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Liberty, Equality, Efficiency

By Paul Krugman

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Most people, if pressed on the subject, would probably agree that extreme income inequality is a bad thing, although a fair number of conservatives believe that the whole subject of income distribution should be banned from public discourse. (Rick Santorum, the former senator and presidential candidate, wants to ban the term “middle class,” which he says is “class-envy, leftist language.” Who knew?) But what can be done about it?

The standard answer in American politics is, “Not much.” Almost 40 years ago Arthur Okun, chief economic adviser to President Lyndon Johnson, published a classic book titled “Equality and Efficiency: The Big Tradeoff,” arguing that redistributing income from the rich to the poor takes a toll on economic growth. Okun’s book set the terms for almost all the debate that followed: liberals might argue that the efficiency costs of redistribution were small, while conservatives argued that they were large, but everybody knew that doing anything to reduce inequality would have at least some negative impact on G.D.P.

But it appears that what everyone knew isn’t true. Taking action to reduce the extreme inequality of 21st-century America would probably increase, not reduce, economic growth.

Let’s start with the evidence.

It’s widely known that income inequality varies a great deal among advanced countries. In particular, disposable income in the United States and Britain is much more unequally distributed than it is in France, Germany or Scandinavia. It’s less well known that this difference is primarily the result of government policies. Data assembled by the Luxembourg Income Study (with which I will be associated starting this summer) show that primary income — income from wages, salaries, assets, and so on — is very unequally distributed in almost all countries. But taxes and transfers (aid in cash or kind) reduce this underlying inequality to varying degrees: some but not a lot in America, much more in many other countries.

So does reducing inequality through redistribution hurt economic growth? Not according to two landmark studies by economists at the International Monetary Fund, which is hardly a leftist organization. The first study looked at the historical relationship between inequality and growth, and found that nations with relatively low income inequality do better at achieving sustained economic growth as opposed to occasional "spurts." The second, released last month, looked directly at the effect of income redistribution, and found that "redistribution appears generally benign in terms of its impact on growth."

In short, Okun's big trade-off doesn't seem to be a trade-off at all. Nobody is proposing that we try to be Cuba, but moving American policies part of the way toward European norms would probably increase, not reduce, economic efficiency.

At this point someone is sure to say, "But doesn't the crisis in Europe show the destructive effects of the welfare state?" No, it doesn't. Europe is paying a heavy price for creating monetary union without political union. But within the euro area, countries doing a lot of redistribution have, if anything, weathered the crisis better than those that do less.

But how can the effects of redistribution on growth be benign? Doesn't generous aid to the poor reduce their incentive to work? Don't taxes on the rich reduce their incentive to get even richer? Yes and yes — but incentives aren't the only things that matter. Resources matter too — and in a highly unequal society, many people don't have them.

Think, in particular, about the ever-popular slogan that we should seek equality of opportunity, not equality of outcomes. That may sound good to people with no idea what life is like for tens of millions of Americans; but for those with any reality sense, it's a cruel joke. Almost 40 percent of American children live in poverty or near-poverty. Do you really think they have the same access to education and jobs as the children of the affluent?

In fact, low-income children are much less likely to complete college than their affluent counterparts, with the gap widening rapidly. And this isn't just bad for those unlucky enough to be born to the wrong parents; it represents a huge and growing waste of human potential — a waste that surely acts as a powerful if invisible drag on economic growth.

Now, I don't want to claim that addressing income inequality would help everyone. The very affluent would lose more from higher taxes than they gained from better economic growth. But it's pretty clear that taking on inequality would be good, not just for the poor, but for the middle class (sorry, Senator Santorum).

In short, what's good for the 1 percent isn't good for America. And we don't have to keep living in a new Gilded Age if we don't want to.

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