Recent Trends in Living Standards in the United States

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The media have been aglow with reports of the booming economy and rising prosperity in the United States since the early 1990s. Indeed, the run-up in stock prices between 1995 and 2000 created the impression that all families were doing well in terms of income and wealth.[1] This, however, was certainly not the case. As I shall demonstrate, most American families have seen their level of well-being stagnate over the last quarter century.

Despite this recent boom, the last quarter of the twentieth century witnessed some disturbing changes in the standard of living and inequality in the United Sates. Perhaps, the grimmest news is that the real wage (average hourly wages and salaries of production and non-supervisory workers in the total private sector, adjusted for inflation) has been falling since 1973. Between 1973 and 1993, the real wage declined by 14 percent, though it since rose by 7 percent from 1993 to 2000, for a net change of -8 percent.[2] Changes in living standards have followed a somewhat different course. Median family income, after increasing by 13 percent in real terms between 1973 and 1989, fell back to its 1979 level in 1993, though it since grew by 17 percent between 1993 and 2000.[3] Despite falling real wages, living standards were maintained for a while

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[1] Over that time period, the S&P 500 Composite index increased by a factor of 2.5.

[2] These figures are based on the Bureau of Labor Statistics (BLS) hourly wage series. The source is: U.S. Council of Economic Advisers (1981, 2002). The BLS wage figures are converted to constant dollars on the basis of the Consumer Price Index (CPI-U). The CPI has recently been criticized for overstating the rate of inflation. While this may be true, it is not clear that the degree of bias in the CPI has risen in recent years. As a result, the sharp break in the wage series before and after 1973 would likely still remain even if the bias in the CPI is corrected. The Current Population survey (CPS) data are deflated to constant dollars using the new CPI-U-RS price index. The CPI-U-RS series makes quality adjustments for housing units and consumer durables such as automobiles and personal computers and employs a geometric mean formula to account for consumer substitution within CPI item categories. As a result, the CPI-U-RS deflator is not subject to the same criticisms as the CPI-U series.

[3] The data source is the U.S. Bureau of the Census, "Detailed historical income and poverty tables from the March Current Population Survey 1947-1998," available on the Internet at http://www.census.gov/hhes/income/histinc/.

by the growing labor force participation of wives, which increased from 41 percent in 1970 to 57 percent in 1988.[4] However, since 1989, married women entered the labor force more slowly and by 2000 their labor force participation rate had increased to only 61.3 percent, and with it, occurred a slowdown in the growth of real living standards.

Another troubling change was the turnaround in inequality witnessed in the United States over the last quarter of the twentieth century. Inequality in the distribution of family income, which had remained virtually unchanged since the end of World War II until the late 1960s, increased sharply since then. What makes the rise in inequality particularly worrisome is that not only has the **relative** share of income fallen among the bottom half of the income distribution but so has their **absolute** income as well. The poverty rate, which had fallen by half from a postwar peak in 1959 (the first year the poverty rate was computed) to 1973, has since risen.

The main source of the rising inequality of family income stems from changes in the structure of the labor market. Among male workers alone, wage disparities widened between the high-payed workers and the low-paid ones. Another indication of the dramatic changes taking place in the labor market is the sharp rise in the returns to education, particularly a college degree, that occurred during the 1980s and 1990s.

Current policy discussions in the U.S. and other advanced industrial countries have emphasized the need for better education of the labor force and the importance of the school-to-work transition. The underlying theme is that more education, more training, apprenticeship programs, and, in general, more skill creation will lead to a more productive labor force and hence higher wages and faster economic growth. Moreover, presumably, a more equal distribution of income will ensue from a more equal distribution of human capital.

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[4] The source for these data is the U.S. Bureau of the Census (2002).

There has now accumulated abundant evidence that individual workers benefit in the job market when they receive additional training and education. But it is much less clear that living standards will increase and economic inequality decline if the government enhances opportunities for Americans to improve their job skills. Indeed, this paper will explore the reasons for this by investigating two other underlying paradoxes: (1) Even as educational attainment has increased in recent decades, real wages have still fallen. (2) As educational opportunities have improved for a broader swathe of the U.S. population, economic inequality has not fallen but rather has increased.

The paper will attempt to weigh whether government investment in education and training would be more or less effective at alleviating economic inequality and strengthening the U.S. economy than direct subsidies to workers who are falling behind. Improved educational and training opportunities are essential for society for several reasons: (1) education provides benefits that transcend the job market, particularly a more knowledgeable citizenry for a democratic society (this was the original rationale for public education in the United States); (2) greater schooling and skills lead to more satisfying work opportunities; and (3) investment in training made by firms lowers worker turnover.

However, the evidence the paper will explore seems to show that such initiatives will not substantially alleviate inequality or bolster income. Confronting the inequality challenge may require direct subsidies to those at the bottom and tax relief for those workers in the middle who also have been falling behind. Labor law reform aimed at promoting unionization may also prove necessary to improve living standards for most workers.

1. Recent trends in income, poverty, and earnings

As shown in Figure 1, median family income (the income of the average family, found in the

middle of the distribution when families are ranked from lowest to highest in terms of income) grew by 25 percent in real terms between 1973 and 2000.[5] In contrast, between 1947 and 1973, median family income more than doubled. **Mean** family likewise doubled between 1947 and 1973, but then increased by 43 percent in the succeeding 27 years. This is less than the increase over the preceding quarter century but greater than the rise in median family income. The disparity between the two series is due to differences in time trends between the mean and median. While mean and median income rose at about the same pace before 1973, mean income grew at a much faster rate than median income after 1973. The discrepancy stems from rising inequality since the early 1970s (see below).

Another issue concerns the use of the new CPS deflator, the so-called CPI-U-RS price index. As noted in footnote 2, the CPI-U-RS deflator incorporates quality and other adjustments. However, the adjustments are made only for 1978 to the present. The CPI-U index is used for years prior to 1978. As a result, the CPI-U-RS shows a much slower rate of inflation after 1973 than the CPI-U: 288 versus 238 percent. If we use the CPI-U deflator, then median family income grew by 9 percent between 1973 and 2000, in comparison to the 25 percent growth rate on the basis of the CPI-U-RS deflator.

Another troubling change is with regard to poverty. Between 1959 and 1973, there was great success in reducing poverty in America, with the overall poverty rate declining by more than half, from 22.4 to 11.1 percent (see Figure 2). After that, the poverty rate generally trended upward, climbing to 15.1 percent in 1993, but it has since fallen back to 11.3 percent in of 1998, still above

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[5] The data source is the U.S. Bureau of the Census, "Detailed historical income and poverty tables from the March Current Population Survey 1947-1998", available on the Internet at (see footnote 3).Figures are in 2000 dollars unless otherwise indicated. It would actually be preferable to use **household** income rather than **family** income. Unfortunately, official U.S. Bureau of the Census series on household income begins only in 1967, whereas family income data are available from 1947 onward.

its low point in 1973. [6] Another indicator of the well-being of lower income families is the share of total income received by the bottom quintile (20 percent) of families. At first, their share fell, from 5.0 percent in 1947 to 4.7 percent in 1961, but then rose rather steadily over time, reaching 5.7 percent in 1974. Since then it has fallen off rather sharply, to 4.3 percent in 2000.

A related statistic is the mean income of the poorest 20 percent of families (in 1995 dollars), which shows the absolute level of well-being of this group (the share of income shows the **relative** level of well-being). Their average income more than doubled between 1947 and 1974, from $6,300 to $12,700 (both in 2000$), but then rose only by 12 percent, to $14,200 in 2000. The difference in post-1974 trends between this series and the share of income of the bottom quintile, which fell sharply, is that mean income was rising in the general population after 1974.

The main reason for this turnaround is that the real hourly wage (average wages and salaries of production and non-supervisory workers in the total private sector adjusted for inflation) has been falling since 1973. Between 1973 and 2000, the BLS real hourly wages fell by 8 percent (see Figure 3). This contrasts with the preceding years, 1947 to 1973, when real wages grew by 75 percent. Indeed, in 2000, the hourly wage was $14.08 per hour, about the same level as in 1968 (in real terms).[7]

Other measures of worker pay are shown in Figure 3. The results are quite consistent among these alternative series. Average wages and salaries per FTEE grew by 2.3 percent per year

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[6] The data source for this section is the U.S. Bureau of the Census, "Detailed historical income and poverty tables from the March Current Population Survey 1947-1998", available on the Internet (see Footnote 3).

[7] The first series is based on the Bureau of Labor Statistics' hourly wage series and refer to the wages and salaries of production and non-supervisory workers in the total private sector. The next three wage series are the National Income and Product Accounts wages and salaries per full-time equivalent employee (FTEE), employee compensation (the sum of wages and salaries and employee benefits) per FTEE, and employee compensation plus half of proprietors' income per person engaged in production (PEP). The fifth series comes from the Current Population Survey (CPS). The first four series are deflated to constant dollars using the CPI-U price index. The fifth uses the CPI-U-RS deflator (see footnote 2 above).

from 1947 to 1973 and then 0.3 percent per year from 1973 through 2000; average employee compensation per FTEE increased by 2.6 percent per year during the first of these two periods and then by 0.4 percent per year in the second; and the sum of employee compensation and half of proprietors' income had an annual gain of 2.7 percent in the first and 0.4 percent in the second.[8] CPS mean earnings for year-round, full-time workers grew at an annual rate of 2.7 percent from 1960 to 1973 and by 0.0 percent from 1973 through 2000.

The United States has also witnessed a disagreeable turnaround in inequality over the last quarter century. Figure 4 shows different indices measuring economic inequality in America. The first series is the Gini coefficient for family income. The Gini coefficient ranges from a value of zero to one, with a low value indicating less inequality and a high value more. Between 1947 and 1968, it generally trended downward, reaching its lowest value in 1968, at 0.348. Since then, it has experienced an upward ascent, gradually at first and then more steeply in the 1980s and 1990s, culminating at its peak value of 0.430 in 2000.[9]

The second index, the share of total income received by the top five percent of families, has a similar time trend. It fell gradually, from 17.5 percent in 1947 to 14.8 percent in 1974 and then rose after this point, especially in the 1990s, reaching its highest value in 2000, 20.8 percent. The third index is the ratio of the average income of the richest 5 percent of families to that of the poorest 20 percent. It measures the spread in income between these two groups. This index generally declined between 1947 and 1974, from 14.0 to 10.4, and then trended steadily upward,

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[8] The reason for including only a portion of proprietors' income is that part of the income of self-employed workers is a return on the capital invested in unincorporated businesses. Alternative calculations show that the resulting time-series is quite insensitive to the fraction used in the calculation.

[9] The data source for the first three series in Figure 3 is the U.S. Bureau of the Census, "Detailed historical income and poverty tables from the March Current Population Survey 1947-1998", available on the Internet (see footnote 3). These figures are based on unadjusted data.

reaching 19.7 in 1998, and then declined slightly to 19.1 in 2000.[10]

Figure 5 shows another cut on family income inequality, based on "equivalent income." Equivalent income is based on the official U.S. poverty line, which, in turn, adjusts family income for family size and composition (the number of individuals age 65 and over, the number of adults, and the number of children in the family unit). A figure of 3.0, for example, indicates that the income of a family is three times the poverty line that would apply to their family size and composition. The series begins in 1967 only. [11]

It is first of interest to compare the trend in the equivalent income index of the middle quintile with that of median family income. The former rose by 18.0 percent from 1967 to 1973 and by 16.8 percent from 1973 to 2000. In comparison, median family income increased by 16.7 percent in the first period and by 25.0 percent in the second. The difference in growth rates after 1973 reflects the difference in price indices. Whereas the calculation of equivalent income is based on the CPI-U deflator (as is the computation of the poverty rate), CPS median family income is indexed by the CPI-U-RS deflator (see above). Indeed, as indicated above, median family income grew by only 9 percent in real terms between 1973 and 2000 if the CPI-U deflator is used. The faster increase in equivalent income than median family income deflated by the CPI-U price index over the 1973-2000 period is consistent with the fact that average family size fell over the period. It is also of note that the annual growth of equivalent income slowed down for each of the five

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[10] It would have been preferable to compare the average income of the top five percent with that of the bottom 5 percent but figures for the latter are not available.

[11] The data are from the U.S. Bureau of the Census, "Detailed historical income and poverty tables from the March Current Population Survey 1947-1998", available on the Internet (see Footnote 3). The average income-to-poverty ratios are computed by dividing the mean income of families in each quintile (as ranked by family income) by the mean poverty threshold of the families in that quintile. It would have been preferable to compute equivalent income for each family in the sample and then rerank the sample by equivalent income to obtain new "equivalent income" quintiles but the underlying data are not available.

income quintiles between the two periods. In the case of the middle quintile, the annual growth rate was 1.20 percent in 1967-1973 and 0.25 percent in the 1973-2000 period.

From the standpoint of inequality, the most telling result is that between 1973 and 2000, equivalent income grew faster the higher the income level. The differences are quite marked. Equivalent income increased by 54 percent among families in the highest quintile, 26 percent in the fourth quintile, 17 percent in the middle quintile, 8 percent in the second quintile, and a **negative** 0.9 percent in the bottom quintile.

I also show trends in marginal tax rates of the personal income tax, since this also affects the well-being of families (see Figure 6). The first series is the top marginal tax rate (the marginal tax rate faced by the richest tax filers). Back in 1944, the top marginal tax rate was 94 percent! After the end of World War II, the top rate was reduced to 86.5 percent (in 1946), but during the Korean War it was soon back to 92 percent (in 1953). Even in 1960, it was still at 91 percent. This generally declined over time, as various tax legislation was implemented by Congress. It was first lowered to 70 percent in 1966, then raised to 77 percent in 1969 to finance the War in Vietnam, then lowered again to 70 percent in 1975, then to 50 percent in 1983 (Reagan's first major tax act), and then again to 28 percent in 1986 (through the famous Tax Reform Act of 1986). Since then, it has trended upward, to 31 percent in 1991 (under President Bush) and then to 39.6 percent in 1993 (under President Clinton).

The second series shows the marginal tax rate faced by filers with an income of $135,000 in 1995 dollars. This income level typically includes families at the ninety-fifth percentile (the top five percent). This series generally has the same trajectory as the first, declining in 1966, rising in 1975, falling in 1983 and 1986, and then increasing in 1991 and again in 1993.

The last two series show the marginal tax rates at $67,000 and $33,000, respectively, both

in 1995 dollars. The time patterns are quite a bit different for these than the first two. The marginal tax rate at $67,000 (about the sixtieth percentile) was relatively low in 1946, at 36 percent, generally trended upward, reaching 49 percent in 1980, before declining to 28 percent in 1986, where it has remained ever since. The marginal tax rate at $33,000 (about the thirtieth percentile) was also relatively low in 1946, at 25 percent, but it actually increased somewhat over time, reaching 28 percent in 1991 and since remaining at this level.

All in all, tax cuts over the postwar period have been much more generous for the rich, particularly the super-rich. Since 1946, the top marginal tax rate has fallen by more than half (54 percent), the marginal rate at $135,000 by 32 percent, and the marginal rate at $67,000 by 35 percent, while the rate at $33,000 actually increased by 13 percent.

2. Trends in schooling and earnings

One of the great success stories of the postwar era is the tremendous growth in schooling attainment in the U.S. population. This is documented in Figure 7.[12] Median years of schooling among all people 25 years old and over grew from 9.0 years in 1947 to 13.6 in 2000. Most of the gain occurred before 1973. Between 1947 and 1973, median education increased by 3.3 years and from 1973 to 2000 by only another 1.3 years.

Trends are even more dramatic for the percentage of adults (age 25 and over) who completed high school and college. The former grew from 33 percent of all adults in 1947 to 84 percent in 2000. Progress in high school completion rates was almost as strong after 1973 as before -- from 33 percent in 1947 to 60 percent in 1973 and from 60 percent in 1973 to 84 percent in 2000.

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[12] The data are from the U.S. Bureau of the Census, "Detailed historical income and poverty tables from the March Current Population Survey 1947-1998", available on the Internet (see Footnote 3). Adults refer to persons 25 of age and over in the non-institutional population (excluding members of the Armed Forces living in Barracks).

The percent of college graduates in the adult population soared from 5.4 percent in 1947 to 26.2 percent in 2000. In this dimension, progress was actually greater after 1973 than before. Between 1947 and 1973, the percentage of adults who had graduated college rose by 7.2 percentage points, while between 1973 and 2000, it grew by 13.6 percentage points.

Figure 7 also shows the trend in real hourly wages between 1947 and 2000. As noted above, it rose by 75 percent between 1947 and 1973 and then declined by 8 percent in the ensuing 27 years. Yet, educational attainment continued to rise after 1973 and, indeed, in terms of college graduation rates even accelerated. This is the first paradox noted above, the growing discordance between wages and skills.

The main source of the rising inequality of family income stems from changes in the structure of the labor market. One indication of the dramatic changes taking place in the labor market is the sharp rise in the returns to education, particularly a college degree, that occurred during and after the 1980s. This trend is documented in Figure 8.[13] Among males, the ratio in annual earnings between a college graduate and a high school graduate increased slightly between 1975 and 1980, from 1.50 to 1.56, and then surged to 1.95 in 2000. For females, the ratio actually dipped slightly between 1975 and 1980, from 1.45 to 1.43, before climbing to 1.81 in 2000.

Among men, the increase in the return to a college degree relative to a high school degree was due, in part, to the stagnating earnings of high school graduates (see Figure 9). Between 1975 and 2000, their annual earnings (in 2000 dollars) gained only 4 percent, while the earnings of men with a bachelor's degree (but not further schooling) increased by 26 percent. The biggest increase in earnings occurred among males with an advanced degree (master's or higher), who saw their annual

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[13] The figures are for annual earnings, which are not adjusted for hours worked or the experience level of the workers. The source for the data in Figure 6, as well as the next three figures, is the U.S. Bureau of the Census, "Detailed historical income and poverty tables from the March Current Population Survey 1947-1998", available on the Internet (see Footnote 3).

incomes grow by 30 percent. Among males who did not graduate high school, earnings plummeted by 9 percent.

Another indicator of the country's success in education is the dramatic decline in the inequality of schooling in this country. According to the human capital model, there is a direct and proportional relationship between earnings inequality and the variance of schooling. From the standard human capital earnings function,

$$\text{Log } E_i = b_0 + b_1 S_i$$

where E_i is the earnings of individual i, Log is the natural logarithm, S_i is i's level of schooling, and b_0 and b_1 are coefficients (see, for example, Mincer, 1974). This equation states that labor earnings should rise with years of schooling. It then follows that:

$$\text{Var(Log } E) = b_1^2 \text{ Var(S)},$$

where Var is the variance. The variance of the logarithm of earnings is a standard inequality index used in the economics literature, and this equation indicates that earnings inequality rise at the same rate as that of the variance (or dispersion) of schooling levels among workers.

Yet, as shown in Figure 10, while income inequality has risen since the late 1960s, the variance of schooling (of adults 25 years of age or older, computed from CPS data), has trended sharply downward since 1950. In fact, the variance of schooling fell by 48 percent over the period from 1950 to 2000 (from 12.5 to 6.9). The simple correlation between the two series is, in fact, -0.78. This finding leads to the second paradox of the paper -- namely, the growing discord between the inequality of income and the inequality of human capital.

3. Trends in productivity and profitability

Another anomaly arises when we consider the relation between productivity and earnings. In particular, the historical connection between labor productivity growth and real wage growth also appears to have broken down after 1973. In the case of an economy characterized by competitive input markets and constant returns to scale, it follows that wages and labor productivity should grow at exactly the same rate:

$$w = \vartheta X / \vartheta L = \alpha_L X / L$$

where X is total output, L is total employment, and α_L is output elasticity of laobr, which equals the wage share in this special case.

From 1947 to 1973, real wages grew almost in tandem with the overall labor productivity growth (see Figure 11).[14] Indeed, the correlation coefficient between GDP per FTEE and employee compensation per FTEE is 1.00 for this period.

Labor productivity growth plummeted after 1973. Between 1947 and 1973, it averaged 2.0 percent per year, while from 1973 to 2000 it averaged about 0.9 percent per year. The period from 1973 to 1979, in particular, witnessed the slowest growth in labor productivity during the postwar, 0.5 percent per year, and the growth in real employee compensation per FTEE actually turned negative during this period. Since 1979, the U.S. economy experienced a modest reversal in labor productivity growth, which averaged 1.0 percent per year by both measures from 1979 to 1997, while real wage growth was 0.6 percent per year. Consequently, for the 1973-2000 period, the correlation coefficient between labor productivity and real earnings are lower than in the early postwar period -- a value of 0.88.

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[14] Results are shown for employee compensation per FTEE. Results are almost identical for employee compensation plus half of proprietors' income per PEP

If productivity rose faster than earnings after 1973, where did the excess go? The answer is increased profitability in the United States. The basic data are from the U.S. Bureau of Economic Analysis' National Income and Product Accounts, as well as its series on net capital stock. For the definition of net profits, I use the total gross property-type income, including corporate profits, interest, rent, and half of proprietors' income. The definition excludes the Capital Consumption Allowance (CCA). The net rate of profit is defined as the ratio of total net property income to total private net fixed capital. The net profit rate declined by 7.5 percentage points between 1947 and its nadir, 13.1 percent in 1982 (see Figure 12). It then climbed by 6.0 percentage points from 1982 to 1997, though it fell off by 0.5 percentage points between 1997 and 2000. However, even by 2000, it reached 18.6 percent, well above its low point in 1982.

Figure 12 also shows trends in the net profit share in national income. It rose by 2.4 percentage points between 1947 and its peak value of 32.0 percent in 1950 and then fell by 7.2 percentage points between 1950 and its low point of 24.8 percent in 1970. It then generally drifted upward, rising by 4.2 percentage points between 1970 and its next high point of 29.1 percent in 1997. Since then, it fell off by 1.7 percentage points between 1997 and 2000, though the net profit share was still above is nadir in 1970. The results clearly show that the stagnation of earnings in the U.S. since the early 1970s has translated into rising profits in the economy.

4. Household wealth.

As noted in the Introduction to the paper, the media has promoted the idea of people's capitalism -- that all families are benefiting from the stock market boom of recent years. In this section, I look at recent trends in household wealth. I use marketable wealth (or net worth), which is defined as the

current value of all marketable or fungible assets less the current value of debts. Net worth is thus

the difference in value between total assets and total liabilities or debt. Total assets are defined as

the sum of: (1) the gross value of owner-occupied housing; (2) other real estate owned by the

household; (3) cash and demand deposits; (4) time and savings deposits, certificates of deposit, and

money market accounts; (5) government bonds, corporate bonds, foreign bonds, and other financial

securities; (6) the cash surrender value of life insurance plans; (7) the cash surrender value of

pension plans, including IRAs, Keogh, and 401(k) plans; (8) corporate stock and mutual funds; (9)

net equity in unincorporated businesses; and (10) equity in trust funds. Total liabilities are the sum

of: (1) mortgage debt, (2) consumer debt, including auto loans, and (3) other debt.

I first look at long-term trends in average wealth on the basis of the Federal Reserve

Board's Flow of Funds data.[15] Average household wealth, after surging by 42 percent over the

1947-1973 period, gained only another 10 percent between 1973 and 1995, though it added an

additional 28 percent from 1995 to 2000, mainly because of the stock market boom of the late

1990s (Figure 13). The total gain from 1973 to 1998 was 30 percent. This compares to a 43 percent

increase in mean family income over the same period.

Trends in wealth inequality, as measured by the share of total personal wealth owned by

the richest one percent of households, are displayed in Figure 14.[16] The share of the top percentile

generally trended downward from 31.1 percent in 1947 to 21.8 percent in 1976 and then rose

steeply thereafter, reaching 38.1 percent in 1998 (the last date available). In contrast, the share of

total income received by the top five percent of families fell moderately from 17.5 percent in 1947

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[15] The source is the Board of Governors of the Federal Reserve Board of Washington, Flow of Funds
data, available on the Internet at http://www.federalreserve.gov/releases/z1/Current/data.htm.

[16] The source for the wealth series is: Wolff (1996), extended to 1998 using data from the Federal Reserve Board's
1998 Survey of Consumer Finances (see below).

to its low point of 14.8 percent in 1974 and then climbed to 20.7 percent in 1998. Changes in wealth inequality have thus been more marked than those in income disparities.

I next focus on the period from 1983 to 1998. The data sources used for this part of the study are the 1983, 1989, 1992, 1995, and 1998 Survey of Consumer Finances (SCF) conducted by the Federal Reserve Board of Washington. Each survey consists of a core representative sample combined with a high-income supplement, which is drawn from the Internal Revenue Service's Statistics of Income data file. The survey questionnaire consists of hundreds of questions on different components of family wealth holdings. Though there are other data sources available for analyzing household wealth in the U.S., the SCF is the best one for capturing both the wealth at the top of the distribution and the complete wealth portfolio of households in the middle.[17]

Perhaps, the most striking result from Table 1 is that median wealth (the wealth of the household in the middle of the distribution) was only 11 percent greater in 1998 than in 1983. After rising by 7 percent between 1983 and 1989, median wealth fell by 17 percent from 1989 to 1995 and then rose by 24 percent from 1995 to 1998. Overall, it grew by only 3.8 percent between 1989 and 1998. One reason for the slow growth in median wealth is evident from the third row of Table 1, which shows that the percentage of households with zero or negative net worth increased from 15.5 percent in 1983 to 18.0 percent in 1998. The share of households with net worth less than $5,000 and less than $10,000 (both in 1998 dollars) also rose over the period.

Mean wealth is much higher than the median -- $270,000 versus $61,000 in 1998. This implies that the vast bulk of household wealth is concentrated in the richest families. Mean wealth also showed a sharp increase from 1983 to 1989 followed by a rather precipitous decline from 1989

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[17] Full technical details on data sources and methods can be found in Wolff (2001).

Table 1. Mean and Median Wealth and Income. 1983-1998						
(In thousands, 1998 dollars)						Percent Change
	1983	1989	1992	1995	1998	1983-1998
A. Net Worth						
1. Median	54.6	58.4	49.9	48.8	60.7	11.1
2. Mean	212.6	243.6	236.8	218.8	270.3	27.1
3. Percent with net worth						
a. Zero or negative	15.5	17.9	18.0	18.5	18.0	
b. Less Than $5,000[a]	25.4	27.6	27.2	27.8	27.2	
c. Less Than $10,000[a]	29.7	31.8	31.2	31.9	30.3	
B. Income [b]						
1. Median	34.2	38.0	35.6	36.4	38.9	13.8
2. Mean	41.6	48.0	45.1	48.1	51.9	24.7

Source: own computations from the 1983, 1989, 1992, 1995, and 1998 Surveys of Consumer Finances

a. Constant 1998 Dollars.

b. The source for the income data is the Current Population Survey.

to 1995, and then, buoyed largely by rising stock prices, another surge in 1998. Overall it was 27 percent higher in 1998 than in 1983, and 11 percent larger than in 1989.[18]

A comparison with income trends is also provided. Median household income, based on the Current Population Survey, increased by 11.2 percent from 1983 to 1989 and then by only 2.3 percent from 1989 to 1998.[19] The pattern is similar to that of median wealth, whose growth also slowed down substantially before and after 1989. Mean household income gained 25 percent between 1983 and 1998, in comparison to a 27 percent growth in mean household wealth. As with wealth, income grew faster in the 1983-89 period than in the 1989-98 period.

Figure 15 provides further details on the 1983-1998 period for time trends in CPS median household income and SCF median household wealth. Both show similar dips in the early 1990s.

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[18] The time trend is similar when the value of vehicles is also included in net worth, as some researchers are wont to do. Instead of rising by 11 percent between 1983 and 1998, median net worth increases by 15 percent, and the mean rises by 28 percent instead of by 27 percent.

Median household income in 2000 dollars rose briskly between 1983 and 1989, by 13 percent but the dropped rather precipitously over the next four years, by 6 percent. It then climbed upward between 1993 and 1998, just exceeding its 1989 peak by 5 percent. Median household wealth, also in 1998 dollars, first rose by 7 percent between 1983 and 1989, declined by 6 percent from 1989 and its low point in 1992, and then surged by 10 percent from 1992 to 1998.

In Table 2, I provide some other indicators of the fortunes of the middle class, as defined by the middle quintile of the income distribution. The first of these is home ownership. Here, there has been some progress. In 1983, 60 percent of middle class households owned their own home. This figure rose to 63 percent in 1989, fell over the subsequent two periods and then climbed to 68 percent in 1998. The second is with regard of the debt position of the middle class. The debt to asset ratio fell slightly from 24 percent in 1983 to 23 percent in 1989 and then grew to 26 percent in 1992 (a result of the 1991-92 recession). Since then, it tumbled to back to 23 percent in 1998. In contrast,

Table 2. Wealth Holdings of the Middle Quintile of the Income Distribution, 1983-1998					
Wealth Component	**1983**	**1989**	**1992**	**1995**	**1998**
A. Percent of Households Owning Homes	60.3	63.3	60.6	62.4	68.0
B. Household Indebtedness					
1. Debt/Assets	0.24	0.23	0.26	0.24	0.23
2. Debt/Income	0.54	0.71	0.86	0.94	1.00
C. Percent of Households Owning Stock Directly or Indirectly[a]					
1. Any stock holdings	17.2	29.9	35.2	44.3	49.9
2. Stock worth $5,000 or more[b]	9.2	18.5	18.7	28.4	34.8
3. Stock worth $10,000 or more[b]	5.9	1.4	13.5	21.0	27.7

Source: own computations from the 1983, 1989, 1992, 1995, and 1998 Surveys of Consumer Finances

a. Includes direct ownership of stock shares and indirect ownership through mutual funds,

[19] The statistics here differ from those portrayed in Figure 1, which are based on **family** income.

trusts, and IRAs, Keogh plans, 401(k) plans, and other retirement accounts. In 1983, ownership of stocks and mutual funds only.

b. 1998 dollars

the debt to income ratio of the middle class increased almost monotonically over the 1983-98 period, from 0.54 to 1.00.

The third indicator is stock ownership. There have been widespread reports in the media that stock ownership has substantially widened in the U.S., particularly during the 1990s. There is some truth to these reports. The proportion of middle class households who own some stock either outright or indirectly through mutual funds, trusts, or various pension accounts increased from 17 percent in 1983 to 50 percent in 1998. Much of the increase was fueled by the growth in pension accounts like IRAs, Keogh plans, and 401(k) plans. Indeed, between 1983 and 1989, direct stock ownership declined somewhat, from 14 to 13 percent -- likely, a result of the 1987 stock market plunge. However, the share of households with pension accounts nearly doubled over this period, from 11 to 23 percent, accounting for the overall increase in stock ownership. Between 1989 and 1998, the direct ownership of stocks grew rather modestly, by 6 percentage points, while the share of households with a pension account again doubled, accounting for the bulk of the overall increase in stock ownership (these figures which separate out direct from indirect stock ownership are computed by the author but are not shown in Table 2)

Despite the overall gains in stock ownership, about half of middle class households had any stake in the stock market by 1998. Moreover, many of these families had only a minor stake. In 1998, while 50 percent of households owned some stock, only 35 percent had total stock holdings worth $5,000 or more and only 28 percent owned $10,000 or more of stock.

5. Conclusion

The last quarter of the twentieth century or so saw slow growing earnings, income, and wealth for the middle class, as well as a stagnating poverty rate and rising inequality. In contrast, the early postwar period witnessed rapid gains in wages, family income, and wealth for the middle class, in addition to a sharp decline in poverty, and a moderate fall in inequality. Personal tax rates have generally fallen over time but by much more for the rich than the middle class. In sum, the middle class has gotten squeezed in terms of income, earnings, and wealth since the early 1970s.

The "booming 1990s" has not brought much relief to the middle class. Median household income grew by only 8 percent between 1989 and 1998 (6 percent with the CPI-U deflator), while median wealth gained 3.8 percent from 1989 to 1998. The homeownership rate among the middle income quintile did expand from 63 to 68 percent. Household debt as a fraction of assets in this group remained steady at 0.23 but the debt-to-income ratio soared from 0.71 to 1.00. Stock ownership among the middle class did grow from 30 to 50 percent and the share of households with stocks worth $10,000 or more climbed from 1 to 28 percent. All in all, the standard of living among the middle class, as measured by these economic indicators, did not show much progress in comparison to the early postwar period and even compared to the 1980s. Part of the poor performance is attributable to the sharp drop in income, wealth, and consumption experienced during the 1991-92 recession. Income and wealth did recover after 1993 but not enough to get much ahead of 1989.

The stagnation of living standards among the middle class over the last 30 years is attributable to the slow growth in labor earnings over this period. While average earnings (employee compensation per FTEE) almost doubled between 1947 and 1973, it advanced by only 11 percent from 1973 to 2000. From 1989 to 2000, it grew by 9 percent. This occurred in spite of

substantial progress in educational attainment made since the early 1970s. Moreover, despite incredible success in reducing disparities of schooling within the American population, the inequality of income has not only failed to decline but has actually risen sharply over the last three decades. These results suggest a growing disconnect between earnings and schooling.

The main reason for the stagnation of labor earnings derives from a clear shift in national income away from labor and towards capital, particularly since the early 1980s. Over this period, both overall and corporate profitability has risen rather substantially, almost back to postwar highs. The stock market has, in part, been fueled by rising profitability. While the capitalist class has gained from rising profits, workers have not experienced much progress in terms of wages. On the surface, at least, there appears to be a trade off between the advances in income and wealth made by the rich and the stagnation of income and wealth among the working class.

What can be done about the stagnating fortunes of the average (working) American? Current policy discussions in Washington have emphasized better education of the labor force and improved training. Education and training are seen to be the key remedies for two major problems that ail the economy: (1) They will lead to higher skills and thus high paying jobs and increase the real wage. (2) They will lead to a more equitable distribution of skills in the labor force and thus reduce wage inequality. The results of the paper seem to cast doubts on the efficacy of this solution.

What should Washington do? I believe that the most effective way to reverse the decline of the real wage and to reduce income disparities is through incomes policy. Among the remedies that I propose are the following:

(1) <u>Restore the minimum wage to its 1968 level</u>. The minimum wage in 2000 was down about a third in real terms, from its peak level in 1968 (when the unemployment rate was only 3.6 percent!). Raising the minimum wage will help increase the wages of the low wage earners. A

more powerful idea is to extend the coverage of "Living Wage" ordinances, which mandate a minimum wage, usually around $10.00 per hour, for city workers and those employed under city contracts. These programs are now in effect in a few dozen municipalities around the country but could be vastly extended.

(2) Extend the Earned Income Tax Credit (EITC). The EITC provides supplemental pay to low wage workers in the form of a tax credit on their federal income tax return. In fiscal year 1999, the EITC provided $29 billion in supplemental aid. An expansion of this credit will further raise the (post-tax) income of low income families.

(3) Make tax and transfer policy more redistributional. A more potent weapon to meet these objectives is to redesign our tax and income support systems so that they transfer more income from the rich to the poor. Tax policy over the last two decades, as shown above, have clearly benefited the rich over the poor (and capital over labor). Comparisons between the U.S. and other advanced industrial countries (including Canada), which face similar labor market conditions, indicate that tax and transfer policies can be effective in reducing inequality and increasing post-tax income (See, for example: Atkinson, Rainwater, and Smeeding, 1995)

(4) Re-empower labor. The findings presented here and the cross-national evidence compiled elsewhere suggest that one of the principal reasons for the greater level of inequality in this country and its relatively rapid rise in recent years in comparison to other advanced economies is the low level of unionization in this country (see, for example, Blau and Kahn, 1996). This is also a principal factor in explaining declining real wages in the United States. Steps should be taken to help promote unionization in the workplace and expand the power of labor generally. This can start with reform of existing labor law. Other work has documented how existing labor law is biased against the establishment of new unions and how is notoriously difficult the certification

process (see, for example, Gordon, 1996).

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Figure 1. Median and Average Family Income, 1947-2000

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**Figure 2. The Poverty Rate and the Share and Mean Income of
The Bottom Quintile, 1947-2000**

Legend: —□— Overall Poverty Rate (in Percent) —+— Share of Bottom Quintile (in Percent) —◇— Mean Income of the Bottom Quintile (in 1000s, 2000$)
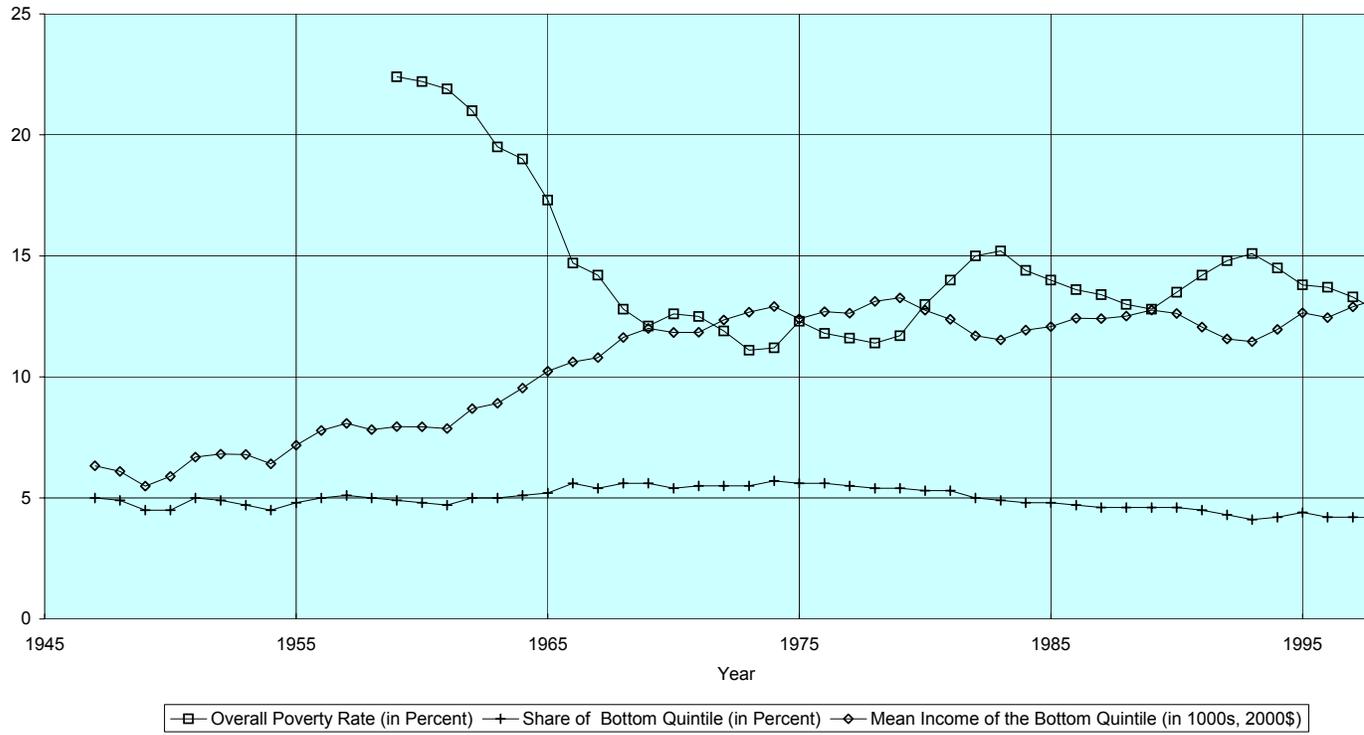
Figure 3. Labor Earnings Indices, 1947-2000
[1973=100]

Legend:
- —□— BLS Mean Hourly Earning
- —+— NIPA Wages and Salaries per FTEE
- —◇— NIPA Employee Compensation per FTEE
- —△— NIPA Employee Compensation plus 1/2 Proprietors'
- —✕— CPS Mean Earnings per Full-time, full-year Workers
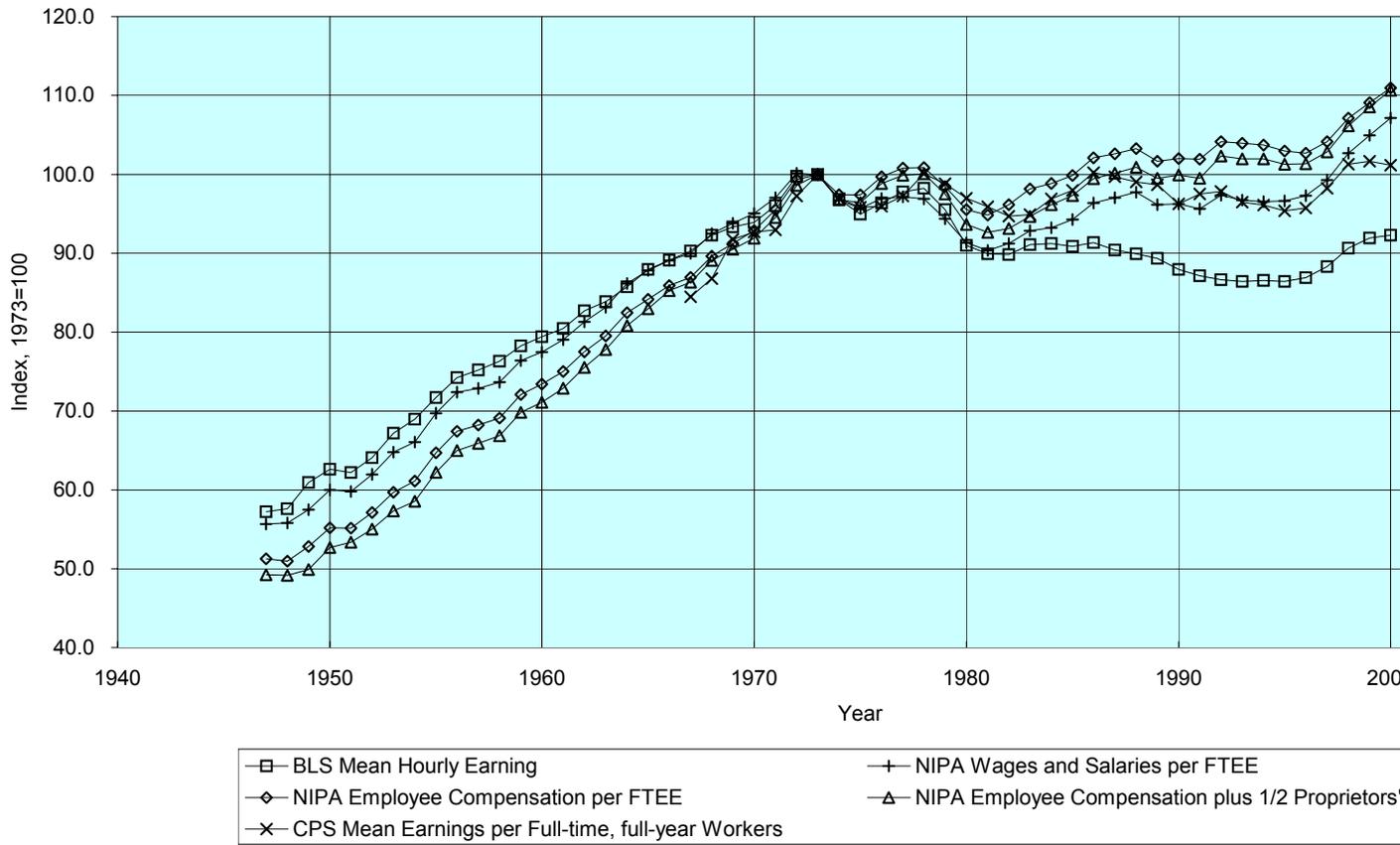
Figure 4. Income Inequality Trends, 1947-2000
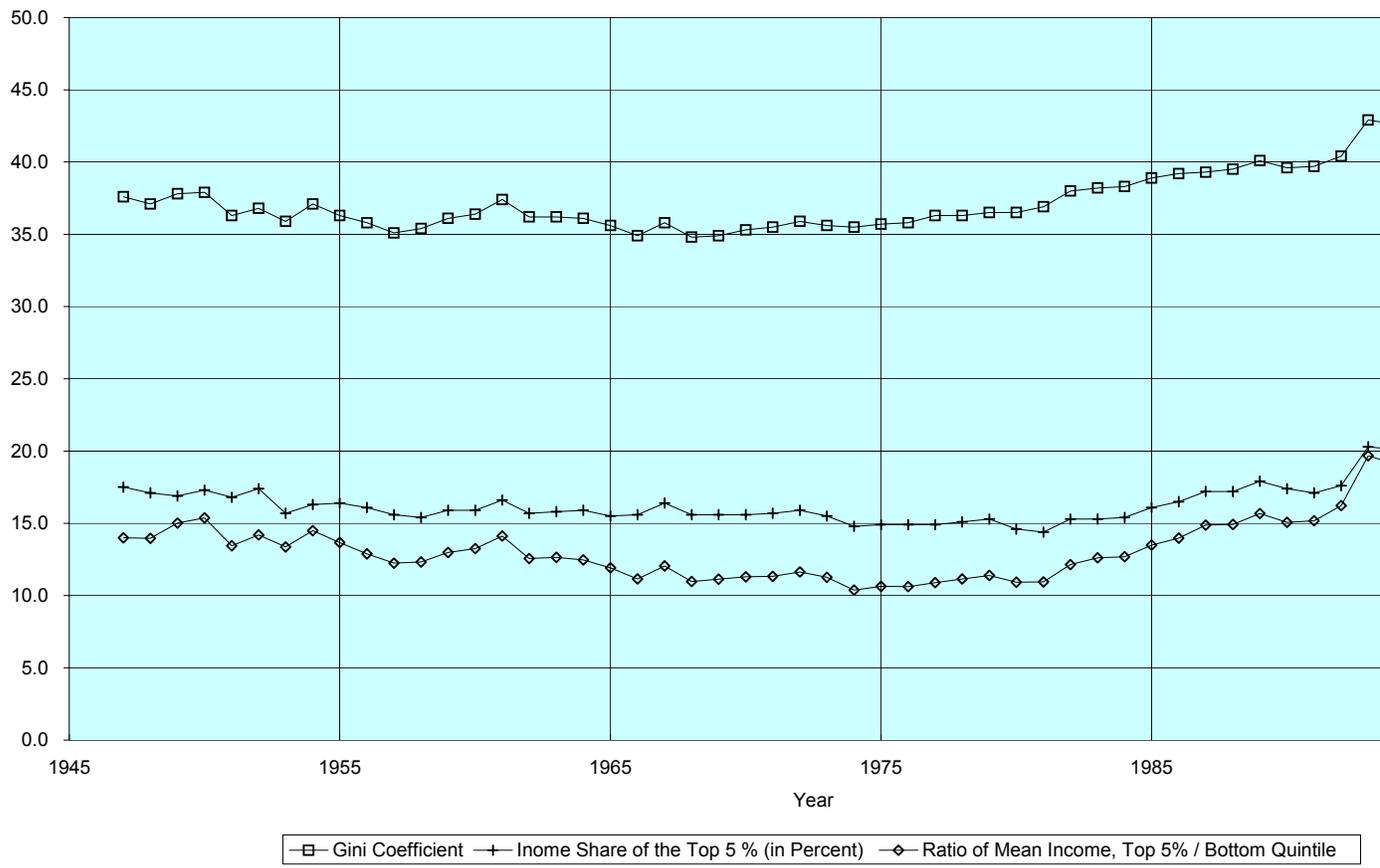
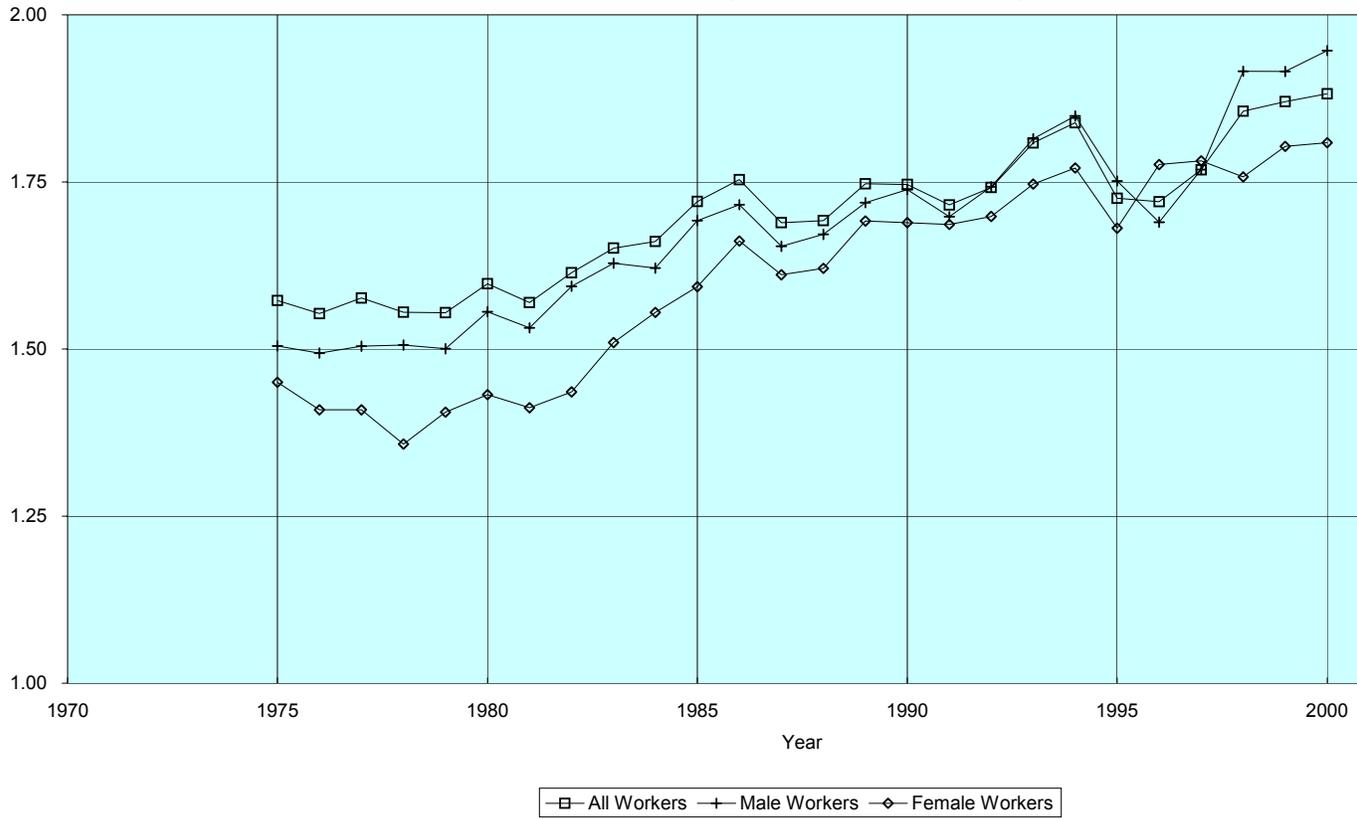**Figure 5 Trends in Equivalent Income by Income Quintile, 1967-2000**
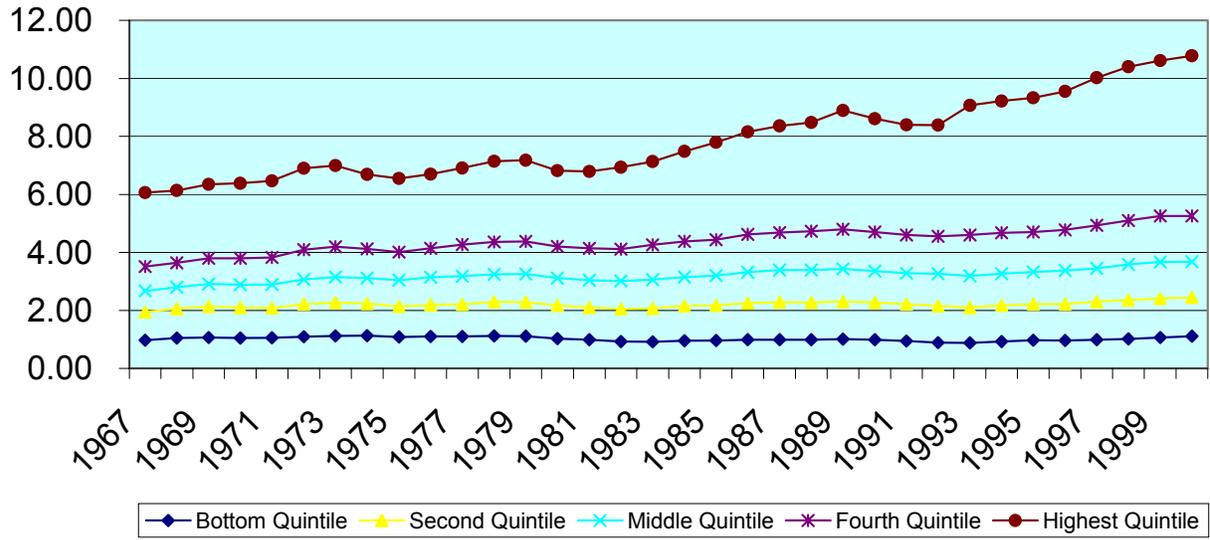
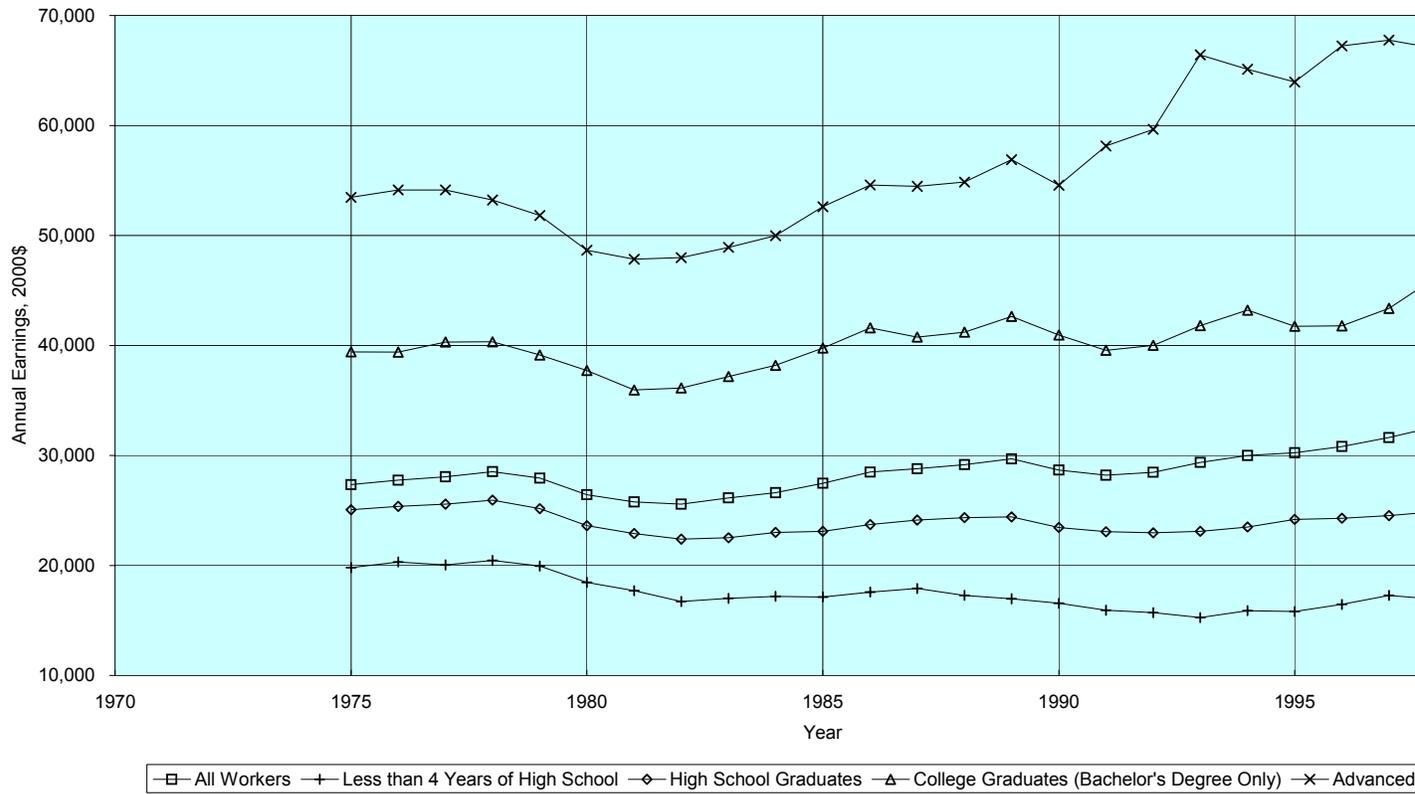**Figure 6. Marginal Tax Rates, Selected
Income Levels in 2000$, 1946-2000**
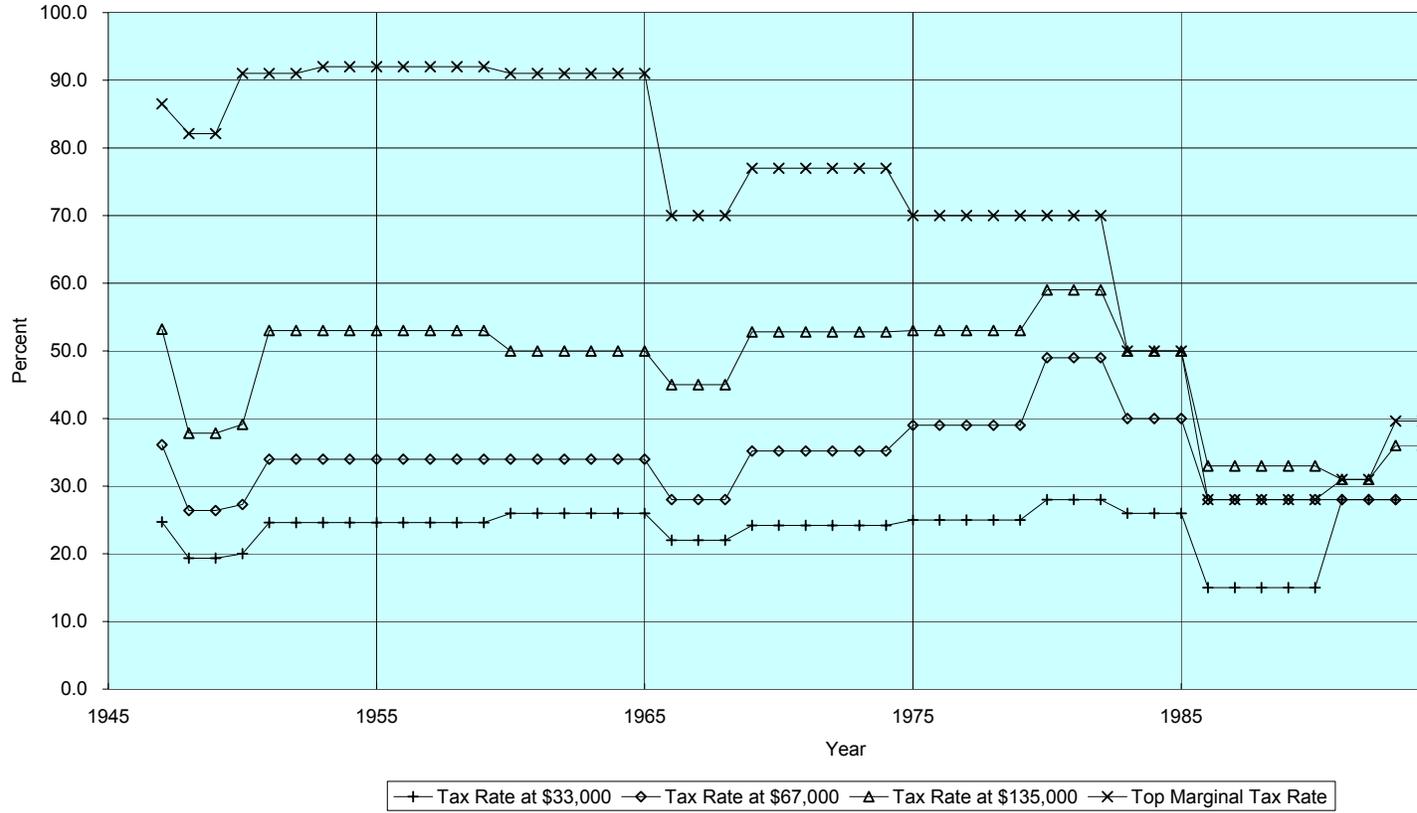
**Figure 7. Years of Schooling Completed
By People 25 Years Old or Over, 1947-2000**
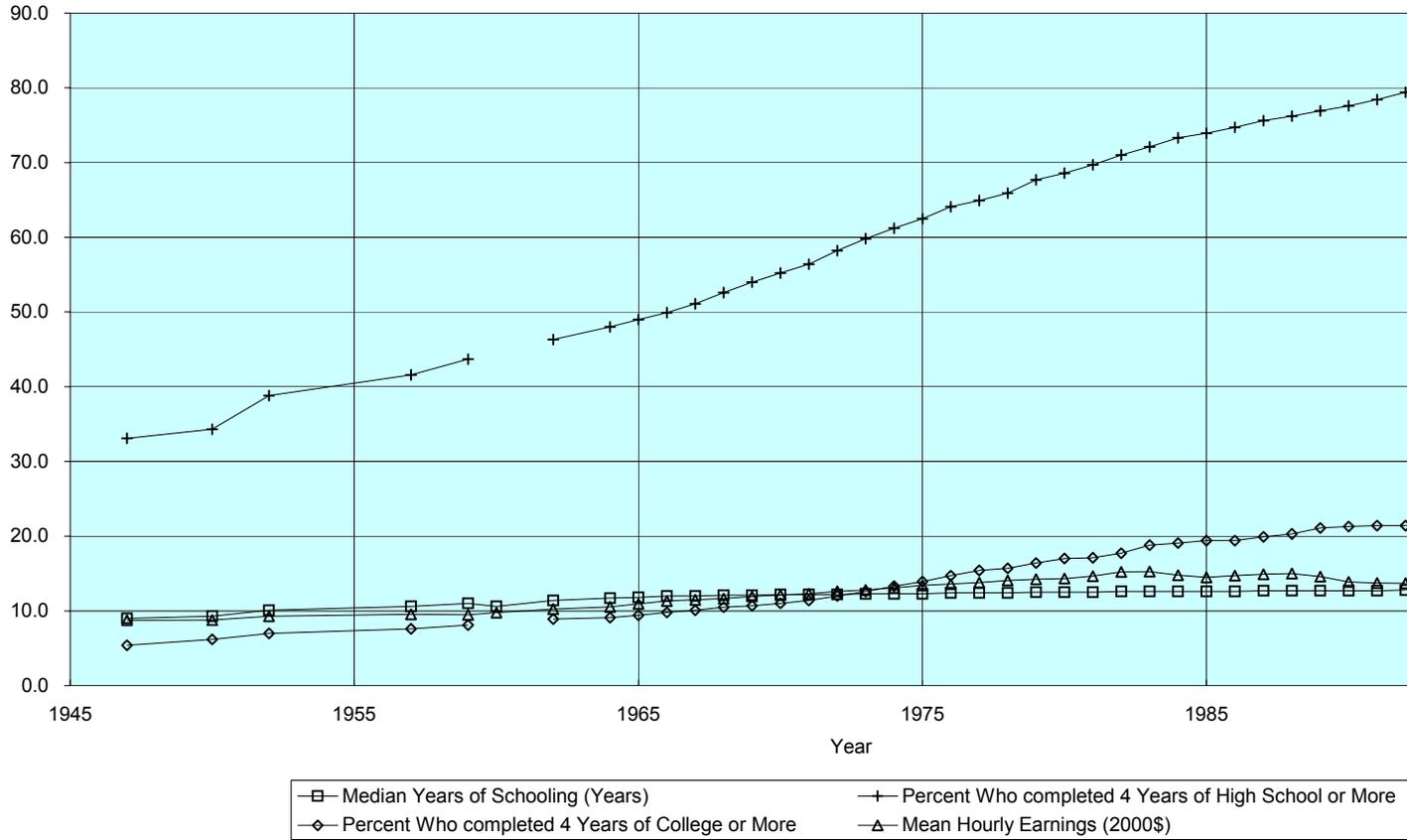
Figure 8. Ratio of Mean Annual Earnings
Between College Graduates and High School Graduates by Gender, 1975-2000
(Includes all workers age 18 and over with earnings)

Figure 9. Mean Annual Earnings, in 2000$
By Educational Attainment Level, 1975-2000

Legend: All Workers · Less than 4 Years of High School · High School Graduates · College Graduates (Bachelor's Degree Only) · Advanced

**Figure 10. Family Income Inequality and Educational
Trends, 1947-2000**

Legend: Family Income Gini Coefficient/10 · Mean Schooling, Adults 25 years Old or Over · Variance of Schooling, Adults 25 Years O
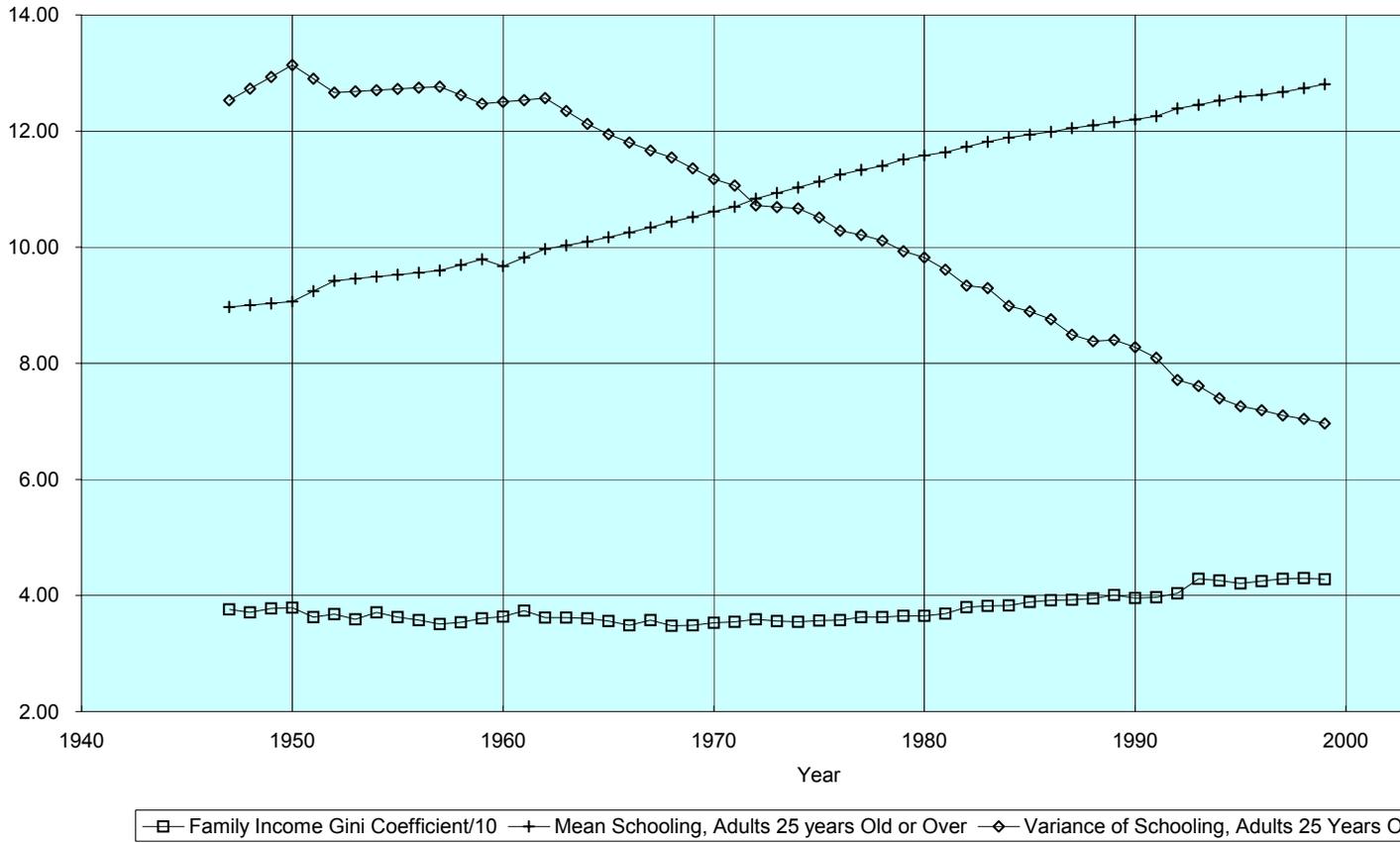
Figure 11. Average Earnings and Labor Productivity, 1947-2000

Index, 1973=100

Legend:
- ■ Employee Compensation per FTEE
- ○ GDP in 1996$ per FTEE
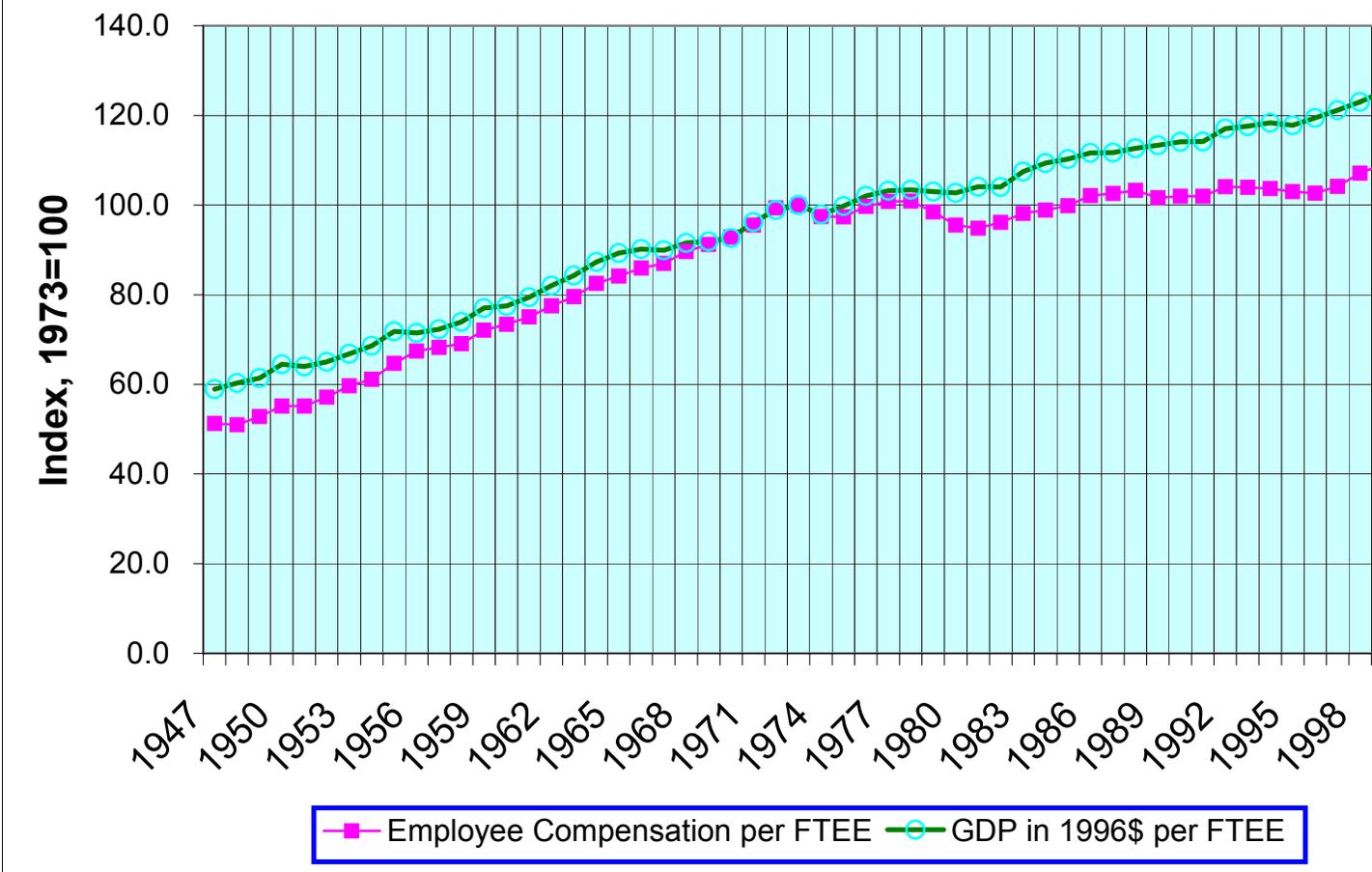
Figure 12. Trends in the Net Rate of Profit and the Net Profit Share, 1947-2000
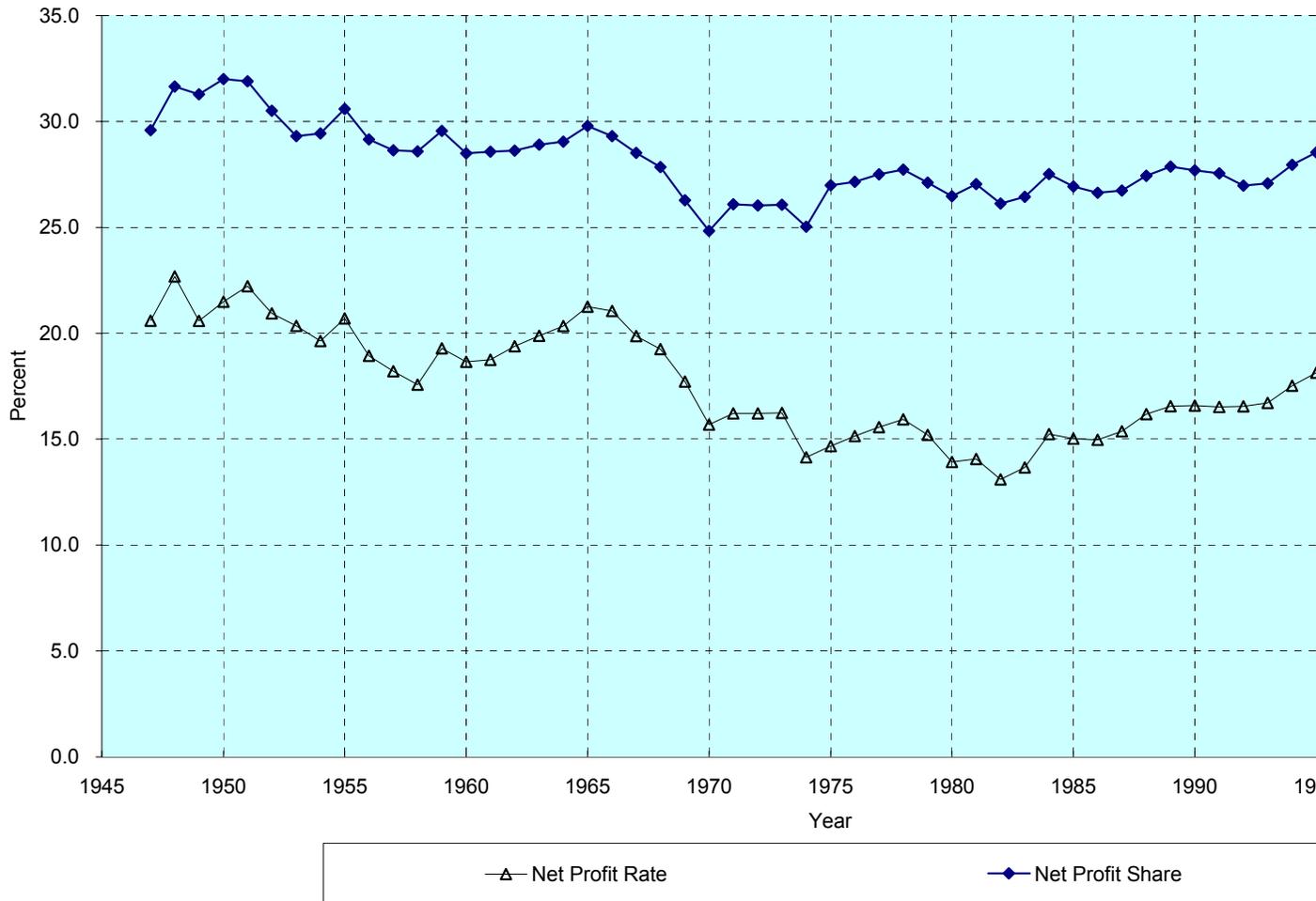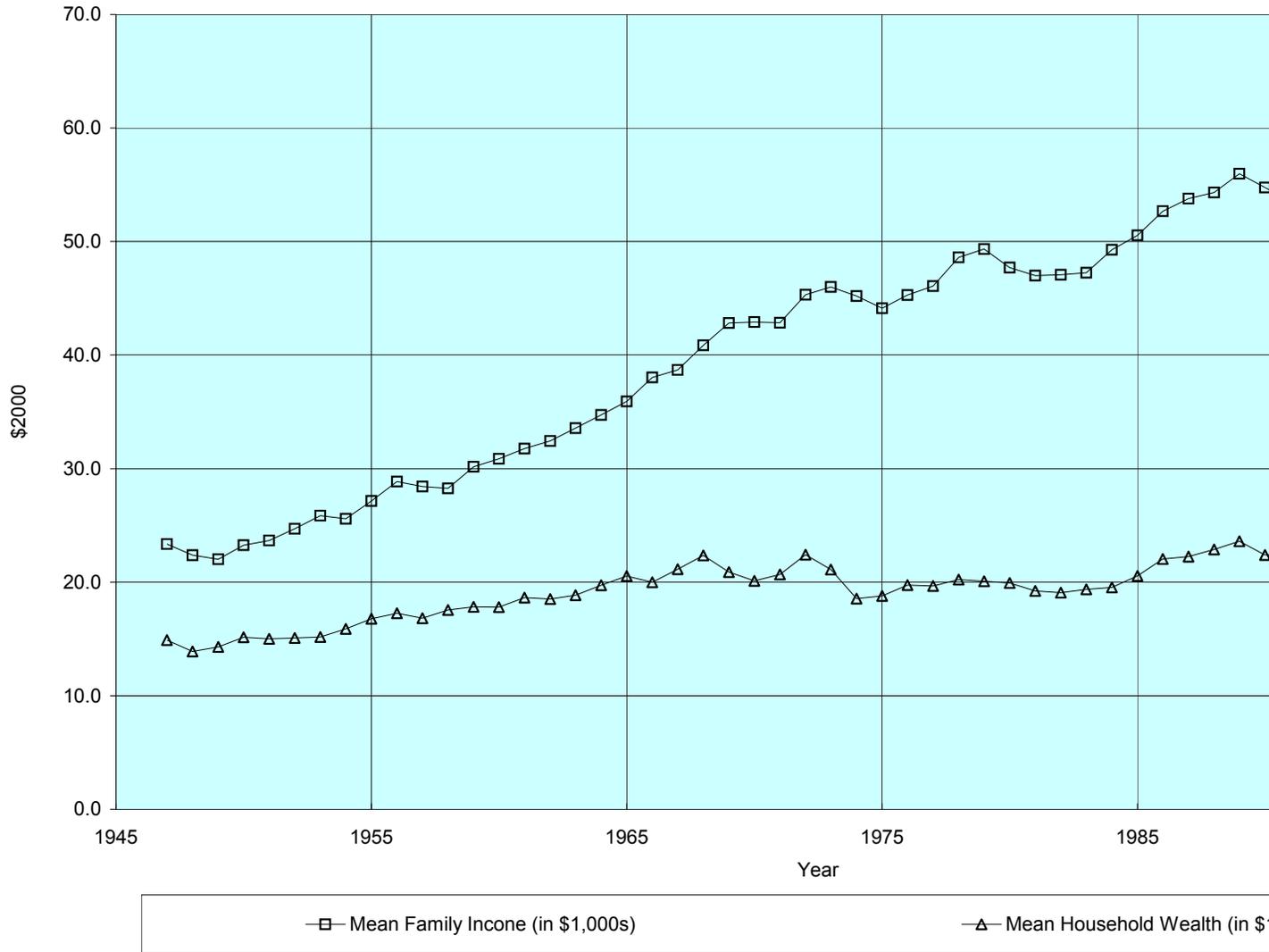
Figure 13. Average Income and Wealth, 1947-2000

Figure 14. Income and Wealth Inequality Trends, 1947-1998