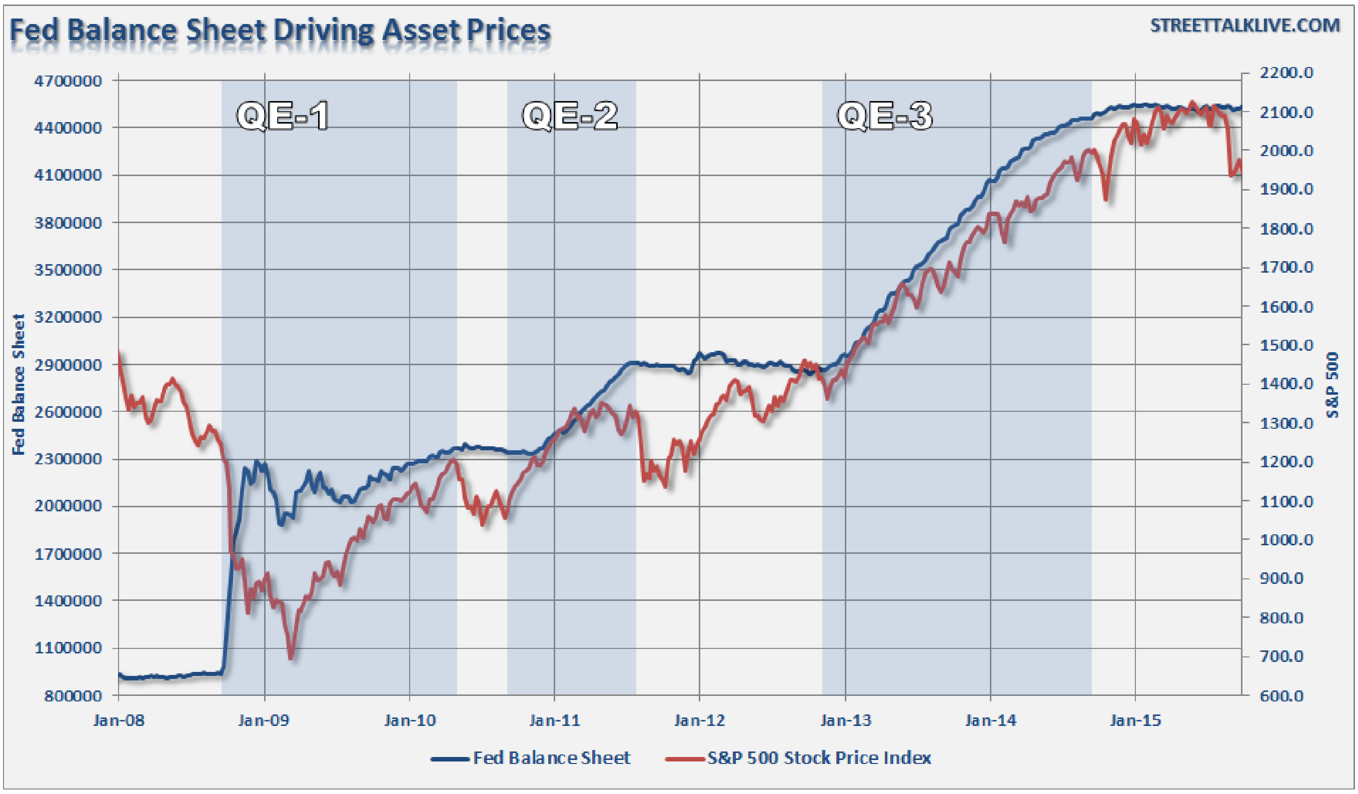
The 80/20 Rule Is Crushing The Economy

In business, the 80/20 rule states that 80% of your business will come from 20% of your customers. In an economy that is more than 2/3rds driven by consumption, such an imbalance of the "*have*" and "*have not's*" impedes real economic growth.

I have often written about the disconnect between Wall Street and Main Street. As shown in the chart below, while asset prices were inflated by continued interventions of monetary policy from the Federal Reserve it only benefitted the small portion of the population with assets invested in the market. Cheap debt, excess liquidity and a buyback spree led to soaring Wall Street and corporate profits, surging executive compensation and rising incomes for those in the top 20%. Unfortunately, the other 80% known as "*Main Street*" did not receive much benefit.



This divide is clearly seen in various data and survey statistics such as the recent survey from Bankrate.com which showed **30 million Americans borrowed from their retirement plans over the last 12-months.** Importantly, "*baby boomers*" were the most likely to take a premature withdrawal as well as incur a tax penalty for doing so. A full 2/3rds of Americans agreed that the effects of the "financial crisis" are still being felt in the way they work, live and spend.

How can it be that in an environment where Central Bank interventions have fostered surging asset prices, there are 30 million American's tapping retirement plans to meet current expenses? Of course, the picture is much worse when looking at a variety of measures I discussed previously in "Don't Blame Boomer's For Not Retiring:"

> "Let's start with the retirement of the boomer generation. Recent statistics show that the average American is woefully unprepared for retirement. **On average, 40% of American families are NOT saving for retirement, and of those who are, it is primarily about one year's worth of income.** Furthermore, important to this

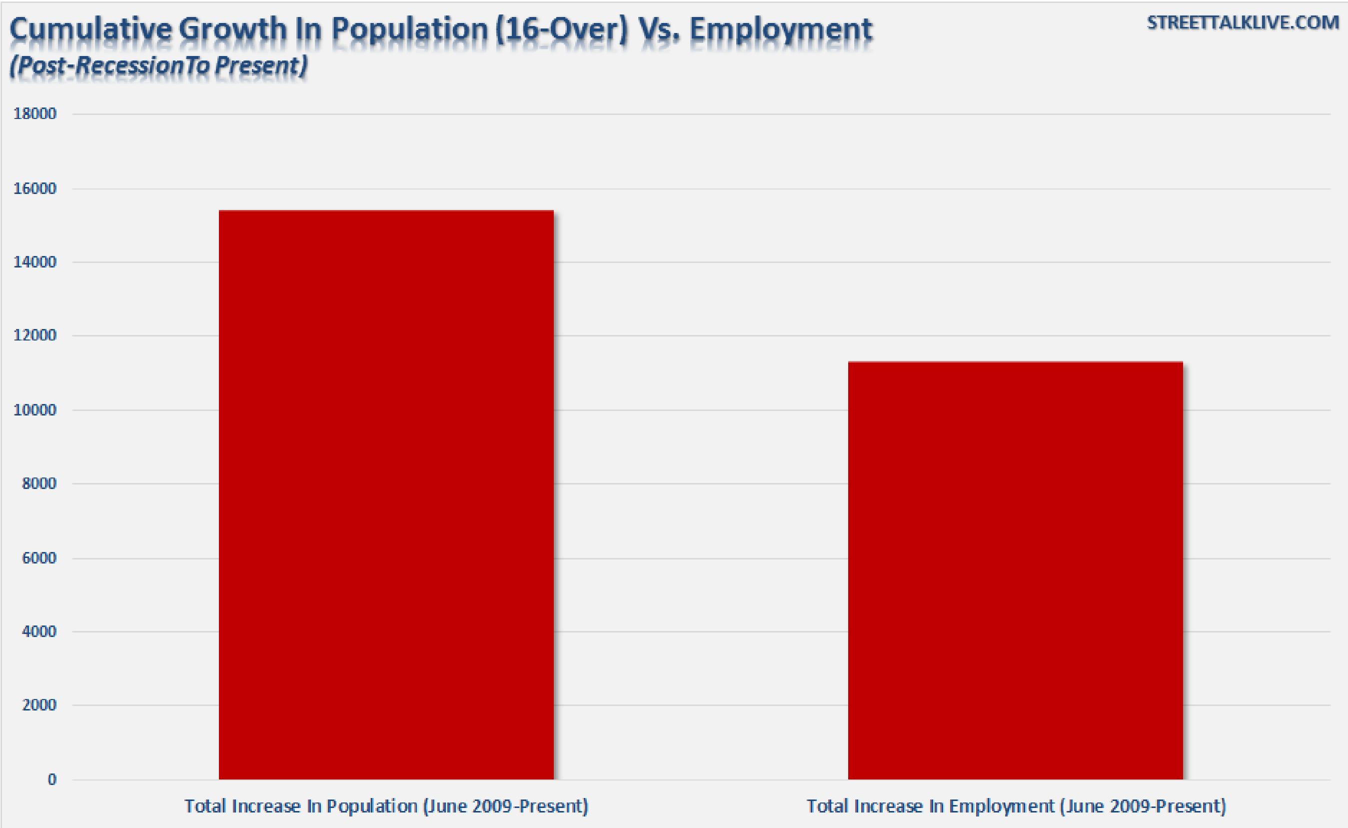
particular conversation, **one-fourth of those at retirement age postponed retirement with only 18% being confident of having enough saved for retirement."**

American Family Financial Statistics	Data
Average American family savings account balance	$3,800
Percent of working Americans who are not saving for retirement	40 %
Percent of American families who have no savings at all	25 %
Average amount saved for retirement	$35,000
Average American household debt	$117,951
Average American family home value	$160,000
Average amount owed on home mortgage	$95,000
Average American household annual income	$43,000
Average credit card debt	$2,200
Percent of American workers who postponed their retirement age this year	24 %
Percent surveyed who are very confident about having enough money for retirement	18 %
Percent of American adults who do not have a bank account	7.7 %
Percent of American adults who have an emergency fund to fall back on	38 %

Despite the Fed's best intentions that inflating asset prices would spur consumer confidence, the problem is that it only benefitted those with the ability to invest. Of course, **inflating asset prices for those that already have wealth does not increase spending within the economy to any great degree.**

Conversely, for the bottom 80% there has only been minor increases in household incomes due to an economy that is growing at the slowest rate in history. As I discussed in ["Dimon's Delusionary View Of Economic Realities:"]

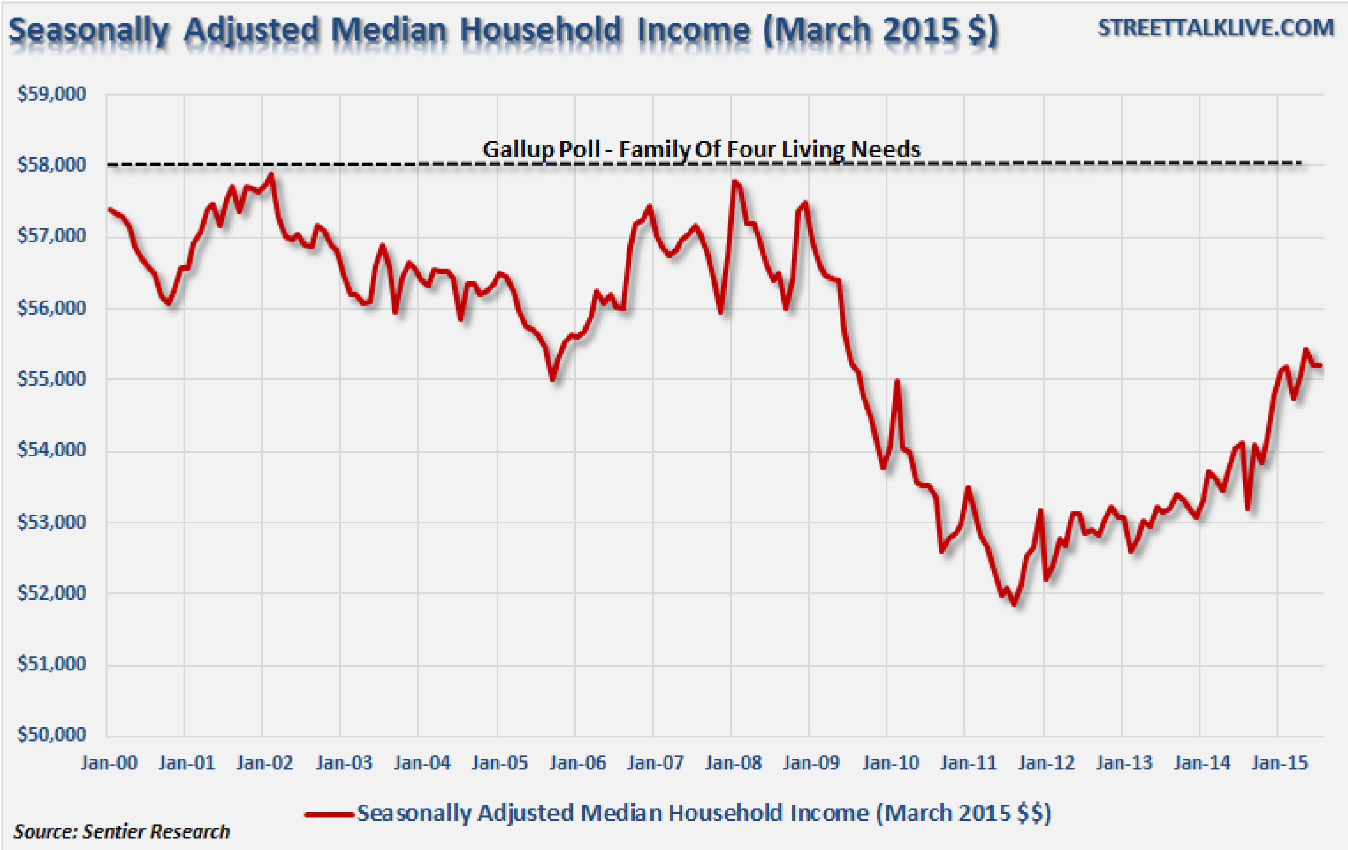
"While "creating 10-million jobs since the end of the recession sounds like a strong accomplishment it was not sufficient enough to absorb the increase in the population. **In other words, for every job created there are more individuals actually 'needing' a job."**



> "With roughly 94-million individuals not counted as part of the 'official labor force,' **the downward pressure on wage growth due to the increasing demand for available jobs remains a pervasive force.** Of course, since individuals must produce first to consume, the expectations for stronger future growth rates are likely to be disappointed in an economy which is almost 70% based on consumption."

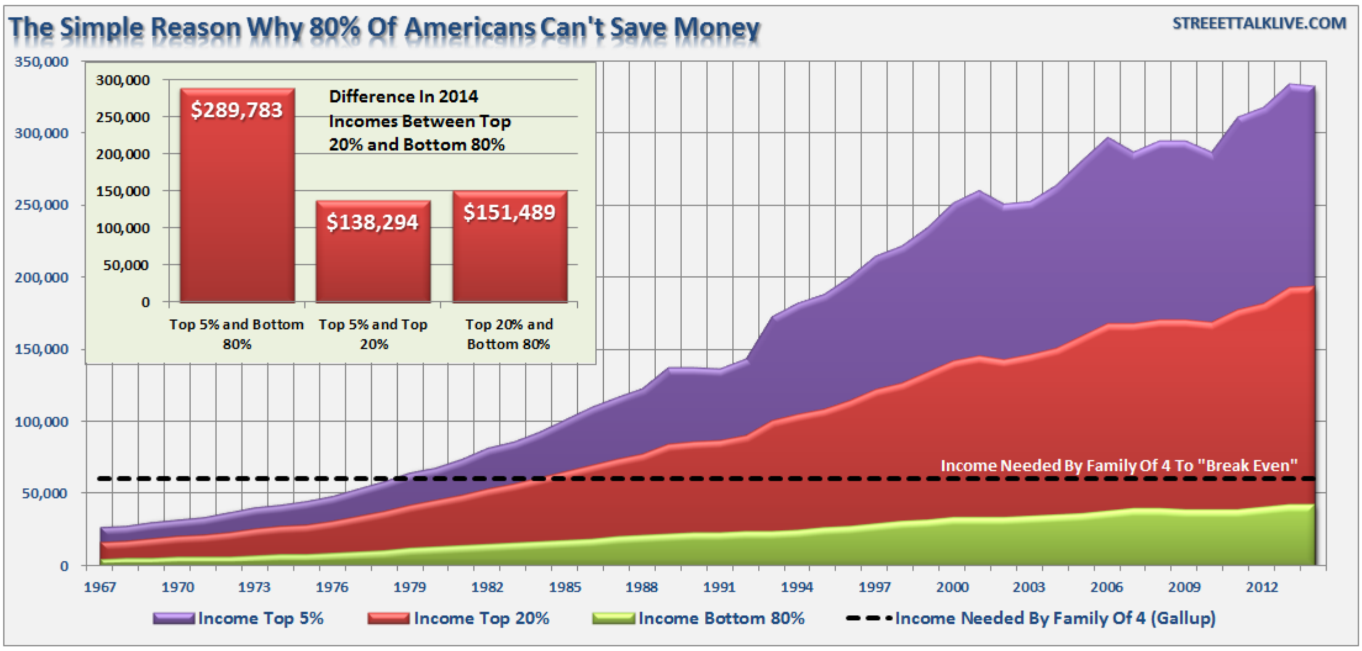
This downward pressure on wage growth has been dramatically offset by the **real cost of living which** includes food, energy, healthcare and education costs that have far outpaced any increases in incomes. With an inability to further leverage the household balance sheet to any great degree, the differential between incomes and expenses have depleted the majority of household savings.

This can be clearly seen in the latest survey data from the [Census Bureau] for the year 2014 which showed the median national household income to be just $54,041. The problem, [as I addressed previously], is on average it requires $58,000 to support a family of four today.



Importantly, this is the MEDAN national income of all Americans. When applying the "*80/20 rule*" a far more discouraging picture emerges.

The chart below breaks out the national income for the top 5% of the population, the top 20%, and the bottom 80%. See the problem here?



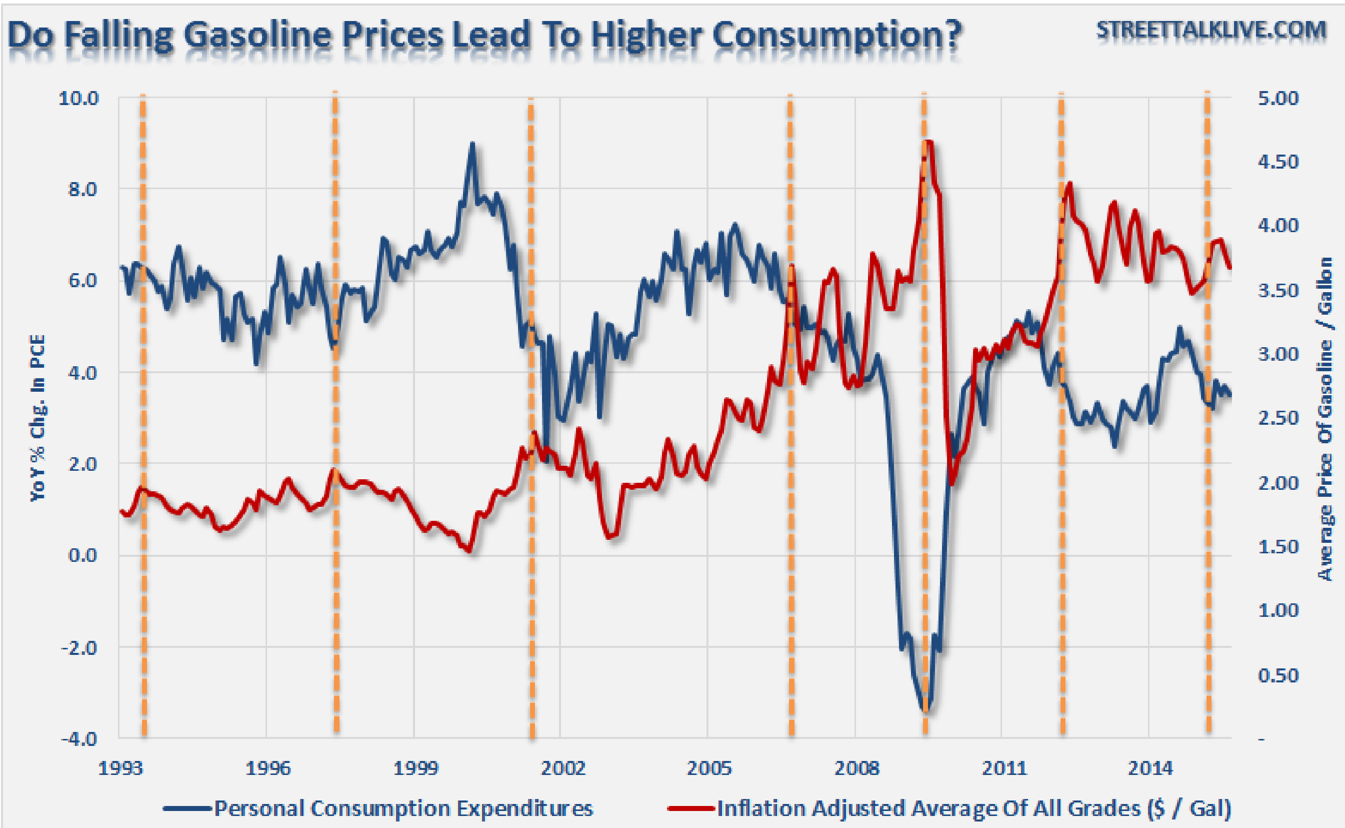
In 1967, the bottom 80% of the country had a national median income of $5,755. Today, nearly fifty years later, the national median income for the bottom 80% has risen to just $42,564.

This is in contrast to the top 20% who saw incomes rise from $17,280 in 1967 to $194,053 today. But even that increase pales in comparison to the top 5% whose incomes rose from just $28,110 to

$332,347 today. The difference in incomes between the top 20% and bottom 80% is a staggering $151,489 annually.

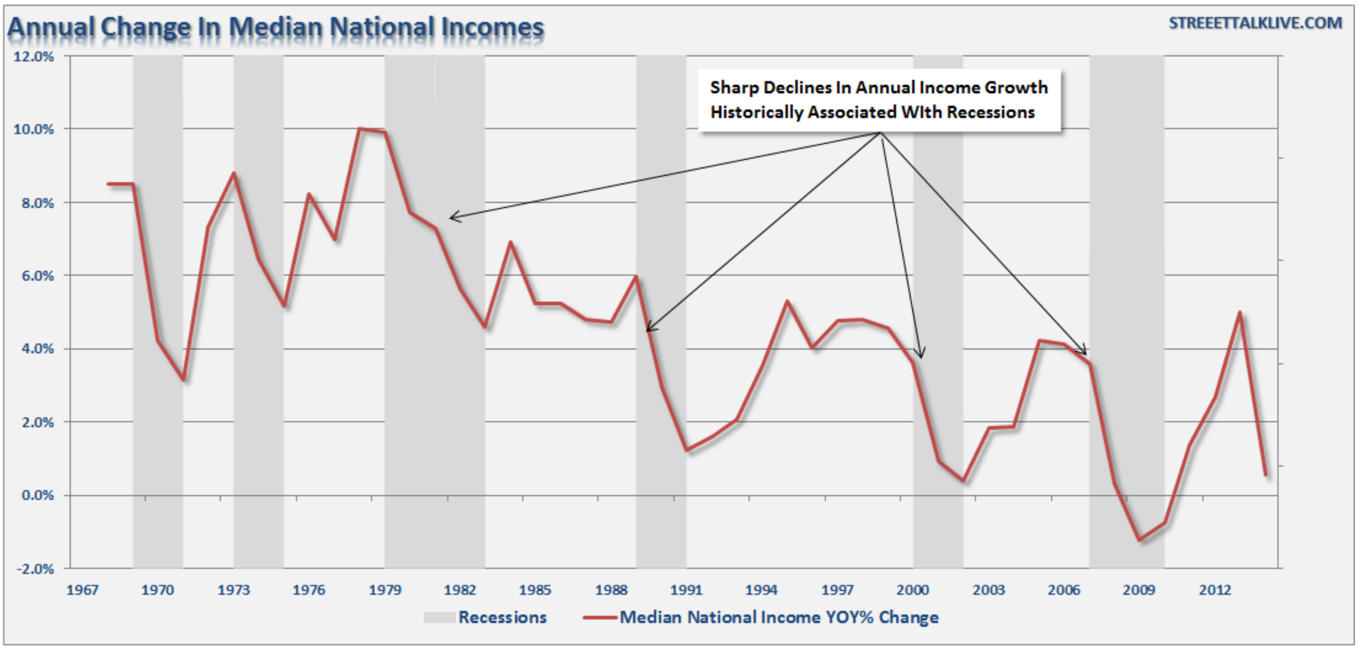
These statistics explain why despite falling oil and gasoline prices in recent months, any "*savings at the pump*" were not redeployed into additional consumption. **Of course, that mistaken belief by the majority of economists was based on a false assumption of both human behavior and household economic realities to begin with.** [To wit:]

> "Simply put, lower oil and gasoline prices may have a bigger detraction on the economy that the 'savings' provided to consumers. Newton's third law of motion states:
>
> 'For every action there is an equal and opposite reaction.'
>
> **In any economy, nothing works in isolation. For every dollar increase that occurs in one part of the economy, there is a dollars' worth of reduction somewhere else."**



But it is in this data that we find the real reason, despite repeated monetary interventions, both economic growth and inflationary pressures have failed to take hold.

> **Note:** During the analysis of median incomes, the following chart of the annual rate of change in incomes *(all brackets)* suggests that the economy may actually be closer to the next recession than not. **Historically, when the national median income has experienced a sharp decline it has been coincident with a recession.** In 2014, the national median incomes declined from a 5.01% annual growth rate to just 0.56%.



While the ongoing interventions by the Federal Reserve have certainly boosted asset prices higher, the only real accomplishment has been a widening of the wealth gap between the top 20% of individuals that have dollars invested in the financial markets and everyone else. What monetary interventions have failed to accomplish is an increase in production to foster higher levels of economic activity.

Furthermore, the structural transformation that has occurred in recent years has likely permanentely changed the financial underpinnings of the economy as a whole. With the average American still living well beyond their means savings will continue to be diverted from productive investment into debt service. This suggests that the current state of slow economic growth is likely to be with us for far longer than most anticipate. It also puts into question the ability of the Fed to extract its monetary support before the cracks in the economic foundation begin to widen.

In the meantime, stop blaming "*baby boomers*" for not retiring - they simply can't afford to.

Tags: [Economics]