SALON

The meritocracy is a lie: The wild myths that allow CEOs, hedge funders and the 1 percent to outearn us all

The rich aren't smarter than us and they don't do more for society. We must rethink how people get paid

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A few years ago I was invited to speak to a group of employees at a power plant who were considering whether to form a union. One young man who intended to vote against it told me he was worth no more than the fourteen dollars an hour he was then paid. “I say for these people making their millions, that’s fantastic. I could have done the same thing if I went to school and had the brains for it. I do not, so I’m a laborer.”

The man apparently had no knowledge of the 1950s, when more than 30 percent of the nation’s private-sector workforce was unionized. That gave the nation’s blue-collar laborers enough bargaining power to summon the equivalent (on average, and in today’s dollars) of thirty dollars an hour—even though many hadn’t finished high school. It wasn’t their brains that accomplished this. It was their bargaining clout. But the power of trade unions to negotiate good wages for hourly workers has declined markedly since then. That’s why the young man I met was “worth” no more than fourteen dollars an hour.

Yet the notion that you’re paid what you’re “worth” is by now so deeply ingrained in the public consciousness that many who earn very little assume it’s their own fault. They feel ashamed of what they see as a personal failure—a lack of brains or a deficiency of character. The same notion allows those who earn vast sums to believe they must be extraordinarily clever, daring, and superior; otherwise, they wouldn’t be doing so well. This reassuring conviction seemingly justifies not only their great wealth but also their high status in society. They would prefer not to view their money as winnings in an economic contest over whose rules they and others like them have disproportionate influence. Presumably they would prefer the public not to see it that way, either.

In 2013, the hedge-fund manager Steven A. Cohen earned $2.3 billion. During his twenty years at the helm of SAC Capital Advisors, he had amassed a fortune estimated to be around $11 billion. Was he really worth it? In the trivial, tautological sense he must have been, because that is what he earned. "Private hedge fund people only make money because others voluntarily decide that it's worth it to invest their money with them," noted Dan Mitchell of the Washington-based Cato Institute, in response to my public questioning of Cohen's pay.

But there may be a reason people decided to invest their money with Steven A. Cohen that raises a deeper question about his "worth." According to a criminal complaint filed by the Justice Department in 2013, insider trading at SAC Capital under Cohen's leadership was "substantial, pervasive, and on a scale without known precedent in the hedge fund industry." Nine of Cohen's present or former employees pleaded guilty to using insider information. The firm itself entered a guilty plea and paid a $1.8 billion fine. For years, investors had put their money into SAC Capital presumably because the firm's trades on inside information generated huge returns. Had the firm's insider trading been discovered and prosecuted earlier, those returns would not have been nearly as high, investors would not have put their money there, and Cohen's wealth would never have amounted to $11 billion (minus the $1.8 billion fine).

In other words, if unions were as strong today as they were six decades ago, the laborer I spoke with might well have earned thirty dollars an hour instead of fourteen. And if the ban on insider trading had been stronger and fully enforced, Steven A. Cohen would not have accumulated $11 billion, and his clients would not have "voluntarily" decided it was "worth it" to invest their money with him.

People are "worth" what they're paid in the market in the trivial sense that if the market rewards them a certain amount of money they must be. Some confuse this tautology for a moral claim that people deserve what they are paid. One of the most broadly held assumptions about the economy is that individuals are rewarded in direct proportion to their efforts and abilities— that our society is a meritocracy. But a moment's thought reveals many factors other than individual merit that play a role in determining earnings—financial inheritance, personal connections, discrimination in favor of or against someone because of how they look, luck, marriage, and, perhaps most significantly, the society one inhabits. "If we are very generous with ourselves," economist Herbert Simon once said, "I suppose we might claim that we 'earned' as much as one fifth of [our income]. The rest is the patrimony associated with being a member of an enormously productive social system."

This "enormously productive social system" now distributes a very large portion of the income it generates to those at its upper-most rungs—a higher portion to the one-tenth of 1 percent than in more than eighty years. This lopsidedness, in turn, is largely the consequence of how power has been allocated and utilized.

Unless one assumes that the allocation of power is just, it does not follow that people deserve what they are paid in any moral sense.

As I noted earlier, starting in the early 1980s, large corporations and their top executives, major actors on Wall Street, and other wealthy individuals have exercised disproportionate and increasing influence over how the market is organized. The basic building blocks of capitalism thereby give an advantage to the owners of capital (corporations, their shareholders, and their executives; Wall Street traders, hedge-fund managers, and private-equity managers) and handicap average workers. This helps explain why, as I have pointed out, share prices have risen while the median wage has dropped.

Higher share prices have added substantially to the incomes and the wealth of those at the top.* In the bull market that sent stocks soaring from 1994 to 2014 (the downturn from 2008 to 2011 notwithstanding), America's rich hit the jackpot. By 2010, the richest 1 percent of Americans owned 35 percent of the value of American-owned shares, both directly and indirectly through their pension plans. The richest 10 percent owned more than 80 percent. Yet most Americans did not benefit from the bull market because they were not able to save enough to invest much, if anything, in stocks. The bottom 90 percent owned just 19.2 percent, directly or indirectly. In 2014, more than two-thirds of Americans were living from paycheck to paycheck.

If the rules governing how the market is organized took full account of the benefits to society of various roles and occupations, moreover, some people would be paid far more. Social work, teaching, nursing, and caring for the elderly or for children are among the lowest-paid professions, yet evidence suggests that talented and dedicated people in these positions generate societal benefits far out of proportion to their pay. One such study found that good teachers increase the average present value of their students' lifetime income by $250,000 per classroom, for example. Presumably, if teaching jobs paid better they would attract many more such teachers.

On the other hand, the worth to society of many CEOs, hedge-fund managers, investment bankers, "high-frequency" traders, lobbyists, and high-end corporate lawyers may be less than they command in the market. Much of what they do entails taking money out of one set of pockets and putting it into another, in escalating zero-sum activity. High-frequency traders, for example, profit by getting information a fraction of a second earlier than other traders, necessitating ever-greater investments in electronic systems that give them that tiny edge. Similarly, squadrons of corporate lawyers are paid substantial sums by their clients because squadrons of corporate lawyers on the other side are paid vast sums to attack them and defend their own clients.

People in these professions do not generate discoveries that transform society or create works of art that enrich and deepen human consciousness. Their innovations are financial and tactical—finding new ways to squeeze more money out of a given set of assets, including employees, or to expropriate the assets and incomes of others. Such contests also use up the time and energies of some of the nation's most educated young people, whose talents could, one supposes, be put to more socially beneficial uses.

Just before the financial crisis, almost half of Harvard's graduating class took jobs on Wall Street. That portion dropped during the financial crisis but began rising again after 2009. According to research by sociologist Lauren Rivera, around 70 percent of Harvard's senior class routinely submit résumés to Wall Street and corporate consulting firms. The percentages are similar at other Ivy League colleges. At Princeton, close to 36 percent of 2010 graduates went into finance, down from the pre–financial crisis high of 46 percent in 2006. Add in corporate management consulting, and it was more than 60 percent.

The hefty endowments of such elite institutions are swollen with the tax-subsidized donations of wealthy alumni, many of whom seek to increase the odds that their own kids will be admitted so they too can become enormously wealthy financiers, management consultants, and corporate executives. Personally, I could think of a better way for taxpayers to subsidize occupations with more social merit: Forgive the student debts of graduates who choose social work, child care, elder care, nursing, legal aid, and teaching.

The prevailing assumption that individuals are paid what they're "worth" is a tautology that overlooks the legal and political institutions defining the market. Most fundamentally, it ignores power. As such, it lures the unsuspecting into thinking nothing can or should be done to alter what people are paid because the market has decreed it.

According to this logic, the minimum wage should not be raised because workers at today's minimum are worth no more than they are already paid. If they were worth more, they would be paid more. Any attempt to force employers to pay them more will cause employers to lay off workers. By the same logic, the median wage of the bottom 90 percent has stagnated for thirty years and dropped since 2000 because middle-income workers are worth less than they were before new software technologies and globalization made many of their old jobs redundant. The only way they can get better pay is by getting better skills, so they are worth more.

CEOs of big companies, by this reasoning, are worth every penny of their compensation packages, which fifty years ago averaged twenty times that of the typical worker but now average almost three hundred times. CEOs must be worth these sums or they wouldn't receive them. Any reduction or limitation on their pay would deter them from working as hard and as well as they do, to the detriment of all who depend on them. By the same logic, the denizens of Wall Street must be worth the tens or hundreds of millions they are paid every year because people are willing to pay them that much. Limiting their pay would reduce their incentives, distort the market, and cause the financial system to become vastly and perhaps terminally inefficient.

This fabricated logic is a substitute for clear thought. As I have shown, large corporations have increased their profits and stock prices through their influence over the basic rules of the "free market"—property, market power, contract, bankruptcy, and enforcement. A growing portion of the compensation of top corporate executives and Wall Street bankers, hedge-fund managers, and private-equity managers—who together constitute the majority of the top one-tenth of 1 percent of earners—turn on these rising profits and stock prices. To this must be added the political influence of corporate executives and Wall Street traders and managers over specific rules pertaining to fraud, conflicts of interest, insider trading, and limited liability, which also affect their compensation. An analysis of their after-tax incomes would reveal their growing influence over the effective tax rates they pay as well, but my focus here is on their more consequential and less understood roles in shaping the basic rules of the game. As I hope I make clear, the current incentives operating on the richest members of society are not at all necessary in order to get them to do the work they do, and those incentives do not in any meaningful way reflect the social value of their work relative to the value of the work that others do.