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That Horrible Income Gap

by George C. Leef

Karl Marx's biggest selling point has always been his argument that workers are systematically underpaid under capitalism. They produce value and greedy capitalist owners cheat them out of it. Good economists have understood for centuries that in a free (and therefore competitive) labor market, it isn't possible to underpay anyone for long. That fact, however, has never kept demagogues who need issues that will help them gain political power from telling people, "You're not getting as much as you should. Vote for me and I'll make sure you get your fair share!"

That political pitch has never gone out of style, but it seemed to fade somewhat during the Clinton era. In 2005 and 2006, however, it roared back to prominence, thanks to some tendentious studies and advocacy journalism. Responding to all the chatter about the increasing unfairness of life in America, David Brooks wrote in his *New York Times* column on the death of Milton Friedman, "Growing evidence suggests average workers are not seeing the benefits of their productivity gains — that the market is broken and requires heavy government correction. Friedman's heirs have been avoiding this debate. They're losing it badly and have offered no concrete remedies to address this problem, if it is a problem." ("The Smile of Reason," November 19, 2006 — available to NYT "premium content" subscribers only.)

At least Brooks said, "if it is a problem." To many other people, the case is closed. Virginia's new U.S. senator, James Webb, wrote shortly after the election that back in the 1960s, the average business CEO made 20 times as much as the average worker, but now CEOs make 400 times as much. Workers' wages are stagnant, with no real gains in decades, while the very rich rake in more and more. Obviously, it's time for the government to do something. ("American Workers Have a Chance to Be Heard," *The Wall Street Journal*, November 15, 2006)

So is the market "broken?" Do we need politicians like Webb to fix it so things can again be fair? And why are Friedman's heirs avoiding debate on this, unless it's because they know that the neo-Marxist populists are right?

It's all utter rubbish, a slick PR campaign to woo both voters who envy the success of others and voters who feel guilty over their own affluence. The U.S. economy has plenty of real problems, but this meretricious campaign is intended to support politicians who want an excuse to expand the Nanny State. That can no more cure our economic troubles than another long drink of booze can cure a hangover.

First of all, it just isn't true that "Friedman's heirs" have avoided this debate. *Income and Wealth*, by Cato Institute scholar Alan Reynolds, is a thorough demolition job on the entire wealth gap/wage stagnation thesis. Reynolds looks at this controversy from every angle and finds no merit in any aspect of the case. It's purely a political contrivance based on bad statistics and feeble analysis. (Reynolds's book reminds me of Henry Hazlitt's *Failure of the New Economics*, in that by the time the author is finished there's just nothing left of his target.)

Just to cite one example, pertinent to Webb's contention that compensation for top business executives is much too high, Reynolds shows that the evidence for this is income-tax returns for some executives in big companies in 2001. The year is very important because many of them cashed in stock options at the top of the bull market in 2000. Those huge one-time gains (a) were earned, (b) were transitory, and (c) detracted not one dollar from the compensation of anyone else. How much business executives are paid should be a matter of concern only to the executives and the firm's stockholders and not to politicians, but it is certainly not true that the average CEO continually earns 400 times as much as the average worker.

A fixed pie?

The great, big, glaring flaw in this whole "unfairness" project is the implicit assumption that there is just a fixed amount of wealth and that if some people earn more others must be earning less. Here is Reynolds on the well-known case of Apple Computer:

When Steve Jobs returned as CEO of Apple Computer, his salary was a dollar a year and his pay consisted of 5.4 million shares of restricted stock amounting to less than 1 percent of the company's shares. He ended up being paid extremely well after three years, when the shares became vested (they were then worth \$351 million), but only because those who invested in his company were also greatly enriched by the company's astonishing revitalization. It is hard to imagine how Mr. Jobs's stock market gains might be said to have been obtained at anyone else's expense. Yet that is what is implied by zero-sum theorists, who insist the top 0.1 percent's increased share of income was "at the expense of" everyone else.

Furthermore, there is the little problem that everything the government might do in an effort to solve this non-problem would be counterproductive. Raise the minimum wage? That prices low-skilled workers out of the market and merely reinforces the illusion that prosperity can

be legislated. Impose higher taxes on the rich? That would slightly reduce the wealth gap; but, by taking money from people who might invest it sensibly and giving it to politicians who never invest sensibly, we reduce the capital stock and retard the growth of production and job creation. That doesn't help the poor. High tariffs to keep out those "cheap foreign goods" that deprive American workers of jobs? That makes poor people spend more for things they need.

The best economic policy is to have no policy. Laissez-faire capitalism can't be improved on. Unfortunately, laissez faire is not politically appealing because politicians don't get to take credit for bettering people's lives. Or, to be more precise, they would get credit only from the small percentage who understand the benefits of getting government out of the way.

This business of trying to manufacture issues for political advantage is, of course, nothing new. Here's what H.L. Mencken had to say about it: "The whole aim of practical politics is to keep the populace alarmed (and hence clamorous to be led to safety) by menacing it with an endless series of hobgoblins, all of them imaginary."

That fits the hubbub over the "income gap" precisely.

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