“In an era when the rich are the only income group getting richer,” begins an article in the April 13 Washington Post. (Blaine Harden, “As the Rich Ride In, Many Are Priced Out of Homes on the Range.”) But in this one 13-word statement, versions of which have become so common in conversations and newspaper reports, are not one but two mistaken claims.

First, the rich are not an income group but a wealth group. When you say someone’s rich, you are typically referring to how wealthy the person is, not to the person’s income. Wealth and income are two different things. Wealth is typically measured by a person’s net worth—the value of his tangible assets minus his debts. Income is, well, income, the amount of money the person makes or receives annually. Although the two are positively correlated, they are not close to being perfectly correlated. People can be high-income but not wealthy if they spend everything they earn; alternatively, they can be low-income but rich if they started to save early and to invest in assets that appreciated. Many of the elderly in this country are in that position—they have low retirement incomes but high net worths. Indeed, one of the striking findings in the popular book The Millionaire Next Door, by Thomas J. Stanley and William D. Danko, is that most of the few million millionaires in the United States have never had particularly high incomes. I would have thought that fact would be common knowledge among reporters who write about the wealthy for such prestigious publications as the Washington Post. But apparently not.

It is clear from the rest of Harden’s article that he is talking about the wealthy, not about high-income people. That brings us to the next question: are the wealthy—a term that Harden never defines, but he seems to mean people with a net worth of well over one million dollars—the only group getting wealthier? The answer is no. And the data that tell us that are from an article published by the Federal Reserve Board. Every three years the Fed carries out a “Survey of Consumer Finances,” and its most recent survey was based on data from 2004. Using those data, Federal Reserve economists Brian Bucks, Arthur Kennickel, and Kevin Moore found that although wealth grew, it grew less between 2001 and 2004 than between 1998 and 2001. The median wealth of families grew by 1.5 percent, adjusted for inflation, while average net wealth grew by 6.3 percent.

It’s true that families in the bottom 25 percent, measured by wealth, had on average a $1,400 decline in net worth between 2001 and 2004, going from about $0 to minus $1,400. Families in the second-lowest 25 percent had essentially no change, their average net worth rising from $47,000 to $47,100. (All data are inflation-adjusted to 2004.) But families in the second-highest 25 percent, a group not normally characterized as rich, saw their average net worth climb from $176,600 to $185,400, an increase of 5 percent. Families in the 75th to 90th percentile, again a group not normally characterized as rich, saw their average net worth rise from $2,936,100 to $3,114,200, an increase of 6.1 percent.

In short, “the rich” were not the only group whose wealth rose. Moreover, the biggest percentage increase in

David Henderson is a research fellow with the Hoover Institution and an economics professor at the Naval Postgraduate School in Monterey, California. His latest book, coauthored with Charles L. Hooper, is Making Great Decisions in Business and Life (Chicago Park Press, 2006).
net worth was not for those in the top 10 percent (“the rich”), but for those in the 75th to 90th percentile. To put that in perspective, these were families whose net worth in 2004 was at least $328,500 and no more than $831,600, a group that is clearly well-to-do but not “rich.”

But the true increases are understated. As mentioned, these data are in real—inflation-adjusted—terms. To do the inflation adjustment, the Federal Reserve economists used the Consumer Price Index (CPI). But economists have found that the CPI overstates increases in the cost of living in three ways. First, because it measures the cost of a given basket of goods and services over time, it fails to account for people substituting away from goods whose prices went up a lot to goods whose prices went up less, the so-called substitution effect. Second, it fails to account for shifts over time regarding where people buy their goods, the so-called Wal-Mart effect. Third, the CPI fails to account adequately for new products and for quality increases in products (most goods and services not produced by government get better over time). Hoover Institution economist Michael Boskin, who chaired the Advisory Commission on the Consumer Price Index from 1995 to 1996, concludes that even after some reforms were made in computing the CPI, it still overstates annual inflation by 0.8–0.9 of a percentage point.

This might sound small, but over a few years it adds up. Even taking the low end—an overstatement of 0.8 of a point annually—it means that the real net worths of all groups except those in the lowest 25 percent increased. The second-lowest 25 percent, for example, had their net worths climb by 2.4 percent. And we can tack on 2.4 points to the increases in wealth reported for people in the top half.

One large limitation on the use of the Federal Reserve data is that they don’t track families but instead just take snapshots. Because people move in and out of wealth categories, just as they move in and out of income categories, we don’t really know what’s happen-

Inflated Housing Prices

There is one other limitation. The Federal Reserve study found that, among the groups whose wealth did increase, a major component of that increase was the rise in their equity in their homes. To the extent that this increase was due to government restrictions on building, which MIT economist Edward Glaeser and Wharton economist Joseph Gyourko have found to be the biggest factor in housing-price increases since 1970, it does not represent a real wealth increase but rather an artificial scarcity. The solution would be to relax the restrictions on construction. As a side note, local governments in the United States, spurred on by homeowners, seem dead set on making housing unaffordable to the lowest 25 percent of the population.

Finally, as noted earlier, it’s true that wealth did increase less between 2001 and 2004 than between 1998 and 2001. This higher growth in the earlier period cannot be attributed to the stock-market boom because most of the dot-com crash had occurred by 2001. The lower growth in the later years can in part be attributed to the recession that began in 2001. Probably more important, when a government takes an increasing share of the economy’s output and wastes it, the result will be less wealth or, more exactly, less growth in wealth than otherwise. Under George W. Bush federal spending increased from 18.5 percent of gross domestic product in 2001 to 19.9 percent in 2004. For those wondering how to have wealth increase more for people at all levels, a good place to start would be to pare back the size and power of the federal government.