

The Levy Economics Institute of Bard College



Levy Institute Measure of Economic Well-Being

Has Progress Been Made in Alleviating Racial
Economic Inequality?

THOMAS MASTERSON, AJIT ZACHARIAS, and EDWARD N. WOLFF

November 2009

THOMAS MASTERSON is a research scholar at The Levy Economics Institute.

AJIT ZACHARIAS is a senior scholar at The Levy Economics Institute.

EDWARD N. WOLFF is a senior scholar at The Levy Economics Institute and a professor of economics at New York University.

The Levy Institute is grateful to the Alfred P. Sloan Foundation for its financial support of the LIMEW project.

The Levy Economics Institute of Bard College, founded in 1986, is an autonomous research organization. It is nonpartisan, open to the examination of diverse points of view, and dedicated to public service.

The Institute is publishing this research with the conviction that it is a constructive and positive contribution to discussions and debates on relevant policy issues. Neither the Institute's Board of Governors nor its advisers necessarily endorse any proposal made by the authors.

The Institute believes in the potential for the study of economics to improve the human condition. Through scholarship and research it generates viable, effective public policy responses to important economic problems that profoundly affect the quality of life in the United States and abroad.

The present research agenda includes such issues as financial instability, poverty, employment, gender, problems associated with the distribution of income and wealth, and international trade and competitiveness. In all its endeavors, the Institute places heavy emphasis on the values of personal freedom and justice.

Editor: W. Ray Towle

Text Editor: Barbara Ross

The Levy Institute Measure of Economic Well-Being is a research project of The Levy Economics Institute of Bard College, Blithewood, PO Box 5000, Annandale-on-Hudson, NY 12504-5000. For information about the Levy Institute and to order publications, call 845-758-7700 or 202-887-8464 (in Washington, D.C.), e-mail info@levy.org, or visit the Levy Institute website at www.levy.org.

This publication is produced by the Bard Publications Office.

Copyright © 2009 by The Levy Economics Institute. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording, or any information-retrieval system, without permission in writing from the publisher.

ISBN: 978-1-936192-01-4

Preface

In this report, the authors examine trends in economic well-being between 1959 and 2007 based on the race/ethnicity of households. Using the Levy Institute Measure of Economic Well-Being, they find that changes in household wealth and net government expenditure are the key elements in the story that unfolds about racial differences.

The gap between white and nonwhite households showed a relatively small increase over the period. However, this increase conceals a significant deterioration of well-being for blacks and Hispanics relative to whites due to the influence of the Asian group, which has the highest average income of all the groups surveyed. It also obscures the large decrease in the gap that occurred in the 1960s, when nonwhites benefited from an improvement in earnings and government expenditures (transfers and public consumption). The introduction of Medicaid and increased public spending on education and infrastructure went a long way toward alleviating racial inequality in economic well-being. The significant reversal in the 1990s was dominated by an increase in the gap due to the income from wealth component, a result consistent with nonwhites' pervasive disadvantage in asset accumulation.

These observations are particularly significant in the context of the current economic downturn. Employment losses have been especially severe among blacks, and foreclosure rates have been much higher among black and Hispanic households. This indicates that the asset gap has worsened.

The level of racial disparity in economic well-being has stagnated over the past 40 years. The experience of the 1960s, which includes poverty alleviation, public education, affirmative action, and increased public sector employment for nonwhites, shows that government policy can be instrumental in diminishing racial inequality. Therefore, it is imperative to contemplate serious policy initiatives to address this issue, such as a proactive policy strategy that combines elements of both asset building and job creation.

As always, I welcome your comments and suggestions.

Dimitri B. Papadimitriou, *President*

November 2009

Introduction

Reports of a postracial society may be premature. Studies continue to show wide racial gaps in income and, especially, wealth (Oliver and Shapiro 2006). There is some evidence that income gaps have shrunk over the past half century, but wealth inequality is large and persistent.

The standard measures used to assess economic inequality include wages, earnings, income, and wealth. These measures all lack an accounting of the impact of important components of economic well-being, such as household production, taxes, and government spending on public services for households (which we call public consumption). In addition, the standard measures do not adequately capture the effect of wealth on economic well-being. The Levy Institute Measure of Economic Well-Being (LIMEW) is a more comprehensive measure that includes estimates of both public consumption and household production. We also include estimates of long-run benefits from the ownership of wealth (other than homes) in the form of an imputed lifetime annuity—a procedure that, in our view, is superior to considering only current income from assets.¹ Using LIMEW to assess long-term trends in racial inequality gives us a better picture of the changing impact of public policy (see Table 1 for the

measure’s components). As shown below, changes in household wealth and net government expenditure are the key elements in the story that unfolds about racial differences.²

Long-run Trends in Racial Inequality

We confine our discussion to two groups: non-Hispanic whites (“whites”) and everyone else (“nonwhites”). Our unit of analysis is the household. A household is placed in one or the other group depending on whether the householder³ is “white” or “nonwhite.” Data limitations in the earlier years of the period covered prevent us from breaking down the nonwhite group into black, Hispanic, and other nonwhites. In the concluding section, however, we present some evidence on recent trends in the relative well-being of nonwhite groups, and speculate on how our results might have been affected by treating all nonwhites as a single group.

Estimates of the LIMEW and its components for white and nonwhite households are shown in Table 2. The relatively small increase in the gap in LIMEW between whites and nonwhites (from \$26,100 in 1959 to \$30,600 in 2007) masks the great reduction in overall inequality in the 1960s.⁴ The gap stood at \$19,000 in 1972. In contrast to a substantial decline of roughly \$7,000 between 1959 and 1972, the gap shrank by only \$800 between 1972 and 1989. The subsequent widening of the gap in the 1990s, to \$31,500 by 2000, remained resistant to developments in the economy during the first decade of the 2000s. In 2007, the gap in LIMEW was \$30,600, and the LIMEW for nonwhite households was equivalent to the LIMEW for white households 20 years previously.

There was relatively steady improvement in each component of LIMEW for white and nonwhite households over the period, with the exception of household production,⁵ which declined beginning in the 1960s and then picked up in the mid ’80s. However, the components had varying degrees of influence on the change in the overall LIMEW gap. The biggest shifts occurred in the 1960s and 1990s. In the 1960s, the large decrease in the LIMEW gap (to \$7,000) was mainly due to the improvement for nonwhites in base income and government expenditures (transfers and public consumption).⁶ The significant reversal in the 1990s (during which the LIMEW gap reached \$31,500) was dominated by the hefty increase in the gap in income from nonhome wealth. In fact, a comparison of income from nonhome wealth between 1959 and 2007 shows that the level of such income for nonwhites in 2007 was similar to the level that whites had attained in 1959. A similar comparison for income from home wealth shows that the level for nonwhites in 2007 was considerably lower

Table 1 Components of the LIMEW

Money income (MI)	
<i>Less</i>	Property income and government cash transfers
<i>Equals</i>	Base income
<i>Plus</i>	Income from wealth
	Income from nonhome wealth (annuitized value of nonhome wealth <i>less</i> the annuitized value of nonhome debt)
	Income from home wealth (imputed rent on owner-occupied housing <i>less</i> the annuitized value of mortgage debt)
<i>Less</i>	Taxes
	Income taxes ¹
	Payroll taxes ¹
	Property taxes ¹
<i>Plus</i>	Cash transfers ¹
<i>Plus</i>	Noncash transfers ^{1,2}
<i>Plus</i>	Public consumption
<i>Plus</i>	Household production
<i>Equals</i>	LIMEW

1. Aligned with National Income and Product Account estimates.

2. Valued at government cost.

than the level observed for whites in 1959. These results are consistent with nonwhites' pervasive disadvantage in asset accumulation, which has been documented in several studies.⁷

Table 3 reports annual percentage shares of each LIMEW component by race. Two important changes occurred over the period: the share of government transfers and taxes rose for both

Table 2 LIMEW Components by Race, 1959–2007 (in 2008 dollars)

		Base Income	Income from Home Wealth	Income from Nonhome Wealth	Government Transfers	Public Consumption	Taxes	Value of Household Production	LIMEW
1959	White	42,591	2,828	6,412	3,215	5,197	-7,668	24,985	77,560
	Nonwhite	26,259	1,053	1,842	2,643	6,156	-3,453	16,997	51,495
1972	White	48,788	4,070	8,978	5,992	8,356	-12,989	19,509	82,705
	Nonwhite	35,194	1,794	2,029	7,124	10,649	-6,922	13,820	63,689
1982	White	49,255	4,354	9,774	7,817	7,287	-13,624	16,657	81,520
	Nonwhite	35,850	1,607	1,320	8,797	10,643	-7,935	12,948	63,230
1989	White	57,979	5,000	12,862	8,360	8,197	-17,561	22,813	97,652
	Nonwhite	43,741	2,421	4,036	9,759	12,254	-10,964	18,230	79,476
2000	White	68,534	5,054	27,937	10,418	9,243	-22,898	25,162	123,449
	Nonwhite	53,933	1,886	4,618	10,840	13,380	-15,381	22,678	91,954
2004	White	64,617	4,432	23,833	12,630	9,730	-17,251	25,953	123,944
	Nonwhite	49,718	1,723	5,162	12,054	13,967	-11,220	23,304	94,707
2007	White	68,883	4,251	28,539	13,292	10,231	-22,334	25,921	128,783
	Nonwhite	54,120	1,539	6,651	13,222	15,005	-14,918	22,600	98,219

Source: Authors' calculations

Table 3 Percentage Share of LIMEW Components by Race, 1959–2007

		Base Income	Income from Home Wealth	Income from Nonhome Wealth	Government Transfers	Public Consumption	Taxes	Value of Household Production
1959	White	55	4	8	4	7	-10	32
	Nonwhite	51	2	4	5	12	-7	33
1972	White	59	5	11	7	10	-16	24
	Nonwhite	55	3	3	11	17	-11	22
1982	White	60	5	12	10	9	-17	20
	Nonwhite	57	3	2	14	17	-13	20
1989	White	59	5	13	9	8	-18	23
	Nonwhite	55	3	5	12	15	-14	23
2000	White	56	4	23	8	7	-19	20
	Nonwhite	59	2	5	12	15	-17	25
2004	White	52	4	19	10	8	-14	21
	Nonwhite	52	2	5	13	15	-12	25
2007	White	53	3	22	10	8	-17	20
	Nonwhite	55	2	7	13	15	-15	23

Source: Authors' calculations

white and nonwhite households, and income from nonhome wealth as a share of LIMEW increased much more for white households than for nonwhite households. The increase in transfers occurred mostly in the 1960s for both white and nonwhite households; however, while the increase in the share of taxes for white households was in large part limited to the 1960s, the share for nonwhite households increased steadily over time. As a result, the gap between the two groups in the share of taxes in LIMEW has narrowed overall.⁸ The increase in the share of income from nonhome wealth in LIMEW for white households was almost entirely confined to the 1990s, although those households did experience a smaller increase in the 1960s.

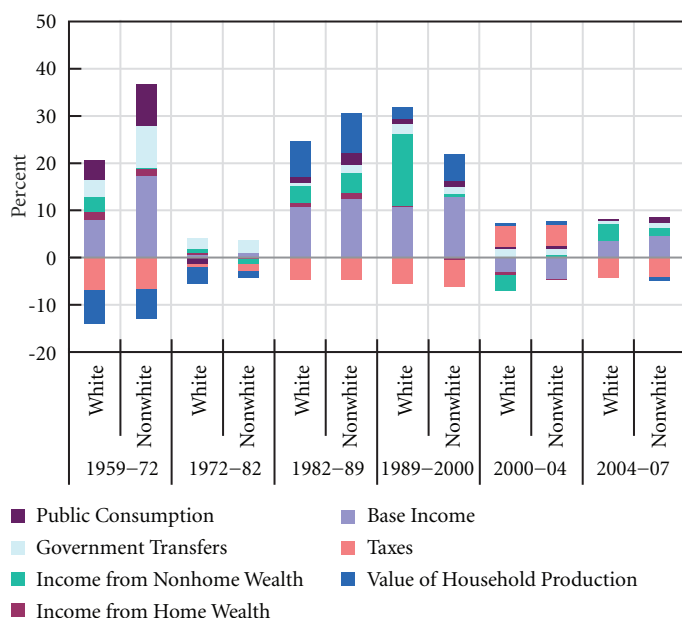
Figure 1 shows each component's share of the growth in LIMEW by period and race. LIMEW increased by 66 percent for white households and 91 percent for nonwhite households between 1959 and 2007, so there has clearly been some convergence. The bulk of that convergence happened between 1959 and 1972, when LIMEW increased by 24 percent for nonwhites and only 7 percent for whites. Base income led the way, with a 17 percent increase for nonwhite households, compared to 8 percent growth for white households. In addition, both government transfers and public consumption favored nonwhites (9 percent increases) over white households (4 percent increases). During

the 1970s, average LIMEW shrank by 1.4 percent for whites and only 0.7 percent for nonwhites. Greater gains were made in the 1980s, when white households' average LIMEW grew by 20 percent, compared to nonwhite households' 26 percent growth. However, these gains were undone in the 1990s: although average LIMEW grew by 16 percent for nonwhites, it grew by 26 percent for whites.

There were not such stark differences in the growth of components by race in the period 1982–89, which, along with the shorter time period, accounts for relatively slower convergence in LIMEW. The largest contributor was again base income, which increased LIMEW by 12 percent for nonwhite households and 11 percent for white households, followed by public consumption, which contributed 1.4 percent more to nonwhite than to white households. Interestingly, the impact on LIMEW of growth in base income was virtually the same for white and nonwhite households in the 1980s as in the 1990s. The turnaround in racial convergence derives almost entirely from the large gap in the growth of income from wealth: while nonwhite households saw less than a 1 percent increase in LIMEW due to income from nonhome wealth between 1989 and 2000, white households gained 15 percent over the same period. The value of household production helped offset some of this, increasing LIMEW for nonwhite households by 3 percent more than for white households.

Turning now to the two most recent subperiods (2000–04 and 2004–07), the 2000s saw tepid growth in LIMEW. Base income and income from wealth were lower in 2004 than in 2000 for both groups. The blows from the “jobless recovery” after the 2001 recession and the bursting of the stock market bubble were partially offset by tax cuts and, to a lesser extent, higher transfers. As a group, whites were harder hit than nonwhites during this period in terms of the growth in LIMEW because they suffered relatively more from the decline in income from nonhome wealth. Base income and income from nonhome wealth resumed their growth between 2004 and 2007, and were the principal contributors to the growth in LIMEW for both groups. Base income's recovery restored it to the 2000 level, while income from nonhome wealth was higher in 2007 than in 2000 due to the resurgence in financial markets. Notably, income from home wealth was lower in 2007 than in 1989 for both groups, reflecting the fact that growth in the annuitized value of mortgage debt had outstripped the growth in imputed rent for owner-occupied homes.⁹

Figure 1 Contributions of Components to LIMEW Growth by Race, 1959–2007 (in percent)



Source: Authors' calculations

Policy Interventions Can Work

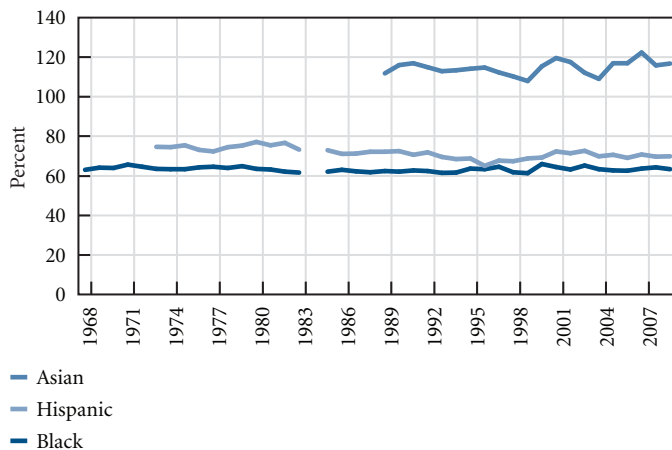
The 1960s saw large gains for nonwhites in every component of LIMEW except income from wealth. The narrowing of the race gap in the 1960s resulted from shifts in base income and net government expenditure. The introduction of Medicaid and increased public spending on education and infrastructure went a long way toward alleviating racial inequality in economic well-being. However, estimates reported in Table 2 imply that, as a percentage of average LIMEW of white households, nonwhites' average LIMEW made very little progress between the early 1970s and the end of the 1980s (as compared to the progress made in the 1960s). Since then, the relative average LIMEW of nonwhite households has hovered at levels lower than its 1972 level: the average LIMEW of nonwhite households was 76 percent of that for whites in 2007, as compared to 77 percent in 1972.

The conclusion that nonwhites as a whole have not experienced much improvement in their income relative to whites since the early 1970s appears to hold true for blacks and Hispanics if we use the U.S. Census Bureau's gross money income measure. As

shown in Figure 2, the Asian group has an average income that exceeds that of blacks and Hispanics, as well as that of whites. Given their growing share in the nonwhite group, it is quite likely that the stagnation in the LIMEW of nonwhites relative to whites since the 1970s conceals an actual deterioration in the LIMEW of blacks and Hispanics relative to whites. A closer look at the wealth data underlying the LIMEW income from wealth component verifies this intuition. While the average net worth of other nonwhites to whites has grown dramatically—from 44 percent to 85 percent between 1983 and 2007—that of blacks to whites is essentially unchanged at 19 percent (Figure 3). The ratio for Hispanic households has grown more, from 16 to 26 percent. This is driven by the much greater increase in the average value of assets for white and other households (\$447,000 and \$540,000, respectively) than for black and Hispanic households (\$126,000 and \$198,000, respectively) between 1983 and 2007.

These considerations gather special urgency in the context of the current economic downturn. Employment losses since the start of the recession in December 2007 have been especially severe

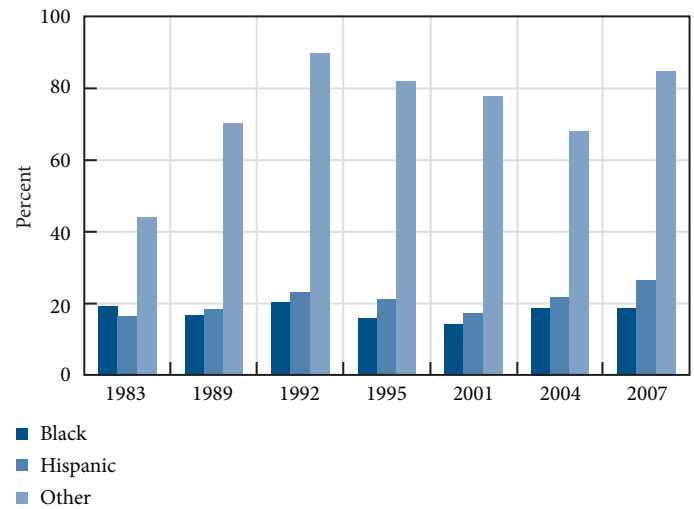
Figure 2 Average Nonwhite to White Household Money Income, 1967–2008



Notes: Whites are defined as “white, not Hispanic” between 1967 and 2001, and as “white alone, not Hispanic” between 2002 and 2008. Blacks are defined as “black” between 1967 and 2001 and “black alone or in combination” between 2002 and 2008. Hispanics are defined as “Hispanic of any race.” Asians are defined as “Asian and Pacific Islander” between 1988 and 2001, and as “Asian alone or in combination” between 2002 and 2008. The figure does not include mean values for 1983.

Source: Authors' calculations based on U.S. Census Bureau Table H-5, “Race and Hispanic Origin of Householder—Households by Median and Mean Income,” www.census.gov/hhes/www/income/histinc/inchhtoc.html (accessed October 8, 2009).

Figure 3 Nonwhite to White Mean Net Worth,¹ 1983–2007 (in percent)



¹ Net worth is defined using LIMEW wealth variables (excluding durable consumption items and vehicles).

Source: Authors' calculations based on the Survey of Consumer Finances

among blacks relative to whites (Figure 4). While the decline among Hispanics as of September 2009 appears comparable to that experienced by whites, it should be noted that the former has been subject to greater volatility. In addition, foreclosure rates are much higher among black and Hispanic households than among their white and other nonwhite counterparts,¹⁰ indicating that the asset gap has only gotten worse in the past two years.

The experience of the 1960s showed that government policy could be instrumental in diminishing racial inequality. Subsequent improvements in the earnings of nonwhites could be partially due to the lasting effects of the policies initiated in that era regarding poverty alleviation, public education, affirmative action, and increased public sector employment for nonwhites. The stagnation in the level of racial disparity in economic well-being over the past 40 years is reason enough to contemplate serious policy initiatives to address this issue. With the current economic crisis hitting minority communities (especially black and Hispanic communities) particularly hard, a national debate on alleviating the racial economic gap is imperative. A proactive policy strategy that combines elements of both asset

building and job creation might be the appropriate option if a substantial dent is to be made in this salient disparity in the economic well-being of U.S. households.

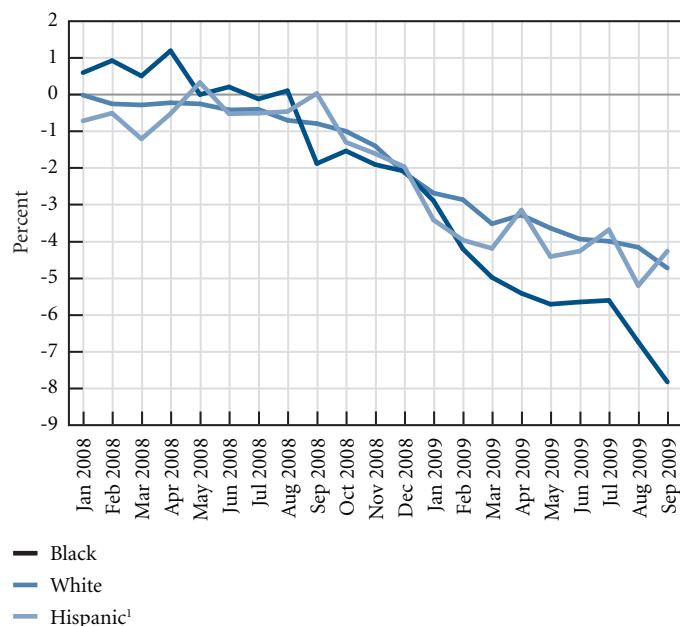
Acknowledgments

The authors thank President Dimitri B. Papadimitriou for his advice, Selcuk Eren for helping to produce the estimates for 1992 and 2007, and Travis Bostick for research assistance.

Notes

1. For details of the construction of the LIMEW estimates used in this note, see Wolff, Zacharias, and Masterson (2009).
2. For a more detailed analysis of racial inequality in economic well-being, see Masterson, Zacharias, and Wolff (forthcoming).
3. The U.S. Census Bureau defines the householder as the person in whose name the housing unit is owned or rented. In the case of joint ownership or rentals, the Bureau randomly designates one of the owners or tenants as the householder. For the years 1959 and 1972, we assigned the household to a group based on whether the head of the household—which was always the husband in married-couple families—was “white” (i.e., non-Hispanic white) or “nonwhite” (i.e., all others).
4. All dollar values are in 2008 dollars.
5. Household production is valued using the prevailing hourly wage of private household employees, adjusted for each person according to an index of available hours, education, and household income.
6. It should be noted that the effect on LIMEW of the increase in both base income (consisting primarily of money earnings) and, to a lesser extent, transfers would be offset by higher taxes.
7. See for example, Oliver and Shapiro 2006, Nembhard and Chiteji 2006, Gittleman and Wolff 2004, and Shapiro and Kenty-Drane 2005.
8. This trend is even more striking if taxes are expressed as a percentage of pretax income. We defined the latter as the sum of base income, income from wealth, government transfers, and taxes, and then calculated, from the numbers in Table 2, effective tax rates for the two groups by dividing taxes with pretax income. The calculations showed that the effective tax rate for the two groups was identical in 2007 at 16 percent, as compared to 12 percent for whites and 10 percent for nonwhites

Figure 4 Change in Monthly Employment Relative to Precession Employment by Race, January 2008 – September 2009 (in percent)



¹ “Hispanic” can be of any race.

Source: Authors’ calculations based on Bureau of Labor Statistics Table A-4, “Employment Status of the Civilian Noninstitutional Population by Race, Hispanic or Latino Ethnicity, Sex, and Age, Seasonally Adjusted,” <http://ftp.bls.gov/pub/suppl/empstat.cpseea4.txt> (accessed October 8, 2009).

- in 1959. Much of this trend has to do with increases in the Social Security tax rate, which disproportionately impacts nonwhites.
9. The use of homes as an ATM has been widely commented upon as an important factor behind the onset of the current financial and economic crisis (Papadimitriou, Chilcote, and Zezza 2006). According to the data published by the Federal Reserve, owners' equity in real estate (as a percentage of household real estate assets) declined from 64.8 percent in 1989 to 47.9 percent in 2007.
 10. See, for example, Gerardi and Willen (2008).

References

- Gerardi, K. S., and P. S. Willen. 2008. "Subprime Mortgages, Foreclosures, and Urban Neighborhoods." Federal Reserve Bank of Boston Public Policy Discussion Paper No. 08-6, December 22.
- Gittleman, M., and E. N. Wolff. 2004. "Racial Differences in Patterns of Wealth Accumulation." *Journal of Human Resources* 39, no. 1 (Winter): 193–227.
- Masterson, T., A. Zacharias, and E. N. Wolff. Forthcoming. "Why Has Racial Inequality Stagnated for the Last Four Decades?" Working paper. Annandale-on-Hudson, N.Y.: The Levy Economics Institute.
- Nembhard, J. G., and N. Chiteji, eds. 2006. *Wealth Accumulation and Communities of Color in the United States*. Ann Arbor: University of Michigan Press.
- Oliver, M. L., and T. M. Shapiro. 2006. *Black Wealth / White Wealth: A New Perspective on Racial Inequality*. 2nd ed. New York: Routledge.
- Papadimitriou, D. B., E. Chilcote, and G. Zezza. 2006. *Are Housing Prices, Household Debt and Growth Sustainable?* Strategic Analysis. Annandale-on-Hudson, N.Y.: The Levy Economics Institute. January.
- Shapiro, T. M., and J. L. Kenty-Drane. 2005. "The Racial Wealth Gap." In *African Americans in the U.S. Economy*, ed. C. A. Conrad, J. Whitehead, P. Mason, and J. Stewart, 175–81. New York: Rowman & Littlefield Publishers.
- Wolff, E. N., A. Zacharias, and T. Masterson. 2009. "Long-Term Trends in the Levy Institute Measure of Economic Well-Being (LIMEW), United States, 1959–2004." Working Paper No. 556. Annandale-on-Hudson, N.Y.: The Levy Economics Institute. January.

Related Levy Institute Publications

LEVY INSTITUTE MEASURE OF ECONOMIC WELL-BEING *Has Progress Been Made in Alleviating Racial Economic Inequality?*

THOMAS MASTERSON, AJIT ZACHARIAS,
and EDWARD N. WOLFF
November 2009

New Estimates of Economic Inequality in America, 1959–2004

AJIT ZACHARIAS, EDWARD N. WOLFF,
and THOMAS MASTERSON
April 2009

What Are the Long-Term Trends in Intergroup Economic Disparities?

THOMAS MASTERSON, EDWARD N. WOLFF,
and AJIT ZACHARIAS
February 2009

Postwar Trends in Economic Well-Being in the United States, 1959–2004

EDWARD N. WOLFF, AJIT ZACHARIAS,
and THOMAS MASTERSON
February 2009

STRATEGIC ANALYSIS

Recent Rise in Federal Government and Federal Reserve Liabilities: Antidote to a Speculative Hangover

DIMITRI B. PAPADIMITRIOU and GREG HANNSGEN
April 2009

A "People First" Strategy: Credit Cannot Flow When There Are No Creditworthy Borrowers or Profitable Projects

JAMES K. GALBRAITH
April 2009

Flow of Funds Figures Show the Largest Drop in Household Borrowing in the Last 40 Years

GENNARO ZEZZA
January 2009