The Material Well-Being of the Poor and the Middle Class since 1980

by **Bruce Meyer and James Sullivan**

Comments by Gary Burtless
THE BROOKINGS INSTITUTION

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Discussion

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Bruce Meyer and James Sullivan have spent a great deal of time and effort trying to persuade us that American living standards have improved over the past three decades. Further, living standards have improved not only at the very top of the income distribution, as everyone suspects, but also in the middle and at the bottom.

I hope Bruce and James have succeeded in persuading most of their readers, because they're basically correct. It may seem odd for them to make this particular claim in the midst of the worse post-World-War-II slump, but maybe that is exactly the right time to make and defend such a claim.

People who think middle-income living standards have stopped rising, if they are well informed, are thinking of living standards over a fairly brief period – say, the last five or ten years, when living standards have been affected by a steep recession and anemic recovery. Alternatively, if they're thinking about living standards over two or three decades, they are only thinking about the trend in living standards within fairly narrow slices of the population – unmarried men in their 20s and early 30s who have below-average schooling, for example, or groups that have been particularly hard hit in the recent slump.

Americans in the broad middle and at the bottom of the distribution have, on average, seen their real incomes and consumption improve over the past three decades.

Why is this claim so controversial? There are four main reasons:

- A defective price index, which makes unwary observers think real incomes are climbing more slowly than they really are.
- Household income measures that fail to account for shrinking household size. If median household income has remained unchanged (and I'm not saying it has), then shrinking household size means there is an increase in the amount of income per household member.
- Incomplete measures of income, in other words, definitions that exclude or undercount sources of income particularly important at the bottom and in the middle of the income distribution than they are at the top.
- Finally, inequality has unquestionably increased over the past 30 years (and in the past 10 years and 20 years). This means that *average* living standards have improved faster than *median* living standards. More of the economy-wide income gains have been enjoyed by Americans with a high perch in the income distribution; smaller fractions have been received by people in the middle and at the bottom.

Improvements in *median* living standards are nonetheless continuing, at least if we take a long enough perspective. The plain fact is, however, they are improving more slowly than they did in the first three or four decades after World War II. That is especially true if we focus solely on the past 11 or 12 years. Under any plausible measure of Americans' income or consumption possibilities, gains in middle-class living standards have been slower in the recent past than they were in the earlier post-war period. You cannot put a happy face on a decade-long period that ends with the longest and worst economic slump of the post-war era. Rising inequality has certainly made things worse for many folks now in the middle and at the bottom. If the pain of the slump were more equally distributed across the nation's households, many people would certainly feel better about progress in their living standards. But a deep slump combined with rising inequality will never be kind to either the poor or the middle class.

I brought 10 slides, and I now have a lot less than 10 minutes to go over them. They were created to defend the statements I just made and to lend support to the basic conclusions reached by Bruce and James.

Chart A shows the impact of defective price measures and changing household size on our estimates of progress in living standards over the past 30 years. All of these numbers are based on the Census Bureau's estimates of the trend in *median pre-tax cash* incomes over the 1980-2010 period. The bottom line in the chart shows how fast median incomes rose if we use the official CPI-U measure of consumer price inflation: +5% over the thirty years. The next line up shows the gain if we consistently use the BLS's current measure of price inflation, the CPI-U-RS: +11%. The next, green line shows income gains using a still broader measure of price inflation, the PCE deflator: +17%. And the top line shows how fast *income per person* in the median household improved, using the PCE deflator and accounting for the fact that household size has shrunk over the past 30 years: +24%.

Note, however, that there is no way any of these adjustments can mask the fact that median incomes stagnated between 1999 and 2007 and then plunged after 2007: There has been no gain in median money income since the late 1990s.

Chart B demonstrates the well-known fact that pre-tax cash incomes have risen at an unequal pace since 1980. An American household at the 20th income percentile saw incomes grow 12%; an American in the middle saw income climb 17%; at the 80th percentile PCE-deflated income increased 33%; and at the 95th percentile income rose 50%. The well-off got a bigger slice of the pre-tax cash income gains that our economy generated.

At the very top, income gains were even more impressive. This is reflected in well-known calculations by public finance economists Thomas Piketty and Emmanuel Saez (**Chart C**). Using IRS data, they have calculated the percentage of total market income that was received by tax filers in the top 1% of income recipients. These calculations ignore capital gains income, which in good years would make the gains at the top even more impressive. The share of market income received by the top 1% has more than doubled since the 1960-1980 period, rising from 8% of all market income to 18% of all market income.

Having covered defective price measures, shrinking household size, and growing inequality, let me now turn to incomplete measurement of household income. This is a topic Bruce and James treat at length in their paper. Piketty and Saez's income measure is *gross* (pre-tax), *taxable*, <u>*market*</u> income. But a rising percentage of income comes from transfers or is untaxed market income. <u>**Chart D**</u> shows this fact by tracing out the trend in total NIPA income that is included in the Piketty-Saez measure. The bottom line shows ratio of Piketty-Saez income to total personal income in the NIPA. This ratio was a little more than 75% in 1970; in 2008 it was just 63%. Put another way, the Piketty-Saez measure excluded 24% of NIPA "personal income" in 1970, but it excluded 37% of "personal income" in 2008.

Well, that's not surprising. A lot of personal income is (a) not market income; or (b) not cash income; or (c) is taxed away in income and payroll taxes. Let's take a narrower NIPA income definition, <u>*disposable*</u> personal income, that is, income after income and payroll taxes have been subtracted. Still, the ratio of Piketty-Saez income to this definition of income has shrunk over tme. It was 84% in 1970, but just 72% in 2008.

Let's try an even narrower income definition: Gross personal income minus employer supplements to employees' money wages and minus government transfer payments in the form of health benefits. This income definition is tolerably close to the Census Bureau definition of "money income." Still, the Piketty-Saez income definition misses a growing percentage of that kind of income, too. In 1970, it missed 13% of this kind of consumer income; in 2008 it missed 22% of this kind of income.

What's going on? **Chart E** shows one important development: The increase in the fraction of our income that consists of employer contributions for health insurance and government reimbursement of health costs. (These forms of income are excluded from both the Piketty-Saez *and* Census money income definition.) This chart displays the 1960-2007 trend in consumer expenditures on health care and health insurance administration as a percentage of *total* American personal consumption. The GREEN part shows the fraction of this health consumption that is financed out of households' cash incomes. The RED part shows the percentage that is paid for with employer health insurance premiums and government reimbursement of Americans' health purchases. The RED portion accounted for just 2.7% of household consumption in 1960, but 15½% of total consumption in 2007. None of it is counted in the Piketty-Saez measure of income or the standard Census Bureau measure of money income.

Why does this matter? Because the health consumption that is financed with employer health premiums and government health insurance programs is a great deal more egalitarian than other components of U.S. income. Or, more precisely, it is distributed in an egalitarian way across families in different parts of the money income distribution. **Chart F** shows who in the income distribution receives the employer and government health subsidies. I have divided the income distribution into 10 equal-size groups based on their money incomes. The lowest income group is on the left; the highest income group is on the right. I then calculated the average employer-plus-government health insurance subsidy that was received by each person in each income decile, on average, between 2001-2005. (My latest estimates for 2006-2008 would look very similar.) Obviously, folks at the bottom get bigger helpings of free medical care than folks at the top.

That doesn't mean that these uncounted consumption gains are completely equally distributed across the population. On the contrary, a dwindling percentage of adults has been covered by a private or government health insurance plan over the past quarter century. **<u>Chart G</u>** shows the percentage-point change in health insurance coverage, by age group, between 1987 and 2009. Coverage in every adult age group (especially between ages 19 and 44) has fallen significantly. Only coverage rates among children have improved, entirely because eligibility conditions for government insurance of low- and moderate-income children have been liberalized.

[Next slide] So how does health insurance affect our interpretation of standard income series?

- Health care consumption has increased sharply over the past 30 years.
- The share of health care financed out of households' cash incomes has declined sharply.
- The percentage of it paid with employer contributions and government-provided insurance has increased considerably over time. None of this is counted in standard income statistics.
- The increase in government subsidies for insurance is much more economically significant in the lower ranks of the income distribution.
- Although on balance the pattern of health subsidies has operated as an (uncounted) offset to widening inequality in *<u>measured</u>*, *<u>money</u>* incomes, health insurance coverage rates have nonetheless fallen among American adults.

Now let me come to my unhappy bottom line: No matter how you slice the statistics, a decade that ends with a deep, prolonged slump is going to show slower improvement in living standards than decades that end in prosperity or mild recessions. (**<u>Chart H</u>**) Here are the decade-by-decade statistics on gains in per capita real disposable incomes. I show the annual rate of change in each one-decade period. Note that the income measure used here – per capita real disposable income – is not subject to most of the criticisms leveled by Bruce and James against standard income statistics. It is all inclusive: It includes both transfer and market incomes and both cash and noncash income sources. (It only excludes capital gains.) Clearly, disposable income has grown much more slowly over the past decade than it did in any other post-war decade. If we calculated 20-year rates of income gain, the past 20 years would also be slower than earlier ones. If we calculated *30*-year income gains the same would be true.

Finally, even if we reject income statistics and choose to look only at consumption statistics, as Bruce and James prefer, the facts do not change. (**Chart I**) Here are the decade-by-decade statistics on gains in per capita real personal consumption. The most recent decade looks even worse under this measure than it does if we use disposable personal income. (That's because the saving rate has increased.)

Neither of the last two charts show us how income or consumption gains were distributed up and down the income distribution. Compared with earlier post-war decades, when income gains were more equally distributed across the population, my guess is that inequality trends in the past 3 decades have made trends in middle-income households look even worse: Middle- and low-income families received smaller-than-average helpings of the income gains that our economy has generated.

Bruce and James are nonetheless correct: The U.S. economy has delivered income gains to low- and middle-income families over the past three decades. Whether and how much it has done so over the past decade is very much an open question. What seems beyond dispute, even using the statistics in this paper, is that the past decade has seen *smaller* gains in middle class living standards than the previous five decades.

- *Gary Burtless*
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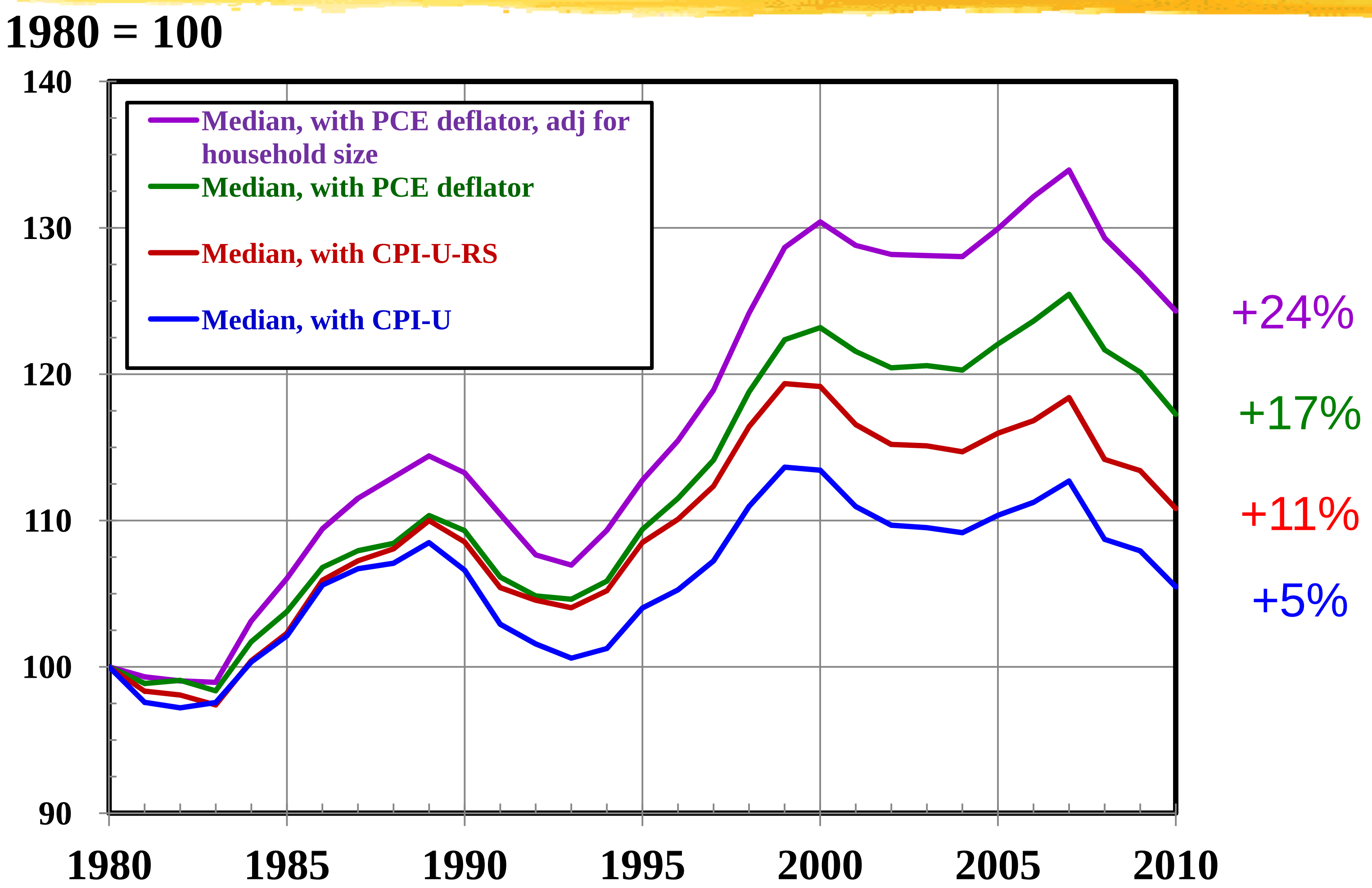
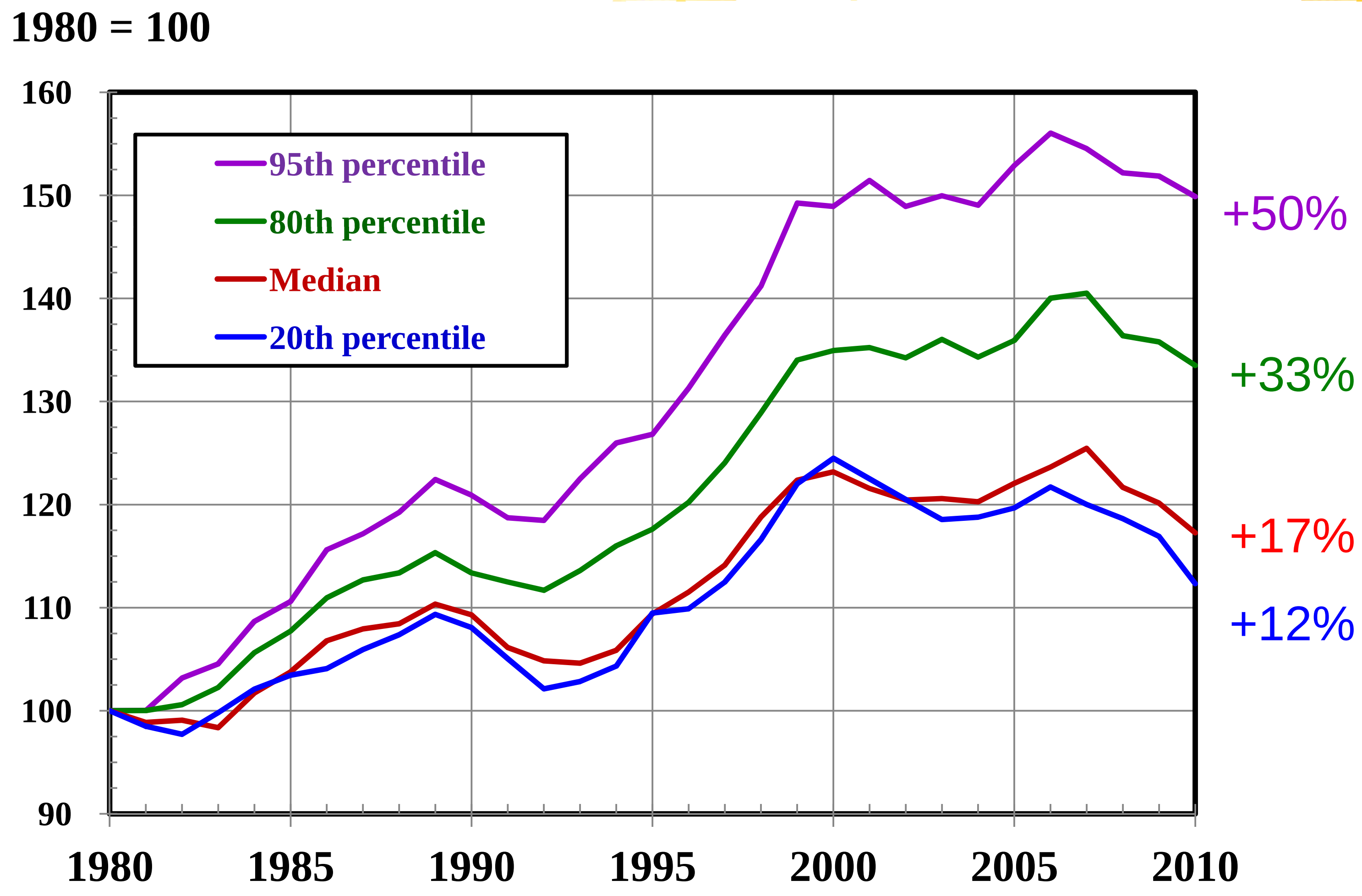
Chart A. Real Income Gains of Households at the 50th Percentile of the **Money** Income Distribution using Alternative Price Deflators and an Adjustment for Household Size, 1980-2010



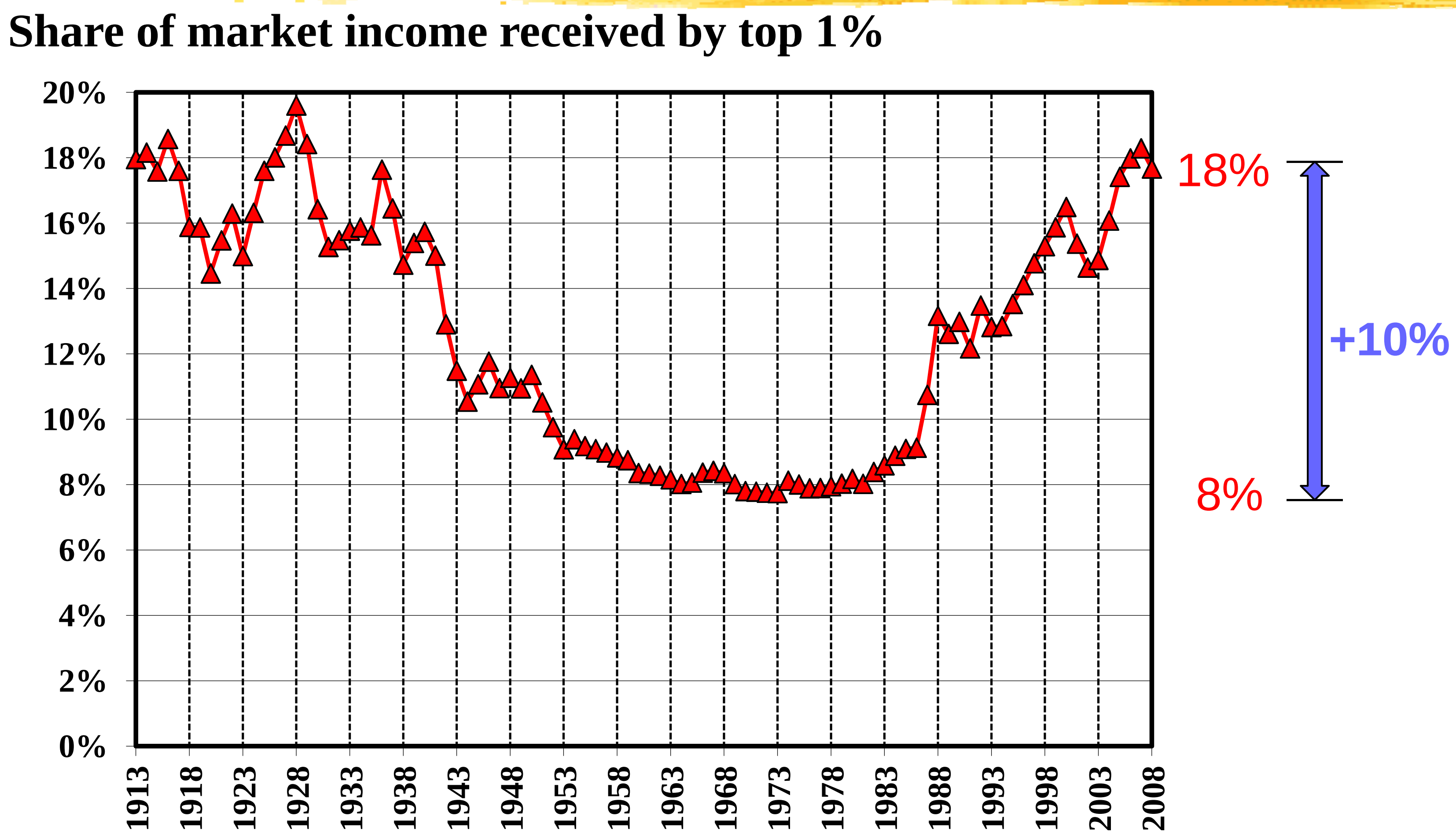
Source: U.S. Census Bureau (P-60 reports); U.S. BLS; and Dept. of Commerce, National Income and Product Accounts.

Chart B. Real Income Gains of Households at Selected Positions of of the **Money** Income Distribution using PCE Price Deflator and **No** Adjustment for Household Size, 1980-2010



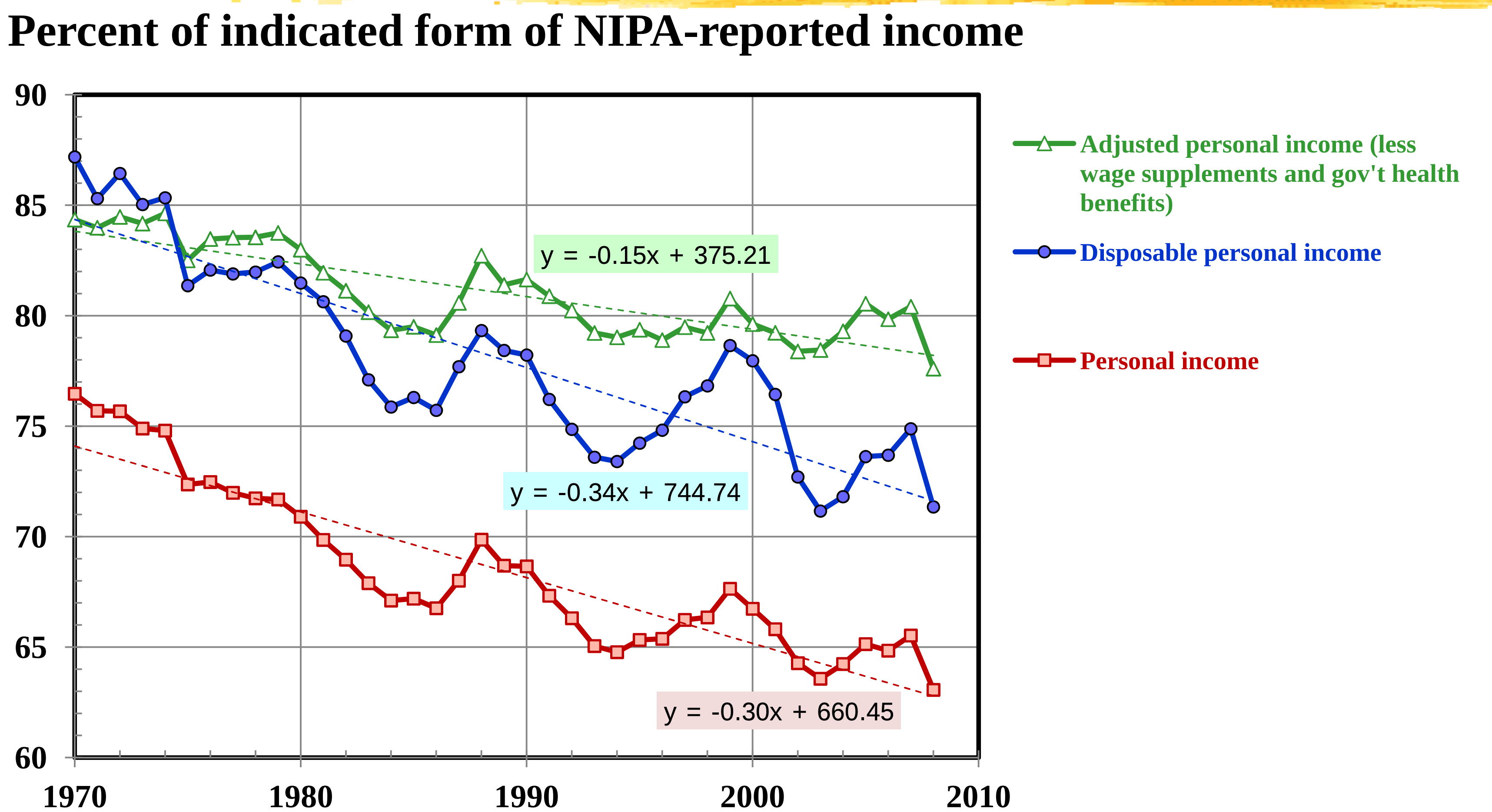
Source: U.S. Census Bureau (P-60 reports) and Dept. of Commerce, National Income and Product Accounts.

Chart C. Share of Estimated U.S. **Market** Income, Exclusive of Captial Gains, Received by Top 1% of Income Recipients, Piketty-Saez Estimates, 1913-2008



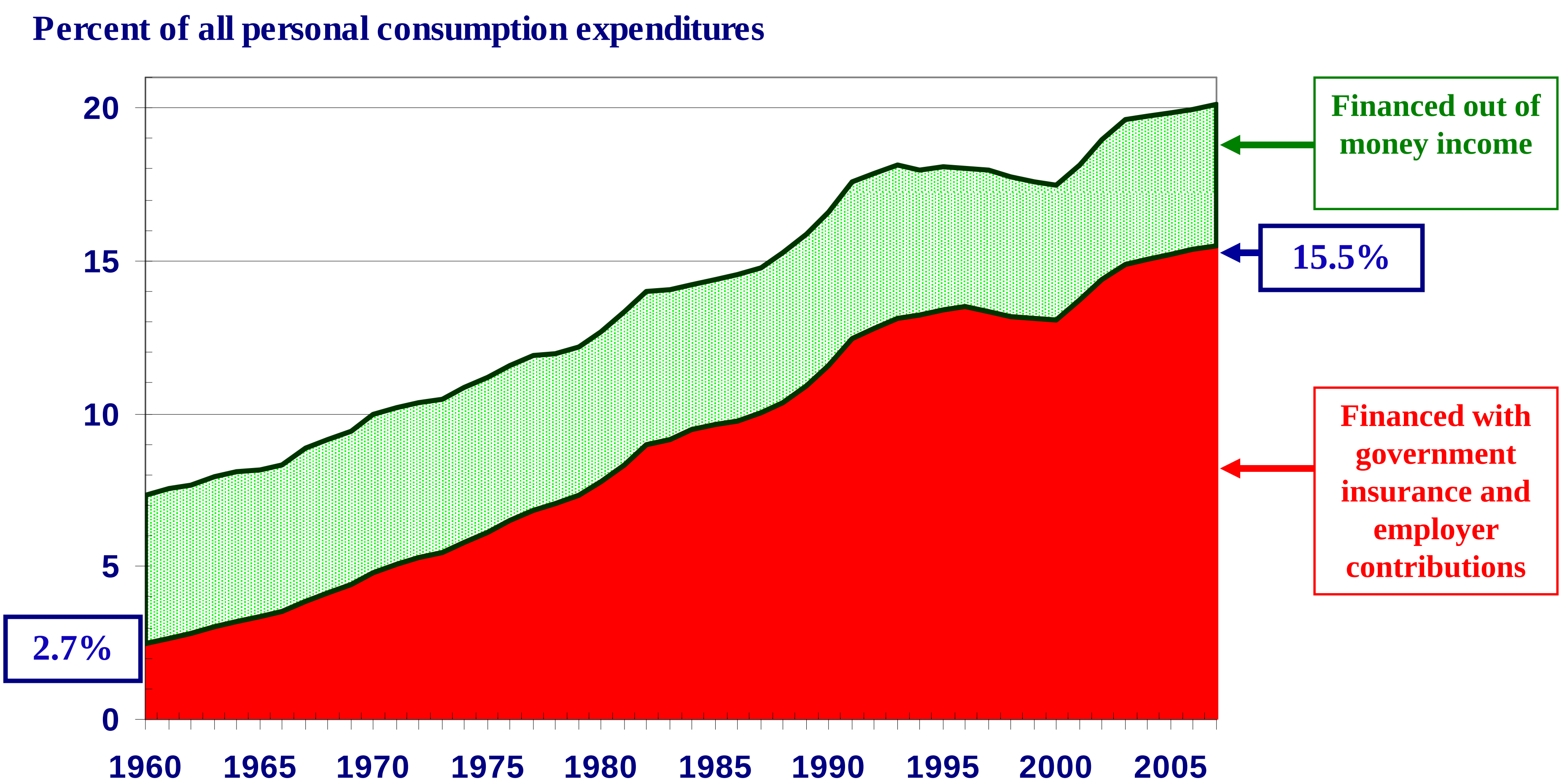
Source: Piketty and Saez, tabulations of U.S. income tax data (2011).

Chart D. Piketty and Saez's "Reference Total Market Income" as a Percent of Total Personal Income in the NIPA, 1970-2008



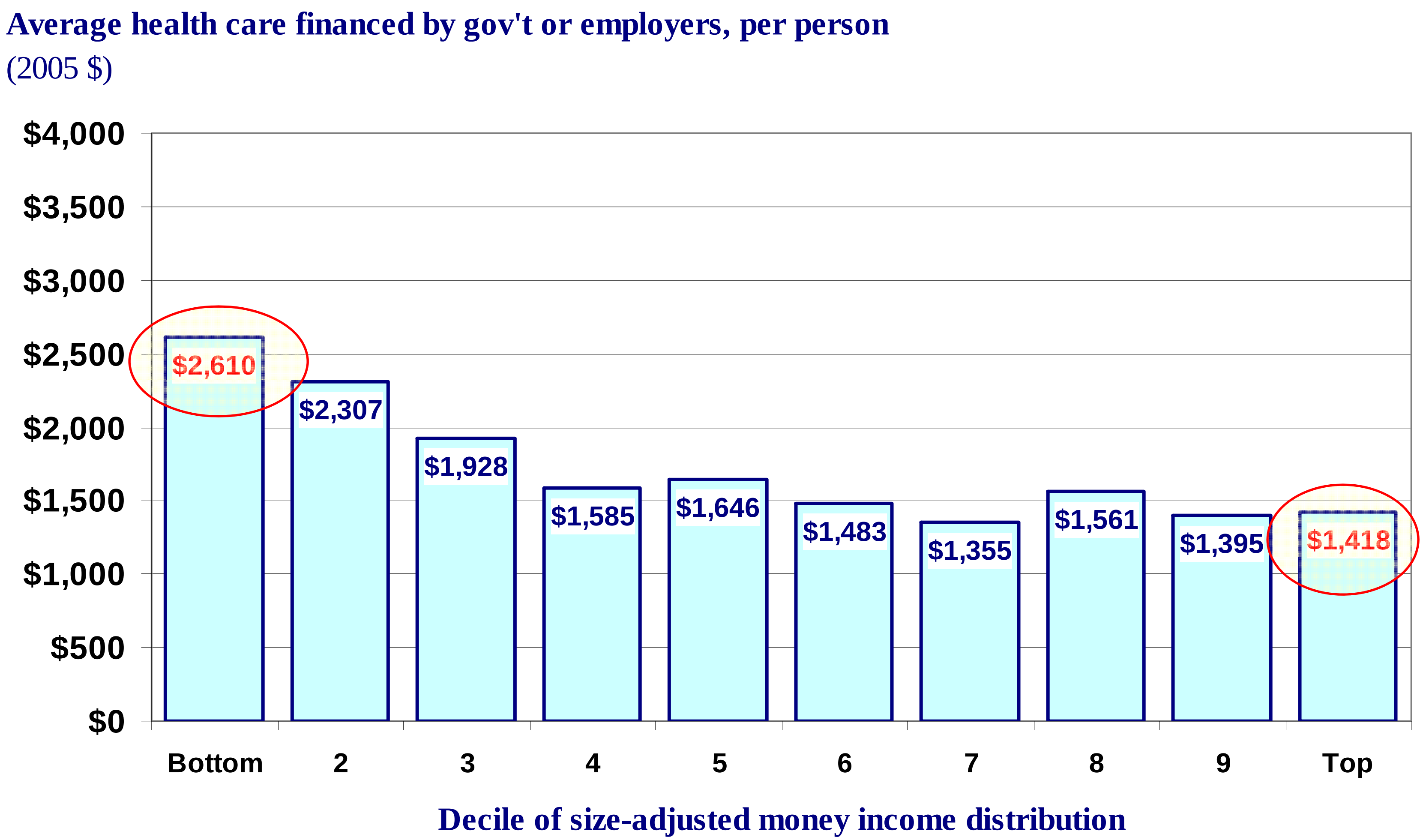
Sources: Piketty and Saez, tabulations of U.S. income tax data (2011); NIPA income data; and author's calculations.

Chart E. Personal Consumption Expenditures on Health Care Goods and Services, 1960-2007



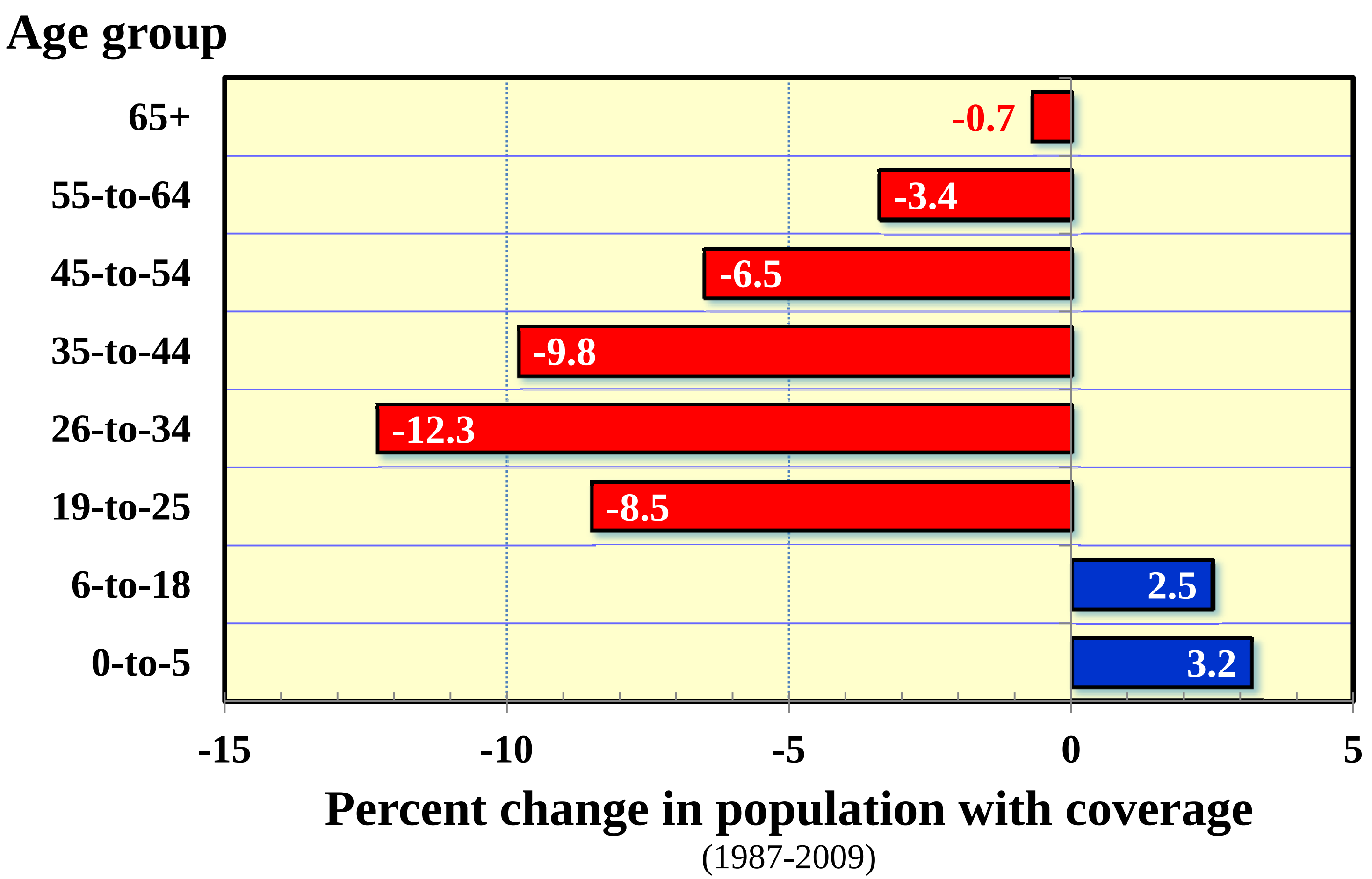
Source: NHEA and Consumer Expenditure Survey data.

Chart F. Total Health Expenditures Paid by the Government or through Employer Contributions (Per Person), by Money Income Decile, 2001-2005



Source: Author’s tabulations of 2001-05 MEPS files.

Chart G. Change in Health Insurance Coverage, by Age Group, 1987-2009

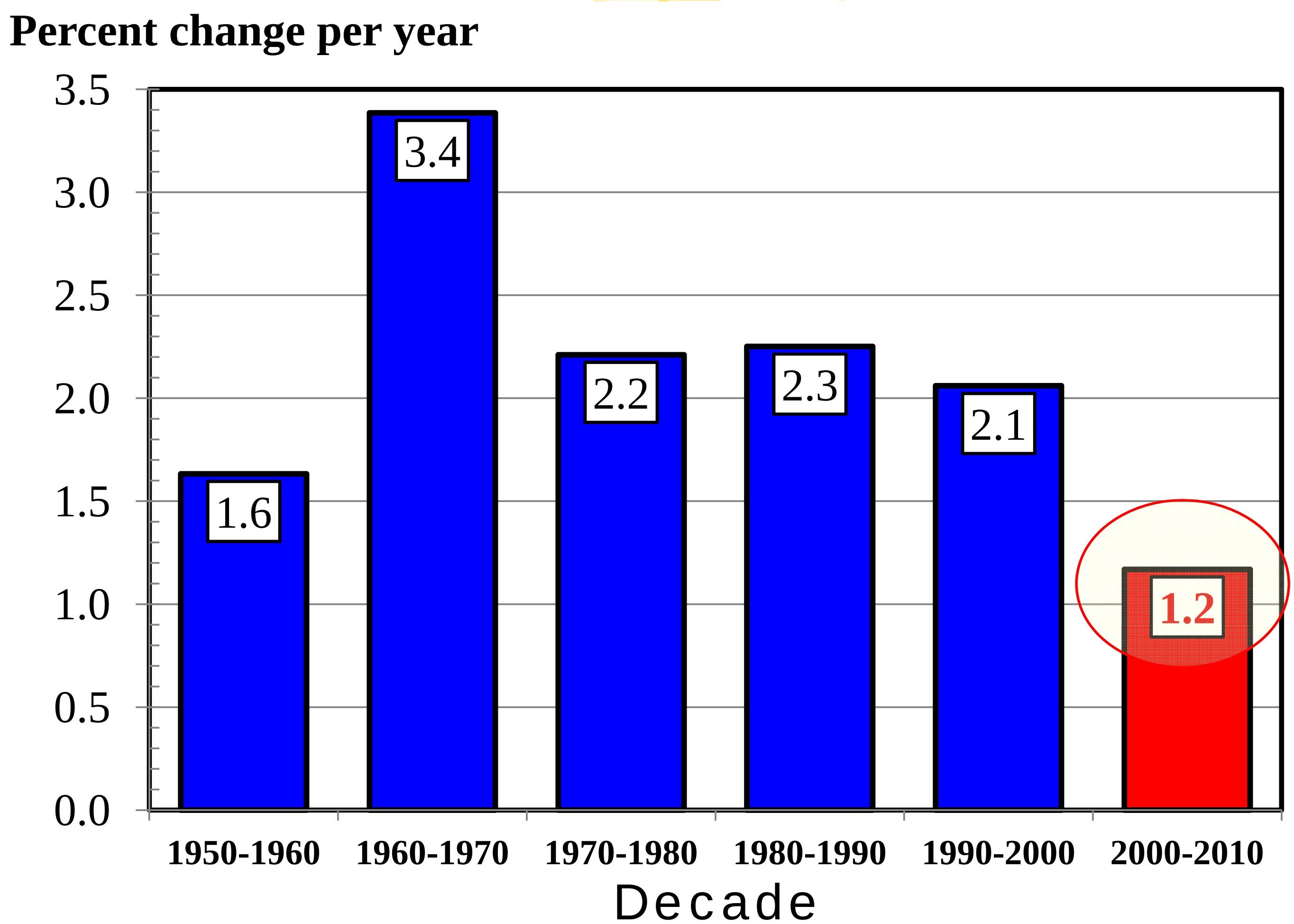


Source: U.S. Census Bureau, P-60 Reports.

Health consumption, income measurement, and the distribution of personal well-being

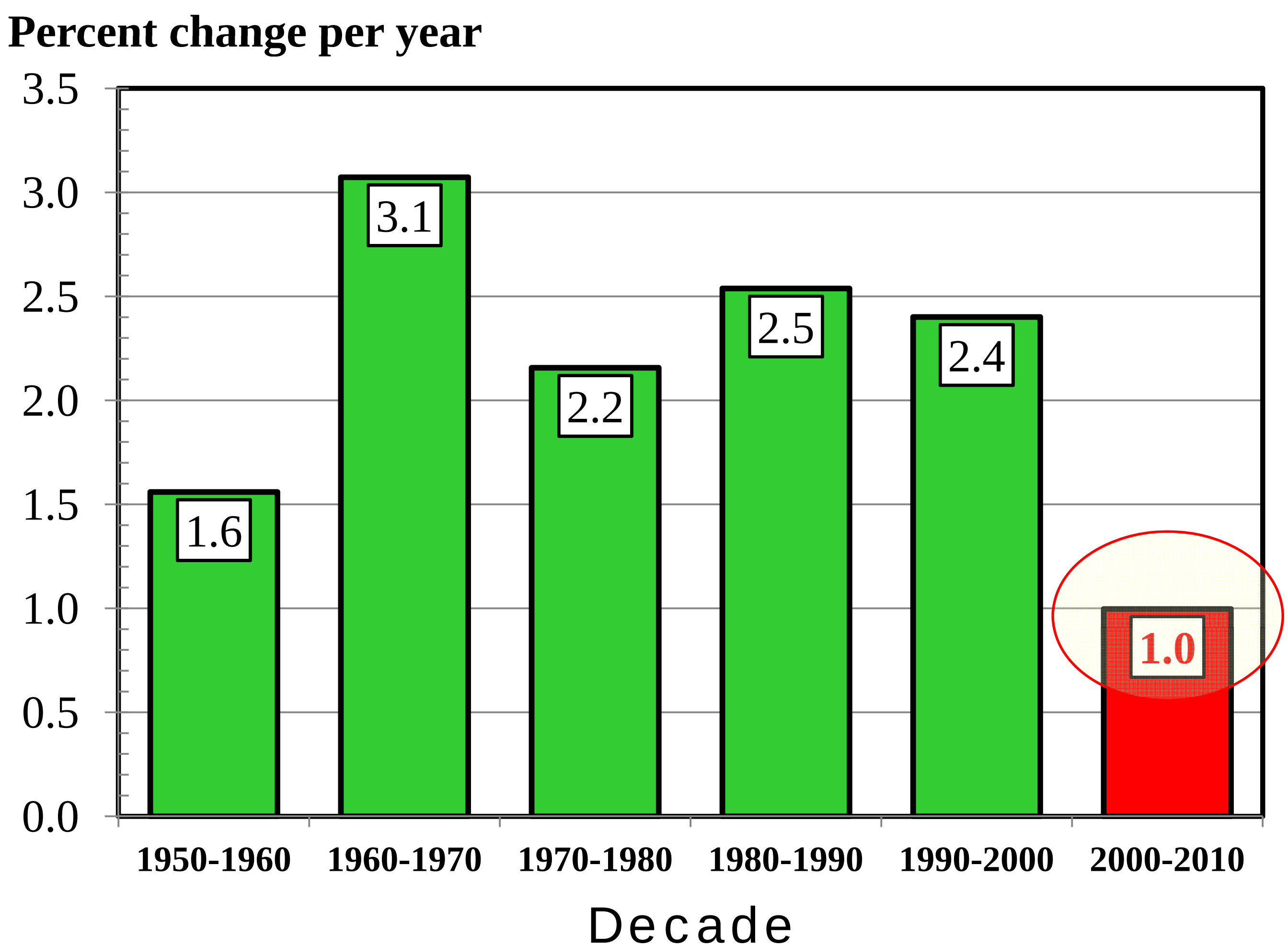
- Health care consumption has increased
- The share of health care financed out of households' cash incomes has declined
- The percentage paid with employer contributions and gov't-provided insurance has risen
- The increase in subsidies for insurance is much more economically significant in the lower ranks of the income distribution
- But health insurance coverage has fallen (adults)

Chart H. Annual Rate of Growth in Real (PCE-deflated) Personal Disposable Income per Person, by Decade, 1950-2010



Source: Dept. of Commerce, BEA: NIPA.

Chart I. Annual Rate of Growth in Real (PCE-deflated) Personal Consumption Expenditures per Person, by Decade, 1950-2010



Source: Dept. of Commerce, BEA: NIPA.