The Dangerous Economics of Inequality

The IMF adds its voice to a growing chorus

Jane Carter, March 2014

A policy paper brought out by the International Monetary Fund (IMF) on March 13, 2014 argues that "*there is growing evidence that high income inequality can be detrimental to achieving macroeconomic stability and growth*" (1). For many people, particularly those on the left of the political spectrum, this conclusion will not be surprising. Nevertheless, it is a significant policy step for the IMF, especially as the paper further notes that there is no evidence to suggest that redistributive policies are bad for growth, except in extreme cases. Whilst the IMF is careful to avoid any prescriptions for fiscal redistribution, it discusses a variety of options. The paper has been broadly welcomed in development circles; for example Oxfam spokesperson Nicolas Mombrial was quoted as saying, "*This is the final judgment on inequality being bad for growth*." (2)

The IMF position

The March policy paper builds on a Staff Discussion Note by Jonathan D. Ostry, Andrew Berg and Charalambos G. Tsangarides that was published a month previously (3), and which uses a recently compiled cross-country dataset distinguishing "market equality" (before taxes and transfers) from "net inequality" (after taxes and transfers). This dataset allowed the possibility of calculating redistributive transfers for many countries over many years. There is thus a robust base of evidence for the IMF's findings. They represent a major setback for those who argue in favour of economic austerity measures (notably the cutting of public expenditure), and the limitation of taxes on the most wealthy. In other words, austerity measures can be counter-productive; countries should instead be encouraged to invest in health services and education for all. Although the IMF accepts that high taxation levels serve as a disincentive for economic growth, it points out that unless they are highly punitive, the negative effects of "capping" economic growth in this way are generally outweighed by the benefits of economic stability.

Other voices on inequality

The IMF position resonates with a documentary film on income inequality in the USA that was brought out last year and hailed as « the *Inconvenient Truth* for the economy » (4; 5). The key narrator, Robert Reich, Professor of Public Policy at the University of California, Berkeley, and former advisor to a number of Democrat administrations, argues that fiscal policy in the USA has resulted in an unprecedented garnering of wealth by the "super-rich" 1%. Half of the country's total assets are now in the hands of just 400 people. Being aimed at an American audience, the film points to the threat that this poses to the country's democracy – but of course what happens in the USA has implications well beyond its borders. Meanwhile, the incomes of many Americans who aspired to middle class lives have been reduced to below the poverty line, with their children apparently having little prospect of bettering their lives (6). Two powerful short videos on YouTube make a similar point with regard to wealth distribution in the USA (7) and the entire world (8), although the statistical sources are not as clearly defined.

There is in fact nothing new in claiming that inequality is bad for society overall. Authors such as Richard Wilkinson and Kate Pickett have been putting forward such a case for many years, using evidence drawn from studies on physical and mental health, child development, crime and violence, amongst others (9). Morally, huge income inequalities cannot be justified. Perhaps finally the macroeconomic case will convince those who have until now remained impervious to other lines of argument.

References

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