



The successes and dangers of a thriving market economy

*Talent is rewarded.
Immigrants escape poverty.
Yes, inequality is an issue.
But so is envy-driven politics.*

BY RICHARD ESENBERG

There is an old observation, often misattributed to Alexis de Tocqueville, that a democracy can last only until the majority realizes that it can vote to take other people's money. Such is the seductive lure of — take your pick — “envy” or “justice” in politics.

Tocqueville did observe that Americans “are so enamored of equality, they would rather be equal in slavery than unequal in freedom.” James Madison understood democracy's susceptibility to demagoguery as well. He believed that the passions of the majority would threaten the public good, including the protection of rights in property. His answer was a constitutional structure of separated powers webbed with checks and balances.

This is what makes our conversation about inequality so difficult. Economic arguments only go so far in the

face of the natural desire of people to have more of what they do not have and their sense that the wealth enjoyed by others is “unfair.”

But we can hardly decide whether inequality is a problem and, if so, what to do about it, without understanding what we are talking about.

Our envy is not really over the 1% — a group that begins at somewhere in the neighborhood of \$400,000 to \$500,000 in annual income. This is a tidy sum, to be sure, but not nearly enough to finance the life of the rich and famous. We are actually green over some fraction of the 1% — those who earn millions every year and enjoy private jets and villas in Martinique.

But even then, we aren't bothered by all of these people. We complain about CEOs and investment bankers. We don't complain about pop stars and utility infielders. There's a reason for that.

Most of us understand that someone who can play in the NFL or star in “Breaking Bad” is highly talented and earns huge sums of money for those paying the bills.

We can't see that with CEOs who seem to be doing something less extraordinary — sitting behind a desk and managing an organization. It doesn't seem so special.

But, in economic terms, we are wrong about that. Liberal economist Robert Frank, in his book *The Darwin Economy*, explains that the only thing surprising about CEO salaries is that they are not higher. The reason, he says, is that the quality of the decisions made by people who run extremely large entities can add or subtract hundreds of millions of dollars to or from the bottom line. It is, Frank argues, perfectly rational to pay huge salaries to maximize the possibility of getting the right person to make the right decisions.

This doesn't mean that companies will always choose wisely. The argument for markets is not that they are perfect, just better than command economies. To be sure, there was a time when the most highly paid earned less than they do today. Many on the left long to return to those days, calling it the Great Compression. This is more than a tad ironic. Back in the '50s and '60s, when that world still existed, the left hated it.

There are other ways in which the greater emphasis on markets and the move to a global economy has expanded opportunities and even led to greater equality. Globalization has dramatically increased standards of living in the developing world. This may harm the position of certain workers in the United States — increasing inequality here — while reducing global poverty. Immigrants earn substantially more than what they earned in their old country. Nevertheless, this influx of low-income workers increases measured inequality within this country.

The removal of barriers to full participation in the labor force by women and minorities may increase the supply of labor in a way that restrains wage growth but increases overall prosperity.

As Frank and others point out, the old economy was riddled with regulatory and cultural barriers that tended to protect established producers and discourage competition. The freer global economy that we have today tends to reward people at levels

more commensurate with the economic value of their contributions, and that certainly increases income inequality.

There is a robust debate among economists as to whether globalization and the turn to markets have helped the majority. While we hear claims that


Economist Robert Frank says that the only thing surprising about CEO salaries is that they are not higher. CEOs, he points out, can add or subtract hundreds of millions of dollars to or from the corporate bottom line.

wages have been stagnant over the past 30 years and that mobility of generations is not what it should be, measuring these things over time is far more complicated than the sound-bite critics allow.

When you peel this statistical onion, I think you'll find that the standard of living for almost all Americans is far better than it was when I was young.

Having said this, I think it's fair to say that the new economy places a premium on marketable skills in a way that makes it more difficult for those lacking these skills to keep up.

This will require policy responses. But, as Tocqueville and Madison noted long ago, the greater challenges may be political. They saw that envy could trump reason. Avoiding that will require a conversation rooted in fact and not passion. ■

Richard Esenberg is president of the Wisconsin Institute for Law & Liberty and an adjunct professor of law at Marquette University. He blogs at sharkandshepherd.blogspot.com