

What Government Can Do: Dealing with Poverty and Inequality

**Benjamin I. Page and James R. Simmons
University of Chicago Press (Chicago, 2000)**

**Reviewed by Michael Raleigh
University at Buffalo Law School**

Brief Summary

In the United States, the scale of inequality is so great and the pervasiveness of poverty is so widespread that effective action must be taken by the government. This book examines the causes of poverty and inequality, the justifications for government action, the successes and failures of previous government action, and new actions that should be taken.

Facts, Findings, and Recommendations

Should Government Deal with Poverty and Inequality?

Before addressing *what* the government can do, the authors first explore *why* the government should act to alleviate poverty and inequality. Their best justifications are based on the values of utilitarianism, law and order, and freedom.

The utilitarian argument says that the purpose of government is to promote the general welfare or happiness. This argument is based on the concept of marginal utility. Marginal utility is the amount of satisfaction that a person gets from the consumption of the last unit of a commodity. Marginal utility usually decreases as the total consumption of the commodity increases. For example, if a person only has one pair of socks, a second pair of socks would be very useful to that person. The person would derive a large amount of satisfaction from the extra socks. However, if a person has fifty pairs of socks, another pair of socks is not very useful. In fact, the person with fifty pairs of socks might not even notice if five or ten of his pairs were taken. Thus government action to redistribute socks to make sure everyone has enough to meet basic needs would produce a net increase of happiness in society because the people

without socks would benefit greatly from a small increase while the people with abundant socks would not be harmed.

The law and order argument is also known as the big bribe. It says that massive inequality threatens the peaceful order of a law abiding society. The most widely accepted role of government is first to provide order and protect private property. To the extent that inequality threatens the government's ability to provide order, the government is justified in acting to reduce inequality.

The freedom argument says that there is very little freedom for the destitute. Economic conditions limit choices for poor people; therefore, the government should ease these constrictions to promote freedom.

The justifications for government action are tempered by the interest in fairness that is fundamental to American values. Fairness oftentimes requires the reduction of inequality. Most Americans would likely agree that it is unfair that many people work full time, yet remain in poverty. However, the government imposition of total equality would be unfair to people who work hard to get ahead in life. Furthermore, a government guarantee of total equality would create remove the incentive for many people to work at all. What we really want then is relatively equal outcomes for relatively equal effort.

The meat of the book covers what can be done, assuming that government action to reduce poverty and inequality is justified.

Social Insurance

Social insurance typically protects people against the risk of lowered income or medical costs due to factors beyond their control. Social insurance programs must be compulsory to prevent free rider problems. In social insurance, a free rider is someone who does not buy insurance because they know that they are guaranteed the benefit of the insurance without paying. Social insurance programs must be centrally administered because it reduces the cost of providing the program and a higher percentage can be paid out for benefits. These programs include Social Security, Medicare, Medicaid, Unemployment Insurance, and Disability Insurance and represented over half of all Federal spending in 2000.

Social security is the largest social insurance program. It is compulsory. Benefits are paid out roughly proportionally to what was paid in by workers over their careers. Because it is roughly proportional, social security is limited in alleviating inequality between people, but it has a major effect on reducing poverty among the elderly. The effect of many social insurance programs, especially social security, is to smooth out income over a person's lifetime.

Disability insurance protects people against the risk of lower income due to injury or disease. There are two social security disability programs and a veterans disability program run by the federal government and workers compensation programs largely run by the states. The workers compensation programs have highly variable benefit levels across states.

Unemployment insurance protects people against the risk of unemployment due to factors beyond their control. The program is largely state run, benefits are temporary and expire after a set number of weeks, and the programs exclude many workers, including the self employed. The benefits are based on past earnings and are taxable. The program is regressive because low income workers pay the highest proportion of their earnings into the insurance.

Medical social insurance programs in the United States are limited to coverage for the elderly through Medicare and the poor through Medicaid. The United States is alone in the industrialized world in that it does not mandate universal medical coverage. Despite the fact that the United States pays the highest proportion of Gross Domestic Product on healthcare. Medicaid and Medicare address the problems of access and cost containment because they cover people who otherwise might not have health insurance and set lower reimbursements for medical care than private insurance. Despite these positive effects, the healthcare system as a whole is financially unsustainable.

Social insurance programs in the United States have been successful at reducing poverty, especially among the elderly, but have done little to address inequality. In 2000, the top fifth of the population earned 14 times the amount that the bottom fifth did after accounting for social insurance benefits.

In order to better address inequality, the government should increase the minimum benefits awarded by social insurance, increase the amount paid in by the rich, and eliminate gaps that exist in coverage.

To address the financial sustainability of social insurance programs, the government should pay down the national debt and adopt a single payer medical insurance program similar to Canada's.

Fair Taxes

The government can deal with inequality with a thoroughly progressive tax system. A progressive tax system is one that requires high income people to pay a higher percentage of their incomes in taxes than low income people. A regressive tax system requires high income people to pay a lower percentage of their income in taxes than low income people and increases inequality. A proportional tax system has no effect on

inequality. Altogether, the federal and state tax systems are only mildly progressive and do not substantially redistribute wealth.

The federal income tax was originally very progressive but has become decreasingly so since its creation. The nominal tax rate, which reached a peak of 92 percent for the top tax bracket just after World War II, never reflected the rate actually paid by the rich because of exemptions. The greatest exemption is for capital gains. People do not pay income tax on capital gains until they realize the gains through sale, which does not happen at all if the stocks are not sold before death.

The corporate income tax has declined as a percent of federal revenue from 33% in World War II to 10% percent in the 1990s and 2000s. This decline began with overestimated deductions from corporate income for the depreciation of capital assets from wear and tear and continued with cuts in the corporate tax rate. Increasing the corporate income tax could encourage the flight of capital from the United States through globalization. A heavier reliance on personal income tax is appropriate because it can be made indisputably progressive and individuals are less likely to leave the country than corporate capital.

Payroll taxes are borne by workers. The payroll tax could be made more progressive by raising or eliminating the cap on taxable income. This would also help cover the projected deficits in the United States' social insurance programs.

Excise taxes are paid for by consumers and are regressive because low income people spend a higher percentage of their income on consumption. The excise tax on gasoline is notably much lower than in other countries due to the influence of energy and automobile interests.

The estate and gift taxes are tools available to break up economic dynasties and address inequality. The taxes are often evaded through complicated trusts and other legal mechanisms. Also both members of a couple are allowed to give 10,000 dollars to as many people as they want every year. Over many years, such gifts can add up to a large number and therefore evade the taxes.

State and local taxes fall into the categories of property, sales, and income taxes. Sales taxes are similar to federal excise taxes and are regressive. Property and income taxes have the potential to be progressive. Property taxes could be improved with standard assessment practices. State income taxes can be progressive or proportional. States that do not have an income tax and thus rely more on sales taxes have more regressive tax systems.

Jobs and Good Wages

To successfully deal with poverty, the government must act to ensure that every person who wants a job can find a job and that every job pays enough to provide for a person's basic needs.

The government's use of monetary policy to stimulate the economy during economic downturns can help moderate the amount of inequality that results. Stimulating the economy generally means lowering interest rates and printing more money.

Government spending on public goods has an effect on poverty and inequality that could be greatly enhanced. Military spending on personnel lowers inequality and poverty because it employs many people that otherwise would be in the low wage labor market. The effect is not only to provide an adequate salary, training, and benefits to those in the military, but also to reduce unemployment and hence to drive up wages. High tech spending on advanced weapons systems makes up a large portion of military spending and does very little to address poverty and inequality. There is a question of why such a large military force and budget is necessary today. The money would be better spent paying people to improve the environment as was done with the Civilian Conservation Corps during the Great Depression.

To address the lack of jobs for everyone, the government could guarantee jobs. This would be done by providing jobs for people to create public goods and new work that would not otherwise be done in the private market. A government jobs guarantee has broad public support but is opposed by business interests because it would raise the cost of all labor.

The creation of jobs for all at sufficient wages can likely only be achieved by a combination of these government actions with several others. Further government action could include the expansion of the Earned Income Tax Credit, which supplements the wages of low income people; provision of training to make individuals more employable; and the raising of the minimum wage to make it closer to a living wage.

Analysis/Critique

The book is very useful in that it lays out the arguments for and against government action to address poverty and inequality, identifies the obstacles to achieving policy, and explains the current systems of social insurance and safety nets.

One overarching theme is that government solutions to poverty and inequality are not pursued because of the disparity in power of business versus labor. This disparity is complicated by globalization, which has vastly increased the mobility of capital. Thus, the already tilted scale in

favor of business and against actions to address poverty has been further tipped by the fear of enacting policies that will hurt the United State's economic competitiveness.

A lesser theme from the book that may be more relevant today is that government action to address poverty and inequality is more likely to occur in times of war and economic crisis. The corporate tax rate increase during World War I and the New Deal policies enacted during the Great Depression are both examples. This suggests that government inaction on poverty and inequality today is a major wasted opportunity.

Finally, though the book was published only ten years ago, it is outdated because it advances arguments based on the economic conditions of the late 1990s and early 2000s. The economic landscape today has changed starkly after a decade of rising deficits, wars, tax cuts for the wealthy, energy price spikes, natural disasters, and the largest financial crisis since the great depression. The title of the book re-written for 2010 might be "What CAN Government Do?"