

Analyzing the Effects of Forced Redistribution and its Implementation through Government Policies

Siddharth Makharia

Abstract: This paper examines the inequalities that plague modern society by using global historical data. A need for change is apparent due to the wide-scale income and wealth inequalities, and this change can be orchestrated by forced redistribution. The paper goes on to analyze the effectiveness of forced distribution as a concept by integrating several schools of thought, and then take specific case studies to highlight the economic effects – both negative and positive – of forced redistribution policies. Progressive tax systems are extensively focused on due to their potent ability to enforce income redistribution. However, an exploration of their shortcomings; distortionary effects, administrative leaks, and costly inefficiencies; conveys that it is an imperfect system that does not yield the expected results. Instead other alternatives such as a negative income tax, which would theoretically minimize inefficiencies by eliminating administrative costs and indirect transfer programs. Wealth redistribution through past land reform acts are analyzed, which suggest that certain changes in the execution are needed to ensure their success. The return of an estate tax is also considered due to its fundamental rationale. Lastly, the development of the public sector is presented as essential due to the correlation between equal opportunities and incomes.

Keywords: Forced redistribution, income inequality, progressive taxation, inefficiencies.

1. INTRODUCTION

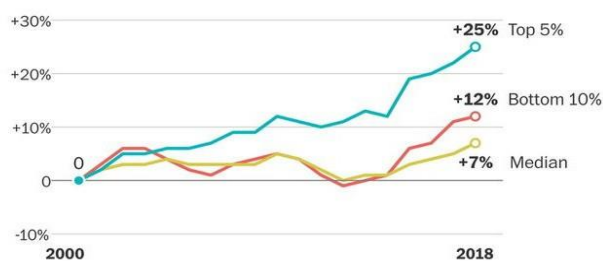
'Redistribution' seems to be a ubiquitous phenomenon in today's complex global society. It refers to modifications of the holdings of particular persons, collective agents, or groups (as defined in terms of non-resource holding characteristics), or changes in holdings by groups. However, 'forced' explicitly conveys that this redistribution is involuntarily imposed on the general public. It is clear that every modern economy requires some form of forced redistribution simply due to the prevalent inequality in terms of income, wealth and opportunities.

2. REASONS FOR ITS EXIGENCY

Forced redistribution is necessary due to the widening disparity between the apparent economically 'rich' and 'poor'. In the United States, since 1980, incomes for the top 40% of earner grew 3 times faster than incomes of the bottom 60%. More specifically, comparisons of the upper strata to the

average working class also yield the same result, as seen below.

Top earners continue to pull away from everyone else
 Cumulative percent change in real hourly wages since 2000



Source: Economic Policy Institute

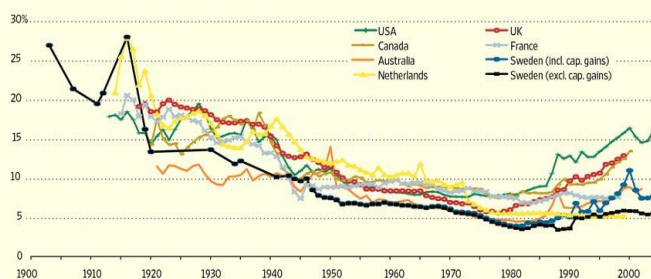
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Figure 1

As shown in figure 1, it is evident that income inequality is only increasing. The income of the median has population has only increased at a rate of 7% whereas that of top earner has increased by more than 4 times that amount. This data is only for the United States but income inequality is rapidly rising even in Western Countries that had lowered their income inequalities in the past, as seen in fig. 2 below.

The Rich Get Richer and Poorer Together

Income shares of the top percentile in Western countries, 1903-2004



Source: Jesper Roine and Daniel Waldenström

Figure 2

Source: The Atlantic

Figure 2 clearly displays the inequality from a more global perspective. Taking a set of Western countries that would be expected to have lower inequalities due to their development, it is clear that they are no exception to the general trend. There was a steady downward movement throughout the 20th century until about the '80s where income inequality began rising. Since then, there has been an upward trend for all countries with USA, UK, and Canada having the steepest increases. These trends simply highlight the need for a major redistribution of income in order to avoid its accumulation in the top band of each country.

Furthermore, (Chiswick, 1971) uses cross-sectional data from 9 countries to suggest that income inequality is correlated to educational inequality. In other words, inequality of opportunities (like education) is also a major issue that has multiplier effects.

3. THEORETICAL BENEFITS

The primary argument for forced redistribution is the theory of diminishing marginal utility of money, which we assume applies to all decision-making individuals. Since humans would first use their money to fulfill their most urgent needs, like food and healthcare, and then use surplus cash for less urgent ones, such as designer clothes or meals out, the first dollar that they earn has a higher value to them than their thousandth dollar. For example, a hundred dollars that Jeff Bezos spends on new seats for his helicopter is, indeed, less important to him than those hundred dollars would be to a starving destitute.

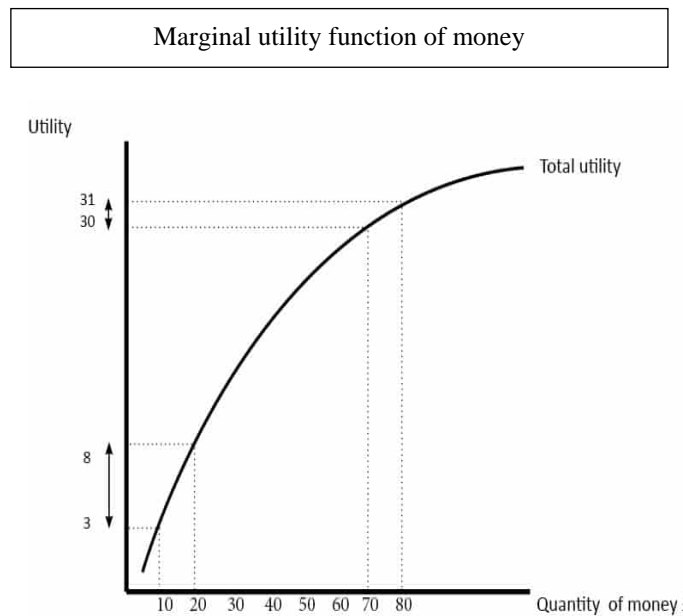


Figure 3

This can be modelled by the figure 3: it has a negative derivative, which signaling that the gradient, or the marginal utility, is always decreasing. The more money one has, the lesser will be the gained utility from each additional dollar due to the constantly decreasing value of the gradient. The shape of the graph is what results in the diminishing marginal utility of money.

Based on this, a utilitarianist school of thought, which assumes utilities of all members of society to be equal, does not accurately describe social welfare functions in such a situation and so will not be used to analyze this situation. According to a Rawlsian approach, the welfare of society should be measured by the wellbeing of the worst-off individual (John Rawls, 1971). By taking the Rawlsian approach to a social welfare function, forced redistribution would eventually maximize social welfare through the attainment of Pareto optimality which would occur once all incomes/asset ownerships become equal. Theoretically, society could vigorously use forced redistribution to achieve complete allocative efficiency, as transfers from the rich to the poor are bound to increase the absolute amount of utility in society, according to the marginal utility theory of money. There are several examples large scale forced redistribution such as progressive taxation, and land reform acts (Besley and Burgess, 2000).

4. TAX SYSTEMS

Not all taxation is completely redistributive in nature, but progressive taxation is one such prominent mode. It is important to focus on its numerous drawbacks, as a generalized exploration, in contrast to the aforementioned theoretical benefits.

Primarily, taxing the relatively well-off to facilitate transfers to those worse off could be compared to "carrying water in a leaky bucket" (Arthur Okun, 1975). This leak alludes to administrative inefficiency of government intervention as judged by the canon of economy (Adam Smith, 1776), and to the deadweight losses caused by distorting effects. In 2007, the US government spent 1.45 trillion dollars on programs aimed at redistributing wealth, mainly financed by their progressive tax revenues (US federal reserve database). The lowest quintile of taxpayers was taxed at 4% while bearing solely 0.8% of the total tax burden. Conversely, the wealthiest 1% of taxpayers were taxed at 29.5%, thus bearing 28.1% of the total federal tax burden. If the total amount was simply divided up among the poorest 20%, each household would receive about \$62,000, about 20% greater than the median income of \$50,000. This raises the question of whether the plethora of redistribution methods such as social security benefits, Medicaid, Unemployment transfers etc. are actually worth the resources, when a pure cash redistribution seems to have a more significant effect.

In addition to glaring inefficiencies like this, the distortionary effect of taxes cannot be discounted, as it interferes with the natural equilibria of labor supply and capital accumulation (Harberger, 1964). Progressive taxation ensures that higher earners keep a lower share of their income, which theoretically reduces the incentive to work harder and secure higher incomes, because the rise in after tax income may not be significant. It has been found that individuals are less likely to move to better jobs when the share of rewards (eg. income) they receive is lower i.e. increasingly progressive taxation reduces positive job turnover (Gentry and Hubbard, 2002). People who earn significantly more than the median income may argue that their hard work and efforts is what got them their wealth and taking it away is an unjust culmination of their efforts. We can combine the morality of this argument against progressive taxation with the general disincentivizing of people to hard work, which undermines the system of capitalism, that drives most modern economies. Moreover, repealing the 1993 American increases in tax rates would actually reduce the deadweight loss of the system by \$24 billion while increasing tax revenue (Feldstein, 1993), which corresponds to the idea of the Laffer curve (Arthur Laffer, 1974). Despite heavy research, government economists find it difficult to find the optimum spot on the Laffer curve, which reiterates the existence of inefficiencies in the contemporary tax systems.

5. AN ALTERNATIVE SYSTEM

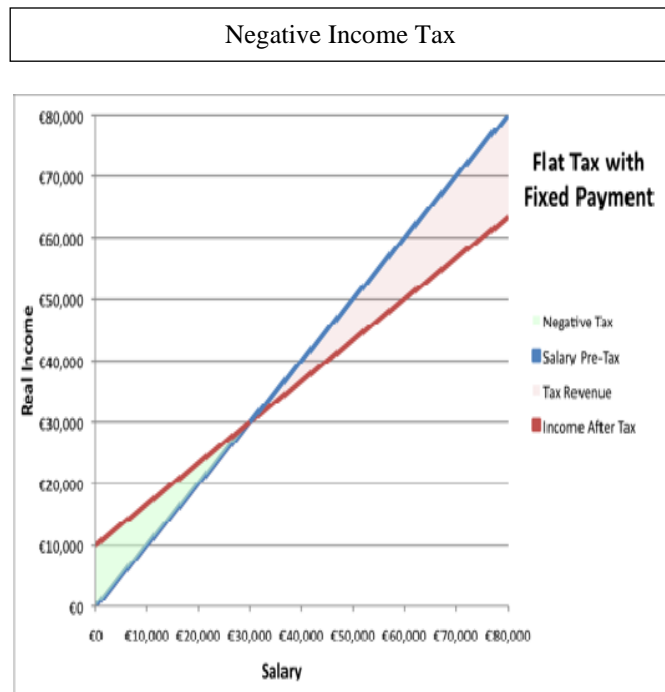


Figure 4

Alternatively, governments May consider implementing a system that involves a negative income tax (Friedman, 1962) in order to maximize the benefits to the poor while minimizing the costs to the general public. As explained by the Nobel laureate, this tax works by setting a guaranteed minimum amount, eg. \$10,000 with a rate of 10%. Anyone earning above this will be taxed accordingly, eg. An income of \$20,000 will be taxed \$1,000; all earner below this level will receive transfers of the same magnitude: an income of \$5,000 will receive a transfer of \$500.

Fig. 4 details this tax: the point of intersection could be considered as the break-even point where no tax is collected. At salaries to the left of this point, they would receive transfer due to their failure to draw the basic salary that one is expected to need to survive. The green shaded area shows the total government spending on transfers to this impoverished group. At salaries right of the break even, each person would pay a tax given the decided upon rate. The slope of the income after tax slope is decided by the fixed rate, eg. 10% that the government chooses. The higher the rate, the flatter the curve, and the greater is the extent of redistribution.

This is advantageous because there will be significantly lower administrative costs involved in running said program as compared to current tax systems all around the world. Furthermore, it would not distort incentives for people to work harder, as the progressive system does, because the tax rate doesn't accelerate with rising incomes, and this helps to maximize the productivity of a workforce. Additionally, it fulfills the main aim of forced redistribution which involves engendering equality and serving the impoverished, vulnerable parts of populations. Obviously, it isn't possible in contemporary society for a government to revamp their entire system of taxation. Instead a negative income tax can be slowly phased into the system and used to replace anti-poverty benefits such as the Mexican PROCAMPO subsidy and Colombia's conditional cash transfer system as it targets the same section of society but ensure that everyone has equal access to it irrespective of profession, age, gender etc. Moreover, this tax would solve other problems such as the minimum wage issue by removing it because people are already guaranteed a basic income. This could potentially increase employment as labor would become cheaper, incentivizing firms to hire more. Thus, a negative income tax would clear up labor market inefficiencies such as disincentives to hire, and would boost the potential output of an economy.

6. ASSET REDISTRIBUTION

Another major type of forced redistribution involves assets, or resources with economic value, most commonly seen through land reform acts which transfer land from the 'rich' to the

'poor'. This is needed due to the massive differences in wealth of the different economic classes, as seen below.

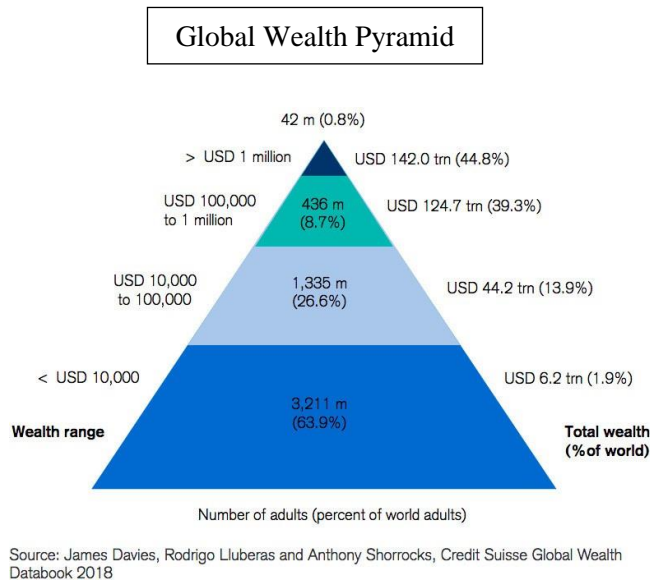


Figure 5

As seen in Fig. 5, wealth inequalities are rampant: the top 0.8% of the population almost triple the wealth of the bottom 90%. Combined, the top 9.5% control about \$266.7 trillion whereas the bottom 90.5% own less than a fifth of that, only \$50.8 trillion. The fact that such a small portion of the global population dominates the rest is concerning, considering the abject poverty that millions are forced to live in. This clearly suggests that reformative actions are needed to improve both equity and equality in this inequitable world we live in. This issue is global in nature, yet is more rooted in certain countries as compared to others.

This often occurs in agrarian economies where there are stark inequalities in wealth amongst the rural population. For example, Tajikistan enforced major land reforms over the '90s that transferred land from collective and state farms to poor households leading to the formation of 'dekhans' (self-owned farms). The government shouldn't expect sizable economic gains from land reforms, but rather should view it as a vessel of security and subsistence to a populous unemployed rural workforce (Binswanger, 2009). Nonetheless, we could relate the strong rebound of the GDP following the 1997 civil war to the prosperity of the agricultural sector. Thus, it seems possible that redistribution in an economy can be propitious to growth (Aghion, 1999). Yet we must look at the inefficiencies, such as failed applications of this policy since only 7.8% of surveyed farmers know how to apply of their own dekhkan. A combination of bureaucracy and illiteracy has reduced the effectiveness of these land reforms, which in theory should benefit all involved parties.

India, another largely agrarian economy, faced a similar situation in terms land reforms, yet the results were perhaps unexpected. Basic theory of firms dictates that, over time, larger entities (farms) could be more efficient than smaller ones due to their ability to exploit economies of scale. In reality, the large firms are riddled with inefficiencies due to lack of worker motivation, and empirical observations have actually shown an inverse relationship between farm size and productivity (Banerjee, 1999). This mode of asset redistribution seems to be ideal based on grounds of efficiency and equity, yet in a country where the better part of a billion people rely on agriculture, re-dividing up the land seems to be a cumbersome and unending process.

7. POTENTIAL COURSES OF ACTION

It is impossible to generalize rules for asset redistribution; nevertheless, it is possible that a revamped estate tax would be effective. Estates taxes, levied on the affluent, redistribute generational wealth away (taxes fund government spending on the poor). They also provide incentives to the rich to continue working in order to keep their sizable fortunes from dwindling. This means that any traditionally 'old' money that has been passed down generations will eventually fade away, unless the heirs of said inheritance continue to add value to society in terms of the additional income they generate, or assets they create.

When talking about redistribution of land, excessive bureaucracy makes it difficult for the target population to actually apply for land, and the corruption of low-income government officials ensures ineffective implementation. Conversely, the government should focus on more stringent tenancy laws which ensure that landless peasants and low-income rural workers are protected from exploitation.

Withal, the public sector, if correctly developed, has unparalleled positive impacts in terms of providing equal opportunities. Take the provision of education, something which is considered as essential, and which is directly correlated to future income inequalities (Chiswick, 1971). People who receive education tend to have higher future wages than those who don't, and by ensuring everyone has equal access to this ensures reduced future inequalities. Additionally, improved health care directly impacts job productivity and the ability to earn and so its universal availability is imperative in reducing the magnitude of inequalities, and in breaking the vicious cycle of poverty. These government provided services are primarily funded through taxation of all citizens, regardless of whether they'll actually use public goods or not. This is an example of forced redistribution for places that have progressive taxation systems or where the well-off tend to use private sector substitutes (eg. private schools) instead.

Government resources are often wasted due to myriad inefficiencies that have severe opportunity costs. As mentioned earlier, the new taxation system compounded with reduced administrative costs could greatly reduce preexisting budgets deficits, thus freeing up funds for government use. In the public sector, the issue of overuse of scarce resources is problematic. Some examples include when there are no seats left on public transport, when public schools have overcrowded classrooms and forced free periods, or when public hospitals have a shortage of medical personnel. Heavy investment in these will ensure that the poorest sections of society have equal opportunities as their richer counterparts. Moreover, by ensuring adequate levels of education and good health, the impoverished can compete for jobs, university placements, sponsorships etc. that they wouldn't be able to do without the forced redistribution of opportunities away from particular exclusive groups.

8. CONCLUSION

All things considered, equity always comes at the expense of certain inefficiencies, which must be accepted, because it is crucial that no one lives in abject poverty. Currently, valiant forced redistribution efforts are being made, but that doesn't mean they cannot be improved. Yes, the suggested changes may be radical in nature and disruptive to short term stability, but in the long term, equal opportunities and free provision of social overhead would improve the productivity of vulnerable sections, leading to a more equitable world.

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