Federal Reserve report documents widening inequality in US

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Aggregate figures such as those published in the Federal Reserve report can be misleading, and can often distort as much as reveal economic trends. However, it is worth picking apart the data in some detail in order to uncover the reality behind the numbers.

The report includes two basic measures of economic well-being for US families: before-tax income and net worth. Both of these indicators are calculated using mean and median averages, and the report includes a breakdown of these figures by income percentile. The mean is the total income divided by the total number of US families, while the median is the point at which half of households make more and half make less.

According to the report, the mean family before-tax income in 2004 fell to $70,700, from $72,364 in 2001, after taking into account inflation. The median family income, on the other hand, rose only 1.6 percent over the three-year period, to $43,200. By contrast, federal figures from 1995 through 1998 indicate that mean family incomes rose by 12.3 percent. In the pre-recession period from 1998 to 2001, mean incomes rose another 17.3 percent.

The difference between the median and the mean figures for income ($43,200 as compared to $72,364) reflects the concentration of income in the hands of the top income-earners. If the distribution of income above the median were similar to the distribution below the median (as in a normal or bell curve), then one would expect the mean and median calculations to be roughly equal. However, while the median figure indicates that half of US families have a before-tax income of less than $43,200, the large earnings by a relatively small section at the very top are enough to pull up the mean substantially.

When analyzed across different sections of the population, the data present a deeper understanding of certain social dynamics in the US. For most sections of the population, both mean and median before-tax incomes remained relatively flat from 2001 to 2004—a product of the general stagnation or decline of wages. The decline in the mean figure is largely a consequence of the decline in pre-tax incomes for the top 10 percent of the population by income. Mean family income for this layer fell substantially, from $322,400 to $302,100, while median income rose from $180,600 to $184,800. The decline in mean income for the top 10 percent came after a sharp rise during the previous periods—from $215,800 in 1995, to $254,500 in 1998, to $322,400 in 2001.

The report attributed the decline to a fall in investment income, which goes largely to the wealthy. The drop in the stock market began in mid-2001, so 2001 incomes still reflect the elevated levels that preceded the fall—including the cashing-in of executive stock options and the like prior to the market's collapse.

While pre-tax income has likely been increasing for the top layer over the past two years—a fact that cannot be divined from the Fed's figures—by 2004 the investment incomes of the wealthy had still not come back to their 2001 peaks. A slight relative decline in the most wealthy sections of the population could bring the mean income of the top 10 percent down, while a general rise in the top bracket as a whole would cause the median income figure to rise. (The distribution of the top bracket here is becoming slightly more like a normal distribution, in which mean and median would be identical, although of course the distribution is still heavily skewed.)

Even with this decline, the top bracket still earns substantially more now than it did in 1998, while the same cannot be said for those at the bottom income levels. The bottom 20 percent of the population saw their mean income go from $8,200 in 1995, to $9,200 in 1998, to $10,700 in 2001, up to only $10,800 by 2004.

The stagnation of incomes for most Americans comes with a decline in real wages. The report notes that the absence of any income growth is largely due to a decline in median wages of 6.2 percent from 2001 to 2004. The Economic Policy Institute recently reported that between 2003 and 2005, only wage earners in the 95th percentile and higher saw any gains in real pay. If family income has not declined in the same way as real wages, this is due to an increase in hours worked to counterbalance falling pay.

The income figures by themselves, however, do not adequately measure the real dynamics of the past period. A closer look at the data on family net worth, which measures total assets against total liabilities, is more revealing. Net worth is in many ways a more accurate measure of the financial stability of US families, since it takes into account such things as debt burdens and increased expenditures.

Here we find a much different story. The median family net worth for the entire population rose by only 1.5 percent from 2001 to 2004. This small rise, however, itself masks the different experiences of the rich and poor. The median net worth, measured in 2004 dollars for families in the lowest quintile by income (the 20 percent of US families with the lowest income), went from $7,400 in 1995, to $6,800 in 1998, to $8,400 in 2001, to $7,500 in 2004. Families in the second quintile saw median net worth go from $41,300, to $38,400, to $39,600, to $34,300.

That is, median family net worth generally stagnated or declined for the bottom 40 percent of the population throughout the period. The drop in the second quintile in particular is astonishing—over 17 percent from 1995 to 2004, and over 13 percent from 2001 to 2004.

For a substantial section of the population, median net worth is negative; that is, their debts outweigh their assets. The mean net worth for the bottom 25 percent of the population as measured by net worth (rather than income, as in the figures above) in 2004 was -$1,400, down from $0 in 2001, and closer to the figure of -$2,100 in 1998.

On the other hand, median family net worth for the top 10 percent rose steadily throughout the period, from $436,900 in 1995, to $524,400 in 1998, to $887,900 in 2001, to $924,100 in 2004. The mean net worth for this group was substantially higher, rising from $1.3 million in 1995, to $1.8 million in 1998, to $2.4 million in 2001, to $2.5 million in 2004. For both mean and median figures, the top 10 percent of US families saw a growth of over 100 percent in family net worth since 1995.

Here we have an interesting disjuncture. Both median and mean net worth for the top 10 percent of the population rose from 2001 to 2004, while mean pre-tax income fell. In other words, the richest 10 percent are earning less income on average, but their overall wealth is actually increasing. What explains this dynamic? It is, at least in part, a consequence of the sharp cut in taxes for the very wealthy legislated in 2001. In spite of a decline in *pre-tax* income for some sections of the rich, they were able to increase their wealth because they took more of their income home than ever before.

The Federal Reserve report does not give after-tax income figures in this report. However, Internal Revenue Service data from last year showed that after-tax incomes for the top 1 percent of the population rose 8.5 percent from 2002 to 2003, while the after-tax income for the bottom 50 percent declined by 1.1 percent over the same period.

The other factor is the rise in property values. An increase in property values has helped push up net worth for the wealthy, who do not face the same sorts of debt problems as lower-income families. If there has been any rise in property values for less wealthy families, it has been balanced by a growth of debt financing.

As a whole, median household debt rose by more than a third over the three-year period, to $55,300. In 2001, families devoted an average of 12.9 percent of their incomes on debt service; by 2004, debt spending accounted for 14.4 percent of income The largest component of the increase in debt relative to assets came from debt secured by real estate, according to the Federal Reserve report, and the fraction of families that were late on payments for 60 days or more has risen sharply. Certainly, it is not the wealthy that are late on their mortgage payments.

The prevalence of interest-only loans, adjustable-rate mortgages and inflated home prices that propped up consumer spending and economic growth for the past five years are now expected by most economists to bear down on low-income mortgage-holders as interest rates rise and the housing market slows. In other words, the factors which to some extent fueled the economy during the past period—loose lending practices and consumer debt—now place millions of Americans in evermore precarious situations, even as the economy is supposedly in recovery.

The decline in income of the most wealthy sections of the population, which came with the stock market fall, helps explain the frenzy with which the American ruling class has been pursuing a policy of attacking jobs and social programs. American businesses have been slashing wages, outsourcing positions, and cutting, reneging, and defrauding pension funds. Tax cuts for the rich have been pushed through, and huge fortunes have been amassed; at the same time, programs serving average Americans have been cut, leaving struggling families with less protection from bankruptcy, foreclosure and homelessness.

All these measures have been attempts to counteract any fall in living standards of the American oligarchy through a ruthless redistribution of wealth up the economic ladder. Judging from the figures in this report, the ruling class appears to have succeeded thus far, but it has done so at the expense of an enormous growth in social tensions within the United States.