

DISCUSSION – Tax Rates

Beginning in the Reagan administration, there has been an overall trend towards lower tax rates as shown in the graph below. Despite differences in timing, the total average tax rate for middle America has declined virtually the same as for the highest 1% of households.

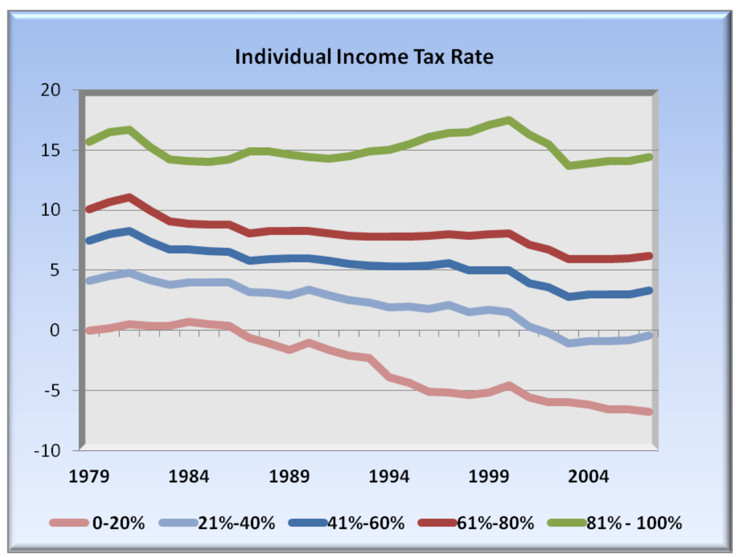


The next graph shows trends in who is paying how much in total federal taxes. Here clearly shows tax rate reductions have brought down the share of lower 80% of all taxpayers from 45% of total taxes to 35%. One group that has an increased share is the top 1%, rising from 15% to a 28% share. With declining rates and overall increases in share of tax payments can mean only one thing. The top 1% are increasing income at a significantly faster rate than other taxpayers.



The total federal taxes in the above two slides comprise several components, individual income taxes, payroll taxes (social security and Medicare), corporate (taxes on interest, dividends, and capital gains from investments), and excise taxes which is a proxy for consumer spending.

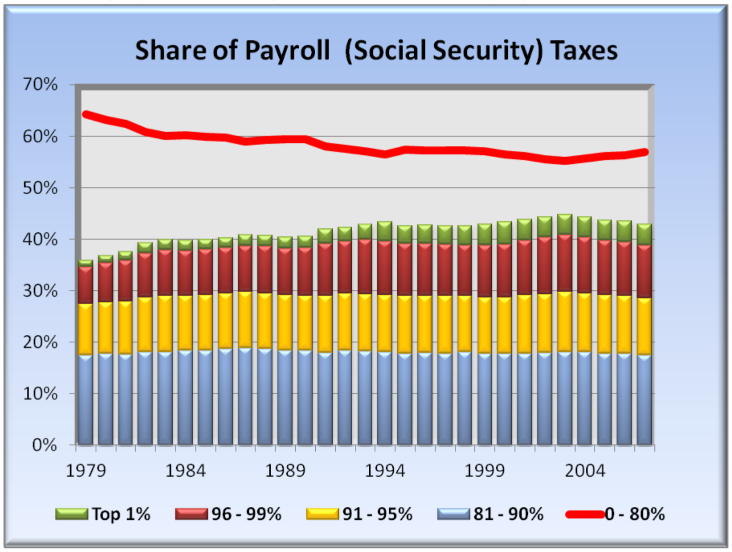
Individual income tax rates from 1979 are shown below. Here we see that the top 20% rates did not decrease as much as the other income brackets which would explain why higher incomes contribute proportionally more taxes now.



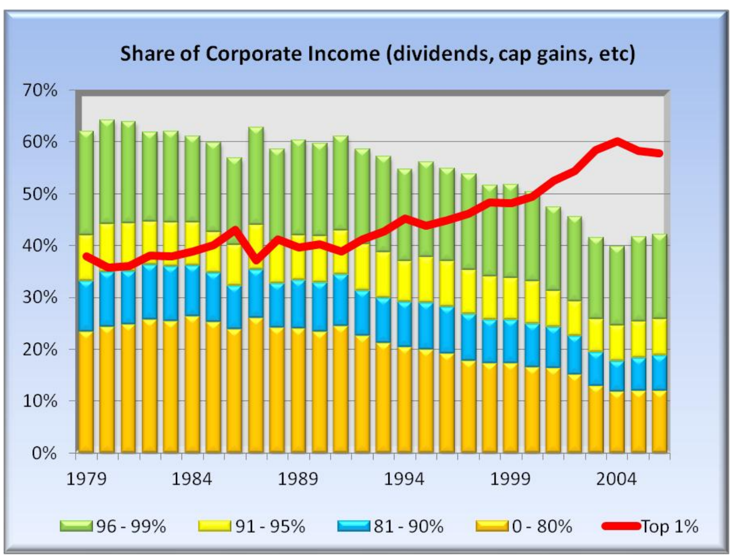
In the next graph, contribution to payroll taxes for social security and Medicare are broken out by income bracket. Because of income ceilings on these payroll taxes, these can be considered regressive as they take a bigger proportion from lower incomes than from higher incomes.

In the next graph the red line combines the lower 80% of taxpayers who now pay 58% of payroll taxes. The top 20%

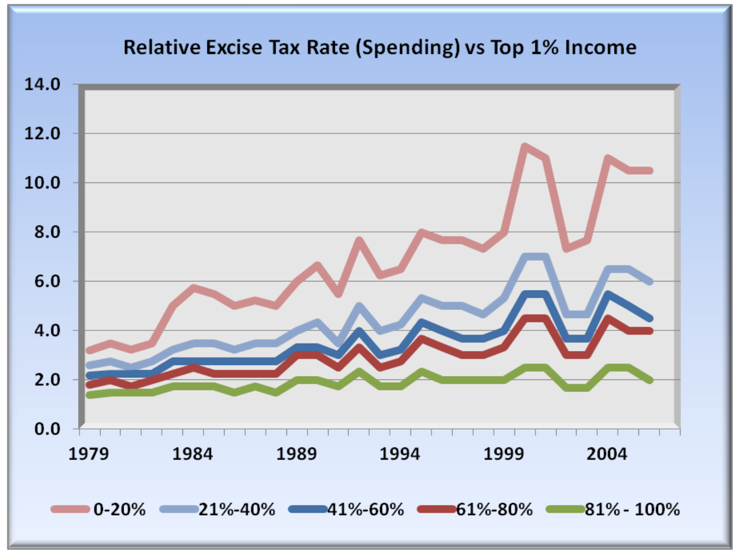
contributions are stacked bars showing their distribution. Generally, the upper 20% all move in concert indicating that these taxpayers are beyond limits set for payroll taxes.



The real difference between the lower and top income earners is their share of corporate income. CBO does not report these directly, but allocates to households according to their share of capital income which are shown below. Here 99% of all households are shown as stacked bars. Their share of corporate income, initially as high as 65% of total, has declined to only 40%. Conversely the share of the top 1% not only has risen sharply over the decades, but now far exceeds the combined income of the remaining 99% of the population. This is an incredible skewing of wealth towards the highest 1% of households.

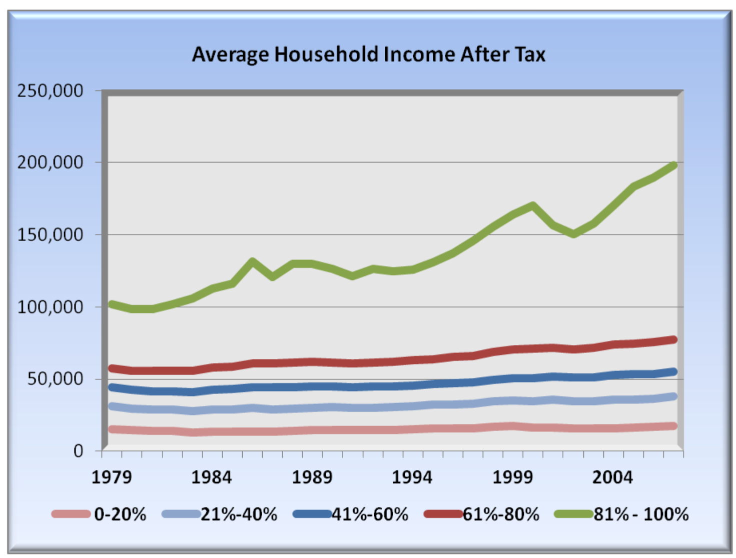


The final component of federal taxes is excise taxes which can serve as a proxy for consumer spending. In the following graph the average excise tax rate for all quintiles is divided by the average excise tax rate for the top 1%. Those in the lowest 20% spend over 10 times more of their income on goods and services. For the 20% - 40% bracket, they spend 6 times as much; for the 40% - 60% and 60% - 80%, they spend 5 times as much. Clearly, the wealthy do not spend nearly the same proportion of their income as do lower income brackets. The political corollary to this is that a dollar tax cut for the lower income earners will have a far greater effect on spending than a same dollar break for the very wealthy.



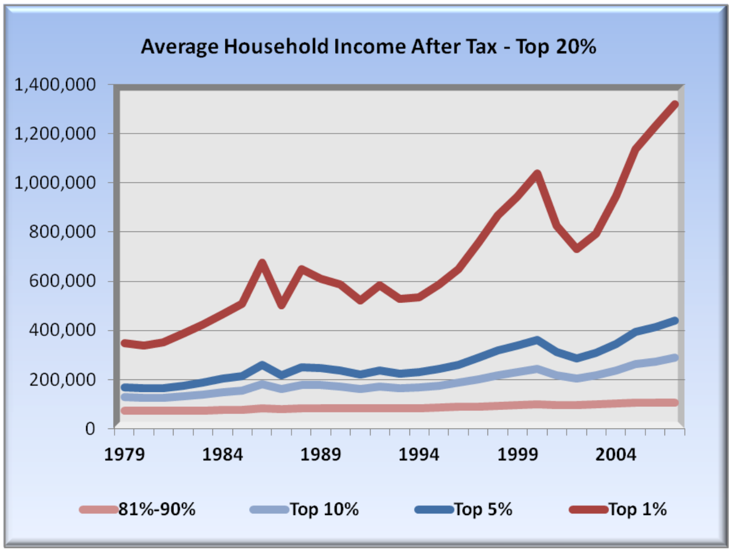
DISCUSSION – Household Income

The focus above was on tax components. The graph below shows the net effect of all these factors on household income after tax. Income in the four lowest quintiles grew only gradually over the decades. For the top 20%, however, the increase has been dramatically higher incomes. But even this does not tell the whole story.

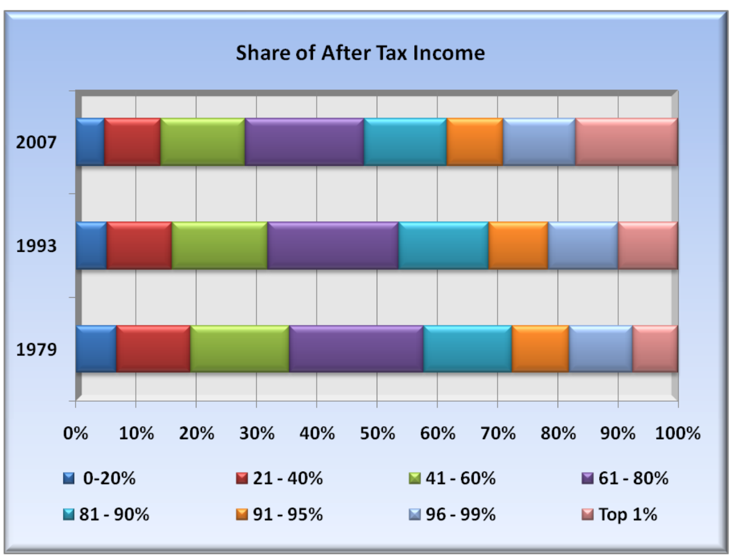


When one looks at only the top 20%, we see a further widening of the differences as shown in the following graph. The increase is not in the 80% - 90% bracket, not so much either in the 90% - 95% or the top 5% brackets, but is virtually ALL CONCENTRATED IN THE TOP 1%.

Some pundits have criticized those who speak of taxing the rich as starting a class war. This data suggest that a class war is already underway, has been for some decades now, and the super rich are clearly if quietly winning this war.

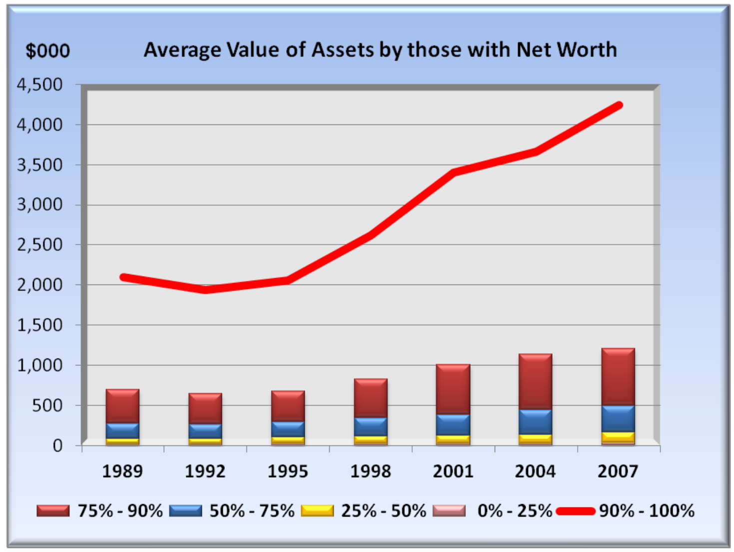


The long term effects of this shift to higher incomes can have a serious effect on the economy. People with higher income spend proportionally less of their income than lower income people, the balance going into savings or permanent wealth. The following graph highlights the share of income for income groups, from low at left to high at right. In 1979, 80% of households brought in nearly 60% of all income. By 2007, that had fallen to under 50%. Far and away the greatest increase in share of total income is the top 1%. The top 5% have over 30%, more than the lowest 60% combined.

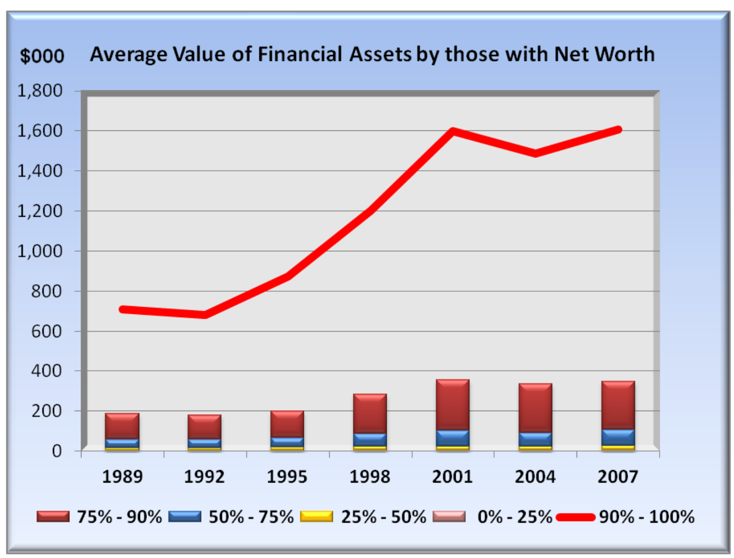


DISCUSSION – Household Wealth

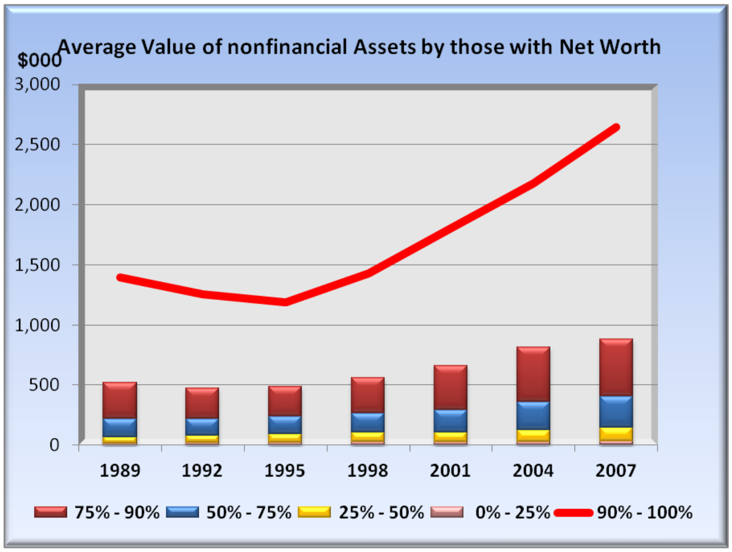
The accumulation of savings from income will, over time lead to an increase in wealth. This report section looks at components of wealth as derived from the Federal Reserve's <u>2007 Survey of Consumer Finances Chartbook</u>. The survey is taken every 3rd year since 1989. The next graph highlights the average value of assets over this period by those who have a positive net worth. Unlike the income section which divided households into quintiles (fifths), these Federal Reserve data are divided into quartiles (fourths) with the top divided again, from 75% - 90% and the top 10%. As with income, wealth is concentrated at the top of the pyramid. The results are not a surprise for 90% of the population that are shown as stacked bars in the graph below. Far above are the top 10% whose wealth dominates.



Those assets are not homogeneous. They consist of several components starting with the graph below. It breaks out the financial asset portion of net worth. This category includes CD's, bonds, mutual funds, stocks, cash value life insurance, and retirement assets. Similar to the total asset graph, the top 10% soar far above the crowd. Here, however, there is a flattening of the financial holdings in this current decade.

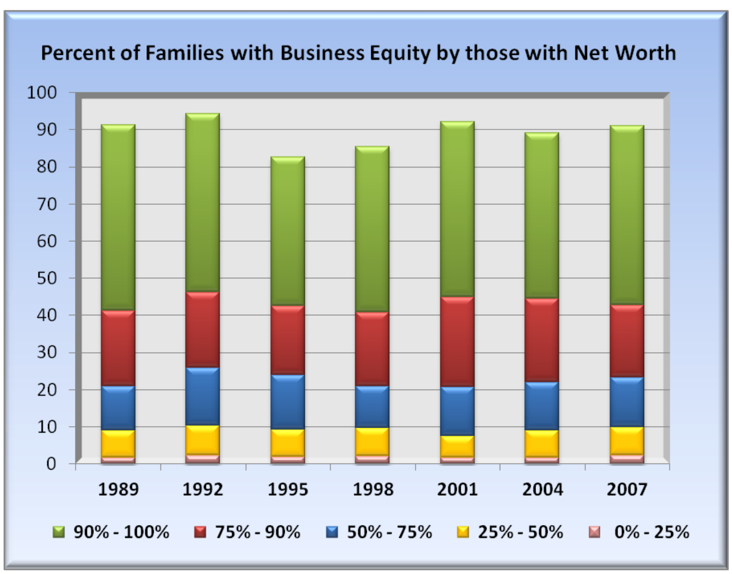


Since total assets continued to climb, it is only logical that nonfinancial assets continued to climb, and indeed this is the case as shown in the following graph on nonfinancial assets. Since 1995, there has been an unrelenting and significant increase in nonfinancial assets.

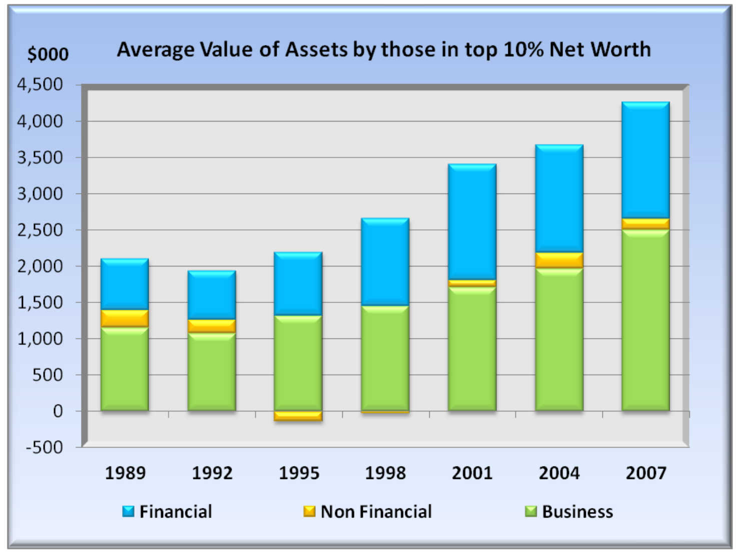


These nonfinancial assets consist of residences, vehicles, real estate, business equity and various forms of debt. Once again, a single component dominates this asset category – business equity. The graph below shows the percent by asset worth of families with business equity. Those in the top 10% exceed all their counterparts combined. Owning a business is where extreme wealth is built. But some are not really small businesses, though they may be classified as such because ownership is concentrated among only a few individuals or in the form of partnerships. Some examples:

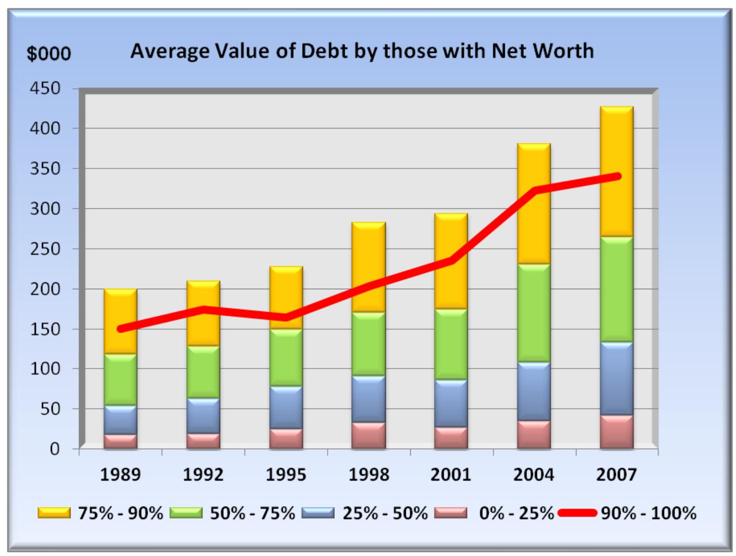
- Price Waterhouse Coopers - $26 billion 2009 revenue
- Koch Industries – partnerships with 70,000 employees
- Ferrellgas - $2 billion 2009 revenue, 1 million customers



Business equity comprises the bulk of nonfinancial assets. The following graph breaks down average assets by financial, business equity, and other non financial. From an average of $2 million in the early 1990's, total assets have more than doubled to over $4 million on average. Further, the growth since 2001 has come from primarily business equity.



The final component of nonfinancial assets is debt, shown in the graph below. All groups leverage a portion of their assets with debt. Here the leverage declines with higher net worth. Since debt does not apply to hedge funds which are financial assets, this debt is primarily associated with business equity. And it makes sense. Smaller businesses tend to carry more debt, particularly those trying to grow. As the business gets large, its growth opportunities are fewer and need for cash is likely to be less an issue.



CONCLUSION

The wealthy always had the lion's share of income and assets. At some point, however, excessive accumulation of wealth can tend to stymie economic growth. A robust middle class will spend more of its earnings than the wealthy and in the US economy, consumer spending constitutes the largest economic component.