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When Low Taxes Don't Help the Rich

By ROBERT H. FRANK

AT first glance, money's growing influence in politics appears impossible to challenge because of a powerful positive-feedback loop. Yet hope remains.

Although big-money donors are a diverse group, many of them want lower tax rates for themselves and less stringent regulations for their businesses — and they've been brilliantly effective in getting them. Their success has increased their incomes still further, allowing them to make even larger contributions and to demand even bigger favors.

This vicious circle was strengthened considerably by the Supreme Court's decision in the Citizens United case. And so, each year, the possibility of any new laws to curb money's influence appears to recede.

But as the economist Herbert Stein once joked, "If something cannot go on forever, it will stop." Eventually, the social and economic consequences of further growth in income inequality may become so severe that even the most generously financed candidates won't prevail against reform-minded opponents.

Alternatively, extreme inequality might one day spawn a violent revolution, as has happened in many other countries. Such routes to change still seem distant, however, and are hardly something to hope for.

There is a more encouraging possibility: in time, wealthy political donors may become convinced that their contributions poorly serve even their own narrow interests.

Lower tax rates have affected these donors in two opposing ways. On the positive side, they have supported higher consumption in the private sector. But on the downside, the resulting budget deficits have reduced the quantity and quality of public services. Compelling evidence suggests that the negatives have been much larger, and the positives considerably smaller, than many donors have expected.

Through private schools, gated communities, personal aircraft and other adaptations, the wealthy have been insulated from many costs of a decaying public sphere. But ill effects remain. Declining quality of public schools, for example, makes it harder for businesses to recruit productive workers, and a shrinking middle class makes it harder to sell their products in volume.

Many other effects of budget deficits also cut across the income divide. First, consider two extreme examples: When a poorly maintained bridge collapses, rich drivers are no less likely to die than poor ones. And if cutbacks in the Energy Department's program for locking down loosely guarded nuclear materials in the former Soviet Union one day enable terrorists to detonate a dirty bomb in Manhattan, hedge fund managers and their families will suffer along with everyone else.

But important, if less dramatic, losses occur often in real life, because the process of social framing often exaggerates the gains from private spending. When all families stage more elaborate celebrations for special occasions — weddings, for example — the main effect is simply to raise the bar that qualifies an event as special.

A RELATED distortion is easily seen in a thought experiment:

Let’s say that two societies differ only in their mixes of public and private spending. In one society, lower taxes on the wealthy allow them to drive very fine cars — say, $180,000 Bentleys. The streets and highways in this society, however, are riddled with foot-deep potholes.

In the other society, the wealthy pay higher taxes that support well-maintained roads, but drive $120,000 BMWs. Some car buffs will grumble, but for argument’s sake, let’s assume that all view the Bentley as the better car.

In which society would the wealthy be happier? Because product-quality improvements cost much more to achieve beyond some point, the absolute quality of a $180,000 car may be only slightly higher than one costing $120,000. And because not even the most sophisticated automotive suspensions can neutralize deep potholes, it’s little wonder that most people think the BMW drivers would be happier, not to mention safer.

That conclusion is reinforced by evidence that consumption standards are highly local. The BMW drivers in the second society don’t often mingle with the Bentley drivers in the first, and are thus unlikely to feel deprived for having less-expensive cars.

If the wealthy often overestimate the attractions of higher private spending, they’re also likely to overestimate the regulatory burden on their businesses. Compliance with regulations, of course, can be costly. And if only one company has to comply, its profits may indeed decline sharply. But regulation applies to all companies in an industry, which typically allows them to cover their costs by raising prices. So if regulation promotes a safer, cleaner environment whose benefits exceed those broadly shared costs, everyone — even a business owner — is ahead in the long run.

Because the market forces causing greater inequality are still playing out, the wealthy will continue to have more power to influence politics. So if donors stick to their strategy of supporting candidates who favor lower taxes and fewer regulations, they're likely to prevail indefinitely.

REFORMERS castigate wealthy donors for supporting self-serving policies. But, instead, the reformers could call attention to evidence that the donors themselves would fare better, in purely practical terms, without the tax cuts and deregulation they've been promoting.

You needn't be a cynical economist to believe that this second strategy has brighter prospects.

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