Mitchell's Musings 4-4-11: Where Are We Going?

Those readers who are members of the American Economic Association may have seen the article "Top Incomes in the Long Run of History," by Anthony B. Atkinson, Thomas Piketty, and Emmanuel Saez, in the March 2011 *Journal of Economic Literature*. Below are some charts on income inequality from that article.

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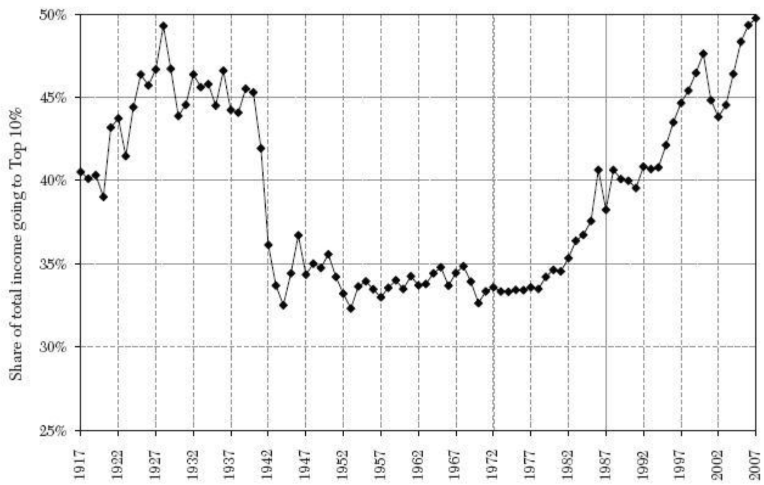

Figure 1. The Top Decile Income Share in the United States, 1917–2007.

Notes: Income is defined as market income including realized capital gains (excludes government transfers). In 2007, top decile includes all families with annual income above $109,600.

Source: Piketty and Saez (2003), series updated to 2007.

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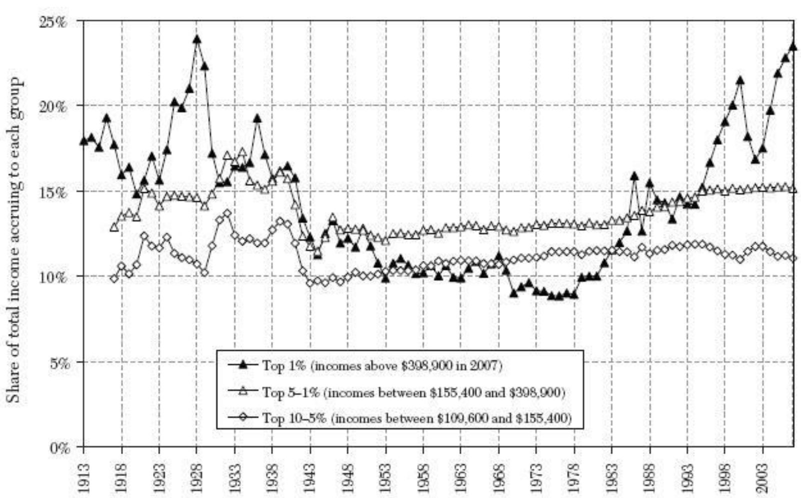

Figure 2. Decomposing the Top Decile US Income Share into three Groups, 1913–2007

Notes: Income is defined as market income including capital gains (excludes all government transfers).
Top 1 percent denotes the top percentile (families with annual income above $398,900 in 2007).
Top 5–1 percent denotes the next 4 percent (families with annual income between $155,400 and $398,900 in 2007).
Top 10–5 percent denotes the next 5 percent (bottom half of the top decile, families with annual income between $109,600 and $155,400 in 2007).

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TABLE 1
TOP PERCENTILE SHARE AND AVERAGE INCOME GROWTH IN THE UNITED STATES

	Average income real annual growth (1)	Top 1% incomes real annual growth (2)	Bottom 99% incomes real annual growth (3)	Fraction of total growth captured by top 1% (4)
Period				
1976–2007	1.2%	4.4%	0.6%	58%
Clinton expansion				
1993–2000	4.0%	10.3%	2.7%	45%
Bush expansion				
2002–2007	3.0%	10.1%	1.3%	65%

Notes: Computations based on family market income including realized capital gains (before individual taxes). Incomes are deflated using the Consumer Price Index (and using the CPI-U-RS before 1992). Column (4) reports the fraction of total real family income growth captured by the top 1 percent. For example, from 2002 to 2007, average real family incomes grew by 3.0 percent annually but 65 percent of that growth accrued to the top 1 percent while only 35 percent of that growth accrued to the bottom 99 percent of U.S. families.

Source: Piketty and Saez (2003), series updated to 2007 in August 2009 using final IRS tax statistics.

Perhaps the extreme concentration at the top shown on these charts no longer surprises anyone. It is interesting that even among the top 10%, the big gains are just in the top 1%. I do imagine, however, that even aficionados of these kinds of data are surprised that public anger of late is targeted at government sector employees and their pensions. Whatever the excesses in that sector, no one there falls in the top 1% (unless someone in the top bracket chooses to run for office in a self-financed campaign).

What may have surprised some observers about current political turmoil is the historical background of the Great Depression. The Great Depression – which as the charts above indicate followed an earlier run-up in inequality - led to a shift to the left in national politics. Note, however, that it is dangerous to rely on an N of 1 in a sample. (And let's be grateful that there is only one Great Depression!) Moreover, while the net effect of the Depression was indeed a shift to the left, there were many social movements put into play back then that either were on the right or were hard to characterize.

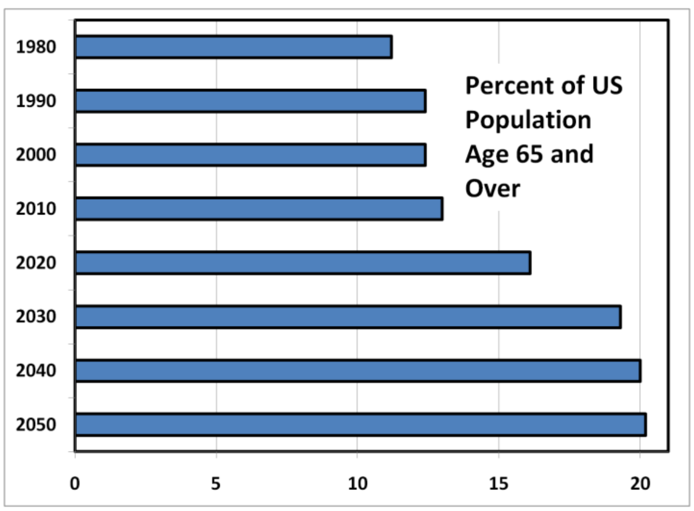
That thought was brought to mind by an invitation for me to speak next week (April 13) at Middlebury College on a book (and related articles) I wrote circa 2000. The talk is entitled "Ham and Eggs in the 21st Century?" which was the title I wanted to give the book. But the publisher insisted folks would think it was a cookbook with such a title. So the title became the dry "Pensions, Politics, and the Elderly: Historic Social Movements and Their Lessons for Our Aging Society" (M.E. Sharpe, 2000). My assignment at Middlebury is to update what I said over a decade ago.

The book deals primarily with various "pensionite" movements that arose in California – especially during the Great Depression – some of which spread nationally. Most notable was the Townsend Plan (federal pensions of $200 a month for every citizen over 60 who promised to spend all the money each month and also promised not to work). The Ham and Eggs movement was a state (California) version -

$30 Every Thursday to be paid by the state to all citizens over 50 and to be financed out a kind of state currency. Ham and Eggs appeared twice on the state ballot in 1938 and 1939 and might well have passed the first time but for the shenanigans of its promoters.

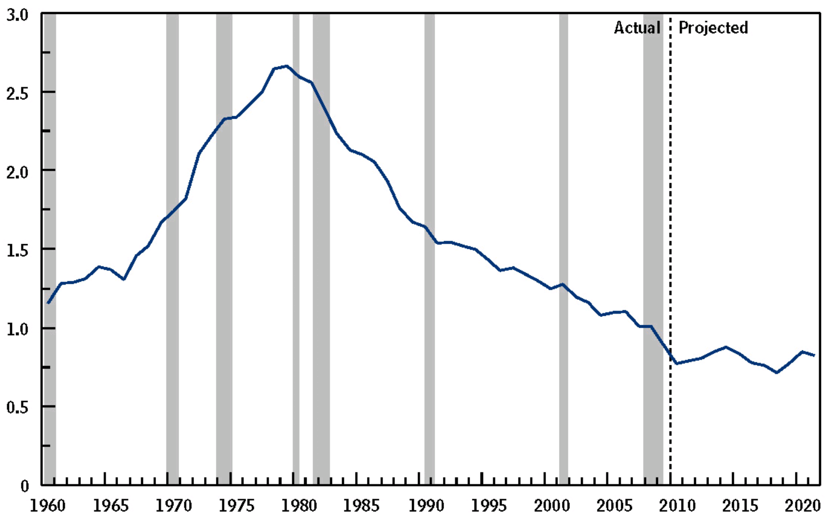
The book notes that there were other movements around in that era not necessarily connected to pensions such as Social Credit (which took over the Province of Alberta in Canada), Senator Huey Long's Share the Wealth movement, or radio priest Father Charles Coughlin's Social Justice movement. California's age-heavy demography drove its movements towards pensions but in other areas of the country, there were other concerns. The various movements synthesized social concerns and currents of thought of the day and often had elements of conspiracy theories as part of their appeal.

In short, it is not evident that inequality and an economic downturn has a predictable directional effect on politics. All we can say is that the combination seems to have roiled politics in the 1930s and seems to be having the same general effect now. Moreover, there are some aggravating circumstances now that are reminiscent of age-heavy California back then. The baby boomers are starting to retire and the proportion of the elderly in the population will be increasing, as the chart below – based on Census projections – indicates.



So more people in the population, even now, are more worried about their retirement years than might have been the case even a decade ago. Viewed that way, it is not surprising that public pensions are now controversial. The average citizen may have some vague knowledge about income inequality. But he/she is unlikely to move in the same circles as anyone in the top 1% of the income distribution. He/she is more likely to know the teacher down the street or the clerk in the county hospital on the next block.

The retirement of the boomers not only means more elderly to be supported in some fashion (and requiring medical care), it also means a smaller fraction of the adult population working. Congressional Budget Office projections (from http://cboblog.cbo.gov/?p=1976) reflect this impact, as the chart on the next page illustrates. There was a marked run-up in labor force particpation beginning in the 1960s, particularly among women. By the late 1990s, that effect had leveled off and we are now in a period of participation decline, aggravated by the Great Recession. What is occurring is not just the usual policy wonk statistical analysis of the ratio of active workers per retiree. In more personal terms, working Americans will be seeing more non-workers, down the street and on the next block.



In short, the historical record doesn't allow us to say much about the left/right political impact of these shifts in income, the business cycle, and demography. The record just suggests instability and conflict are in our future.