Human Events
POWERFUL CONSERVATIVE VOICES

The Dirty Little Secret of "Income Inequality"

People don’t understand what "income" means any more.
by John Hayward
01/05/2012

Cato Institute senior fellow Dan Mitchell and his colleague Peter Van Doren have a fascinating point to make about “income inequality,” which we’ve been hearing so much about in the media these days. There are many flaws in the way this topic is framed and discussed, but one of the most basic problems is that people don’t really understand what “income” means any more.

Do you *really* know what your precise weekly income is? Most employees understand that they can’t answer that question by simply looking at the net payable amount on their paychecks. Fewer appreciate that the answer is not found in the gross pay totals on the paycheck stub, either. Businesses are obliged to pay for many benefits, while others are offered voluntarily, as part of the employee’s compensation package. Benefits such as vacation and holiday pay have a real dollar cost associated with them, although most workers don’t think about them in such terms.

Then there are even more indirect costs associated with labor, so far removed from the employee’s wages and explicit benefits that they’re virtually invisible… except to those who pay for them, of course.

One of those benefits is health care, whose true cost virtually no one understands. Van Doren crunched some numbers from two different studies, and found that much of the “income inequality” battered about in the media is actually due to a rising share of income being delivered in the form of increasingly expensive health benefits:

> While it is true that the cash explicitly paid to employees has become more unequal over the last generation, the…more benign explanation for the change in cash compensation over a generation is the dramatic increase in health insurance

> costs. …inequality in total compensation has not increased because the fixed costs of health insurance are a much larger percentage of the total compensation of lower-earnings workers.
>
> Burkhauser and Simon explore this explanation. They add the value of employer-provided health insurance as well as Medicaid and Medicare to the pre-tax, post-cash-transfer household income data and find that the bottom three income deciles actually exhibit higher growth than the top seven deciles from 1995 to 2008…
>
> Warshawsky makes a similar discovery. Using unpublished BLS total compensation data, including employer health insurance expenditures, from 1999 to 2006, he finds that the growth in compensation by earnings decile (from the 30th to the 99th) averages 35 percent, with 41 percent growth at the 30th percentile (workers earning $10–$14 an hour) and only 35.8 percent growth at the 99th percentile (workers earning $59–$80 an hour).

Mitchell concludes:

> Translating all this into simple English, it turns out that the rich are getting richer slower than the rest of us are getting richer.
>
> By the way, even though I'm glad total compensation is growing more rapidly for the non-rich, these studies should not be interpreted as good news. As noted in the excerpt above, much of the additional money is diverted into a rather inefficient healthcare system.
>
> This is the problem, not inequality. As I've explained before, American healthcare suffers from a third-party payer crisis caused by too much government intervention.
>
> And because this distorted system leads to ever-higher costs, the increase in total compensation for lower-income and middle-income people does not translate into an increase in their living standards. Ordinary people feel like they're on a treadmill.
>
> In other words, while assertions of rising income inequality are dubious, there is a real issue of stagnation.

Shifting these costs into government-controlled programs does not make them go away. Health care benefits are still part of labor cost, whether the employer pays a private insurance company, forks over taxes to fund government programs, or any fusion of the two approaches.

As with so many other statistics, numbers that "prove" income inequality can be made to dance on the head of a pin. It's especially easy when not even the word "income" has a clearly understood meaning anymore. The more compensation is routed through the government, the less aware of it an employee becomes. That's the whole idea behind paycheck withholding: grab those taxes before people even realize the money is gone. Very few of us have a clear idea of just how much of our money is "going," or where it goes.