Originally published in **The Wall Street Journal**

December 13, 2015

The Uncounted Trillions in the Inequality Debate

Wealth isn't so highly concentrated if you take into account Medicare and Social Security benefits.

By MARTIN FELDSTEIN

The Federal Reserve recently estimated total household net worth in the U.S. to be about $80 trillion, including real estate and financial assets. And data from the Fed's Survey of Consumer Finances imply that the top 10% of households by net worth hold about 75%—or $60 trillion—of this total. The bottom 90% of households therefore have a net worth of about $20 trillion.

These data seem to show a country whose wealth is highly concentrated. But the true picture is hardly as stark as critics of inequality claim, because it leaves out the large amount of wealth held in the form of future retirement benefits from Social Security and Medicare. Moreover, the public's traditional financial wealth is depressed because the current entitlement programs lower people's real incomes and deny them the higher returns available through investment-based retirement savings like IRAs or 401(k)s.

Wealth is the ability to spend more than one's income. After a retirement or job loss, a household with financial wealth can maintain its standard of living. Wealth also allows people to make bequests and gifts to help children or grandchildren at early stages in their lives.

Most Americans count on Social Security to finance their consumption in retirement. The Social Security trustees estimate that Social Security "wealth"—the present actuarial value of the future benefits that current workers and retirees are projected to receive—is $59 trillion. Excluding the top 10% of households reduces the amount to about $50 trillion.

However, to qualify for those benefits, current workers must pay future payroll taxes with a present actuarial value of about $25 trillion. So you have to subtract these taxes from the $50 trillion, leaving a net Social Security "wealth" of $25 trillion for the bottom 90% of households. Adding this to the $20 trillion of their conventionally measured net worth, and these households have total wealth of $45 trillion.

Yet this figure leaves out the very large transfers that retirees receive from Medicare and Medicaid. Government actuaries don't estimate the amount of "wealth" implied by these two programs. But we can get an indication of how much is at stake by looking at the benefits paid out under them.

The Congressional Budget Office estimates that over the next decade total Social Security retiree benefits will be $10.2 trillion, while the benefits for Medicare will be $9.0 trillion and those for Medicaid will be $4.6 trillion (about half of Medicaid benefits are for retirees in nursing homes). In short, the benefits for these two government health programs exceed the amount Social Security will pay out to retirees in cash.

But unlike Social Security, receiving government health benefits does not depend on current workers continuing to pay taxes. This suggests that the net "Medicare and Medicaid wealth" implied by current law is probably about as large as these households' "gross Social Security wealth" of $50 trillion.

So what is the grand total? Add the $50 trillion for Medicare and Medicaid wealth to the $25 trillion for net Social Security wealth and the $20 trillion in conventionally measured net worth, and the lower 90% of households have more than $95 trillion that should be reckoned as wealth. This is substantially more than the $60 trillion in conventional net worth of the top 10%. And this $95 trillion doesn't count the value of unemployment benefits, veterans benefits, and other government programs that substitute for conventional financial wealth.

Critics of inequality fail to recognize this wealth and that it represents a poor return. Individuals pay high payroll taxes—directly and through foregone wages—to finance the current system of pay-as-you-go retiree benefits. By my calculations, the implicit real rate of return on those payroll taxes will be less than 3%. That is substantially less than the 5.5% real return earned historically by contributions over a working life to an individual IRA or 401(k) plan invested in a balanced combination of stocks and high-quality bonds.

A wise approach would be to slim down today's Social Security pay-as-you-go system and supplement it with universal investment-based personal retirement accounts. This would reduce the tax burden on workers and raise the national savings rate, thus increasing the rate of economic growth and the future levels of real wages. Those individual accounts would also provide funds that could be bequeathed to the next generation or transferred for special purposes like education.

The apparent inequality of wealth in the U.S. in reality reflects the government's out-of-date way of financing retirement. Politicians worried about inequality should start by fixing the inefficient programs they directly control.

Mr. Feldstein, chairman of the Council of Economic Advisers under President Ronald Reagan, is a professor at Harvard and an economic adviser to Jeb Bush's campaign for the Republican presidential nomination.