EconoFact Chats: Inequality During COVID-19 and Beyond

Karen Dynan, Harvard University

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Michael Klein:

I'm Michael Klein, Executive Editor of Econofact, a non-partisan web-based publication of the Fletcher School at Tufts University. At Econofact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein:

The notion that through hard work and diligence, people can better their stations in life is at the bedrock of the American dream, but there's a growing sense that inequality is a persistent feature of this country. In September, the Federal Reserve released its survey, Consumer Finances. This is published every three years. It is considered the gold standard of statistics on family's financial circumstances.

The 2019 data show improving personal finances for the median household that is the one at the middle of the distribution. This statistic masks, however, big differences across groups. The share of wealth owned by the top 1% of households was near a 30 year high, while many Americans had less in savings than they did before the last recession. And these differences are probably going to get bigger since the survey occurred before COVID and we know that the pandemic has had an especially big effect on lower income households.

To discuss these issues I'm very pleased to welcome to Econofact chats, Karen Dynan. Karen is a Professor of the Practice in the Department of Economics at Harvard University. She served as Assistant Secretary for Economic Policy and Chief Economist at the US Department of the Treasury from 2014 to 2017. Before that, she directed the Economic Studies Program at the Brookings Institution, which followed almost two decades of her service at the Federal Reserve Board.

Michael Klein:

Karen, welcome to Econofact chats.

Karen Dynan:

Thanks, Michael.

Michael Klein:

Karen, let's try it out by discussing the difference between income inequality and inequality in wealth. There's been a lot of focus on the former, but much less on the latter. Why is that?

Karen Dynan:

The lesser attention to wealth inequality largely reflects what data we do and don't have. Ideally, one wants to look at data that is consistently and accurately measuring the wealth of households at different

points in the distribution over time. In the United States we have the survey of Consumer Finances that does this, but it only goes back on a consistent basis to the late 1980s.

Karen Dynan:

That said, some researchers have made clever use of information that is related to wealth to estimate the wealth distribution going back much further. For example, Emmanuel Saez and Gabriel Zucman at UC Berkeley have used tax data on household's capital income to back out estimates of the distribution of wealth going back to the early 1900s.

Michael Klein:

In many ways, a household's wealth is more important than its income, right?

Karen Dynan:

Yes, wealth is very important to household economic security. To start, although most people will receive income and retirement from Social Security and maybe from private pensions, a lot of people will need to supplement that income by drawing down their accumulated wealth if they want to keep up a comfortable standard of living.

Karen Dynan:

Wealth can also foster economic mobility. It's certainly possible for people with low wealth to start a business and to send their kids to college, but it's much easier if they have some wealth to use as funding.

Karen Dynan:

Of course everyone needs at least some accumulated savings to provide a buffer against bad times. If the car you use to get to your workplace breaks down, you could lose your job if you don't have the money to repair it. if you get laid off, you might get some severance pay and you'll probably get unemployment benefits, but it's often not enough to avoid a meaningful cut in your consumption, unless you also have some savings.

Michael Klein:

When it comes to the absolute level of wealth for the households in the middle and the lower part of the distribution, the 2019 survey offers some good news.

Karen Dynan:

Right. The period before the COVID recession really illustrates the broad-based benefits for households of running a hot economy. For a number of years following the Great Recession, the improvements in household finances were concentrated at the top of the distribution, with middle and lower income households making really very little progress.

Karen Dynan:

But then we had this very strong labor market from 2016 to 2019, and, probably relatedly, we saw the largest gains in wealth in percentage terms going to younger households, lower income households, less educated households, and households of color.

Karen Dynan:

I should be clear that most of these groups don't have a lot of wealth in absolute terms, and they were still, in 2019, behind where they were before the Great Recession, but it was still very good to see them making progress.

Michael Klein:

Karen, you published an Econofact memo three years ago, after the 2016 Survey of Consumer Finances was published. I was struck by the statistics you cited, in particular that the bottom 90% of the wealth distribution accounted for just 23% of total household wealth in 2016. And that was down from 33% in 1989. The top 1% of the distribution accounted for 39% of total wealth in 2016, up from 30% in 1989. Are these numbers even more lopsided in the 2019 data?

Karen Dynan:

Well, the story didn't change that much between 2016 and 2019. The bottom 90% held essentially the same share of total wealth, a little less than a quarter if you're using the SCF standard wealth measure in 2019, which, as you noted ,was down from a share of about a third in 1989.

Karen Dynan:

At the top end of the distribution, the richest households lost a bit of share to other households in the top 10% between 2016 and 2019, but most people probably wouldn't view that as a major change in the wealth inequality picture for this country.

Michael Klein:

Maybe they would if they're in the yacht industry.

Karen Dynan:

Yes, that could be.

Michael Klein:

According to the 2019 survey of consumer finances, the median net wealth of the one quarter of households at the bottom of the wealth distribution was $310. That means if these people face a bad shock, like the ones you were describing, they have virtually nothing to fall back on. Of course, at the beginning of 2020, just such a shock materialized with the pandemic. What happened to these people?

Karen Dynan:

We don't have all the answers of course, because the data are limited and things are evolving, but based on what we do know, there's cause for concern. We certainly know that workers lower in the distribution have been hit harder than other households by job losses. You've published a number of Econofact memos on this, and we know that many of them received a lot of financial support early in the pandemic from the stimulus checks and from the $600 a week supplement to unemployment benefits. And studies have shown that because of this support, many low income and low wealth households have been able to maintain their spending and some even were able to do some saving.

Karen Dynan:

But that's changing because the checks were a one-off thing and the supplementary unemployment benefits have come to an end. This very likely means that we're going to see a lot more hardship among low wealth households in coming months if we don't see more fiscal stimulus passed. That's not of course

going to be good for those households, but it's also not going to be good for the broader economy because many businesses are counting, at least in part, on these households to keep spending.

Michael Klein:

Probably not the yacht industry though.

Karen Dynan:

No, probably not.

Michael Klein:

Karen, there are also big differences in wealth across racial and ethnic groups. The 2019 Survey of Consumer Finances reports that the median net worth of black households is about 13% of that of white non-Hispanic households. And Hispanic households have a median net worth of about 19% of white households.

Karen Dynan:

Yes, there are very large and persistent racial and ethnic disparities in wealth. Median net worth levels for Hispanic households, and particularly black households, are low relative to white households, and they're just low in absolute terms. And as we've already discussed, of course, having wealth is important to economic security at any given point in time and also to economic mobility over time. So this issue is a big deal.

Michael Klein:

Do we know why this has occurred? What the source of it is?

Karen Dynan:

Unfortunately, our understanding of the sources of these disparities is limited. The Fed has done some analysis showing that blacks and Hispanics are less likely to receive inheritances, they're less likely to own homes, and less likely to have access to retirement savings plans. And of course there are differences in average income by race and ethnic group. So based on what we know about the determinants of wealth, all of these factors may be playing some role.

Michael Klein:

We have a really interesting and Econofact memo by Sandy Black, she and her coauthors used this unique data set from Sweden to show how wealth passes from one generation to another through things like better opportunities for education, not just through inheritances. And the lack of wealth, the lack of those opportunities, will also pass from generation to generation.

Karen Dynan:

Sandy's work is terrific and I hope people will build off of it to look specifically at racial and ethnic disparities. We're certainly seeing increased attention to the issue. For example, more attention to work by Lisa Cook of Michigan State University who showed how the Tulsa massacre in the 1920s reversed progress by black Americans. And this is a good thing, but we need to deepen our understanding to devise policies that will most effectively boost the wealth of black and Hispanic households.

Michael Klein:

A big reason for accumulating wealth, as you mentioned, is to fund retirement. Many people depend upon Social Security as a key source of their income in retirement. How important is Social Security as part of people's retirement package?

Karen Dynan:

The importance of Social Security really depends on where a person falls in the income distribution. The Congressional Budget Office has done work suggesting that people in the lowest one fifth might get benefits that amount to half or more of the income they were receiving just prior to retiring, which could go a long way towards funding a comfortable retirement. In comparison, benefits for people in the highest one fifth of the income distribution might replace only one quarter or even less of their pre-retirement income.

Karen Dynan:

I think the group we really need to be watching most closely is middle income households, who generally need some accumulated wealth to supplement their Social Security benefits, but many of whom seem to have struggled to save.

Michael Klein:

What about people's retirement plans? For example, people would define benefit plans where they're promised a certain amount per month after retiring.

Karen Dynan:

Yes, Americans currently nearing retirement are less likely to have income from these defined benefit plans to supplement their Social Security income than Americans of the same age a couple of decades ago. So, one third of households nearing retirement were covered by such plans in 2019, down for more than one half in 1989.

Karen Dynan:

One might've expected households to have reacted to this trend by saving more on their own. But in fact, that has not happened. The median ratio of net worth to income for households nearing retirement was only three quarters as large in 2019 as it was at its peak prior to the financial crisis. And it was only barely above where it was 25 years earlier.

Karen Dynan:

Households lower in the distribution have done even less well. So for example, at the 25th percentile, households nearing retirement have savings that amount to only 10 months worth of income. And that's less than what households of that same age had in the late 1980s.

Michael Klein:

You publish an Econofact memo in 2018 entitled Will Social Security Be There For You? What was your conclusion then?

Karen Dynan:

My memo discussed the longer run financing challenges of the Social Security program based on results from the 2018 report of the Trustees of the Social Security Trust Fund. And the challenges basically

reflect the older population growing as a share of the total population, and that's thanks to the aging of the baby boom.

Michael Klein:

That's you and me, right?

Karen Dynan:

Yes. As a result of this, the program is projected to exhaust its ability to fund full retirement benefits in 2034. So that's the point at which we will have fully depleted the Social Security Trust Fund, which is the extra money accumulated in earlier years when boomers were paying in more than what was needed to support the then retirees. So after we've depleted the trust fund, incoming revenues would only be sufficient to pay a little more than three quarters of scheduled retirement benefits.

Michael Klein:

Did the current circumstances, especially the huge downturn we've had with the coronavirus, change these results?

Karen Dynan:

Unfortunately, but perhaps not surprisingly, the pandemic has made things worse for Social Security financing. With so much job loss the incoming revenues of the system have been much lower. So a Congressional Budget Office study from this September suggests that the trust fund may now run out by 2031. So that gives us just 11 years to fix the financing of the system.

Michael Klein:

What would a failure of the system along the lines that you're talking about look like?

Karen Dynan:

Well, getting back to the title of my original memo, I should be clear that Social Security will be there for people, just not exactly in its current form. To shore up the financing of the program, policymakers basically need to either cut benefits or raise taxes, or do both, either across the board or focus just on some households. So, making this fix will require policymakers to make some hard decisions, but I do expect them to eventually step up and do it because Social Security is such an immensely popular and important program.

Michael Klein:

Karen, let's get back to the topic of wealth inequality for a minute. A few years ago, the French economist Thomas Piketty published Capital in the Twenty-First Century, in which he concluded that the distribution of wealth was becoming evermore unequal and he called for a wealth tax. We don't currently have a wealth tax and implementing one has some big challenges, but we do have an estate tax. What do you see as the arguments for, and against, a wealth tax?

Karen Dynan:

There are various arguments people have made for why we should have a wealth tax. Some people think it would be viewed as fairer in a way that strengthens the social fabric. It might also limit the political influence of the richest people. There is also the so-called secular stagnation view that if we didn't have so much wealth locked up with people who have low spending propensities aggregate demand would be

stronger and interest rates wouldn't be so low, so the economy would be less prone to bubbles and the Fed wouldn't be so constrained with monetary policy.

Michael Klein:

Those are the arguments for a wealth tax. What about the arguments against one?

Karen Dynan:

The arguments against a wealth tax is that we can really accomplish many of the same goals by changing capital income taxation in ways that have been well studied by economists and that are feasible within the current system. So for instance, policymakers could raise the tax rate on capital income and they could expand the estate tax.

Karen Dynan:

There are also important loopholes that could be closed. So for example, loopholes that have to do with how capital gains on inherited assets are treated and whether certain types of labor income can be treated as capital income and thus taxed at a lower rate.

Michael Klein:

So unlike what the French economist Piketty is saying, we don't have to go to the barricades. We can have evolution, not revolution.

Karen Dynan:

Yes, we believe in evolution.

Michael Klein:

That's a good thing. Finally, I'd like to ask you about income and wealth inequality from the perspective of policymakers. As I mentioned in the introduction, you served at some of the highest levels of economic policymaking in the US government. You had almost two decades of experience at the Fed and you were the Chief Economist in the US Treasury during the Obama administration. How were issues of wealth and income inequality viewed? Did they even appear on the radar screen of policymakers?

Karen Dynan:

Surprisingly, a rising inequality, both in income and in wealth, was much discussed in the Obama administration. And it wasn't so much the inequality per se, but the fact that so many households in the lower and middle part of the distribution had experienced such limited income growth and had low and stagnant, or even falling, wealth.

Karen Dynan:

Regarding wealth, it was recognized that steps to boost lower and middle incomes were important to wealth accumulation, but that also important was providing people with better tools to build wealth.

Karen Dynan:

One priority at Treasury, for example, was expanding access to retirement savings accounts that are linked to people's paychecks. The evidence behind this effort was based on studies of 401Ks, that suggests that having money taken out automatically of people's paychecks provides what's called a commitment device that turns out to be a very powerful way to help people save.

Michael Klein:

That is providing people with a nudge.

Karen Dynan:

Yes, nudges seem to work. But the reason that policy has a role to play is that at this point only about 40% of working age households in the lower half of the income distribution are participating in 401K type plans, and that that share doesn't appear to be rising with time.

Michael Klein:

Karen, thanks very much for speaking with me today about these really important issues. And also thank you Karen, for the contribution of memos that you've made to Econofact.

Karen Dynan:

You're welcome. I really enjoyed speaking with you Michael.

Michael Klein:

Thanks, Karen.

Michael Klein:

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