Economic Inequality: When and How Does It Matter?

David R. Henderson
Professor of Economics
Graduate School of Business and Public Policy
Naval Postgraduate School
Monterey, California

And

Research Fellow
Hoover Institution
Stanford University
Stanford, California

June 7, 2015

Two big economic issues in recent years, both in the United States and here in Europe, are income inequality and wealth inequality. Those are not the same thing, but people who are concerned about inequality of income are almost always concerned about inequality of wealth and people who are concerned about inequality of wealth are almost always concerned about inequality of income.

You might think that the main reason for the focus on inequality is that inequality within the United States and parts of Europe has grown. But there is strong evidence that that's not the main reason. It turns out that people are generally badly informed about the degree of inequality and about where they themselves are in the distribution. Two researchers, Vladimir Gimpelson of the Higher School of Economics in Moscow and Daniel Treisman of the political science department at the University of California in Los Angeles, conducted a fascinating study recently. For people in 40 countries, they compared what people *thought* the income distribution looked like with what the income distribution actually was. They found little connection. Specifically:

> Respondents turn out to be wrong about their country's income distribution most of the time. Worldwide, 29 percent of respondents chose the "correct" diagram if we refer to their country's post-tax-and

> transfer Gini and 24 percent got it right if we use the pre-tax-and-transfer measure. For reference, a purely random choice among the five possible answers would get the answer right 22.5 percent of the time for post-tax-and-transfer incomes and 20 percent of the time for pre-tax-and-transfer incomes. In other words, respondents worldwide were able to pick the "right" diagram only slightly more often than they would have done if choosing randomly.

Moreover, found Gimpelson and Treisman, no matter which country they studied, they found that few people think they're poor and almost no one thinks they're rich.

It's more likely that the concern in the United States is among the "chattering classes" rather than in the population in general. This concern arose because various commentators started talking about it a lot in the 1990s and have never stopped, and because two candidates for President, Al Gore in 2000 and Barack Obama in 2008 and 2012, made such a big issue of it. Once elected, Obama kept talking about inequality also. One of Obama's biggest goals in political life, certainly one that he is very passionate about, is to impose higher taxes on high-income people.

Of course, another reason for the focus on inequality in both United States and Europe is the publication of French economist Thomas Piketty's best-selling book *Capital in the Twenty-First Century*. But even though it's a best-seller, that doesn't mean that people who buy it actually read it. Jordan Ellenberg, a mathematics professor at the University of Wisconsin, checked the five passages of Piketty's book that were most highlighted on Kindle, and found that the last of the five was on page 26 of this almost-700-page book.[1] It appears that people read enough of Piketty's book to use his views as backing for beliefs that they already hold.

[1] Jordan Ellenberg, "The Summer's Most Unread Book Is . . .", *Wall Street Journal*, July 3, 2014. http://www.wsj.com/articles/the-summers-most-unread-book-is-1404417569

I did read ALL of Piketty's book: not just the 577 pages of text but also the 76 pages of footnotes. So I will refer to Piketty's views in making my case about inequality.

Here, in brief, is *my* message.

There are two important philosophical questions. First, is there something inherently wrong with a large gap in income or wealth within a country? My answer is no. Second, does it matter why that gap exists? My answer is yes.

There are also important factual issues. First, we need to understand the role of age in income inequality. Second, we need to remember the tremendous increase in economic wellbeing in Europe, in America, and, increasingly, in other parts of the world. Third, we need to distinguish between a large degree of inequality and a large degree of poverty.

I also want to consider what arguments there would be for worrying about inequality.

And finally, I will touch briefly on government policies that we could implement that would reduce inequality, reduce the role of government, and increase the wellbeing of those at the bottom.

The Philosophical Issue: When Are Large Differences in Wealth Justified?

I'll tell two true stories.

The Chainsaw Innovator

The first is about Robert McCulloch. In 1949 his McCulloch Motors Corporation introduced a light one-man chainsaw called the 3-25. One-man chainsaws already existed. But McCulloch figured out how to make a *light* one-man chain saw: the 3-25

weighed only 25 pounds. This revolutionized forestry. An economist friend of mine, who is now in his eighties, told me that when he was a teenager, his father made him cut the wood for a whole winter of heating a large house. When my friend found out about the 3-25, he used his own allowance to buy one. It changed his life.

Robert McCulloch made a lot of money with his chainsaw. But every one of the 112,000 3-25s sold[2] was sold to someone who wanted it. Almost all of them, like my friend, likely got a large benefit from the purchase. (We economists call it "consumer surplus.") In short, McCulloch got richer--and so did his customers.

That's not the end of the story. Other competitors produced chainsaws to compete with McCulloch's. They produced either better chainsaws or cheaper chainsaws or both. That increased the benefits to consumers and reduced the profits to McCulloch's company. Did McCulloch get as much as half of the total social surplus he created? Probably not. Yale University economist William Nordhaus has estimated that on average only "2.2 percent of the total present value of social returns to innovation are [sic] captured by innovators."[3]

So both McCulloch and his customers were better off. And, although McCulloch probably earned only a small percent of the value he created, a small percent of a large number is a medium-sized number. So this one change due to McCulloch almost certainly *increased* income inequality. I see no problem with that increased inequality. So my answer to the first philosophical question—"is there something inherently wrong with a large gap in income or wealth"—is no.

---

[2] This number is from "The Chainsaw that Cut Out the Competition," at: http://www.mcculloch.com/int/newsroom/the-chainsaw-that-cut-out-the-competition/

[3] William D. Nordhaus, "Schumpeterian Profits in the American Economy: Theory and Measurement," National Bureau of Economic Research, Working Paper #10433, April 2004.

Which brings me to the second philosophical question: Does it matter why the gap exists? I consider the case of the privilege seeker.

The Privilege Seeker

The second story is of someone with modest income and wealth who used political power to make himself and his wife very wealthy. The cornerstone of their fortune was a license from the Federal Communications Commission (FCC) to operate a radio station. The FCC is the federal regulatory agency that grants radio and television licenses. In 1943, he and his wife had a net worth of approximately zero. But by 1964, when he was elected President of the United States, their net worth was at least $14 million, and the radio station's value accounted for about half of this $14 million. The congressman's and President's name: Lyndon B. Johnson.

LBJ's claim during his 1964 campaign for President was that his wife, who owned radio station KTBC in Austin, Texas, had turned an asset she bought for $17,500 into a property worth millions by working hard. Not quite. Instead, as Robert Caro dramatically documents in his masterful biography *The Years of Lyndon Johnson: Means of Ascent,*[4] LBJ was the one who worked hard—at using his political influence. Between December 1939 and January 1943, despite countless attempts, KTBC's owners had been unable to get permission from the FCC to let them sell the station. But on January 3, 1943, Mrs. Johnson filed her application to buy the station and just 24 days later, after having previously waited over three years, the owners were allowed to sell. In June 1943, Mrs. Johnson applied for permission to operate 24 hours a day, up from daylight hours only, and at a much better part of the AM frequency. She was granted permission just one month later. While all this was happening, the FCC was under attack by a powerful congressman named Eugene Cox. Lyndon Johnson strategized secretly with FCC official Red James and used his

[4] Robert A. Caro, *The Years of Lyndon Johnson: Means of Ascent,* New York: Alfred A. Knopf, 1990, pp. 82–111.

influence with House speaker Sam Rayburn to deflect the attack. In fact, James later admitted that he had recommended to Mrs. Johnson that she apply for the license. Moreover, a *Wall Street Journal* article in 1964 suggested that favorable decisions by the FCC "played a crucial part in establishing the Texas Broadcasting Corporation's effective monopoly on broadcasting in the Austin area."[5]

In going from being a middle-income and low-wealth couple to being a relatively high-income and wealthy couple, Lyndon and Lady Bird Johnson contributed to increased inequality.

So here we have two examples in which income and wealth inequality increased. In the first case, though, inequality increased because a man's company introduced a product that made the lives of those who bought it substantially better, thus increasing their well-being and their real income. In the second case, inequality increased because a politician used his influence to get a special privilege from a government agency. The government's further actions protected a government-granted monopoly for many years, which caused the real income of people in the broadcast area of Austin to be lower than otherwise.

Should we think differently about these two cases? I think we should, for two reasons. The less important reason is that McCulloch's actions made, not just himself, but also others, better off and Lyndon Johnson and his wife's actions did not clearly make other people better off. But what's responsible for this less-important reason is a more-important reason. The increase in real income to McCulloch's customers came about because of a voluntary transaction in the marketplace. The increase in wealth to LBJ and his wife came, not due to market transactions per se but due to his use of raw political power.

---

[5] The quote is actually not from the Wall Street Journal but from David Shreve, *Lyndon B. Johnson: Towards the Great Society, February 1, 1964-May 31, 1964*, p. 347. Shreve was summarizing the *Wall Street Journal* finding.)

If these two tales were only of two people, they would not matter much. But a large percent of the wealth of the wealthy is due to government restrictions. Among the most important restrictions in the United States, especially in the Northeast and on the West Coast, are those on building housing. Here's urban economist Randall O'Toole commenting on a recent critique of Thomas Piketty by Matthew Rognlie:

> "Is capital income displacing labor income?" asks Rognlie in a Brookings paper. "Only if you count housing." As *The Economist* summarizes Rognlie's results, "surging house prices are almost entirely responsible for growing returns on capital," which means that "rising house prices may be chiefly responsible for rising inequality." As a result, Rognlie concludes, Piketty should have titled his book, *Housing in the Twenty-First Century.*[6]

And, it should be added, those surges in housing prices over the last few decades have been due, as Harvard economist Edward Glaeser and Wharton economist Josephy Gyourko[7] have shown, mainly to restrictions on building.

It is difficult to know whether most economists who study inequality think about the difference between the two ways. Most of them tend to look at aggregate data on incomes and wealth and don't even ask how people acquired the incomes or wealth. They might point to particular sources of income—capital income vs. labor income, for example—but that way of dividing income does not tell us whether the income was due to production of a valuable good or service or due to the exercise of political power.

But one thing we do know is that at least some economists, including some of the most prominent economists who have written about inequality, do not seem to care much about the distinction between the two ways of getting income. The reason I

[6] Randall O'Toole, "Housing and Wealth Inequality," *Cato at Liberty*, April 2, 2015. At: http://www.cato.org/blog/housing-wealth-inequality

[7] Edward L. Glaeser and Josephy Gyourko, "The Impact of Zoning on Housing Affordability," NBER Working Paper #8835, March 2002.

say that is that many of these economists advocate higher taxes on higher-income or wealthy people, irrespective of how they got that higher income or wealth. In their proposed tax schemes, the political player who gets his million dollar a year income from a government subsidy for building a football stadium would be taxed at the same rate as the entrepreneur who gets his income by producing a better pizza. Typical, for example, is economist Joseph Stiglitz, former chairman of President Clinton's Council of Economic Advisers. In his textbook, *Economics of the Public Sector,* he writes:

> Consider again a simple economy with two individuals, Robinson Crusoe and Friday. Assume initially that Robinson Crusoe has ten oranges, while Friday has only two. This seems inequitable. Assume, therefore, that we play the role of government and attempt to transfer four oranges from Robinson Crusoe to Friday, but in the process one orange gets lost. Hence Robinson Crusoe ends up with six oranges, and Friday with five. We have eliminated most of the inequity, but in the process the total number of oranges available has been diminished. There is a trade-off between efficiency — the total number of oranges available — and equity.

Notice that Stiglitz does not bother to tell us *how* Crusoe and Friday obtained what they have. He doesn't tell because the process is irrelevant to him; all that matters is the end state. He initially qualifies his statement by saying it "seems" inequitable rather than it is inequitable, but by the end of the paragraph, the qualification is gone and Stiglitz comes right out and says that inequality is inequitable. Stiglitz is not alone. Many economists move almost seamlessly between the words "equity" and "equality" as if they were interchangeable.

To his credit, Thomas Piketty *does* recognize the difference between making a fortune and grabbing a fortune. In this respect, he is one up on Joseph Stiglitz. That's the good news. The bad news is that, when it comes to actual government policy, he throws up his hands at being able to distinguish empirically between the two. In his book, after pointing out specific instances of what he regards as fortunes acquired unjustly, Piketty writes:

> In any case, the courts cannot resolve every case of ill-gotten gains or unjustified wealth. A tax on capital would be a less blunt and more systematic instrument for dealing with the question.[8]

It seems to me that a tax on capital would be extremely "blunt." It would also be profoundly unjust.

The Factual Issues

In discussing inequality, it's important to know some important facts. One fact is about how age affects one's place in both the income distribution and the wealth distribution. A second fact is that in Europe and in America, there has been over the last 200 years, a tremendous growth in economic wellbeing. A third fact is that there's a huge distinction between inequality and poverty.

The Role of Age in Inequality

We all know that most young adults start out with a low income and, as they age, acquire skills and experience that increase their income. Their wealth grows even faster. As our incomes grow, so also, for most of us, our rate of saving grows and our savings, if invested in bonds and stocks, earn interest and dividends. A well-known story, which may not be true, is that the famous Swiss citizen Albert Einstein, when asked what was the most powerful force in nature, replied: "Compound interest."

So even if everyone of a given age had the same wealth, older people would have substantially more wealth than younger people. This slide shows that the wealth of households where the head is over 65 is approximately 25 times the wealth of households where the head is under 35.

---

[8] Thomas Piketty, *Capital in the Twenty-First Century*, Cambridge, MA: Bellknap Press of Harvard University Press, 2014, p. 446.

The Growth in Economic Wellbeing

In the introduction to his book, Piketty writes:

> It is long past the time when we should have put the question of inequality back at the center of economic analysis and begun asking questions first raised in the nineteenth century.

The *center*? Really? That's a strong statement. To say that inequality should be at the *center* of economic analysis is to say that it is more important than *any other question in economics*.

If we put inequality at the center, we can easily miss the tremendous growth in well-being for a huge percentage of people in the world and for almost everyone in the United States and Western Europe. Much later in the book, Piketty shows that he is aware of those improved conditions, writing:

> Nevertheless, according to official indices, the average per capita purchasing power in Britain and France in 1800 was about one-tenth what it was in 2010. In other words, with 20 to 30 times the average income in 1800, a person would probably have lived no better than with 2 or 3 times the average income today. With 5–10 times the average income in 1800, one would have been in a situation somewhere between the minimum and average wage today.

Maybe there's a reason that economists 200 years ago put distribution at the center of economic analysis and until recently, economists have not. When we're all doing better and better, we don't care very much about distribution.

In his own way, Piketty is pointing out, albeit less dramatically, what University of California, Berkeley economist Brad DeLong noted in a study aptly titled "Cornucopia." In that well-argued and documented paper, DeLong examines the 20th century and shows that the price of almost every item we buy—if stated in hours of labor required to earn enough to pay for it—has fallen to a fraction of its cost in 1900.

Moreover, that reduction in cost *understates* the improvement in well-being because many crucial items that we buy today did not exist in 1900. Antibiotics, for example, are a 20th century invention. Their price in 1900 was effectively infinite.

The Distinction Between Income Shares and Absolute Income

Imagine—as Piketty has convinced me seems at least plausible—that the share of income going to owners of capital could rise over time, which means that the share of income going to labor would fall. Would that mean that laborers would become worse off? Not at all. In fact, they are likely to be better off.

Throughout his book, Piketty writes as if he thinks that wealth is zero-sum and, thus, that increases in various groups' wealth *must* come at the expense of others. Writing about early 19th-century France, for example, he refers to a "transfer of 10 percent of national income to capital." But a look at his Figure 6.1, on which he bases this claim, shows no such transfer. All it shows is that the share of income going to capital rose. Similarly, in discussing the United States in the late 20th century, he calls an increase in the income share of the top 10 percent an "internal transfer between social groups." Never mind that on the very same page, he admits that income for the bottom 90 percent slowly grew over that same period.

Or consider Piketty's statement about the United States and France: "And the poorer half of the population are as poor today as they were in the past, with barely 5 percent of total wealth, just as in 1910." That is nonsense. If the poor have the same percentage of wealth as they had in 1910, they are much richer because wealth is much greater, as Piketty well knows. Here, he has gone beyond misleading language into actual error.

Ask yourself this: What if you can choose to push button A or button B. With button A, we have zero growth or slow growth but we reduce inequality. With button B, we

have higher growth, with people at the bottom rising but people at the top rising even more so that inequality increases? Which button would *you* push? I would push button B. If we take Piketty at his word, then he would have to push button A.

Why do I say that Piketty would push button A? Because he favors much higher taxes on wealthy people. He argues that the optimal top income tax rate in richer countries is "probably above 80 percent." He claims that such a rate on incomes above $500,000 or $1 million "will not bring the government much in the way of revenue"—I agree—but will drastically reduce the pay of high-paid people. He also suggests an annual "global tax on capital," with rates that would rise with wealth. "One might imagine," he writes, "a rate of 0 percent for net assets below 1 million euros, 1 percent between 1 million and 5 million, and 2 percent above 5 million." One might imagine many things: I take it, as virtually every reviewer pro or con has, that Piketty is not just "imagining" those taxes, but actually *advocating* them. He even says "one might prefer" a stiff annual tax of "5 or 10 percent on assets above 1 billion euros."

Incentives matter. An annual tax on capital would reduce the incentive to create capital. With less capital than otherwise, the marginal product of workers will be lower than otherwise. With workers' marginal product being lower than otherwise, real wages will be lower than otherwise. In short, Piketty's proposed tax on capital would *hurt* labor.

How does Piketty handle this serious problem? He does not. The only behavioral response to a tax on capital that he discusses at length is that owners of capital would move to lower-tax countries. And to avoid that happening, he puts a lot of thought into how to form, essentially, a tax "cartel" in Europe. He would have countries in the European Union agree to tax capital, making it harder for people to move to lower-tax countries.

Even an economist who likes Piketty's book and favors his tax on capital has pointed out its bad effects on economic well-being. In his *New Republic* review, MIT economist Robert Solow, who won the Nobel Prize in economics for his pioneering work on economic growth, wrote:

> The labor share of national income is arithmetically the same thing as the real wage divided by the productivity of labor. Would you rather live in a society in which the real wage was rising rapidly but the labor share was falling (because productivity was increasing even faster), or one in which the real wage was stagnating, along with productivity, so the labor share was unchanging? The first is surely better on narrowly economic grounds: you eat your wage, not your share of national income. But there could be political and social advantages to the second option. If a small class of owners of wealth—and it is small—comes to collect a growing share of the national income, it is likely to dominate the society in other ways as well.

It appears that Robert Solow would push button A as well. But he certainly recognizes the consequences.

Also, Solow recognizes clearly the distinction between absolute income and income shares. That's what he means when he says "you eat your wage, not your share."

Inequality and Poverty

Many scholars fail to distinguish between inequality and poverty. Mark Thoma of the Economist's View website, recently wrote:

> Recent research (summarized here) from UCLA's Fielding School of Public Health provides evidence that income inequality is associated with inequality in health. In particular, lower income is associated with "high levels of stress, exhaustion, cardiovascular disease, lower life expectancy and obesity." These factors alone could lead to lower economic growth than we would have if the work force were healthier.[9]

---

[9] Mark Thoma, "How Inequality Harms Health—and the Economy," March 6, 2015, at: http://www.cbsnews.com/news/inequality-is-bad-for-health-and-bad-for-the-economy/

The research that Thoma cites might be first-rate. But notice what it says: *lower income* is associated with those bad health outcomes. It does not say that higher inequality is associated with those bad outcomes. If we could reduce inequality while leaving lower income people with the exact same level of income they would have had, would the health of those lower-income people improve? It's hard to see how.

How Big a Problem are Wealth Inequality and Income Inequality?

For Piketty and, presumably, Solow to calmly countenance the possibility of stagnating real wages just to keep capital's share from increasing, they would have to see some large problems with increasing inequality. Solow does not point out any such problems, which makes sense because his review is short. But Piketty, in over 600 pages, does not make a clear statement about why increasing inequality is a problem even in a society where almost everyone's lot in life is getting better and better.

So let's fill in the gaps. How big a problem are wealth inequality and income inequality? I see five main possibilities:

1. Much of the inequality in wealth is due to people using government to make themselves better off at the expense of others.
2.People who are not in the top fifth have very little.
3. Those with great wealth or high incomes use their wealth to dominate those with little wealth and low incomes.
4. Those with great wealth have a disproportionate influence in the political system, an influence that they use to rig the system against those in the bottom end.
5. Those at or near the bottom feel bad when they see people with great wealth.

I'll consider each in turn.

1. *Much of the inequality in wealth is due to people using government to make themselves better off at the expense of others.*

This is a problem. It's like the example I discussed earlier about Congressman Lyndon Johnson using the political system to make him and his wife wealthy at the expense of people in Texas. It's also like the example I discussed earlier of people in my position who own expensive homes using the political system to slow or stop new housing developments. There's a solution: let people build.

2. *The well being of those not in the top fifth.*

I discussed this earlier. The best hope for people below the top fifth is economic growth and the best way to get economic growth is to have more, not less, economic freedom. One component of economic freedom is low taxes on income and wealth so that people are encouraged to invest and the higher resulting capital stock increases the real incomes of workers who work with that capital.

3. *Domination by the rich.*

In the mid-19th century, the poorest people in American were probably slaves. That was awful. The largely rich people who "owned" them could treat them very badly if they wanted to. And even if they did not want to, let me repeat that these poor people were *slaves*. There is nothing like that today. Even the poorest people have choices. And rich people do not dominate.

4. *The disproportionate influence of the rich on the political system.*

It turns out, according to political scientists Gilens and Page (2014)[10], that the rich *do* have a disproportionate influence on U.S. federal government policy. They write:

> [Our findings] certainly constitute troubling news for advocates of "populistic" democracy, who want governments to respond primarily or exclusively to the policy preferences of their citizens. In the United States, our findings indicate, the majority does not rule -- at least not

[10] Gilens, Martin and Benjamin I. Page, "Testing Theories of American Politics: Elites, Interest Groups, and Average Citizens," *Perspectives on Politics*, 12 (3), September 2014: 564-581.

> in the causal sense of actually determining policy outcomes. When a majority of citizens disagrees with economic elites and/or with organized interests, they generally lose.

This sounds bad. But notice, as my co-blogger Bryan Caplan has pointed out,[11] that they do not find that the political system responds disproportionately to the *interests* of the rich; they find that it responds to the *preferences* of the rich. It is reasonable, before judging whether the disproportionate influence of the rich is bad, to compare their opinions on policy to the opinions of the median voter. If the rich favor free trade more than the median voter does, for example, as I believe they do, then it's good that the system tends to reflect their views more. One might argue that the system should reflect the views of voters: but that argument flies in the face of basic morality. I think we can agree with Hayek that Hitler was a bad man and that it would have been better had he not been elected. Yet, in the last German election of the 1930s that could legitimately be called an open and fair plebiscite, the election of March 5, 1933, Hitler received a whopping 44 percent of the vote and the party with the next highest percent received only 18 percent of the vote.[12]

The relevant question is whether those at the top tend to rig the system against those at the bottom. Empirically, whether they do tends to vary with the issue. The top fifth of Californians, for example, tend to lobby against allowing people to have building permits. This restricts the supply of housing and raises the prices of houses and rental rates on apartments and houses. So that seems to be a clearcut example of rigging the system. Changing that would be hard. But one change that would appear to be unlikely to free up the supply of housing would be to impose higher taxes on income and wealth.

5. *Those at or near the bottom feel bad when they see people with great wealth*.

---

[11] Bryan Caplan, "The Logic of Gilensian Activism," Econlog, September 15, 2014, at: http://econlog.econlib.org/archives/2014/09/gilens_page_and.html

[12] http://en.wikipedia.org/wiki/German_federal_election,_March_1933

The evidence is actually that people don't know much about the income or wealth distribution. So even if various measures were taken that increased inequality or decreased inequality, the vast majority of people would not know that inequality changed. Most people who get upset about differences in wealth or income get upset about local differences, not national ones. They notice that their co-worker or their brother in law has a nicer car, lives in a nicer house, or takes an expensive trip to Europe or Asia. Changes in national policy would do virtually nothing to change those local—and small—differences.

Policies to Reduce Economic Inequality

Although I do not think economic inequality—of either wealth or income—is a problem per se, I do think lack of economic freedom is a problem. Also some reductions in economic freedom have increased economic inequality. So it makes sense to reduce or abolish government regulations that have both reduced economic freedom and increased economic inequality.

There's a long list of such regulations. I will mention four.
1. Occupational licensing
2. The minimum wage law
3. Laws against drugs, and
4. Restrictions on immigration.

1. *Occupational licensing*
There are about 800 occupations in the United States for which some states require people to be licensed in order to practice. Not only doctors and lawyers, but also hairdressers, interior designers, dieticians, and nutritionists, must get government permission before they can work in their chosen professions. These restrictions make it harder for people who want to enter those professions. They therefore go to less-desirable occupations where they either make less money or are less satisfied with their jobs. It is likely that such restrictions hurt people at the bottom end more

than those at the top end. My solution: end such restrictions. The only possible pro-consumer rationale for such restrictions is to weed out the low-quality practitioners. People in the free market have been very creative at figuring out how to report on the quality of various providers, with Yelp and other web sites. The result would be a gain to consumers and a gain to workers who want to practice.

2. *The minimum wage*

The minimum wage law does not guarantee that workers will earn good wages. All it guarantees is that someone who is hired will earn the minimum wage. But it is the very fact of the minimum wage that makes it difficult for low-productivity workers to be hired. Ending the minimum wage, or reducing it by 50 percent, would make it easier for many unskilled workers to get on the first run of the economic ladder—and to acquire skills.

3. *Laws against drugs*

We often hear a lot about "the top 1%." We hear much less about the bottom 1%. In the United States, almost everyone in the bottom 1% is in prison, where they often make wages under one dollar an hour. And many of those people in prison are there for consuming, producing, transporting, or selling illegal drugs. Abolishing the drug laws would do more to reduce economic inequality of people currently in the United States than any other measure I can think of. I don't have time here to make a full case for ending the drug laws. I assure you that have I been thinking and reading about this issue for about 40 years, and that I did not come to my views lightly. Almost all of the problems that we associate with illegal drugs are not due to drugs per se but, instead, are due to the fact that they are illegal.

4. *Immigration laws*

So far, I have talked only about economic inequality within a country. But there is a much bigger inequality—in income and wealth—in the world. All but the poorest 10 percent of people in America, for example, are richer than all but the richest 10 percent of people in India.

There's one main reason for this: laws that restrict immigration. Workers who leave the poorest countries to come to Switzerland, Germany, the United States, or my native Canada, can earn incomes that are 5 to 10 times as high as the incomes in the places they left. In an article in last month's *Review of Economics and Statistics*, economist Branco Milanovic points out that less than 3% of the world's population lives in countries where they were not born, and writes:

> [A]s the differences between mean country incomes are large—more than two-thirds of global inequality between individuals is due to national income differences—to what nation one gets ''allocated'' is indeed of significant import for one's life chances.

Ending immigration laws, therefore, would do more to reduce worldwide inequality than any other single measure I can think of. Perhaps you're not willing to advocate ending all immigration barriers—and I can understand why. But a major increase in world wealth and a major drop in income inequality would happen if countries that currently restriction immigration would simply double the number of people allowed in annually. If you're worried about new immigrants voting away the system that creates wealth or taking advantage of the welfare state, then there's a solution: have a 20-year residency requirement before they can vote or collect welfare.

Coda

Income and wealth inequality are problems only to the extent that they result from restrictions on people's freedom. Over the long run, economic freedom will make virtually everyone better off, as it has in the past. Even those who are less confident than I about the effects of economic freedom should at least get their story straight: most of the problems alleged to be due to higher inequality—at least the problems that are real problems—are not due to higher inequality but, instead, are due to low income. So let's focus on that and forget about inequality.