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Statement before the House Budget Committee
On "Solutions to Rising Inequality"

Fostering Broad-Based Prosperity

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Chairman Yarmuth, Ranking Member Womack, and distinguished members of the House Budget Committee, thank you for convening this hearing on "Solutions to Inequality." I am a visiting fellow at the American Enterprise Institute, a fellow at the National Review Institute, a senior editor at *National Review*, and a columnist for *Bloomberg Opinion*. This testimony reflects my own views and not those of any organization with which I am affiliated. It is an honor to be testifying before you.

This committee is to be commended for convening a hearing on economic inequality, which is bound up with many questions that are central to American life. It is a topic intensely debated but often not carefully analyzed.

Income Inequality: Trends, Importance, and Public Opinion

There is little dispute that inequality has risen over the past few generations. The Congressional Budget Office's most recent report on the distribution of household income shows that one measure of inequality, the Gini coefficient for incomes after taxes and transfers, increased by 29 percent between 1979 and 2007.[1]

The report also shows, however, that inequality peaked in 2007. The coefficient has fallen by 6.6 percent from that point through 2016 (the latest year with available data). This measure of inequality was lower in 2016 than it was in 2004.

The extent to which inequalities in income or wealth should matter to policymakers is a value judgment. Some of the relevant values are, however, widely shared. Most of us can see that it is not enough for average incomes to rise. That condition could be met if incomes at the top were growing while most people stagnated or fell behind. We would not consider that a successful economy.

It does not follow, however, that what ought to concern us most is inequality. One long-popular expression of concern about inequality has it that "the rich get richer and the poor get poorer." Note, however, that inequality as measured by a Gini coefficient can widen even if the poor are getting richer. Consider two scenarios. In the first, the poor are getting richer but the rich are getting richer faster, so inequality is widening. In the second, the poor are getting poorer and the rich are getting poorer too, so rapidly that inequality is falling. Nearly everyone would consider the first scenario preferable to the second one.

That shared inclination helps explain some features of public opinion. When Americans are asked about the country's top problem, it is consistently the case that few of them specifically mention either inequality or the gap between the rich and poor. The percentage who volunteer such answers to Gallup has been between 1 and 2 percent this year.[2] At the moment, 11 percent of Americans, a historically low figure, describe any economic problem as the country's top challenge. Even in periods of greater public anxiety about the economy, however, inequality is not a top-of-mind issue for most people. For example, in December 2013, inequality was volunteered by 2 percent, even as 19 percent mentioned the economy in general, 12 percent mentioned unemployment, and 9 percent mentioned the deficit.[3] Public concern about inequality also does not seem to track actual trends in inequality very well: Some measures of concern have risen even during the recent period of falling inequality.[4]

It may be that many people who express concern about inequality do not think about it in the way it is defined in much of the academic, journalistic, and political discussions of it. It seems clear that whether most people are seeing gains in their standard of living is a much more widely held concern than inequality is—which reflects a sensible weighting of these questions.

The Effects of Inequality

It has often been suggested, especially in recent years, that inequality has major negative effects: that a rising gap between rich and poor reduces economic growth, for example. If this is true, then even people who do not place great importance on inequality in itself may have practical reasons to be concerned about it. If some widely acknowledged social good, such as rising median wages, requires falling levels of inequality, then falling inequality is important as a means toward that end.

The range of goods that inequality has been said to compromise or threaten is extremely, even stunningly, broad. But the evidence for any of the hypothesized negative effects is not robust and often countered by other evidence.

Scott Winship has summarized the evidence that should make us doubt that economic inequality reduces economic growth, median wage growth, economic mobility, saving, life expectancy, educational attainment, or financial or political stability or that it increases teen pregnancy rates.[5] Lane Kenworthy, while concluding that inequality is worrisome, reaches similar conclusions and finds that the evidence is weak to nonexistent that inequality increases obesity or crime or reduces trust, employment growth, or happiness; inequality does not even appear to reduce income growth among poor households.[6]

As noted earlier, views on the intrinsic importance of economic inequality differ. However high a priority one believes that reducing inequality should be, the evidence on the effects of inequality do not provide much reason for making it a higher one. Take a person who believes that a set of policies expected to reduce some measure of inequality by a quarter were worth pursuing even if it also reduced median incomes by 5 percent. The evidence about the effects of inequality on obesity, educational attainment, and so forth would not justify raising the threshold for acceptable losses in median income much above that 5 percent.

Given how frequently inequality is said to be linked to wage growth, it is worth discussing wage trends more extensively. It is frequently claimed that average wages have declined over the past 50 years.[7] But that claim depends on using a flawed measure of inflation. Use the available measure that best accounts for how consumers change their behavior to blunt the effects of rising prices on their welfare, and the average wage rose 21 percent from 1973 to 2018.[8] (Average compensation, including nonwage benefits, must have risen even more.)

Median family income has risen faster than average wages, reflecting among other things increased female labor force participation. Families in the middle of the income spectrum in 2015 made 45 percent more than their counterparts in 1970.[9]

The story is not all rosy. The median family income of 2014 was lower than that of 2000, reflecting the effects of one mild and one sharp recession and the slow recoveries from both. What policymakers got wrong during that period is certainly worthy of reflection. But the view that our economic policies have been failing most Americans since the 1970s is incorrect. And the most recent trends on everything from wages to poverty rates are strongly positive.

Policymakers should be looking for discrete areas in which it is possible to correct mistakes and build on successes. While combating economic inequality should not be their focus, some policies that might reduce inequality are worth pursuing—if those policies advance such other objectives as reducing poverty and enhancing economic growth, reducing inequality as a side effect.

Policies to Promote Shared Prosperity

A few of these policies have been advanced in recent years. The Tax Cuts and Jobs Act of 2017 included two important provisions that directly and disproportionately benefited people in the lower and middle quintiles of the income distribution and two more that scaled back tax benefits that disproportionately aided those in the top ones. These four provisions were the expansion of the child tax credit, the expansion of the standard deduction, the reduction of the deduction for mortgage interest, and the reduction of the deduction for state and local taxes. A countervailing policy included in the law was the elimination of the personal and dependent exemptions.

The Joint Committee on Taxation estimated the distributional effects of these five provisions in conjunction.[10] Their net effect was to lower tax liabilities for taxpayers making less than $100,000 a year, as a group, and to raise them for taxpayers making above that threshold.

In 2017, before the expansion, the child tax credit was estimated to lift 2.8 million people, including 1.6 million children, out of poverty and to lessen poverty for another 13 million people, including 6.7 million children.[11] The effect of today’s child credit should be larger. I have elsewhere made the case for further enlarging the credit: increasing its maximum value, making the increase permanent, indexing the increased amount to grow with nominal wages, and making it fully refundable against both employer- and employee-side payroll taxes.[12] While the main point of these expansions would be to recognize and foster investment in the next generation, they would also make the credit more powerful in combating poverty and inequality.

Other policies would likely reduce inequality but would also have other advantages. Loosening restrictions on the construction of housing, especially in areas of the country with high economic growth and severe restrictions, would expand opportunity. People with limited prospects in the part of the country where they now live might find it possible to better their economic circumstances elsewhere if housing were more freely available.

Loosening occupational licensure laws would also increase upward economic mobility, in part by increasing geographic mobility. In the 1950s, 5 percent of workers held jobs requiring a government license; by 2008 that figure had risen to 29 percent. Licensing can suppress economic mobility in particular communities by making it more difficult for people to begin working in the field of their choice, and it can also limit mobility among communities as relocating in a new state may require the acquisition of a new license to work.[13]

A reorientation of policies toward high school education at all levels of government could also expand opportunities in an egalitarian way. The current system is designed to help young adults move from high school to college and then to a job that requires a college degree. But this path is working for only about a sixth of all young people, a fraction that tends to have the higher lifetime incomes than taxpayers in general. A shift in educational priorities to better serve those who are not on the college track would seem to be in order.[14]

Finally, changes in monetary policy that would reduce the risk and severity of recessions should also be considered. Errors in monetary policy may have caused the Great Recession to be as damaging as it was, especially for those with low or no incomes. Current practices at the Federal Reserve may entail a bias toward excessively tight money that could be remedied through the adoption of a nominal spending target.[15]

The Pitfalls of Some Proposals to Reduce Inequality

Policymakers should, however, refrain from enacting policies that in the name of reducing inequality inflict major harms. One such proposal is an increase in the minimum wage to $15 an hour. The Congressional Budget Office's median estimate is that in the year that minimum wage took effect, it would mean that 1.3 million fewer people had jobs than otherwise would. The economy as a whole would sacrifice $8.7 billion.[16] There are, moreover, reasons to believe that the longer-run effects of the increase would be worse.[17]

Some officials have discussed repealing the Tax Cuts and Jobs Act, or large pieces of it. A full repeal, or a repeal of the provisions concerning the standard deduction and the child credit, would be a large tax increase, especially for middle-class parents of minor children. Changes that reduced the growth rate of the economy over the long term by reducing the incentive to work, save, and invest would also have a negative impact.

Concern about income and wealth inequality has understandably led to suggestions for a new tax on wealth. But a wealth tax would have considerable drawbacks. It would reduce national saving and, therefore, either reduce investment in the United States or increase capital inflows or both. To the extent it increased capital inflows, it would raise the trade deficit.[18] It would also be extraordinarily difficult to administer. These trade-offs may help explain why some developed countries have stopped levying wealth taxes in recent years. In the US, a wealth tax may also violate the Constitution.

A universal basic income could almost certainly reduce poverty and inequality, at least post–tax and transfer. But it too would have substantial drawbacks. It would reduce the labor force participation rate, which has already been in secular decline, because people would be able to have a higher income without paid work than they currently can. It would also reduce hours worked because it would require a major increase in taxation; thus, it would also reduce national income, output, and wealth.

Conclusion

As this brief review of some of the issues concerning economic inequality suggests, public policies that could affect it vary widely in their effects and thus their desirability. It would probably be best for policymakers to focus on ways to reduce poverty, increase mobility, and improve living standards, with the effects on inequality of these policies being a second-order consideration in favor of them rather than a driving force behind them.

Notes

[1] Congressional Budget Office, "The Distribution of Household Income, 2016," July 9, 2019, author's calculation from "Data Underlying Figures."

[2] Gallup, "Most Important Problem," https://news.gallup.com/poll/1675/most-important-problem.aspx.

[3] Jeffrey M. Jones, "Americans Cite Gov't, Economy, Healthcare as Top Problems," Gallup, December 12, 2013, https://news.gallup.com/poll/166244/americans-cite-gov-economy-healthcare-top-problems.aspx.

[4] Michael R. Strain, "Maybe Inequality Isn't What's Making People Mad," *Bloomberg Opinion*, July 17, 2019, https://www.bloomberg.com/opinion/articles/2019-07-17/income-inequality-isn-t-the-thing-that-s-making-people-mad.

[5] Scott Winship, "Overstating the Costs of Inequality," *National Affairs* 40 (Spring 2013), https://www.nationalaffairs.com/publications/detail/overstating-the-costs-of-inequality.

[6] Lane Kenworthy, "Is Income Inequality Harmful?," Lane Kenworthy blog, August 2016, https://lanekenworthy.net/is-income-inequality-harmful/.

[7] Drew DeSilver, "For Most U.S. Workers, Real Wages Have Barely Budged in Decades," Pew Research Center, August 7, 2018, https://www.pewresearch.org/fact-tank/2018/08/07/for-most-us-workers-real-wages-have-barely-budged-for-decades/.

[8] Author's calculation using Federal Reserve Economic Data.

[9] Author's calculation using Federal Reserve Economic Data.

[10] Joint Committee on Taxation, "Distributional Effects of Public Law 115-97," March 25, 2019, https://www.jct.gov/publications.html?func=startdown&id=5173.

[11] Center on Budget and Policy Priorities, "Policy Basics: The Child Tax Credit," April 8, 2019, https://www.cbpp.org/research/federal-tax/policy-basics-the-child-tax-credit.

[12] Ramesh Ponnuru, "A GOP for Parents," *National Review*, June 6, 2019, https://www.nationalreview.com/magazine/2019/06/24/a-gop-for-parents/

[13] Janna E. Johnson and Morris M. Kleiner, "Is Occupational Licensing a Barrier to Interstate Migration?," National Bureau of Economic Research, December 2017, https://www.nber.org/papers/w24107.pdf.

[14] See Ramesh Ponnuru, "What Is the Purpose of High School," National Review, July 25, 2019, https://www.nationalreview.com/magazine/2019/08/12/what-is-the-purpose-of-high-school/

[15] Ramesh Ponnuru, "Better Inflation Targets Will Help in the Next Recession," Bloomberg Opinion, April 23, 2019, https://www.bloomberg.com/opinion/articles/2019-04-23/better-inflation-targets-will-help-in-the-next-recession.

[16] Congressional Budget Office, "The Effects on Employment and Family Income of Increasing the Federal Minimum Wage," July 2019, https://www.cbo.gov/system/files/2019-07/CBO-55410-MinimumWage2019.pdf.

[17] Daniel Aaronson, Eric French, and Isaac Sorkin, "The Long-Run Employment Effects of the Minimum Wage: A Putty-Clay Perspective," VoxEU.org, March 19, 2016, https://voxeu.org/article/long-run-employment-effects-minimum-wage.

[18] Alan D. Viard, "Wealth Taxation: An overview of the issues," Aspen Institute Economic Strategy Group, August 12, 2019, http://www.aei.org/publication/wealth-taxation-an-overview-of-the-issues/.