https://www.wsj.com/articles/income-equality-not-inequality-is-the-problem-labor-force-participation-income-taxes-transfer-payments-middle-bottom-rich-household-size-census-11661781351

OPINIONCOMMENTARY

Income Equality, Not Inequality, Is the Problem

Those in the middle work much harder, but don't earn much more, than those at the bottom.

By Phil Gramm and John Early

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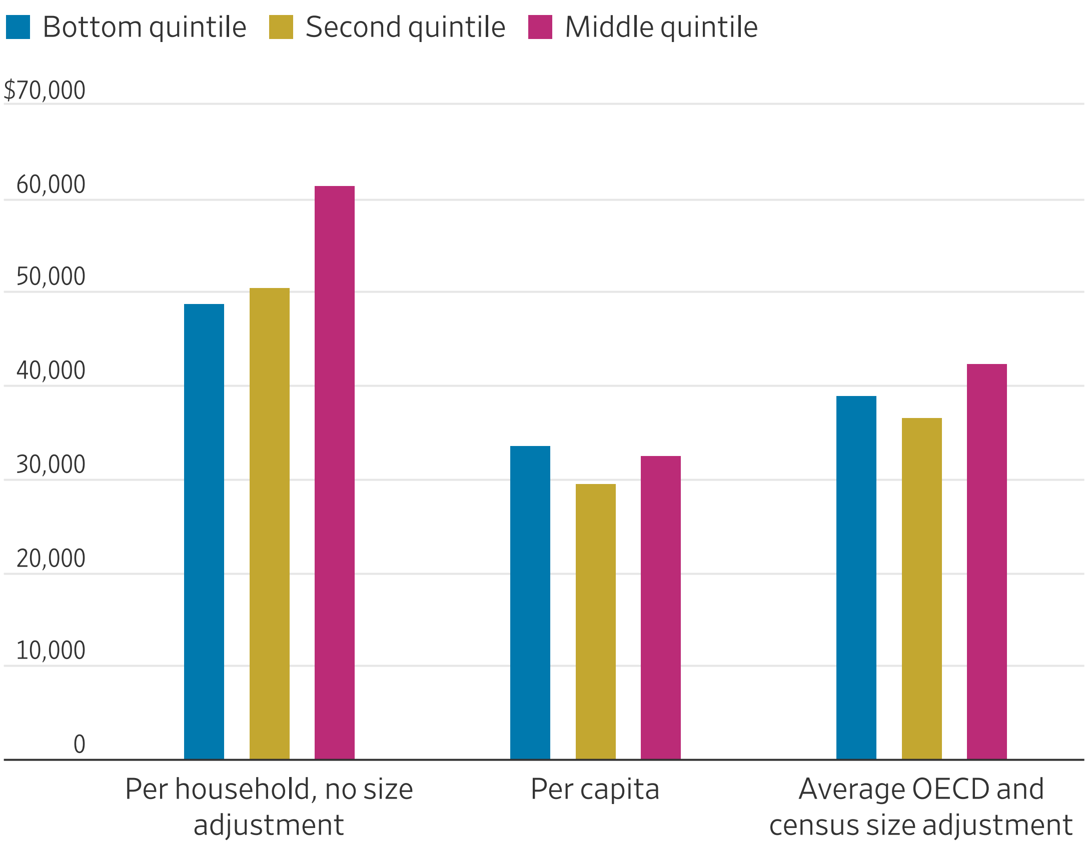
Contrary to conventional wisdom, the most dramatic and consequential change in the distribution of income in America in the past half-century isn't rising income inequality but the extraordinary growth in income *equality* among the bottom 60% of household earners.

Real government transfer payments to the bottom 20% of household earners surged by 269% between 1967 and 2017, while middle-income households saw their real earnings after taxes rise by only 154% during the same period. That has largely equalized the income of the bottom 60% of Americans. This government-created equality has caused the labor-force participation rate to collapse among working-age people in low-income households and unleashed a populist realignment that is unraveling the coalition that has dominated American politics since the 1930s.

On these pages, we have debunked the myth that income inequality is extreme and growing on a secular basis by showing that the Census Bureau measure of income fails to include two-thirds of all federal, state and local transfer payments as income to the recipients and fails to treat taxes paid as income lost to the taxpayer. The Census Bureau measure overstates current income inequality between the highest and lowest 20% of earners by more than 300% and claims that income inequality has risen by 21% since 1967, when in fact it has fallen by 3%.

Our most significant finding from correcting the census income calculations wasn't the overstated inequality between top and bottom earners. It was the extraordinary equality of income among the bottom 60% of American households, regardless of employment status. In 2017, among working-age households, the bottom 20% earned only $6,941 on average, and only 36% were employed. But after transfer payments and taxes, those households had an average income of $48,806. The average working-age household in the second quintile earned $31,811 and 85% of them were employed. But after transfers and taxes, they had income of $50,492, a mere 3.5% more than the bottom quintile. The middle quintile earned $66,453 and 92% were employed. But after taxes and transfers, they kept only $61,350—just 26% more than the bottom quintile.

Household income after all transfers and taxes, for work-age households, by earned income quintiles with alternative adjustments for household size, 2017



Source: Census Bureau, other government agencies and authors' calculations.

Even these figures don't tell the whole story. In the bottom quintile, there are on average only 1.92 people living in a household. The second and middle quintiles have 2.41 and 2.62 people respectively. After adjusting income for the number of people living in the household, the bottom-quintile household received $33,653 per capita. The second and middle quintile households had on average $29,497 and $32,574 per capita, respectively. The blockbuster finding is that on a per capita basis the average bottom quintile household received 14% *more* income than the average second-quintile household and 3.3% more than the average middle-income household.

It should be noted that while per capita comparisons are widely used, they tend to overstate the effects of household size. Two people living together can achieve the same material well-being for less than they could living separately. The Organization for Economic Cooperation and Development has developed a measure widely used internationally to adjust for household size, and the Census Bureau has a similar adjustment it uses in its supplemental poverty measure. Since the results produced by the OECD and the Census Bureau adjustments are so similar, we simply use the average of the two below.

The nearby chart compares the after-tax, after-transfer incomes of the bottom three quintiles of American households with no adjustment for household size, on a per capita basis, and using the average of the OECD and census adjustments for household size. We found that the average bottom-quintile household has $2,401 (or 6.6%) more income than the second quintile and only $3,306 (or 7.8%) less than the middle-income quintile.

The average second-quintile household *earned* almost five times as much as the average household in the bottom quintile, because it had 2.4 times as many working-age members working and on average each worker worked 80% more hours. The average middle-quintile household earned almost 10 times as much and had 2.6 times the percentage of its working-age people working, each working twice as many hours. Yet the bottom 60% of American households received essentially the same income after accounting for taxes, transfer payments and household size.

Given the surge in transfer payments since the war on poverty, it isn't surprising that the percentage of working-age people in the bottom quintile who actually worked plummeted from 68% in 1967 to 36% in 2017. With transfer payments giving recipients about as much for not working as they could earn working, only a mandatory work requirement as a condition for receiving means-tested benefits will bring them back into the labor market. While official statistics don't count two-thirds of those transfer payments and don't show the income equality they produce, Americans who work hard to make ends meet are aware of it. Despite Democratic politicians' efforts to provoke resentment against the rich, when was the last time you heard working people complain that some people in America are rich? The hostility of working people is increasingly focused on a system where those who don't break a sweat are about as well off as they are.

This justifiable resentment is the economic source of today's American populism. It is ravaging the increasingly unstable Democratic political alliance between welfare recipients and blue-collar workers. It was already building in the 1980s, with what were then called Reagan Democrats, and it was fully manifested in the Trump blue-collar political base. It is now driving political realignment among Hispanic voters, who are disproportionately middle-income earners.

By eroding self-reliance, worker pride and labor-force participation, government-generated income equality undermines the very foundations of American prosperity. A democratic society won't knowingly tolerate it.

Mr. Gramm is a former chairman of the Senate Banking Committee and a nonresident senior fellow at the American Enterprise Institute. Mr. Early served twice as assistant commissioner at the Bureau of Labor Statistics. This article is adapted from their book "The Myth of American Inequality," forthcoming Sept. 15.