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Redistributing Wealth to the Poor Doesn't Burden Growth, IMF Note Says

ByIan Talley

The International Monetary Fund, long seen by many around the world as a primary bastion of market capitalism, is building a case for governments to raise taxes on the rich to redistribute wealth to the poor.

Hitting squarely on the sensitive subject of taxes, it's likely to fuel a hot debate, at least in the academic world, if not in the world of politics.

It also represents a larger transformation in the fund's economic philosophy in recent years that has seen the IMF reverse decades of advice on state controls over international capital flows and soften its stance on near-term budget belt-tightening.

A new IMF staff discussion note by several senior fund economists claims to invalidate a conventionally-held economic theory that redistribution is a burden on growth.

"On average, redistribution seems to have helped support faster and more durable growth," said Jonathan Ostry, deputy director of the fund's vaunted research department and one of the four authors of the study.

In fact, Mr. Ostry said, after reviewing years of country data across the world, "We find little evidence of the big tradeoff between redistribution and growth… that has permeated the consciousness of economists and policymakers ever since."

Mr. Ostry's referring to economist Arthur Okun's 1975 book, "Equality and Efficiency: The Big Tradeoff," that argued government efforts to pursue equality undermined economic expansion.

There are merits to inequality, particularly as a motivational driver for growth, the IMF economists said.

But inaction in the face of high inequality seems unwarranted in many cases, said Mr. Ostry. And excessive inequality seems more likely to weigh on growth by undermining access to health and education, and investment is deterred by as disparity between rich and poor brews political instability, he said.

The research note isn't officially IMF policy. Yet. The paper and its authors refrained from pointing to any particular country recommendations. But the paper is likely to help shape fund advice in the future as the world's economic counselor recommends fiscal policies for its 188 member countries.

The hot-button issue has gained particular attention in advanced economies in the wake of financial crisis, as jobless numbers topped record highs in the past several years. President Barack Obama made it a defining issue in his State of the Union Speech in January, and it has become a rallying cry for many on the left.

"Banks, hedge funds and the rest of the financial sector should pay their fair share to clear up the mess they helped create," says RobinHoodTax.org, a coalition of unions, environmentalists and other left-leaning advocacy groups.

Organizations on the other end of the political spectrum such as the Cato Institute argue that free markets, unburdened by government control over spending, spur greater growth and opportunity by using capital more efficiently.

But for many developing countries, where the chasm between classes is often far greater, the issue of is particularly acute.

IMF Managing Director Christine Lagarde appears to have already taken the research note to heart.

"Rising inequality and economic exclusion can have pernicious effects," Ms. Lagarde said Tuesday in speech at California's Stanford University. "It can undermine economic, social—and perhaps even political—stability. It can tear the very fabric that holds society together," she said.

That's why she's encouraging design of tax and spend policies that can help reduce inequality. "Think about improving access to health and education, putting in place effective, targeted social programs, and making taxation more progressive," she said.