ECONOMIC INEQUALITY

By John C. Goodman, April 25, 2023

See: www.goodmaninstitute.org/debater-resources

How Much Inequality Is There?

Most measures of income inequality ignore differences in age. As a result, they end up comparing 20-year-olds (just starting out in life) with 80-year-olds (living off of a lifetime of saving). These measures also ignore the effects of our fiscal system (taxing and spending by government). And they ignore the lifetime effects of fiscal policy (people with low earnings today get more of their pre-retirement wages replaced by Social Security in the future).

The most accurate estimates of inequality (ones that avoid the mistakes just mentioned) are produced by Boston University Professor Laurence Kotlikoff and his colleagues. In fact, *the Kotlikoff model is the only model that accurately measures true inequality in our fiscal system.*

… As an example of what correct measurement tells us, Kotlikoff segments the population according to the amount of resources (wealth) they have at their disposal over the course of a lifetime:

> *Take 40-49-year-olds. Those in the top 1 percent of our resource distribution have 18.9 percent of our net wealth but account for only 9.2 percent of the spending. In contrast, the 20 percent at the bottom (the lowest quintile) have only 2.1 percent of all wealth but account for 6.9 percent of total spending.*
>
> *This means that the poorest are able to spend far more than their wealth would imply, even though they are far short of the 20 percent they would spend, if spending were fully equalized.* - We've Been Measuring Inequality Wrong – Here's the Real Story, Goodman Inst. Brief No 101, March 24, 2016

Resolved: The [USFG] should substantially increase fiscal redistribution in the United States by adopting a federal jobs guarantee, expanding Social Security, and/or providing a basic income.

Bottom line: there is far less inequality than what conventional measures tell us. See Kotlikoff's technical study with the very latest results on inequality.

Surprising Facts about Welfare and Poverty in the U.S.

Here is a summary:

- The U.S. welfare state has almost eliminated poverty in this country – when poverty is properly measured.
- Over the last 75 years, income inequality has actually gone down, not up.
- Since the end of World War II, income has steadily risen for every income group – with the greatest increase among the bottom fifth of the income ladder.
- Over half of the U. S. population gains very little from working because the U.S. fiscal system provides untaxed transfer benefits for those who don't work that are greater than their after-tax income would be if they did work.

For an impeccably researched book that backs up these findings with overwhelming evidence, consult *The Myth of American Inequality* by Phil Gramm (the former U.S. senator), Robert Ekelund, and John Early.

See overview by John C. Goodman: *What I Bet You Don't Know About Poverty, Inequality And The Role Of Government*, Oct 24, 2022 • www.goodmaninstitute.org/2022/10/24/what-i-bet-you-dont-know-about-poverty-inequality-and-the-role-of-government/

A Surprising Finding about The U.S. vs. Europe

Fact: The U.S. has the most progressive fiscal system among all developed countries.

Most people think that the typical European country has a larger welfare state than the U.S. does. That belief is true. What is not true is the belief that these systems are mainly funded by taxes on the rich. To the contrary, they are mainly funded by taxes on the middle class.

The typical European family pays more of its income in taxes than the typical American family. In return, they get more benefits from the state. These are mainly "social insurance" benefits.

…Although the U.S. has less social insurance, it nonetheless engages in more redistribution from rich to poor than the typical European country. …

Although the U.S. has less social insurance, it nonetheless engages in more redistribution from rich to poor than the typical European country.

The U.S. has the most progressive tax system in the developed world – by far. See this overview and this technical study. [Links at Debater Resources page.]

What's Wrong with Current Methods of Redistribution?

A lot.

The marriage tax. Academic studies find that marriage stabilizes relationships, improves children's outcomes and helps adults develop labor market skills. In general, marriage is correlated with economic well-being. One study reports that married couples' average per capita wealth is more than twice that of two similar people who never married. …

In a new book, *Two-Parent Privilege: How Americans Stopped Getting Married and Started Falling Behind*, University of Maryland economist Melissa S. Kearney makes the case:

- Two-parent families are beneficial for children.
- The class divide in marriage and family structure has exacerbated inequality and class gaps.

• Places that have more two-parent families have higher rates of upward mobility,

If more redistribution is channeled through existing entitlement programs, the transfers could create more inequality, not less. [*see more at* Goodman Institute Debater Resources]

When all is said and done, here is the question: When you earn a dollar, how much of that dollar do you get to keep, considering all the ways the government can tax it or reduce entitlement benefits based on it, for the rest of your lifetime? Alternatively, what fraction of the dollar will you lose to the government's fiscal policies? The latter is your net (lifetime) marginal tax rate.

The authors write:

> *The richest 1 percent face a high median lifetime marginal tax rate of roughly 50 percent. That means the poorest income-earners are facing tax rates almost as high and often much higher than the very rich.*

Technical study. NBER WORKING PAPER SERIES MARGINAL NET TAXATION OF AMERICANS' LABOR SUPPLY

Eating your own seed corn. Advocates of redistribution are usually very unclear about where the money they want to redistribute would come from. The least-bad source of funds would be from a progressive consumption tax – one that taxes only consumption (not income or wealth) and taxes the rich at a higher rate. That would lead to less consumption by the rich and more by the poor. But this is rarely ever proposed.

Instead, redistributionists often talk of taxing corporations. That would take money out of the capital market. They also often advocate taxing the investment income of the rich – for example, by taxing unrealized capital gains or by imposing a "payroll tax" on investment income. Bottom line: they would take savings and investment funds away from people who save and invest and give it to people who would use those funds to consume.

Most wealthy people consume only a small fraction of their income and wealth. The rest of it is invested. Warren Buffet, for example, is one of the world's richest men. But he is notoriously frugal in his personal consumption. He spends less than $4 a day on breakfast. That's less, we suspect, than breakfast costs for the average high school debater.

If we increase taxes on Buffett, he is still going to eat breakfast. Those higher taxes will come from funds he otherwise would leave in the capital market. …

The Economic Costs of Redistribution

They can be quite large.

Case study: the Biden economic plan. When he was running for president in 2020, Joe Biden proposed an economic plan that incorporated many of the measures mentioned above. It included a higher corporate income tax, higher taxes on unrealized capital gains and investment income for high-income earners, among other measures. Much of the Biden economic plan also found its way into Democratic proposals in Congress – although most of the proposals have not passed and become law so far. …

For example, the tax on Peter encourages Peter to produce less (because there is smaller reward for producing) and to engage in tax avoidance and tax evasion activities. At the same time, the gift to Paul encourages Paul to work less (because part of his income is now provided without working) and to change his behavior in other ways that increase his eligibility to be a recipient of funds.

The Leaky Bucket Theorem may explain why the United States had more substantial economic growth over the last two decades than European and other developed countries. (See the graphic [in online post])

While European countries do not redistribute more funds from rich to poor than the U.S. does, they do redistribute more within the middle class. Middle-income families pay higher taxes and get more benefits from government than U.S. families do.

This may be why they also produce less over time. …

Understanding the U.S. Welfare System

History. The percentage of the population living below the federal poverty level fell almost continuously through the 20th century. The reason: economic growth – which is the greatest force for eliminating poverty the world has ever known. …

Do We Have Too Much Redistribution Already?

As the above example shows, government tax policy already makes it possible for people to escape poverty by working. But our fiscal system appears to give people the opportunity to enjoy an even better life style by avoiding work altogether.

Gramm and his colleagues write that, since the War on Poverty started in 1965, the labor force participation of the bottom one-fifth of households – who now receive more than 90 percent of their income from government – has dropped from 70 percent to 36 percent.

It's not hard to understand why. Gramm et al. adjust for taxes, transfers (again, counting non-cash benefits as dollar-for-dollar income), and the number of people living in each household. Then they divide households into quintiles, based on earned income. The finding: the bottom fifth of households, based on earned income, had an average income of $33,653 per capita. The second and middle fifths, based on earned income, had $29,497 and $32,574 …

Better Ways to Reduce Inequality Other than Redistribution

• Promote school choice
• Reduce occupational licensing
• Reduce zoning restrictions that prevent low-cost housing
• Make most non-cash benefits independent of income
• Give families cash instead of in-kind benefits

Full post with reference links at: **www.goodmaninstitute.org/debater-resources/**