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A bigger welfare state makes the wealth inequality Labour bemoans worse

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In a speech in Corby this week, Jeremy Corbyn made reducing inequality central to his pitch to be the next prime minister. Certain polling emboldens the Labour leader. When asked in the abstract, the UK public expresses strong concern about the gap between rich and poor.

Brexit, the NHS and now crime, remain more important concerns. But US evidence during the last crash suggests inequality rises in the public consciousness in a weakening economy. It spiked here last year too when the economy slowed. A messy Brexit or the threat of Corbyn's agenda slowing growth further could produce fertile ground for egalitarian sentiment in a coming election.

A reawakening of this age-old debate though provides opportunity to highlight inconvenient truths for the Left about the trends and causes of inequality. Contra claims it's spiralling out of control, UK income inequality has been pretty much unchanged for a quarter of a century. Wealth inequality – an aggregated measure comprising physical, financial, housing and private pension wealth– has risen somewhat over longer periods, but likewise has been near-flat for at least a decade.

Labour retorts that both are still too high. Wealth inequality is the bugbear de jour, being (as it always is given the life cycle) more unequally distributed than income. Scary-sounding data from the Office for National Statistics (ONS) suggest the richest 10pc of Britons hold 44pc of aggregate private wealth, while the bottom 10pc own nothing. In Corbyn's world, this justifies more "Robin Hood policies" that take from the rich and spend on the poor.

Yet there's another unhelpful observation you won't find Corbyn and Co admitting. Heaps of evidence around the world shows the sort of big welfare state he favours actually widens the same wealth inequality measures he deems obscene.

How can "progressive" programmes make countries more unequal? Quite simply, taxpayer-funded state pensions, health and social care spending, housing subsidies, unemployment benefits and subsidised student loans, all reduce our need to save or build up personal financial assets. Broad-based higher taxes to finance them also reduce the means for ordinary households to save and invest for themselves. Across time and countries, these government programmes and transfers have therefore crowded out private savings disproportionately for those of modest means.

Unlike private wealth, the resources for government programmes are not heritable either. Contrary to popular belief, inheritance tends to be wealth-equalizing. While the wealthy can save and invest in business and financial assets to pass on to their heirs, a big welfare state means poorer households have less need or means for saving, and less often see unexpected windfalls. The welfare state thus widens wealth inequality, and Corbyn's plans to expand it further would exacerbate this effect.

That's why Scandinavian economies, despite low income inequality, have wide wealth distributions. Denmark is held up by Corbynistas as a country to emulate on social spending. Yet consider some striking OECD statistics: the bottom 60pc of Danish households have negative net wealth (ie combined, are in debt), while the top 10pc hold 64pc of all wealth. The figures for the UK under these calculations (different from the ONS) are 12.1pc and 52.5pc wealth shares for the bottom 60pc and top 10pc, respectively. In other words, UK wealth is more equally distributed.

Denmark is not just some outlier either. A 2015 European Central Bank study across the eurozone found that "an increase in welfare state spending goes along with an increase – rather than a decrease – of observed wealth inequality". France has high social spending and low wealth among less well-off households, for example, while Luxembourg and Spain have relatively low social spending and high wealth holdings for the poor.

Now, this alone doesn't mean the welfare state is inherently "bad". Most programmes or transfers are introduced to achieve ends other than affecting inequality. Facilitating the poor to worry less about precautionary savings and granting them confidence to spend through their lifetimes may still improve well-being. There are, naturally, other important economic phenomena that shape wealth distributions.

The point here is that Corbyn and others use measures of wealth inequality "worsened" by the welfare state as justification for further expanding it. They risk us getting stuck in a loop whereby more social spending leads to more private wealth inequality, which is then used to justify additional social spending.

There are two potentially honest, rational responses to this evidence. One would be to give up on or augment wealth inequality statistics. Many economists believe a better proxy for well-being would be lifetime consumption, inclusive of private and government-provided services. Alternatively, we could adjust wealth statistics to account for the present value of promised government benefits as if they were "real" wealth. Accounting for government and state pensions for the UK alone has been found to reduce measured wealth inequality by almost a third. Adding more services might reduce it further.

Acknowledging that "lived" inequality is far less dramatic than quoted wealth figures suggest would probably be an ask too far for Corbyn, undercutting as it does his whole economic narrative. Yet the alternative response is equally awkward. For if he insists private wealth inequality is society's premier problem, he might be forced to reconsider some of the welfare state drivers of it.

Could one imagine Corbyn campaigning for privatisation of the state pension or for replacing the NHS with individual health savings accounts to quell this wealth inequality scourge? Probably not. That itself reveals a great deal. Deep down, even the Labour leader would spurn reducing the measured private wealth gap in favour of other priorities.

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