

BOOK REVIEW

THE MYTH OF AMERICAN INEQUALITY: HOW GOVERNMENT BIASES POLICY DEBATE

PHIL GRAMM, ROBERT EKLUND, AND JOHN EARLY
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This book offers a magnificent combination of sophisticated empirical work, historical wisdom and keen policy relevance.

But first, let's have some fun. I think Genesis—aka Phil Collins and company—nicely summed up our “grim” era with a zestful 1988 song titled “Land of Confusion.”¹ Given our sick society today, it was surely ahead of its time. Consider these lyrics: “. . . there's too many people making too many problems Can't you see this is the land of confusion? . . . [L]et's start trying to make it a place worth living in.” So Gramm, Ekelund, and Early—call them GEE—answer the call to make America a better place to live in by

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¹ <https://www.youtube.com/watch?v=nxIFMSPdcR4>



demonstrating that the official statistics we rely on grossly misstate poverty, income inequality, and other measures of well-being. This book launches heretofore unknown good news about these issues and is destined to have a major benign impact on debate and policies about poverty and inequality. If I am proven wrong, that would be disheartening, to put it mildly. The real facts about the U.S. economy should matter, not imaginary ones.

To put it more exactly, facts do not speak for themselves, especially when it comes to government numbers. Where the Census Bureau, Bureau of Labor Statistics, and other agencies—I counted some 21 federal bureaucracies cited as statistical sources in the book—go wrong is that they ignore two thirds of welfare benefits as income, omit the income lost due to taxes that people pay for such programs, and use outmoded price indices that magnify price inflation and thereby understate growth in real income, employer-paid benefits and other variables over time. The result? Grossly over-hyped poverty, income inequality, and stagnation in living standards.

Let's review, beginning with poverty.

1. Between 1967 and 2017, properly measured

annual government transfer payments to the average household in the bottom 20 percent of the income distribution rose more than fourfold in inflation-adjusted dollars from \$9,677 to [a whopping] \$45,389. And yet the official poverty measures tell us that the percentage of people living in poverty hardly changed during that fifty-year period (p. 2) When the Census Bureau applied the poverty thresholds to its income measure, the result was the official 2017 poverty rate of 12.3 percent. When the poverty rate is recalculated using official government data that incorporate a full accounting of all transfer payments as income the percentage of Americans living in poverty drops sharply to only 2.5 percent . . . the poverty rate has . . . almost disappeared. (p. 37)

What about the homeless “crisis,” much touted by major media, and the immigration crisis at the southern border? No mention, but the Department of Housing and Urban Development (HUD) estimates a 2020 homeless population of 580,000, hardly enough to alter any GEE conclusion.

2. Independent studies validate the GEE poverty findings as well. For example, consumption spending varies less than income and a careful study found

only 2.8 percent of people in 2017 consumed an amount of goods and services that would put them below the real-dollar consumption poverty level... the same conclusion [GEE found]—namely, that the current official measure of poverty is about four times larger than it should be. (p. 39)

Another approach relies on a 2011 housing survey which showed that

among households defined as being poor, 42 percent owned their own home with, on average three bedrooms, one and a half bathrooms, a garage, and a porch or patio...A mere 1 percent of all housing for the poor was classified as ‘severely inadequate,’ only one-quarter as much as in 1975...[and] 88 percent of poor households had air conditioning, compared with only 12 percent of the entire population that had air conditioning in 1964. (p. 40)

3. What accounts for these dramatic reductions in “measured” poverty? Biggest factor: stupendous growth of the welfare state since the War on Poverty began in the mid-1960s.

In 2017, federal, state, and local governments redistributed \$2.8 trillion, 22 percent of the nation’s earned household income, and 68 percent of those transfer payments going to households earning in the bottom 40 percent Excluded from the measurement of household income are some \$1.9 trillion of government transfers—programs like refundable tax credits, where beneficiaries get checks from the Treasury; food stamps, where beneficiaries buy food with government-issued debit cards; and numerous other programs big and small, such as Medicare and Medicaid, where government directly pays the bills of beneficiaries. (p. 3)

As one wit put it long ago, “Get into poverty, that’s where the money is.”

4. Next, consider taxes.

Americans pay \$4.4 trillion a year in federal, state, and local taxes, 82 percent of which are paid by the top 40 percent of household earners [fair share!?] . . . the Census Bureau does not reduce household income by the amount of taxes paid when it measures income inequality The net result is that in total the Census Bureau chooses not to count the impact of more than 40 percent of all income...gained in transfer payments or lost in taxes The Census Bureau is accurately measuring what it has chosen to measure, but it is not measuring the *right* things. (p. 3)

Again, if

all transfer payments, not counting government's administrative costs in making the transfers, are counted as income to the recipients of those payments and when all taxes paid are counted as income lost to the taxpayers (p. 3) . . . the ratio of the income for the top 20 percent of households to the bottom 20 percent is 4.0 to 1 rather than the 16.7:1 ratio found in the official Census numbers (p. 4) . . . in 1947, the ratio was 40 percent greater at 5.6 to 1 (p. 44) . . . Census also reports that the top 20 percent of households had average annual income of \$221,846, but BLS reports they consumed only \$116,998. (p. 2)

So, "income inequality is not rising. It has in fact fallen by 3.0 percent since 1947 as compared to the 22.9 percent increase shown in the Census measure." (p. 4)

5. A statistic called the Gini coefficient was "designed as a [summary] measure of the amount of inequality" which equals 0.000 when every household has the same income and approaches 1.000 when a single household has all income, so larger numbers indicate greater inequality. "The Gini coefficient for the Census income measure in 2017 was 0.482, and the Gini coefficient for the more complete income after transfers and taxes . . . was only 0.335 . . . The 2017 Gini coefficient for earned income alone was 0.56." (p. 47)

6. International comparisons of income inequality show the United States with the highest level of income inequality among developed countries. Why? Because the Organization for Economic Co-operation and Development (OECD) compares apples to oranges. The Census Bureau data sent to OECD for the United States Gini coefficient in 2017 failed to include \$2.1 trillion of annual transfer payments, \$1.6 trillion of which went to low-income Americans (p. 52) . . . When all transfer payments are included, the United States falls well within the range of the six other large, developed nations . . . the United States spends 30.0 percent of its gross domestic product (GDP) on transfer payments, more than any other country except France, which spends 31.7 percent (p. 53) . . . The top 10 percent of households in the United States earn about 33.5 percent of all income, but they pay 45.1 percent of income-related taxes, including Social Security and Medicare taxes. In other words, their share of all income-related taxes is 1.35 times larger than their share of income. That is the most progressive income tax share of any OECD nation . . . In Germany, the top 10 percent . . . pay . . . 1.07 times their share of income. The French . . . pay . . . 1.10 times their share of income (p. 54) . . . American income after taxes and transfers

is not distributed more unequally than income in some other large, developed economies . . . [plus] far fewer Americans have low incomes because the American economy creates more economic value, paying higher wages and salaries. (p. 57)

7. For the full period since 1980, the average real earned income of each quintile has grown faster than for each of the quintiles below it . . . has produced increasing earned-income inequality (pp. 61–62) The driving forces producing the growth in earned-income inequality are the decoupling of low-income households from the workforce, the increase in educational attainment at higher levels, the dramatic rise in the value of that education, the increase in economic participation for women, and the rise of the super two-earner household (p. 62) The most significant factor in the growth of earned-income inequality in the last fifty years has been the sharp drop in the proportion of prime work-age persons who worked in the bottom two quintiles. In 1967, 68 percent of prime work-age adults in the bottom quintile had jobs, but by 2017 that percentage had dropped by almost half to 36 percent. The percentage working in the second quintile declined from 90 percent to 85 percent. At the same time, the proportion of work-age persons working in the top three quintiles of households increased by 7 percent, largely from an increase in the employment of women (pp. 64–65) Among the individuals who did work in 2017, those in the bottom quintile, on average, put in . . . only 17.3 hours per week Only one structural change can explain the major decoupling of prime work-age persons in low-income households from the world of work: the near quadrupling (in constant dollars) of government transfer payments to lower-income households. In 2017, transfer payments increased the average bottom-quintile household's income after transfers and taxes to \$49,613—only \$4,908 of which was earned income There has been only one significant attempt to reverse this fifty-year trend of reduced work and increasing dependency . . . the Welfare Reform Act of 1996 (P.L. 104–93) The 1996 reforms were successful. The number of families receiving payments declined by more than half." (p. 65)

But the reforms were gradually undermined by expansion of other transfer payments like food stamps, Social Security Disability Insurance, discretionary changes by administrators like lowering eligibility standards, waiving work requirements, promotionals urging more people to become dependent, etc.

The War on Poverty significantly increased dependency and failed in its primary effort to bring lower-income people into the mainstream of America's economy. It happened just as President Roosevelt said it

would in 1935: “To dole out relief in this way is to administer a narcotic, a subtle destroyer of the human spirit . . . The Federal Government must and shall quit this business of relief.” (p. 68)

8. In 1967 college graduates earned 55.9 percent more than high school grads and in 2017 it was a premium of 96.2 percent. (p. 72) The gender pay gap goes “missing” according to GEE, because the gap is 17 percent for women who work more than 40 hours but women who work fewer hours earn a 4-6 percent pay premium over men. (p. 77) Then we have the super two-earner households consisting of 74.2 percent of graduate degree holders, a combination found in only 1 in 20 households back in 1967 but 1 in 3 in 2017. (p. 75) The authors make a fine policy point at the end of chapter 5, in effect “busting the left”:

...the most vocal critics of our economic system for its growth in earned-income inequality in postwar America are also often the most committed advocates of expanding the very transfer payments to low-income Americans that have been the largest cause of the growth in earned-income inequality. They also have been the biggest promoters of the public education system that has left so many behind and the greatest critics of education reforms, such as school choice, that enable more children to raise their future earnings. (p. 81)

9. What about adjustments for the falling value of the [fiat paper!] dollar over time?

The accuracy of our measures of well-being are . . . heavily dependent on the accuracy of these price indexes (p. 83) . . . We need unbiased measures of inflation that accurately identify pure price changes without erroneously counting quality improvements in price changes for goods and services.” (p. 86) The first problem is how to weight the percentage change in thousands of prices by consumer spending, which is always changing in accord with price changes.

But the traditional CPI [BLS consumer price index] has made no allowance for the effect of substitution of one service for another...This type of overstatement in the CPI is well known in the economic literature and is called “substitution bias” . . . Fortunately, the Bureau of Labor Statistics has developed and for twenty years has published an index called the Chained Consumer Price Index for All Urban Consumers

(C-CPI-U or Chained CPI) that largely solves this “substitution bias” problem . . . it revises the consumption expenditure weights to reflect what was actually bought at the time the price data were collected . . . [instead of] by the estimated expenditure for the item in first time period only The Chained CPI does not exist for periods before December 1999, but a very similar index, the Personal Consumption Expenditure Price Index (PCEPI) calculated by the Bureau of Economic Analysis (BEA) in the Department of Commerce, covers the earlier periods Unfortunately . . . BLS and Census continue to adjust measures of well-being such as hourly earnings, household income and poverty using the traditional CPI rather than the more accurate Chained CPI. For example, BLS data for real average hourly earnings of production and nonsupervisory employees show an increase of only 8.7 percent . . . from 1967 to 2017. But if the more accurate Chained CPI had been used to adjust for inflation . . . hourly earnings would have been found to have increased by 31.8 percent, more than three times the increase shown in the official BLS number. (pp. 88–89)

The second problem is to eliminate “new-product bias” by extending and incorporating the BLS/BEA Disease-Based Price Indexes that implement best methods in the medical sphere. Using both techniques to remove bias imply “real average hourly earnings would have risen 74.0 percent over the last fifty years rather than the official reported number of 8.7 percent.” (p. 93) Wow! Also, “counting the missing transfer payments and using improved price measures... would cause the poverty rate in 2017 to fall to 1.1 percent.” (p. 95) Conclusion? “When a politician today attacks American economic performance because of high poverty rates, stagnant wages, and slow or unequal growth in household income, it is their data, not America’s economic performance, that is bad.” (p. 99)

10. What about the “Super Rich”? These are real outliers. For example, the top 400 households constitute only 3 out of every million American households, or 0.00031 percent of the income distribution, the highest level for which the Internal Revenue (IRS) publishes income data. (pp. 101–02) The big lie is that the rich pay a smaller share of their income in taxes than do middle-income households. The bottom quintile pays 7.5 percent on average, the middle 22.7 percent, and the top 1 percent pay 40 percent although yes, it does drop to 32 percent in the top 400. (p. 102 and pp. 106–07) The average time in the top 400 is only 2.01 years, largely because 60 percent of their income comes from capital gains. (pp. 104–05) Most of the modern wealthy, GEE point out, got wealth by creating new

economic value, and thereby improving the lives of others through saving, investment and entrepreneurship—raising productivity—rather than seizing control of government. (p. 117)

11. And the American Dream? Still very much alive, say GEE. The US economy remains dynamic with enterprises like Google, Facebook and Amazon demoting former giants like Sears, AT&T, AOL, and Hotmail. (p. 120) Economy-wide upward mobility is still widespread. Those with more talent, skill and effort are like those who climb the escalator as it rises. (pp. 122–23)

Studies are

remarkably consistent, [showing] . . . in all cases, the low-income individuals see their income rise faster than those with high incomes, and the average growth of an individual's income is much larger than the growth of the Census averages, which do not capture the effects of increased experience and human capital acquired by individuals over time. (p. 126)

For children reared by parents in the bottom quintile, 93 percent grew up to have more real income than their parents. (p. 131) Far less than half of children grew up to have income in the same quintile as their parents [so much for "privilege"?] and 62 percent of the children reared in top quintile families fell into a lower quintile, including 9.3 percent falling all the way to the bottom quintile. (p. 135) . . . Sixty-three percent rose from the bottom quintile to higher quintiles (p. 140) and 6 percent rose to the very top. (p. 137) . . . Mobility promotes prosperity and prosperity promotes mobility. (p. 140)

12. Chapter 9 celebrates "Fifty Years of Economic Progress." Long overdue. The official data "do not comport with the America we live in. The official statistics do not reflect the economic progress we see everywhere because those statistics are wrong." (p. 141) When properly adjusted for dollar depreciation all but "6.2 percent of households in 2017 had incomes that would have placed them in the top quintile in 1967." (p. 146) Astounding facts fill the chapter. Here's one: "By 2017, the average bottom quintile household spent 34 percent of its food budget away from home, far more than the top quintile did in the mid-1960s and more even than the top 1 percent did." (p. 148)

13. Chapter 10 addresses "Policy Implications and Conclusion." Four matters need attention: fixing the official data to reflect reality;

remove government disincentives to work; reform elementary and secondary education for success; and remove government barriers to opportunity. To fix the official data, see above. Or to be a bit more complete, GEE call for legislation instructing the agencies to adopt the new data approach within three years plus extend work on valuing new products and services since "Much of the foundational data . . . already exist . . ." (p. 170) Remove disincentives to work? I say abolish welfare. Ha, ha, fat chance. Too much pathological altruism among voters plus other obstacles, but we could rely on competitive private charity. OK, the failing welfare-warfare state will continue to grow until collapse, i.e., the money runs out. GEE propose welfare work mandates as their *perestroika*. It won't work, of course. There is too much administrative legerdemain. On reforming education, yes, competition of any and nearly all kinds works wonders. School choice sums it up until we can attain complete separation of education and the bureaucratic state. Finally, expand labor market opportunity via deregulation. "In the 1950s, only one in twenty workers faced government licensing requirements as a condition for holding their job, but by 2012 more than one in four faced government restrictions on their ability to earn a living." (p. 181) Where is the evidence for a safer society by licensing hair braiders, auctioneers, home entertainment installers, upholsterers, etc., after months of training and testing? It's just barriers to entry. Ever heard of regulatory capture? Cronyism serves incumbents and harms potential interlopers, innovators, customers and clients. As GEE remind us, "America's promise is centered on opportunity." (p. 183) Thank you, Gramm, Ekelund, and Early, for your powerfully important book!