The top 1%’s share of U.S income (and more)

By Editorial Staff *Wed, Oct 7, 2020*

The latest crop of research includes a CBO report on U.S. income distribution, a look at the low usage of reverse mortgages, a study of the effect of accumulation guarantees in German IRAs, and an assessment of the safety-net of 'swap lines' that holds the global financial system together.

The “top 1%” receive 18% of U.S. income: CBO

There’s been a lot written in recent years about economic inequality—about the disproportionate neo-Gilded Age wealth of the “top 1%” as well as the top-heavy tax burden and the bottom-heavy government means-tested transfer payments to the poor.

This month, the Congressional Budget Office (CBO) offered a **report**, “The Distribution of Household Income, 2017,” based on the most recent complete data from tax returns. It showed changes in the division of income among Americans and in sources of income over the 39 years from 1979 to 2017.

The roughly 128 million households (~315 million people) in the United States received about $14.1 trillion in annual income in 2017, the CBO reported. (“Income” was defined as household income before means-tested transfers and federal taxes.) The highest-earning Americans derived their incomes primarily from business income or capital gains over that period, while the lowest-earning Americans benefited from rising transfer payments through Medicaid, SNAP and other means-tested programs.

The wealth is concentrated in the top quintile (20%), which received almost 50% of all the annual income in the U.S. The bottom half of the top quintile (the 81st to 90th percentiles) had an average income of about $165,600, or about $4.2 trillion or 30% of the total.

The average income among the 1.28 million households in the top 1% of the distribution was about $2.0 million for a total of $2.6 trillion or about 18% of all pre-tax, pre-transfer income. The average income among the approximately 11,000 households in the top 0.01 percent of the distribution was about $48.5 million.

Incomes within the top 1% varied widely: Average income before transfers and taxes among the approximately 11,000 households in the top 0.01% was $48.5 million in 2017, compared with $5.7 million among households in the 99.9th to 99.99th percentiles and $1.1 million among those in the 99th to 99.9th percentiles.

Business income and capital income (including capital gains) were, on average, a much larger percentage of income for the top 1% of the distribution than in lower income groups. Among households in the top 0.01%, capital income was an average of 66% of income before transfers and taxes in 2017.

Total billionaire wealth reached $10.2 trillion at the end of July 2020, touching a new high after the year’s V-shaped rebound in asset prices, according to a separate **report** by UBS and PwC (Price Waterhouse Cooper). This level surpasses the previous peak of $8.9 trillion, reached at the end of 2017. There are now 2,189 billionaires, up from 2,158 in 2017. (The report didn’t provide total world wealth, or the percentage of it represented by billionaire wealth.)

Among the poorest 25 million households, labor accounted for about 60% of all income before transfers and taxes in the quintile. With the top 20% taking home 50% of all income, the bottom 80% of American households shared the remaining 50% (about $7 trillion or $70,000 each on average).

In 2017, the average federal tax rate also varied widely by income group. Among all households it was about 21%, CBO estimates. Among households in the lowest quintile, the average rate was about 1%; in the middle quintile it was about 14%; and in the highest quintile it was about 26%. The average federal tax rate among households in the top 1 percent of the income distribution in 2017 was about 32%.

Of the five components of income before transfers and taxes, business income expanded fastest, growing more than sevenfold over the 39-year period, the report said. As a share of income among households in the top 1%, business income rose from 11% in 1979 to 23% in 2017. Meanwhile, average capital income (including capital gains) grew at a slower pace than other forms of income.

The most neglected retirement income solution

With mortgage rates extremely low and millions of under-saved retirees holding trillions of dollars in home equity, the U.S. market for “reverse mortgages” (or as the British say, “equity release” products) should be much more active than it is. A new research **paper**, “The Market for Reverse Mortgages among Older Americans,” by Christopher Mayer of Columbia and Stephanie Moulton of Ohio State University tries to solve this puzzle.

The two economists discovered that many retirees are in fact tapping their home equity in retirement. But they’re doing it much more often through refinancing and home equity lines of credit than by purchasing a reverse mortgage (aka Home Equity Conversion Mortgage, or HECM).

“Many seniors do, in fact utilize home equity in order to fund their retirement,” Mayer and Moulton write. “Yet they choose products that require monthly payments lasting decades into retirement and rising as a share of (declining) income as they age.”

In 2018, only 33,000 originated reverse mortgages were recorded, versus 609,000 originated equity extraction loans such as HELOCs (home equity lines of credit), cash-out refinancing, first liens not for refinance or purchase, and second liens. Another 688,000 older Americans originated a mortgage for home purchase or a refinancing. In many cases, people who were turned down for these loans could have qualified for HECMs.

The authors looked into reasons for the underutilitization of reverse mortgages and found four potential reasons: higher costs, bequest motives, product reputation, and regulatory barriers. The last two reasons, they write, play a role “in discouraging the participation of mainstream financial institutions which might be able to bring distribution efficiencies, lower costs, and retirement advice that incorporates home equity into financial plans.”

The high cost of money-back guarantees for IRAs in Germany

As defined benefit pensions disappear, experiments with creating individualized retirement income solutions are taking place all over the world. The results can provide potential solutions (or cautionary tales) for retirement policymakers in the U.S.

So it is with the German Reister plans, which are individual retirements accounts (IRAs) with tax benefits and accumulation guarantees. If, at retirement, the account value is lower than the sum of payments into the IRA, the provider—usually an insurance company—must cover the shortfall with its own equity capital.

Olivia Mitchell, director of the Pension Research Council at the Wharton School, and her German co-authors, Raimond Maurer, Vanya Horner and Daniel Liebler of Goethe University, studied Reister plans. In a recent **paper**, “Implications of Money-Back Guarantees for Individual Retirement Accounts: Protection Then and Now,”they write:

> “these guarantees altered participant consumption, saving, and investment behavior during higher interest rate times, but their impacts are even larger in the present low-return environment.

> "Importantly, we conclude that abandoning these guarantees could enhance old-age consumption for over 80% of retirees, particularly lower earners, without harming consumption during the accumulation phase."

In 2018, 45 million German employees were entitled to contribute to tax-qualified Riester IRAs in 2018 and 16.6 million people did so. The German government pays a yearly subsidy of up to €175 plus €300 per child younger than age 25 into each worker's IRA. To qualify for the full subsidy, the sum of employee contributions plus subsidies must equal 4% of pre-tax labor income (to a cap of €2,100).

During the decumulation phase, payouts can start at age 62, not more than 30% of accumulated assets may be withdrawn as a lump sum, and any remaining assets must be annuitized by age 85. IRA providers devote a share of savers' IRA balances at age 67 to buy a deferred annuity paying benefits to the retiree from age 85 until death.

"Swap lines" and global financial stability

Economic history buffs, take notice. A new **paper** by one of America's premier economic historians and macroeconomists, Michael Bordo of Rutgers University, explains the method (and history) behind the madness (a miracle, in a way) of the Federal Reserve's monetary response to the financial crisis triggered by COVID-19 starting last March.

After a historical review that extends back to the classical pre-World War One gold standard, and proceeds through the collapse of the famous Bretton Wood monetary system in 1971, Bordo concludes that the Fed rescued the global economy this year in part with a safety net of "swap lines" with other countries' central banks.

A "swap line" in this case refers to an arrangement whereby a foreign country that needs dollars—to pay for oil imports, for instance, or to service dollar-denominated debt—can trade its own currency for dollars from the Federal Reserve. The Fed accepts foreign currency as collateral for short-term loans of dollars during financial crises, when everybody is competing for dollars and dollar-denominated assets.

"In the face of a global financial crisis as in 2007-2008 and 2020, central banks have learned to effectively cooperate to prevent a liquidity panic using the swap network to pursue the well-known tenets of Bagehot's rules," Bordo writes. [A reference to Walter Bagehot, the British journalist who in 1873 wrote ***Lombard Street***, the classic analysis of central banking.]

“The international swap network can be viewed as a step in the direction of a global financial safety net,” he says, “Whether it is possible to return to the world before the Great Financial Crisis of small central bank balance sheets, normalized interest rates and the policy rate as the instrument is an open question.”