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MOST AMERICANS TREADING WATER OR FALLING FURTHER BEHIND, CONSUMPTION DATA SHOW

Only High Earners Spending More Than Before Recession

The full report can be viewed at: http://www.cbpp.org/11-28-06inc.htm

Widely reported data on Americans' incomes paint a disappointing picture of the current economic expansion, especially for low- and middle-income families. By most measures, Americans' real (inflation-adjusted) incomes in 2005 were still below their level in the recession year of 2001. Less-well-known data on *consumer spending* — including newly released Labor Department data for 2005 — add an important element to this story, showing that only high-income households have been able to raise their living standards in recent years.

Examination of the Labor Department data by CBPP and EPI shows that:

- **Between 2000 and 2005, consumption grew among high-income households, remained stagnant among middle-income households, and declined among low-income households.** Households in all income categories saw their average before-tax incomes decline between 2000 (the peak of the last business cycle) and 2005 in inflation-adjusted terms. Still, high-income families were able to increase their consumption spending by using their generous tax cuts, prior savings (or reductions in new savings), and borrowing. Low-income families, in contrast, were forced to cut back on expenditures, since they received only tiny tax cuts, had few savings, and had little recourse to borrowing.

  The trends are similar if one examines changes since 2001 instead of 2000, as the table below shows. The table also contrasts these recent trends with the earlier 1984-2000 period (1984 is the first year for which the consumer expenditure data are available), showing that increases in consumption were distributed much more broadly in the earlier period.

TABLE 1:
In Recent Years, Living Standards Improving Only at the Top
Average Annual Change in Consumption

	2000 – 2005	2001 – 2005	1984 – 2000
Lowest-income 20 percent of households	-1.2%	-2.1%	+0.3%
Middle 20 percent of households	-0.1%	-0.1%	+0.8%
Highest-income 20 percent of households	+1.2%	+1.6%	+0.8%

Source: BLS's Consumer Expenditure Survey, adjusted for inflation using the CPI-U-RS.

- **Disparities in consumption between high-income households and all other households are widening.** The top fifth of households made 39 percent of all consumer expenditures in 2005, the highest share on record. The bottom fifth of households made just 8 percent of all expenditures in 2005, a tie with 2004 for the lowest share on record. As a result, the gap in consumption between the top and bottom fifths of the population in 2005 was the largest yet recorded.

(more)

Between 2000 and 2005, the share of total consumer expenditures made by the top fifth of households went up by a larger amount than in any other five-year period on record. Meanwhile, the share of total consumer expenditures made by the bottom 80 percent of households declined. By contrast, during the last economic recovery, from 1991 to 1994, the consumption shares of the various income groups remained the same.

- **Middle-class consumption during the current recovery has been weak in historical terms.** Some consumer expenditure data show a decline between 2000 (or 2001) and 2005 in consumer spending by the middle class, while other data show an increase. But *all* of these data show that during the current recovery, the growth in consumer spending by the middle class has been substantially weaker than historical norms — and substantially weaker than consumption by high-income households.

- **Tax cuts have boosted consumption for high earners but have done virtually nothing for low-income households.** While tax cuts can enable households to increase their consumption even if their pre-tax incomes did not increase, the tax cuts enacted since 2001 have given the largest benefits to high-income families. The top fifth of families received an average tax cut of $4,845 in 2005, according to the Urban Institute-Brookings Institution Tax Policy Center, enough to help them improve their standard of living despite the lack of improvement in their average pre-tax income.[1] The bottom fifth of households, in contrast, received an average tax cut of just $18 in 2005, not enough to have a meaningful effect on their consumption.

The consumption statistics cited here do not paint a complete picture of how the economy is doing for American families.[2] Total consumption has been boosted in recent years by a decline in savings rates, substantial borrowing by households (including home equity withdrawals), and tax cuts that have been financed by increased federal borrowing. The personal savings rate in 2005 was *minus* 0.4 percent, the first time it has been negative since the 1930s, as consumers effectively consumed the rise in the value of some of their assets while also borrowing heavily to offset such developments as declining real median income for non-elderly households. Future consumption is likely to be reduced as a consequence, as debts are repaid and savings return to a more normal level.

Similarly, the tax cuts have provided a temporary boost to consumption but have been financed by substantial federal borrowing. When the tax cuts eventually are paid for, as they ultimately must be (most likely in large part through a combination of higher taxes and reductions in benefits for programs such as Social Security and Medicare), the result here, too, will be lower future consumption. And to the degree that Social Security, Medicare or other government spending is reduced, the adjustments made in the future to cover the costs of the tax cuts are likely to fall disproportionately on low- and moderate-income households.

In sum, the American economy has been spending well beyond its means, borrowing more than $2 billion a day from abroad, an amount equivalent to more than 6 percent of the Gross Domestic Product. Yet even this level of borrowing has not been enough to prop up low- and middle-income families' standard of living.

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[1] Average income for the top quintile as a whole did not increase between 2000 and 2005, but those at the pinnacle of the top quintile apparently saw their income rise. Census data show that income for the household at the 95th percentile (i.e., whose income exceeded 95 percent of all households) increased between 2000 and 2005.

[2] See the full report for details on the Labor Department expenditure data. The report also discusses a recent paper by Aparna Mathur and Kevin Hassett of the American Enterprise Institute that claims, on the basis of the Labor Department data, that middle-income consumption spending *increased* significantly in recent years. As explained in the full report, the AEI paper reflects a mistaken use of the expenditure data.