3 Takeaways Podcast Transcript
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Ep. 124: Former Senator Phil Gramm Explodes the Myth of American Inequality in an Eye-Opening Conversation

INTRO male voice: Welcome to the 3 Takeaways Podcast, which features short, memorable conversations with the world's best thinkers, business leaders, writers, politicians, scientists, and other newsmakers. Each episode ends with the three key takeaways that person has learned over their lives and their careers. And now your host and board member of schools at Harvard, Princeton, and Columbia, Lynn Thoman.

Lynn Thoman: Hi, everyone. It's Lynn Thoman. Welcome to another 3 Takeaways episode. Today, I'm delighted to be with former Senator Phil Gramm, and I'm excited to find out why he believes American inequality is a myth. Public policy, the role of government, and ultimately our happiness depend on knowing the true facts. But Senator Gramm says the publicly believed facts on inequality are wrong. As he notes at the start of his book, The Myth of American Inequality, The Economist magazine sums up the public assessment of income inequality as, "It is a truth universally acknowledged that inequality in the rich world is high and rising." This view, he says, permeates the American political and economic debate and is generally accepted across American society. But, he says, it's wrong. Welcome, Senator Gramm, and thanks so much for joining 3 Takeaways today.

Senator Phil Gramm: Oh, thank you, Lynn. I appreciate the opportunity.

LT: It is my pleasure and my honor. Why did you write The Myth of American Inequality?

SG: For about 20 years, there has increasingly appeared to be a gap between what government says household income is and what people have and what they spend. An economist, Bruce Meyer, did a major study at the University of Chicago, where he looked at the spending patterns of low income Americans and basically concluded that based on those spending patterns, that he found that only about 3% of American households were actually poor, not 14%, which is what the Census Bureau said. Last year, the gap became so big that the Census Bureau put out the household income of the country broken up into five different sections, quintiles, and the Bureau of Labor Statistics put out how much each of those quintiles consumed. Well, last year, the bottom quintile of income earners in America consumed roughly twice their income.

SG: The second quintile consumed 11% more than its income, and the top quintile consumed only 50% of its income, even though there's no evidence that they saved 50%. Now what happened? Well, what we show in the book is that if you go back to 1947 and you look at how the Census Bureau calculates household income, which is the foundation of all of our measures of well-being, they don't count two-thirds of all transfer payments as income to the people who get the transfer. Today, they don't count refundable tax credits where you get a check from the Treasury. They don't count food stamps where you get a debit card from the Treasury. They don't count Medicaid where the government pays your medical bills. They don't count housing subsidies where government pays your rent. They don't count roughly 100 federal, state, and local programs as income to people that receive those transfers.

SG: They also don't take into account taxes so that they count the income of higher-income people as their gross income, not as their net income. So that if you count all transfer payments as income of the people that get the transfer, if you count all taxes as income lost to the people who paid the taxes, the ratio of the top quintile of earners, the top 20% to the bottom 20% is not 16.7 to one as the Census [Bureau] says, but 4 to 1. Now, you can argue 4 to 1 is too much, but there's a huge difference between the two. And in terms of the Economist magazine, we show that if you count all government transfers as income to the people that get the transfers and taxes as income lost to people who paid the taxes, that income inequality in America is actually lower today, very slightly lower, than it was in 1947. So as unbelievable as it sounds, Lynn, we're having this debate about remaking American capitalism to deal with the growth of income inequality when income inequality is actually lower today than it was in 1947.

LT: Wow. Why don't the official statistics count all the transfer payments? How come they leave out what you said, two-thirds of them?

SG: And all taxes. Well, in 1947, when they started calculating household income, there weren't many payments that were made in kind, where somebody else paid for something or gave you a benefit that they paid for. And all government transfer payments at that point, for all practical purposes, were in cash and cash equivalents. So the assumption they made to count only cash equivalent payments was a reasonable approximation in 1947. But as more benefits were paid in kind, like food stamps and housing subsidies, the Census [Bureau] made the decision to stay with their original definition. And now 70 years later, of the $2.8 trillion of transfer payments that governments pay out in America, federal, state, and local government, only about $0.9 trillion is counted as income. The other is not counted. And none of the taxes are counted. So that about 40% of the national income of the country is not counted in our definition of poverty and income inequality.

LT: Wow.

SG: And nobody contests this. This is the point. I've made this presentation at Stanford. And all the data that I use in filling in where the Census left out is all calculated by the federal government. These are all government statistics that since 1947, they've actually calculated these things and asked on their questionnaire about them and recorded them. They've just not counted them as household income. So nobody disputes this. But the point is the public policy debate continues as if the census numbers were valid.

LT: So you say you're getting all of your numbers from the government?

SG: Yes, all of them.

LT: And when you say that the government is not counting any kind of benefits like food stamps and other programs, what about these COVID stimulus payments, those cash payments to households? Were those included in the calculations on income by the government?

SG: No. If you'll remember last year, the Census Bureau put out their measure of household income and poverty. And in that measure, they found that household income had declined and that the poverty rate was up. Those measures didn't pass the smell test in a year where government spending had exploded on transfer payments. And so they were forced to issue a supplemental report that showed that if they had counted the transfers, that income would have been up and not down and the poverty rate would have been down and not up. But yet the numbers that are the permanent figures for household income and poverty remained unchanged. So that 10 years from now, we'll be debating the numbers as if those payments were never made.

SG: And so what this produces is a situation where the Census Bureau doesn't count the payments. So the income is not registered. Government in dealing with poverty, for example, increases expenditures, but the expenditures are not counted, poverty is not reduced, and as a result, we repeat the cycle. Final point on this, poverty. The poverty rate fell dramatically from 1947 to 1967. And then for 50 years, it oscillated between 14% and 11% of the population. But during that 50 years, the value of transfer payments that government provided to the bottom 20% of income earners, the poorest Americans, grew from $9,700 a year in 1967 to $45,400 a year in 2019, the year before the pandemic, and yet the poverty rate remained largely unchanged. Now, how in the world could that possibly happen? Well, the only way it can possibly happen is if you don't count the payments, which is exactly what happened.

LT: About what percentage of total income in the United States comes from transfer payments?

SG: Well, it's $2.8 trillion out of a $20 trillion economy. And if I did the arithmetic, it would come out to be about 16 or 17%.

LT: You just mentioned a figure of $45,000. Is that the average transfer payment to the bottom 20%?

SG: Yes. The average household in the bottom 20% of American earners received in the year before the pandemic, the last good year we have on the measure, received $45,400 from federal, state, and local government. They earned about $5,000 on average, and they received $45,400 from the government. So that almost 90% of the income of the bottom 20% of Americans comes from government transfer payments. And an interesting fact, when the war on poverty started in 1967, 68% of the prime work age people in the bottom 20% of income earners worked. That number has fallen pretty steadily so that 50 years later, only 36% of prime work age persons in the bottom 20% of income earners actually work.

LT: What do we know about the bottom 20% of households? Who are they? Why is their income so low? The stereotype is that these are single mothers with lots of children. Is that true?

SG: No. It used to be true. 50 years ago, it was certainly true. And it's the image that prior to doing this work that I had of what poverty households look like. And that was you had a parent, a single parent, and you had a bunch of children. Now, household size is basically less than two people on average live in a poverty household. And the number of people living in households goes up as the income rate rises. So that the largest households in America are now the households with the largest income. Now, that's an average number. Obviously, there are exceptions, but that's what the average shows.

LT: How does the bottom 20% compare to the top 20%? What do we know about the households?

SG: Well, we know that they receive about one fourth as much in income. We know that about half of them are elderly. So they're receiving basically retirement and social security. But we know of the roughly one half that are of prime work age, we know that the vast majority of them have dropped out of the labor market. And it's obvious, as we show in the book, that if you look at their return for working, relative to what they can get by drawing government benefits, the surprising figure is not that the number of working has fallen from 68% to 36%, but that 36% still work, which is a great testament, it seems to me, to the people in this bottom quintile.

LT: You mentioned that the households in the bottom 20% are smaller. How does the income per person in the bottom 20% compare to the income per person in the top 20%?

SG: The real comparison is that if you adjust the household size, obviously, it falls from 4 to 1 to somewhere 3 point something to 1. But one of the startling findings of the research is that the bottom 60% of American earners now have roughly the same income. The growth of transfer payments in the last 50 years has far outstripped the growth in the income of middle income families after taxes. And so as a result, you've had a compression of the income levels of the bottom three quintiles, the bottom 60% of American households. And so you've created a situation if you adjust for household size, where they're virtually identical.

SG: So that you've got the situation where you've got a family that both husband and wife work, they've got children that are struggling to make ends meet. And then down the street, the same neighborhood, you've got a household where no one is working, and yet they're about as well off as the people who are working. And naturally, that creates a resentment. And that resentment, I believe, is a driving force behind what we now call American populism. In fact, if you think about it, I live out in the country, and I have a lot of working people who come on to my place to do various things, fix things mostly that I break. [chuckle] I never hear them complain about rich people. I hear them complain about people who don't break a sweat and are about as well off as they are.

LT: We've all also heard the idea that the poor get poorer and the rich get richer. Is that true?

SG: We looked at the last 50 years, and in that period, the rich got richer and the poor got richer and everybody in between got richer. The performance of the American economy in the last 50 years has been pretty amazing. In any other country in the world, this 50 years would be called a golden age. When you look at ethnic groups, when you look at racial groups, when you look at the regions of the country, the general prosperity and growth has been pretty broad based. Now look, it's better to be born beautiful and brilliant, there's no doubt about that. But, ugly, ordinary people succeed today. It's just something that we see and we accept. It's often a story that we can find in our own families. This idea, and you've got politicians who are pushing this, that the system is rigged.

SG: Well, neither of my parents graduated from high school. If it's rigged, how did I get here? How did Elon Musk become the richest man in the world? He didn't become the richest man in the world by taking it away from you and me. He created something. A perfect example is Bill Gates. He is really rich, but he earned every penny of it and he made the rest of us richer in the process. I'm using part of his inventions and developments right here on this program. He only owns 7% of Microsoft. And who owns the other 93%? Your pension fund, your insurance policy, your annuity. They all benefited from Bill Gates. He didn't make his money by making the rest of us poorer. I don't understand this resentment of successful people. As long as they succeed by doing something that's valuable to society and that people are willing to pay for, we all benefit.

LT: What do we know about mobility for the households in the bottom 20%? Do we know how long households in the bottom 20% stay?

SG: We know based on a major Pew Foundation study that 93% of people that grow up in the bottom 20% of income earning families have a higher income level than the households when they're adults. And we know that two thirds of them do well enough to move into a higher income earning bracket, including 6.1% who go all the way from the bottom to the top. We also know that it works in reverse. 61% of the people who grow up in the top quintile end up living as adults in a lower quintile. So again, there's no doubt about the fact, look, if you're a parent in the top 20% of income earners, you've got enough money, if your child has a problem, to find out what the problem is, to try to fix it, to send them to private schools, to get tutors, to get counselors. And many people who grow up in the bottom quintile, their parents are not equally well educated. They don't often discover problems.

SG: They're often in failing inner city schools. And yet, 93% of them do better than their parents. And two thirds of them do a lot better. Now, we could make it better than it is. If we, through a work requirement, people that were receiving means tested programs that are aimed at poor people had to work, we could get more people into the economy and they would progress more. The people that have not made progress in the last 50 years basically were people who dropped out of the labor market. The only benefit they could get as an increase is what government gave them. But they've stunted their ability to participate in the American dream. And obviously, anything we could do to improve the quality of primary and secondary education, people would then have the ability to discover their talents and use them. And I think inequality would be reduced.

LT: We all also believe that inequality is higher in America than other countries. How does American inequality compare to the developed countries of the OECD?

SG: Well, remember, the OECD simply takes the numbers that the governments involved give them and it calculates what it calls a Gini curve, which tells you how unequal income is distributed. The Census Bureau submits data to the OECD that does not include many of these transfer payments. The OECD does include taxes. So they find in putting together their calculation using census data that we have the highest income, slightly higher than the seven most developed countries. If you supplement the census data with government data on the actual transfer payments, we fall right in the middle of the seven.

LT: How do America's transfer payments compare to the European ones?

SG: The only nation in the world that transfers a larger percentage of its national income than we do is France. Now, we're a lot richer than France. So even though we transfer a smaller percentage, the dollar amount in purchasing power parity is bigger. But we transfer a larger share of our income through the government in redistribution than Germany, than Britain, than Italy, than Japan. So in a sense, I often joke and say, Senator Sanders went to bed and dreamed that America would be a welfare state. And he woke up and his dream had come true.

LT: You mentioned education. Is there a connection between education spending and outcomes? How does US education spending compare to Europe?

SG: There's not much of a correlation when you look at international performance. There are countries that spend more than us, not many. There are many that spend less than we do that have higher performance on standardized tests. If you look at American education, the level of spending on public education per student has risen dramatically. Quality, however, has declined and is basically continuing to decline. We talk about school choice, vouchers, charter schools, not because we picked that approach, but because the empirical data shows that that approach produces an improvement in quality, especially in inner cities and among minorities. And I think our commitment to equality of opportunity, and this is an important point. America never promised equality of outcome in the competition for life. That idea is alien to the American ethos.

SG: America promised, in Abraham Lincoln's words, a fair chance and an open way to use your energy and intellect. That's all it promised. And so the real promise is opportunity. Anything we can do that improves opportunity is a movement toward that goal. I found in my 25 years in government, to my great frustration, that too often in trying to help people in providing government benefits, that we actually induce them to stop helping themselves. And how to help people without destroying their incentives to help themselves is one of our great failures. Now, I believe that school choice and charter schools and vouchers have proven empirically that they are an improvement over the current system. And until something better comes along, I think we ought to be looking at using more school choice.

LT: And you also believe that the high levels of transfer payments disincentivize people from working?

SG: Yes. Well, I think that the data shows it convincingly, that we've had a dramatic decline in the number of prime work age persons that actually work, as our spending on what, in essence, are welfare benefits has exploded. So we've dealt with a poverty problem for everybody except a small group of people that because of mental illness and because of drug addiction can't take care of themselves and the people they're supposed to take care of. But we bought it at a price of idleness. And so did the war on poverty succeed? Not by the standards that Lyndon Johnson set out. The goal was to put people in a position to become self-reliant. And that's not happened.

LT: And based on your calculations of including transfer payments, what is the poverty rate roughly in the United States today?

SG: Between two and a half and three percent.

LT: You're very interested in and you've worked very hard to increase opportunity. What do you think about state licensing requirements? And can you give some examples?

SG: Yeah, I think they're outrageous. I think that what happens, especially at the state level, is that various groups of people that have a vested interest end up writing licensing requirements that keep people that don't have a broad array of skills from using the skills they have. For example, the New York provision that requires extensive training to be a shampoo assistant in a beauty parlor. Well, we all manage to wash our hair once a day without any serious damage being done to most of us. Hair braiding. In many states, you can't commercially braid people's hair without a license and you can't get a license unless you go through an extensive training program. And the list goes on and on and on and on. And it is an outrage and it's something we need to do something about. And while

I'm talking about that, government is becoming an increasing source of inequality.

SG: The five richest highest income counties in America surround Washington, DC. Now, you can see why there would be a lot of high income people around Wall Street in New York. You can see why there would be a lot of high income people around Silicon Valley, but why do you have all these high income people seat of government? Because government is a major source of income. And I think it's something we ought to be concerned about. I think we ought to be looking at it. And let me make it clear, Lynn. We don't make value judgments in the book. We try to present the facts. In fact, one of the authors started his career working for George McGovern and then went on to be the Assistant Commissioner of the Bureau of Labor Statistics under two presidents. So we don't agree on many value judgments, but we do agree that we need to get our facts straight. And again, I am hopeful that in getting our facts straight, that many of the differences we have may turn out not to be so important when we got the facts straight.

LT: The extraordinary thing to me is that all of your facts are based on government numbers.

SG: That's right. But the government collects them. It didn't collect them in 1947 because it didn't have the capacity, but it does now, but it doesn't use them.

LT: Before I ask for the three takeaways you'd like to leave the audience with today, is there anything else you'd like to mention that you haven't already touched upon? What should I have asked you that I did not?

SG: I will say this. There is this image created that there are these mega rich people, billionaires, as politicians call them. They used to talk about millionaires, but it's clear they're millionaires, so they're now talking about billionaires. There's no bottomless pit out there that if we could take the income of rich people like Warren Buffett, that we could fund all this government. That's a pipe dream. I think that's a point I would want people to understand, and that rich people... Do they pay their fair share? Nobody knows what their fair share is, but the income tax structure is that the average tax rate rises to 41%, roughly, steadily up to 0.01 rate. Then it falls into the 30s for a very small group of people who give vast amounts of money away and who earn most of their income from investment income. And the American tax system is the most progressive in the world. Those are things that I would want people to understand.

LT: What are the three takeaways you'd like to leave the audience with today?

SG: First of all, income inequality in the official numbers of the federal government are grossly overstated because they don't take into account two-thirds of all the transfer payments and they don't take into account taxes. Income inequality exists, but it has actually declined in the last 70 years, not exploded by 22% as the Census [Bureau] figure shows. Rich people created the wealth and made the rest of us better off as a result. Mobility is alive and well. If you work hard, it's very difficult to fail in America. And the American system works. It's not rigged. Neither of my parents graduated from my school. Nobody in my life ever told me you can't be something because of who your daddy was. That's not the world we live in. Now, politicians may tell you it is, but it's not true. There are millions of examples. And again, the world is not perfect. Some people are pretty, some aren't, some are brilliant, some are just ordinary people. But there's room amongst the successful for millions of Americans and a lot of people get there by working hard and by saving their money and investing it. And if you do that, you're going to succeed in America.

LT: Senator Gramm, thank you so much. Thank you for joining 3 Takeaways today and thank you for your service in government.

SG: Oh, thank you. You're a very nice person and it was great doing this.

OUTRO male voice: If you enjoyed today's episode and would like to receive the show notes or get new fresh weekly episodes, be sure to sign up for our newsletter at https://www.3takeaways.com/ or follow us on Instagram, Twitter, LinkedIn and Facebook. Note that 3Takeaways.com is with the number 3, 3 is not spelled out. See you soon at 3Takeaways.com (https://www.3takeaways.com/)

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