A GUIDE TO ECONOMIC INEQUALITY

April 2021

Policymakers, researchers, and commentators are constantly debating the nature and meaning of inequality in America. Depending on the data analyzed and the time frame applied, some conclude that inequality is skyrocketing, while others say it is falling. Some deem it the nation's most pressing problem, while others see little to worry about. Here, we provide a straightforward overview of what the data actually show and why it matters.

1. Inequality in America is wide and getting wider. Using the Gini coefficient, a basic measure of the dispersion of incomes, American inequality has been rising steadily for 50 years and is at its highest point of the post-World War II era. Inequality is higher in the U.S. than in any other developed country—closer to the level of Mexico or Costa Rica than to the OECD median.

2. The major problem is not the wide but the wider. A society with high levels of inequality can still be one where everyone is getting ahead. In America, that is not the case. Inequality is widening because the economic growth of recent decades has been unevenly shared, with the vast majority of gains going to those already at the top. Over the past 50 years, household incomes have grown three times faster for the top quintile than for the middle quintile.

3. As a result, only the wealthy are accumulating wealth. With income growth concentrated at the top, middle-income households have not successfully accumulated savings in recent decades, which also means they have not shared in the gains from rapidly rising asset values. Over the past 30 years, top-quintile households gained nearly $500,000 in liquid net worth on average (after excluding the top 1%), while households in the middle quintile saw their debt rise faster than their financial assets.

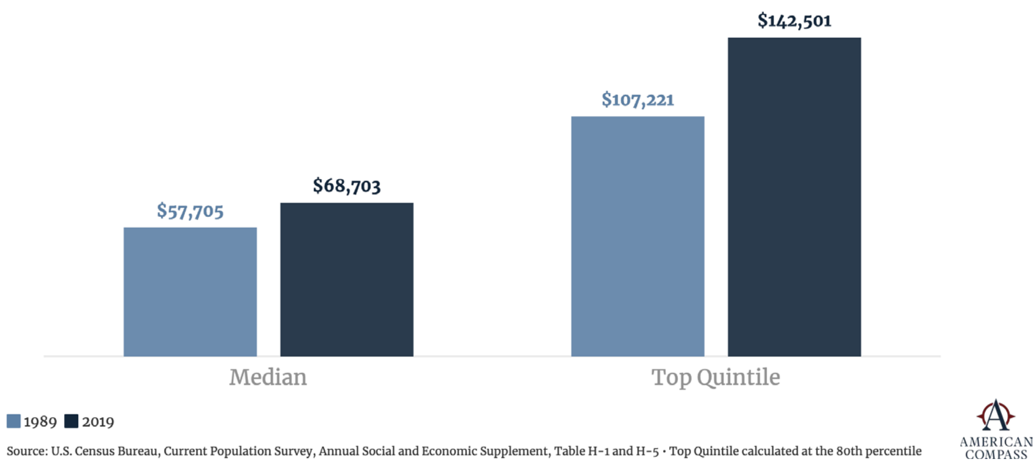
This is not the widespread prosperity that market capitalism is supposed to generate, and it is not an outcome that Americans at any income level should accept.

Part I. Income Inequality

Compare the typical American household at the median income to one further up the income ladder. According to the Census Bureau, our typical family saw its income grow from $58,000 in 1989 to $69,000 in 2019, after adjusting for inflation. A family at the 80th percentile saw its income grow almost twice as quickly, from $107,000 to $143,000.

Higher-income households have seen much larger income gains

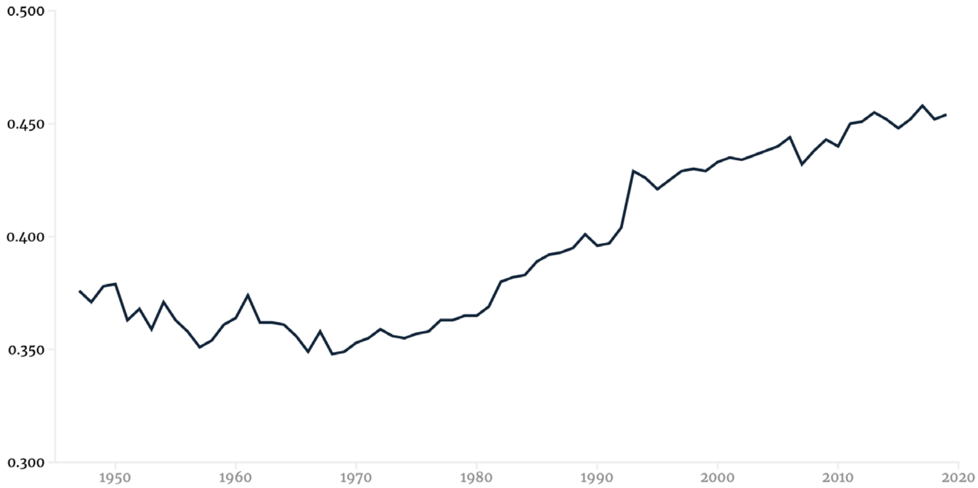
Household income (2019 dollars)



This pattern repeats throughout the income distribution, with the higher income tiers pulling away from those lower down. The Census Bureau calculates a standard measure of income inequality called the "Gini coefficient" and finds that it has been rising steadily in America for decades. Inequality is higher now than at any time since World War II.

Income inequality is at its highest point in nearly 75 years

U.S. Gini coefficient, 1947–2019

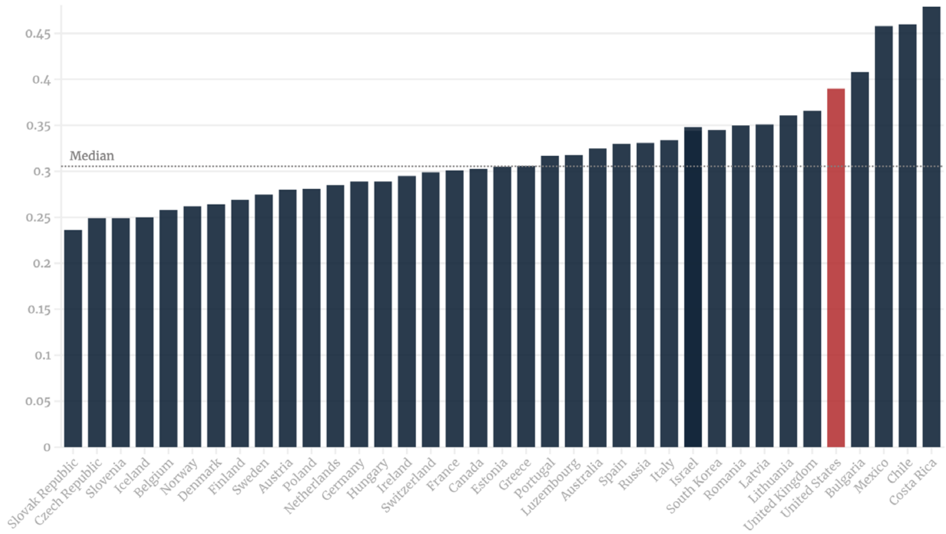


Source: U.S. Census Bureau

The American experience is an outlier. According to the OECD, which reports Gini coefficients for all of its members, the U.S. Gini coefficient is among the highest of any developed economy. Our level of inequality is closer to that seen in Latin America than in Europe.

American income inequality far outpaces other developed economies

International Gini coefficient, 2018 or latest available



Source: Organisation for Economic Co-operation and Development (OECD) • OECD Gini measure differs from U.S. Census Bureau figure
All data from 2016–2018

The problem with rising inequality is not that some people are doing well, but that others are falling behind. It suggests that our economy is failing to spread prosperity and that our gains are not being widely shared.

The longer such trends continue, the greater the threat to our social fabric, our political solidarity, and the legitimacy of our free-market system.

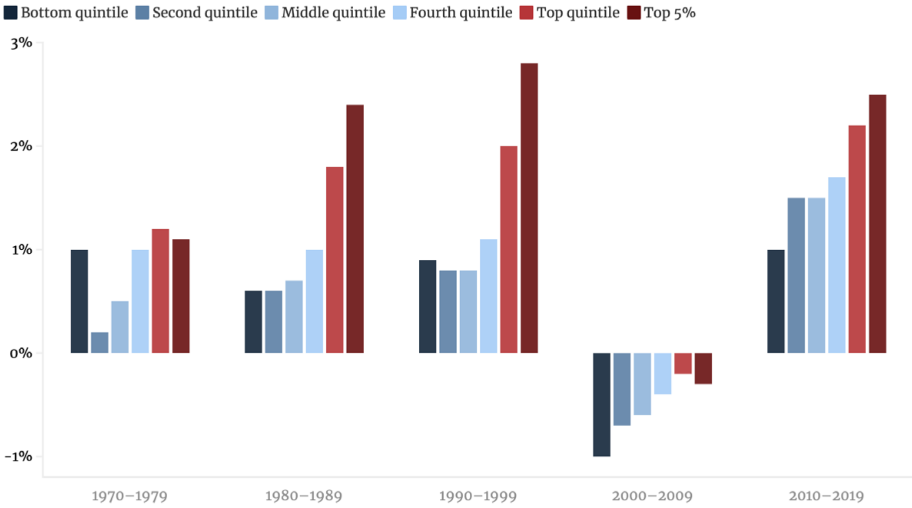
Part II. Rising Inequality Is Driven by Uneven Growth

Income inequality rises when those already earning higher incomes experience faster income growth. The American economy has delivered this result with remarkable consistency in recent decades, generating a strong correlation between income level and income growth.

We seem to take for granted that this is how things go, but there's no reason it should be the case—one could just as easily imagine a trend in which those at the top experienced the slowest growth and the income distribution compressed.

Higher-income households have consistently achieved higher income growth

Annualized growth of average real household income by quintile



Source: U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements, Table H-3

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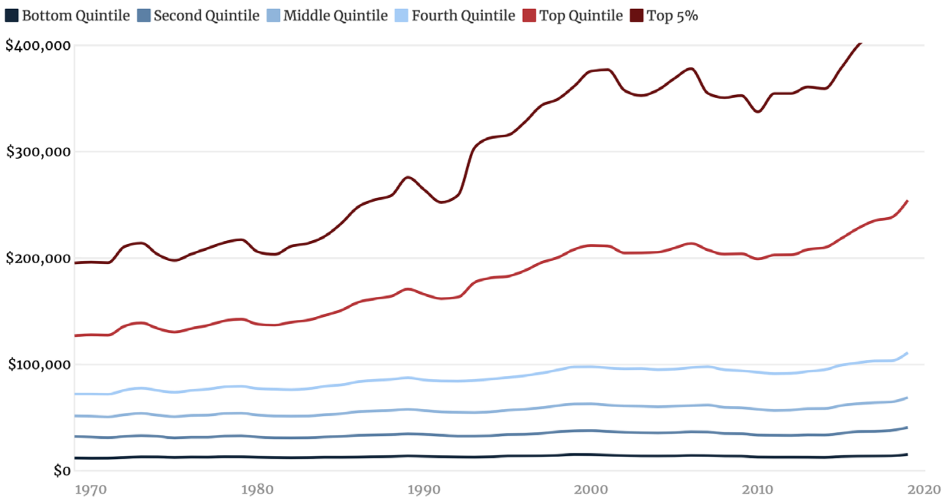
With faster growth at higher income levels, household incomes diverge. Over the past 40 years, the growth rate of household income in the top quintile has been three to four times faster than in the middle class.

Unequal growth rates lead to widening disparities

Mean household income, 2019 dollars



Source: U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplement, Table H-3

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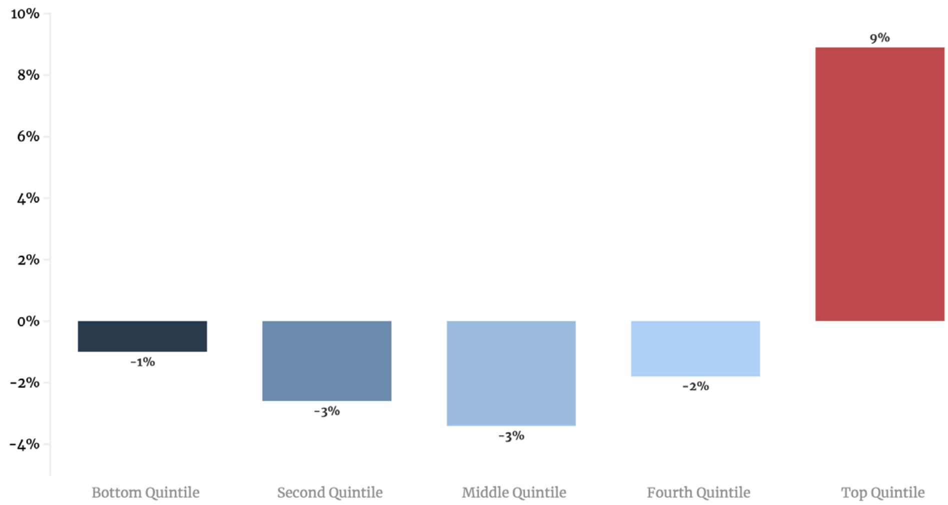
As a result, higher-earning households have seen their share of the nation's income rise while that of middle- and lower-class families has declined. All told, the top quintile increased its share of national income by 9 percentage points over the past 50 years and now earns the majority of the nation's income. All other quintiles saw their shares decline, with the middle quintile's 3-point loss the largest.

9% of national income shifted to the top, while the middle lost the most

Change in share of aggregate income by quintile, 1969–2019



Source: U.S. Census, Current Population Survey, Annual Social and Economic Supplement, Table H-2

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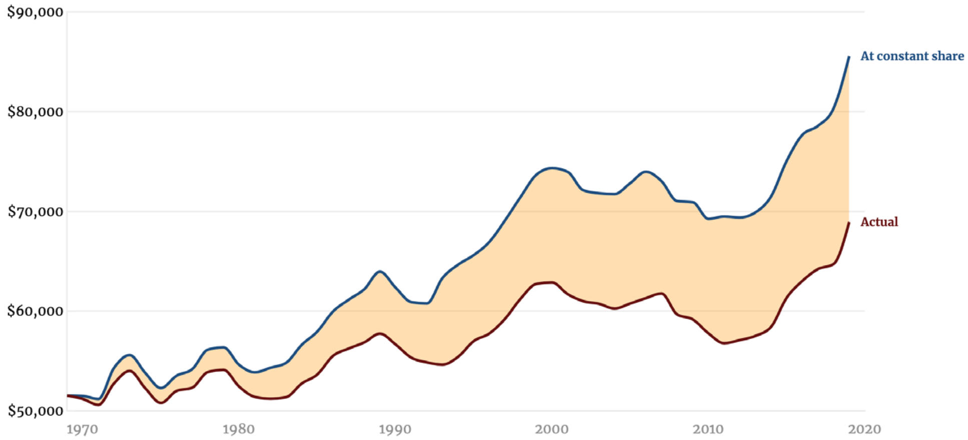
A 3-point decline in the middle quintile's share of national income may not sound like much, but it represents an enormous shift in earnings. If the middle class had shared equally in the economic growth of the past 50 years, maintaining its 17.5% share of national income instead of experiencing a decline to 14.1%, the typical household would earn an extra $17,000 annually.

A lower share of national income each year also adds up over time. Since 1990, the lower earnings associated with a declining share of national income has meant $337,000 less in cumulative income for the typical household.

A declining share of national income translates to lower household income

Average real middle-quintile household income, 2019 dollars



Source: U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplement, Tables H-2 and H-3
Constant-share income calculated as each year's income at 1969 share of national income

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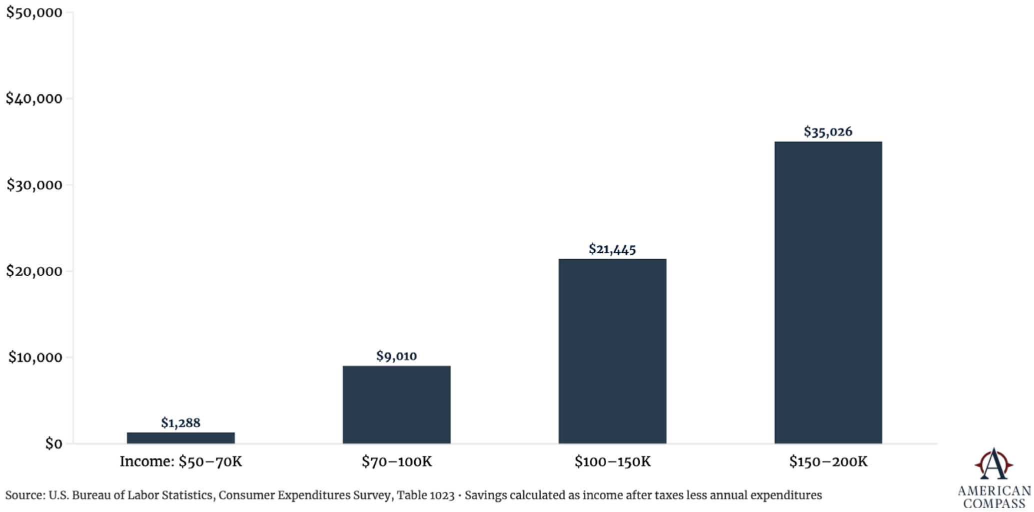
Part III. Uneven Growth Generates Enormous Wealth Gaps

Higher income translates to greater disposable income and thus a greater opportunity for saving, which accumulates over time. Government transfer programs help to meet the needs of households lower down the economic ladder, but they rarely provide the opportunity to amass reserves.

Households earning $50–70K save just $1,000 per year. Those earning $70–90K save almost 10 times more. Those earning $100–150K save 20 times more.

Income gains dramatically increase the ability to save

Average savings by income before taxes, 2019

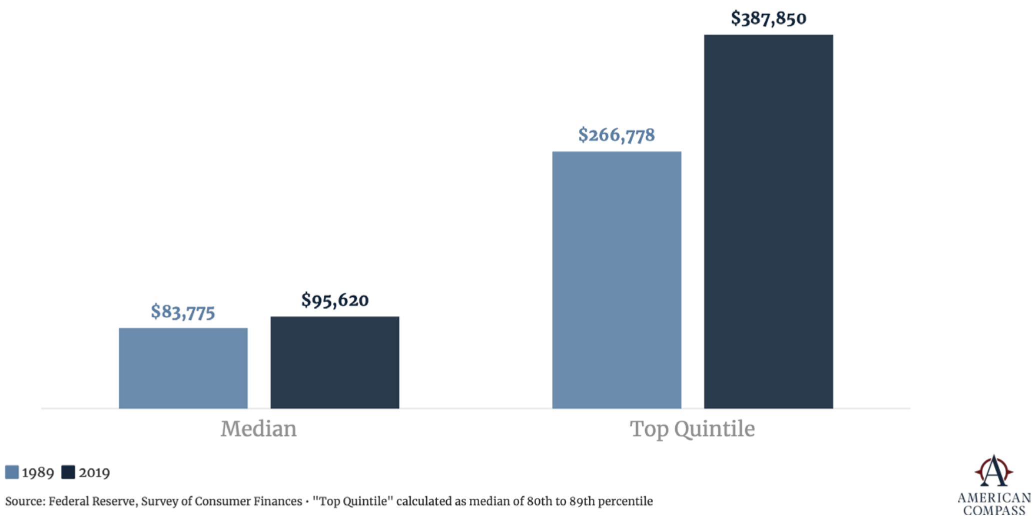


Source: U.S. Bureau of Labor Statistics, Consumer Expenditures Survey, Table 1023 · Savings calculated as income after taxes less annual expenditures

Thus, while the net worth for a median-income household rose by about $12,000 over the past 30 years, after adjusting for inflation, a household between the 80th and 90th percentile of income added 10 times as much wealth.

Higher-income households added wealth 3X faster

Household net worth (2019 dollars)

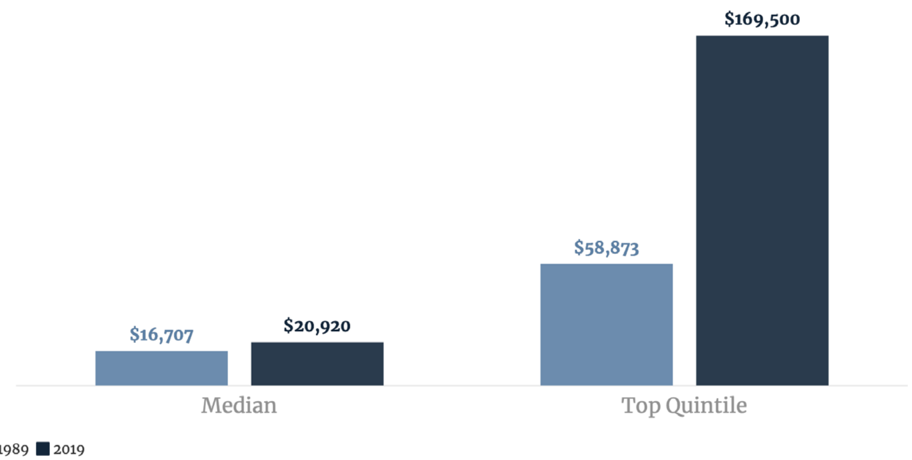


Source: Federal Reserve, Survey of Consumer Finances · "Top Quintile" calculated as median of 80th to 89th percentile

Estimates of net worth overstate the financial health of the typical family, though, because they include the value of the family's home. Rising home prices are encouraging, but so long as each household requires a house, selling one and using the money for something else isn't really an option. Other homes will have gone up in price, too. Looking at just financial assets—cash accounts, stocks, bonds, and so forth—the typical household has added almost no wealth in the past 30 years.

Wealth accumulated at the top while the middle class was left behind

Household financial assets (2019 dollars)



Source: Federal Reserve, Survey of Consumer Finances · "Top Quintile" calculated as median of 80th to 89th percentile
Data exclude households with no financial assets.

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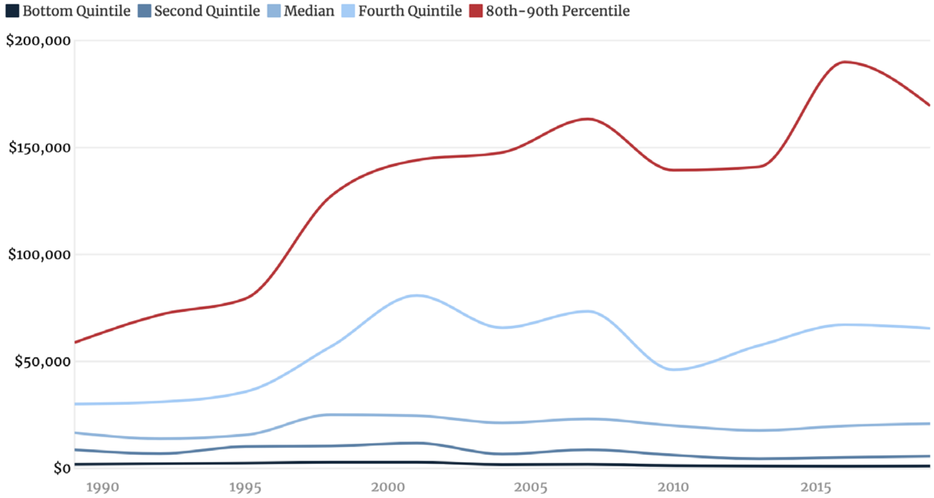
Across the income distribution, the pattern of wealth accumulation looks similar to that of income growth, only amplified. The bottom two quintiles see declines in wealth, while the middle quintile treads water. Meanwhile, the 80th–90th percentile experiences dramatic gains, and the top 10% is omitted from the chart entirely—its wealth is about five times higher still.

Only higher-income households have gained financial assets

Household financial assets by income level, 2019 dollars



Source: Federal Reserve, Survey of Consumer Finances
Data exclude households with no financial assets.

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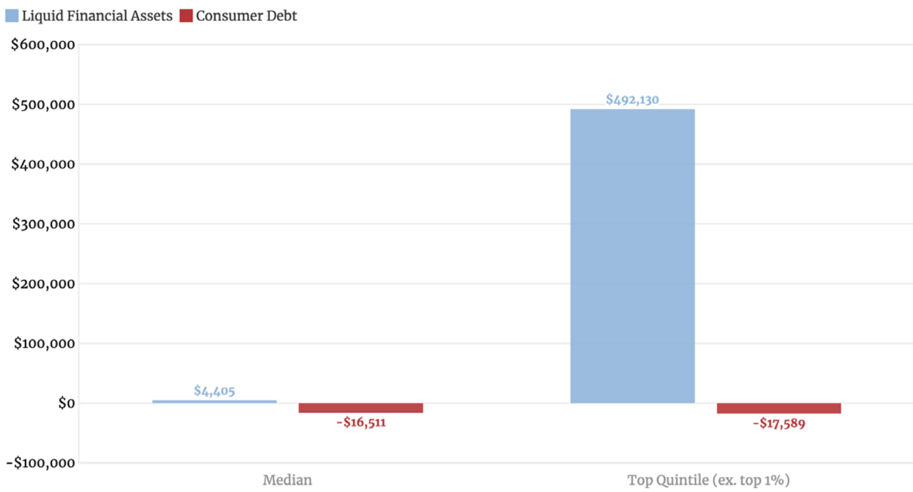
Middle-class households have managed to maintain some limited financial liquidity, but in the process they have doubled their levels of debt. Offset the small increase in liquid assets with the much much larger increase in debt, and 30 years of extraordinary economic growth for the nation as a whole translates to a worsening financial picture for the typical household. By contrast, the average top-quintile household (leaving out the top 1%) is up almost half a million dollars.

Factoring in debt, the middle class has lost ground

Change in average household wealth by income percentile, 1989–2019 (2019 dollars)



Source: Federal Reserve Distrbutional Financial Accounts · Median calculated as average of 40th to 60th percentile
Liquid Financial Assets include checkable deposts and currency, time deposits and short-term investments, money market fund shares, debt securities, and corporate equities and mutual fund shares. Adjusted for inflation with CPI.

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Whether these trends are sustainable, and what options policymakers have for altering the nation's economic trajectory, are among the vital policy debates for the years to come. ■

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ATLAS

Our Mission

To restore an economic consensus that emphasizes the importance of family, community, and industry to the nation's liberty and prosperity:

REORIENTING POLITICAL FOCUS from growth for its own sake to widely shared economic development that sustains vital social institutions.

SETTING A COURSE for a country in which families can achieve self- sufficiency, contribute productively to their communities, and prepare the next generation for the same.

HELPING POLICYMAKERS NAVIGATE the limitations that markets and government each face in promoting the general welfare and the nation's security.

Our Activities

AFFILIATION. Providing opportunities for people who share its mission to build relationships, collaborate, and communicate their views to the broader political community.

DELIBERATION. Supporting research and discussion that advances understanding of economic and social conditions and tradeoffs through study of history, analysis of data, elaboration of theory, and development of policy proposals.

ENGAGEMENT. Initiating and facilitating public debate to challenge existing orthodoxy, confront the best arguments of its defenders, and force scrutiny of unexamined assumptions and unconsidered consequences.

Our Principles

American Compass strives to embody the principles and practices of a healthy democratic polity, combining intellectual combat with personal civility.

We welcome converts to our vision and value disagreement amongst our members.

We work toward a version of American politics that remains inevitably partisan and contentious but operates from a common commitment to reinforcing the foundations of a healthy society.

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