A Slowdown in Growth, an Increase in Income Inequality

By DAVID LEONHARDT

The income stagnation of the last decade stems, in the simplest terms, from two factors: a slowdown in economic growth and a rise in inequality, which has concentrated the economy's modest gains among a small share of the population. In this post, I want to look at both factors in a bit more detail.

The Agenda: Economy

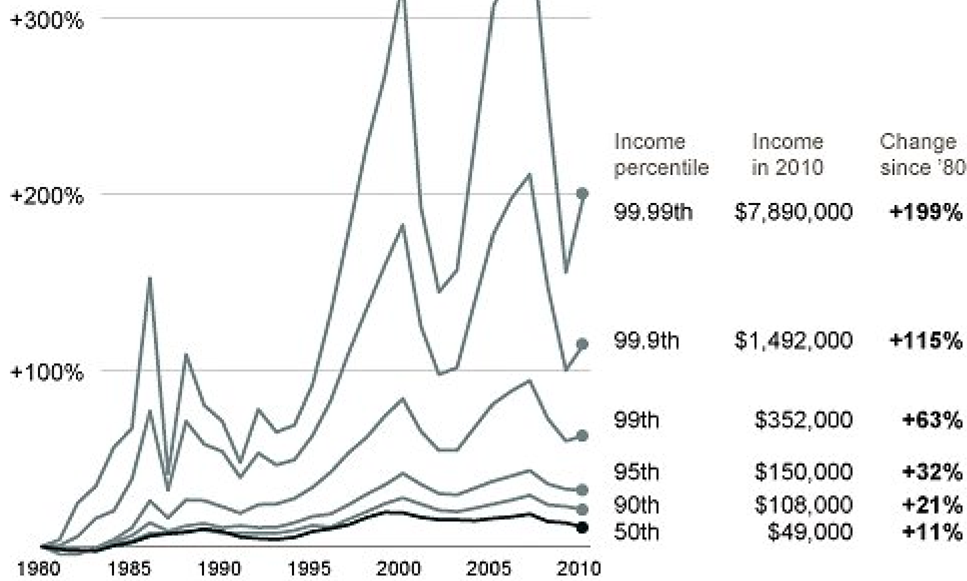
Middle class stagnation and inequality.

The economy's recent struggles arguably began in late 2001, when a relatively mild recession ended and a new expansion began. The problem with this new recovery was that it wasn't especially strong. From the fourth quarter of 2001 through the fourth quarter of 2007 (when the financial crisis began), the economy grew at an average annual rate of only 2.7 percent. By comparison, the average annual growth rate of both the 1990s and 1980s expansions exceeded 3.5 percent.

This mediocre expansion was followed by the severe recession and weak recovery brought on by the financial crisis. The combined result is that, in recent years, the economy has posted its slowest 10-year average growth rates since the Commerce Department began keeping statistics in 1947:

In addition to slow growth, the bounty from the economy's growth has largely flowed to a small slice of the population: the affluent. Since 2000, no income group has done particularly well. Income in households that rely on wages has failed to keep pace with inflation, while in households that have large investment holdings the value of many of those holdings — both real estate and stocks — has fallen.

Over a longer term, though, the affluent have done extremely well. Since 1980, a household at the cutoff for the top 1/1,000th of earners — making about $1.5 million in 2010 — has received a pay increase of more than 100 percent, after adjusting for inflation. A household in the middle of the income distribution has received an inflation-adjusted raise of only 11 percent.



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Fed Action May Widen Wealth Gap

ByKathleen Madigan

One unintended consequence of another round of quantitative easing by the **Federal Reserve** is that it will likely widen the gap in the consumer sector between the recovered-from-recession and the still-struggling.

That's because the plan to buy long-term mortgage securities will have the effect of making investors richer while penalizing small-time savers. The Fed also seems to be more tolerant of future inflation. That's another negative for low-income earners who have already seem their paychecks lose buying power.

This isn't a criticism of the Fed, just an acknowledgement that monetary policy benefits those who have skin in the financial markets. Fiscal policy works better to target help toward specific income groups.

The consumer sector is already split. The recovery has done more to restore the confidence of those who kept their jobs over the past five years and still have equity in their homes. Those households typically have higher incomes and wealth levels. No surprise then, that the **Conference Board**'s consumer survey shows confidence among high-earning households has come back faster than those earnings less than $25,000.

Equity prices have soared since the Fed announced QE3–and that was one of the Fed's intents. Stronger stock prices will make consumers feel wealthier and more likely to spend. As Fed chairman Ben Bernanke mentioned in his press conference, consumers should feel happier when they open up their 401(k) statements and see bigger totals.

But stock ownership overall and retirement funds in particular are more prevalent among high earners. According to the Employee Benefit Research Institute, only 35% of workers with household incomes less than 35,000 have saved for retirement, down from a 49% share in 2009. Among households earning more than $75,000 the share has remained at 93%.

Meanwhile, savers are getting creamed by the Fed's zero-rate policy, and lower-income households have more of their financial assets in savings accounts and certificates of deposits than do higher earners.

Of course, these skewed effects will be overlooked if the Fed succeeds in creating more jobs for workers in all income groups. It's just hard to see how QE3 will accomplish that.