Wealth Gap Rhetoric in the Face of Reality

When state power trumps free markets, choices are narrowed and opportunities for wealth creation lost

By James A. Dorn

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French economist Thomas Piketty's best-seller "Capital in the Twenty-First Century" has given widespread attention to the rising gap between the world's rich and poor, and to populist calls for government action that lead to more equal distributions of income and wealth.

That rhetoric, however, overlooks the reality that any major state role in leveling income-wealth differences risks eroding economic freedom, which is the true engine of economic progress for all people.

Income and wealth are created in the process of discovering new markets and extending the public's range of choices. Evident reality points to significant differences among people in abilities, motivations, entrepreneurial talents and personal circumstances. These differences are a basis for comparative advantages and gains from voluntary exchanges in a private, free market. Both rich and poor gain from free markets; trade is not a zero- or negative-sum game.

Attacking the rich, as if they commit crimes, and calling for state action to bring about a "fairer" distribution of income and wealth leads to an ethos of envy rather than one that supports private property, personal responsibility and freedom.

In an open-market system, people who create new products and services prosper, as do consumers. Entrepreneurs create wealth and choices. The role of the state should be to safeguard property rights and let markets flourish. When state power trumps free markets, choices are narrowed and opportunities for wealth creation are lost.

Throughout history, governments have discriminated against the rich, ultimately harming the poor. Central planning should have taught us that replacing private entrepreneurs with government bureaucrats merely politicizes economic life and concentrates power; it does not widen choices nor does it increase income mobility.

Peter Bauer, a pioneer in development economics, recognized early on that "in a modern, open society, the accumulation of wealth, especially great wealth, normally results from activities which extend the choices of others."

A government has the power to coerce, but private entrepreneurs must persuade consumers to buy their products and convince investors to support their vision. The process of "creative destruction," as described by Joseph Schumpeter, means that dynastic wealth is often short-lived.

Bauer preferred to use the term "economic differences" rather than "economic inequality." He did so because he thought the former would convey more meaning than the latter. The rhetoric of inequality fosters populism and even extremism in the quest for egalitarian outcomes.

In contrast, addressing differences recognizes realities and reminds us that "differences in readiness to utilize economic opportunities — the willingness to innovate, to assume risk, to organize — are highly significant in explaining economic differences in open societies."

What interested Bauer was how to increase the range of choices open to people, not how to use government to reduce differences in income and wealth. As he reminded us, "Political power implies the ability of rulers forcibly to restrict the choices open to those they rule. Enforced reduction or removal of economic differences emerging from voluntary arrangements extends and intensifies the inequality of coercive power."

Equal freedom under a just rule of law and limited government doesn't mean that everyone will be equal in terms of endowments, motivations or aptitudes. Disallowing those differences, however, destroys the driving force behind wealth creation and poverty reduction.

There's no better example than China. Under Mao Zedong, private entrepreneurs were outlawed, as was private property, which is the foundation for a free market. Slogans such as "strike hard against the slightest sign of private ownership" left little room for improving the plight of the poor. Communes established during the Great Leap Forward (1958-1961) and centralized economic decision-making led to the Great Famine, brought an end to civil society, and built an iron fence around individualism. The government adopted a policy of forced egalitarianism.

In contrast, China's paramount leader Deng Xiaoping allowed a market resurgence and opened China to the outside world. Now the largest trading nation in the world, China has demonstrated that economic liberalization is the best cure for broadening people's choices. This has allowed hundreds of millions of people to lift themselves out of poverty.

Deng's slogan "to get rich is glorious" stands in stark contrast to Mao's leveling schemes. In 1978, and as recently as 2002, there were no Chinese billionaires. Today, there are 220. That change would not have been possible unless China had developed into what it is today, a trading nation.

There are now 536 billionaires in the United States. There's also growing animosity toward the high-wealth "1 percent" of the nation's population. Especially bitter are those who were hurt during the Great Recession. Nevertheless, polls have shown that most Americans think economic

growth is far more important than putting a cap on incomes of the very rich or narrowing the income gap. Only 3 percent of those polled by CBS and The New York Times in January thought that economic inequality was the primary issue facing the nation.

More Americans are more concerned about income mobility — that is, moving up the income ladder — than penalizing success.

Of course, that does not mean that some politicians will not use inflammatory rhetoric to make differences between rich and poor the focus of their campaigns in the presidential election season. In doing so, however, they should recognize the risks that government intervention in the creation and distribution of income and wealth pose for a free society and for all-round prosperity.

It should also be understood that government policies can widen gaps between rich and poor through corporate welfare, unconventional monetary policies that penalize savers while pumping up asset prices, and by imposing minimum wage laws and other legislation that prices low-skilled workers out of the market and thus impedes income mobility.

A positive program designed to foster economic growth — and let people freely choose — by lowering marginal rates for taxes on labor and capital, reducing costly regulations, slowing the growth of government, and normalizing monetary policy would be the best medicine to benefit both rich and poor.

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