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Join the Inequality Debate

Inequality is a sign of a healthy economy — but only in a free market, without cronyist distortions.

By Brad Lips
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When Margaret Thatcher died, a little more than one year ago, several video clips from her career as prime minister made the rounds online. Among the most popular was this confrontation from her last appearance as PM in the House of Commons regarding whether we should worry about inequality. MP Simon Hughes, a Liberal Democrat, acknowledges the "substantial success" of Thatcher's reforms, but decries the widening gap between those in the top and bottom income deciles.

Thatcher restates his argument with amazement: "He would rather the poor were poorer, provided the rich were less rich!"

Later in the same session, she returns to this theme, raising her arms to show the options: a wider gap where all are elevated, or — bringing her hands closer together, while lowering them toward the level of her lectern — a narrowed gap with diminished outcomes. "So long as the gap is smaller," she said, "they'd rather have the poor, poorer. You do not create wealth and opportunity that way. You do not create a property-owning democracy that way."

The video is newly relevant given all the attention to the topic of inequality that has come from Thomas Piketty's book, *Capital in the Twenty-First Century*.

The book taps into a leftist fever to march behind a dusted-off "inequality" banner.

Long gone — with the Berlin Wall 25 years ago — is the once-prevalent idea that a planned economy could outperform a market economy. It was an idea that lasted until the bitter end; the *1989* edition of Paul Samuelson's *Economics* textbook claimed: "The Soviet economy is proof that . . . a socialist command economy can function and even thrive."

But, alas, envy is a permanent feature of the human condition, so "inequality" is likely to have ongoing political appeal.

A big problem, of course, is that envy is not healthy for the individual. It made the Top Ten list that Moses brought down from Mount Sinai, after all. Nor is it helpful for society as a whole. As Thatcher pointed out, economic policies based on reducing envy will underperform those based on creating opportunity. So while Piketty's book has several virtues, his concluding prescription of a globally imposed capital tax is problematic to say the least.

Scholars from the think-tank community have begun the important task of voicing a rebuttal to this redistributionist agenda and Piketty's justification for it.

Piketty says income inequality is growing and will continue to grow because, in his locution, "$r > g$," which is to say, Return on investment outperforms the growth of the larger economy.

The Mercatus Center's Tyler Cowen challenges the central hypothesis, pointing out that, "in too many parts of his argument, [Piketty] seems to assume that investors can reap such returns automatically, with the mere passage of time, rather than as the result of strategic risk-taking." The law of diminishing returns is unlikely to allow a risk-adjusted r to race ahead of g over time, and as a society we ought to be cautious about reducing the incentives for such risk-taking. After all, when capital is accumulated and invested, the higher capital-to-labor ratio raises the marginal value created — and the wages that can be earned — by labor.

Kevin Hassett at the American Enterprise Institute has pointed out flaws in the premise of Piketty's work. Piketty demonstrates growing income inequality, but he ignores the effect of taxes and government transfers. (I'd add that this is an odd tack to take when your solution consists of more taxes and transfers.) The U.S. Gini coefficient — measuring income disparities — has remained fairly steady over the last three decades when one factors in the effect of progressive taxation and a growing system of payments to the poor.

French economist Guy Sorman makes the same point in the Manhattan Institute's *City Journal*, while also raising his eyebrows at Piketty's embrace of income equality as an end in itself. Income inequality would be even worse than it is, Piketty tells us, but for the "shocks" of two world wars and an intervening depression that, in Piketty's language, "wiped the slate clean" and reset the accumulation of capital. Surely Piketty — who does not come across in his book as a misanthrope — would not be so singly focused on equal outcomes as to see the destruction of wealth itself as beneficial.

Michael Tanner of the Cato Institute assumes Piketty is not, and therefore focuses his argument on Piketty's remedy. If returns on capital exceed returns on labor, says Tanner, "why not expand the number of people who participate in the benefits of having capital?" That would lead to libertarian prescriptions, like transitioning Social Security to a system of privately held investment accounts, rather than a kill-the-goose-that-lays-the-golden-eggs approach to capital accumulation.

All of the above are important points in engaging an important book. They join and further substantiate Lady Thatcher's critique of those focused on inequality rather than on economic growth. We must defend the benefits of a dynamic free market against egalitarians who would "rather have the poor, poorer."

But let me conclude with a very different point. When I speak with ideological allies from unfree countries, they often cannot relate to the language we use in the U.S. in defending society's rich as “makers” who earned their success in the free market. In too many countries, systems of cronyism almost guarantee that the wealthy man has dirtied his hands along the way.

The situation in our country is not nearly so bad. The United States has an amazing number of true entrepreneurial success stories. Given that, conservatives and libertarians ought to continue to make the case that “equality of outcomes” is not a desirable goal for a free society.

But let’s not ignore the way cronyism is increasing in order to benefit a political elite and its allies on Wall Street and in certain favored industries. The resentment over inequality — which fuels the interest in Piketty’s work — is part of a larger, and legitimate, sense of the unfairness that’s baked into crony capitalism.

For this reason, we should not simply dismiss concerns about inequality. We should use the opportunity to make the case *against* cronyist government policies that reward the politically connected and distort a free and fair marketplace. The inequality premise can be seized upon to advance free-market reforms that would actually benefit the poor, and that should have us all running to join Piketty in this important debate.

— *Brad Lips is CEO of Atlas Network.*