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Hassett and Mathur: Consumption and the Myths of Inequality

The standard of living has increased among all income groups over the past decade.

By KEVIN A. HASSETT and APARNA MATHUR - 10/25/2012

In multiple campaign speeches over the past week, President Obama has emphasized a theme central to Democratic campaigns across the country this year: inequality.

Blasting a caricature of his opponent's economic policies, Mr. Obama has said, "it's the same philosophy that's been squeezing the middle class for more than a decade." Massachusetts Senate candidate Elizabeth Warren made inequality a theme in her speech at the Democratic National Convention in September. "The system is rigged," Ms. Warren said, "for many years now, our middle class has been chipped, squeezed and hammered."

These statements echo a standard left-wing critique of capitalism: Economic growth does not serve all classes of society. In the mid-19th century, socialists of various stripes asserted that capitalists grow richer while exploiting workers, who grow poorer. Today we hear that the gains from economic growth accrue to the highest-income earners while the standard of living of the poor and middle America stagnates and the gap between the richest and the poorest grows ever wider. That portrait of the country is wrong.

To be sure, there are studies of income inequality—most prominently by Thomas Piketty of the Paris School of Economics and Emmanuel Saez of the University of California at Berkeley—that report that the share of income of the wealthiest Americans has grown over the past few decades while the share of income at the bottom has not. The studies have problems. Some omit worker compensation in the form of benefits. And economist Alan Reynolds has noted that changes to U.S. tax rules cause more income to be reported at the top and less at the bottom. But even if the studies are accepted at face value, as a read on the evolution of inequality, they leave out too much.

In the first place, studies that measure income inequality largely focus on pretax incomes while ignoring the transfer payments and spending from unemployment insurance, food stamps, Medicaid and other safety-net programs. Politicians who rest their demands for more redistribution on studies of income inequality but leave out the existing safety net are putting their thumb on the scale.

Second and more important, it is well known that people's earnings in general rise over their working lifetime. And so, for example, a person who decides to invest more in education may experience a lengthy period of low income while studying, followed by significantly higher income later on. Snapshot measures of income inequality can be misleading.

Another way to look at people's standard of living over time is by their consumption. Consumption is an even more relevant metric of overall welfare than pre-tax cash income, and it will be set by consumers with an eye on their lifetime incomes. Economists, including Dirk Krueger and Fabrizio Perri of the University of Pennsylvania, have begun to explore consumption patterns, which show a different picture than research on income.

Our recent study, "A New Measure of Consumption Inequality," found that the consumption gap across income groups has remained remarkably stable over time. According to data from the Bureau of Labor Statistics' Consumer Expenditure Survey, if you sort households according to their pretax income, in 2010 the bottom fifth accounted for 8.7% of overall consumption, the middle fifth for 17.1%, and the top fifth for about 38.6%. Go back 10 years to 2000—before two recessions, the Bush tax cuts, and continuing expansions of globalization and computerization—and the numbers are similar. The bottom fifth accounted for 8.9% of consumption, the middle fifth for 17.3%, and the top fifth for 37.3%.

While this stability is something to applaud, surely more important are the real gains in consumption by income groups over the past decade. From 2000 to 2010, consumption has climbed 14% for individuals in the bottom fifth of households, 6% for individuals in the middle fifth, and 14.3% for individuals in the top fifth when we account for changes in U.S. population and the size of households. This despite the dire economy at the end of the decade.

What about the standard of living over those years? The Department of Energy regularly surveys Americans and asks them to report on the characteristics of their homes, including the types of devices and appliances they have. If the standard left-wing narrative is correct, then a typical poor American would trade his current circumstances for those of the past in a heartbeat.

Yet the access of low-income Americans—those earning less than $20,000 in real 2009 dollars—to devices that are part of the "good life" has increased. The percentage of low-income households with a computer rose to 47.7% from

19.8% in 2001. The percentage of low-income homes with six or more rooms (excluding bathrooms) rose to 30% from 21.9% over the same period.

Appliances? The percentage of low-income homes with air-conditioning equipment rose to 83.5% from 65.8%, with dishwashers to 30.8% from 17.6%, with a washing machine to 62.4% from 57.2%, and with a clothes dryer to 56.5% from 44.9%.

The percentage of low-income households with microwave ovens grew to 92.4% from 74.9% between 2001 and 2009. Fully 75.5% of low-income Americans now have a cell phone, and over a quarter of those have access to the Internet through their phones.

We would hazard a guess that if you were to ask a typical low-income American in 2009 if he would like to trade his house for its 2001 version, he would tell you to take a hike. How then is he worse off in 2009?

The data suggest the following picture. Over time, Americans have constructed a vast safety net that has adequately served the poor and helped them—as well as the middle class—to maintain significant consumption growth despite the apparent stagnation of cash incomes. The notion that a society that has accomplished such a feat is rigged or fundamentally unjust is ludicrous.

It is true that the growth of the safety net has contributed to massive government deficits—and a larger government that likely undermines economic growth and job creation. It is an open question whether the nation will be able to reshape the net in order to sustain it, but reshape it we must. We might make significant progress in that regard if those on the left would stop seeking political gain by inflaming class hatreds with misleading statistics.

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