

WEEKLY MARKET THOUGHTS

May 27, 2014

The Income Question

I would like to pose a series of questions. These questions may strain your sense of equality, what is justified and what should be the norm.

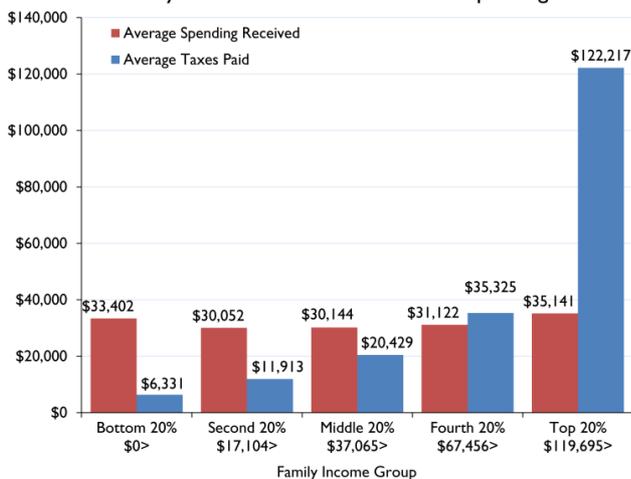
Questions:

1. Are Americans, by and large, financially better off today than in the past?
2. Are Americans, relative to people outside the United States, financially better off?
3. Are the highest 20% of income earners better off today, relative to all others in the country, than in the past (i.e., has the top quintile of income earners taken a bigger share of the national “income pie”)?

Quick disclosure: These questions are highly relevant in today’s national discussion. Many of our leaders in Washington are highly focused on income re-distribution in the name of “fairness.” The word and concept of fairness is a judgmental term - one that isn’t absolute. When faced with an act or condition that some find offensive, many in our society draw the fairness statement like a sword. So when I hear the phrase “it isn’t fair,” I need to understand the biases of the person utilizing that judgmental statement.

Many leaders and members of the press have waived the fairness standard in the face of others in continuing attempts to *not provide social equality of opportunity, but to provide equality of outcome,*

Chart I. Comparing How Much Families Paid in Total Taxes to How Much They Received in Total Government Spending in 2012



in a financial sense. Our Constitution outlines rights of individuals that are structured to provide equality of opportunity, not equality of outcome. The social mandates that some are now embracing has little to do with historical social norms, but has everything to do with what they consider represents social justice and what is fair.

When reports regarding income disparity are generated, it is *common to use market income information.* This data is raw and excludes taxes, government transfers and

adjustments for household size. Market income is an accurate measurement of employment compensation, but it is a very misleading way to consider a family's financial resources. It overlooks the welfare state's enormous power to redistribute income. The data we show is from the CBO (Congressional Budget Office) and includes these transfers and tax effects. Additionally, the chart above shows average transfer payments (spending received) as compared to the taxes paid per income quintile. As can be seen, welfare state policies help level the playing field rather dramatically.

Just the Facts, Please

Now that we have laid the groundwork for this discussion, let's get back to the three questions. As an economist, I will simply lay out the facts as to data generated by various government organizations. We will use the year 1979 as our base year in answering the questions above. Why 1979? This 35-year span includes a period of rising inflation, a period of rapidly declining inflation, a period of extended economic growth and a multiple periods of economic contraction. Temporary dislocations (the elimination of certain industries for example) are lost in the sheer magnitude of the data involved over a 40-year period.

1. Are Americans better off today (financially) than in the past?

The quick answer – yes, by a wide margin. Real (after inflation) Personal Disposable Income was \$20,248 per capita in 1979. Currently, Personal Disposable Income (adjusted for inflation) is \$36,773 per capita. So, after-inflation personal “real” incomes have risen by 82% over the last 35 years.

2. Are Americans better off today as compared to those outside our country?

The answer to this question is a resounding “yes.” We are much better off financially than most others outside the United States. According to data published by the United Nations, the cutoff for the wealthiest 50% of global income distribution was \$2,138 per capita in 2008 dollars. Branko Milanovic shows in his book *The Haves and the Have-Nots* that U.S. personal income levels reside well above median. As a matter of fact, the bottom 10% of the U.S. income distribution registers in the top 30% of global income levels. Our nation's poor would be considered well-off in the majority of the world. The American middle class has the fourth highest income level of all countries in the world. According to Neil Gilbert, professor of social welfare at the University of California – Berkeley, only folks in Luxembourg, Norway and Switzerland boast a higher average income level than we Americans.

3. Are the highest 20% (top quintile) of earners, better off today than in the past? Compared to the other four quintiles?

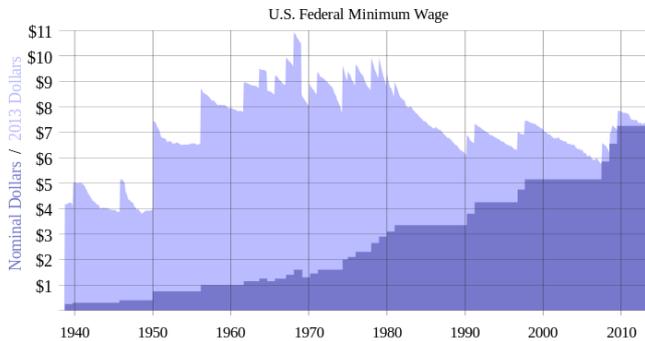
The quick answer to this question is yes. The top quintile of income earners has seen an outsized rise in income growth over the last 35 years as compared to the other quintiles' increases. As a matter of fact, the top 1% of earners' income rose by 210% over the period discussed (1979 – 2012), whereas middle quintile real incomes rose by 40%. The lowest quintiles income growth rate? Higher than many would think, at 49% over the same period, given transfer payment changes and taxation increases for the “wealthy.”

In summary, the income inequality issue is debatable, but real. Wealthier citizens' incomes have risen more rapidly than others. But all incomes have risen. Additionally, the average citizen in the United States is still considered reasonably wealthy when compared to most other parts of the world.

Minimum Wage

Recently, our President asked Congress to approve an increase in the minimum wage from the

current \$7.25 per hour to \$10.10, an increase of 39%! Congress didn't approve the increase, but the debate over the minimum wage continues. Is the national minimum wage too low? This chart shows the minimum wage on a nominal basis (dark portion) and the minimum wage adjusted for inflation (light portion).



As can be seen, the minimum wage adjusted for inflation is about the same level it has been for the majority of the time since 1940. If the wage was raised to \$10.10, the new wage would rival the highest it has been - adjusted for inflation - since the 1960/1970 time frame, a time when inflation was much higher than it is today.

There have been some commentators making statements that people making the minimum wage can't live off that wage. Frankly, the minimum wage was never meant to be a "living" wage. So this argument is not valid from the start. It is an entry level wage that allows unskilled workers the chance to join the labor force and eventually move upward from that entry spot. Most of us who worked during our youth understand this concept. I earned the minimum wage when I was 16 years old pumping gas (something you don't see much of these days). I believe the minimum wage was \$1.50 per hour at that time, scarcely a living wage at that time or any other.

Because folks who are first entering the work force tend to be less productive than more experienced workers, employers are sensitive to hiring first-time workers on the margin. Now, if the national minimum wage was raised to \$10.10, the Congressional Budget Office (CBO) has suggested that 900,000 people would be lifted out of poverty, but 500,000 may indeed lose their jobs. As I have always said, there are few solutions regarding economic policy changes – only tradeoffs.

We will be back next week.

William B. Greiner, CFA
Chief Investment Officer

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