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## Consumption and Income Inequality in the United States since the 1960s

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**T**rends in inequality and the appropriate responses to them are the focus of national discussion in the United States. The extent of inequality is an important factor in the debates on some of our largest policy issues, including income tax policy, immigration, and globalization. Much of this discussion focuses on inequality at the very top of the distribution. Political rhetoric emphasizes a growing divide between the rich and the poor, highlighting the rise in executive pay and the increasing ranks of the very rich. While the extremely affluent are an important group to study, they are a small share of the population. Measures of inequality that look beyond the very top of the distribution and that more accurately reflect economic well-being are essential for evaluating existing policies and for determining the need for policy changes.

The debate over inequality relies almost exclusively on income data. Official income statistics indicate that inequality has increased sharply. But these official statistics may not accurately reflect changes in economic well-being. They ignore taxes and transfers and rely on income that is badly reported in surveys. Even improved income measures fail to capture consumption of durables such as housing and cars. In addition, income typically fluctuates more than economic well-being

because people can save when income is temporarily high and borrow when it is temporarily low. Consequently, income provides a narrow, short-term view of how well-being has changed. For these reasons, the consumption patterns of families may provide a better indicator of economic well-being.

Several researchers have documented the patterns in consumption inequality. The evidence from this literature is mixed, with some studies showing little change in consumption inequality over the past few decades and others showing a proportional rise equal to or exceeding that for income. These differences arise from the use of different data sources or definitions of consumption (i.e., total consumption or nondurable consumption) and different methods of addressing measurement error.

Our research advances this literature by presenting new evidence on consumption inequality that relies on improved ways of measuring consumption. Our way of accounting for measurement error in consumption is simple and relies on clear and transparent assumptions. We also extend the literature by providing results for both income and consumption inequality for more recent years that span the Great Recession, by considering possible explanations for changes in inequality over time, and by investigating why the patterns for income and consumption inequality differ.

To address concerns about measurement error in consumption, we build on recent evidence showing that some components of consumption reported in survey data compare quite favorably to national accounts, both in levels and in changes over time. Other components are sharply underreported with this bias increasing over time. We construct a way of measuring consumption that relies on the well-measured components. These components represent an important share of overall consumption—they include key components of consumption such as food at home, housing, and vehicles. Even though several other studies rely on subsets of total consumption, they rarely test the conditions under which distributional statistics for these subsets can be extrapolated to total consumption. In order to draw conclusions about changes in consumption inequality from evidence on the well-measured components, it is critical that these components are equally important for high and low consumption households. It is also important that price changes for well-measured consumption mirror the changes for overall spending. The data indicate that both these conditions hold: well-measured consumption is roughly a constant share of overall consumption throughout the distribution, and the price of the bundle of well-measured goods has not changed noticeably relative to the prices for all goods.

We report measures of inequality for income and consumption over the past five decades, using income data from the Current Population Survey and consumption data from the Consumer Expenditure Interview Survey. We investigate inequality patterns in different parts of the distribution by reporting ratios of percentiles, which are not sensitive to errors in the extreme tails of the distribution. In particular, we focus on the ratio of the 90th percentile to the 10th percentile (the 90/10 ratio), the 90/50 ratio, and the 50/10 ratio. Thus, our analyses do not capture changes in the extreme tails of the distribution.

Our results for income show that the way one measures income has a significant effect on changes. Accounting for taxes considerably reduces the rise in income inequality since 1963. Accounting for noncash benefits, using data available only since 1980, has only a small effect on changes in income inequality, likely due to increased underreporting of transfer income at the bottom.

Using our improved ways of measuring consumption, we show sharp differences in the patterns for consumption and income inequality. Since the early 1960s, the rise in income inequality as measured by the 90/10 ratio (29 percent) has significantly exceeded the rise in consumption

inequality (7 percent). Furthermore, this much smaller percentage increase in consumption inequality started from a considerably lower base. In some decades, such as the 1960s and 1990s, income and consumption inequality moved in parallel, but in other decades the differences were sharp. In the 1980s, inequality for both measures rose, but the increase was much greater for income (28 percent) than for consumption (5 percent). After 2005 these measures moved in opposite directions as income inequality rose sharply while consumption inequality fell. The differences between income and consumption through 2005 are almost exclusively in the bottom half of the distribution, indicating that the underreporting of consumption by the rich is not an explanation for the differences.

We also consider several possible explanations for the differences in inequality patterns. We decompose the changes in income and consumption inequality to determine the extent to which the patterns can be explained by changing demographics. These decompositions show that changing demographics can account for some of the changes in consumption inequality, but they account for few of the changes in income inequality. We do find that the divergence between income and consumption inequality measures is almost exclusively concentrated in single-parent-headed families and single individuals, who have the largest increases in income inequality but the largest declines in consumption inequality. Consumption smoothing is not consistent with differences between income and consumption at the very bottom, but the declining quality of income data plays an important role. Changes in asset prices likely account for some of the differences between the measures in recent years for the top half of the distribution.

Our evidence of only a modest rise in consumption inequality over the past five decades contrasts sharply with Thomas Piketty and Emmanuel Saez's evidence from tax data that an increasing share of the nation's income is going to the very highest income families; though several papers using broader and more consistent measures of income in tax data do not show large increases in the top 1 percent income share. Our analyses are distinct from these studies that focus on the highest income households. We do not include the extreme tails of the distribution because resources are likely to be poorly measured in survey data for these observations. Tax data alone are also unsuitable for measuring incomes at the bottom since they miss nonfilers and important sources of income such as TANF, SSI, SNAP, and housing benefits, which are not taxable.

Most of the discussion around recent trends in inequality

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highlights growing dispersion. However, the evidence from consumption data indicates that changes in inequality in economic well-being is more nuanced than a simple story of rising dispersion throughout the distribution. Rather, in the bottom half of the distribution there is little evidence of rising consumption inequality, and in the top half of the distribution the rise in consumption inequality has been much more modest than the rise in income inequality, particularly since 2000. In light of the deficiencies of income and the contrast

with consumption, policymakers should look beyond income when assessing the need for policy changes.

**NOTE:**

This research brief is based on Bruce Meyer and James Sullivan, "Consumption and Income Inequality in the U.S. since the 1960s," Becker Friedman Institute Working Paper no. 2017-12, September 2017.

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