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The Myth of Growing Income Inequality

by Richard W. Rahn

If your income remains constant but the prices of many things you buy decline, you are richer. There are many articles and books asserting that the inflation-adjusted incomes for the middle- and lower-income groups in the U.S. and some of the other developed countries have remained almost flat while the upper-income “rich” have seen a great rise in their incomes. Not true when correctly measured.

There has been much hand-wringing about the lack of productivity growth. The world economy has radically changed, and old measures of gross domestic product (GDP) are no longer valid. GDP measures the value of all goods and services both produced and consumed at market prices. But now, people increasingly consume what is not measured. When a person buys a smartphone, the cost of the phone is included in the measure of GDP. But once in possession of a smartphone, one can consume what were costly goods and services only a few years ago for no or little cost. The use of almost all the apps is not included in GDP. A smartphone enables one to easily access almost all of the world’s stock of knowledge for nothing. Encyclopedias and reference books were expensive and rarely owned by low-income people.

It is now possible, because of Skype and other services, to talk to almost anyone in the world at virtually no cost. Domestic long-distance calls used to be very expensive, and international ones were so expensive that people rarely made them. Calls from the U.S. to Europe, even as recently as two decades ago, were many dollars per minute.

On a phone or tablet, one can play almost every song for free. With a few notable exceptions, it is possible to read most newspapers from all over the world for free. Less than 20 years ago, those who wanted to take pictures on a trip would have to lug along a camera and rolls of film, and then be very careful about how many photos they took. The exposed rolls needed to be taken to a camera store for developing, which was a non-negligible cost, and copies were extra. Now it is possible for people to take as many high-quality photos as they wish for free and share them with an unlimited number of friends in real time at no cost.

Look at all of the apps you have on your phone or tablet, and then try to estimate what the cost of the goods and services you receive from each app would be if you wanted to buy that service a decade ago (if even available). For almost all, it would be thousands of dollars per year. Many of us would easily pay at least 10 times as much for our smartphone or tablet rather than try to do without them. Some surveys have shown that the average person spends an average of five hours a day on their cellphone, tablet or computer for pleasure — not work. That comes out to about 1,800 hours a year.

Assume that a person values the use of the smartphone or tablet at $5 per hour — which is probably low because of all of the cost savings (cost avoidance) and opportunities to obtain free or very low-cost services. The $5 per hour times 1,800 hours per year gives a value of $9,000 per year. The average per capita disposable income is about $36,000 a year in the U.S. So, the unpaid and untaxed value of goods and services that a person enjoys from the use of the smartphone, tablet and other devices now provides about a 25 percent increase in real disposable income equal to about $45,000.

The value of the goods and services provided to a person by the smartphone or tablet is not dependent on income. Whether people are poor or rich, they can get equal value from these devices, depending on features they use. A person who has a disposable income of half of the average ($18,000) per year still gets the $9,000 benefit, for a 50 percent raise in consumption to the equivalent of $27,000. A very high-income person (e.g., $500,000 per year) will still only receive the $9,000 benefit, assuming the same use of apps and features, or less than a 2 percent increase in real equivalent purchasing power.

Currently, there are an estimated 3 billion smart phones around the world — and that number is rapidly increasing. Many of the people who have these phones are poor, with incomes of less than $10,000 a year. They use the phones not only for communication but for banking and many other things. The smartphone has perhaps doubled their real ability to consume and has given them enormous new opportunities.

As a result of these new technologies, the internet and all of the devices that make it useful, there has been a leveling of the real ability to consume, which is a much more accurate measure of real relative well-being than nominal dollars. Technologies that are coming along will accelerate the leveling. For instance, in a very few years, people will be wearing devices that constantly measure their health, and if something needs to be corrected, everyone — because of artificial intelligence — will have the same access to the very best medical advice.

It is the wealthy who pay for the new innovations, and once they are perfected, their prices fall radically so all are beneficiaries. Less than 10 years ago, only extremely expensive cars had lane change warning indicators. Now, improved versions are available on most $40,000 cars.

The current GDP measures were largely developed in the 1930s. But they do not accurately measure relative well-being in the new technological world. To make tax and government spending, and other public-policy decisions based on these old measures, without fully recognizing the ramifications of the new technologies, is folly.

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