It’s Not So Bad

U.S. Income Inequality: Income Gap

By Thomas A. Garrett

1996-2005

Example, more than 57 percent dropped to a lower category by 2005. The reverse also moved to a higher category by 2005. The point is, over time, a significant number of households move to higher positions along the income distribution and a significant number move to lower positions along the income distribution.

Common reference to “classes” of people (e.g., the lowest 20 percent) is misleading because income classes do not contain the same households and people over time.

Another problem with the inequality statistics is that they do not consider the noncash resources received by lower income households and the tax payments made by wealthier households to fund these transfers. Lower income households annually receive tens of billions of dollars in subsidies for housing, food and medical care. None of this is considered by the Census Bureau. Thus, the resources available to lower-income households are actually much greater than is suggested by their income.

On the other hand, these noncash payments to lower-income households are funded through taxpayer dollars, mostly from wealthier households. Thus, it is important to understand that income inequality is worthy of public policy.

It is important to understand that income inequality is a byproduct of a well-functioning capitalist economy. Individuals’ earnings are directly related to their productivity. Wealthy people are not wealthy because they have more money; it is because they have greater productivity. Different incomes, thus, reflect different productivity levels.

The unconstrained opportunity for individuals to create value for society, which is reflected by their income, encourages innovation and entrepreneurship. Economic research has documented a positive correlation between entrepreneurship/innovation and overall economic growth. A wary eye should be cast on policies that aim to shrink the income distribution by redistributing income from the more productive to the less productive simply for the sake of “fairness.”

Redistribution of wealth would increase the costs of entrepreneurship and innovation, with the result being lower overall economic growth for everyone.

Poverty and income inequality are related, but only the former and not the latter deserves the label “poverty.” Some economists argue that reducing poverty would lift those out of poverty (increase their productivity) while not reducing the well-being of wealthier individuals.


The economic literature indicates that an increase in income inequality in the United States is not only positive but necessary for a growing economy. The cumulative research strongly supports the proposition that income mobility is beneficial for the nation’s economic growth and stability.

ENDNOTES


2. Except the upper 20 percent, which is not limited. The upper income limit for 2006 was household income was: lowest quintile $15,290; second quintile $57,726; third quintile $66,400; fourth quintile $97,032. To be in the top 5 percent of all incomes in 2006, a household needed an income of $374,302.

3. See the Treasury Department. The report is available online at www.taxpolicycenter.org/taxfoyer/taxpapers/

4. See Rector and Hederman.


6. See Rector and Hederman.

7. The degree of income inequality is also less than is reported by the Census Bureau. The reason is differences in income across different income groups. Broda and Romalis (2008) argue that the purchasing power of lower-income groups has increased relative to higher-income groups due to the fact that the goods that lower-income people spend a greater percentage of their income on, such as food and clothing, have increased in price at a much faster rate than the goods and services that higher-income groups purchase.

8. See L. R. Baeumler, Joel Leib erg, and Simon for recent examples.

9. The economic literature indicates that an increase in income inequality in the United States is not only positive but necessary for a growing economy. The cumulative research strongly supports the proposition that income mobility is beneficial for the nation’s economic growth and stability.

REFERENCES


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