To Reduce Inequality, Use Well-Structured Regulations to Make Markets Work Better for Everyone

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Few are prepared to suggest that any good comes from rapidly rising economic inequality. Studies show that the greater the inequality, the weaker the social cohesion at virtually all levels of society. More unequal societies generate more pollution and people living in more unequal societies tend to experience worse overall health, higher rates of violent crime, and shorter lives. Even more worrisome are the corrosive effects of extreme economic gaps on equality of opportunity and democratic governance. Differences in income and wealth translate into dramatic differences in political power.

Consensus that rising inequality is problematic does not carry over into agreement about proposed remedies. Almost every economist and politician has his or her own ideas about what to do. Judging from recent public discussions, the step with the broadest support involves raising taxes on people with very high incomes and great wealth and using the resulting revenues to improve the economic position of middle class and poor people. For example, tax revenues could be used to increase funding for public education from pre-kindergarten through college.

Markets Can be Made More Equitable

Most existing proposals for reducing economic gaps make the mistake of presuming that the structure and operations of economic markets are fixed and unalterable. But in fact governments and citizens have a great deal of control over the structure of markets. We need not simply let markets produce damaging results and then struggle to use taxes and social programs to remedy problems and inequities after the fact. As the traditional saying goes, “an ounce of prevention is worth a pound of cure.”

A more effective strategy for fighting rising economic inequalities recognizes that markets are hardly set in stone. They are not natural phenomena determined by forces beyond human control; rather, they are shaped by complex political interests and social practices. Faced with escalating economic inequality, governments can reshape laws and regulations to encourage healthier income distributions in the future.

Reshaping U.S. Market Forces

A few examples illustrate my overall point about market malleability and suggest ways in which U.S. markets could be patterned to reduce economic inequalities:

- Strong labor unions can serve as a counterweight to economic inequality by improving wages and benefits, not just for union members but also for other workers in the same industries and regions. Over the past few decades in the United States, legal, regulatory, and social changes have undercut the clout of organized labor. But new federal and state laws and regulations could facilitate unionization and collective bargaining.

• Lax regulations governing banks and investment firms directly boost profits on financial investments and increase the incomes of top executives. The apparent acceptance of the “too big to fail” principle by federal regulators dealing with big banks gives financiers confidence that the federal government will step in to support large firms if they run into serious trouble. Such regulatory practices are an implicit subsidy to speculative firms, because investors are willing to provide funds to them on favorable terms. But regulations could be redesigned to encourage less volatile and more productive investments in industries with more equal systems of compensation.

• The U.S. system of intellectual property rights contributes to inflated profit rates and outsized executive salaries in certain industries, especially pharmaceuticals. Appropriate modifications in patent laws could reduce such harmful effects without stifling innovation – indeed, innovation might even be enhanced, because the case can be made that current U.S. patent laws limit it.

• Current regulations and subsidies in the oil and gas industry (including state policies to encourage “fracking”) artificially inflate the profits of energy companies and harm the environment. If firms were required to pay the real cost of their production activities, including the cost of degrading the environment and spewing emissions that cause global warming, corporate decisions might well be different. Environmental damages – the harms of which fall heaviest upon low-income people – might be reduced.

• Economic markets influence and are influenced by the way young people are educated and older workers re-trained. Increased and better-tailored investments in public education, including vocational training, would translate into a more equal distribution of income.

The Way Forward

Some will object to “interfering with” market operations in the ways suggested here, on the grounds that future economic growth would be negatively impacted. U.S. history suggests the opposite. In periods when the U.S. economy has grown most rapidly – following World War II, for example – many of the policies suggested here were firmly in place. Across the globe, moreover, nations with effectively structured markets have achieved both lower levels of economic inequality and higher rates of growth.

The basic point is straightforward: the choice we face is not between regulated and totally unregulated markets. Governments always intervene and use laws and regulations to shape markets. The questions are how interventions are designed and to what effect. As Americans grapple with the harmful effects of rising economic gaps, we have the power to choose policies that can encourage the market to limit inequality.