OPINION

The Supply-Side Case for Government Redistribution

Inequality and poverty take a toll on the productivity of the workforce. Policies to reduce both can be pro-growth.

By ALAN S. BLINDER

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You hear a lot of talk these days about the ill-effects of income inequality in the United States. Even Standard & Poor’s got into the act earlier this month with a well-publicized report on "How Increasing Income Inequality is Dampening U.S. Economic Growth." And it was gratifying to see Rep. Paul Ryan (R., Wis.) call attention to the poverty problem in a speech last month.

It’s most unlikely that the current Congress will do anything to reduce inequality—or do anything constructive, period. But recognizing that you have a problem is a necessary first step toward solving it. Why is high and rising inequality a problem?

The fundamental case against high inequality begins—and for some people ends—with an ethical judgment. On the left, people tend to believe that greater equality is a goal that government should pursue per se; it makes for a better, more just society. On the right, people tend to see the distribution of income as determined by the impersonal forces of the market; they often oppose using government power to equalize that distribution.

Either side can talk until it's blue in the face without convincing the other. So let's move on to the economics.

I've recently heard claims in the media that rising inequality slows the growth of consumer spending because—isn't it obvious?—the rich spend less of their incomes than the poor. So, as more and more of the nation's income accrues to the upper echelons, the fraction spent declines. The deduction is logical. But the premise is not true.

At the extremes, of course, it is. Give them each $100, and Warren Buffett will spend less than a starving family. But few Americans live at either of those extremes. In the vast "middle"—and here I mean the range from the quite poor to the quite prosperous—there is not much difference in the spending propensities of households at different income levels. Families living on $20,000 (near the poverty line) versus $200,000 (which gets you into the top 5%) buy different things. But they all spend like Americans.

Research by me and others decades ago found that, contrary to the common assumption, more inequality does not lead to less spending; and history has since given that finding an acid test. Regardless of how you measure it, income inequality has surged since about 1979. If rising inequality...
reduced spending, American consumers as a group would now be spending less of their aggregate income than they did then. In fact, they are spending more.

In thinking about the effects of inequality on growth, we should look more at the supply side than the demand side. That's ironic. The clarion call of "supply-side economics" since the 1970s has been to cut taxes on the rich on the hope (not supported by much evidence) that benefits would "trickle down" the economic ladder. But nowadays the best supply-side policies may be those aimed at reducing income inequality. Consider:

Children who grow up poor get inferior K-12 education, and most likely don't go to college. They don't develop their talents as fully as middle- and upper-class kids do. Children who grow up undernourished do not reach their full physical or mental potential, which means, among other things, that they may struggle in school. Children who don't have enough access to health care grow up to be less healthy and productive adults.

These and other ill-effects of poverty are well known. And they aren't limited to poor countries. Inequalities have grown so extreme that we have such phenomena in America, too. That's one fundamental rationale for such government programs as Title 1 of the Elementary and Secondary Education Act, which is dedicated to improving the academic achievement of disadvantaged children, food stamps, Medicaid and, lately, ObamaCare.

Still, the U.S. is not doing nearly enough. Inequality is rising, and so is poverty—which takes a toll on the productivity of the American workforce. Anti-inequality policies can be pro-growth.

The strongest arguments against rampant inequality may nonetheless be political, not economic. Jefferson notwithstanding, all Americans aren't really created equal. But our constitution, as amended, is supposed to grant equal political rights to everyone. Remember "one man, one vote"?

Sadly, with our political system so dominated by money, "equal political rights" is a cruel deception. Does anyone doubt that political influence is skewed toward the rich, who can afford, among other things, political contributions and lobbyists? At the low end of the income distribution, hardly a day goes by without news of people being disenfranchised, gerrymandered out of any political influence, or simply ignored.

Meanwhile, the Supreme Court wants corporations to have the same rights as people. It is doing its best to obliterate the distinction between free speech and free political spending.

Political and economic inequalities reinforce one another, creating a well-known vicious circle. Bending the political system in their favor helps upper-income groups maintain or even enhance high levels of income inequality. Huge economic inequalities, in turn, provide money for the rich to spend on buying political influence. Is this what Madison had in mind?

History teaches that oligarchy mixes uneasily with democracy. We have not yet approached the levels of income inequality that characterized old-style Latin American oligarchies, but we are heading in that direction. For example, according to economist Emmanuel Saez, about 95% of the income gains from 2009 to 2012, as we emerged from recession, accrued to the top 1% of American families.

So even if you don't buy the ethical argument for redistribution, and even if you thought 1979 levels of income inequality were just fine, there are good reasons to reconsider the case in 2014. Inequality has risen so much in the past 35 years that it may now be retarding economic growth on the supply side.
while leaving us with the finest government money can buy.

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