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OFFICIAL MEASURES OVERSTATE THE IMPACT OF GOVERNMENT SPENDING AND TAXATION POLICIES IN REDUCING INEQUALITY, SUGGESTS NEW LEVY INSTITUTE STUDY

Report Features Latest Results from Levy Economics Institute's Comprehensive New Measure of Economic Well-Being

ANNANDALE-ON-HUDSON, N.Y.—The U.S. Census Bureau recently began placing what used to be called "experimental measures of income" on par with gross money income (MI) in its annual reports, the official scorecard of the level and distribution of economic well-being in the United States. Yet, contrary to even these most comprehensive measures of economic well-being used by the government to formulate programs and policies, a new report from The Levy Economics Institute of Bard College finds the increase in economic well-being attained during the 1990s economic boom came at the price of more hours worked, and that the effectiveness of government spending and taxation policies on reducing inequalities generated by market forces has declined. These conclusions are part of the latest findings of the Levy Institute Measure of Economic Well-Being (LIMEW).

In their new report, Levy Institute scholars Edward N. Wolff, Ajit Zacharias, and Asena Caner extend their analysis of economic well-being to include additional years, 1995 and 2001, and compare their results with the U.S. Census Bureau's most comprehensive measure of a household's command over commodities, referred to as extended income (EI). The comparison shows that while inequality in MI has hardly changed since 1995, inequality in the EI and the LIMEW grew significantly, with the LIMEW showing the greatest increase. Furthermore, the structure of that inequality is radically different due to the different methods of measuring the income from nonhome wealth and the LIMEW's inclusion of household production and public consumption as vital components in the measure of well-being.

By studying and comparing the incremental effects of similar components of both measures, EI and LIMEW, the authors draw several important insights. First, the incremental effects of base income, which is the amount of money income a household would have without counting the income it might have from wealth and government programs, and income-from-wealth components on inequality are strikingly different in the LIMEW and EI, with base income having a much larger positive effect on inequality in EI and income from wealth having a much larger positive effect in the LIMEW. Also, while net government expenditures considerably reduces overall inequality in both measures, the effect is much larger (-22.2 percent in 2001) in EI as compared to the LIMEW (-12.8 percent). Last, the EI suggests that taxes and expenditures have similar incremental effects in reducing inequality, whereas the LIMEW suggests that expenditures have a markedly higher incremental effect in reducing inequality than do taxes.

Wolff, Zacharias, and Caner contend that important policy considerations are often informed by the incremental effects of variables and suggest that elements contained in the LIMEW, such as public and self-provisioning and a different measure for income from wealth, are vital to the study of inequality. "Earnings, which make up the overwhelming portion of base income, are the decisive factor shaping the overall level of inequality in EI. But they represent a much smaller portion of inequality in the LIMEW. The difference suggests that to consider economic inequality as shaped, basically, by earnings inequality may be misleading. Wealth inequality also plays an important role," the authors write, stressing that there are positive signs that officials are beginning to consider broader measures of inequality. "The elevation of more comprehensive income measures to a status that is on par with MI in the official scorecard of the economic well-being of U.S. households is a sure indication that academic discussion and policy making will be increasingly informed by such measures."

To obtain copies of the latest LIMEW report contact Mark Primoff, the Levy Economics Institute of Bard College, Annandale-on-Hudson, NY 12504-5000; call 845-758-7412; or email primoff@levy.org.

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