

Income Distribution and the Housing Industry

Michael Carliner

The housing market in recent years has seen a widening gap between the well-housed and the ill-housed or unhoused, with a boom in the construction of luxury housing occurring at the same time as an increase in homelessness. Partly this has been due to developments in the housing market and to government housing policy. Partly it has been due to changes in the financial markets or to demographic or social trends that are only indirectly related to changes in the economy. But to a large extent the increasing distinction between "haves" and "have nots" in the housing market has been due to greater inequality in the distribution of income.

Fewer people or households are close to the median

Recent trends in income have included the following:

- A clear trend toward greater inequality in the income distribution, meaning that a greater percentage of total national income has gone to people or households with the highest incomes and a smaller percentage has gone to the people or households with the lowest incomes. Fewer people or households are close to the median.¹
- Average and median incomes in real terms have increased when calculated using appropriate measures of inflation, but the rate of increase since 1973 has been much slower than in earlier years.
- People born at the peak of the baby boom have incomes that are relatively low compared to those born earlier. There are simply too many of them, and their competition for jobs has lowered their wages.

These income trends, along with demographic trends and changes in housing finance (such as tighter underwriting standards for buy-downs and for high-ratio loans) have contributed to the shift in demand for new housing toward an increased share for high-end homes for trade-up buyers. The increased income inequality has also contributed to the housing affordability problems of low-income families.

The Distribution of Income

Table 1 shows the distribution of total money income among families in the highest and lowest fifth of the income distribution. In 1987, the top

fifth of all families received 43.7% of the total money income recorded in the Census Bureau's Current Population Survey, while the lowest fifth received 4.6%.

These data actually understate the share of income received by the highest fifth, because the survey form does not allow incomes above a certain level to be recorded. Earned incomes are capped at \$299,999, and unearned income categories such as interest and dividends are capped at \$99,999. Prior to 1985, the cap for earned income was \$99,999. Table 1 shows the distribution for 1985 with both the current cap on recorded earned income and the old cap. In 1985, the estimated number of people with earnings of \$100,000 or more

Table 1 Share of Income Received by Highest & Lowest Fifth of Families

	Lowest	Highest		Lowest	Highest
1947	5.0%	43.0%	1969	5.6	40.6
1948	4.9	42.4	1970	5.4	40.9
1949	4.5	42.7	1971	5.5	41.1
1950	4.5	42.7	1972	5.4	41.4
1951	5.0	41.6	1973	5.5	41.0
1952	4.9	41.9	1974	5.5	41.0
1953	4.7	40.9	1975	5.4	41.1
1954	4.5	41.8	1976	5.4	41.1
1955	4.8	41.3	1977	5.2	41.5
1956	5.0	41.0	1978	5.2	41.5
1957	5.1	40.4	1979	5.2	41.7
1958	5.0	40.6	1980	5.1	41.6
1959	4.8	41.3	1981	5.0	41.9
1960	4.8	41.3	1982	4.7	42.7
1961	4.7	42.2	1983	4.7	42.8
1962	5.0	41.3	1984	4.7	42.9
1963	5.0	41.2	1985	4.7	42.9
1964	5.1	41.2	New Income Caps:		
1965	5.2	40.9	1985	4.6	43.5
1966	5.6	40.5	1986	4.6	43.5
1967	5.5	40.4	1987	4.6	43.7
1968	5.6	40.5			

Source: Census Bureau, *Current Population Reports: Consumer Income*, Series P-60, No. 159, p.39; No. 154, p.5, and No. 151, p.17.

Money income includes wages and salaries, self-employment income, social security benefits, SSI, public assistance, interest, dividends, rents, royalties, pensions, alimony, and other regularly received sources, before deducting income tax, social security tax, etc. Capital gains and lump-sum or one-time payments are excluded.

was 627,000, of which 16,000 had earnings of \$300,000 or more.¹ Judging from IRS data on the distribution of income reported for tax purposes, it appears that the effect of the caps is a reduction in the top fifth's share of income of about 2 percentage points.² Even taking into account the 1985 revision in the cap on recorded earned income, pretax money income in 1986 and 1987 is clearly distributed less equally than in any of the preceding 40 years.

Another way of looking at the degree of inequality is to examine the extent to which incomes are clustered around the middle or concentrated at the extremes. The share of families with incomes close to the median has declined over the past two decades,³ with corresponding increases in the share of families with incomes that are a high percentage or low percentage of the median.

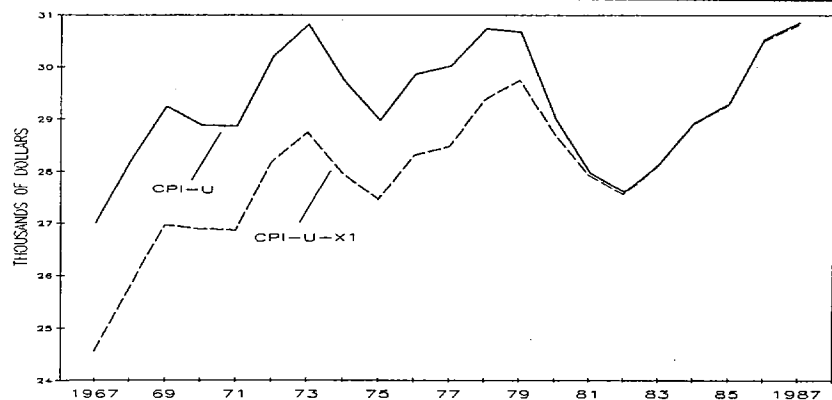
The income distribution in the U.S. is not only more unequal than it has been in the past, but also more unequal than in other industrialized countries.⁴ The extent of the inequality would change somewhat if non-cash benefits (such as food stamps or employer-paid health benefits) or capital gains were taken into account, or if after-tax, rather than pretax, income was considered. But the basic trend toward greater inequality during the past decade would still be present. That trend is also present among households and among individuals, as well as among families.⁵

Trend in Level of Income

Census Bureau reports show that the \$30,853 median family income in 1987 was not significantly greater than the 1973 median in terms of 1987 dollars. The Census Bureau's calculation of real income is based on the Consumer Price Index for all urban consumers (CPI-U).

Until 1983, the CPI-U included an estimate of housing costs for owner-occupied homes based on the

Figure 1 Median Family Income In 1987 Dollars Using Alternative CPI Measures



Source: Bureau of the Census and Bureau of Labor Statistics.

monthly payments on the purchase of a home. As house prices and mortgage rates rose, this pushed up the CPI-U. That treatment of housing cost ignored the fact that houses could be resold at a profit, and because mortgage rates included an inflation premium, inflation was effectively double-counted. Beginning in 1983, a measure of the market rent for equivalent homes was used to represent housing costs for owner-occupants. The use of the CPI-U to adjust for inflation before 1983 has the effect of overstating inflation and understating real income growth.

The Bureau of Labor statistics, purveyors of the CPI, have calculated an alternative version of the index that uses the equivalent rent approach to measure housing cost for the period before 1983 as well as for the period

From 1981 to 1987 the number of high-income families increased 81 %

beginning in 1983. This alternative measure, known as CPI-U-X1, shows less inflation during the 1970s and early 1980s. As a result, when that index is used to convert historical income data to 1987 dollars, the median real income in 1987 is calculated to be significantly higher than in 1973. Figure 1 shows the real median

family income in 1987 dollars, as reported by the Census Bureau using the CPI-U and as recalculated using CPI-U-X1.

There are other measures of prices that could be used to convert historical data to 1987 dollars, such as the deflator for Personal Consumption Expenditures from the National Income and Product Accounts. Those other alternatives produce estimates of real income similar to those resulting from use of the CPI-U-X1. Unless otherwise stated, all the real income data reported in this article are calculated using the CPI-U-X1.

Real median family income declined by 4% from 1973 to 1982, but real median family income rose between then and 1987, producing a net increase of 7% from 1973 to 1987. That increase was pretty meager compared to the 46% increase in real median family income over the preceding 14-year period.

Growth in High-Income Families

The extent of the increase in the inequality of the income distribution has been modest. The rate of increase in average incomes has also been modest. And growth in the number of families has been modest as well. But the joint effect of those trends on the number of high-income families has

been dramatic. From 1981 to 1987, the number of families with incomes of over \$75,000 in 1987 dollars increased from 2.8 million to 5.1 million, an increase of 81%. During that same period, the median real family income increased only 10% and the total number of families increased only 7%.

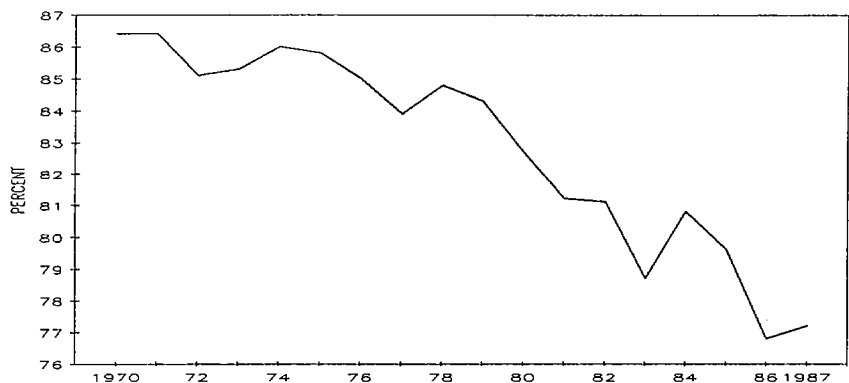
The number of new homes sold for more than \$150,000 (in 1987 dollars) has grown even faster than the number of families with incomes greater than \$75,000. In 1981, about 65,000 of the 436,000 homes sold, or 15%, were priced at more than \$120,000 (equivalent to about \$150,000 in 1987 prices). In 1987, about 166,000 of the 671,000 homes sold, or 26%, were priced at more than \$150,000. Just between 1986 and 1987, the share of homes sold for more than \$150,000 increased from 19% to 26%. Does that mean that households are buying homes that are more expensive relative to their incomes? Not necessarily.

A year's worth of new construction represents only about 1 to 2 percent of the existing supply of housing. A small percentage change in the overall demand for homes can translate into a huge percentage change in new construction. That same leveraged relationship between total housing demand and demand for new construction also applies to particular market segments. The existing stock of luxury homes is limited, and as the number of high income families has grown, the volume of new construction to augment the luxury stock has increased dramatically without making much of a dent in the ratio of the stock of high-priced homes to the number of high-income families.

On the Other Hand

At the other end of the income scale, things have looked decidedly less rosy. The decline in the share of income going to the lowest fifth of families more than offset the increase in average real family incomes, so that families in the bottom fifth were

Figure 2 Median Family Incomes by Age
25- to 34-Year-Olds as a Percentage of 35- to 44-Year-Olds



Source: Bureau of the Census, *Consumer Income* (Series P-60).

receiving 6% less real income, on average, in 1987 than in 1973. The percentage of families falling under the government poverty standard has fallen from 12.3% in 1983 to 10.8% in 1987, but it is still above the 8.8% family poverty rate in 1973 or the 10.3% rate in 1980.

At the same time that real incomes of families at the low end of the income distribution have been falling, real rents have been rising, and rents for households at the low end of the income distribution have risen particularly fast.⁶ The result has been a sharp increase in the rent burden on low-income households.

There is one group of families that are excluded entirely from the statistics on income distribution. Because the Current Population Survey collects information from people living in a sample of housing units, the homeless, who don't live in housing units, are not included. The apparent explosion in the homeless population is the result of a number of complex, poorly understood causes, but low incomes, juxtaposed against high housing costs, are undoubtedly among the key factors.

If the number of low-income families increased, why didn't that translate into more construction of low-cost housing, just as the increase in high-income households translated into construction of luxury housing? It just isn't feasible to build unsub-

sidized housing with rents or purchase prices low enough to be affordable, in part because building codes proscribe the construction of new housing comparable in price and quality to the rundown older units that serve low income households.

Boomer Incomes

The pattern of births following World War II has had a profound and pervasive impact on the economy. The number of births rose from 2.8 million in 1945 to 3.6 million in 1950, and continued upward to a peak of 4.3 million in 1957. After that point, births remained high for about 5 years, but the number began to fall in 1962 and the decline accelerated in 1965.

Despite the Yuppie myth, the reality is that people born at the peak of the baby boom are at an economic disadvantage. Primarily because peak Baby Boomers are supernumerous, they aren't able to command high wages. They are now in the 25 to 34-year-old age bracket, and they find themselves with lower incomes relative to other age groups than was true for other generations. As Figure 2 shows, the incomes of families in the 25 to 34 year old age bracket have been falling relative to incomes in the 35 to 44 year old bracket, as the peak boomers moved in. While the real median income of all families in 1987

was 8% higher than in 1977, the real median for families in the 25 to 34-year-old bracket was virtually identical in 1977 and in 1987. Unfortunately for the Peak Boomers, the current large income gap between 25 to 35-year-olds and 35 to 44-year olds does not mean that the younger group can expect large income increases over the next 10 years, as they get older.

The low incomes of peak Baby Boomers relative to other age cohorts is yet another reason for the increasing share of new homes being sold to trade-up buyers. Those peak Baby Boomers who do buy homes are more likely to buy existing homes.

Why?

There is no single, simple explanation for the recent trend toward inequality in the income distribution. One reason that has been suggested is a decline in unionized blue collar jobs in traditional goods-producing industries and a corresponding increase in service-sector jobs, such as those of lawyers and hamburger-flippers, that are at the extremes of the wage distribution. There is little, if any, statistical support for that theory. Another factor that has been cited is the shift in the family structure toward more single-parent households or toward more two-earner married couples. In most cases the distribution of income *within* industry, occupation, demographic, or regional groups has become more unequal, so that shift *among* those groups cannot fully explain the trend.

One factor that may have contributed to greater inequity over the past decade and a half is a shift among the sources of income. Earned income—mainstay of the nonelderly middle class—has become a smaller share of total income, while property income, pensions, and social security have become more important. The increases in social security and pensions have raised the incomes of elderly households and tend to reduce

inequality in the overall distribution, but the increase in property income (mainly interest, dividends, and rents) disproportionately benefitted higher income families.

Since 1982, earned income has increased somewhat as a share of total income, although the earned income share is still lower than it was in the 1970s.

People born at the peak of the baby boom are at an economic disadvantage

Differences in the relative incomes of different age cohorts have contributed to the changes in the overall distribution. As noted above, the relative size of different age cohorts, due to historical variations in the number of births, affect the incomes of members of each cohort. But cohort size is not the only factor affecting relative cohort income. Members of the pre-1923 baby boom, now 65 and over, and enjoying increased social security and pensions, are doing quite well, unlike members of the post-World War II boom.

The post-Baby Boom cohort—those people born in the mid-1960s and later—have not enjoyed the enhanced relative incomes economic theory would have suggested. Compared to past experience, the incomes of 20 to 24 year-old families in 1987 were low relative to older groups. Perhaps that is because they come so close on the heels of peak Boomers, and compete with them for jobs.

Conclusion

The income distribution has become somewhat more unequal over the past 10 to 15 years. Although the increase in inequality among all households appears modest by most measures, the growth in the upper tail of the distribution has been quite

remarkable. At the same time, the decline in the share of income going to the poorest families, combined with a shortage of affordable rental housing in many areas, has contributed to severe housing problems. Thus, change in the income distribution has important implications for private producers of housing and for public policy.

There is no strong reason to expect even greater inequality in the income distribution in the future. In fact, the demographics suggest that over time the distribution may shift toward greater equality. But the shifts that have already occurred will have an impact for some time to come.

1. U.S. Bureau of the Census, Current Population Reports, Series P-60, No. 154, *Money Income and Poverty Status of Families and Persons in the United States: 1985*, p.4.

2. Data on incomes included in Internal Revenue Service, *Individual Income Tax Returns 1985* (Publication 1304, Washington, 1988). Data are shown for number of tax returns and amount of Adjusted Gross Income in Table on page 9. AGI for returns reporting \$300,000 or more, net of amount that would have fallen under a \$300,000 cap, represented 2.5% of all reported AGI. Capital gains accounted for 27% of the AGI of the high-income tax payers. The 2% estimate is a rough guess based on those data, plus the fact that taxpayers in that income range often have large incomes from interest or dividends, and taking into account income growth from 1985 to 1987.

3. Michael W. Horrigan and Stephen E. Haugan, "The Declining Middle Class Thesis: A Sensitivity Analysis", *Monthly Labor Review*, May, 1988, p. 7.

4. Gary Burtless, "Inequality in America: Where Do We Stand?", *The Brookings Review*, Summer 1987, p. 13.

5. Families are used in this article because consistent data are more readily available and because most new homes are sold to families. The trends among specific household types are discussed in Congressional Budget Office, *Trends in Family Income: 1970-1986* (February 1988).

6. National Association of Home Builders, *Low-and Moderate-Income Housing* (Washington NAHB, 1986), p.12.