What can be done about income inequality?

For all the attention devoted to the widening chasm between the very rich and the rest of American society, perhaps the most urgent question is whether the trend can realistically be turned around within, say, the next two or three decades. The answer may well be no.

“I am very pessimistic about the capacity of the American political system to redistribute income within a reasonable period of time,” said Robert Solow, the Nobel laureate economist from the Massachusetts Institute of Technology, in concluding comments at a seminar on inequality that drew some of the top scholars on the subject to New York last month.

“I simply don’t think that legislation either to support the safety net or to tax high incomes stands a chance in the Congress,” Mr. Solow told me in a follow-up interview last week, particularly given the likelihood that the midterm election will lead to a more conservative Senate next year.

If further redistribution turns out to be politically impossible, the question is whether any better tools are available.

Washington already redistributes income from the rich to the poor. Richard Burkhauser and Philip Armour from Cornell and Jeff Larrimore from the Joint Committee on Taxation have become heroes to the right by trying to establish that government redistribution has, in fact, erased the trend of increasing inequality.

While these claims rest on fanciful assumptions about what counts as income, their analysis of taxes and government programs does support the argument that the government does more than it has in a long time to protect lower-income Americans from the blows of the market economy.
During the Great Recession from 2007 to 2010, the market income of the poorest fifth of the population, before taxes and government transfers, fell more than 30 percent. Yet adding in taxes and all government transfer payments except health insurance, the income loss of the poor was limited to about 4 percent.

This is a substantial feat. The last time the United States had an economic downturn of comparable magnitude — 1979 through 1982 — taxes and transfers, including Social Security, food stamps, unemployment payments and the like, softened the blow on the poorest Americans by only about half: before taxes and transfers their incomes dropped 25 percent. After taxes and transfers they fell 13 percent.

“Substantial changes in tax and transfer policies during the Bush and Obama administrations have increased dramatically the resources available at the middle of the distribution and at the bottom more so,” Professor Burkhauser told me.

President Obama has certainly tried to redistribute more. In a deal with Republicans in Congress two years ago, he was able to increase the top tax rate on long-term capital gains and push the top rate of income tax back to 39.6 percent, where it was when President Bill Clinton left office in 2001.

Obamacare has also added 0.9 percentage points to the payroll tax for richer families and imposed a 3.8 percentage-point tax on their investment income. The nonpartisan Tax Policy Center projects that the richest 1 percent of households will pay 33.4 percent of their income in federal taxes this year, on average. That’s almost six percentage points more than in 2008.

Social scientists still debate furiously how much government-provided health insurance is truly worth for poor Americans. But the health care these taxes will pay for is certainly better than nothing.

After all this redistribution, however, the question remains: Is any of this enough to make a noticeable impact on the income gap? The answer still seems to be no.

According to the Tax Policy Center, federal taxes in 2014 will trim the one-percenters’ share of national income to 14.1 percent, from 17.1 percent. That’s only slightly more than in 2008, when taxes reduced their slice of the national pie to 13.6 percent, from 15.5 percent.

And the underlying tide is so powerful that redistribution efforts can only slow the trend. By 2024, at the end of the Policy Center’s forecast window, it expects the richest 1 percent of Americans to take 19.7 percent of income before federal taxes. Under current law, taxes would trim that to 16.6 percent.
Reducing inequity is hard. Last year the nonpartisan Congressional Budget Office took a look at the history of government efforts to temper rising income inequality over the last three decades. It didn’t find much improvement.

In 1979, government taxes and transfers shrank the Gini index, a measure of income inequality, to 0.358 from 0.476 — about the same as cutting inequality to the level prevalent in a more egalitarian European nation like Spain from the level prevalent today in a highly unequal Latin American country like Chile.

American inequality has increased significantly over the intervening decades. But the government does roughly the same job today. In 2010 taxes and transfers reduced the Gini measure to 0.434 from 0.586.

Are we condemned, then, to largely futile efforts to reverse the widening gap? Many economists argue that there are better tools than government redistribution to mitigate rising inequality. Education is a favorite. Raising the minimum wage is also a popular choice. Reducing tax benefits for corporations and well-to-do Americans (tax breaks for oil companies or the mortgage interest deduction, for example) might also help.

But enough to do the trick? A simulation by economists at the Organization for Economic Cooperation and Development, a policy shop for advanced industrialized countries, concluded that raising the ratio between the minimum wage and the typical wage in the United States to the average across all the countries in the group would have only a minimal effect on the income gap.

Providing more education for all might have more punch. The problem is, in the United States the education system appears to be contributing to income inequality, rather than reducing it.

Thomas Piketty, who prompted the current inequality fever when he published the English translation of his blockbuster “Capital in the Twenty-First Century” in March, still holds hope that redistribution could save the day.

“Things can change faster than expected,” he told me. “The U.S. invented sharply progressive taxation of income and inherited wealth in the interwar period, and nobody would have guessed this around 1910.”

But maybe we should think about inequality in a different way. If redistribution via taxes and transfers cannot make more of a dent in the prevailing pattern of income inequality, perhaps a focus on what determines market incomes, before taxes and transfers kick in, would prove more promising.

“We need to think of ways to change the market determination of income,” Professor Solow told me. “How does capitalism generate inequality?”
To the extent that widening inequality is caused by the yawning gap between the epicurean pay deals in the executive suite and the stagnant wages paid to those on the shop floor, it might best be addressed at the level of the corporation, not by government.

Voters seem to agree. Research by Leslie McCall of Northwestern University finds that while American voters remain lukewarm about government interventions to reduce income inequality, they say corporations themselves could do more to attack the income gap.

Among Republicans, 36 percent say major companies are most responsible for narrowing the income gap, Professor McCall found, compared with 23 percent who say it is the responsibility of poor Americans to improve their own lot and 12 percent who say it is the government’s job.

To Professor Solow, that means “we have a better shot at doing something with changes in corporate governance than with direct redistribution.”

It’s worth trying. Redistribution hasn’t made much difference.

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