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GOVERNMENT SPENDING BOOSTED MIDDLE CLASS WELL-BEING DURING 2001-2002 RECESSION, BUT FLATTER TAX SCHEDULE CONTRIBUTED TO GREATER INEQUALITY, ACCORDING TO NEW LEVY INSTITUTE STUDY

Latest Report from Levy Economics Institute's Comprehensive New Measure of Economic Well-Being Focuses on Middle Class Well-Being Between 1989–2002

ANNANDALE-ON-HUDSON, N.Y.—Just as policymakers and economists examine how different issues—such as oil and housing prices, trade and budget deficits, interest rates, and job growth—impact the prospects of the U.S. economy, it is equally important to consider how these larger macroeconomic circumstances affect the well-being of everyday Americans and the economic disparities that exist between households. Toward that goal, the latest report of the Levy Institute Measure of Economic Well-Being (LIMEW) compares the LIMEW and official measures of economic well-being for 1989-2002, a period marked by the U.S. economic boom of the late 1990s and a mild recession in 2001-02.

Among the report's key findings, is that, because of the comprehensive way it measures well-being, the LIMEW shows that dramatic increases in government spending during the 2001-02 recession led to a significant improvement in economic well-being for the middle class and even tempered the larger shift towards greater inequality that existed during the 1989-2002 time frame. The results contrast with the government's most comprehensive measure, extended income (EI), which showed a deteriorating level of well-being for average households after 2000. In their study, *Interim Report 2005: The Effects of Government Deficits and the 2001-02 Recession on Well Being*, Levy Institute scholars Edward N. Wolff, Ajit Zacharias, and Hyunsub Kum argue that the incremental effects of the different components of each measure of well-being, in areas that display both similar and contrasting results, could have significant implications for public policy.

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For example, in examining the middle quintile of the LIMEW and EI distributions (i.e. the "middle class"), the Levy Institute scholars find that the contrast between the LIMEW's increase in well-being and EI's decrease can be attributed to the fact that EI relies more heavily on base-income, which fell after 2000. Furthermore, the LIMEW formulates the income from wealth component as a lifetime annuity rather than as current income from assets as EI does. Therefore, while both measures show the positive impact that net government expenditures and a decline in taxes had on middle class well-being after 2002, the impact in EI is not enough to offset the impact that stock market losses had on middle class assets during that time.

Looking more closely at inequality, which increased overall between 1989 and 2002, Wolff, Zacharias, and Kum contend that, while both the LIMEW and EI show increased government transfers and tax cuts after 2000 reducing inequality, the impact of government spending plays a much greater role in reducing inequality in the LIMEW. Their analysis showed that taxes contributed to an increase in inequality in the LIMEW largely because of the flattening of the tax schedule between the second and ninth deciles, which was due to a shift in the tax burden caused by a greater relative decline in tax rates for the higher deciles.

Other findings in the LIMEW report yielded several conclusions that are relevant for social policy. The authors found that single female-headed families made no progress in well-being relative to married-couple families between 1989 and 2002, and that the elderly appeared to be worse-off relative to the non-elderly in 2002 than in 1989.

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Interim Report 2005: The Effects of Government Deficits and the 2001-02 Recession on Well Being

(6.24.05)