Inequality and economic growth

Economic policymakers can no longer afford to view inequality as an issue separate from boosting employment and incomes. Addressing it through a wealth tax, combined with more effective antitrust policies and enforcement, has become essential to sustaining economic growth, including by encouraging the creation and growth of new business

Sustaining higher aggregate growth rates

In previous eras, top economic decision-makers considered inequality to be distinct from the main concerns of macroeconomic policy. Since the Industrial Revolution, the general view has been that, on average, people want higher incomes and a larger number of good jobs – and that the best way to achieve these goals is through faster economic growth. Not surprisingly, therefore, much thought has been devoted to the question of how to design and run monetary and fiscal policies that can sustain higher aggregate growth rates.

Inequality was regarded as a separate issue, which could be addressed at the margin through making net taxes more or less progressive. Rich people would contribute a higher share of their total incomes to the public finances than would the middle class.

Three main problems

It is increasingly apparent that there are three main problems with this view of the world, at least as it applies to the modern United States. All three are made fully apparent in Heather Boushey's brilliant new book, Unbound: How Inequality Constricts Our Economy and What We Can Do About It.

First, the tax system has ceased to be progressive. Warren Buffett famously remarked in 2011 that his tax rate is lower than his assistant's – and this is not an isolated occurrence. Since the 1970s, effective taxes on income from capital (for Buffett) have fallen dramatically, while taxes have remained much steadier for wage earners such as assistants (including to billionaires, it turns out).

If we include health-care costs – insurance premiums, deductibles, and out-of-pocket expenses – then median take-home pay (available to spend on everything other than health care) has barely budged in recent decades. There is nowhere near as much redistribution as there was in the post-World War II decades. (In my book with Jon Gruber, Jump-Starting America, we examine the statistics and history in more detail.)

> *Inequality has become a driver of worsening outcomes in a broader political-economy sense*

Second, the extent of inequality has increased, owing partly to barriers to market entry, which also undermine economic growth. It is easy to understand why Buffett likes investing in companies with "moats" – for example, in insurance, railways, and other sectors. Owning firms that are difficult for others to challenge is undoubtedly good for his profits. But economic policymakers' goal should not be to maximize profits for one sector, let alone one group of investors. Across the entire economy, more entrepreneurship and more market entry tend to erode incumbents' profits and thus mitigate inequality, because the entry of new firms into an industry will likely create more jobs, boost incomes, and lead to new products, better services, or both.

Third, inequality has become a driver of worsening outcomes in a broader political-economy sense. When rich people spend their money to influence political decisions, they do not typically seek to ensure freer entry for others into the sectors that generate their wealth, precisely because that would likely mean less for them. On the contrary, powerful incumbents want more protection from domestic and foreign competition. They also want more subsidies, whether through the tax code or otherwise. And their most cherished goal is to become too important to fail, so that they are likely to be bailed out in times of trouble.

A powerful signal

Boushey connects these dots in a remarkable and refreshing manner. Even for people who have studied the issue, the links and specific policy issues she identifies are illuminating. This is not an argument against markets or against private enterprise, but it is an important cautionary tale: we get the inequality that we choose, regardless of whether we are aware that we are making a choice.

Unbound is not an explicitly partisan book, but it is easy to draw inferences for the current political season.

For starters, if the existing system is broken, the easiest and fairest way to fix it would be with a modest wealth tax. The specifics can be debated, but a tax on wealth over $50 million would impact only the richest 0.1% of all Americans.

Moreover, if barriers to market entry are becoming a problem, then we should change the focus of antitrust activity to reduce those barriers in a reasonable and timely manner. If traditional criteria, developed in and for the pre-Internet era, prove cumbersome or ineffective, then we should update them.

> *Tax on wealth over $50 million would impact only the richest 0.1% of all Americans*

And if wealthy people are buying political access, with the result that the economy is becoming more distorted and less fair, then we should change the campaign-finance and lobbying rules. In the US, a higher rate of tax on wealth over $1 billion (or a similar very high level) would affect only about 600 people, but it would send a powerful signal that their outsize influence will be addressed.

Inequality is not an accident

Inequality at modern levels is not an accident. It is the result of policy choices that were influenced or swayed by relatively rich people (again, Unbound has the details). The pendulum can – and should – swing back in the other direction.

Economic policymakers can no longer afford to view inequality as an issue separate from boosting employment and incomes. Addressing it through a wealth tax, combined with more effective antitrust policies and enforcement, has become essential to sustaining economic growth, including by encouraging the creation and growth of new business.

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