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Growth and envy

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Would you prefer a United States where the typical family income was \$100,000 per year but the top 5 percent averaged \$500,000 a year or five times the typical family, or a United States where the typical family income was \$30,000 a year but the top 5 percent averaged only \$60,000 or twice that of the typical family?

Your answer to that question not only defines where you are likely to be on the political spectrum, but much of what the political debate and the election is all about.

There are those who think equality is more important than the overall level of prosperity, and there are those who think the overall level of prosperity is more important than equality. In truth this is a false dichotomy, because the empirical evidence from around the world during the last half-century clearly shows that, in general, high-growth and prosperous economies on average have less income disparity than low-growth and low-income societies. The former Soviet Union, for example, had some of the highest income disparities as a result of the privileges granted to the ruling elite and their minions, while falsely claiming equality.

The American left has revived its rant against the greedy capitalists. The politicians, like Senate Majority Leader Tom Daschle of South Dakota, who are leaders of the rant, speak in senseless inconsistencies. Their so-called intellectual leaders, like New York Times economist and columnist Paul Krugman, try to give some respectability to this movement by taking anecdotal information and drawing unjustified conclusions from it. Mr. Krugman is an interesting case study because he has become a major voice in the new economic left.

M. Krugman had a lengthy piece in the New York Times Sunday Magazine on Oct. 20, which more fully developed the theme of many of his regular columns. The theme simply stated is that the rich are getting richer at the expense of the rest of us. Karl Marx, the Fabian Socialists, the New Dealers and many others over the last couple of hundred years have used this same theme in their attempts to gain economic and political power.

There are some interesting empirical questions: Are the rich getting richer? Is this at the expense of the rest of us? Should we do anything about it? If so, what?

Mr. Krugman is right that there has been explosion in the number of extremely large and opulent new homes, and there have been undeniable excesses and abuses by a few corporate leaders (even Mr. Krugman was found to have received hefty "consulting" payments from Enron). Top corporate incomes have grown far faster than most incomes, and those of the left have taken aim at this fact. However, incomes for most players in major professional sports have also grown at extraordinary rates. The attack on these pay increases has been somewhat less fierce, one suspects, because so many of these accomplished athletes are not white guys from well-off families. Many entertainment figures have also grabbed a larger share of the economic pie but, because many of these figures spout leftist rhetoric, they have been largely immune from attack. The evidence does support

Mr. Krugman's argument that there was some shift in relative income to very high-income people in the 1990s until 2000 (Bill Clinton years), but almost everyone else was also seeing a substantial rise in income.

Ah, but what has happened since 2000? The income data is just starting to come in, but the tax data (which comes in more quickly) has shown a very steep drop in tax revenues from the wealthy. This stemmed from a sharp drop in their incomes and not from the tax cut that has yet to take place for the wealthy. This drop in incomes has come primarily from the more Republican-leaning corporate and investment sectors than from the Democratic-leaning sports and entertainment sectors. In short, we don't yet have enough data for a long enough period of time to say definitely whether or not we are becoming more unequal.

The question then becomes, should we try to do anything about it and if so, what? Those on the left, like Mr. Krugman, argue for more taxes on the wealthy, but this is becoming self-defeating as the top 5 percent already pay 56 percent of the taxes even though they earn only 34 percent of the income.

One of the results of this shift in the tax burden to the wealthy is that tax revenues are becoming much more volatile, causing sharp shifts from deficits to surpluses and back to deficits. This is because high-income people tend to receive much of their income from risky investments, which are very sensitive to economic conditions, while middle and lower income people, and particularly government workers, have much more income stability. Thus, the tax system is increasingly relying on a volatile base that undermines the ability of those on the left to sell new spending programs.

The fact is that many tax rates are now above both revenue and growth maximizing rates. That is, any increase in rates will cause a greater fall of income than the rate increase can produce in revenue over the long run.

Hence, if you want more tax revenue for government, you need to increase economic growth rather than increase tax rates on the rich. Mr. Krugman prides himself on being a well-educated economist. But he and others on the left put their heads in the sand when confronted with such unpleasant (from the view of the left) economic facts.

Mr. Krugman recently attacked Dan Mitchell of the Heritage Foundation for correctly referring to corporations and individuals who decide to move out of the United States for tax reasons as runaway tax slaves. Mr. Krugman and most American liberals claim to believe in freedom, but the freedom to move from a tax system that no longer allows you to compete on a level playing field and extorts a large share of your income, which is often wasted by the political class, is fundamental to civil society.

The failures of socialism and welfare statism clearly show those who demand equality at the expense of prosperity will get neither equality nor prosperity.

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