

INDEPENDENT JOURNAL REVIEW

7 Charts Take Down Common Myths About Income Inequality

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A new report from the libertarian Cato Institute aims to remove emotion and misinformation from the debate on economic inequality.

"Yes, there is a significant amount of inequality in America," Michael Tanner, the paper's author writes, but these five myths and false assumptions need to be toppled in order to get a clear-eyed look at the issue:

1. The Severity of Inequality

The report opens by challenging the notion that income inequality is at a record high in the United States.

That statistic is only based on the "market income" of individuals and does not consider taxes or transfer payments. "The failure to consider those factors," the report notes, "considerably overstates effective levels of inequality."

Cato's review of the economic literature finds the United States to have a highly progressive tax system (in which the wealthier one is, the more he pays in taxes).

A 2013 report from The Washington Post also confirms that review, going even further in noting that the U.S. has the most progressive system in the developed world:

Income and taxes for the top 10 percent, around the world

Source: OECD, "Growing Unequal?"

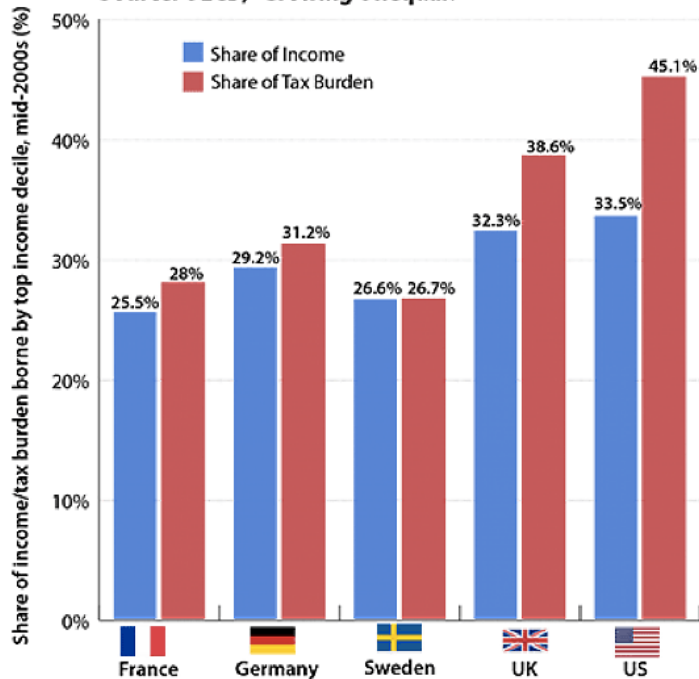


Image Credit: The Washington Post

Taking existing "redistribution into account," Cato notes:

"Significantly reduces inequality. According to the (Congressional Budget Office), accounting for taxes reduces the amount of inequality in the United States by more than 8%, while including transfer payments reduces inequality by slightly more than 18%.

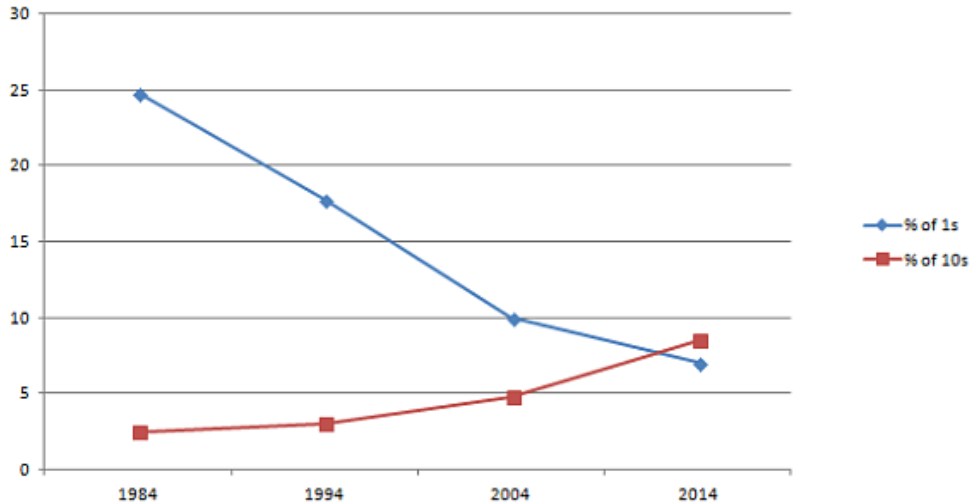
"By fully accounting for redistribution from taxes and transfers, true inequality is almost 26% less than it initially appears."

2. Inherited Wealth

Forbes magazine releases annually a list of the richest people in the United States. In recent years, the rankings reveal a trend of the growing power of self-made billionaires at the expense of those who inherit their wealth.

From 1984, Forbes's data shows the proportion of entirely self-made fortunes (called "absolute bootstrappers" by the magazine) steadily grow while the proportion of entirely inherited fortunes declines:

Evolution: % of 10s vs 1s



The evolution of absolute self-made fortunes (10s) and inherited, but not growing (1s) in the Forbes 400 from 1984 to 2014

Image Credit: Forbes

The Cato report argues that "much of the debate over inequality is tied together with notions of fairness" and while "Americans don't necessarily resent wealth," they do have "a feeling that the rich haven't 'earned' their wealth."

Those sentiments are challenged by the Forbes data.

3. Economic Mobility

Do the rich stay rich and the poor stay poor?

According to the report:

"Only about 2.2% of people spend five or more years in the top 1% of the income distribution from age 25 to 60. Just 1.1% spend 10 or more years in the top 1%.

"Attaining 10 consecutive years in the top 1% of income is even rarer: just over half of 1% do so. In short, there is no calcified class of 1 percenters who stay there, earning enormous incomes year after year."

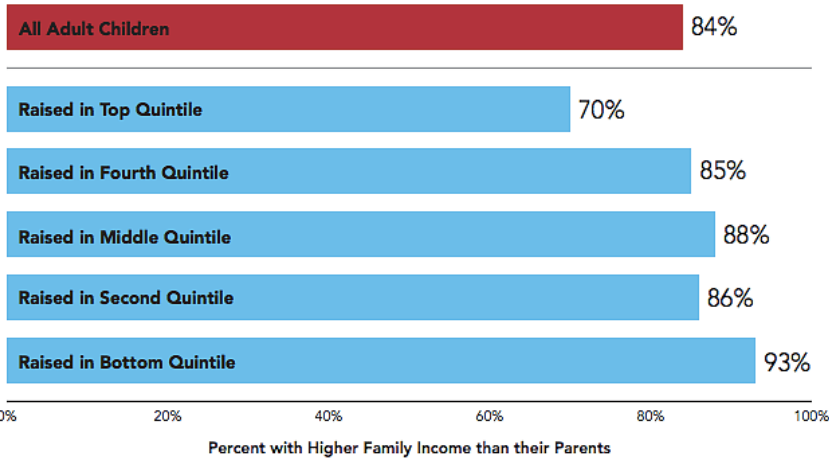
At the same time, studies show that "roughly half" of those in the bottom-fifth of the economic ladder "move up to a higher quintile within 10 years."

According to a 2012 report by the Pew Charitable Trusts, more than 8-in-10 Americans will have an income exceeding their parents':

Figure 1

Eighty-four Percent of Americans Exceed their Parents' Family Income

Percent with family income above their parents, by parents' quintile



Note: Income is adjusted for family size.

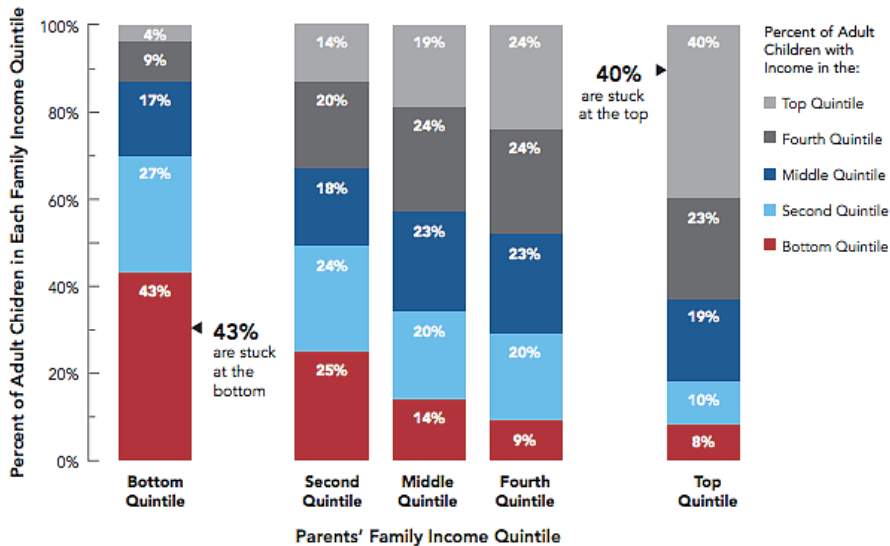
Image Credit: Pew Charitable Trusts

But Pew also found a 40% chance of "stickiness." Americans raised at the top and bottom income brackets have a strong chance of staying there, but a majority have the chance to move up or down the ladder:

Figure 3

Americans Raised at the Top and Bottom Are Likely to Stay There as Adults

Chances of moving up or down the family income ladder, by parents' quintile



Note: Numbers are adjusted for family size.

Image Credit: Pew Charitable Trusts

4. Money in Politics

When the 2016 election kicked off, it was supposed to be the year big money, let loose by the U.S. Supreme Court's decision in *Citizens United*, that would roll over the voters and straight into the White House.

Instead, former Florida Gov. Jeb Bush burned through \$130 million without winning a single GOP primary; spry socialist Vermont Sen. Bernie Sanders raised more than \$200 million from mostly small donors; and Donald Trump, hardly the favorite of the moneyed Republican establishment, largely self-funded his own primary challenge.

The Cato report takes this point further, noting that political opinions don't significantly correlate with wealth:

"According to a Gallup poll, about one-third of the top 1% of wealthiest Americans self-identify as Republicans, compared to roughly a quarter who self-identify as Democrats."

"Wealthy Americans are slightly more likely to call themselves conservatives than liberals, but so is the American public as a whole."

Yet the report grants Americans are right that favoritism comes into play, "some individuals and businesses are able to secure favors and privileges from the government." But Cato credits this more to cronyism enriching business allies rather than business overpowering government officials.

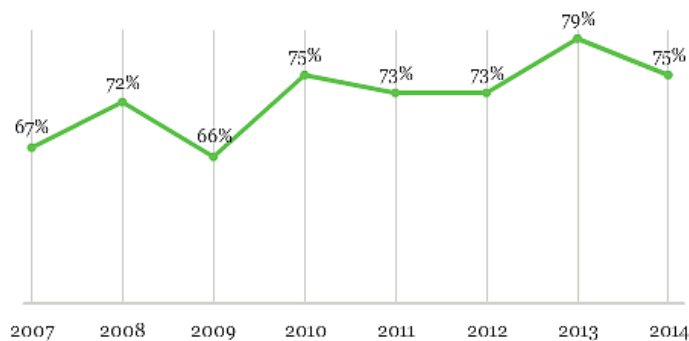
Polls suggest Americans feel the same way.

In a survey released late last year, Gallup found that an astounding 75% perceived corruption as "widespread" in the United States government:

Is corruption widespread throughout the government in this country, or not?

Asked of U.S. adults

■ Yes



GALLUP

Image Credit: Gallup

5. Inequality's Connection to Poverty

Cato's report notes that poverty and inequality are often confused as the same thing:

"If we were to double everyone's income tomorrow, we would do much to reduce poverty, but the gap between rich and poor would grow larger. Would this be a bad thing?"

It cites multiple studies that show the amount of poverty in a society doesn't have an obvious connection to increase in wealth for the top 1%:

Figure 10. Poverty and the 1 Percent

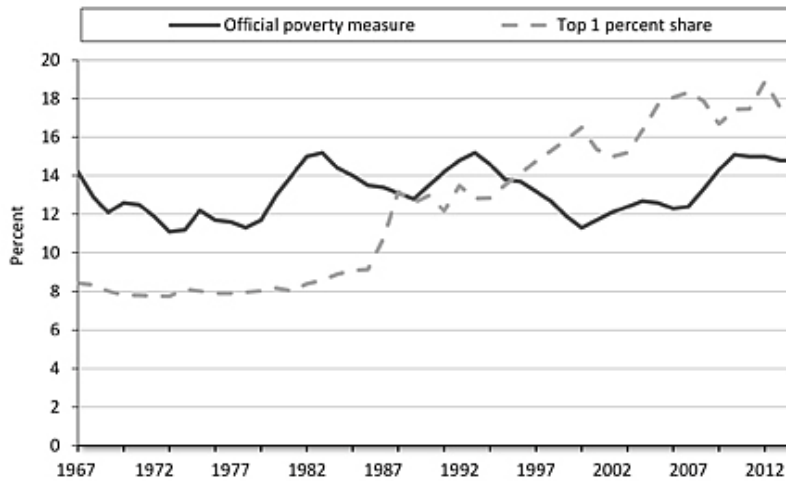


Image Credit: Cato

Even as inequality has increased, the material conditions of poor families has improved over time:

Figure 11. Adoption of New Technologies

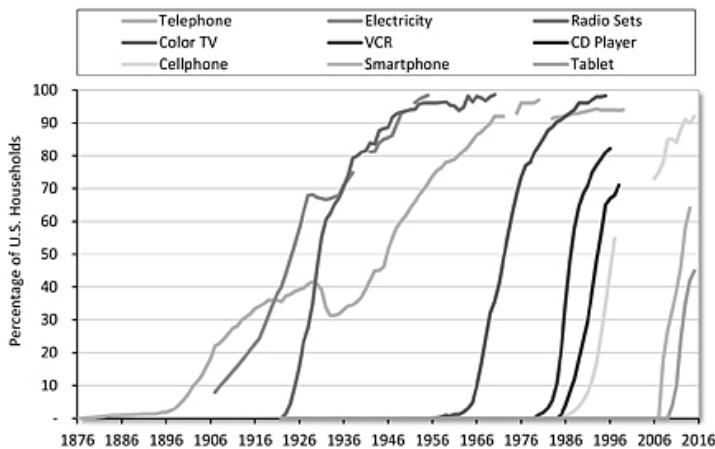


Image Credit: Cato

As Donald Trump and Hillary Clinton both tout their commitment to reducing economic inequality as president, a bit of context can put what that inequality looks like in practice.

After all, wrong assumptions are unlikely to lead to right results when it comes time to implement policy.