

# **Income from Wealth and Income from Labor: Stocks, Flows and More Complete Measures of Well Being**

## *Executive Summary*

Timothy M. Smeeding and Jeffrey P. Thompson  
Center for Policy Research, Maxwell School, Syracuse University

There is a widespread concern about growing inequality in the distribution of household income in America. Over the past five years, the income distribution as normally measured by the Census Bureau has shown no change in incomes below the 90<sup>th</sup> percentile (US Bureau of the Census, 2006) and a declining median for non-elderly households. Several analysts have suggested that most, if not all, of the gains in incomes over this period of rapidly expanding productivity have accrued to the richest 1-5 percent of Americans. Labor economists also point to the growing inequality in the US earnings distribution, also at the very top, and to conventional household micro data showing earned incomes are more or less 70-75 percent of total income in most years. Therefore, earnings are the key determinant of changes in the distribution of income according to these sources. However, it seems to us that these studies all seem to ignore the major source of growing income inequality: income from accumulated wealth. Wealth is more permanent and more durable than traditionally measured annual income. It offers a buffer against income downturns and provides a source of consumption, private security and power, especially amongst top wealth and income holders.

At the same time that micro oriented labor economists suggest labor income is the major determinant of household incomes and concentrate on its effect on inequality, macro economists and national income accountants find that labor income in the form of wages and salaries has now declined to 51.9 percent of national income, a 50 year low. Macro analysts point to the rising share of corporate profits in national income, now 13.6 percent of total national income. But adding together labor income (even including supplements or employee benefits) and corporate profits still misses more than a fifth of the nation's economic pie. Other uncounted components such as net interest, proprietor's income and rental incomes are largely missing from income distribution calculations (see Table 1).

The key question we address in this paper is to whom did this income from wealth accrue? We employ the 1989-2004 Surveys of Consumer Finances to develop new estimates of 'more complete income', those that are accrued from the ownership of wealth. Decades ago, Haig and Simons defined income as ones ability to consume without drawing down their stock of wealth. We use their identity to impute both short and long term returns to capital income and to construct our measure of "more complete income" (MCI). We then compare these distributions in a given period to those from traditional income measures such as Survey of Consumer Finance (SCF) income.

We note that these imputations increased the real incomes of almost all households, and most by a substantial amount: 46 percent at the mean, and 24 percent at the median in 2003. Of course the top percentiles of the MCI distribution saw larger income from wealth gains of 54 and 81 percent at the 95<sup>th</sup> and 99<sup>th</sup> percentiles respectively (Figure #1). The major source of income from wealth gains at the median were those due to home ownership. Ownership of financial assets, other investments and the value of businesses increased income from wealth for the top income groups relative to the median. We argue that our measures are more durable and permanent than those of others based on annual 'high income' flows or annuitized wealth distributions.

We also assess the level and trend in the functional distribution of income between capital and labor as we have defined it, and find a steadily rising share of income accruing to real capital or wealth from 1989 to 2003 (Figure 2). We find that our measure of income from labor and from wealth, MCI, shows a more pronounced trend toward greater income inequality than that found in the 'high income' series of Piketty and Saez or in other expanded definitions of income such as that used by the CBO to assess tax effects on income distribution. We do our best to identify high MCI households and find they are a varied lot, which loosely identify with most definitions of 'entrepreneurs' based on education, occupational profession and industry. They are not especially the aged and almost half of high MCI families still have children under age 18.

We conclude that one cannot fully understand the distribution of economic well being and the way it affects key social and economic institutions, especially over the past decade, without also understanding how income from wealth affects consumption, tax revenues, living standards, the growth of non-profits, fundraising at educational institutions, socio-economic mobility and well-being more generally. Indeed, we believe that the 21<sup>st</sup> Century may become the century of wealth, as pension funds and other investors increasingly find high yield investments in capital hungry middle-income countries and in globalizing firms. Our institutions and values suggest more of the same type of entrepreneurial growth and perhaps then greater income inequality in the future.

But we do not recommend that policy dissuade entrepreneurship. Nor do we recommend tax and spend programs to redistribute wealth. Everyone amongst policy pundits suggests that we increase our stock of human capital. But the trouble is that we are not very effective at reaching this goal. Rather based on the belief in a balanced portfolio of human and non-human wealth, we suggest policy options to broaden and deepen the ownership of non-human capital or wealth and policies which will reap its rewards for a wider share of Americans.

The longer technical version of this paper is available at:

[http://www.cpr.maxwell.syr.edu/faculty/smeeding/pdf/INCOME%20FROM%20WEALTH\\_\\_June12\\_07\\_FINAL.pdf](http://www.cpr.maxwell.syr.edu/faculty/smeeding/pdf/INCOME%20FROM%20WEALTH__June12_07_FINAL.pdf)

**Table 1.--Components of National Income -  
Including Those Accounted for in This Paper (shaded)**

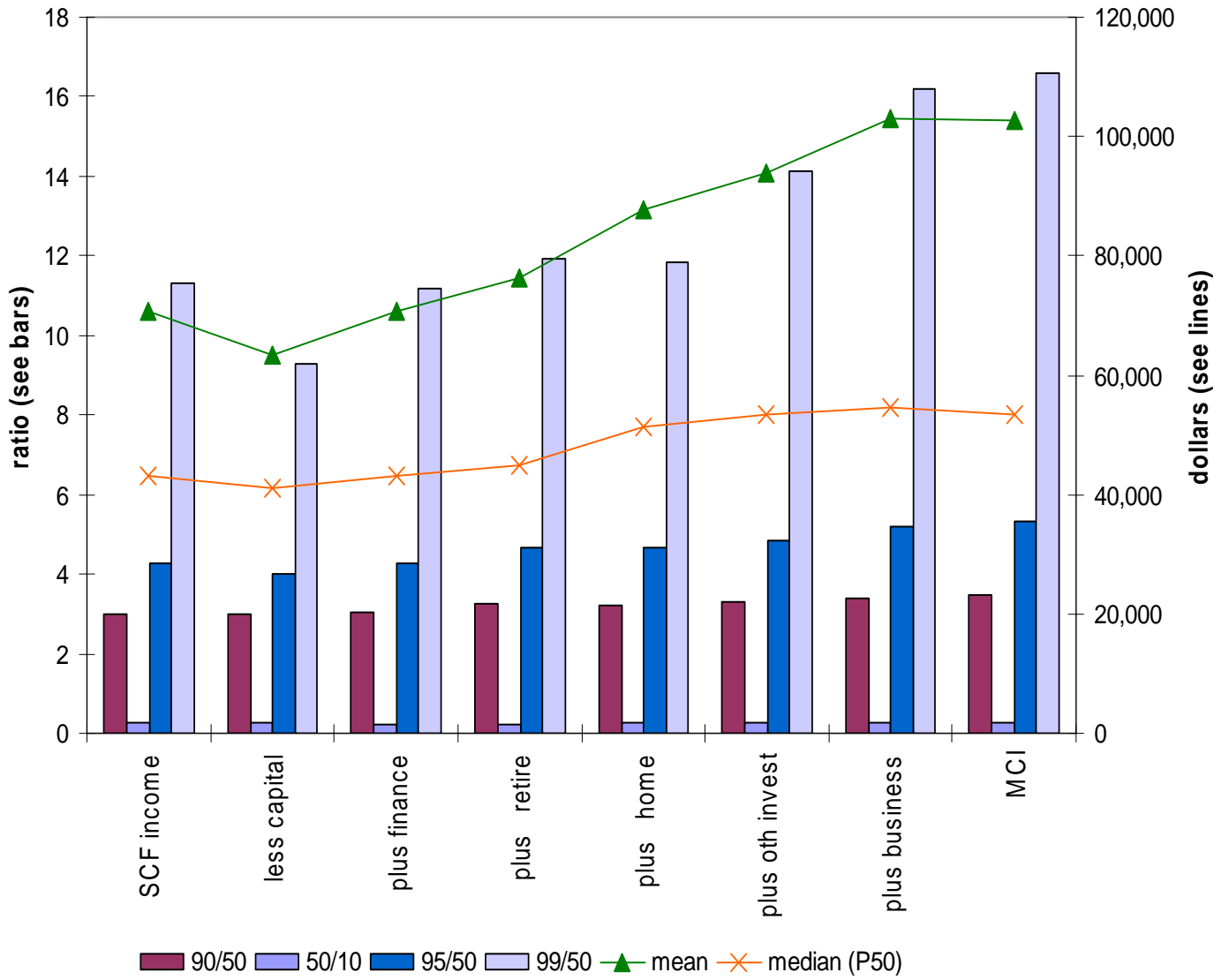
[Billions of dollars; quarters seasonally adjusted at annual rates]

	2006:Q1	Share
National income	11,551.3	100.0%
Compensation of employees	7,400.3	64.1%
Wage and salary accruals	5,970.1	51.7%
Supplements to wages and salaries	1,430.3	12.4%
Proprietors' income with inventory valuation and capital consumption adjustments	1,008.3	8.7%
Rental income of persons with capital consumption adjustment	76.8	0.7%
Corporate profits with inventory valuation and capital consumption adjustments	1,569.1	13.6%
Net interest and miscellaneous payments	514.8	4.5%
Taxes on production and imports less subsidies	897.4	7.8%
Business current transfer payments	93.8	0.8%
Current surplus of government enterprises	-9.2	-0.1%

Source: BEA Release - GROSS DOMESTIC PRODUCT: SECOND QUARTER 2006 (FINAL) & CORPORATE PROFITS: SECOND QUARTER 2006 (FINAL)

We account for supplements to wages and salaries only in so far as they appear as part of defined contribution pension plans. Health care and other employer subsidies are not counted.

Figure 1. Full-income 2003-04 SCF - Short-run returns



**Figure 2. Labor and Capital Shares (MCI Long-run Rates)**

