FirstPoint Financial

WEEKLY MARKET THOUGHTS

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Where Has All the Income Gone?

At times, I notice an event that strikes me as a major socio/political issue with extreme economic overtones. Recently, I completed a three-part commentary regarding the importance of productivity in any economy. Today's piece begins to cover an issue that has become a hot-button topic for our society – one that needs rational, thoughtful study. The topic is income disparity.

Income disparity. It is a subject that has significant cultural overtones. Some call the subject income inequality; however, I believe that phrase is laced with built-in biases. Headlines scream that top wage earners have continued to succeed with higher income levels, while the rest of wage earners have experienced stagnant incomes. Some in our country believe that the income dispersion is unfair and needs to be fixed. To fix something one must believe it is actually broken. Is our market-based income system broken?

Data – Give Me Data!

Let's take the emotion out of this issue by looking at some data. The Congressional Budget Office is a non-partisan government data crunching organization that provides information to congress for various purposes. It created a very detailed report late in 2012, which provided data concerning income/tax information for the year 2010. It broke the country down into quintiles (groupings of 20% of the population), driven by income levels, with the lowest quintile representing the bottom 20% of household incomes.

	Market Income	Govt. Transfers	Taxes Paid	After-Tax Income
Lowest Quintile	$8,100	$22,700	*	$30,800
Middle Quintile	$54,800	$10,800	$8,100	$57,400
Highest Quintile	$234,400	$6,500	$58,900	$181,900
All Quintiles	$79,300	$12,900	$16,600	$75,500

Source: Congressional Budget Office. The Distribution of Household Income and Federal Taxes, 2010.

*denotes between $0 and $50

Share of Totals	Market Income	Govt. Transfers	Taxes Paid	After-Tax Income
Lowest Quintile	2.3%	36.3%	0.4%	3.0%
Middle Quintile	13.0%	17.2%	9.1%	17.4%
Highest Quintile	57.9%	10.4%	68.8%	47.6%

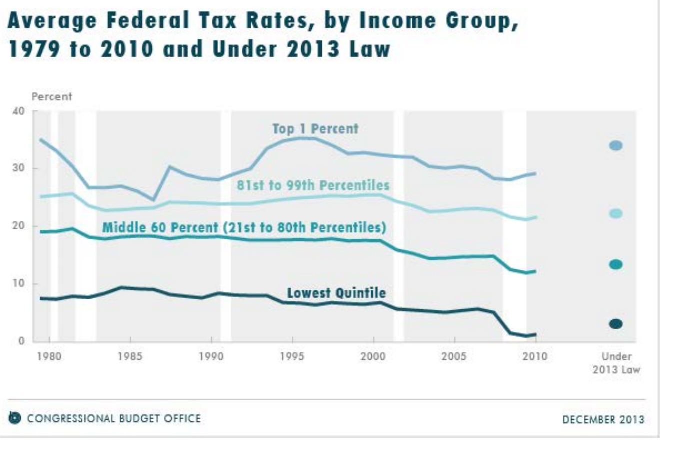
Source: Congressional Budget Office. The Distribution of Household Income and Federal Taxes, 2010.

The following conclusions can be drawn from the data presented above:

- Market Income includes labor income, business income, capital gains, capital income, income received in retirement for past services and other. The data shows that about 58% of household income is generated by the 20% highest earners. The same data shows the lowest 20% of earners generate a mere 2.3% of income.
- Taking into consideration government transfers (social security, welfare, unemployment, disability, etc.) and taxes paid, the net after-tax income levels, while still skewed toward the top earners, is more even. About 10% of national household income is redistributed from the highest income groups to the lower groups through these mechanisms.
- The highest earning quintile pays about 70% of all personal taxes, while the lowest pays little to none.
- The lowest quintile receives almost 75% of after-tax income from government transfer systems.

Have the "Rich" Gotten All the Tax Breaks?

Egalitarians will look at this data and ask why the dispersion is so wide. Why shouldn't it be much more equal? Why not tax the rich more and move that capital to others lower in the income spectrum? Why hasn't this happened before? As illustrated by the chart, the top 1% and top quintile's tax rates have remained rather steady since 1980, while the lowest and the middle quintiles' tax rates have declined. In the lowest quintile's case, the decline was from about 9% to almost 0%. Frankly, politicians who demagogue the rich for not paying their fair share in taxes need to understand from where tax rates have come. The CBO's own data shows the rich are paying about the same in taxes now as they have for the last 30 years. It is the poor who are paying less. So, the argument that the rich aren't paying their fair share falls flat when looking at unbiased historical data.



More Historical Data – When Did the Disparity Start to Widen?

If we want to offer solutions to a problem, we need to understand why the problem exists. We also need to understand how long the problem has been in existence and the fundamental social/economic factors that led to the disparity.

Has income disparity between the more wealthy and poorer always been this wide? When answering this question,

Source: Thomas Piketty and Emmanuel Saez.

many commentators will focus on the last 10, 20 or 30 years of data, which shows a consistent widening disparity in income between the highest and lowest income earners (see chart above).

A different picture emerges if we go back farther in time. Income disparity is roughly the same level today as it was in the 1920s. From the 1920s until the 1970s, income disparity narrowed significantly. Later in the 1970s, income disparity started to accelerate and has been doing so for the majority of the last 30+ years.

Now, we know that income disparity in the United States is wide, but this isn't new. We have been here before. We know when income disparity started to rise and we can look back in time to consider the changes that were occurring in our national economic landscape in order to offer practical, reasonable solutions to this issue.

In the upcoming weeks, we will examine the social underpinnings of this problem from a factual, historical standpoint. We hope you stay with us on this subject. Income disparity is a major issue in our society that needs practical, effective solutions.

Just for Fun

Do you want to make more money? Of course, we all do. Your chosen profession and your skill set within that profession tend to be major factors in your income profile – right? Well, that is only part of the picture. Where you live also is a major determining factor behind your income level. According to data from our friends at the Federal Reserve of St. Louis, the disparity of income is significant between cities.

The geographic disparity between cities in the United States has always been present, as the cost of living in one city relative to another can be higher or lower. But, the incomes of workers in some cities have risen much more rapidly than in others. Let's take a look at *per capita personal income levels for the New York and Washington D.C. areas, stated as a percent of the national average income.*

	1969	2012	Percent Gain
New York City	124%	132%	+8%
Washington, D.C.	**120%**	**140%**	**+20%**

The Federal Reserve's data shows that people in Washington, D.C., on average, make more than folks in New York and 40% more than the national average! Additionally, relative to the rest of the nation, workers' incomes in Washington have increased by 20% since 1969. Talk about income disparity…

We will be back next week.

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P. S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this e-mail with their e-mail address and we will ask for their permission to be added.