

July 24, 2007

OP-ED COLUMNIST

## A Reality-Based Economy

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If you've paid attention to the presidential campaign, you've heard the neopopulist story line. C.E.O.'s are seeing their incomes skyrocket while the middle class gets squeezed. The tides of globalization work against average Americans while most of the benefits go to the top 1 percent.

This story is not entirely wrong, but it is incredibly simple-minded. To believe it, you have to suppress a whole string of complicating facts.

The first complicating fact is that after a lag, average wages are rising sharply. Real average wages rose by 2 percent in 2006, the second fastest rise in 30 years.

The second complicating fact is that according to the Congressional Budget Office, earnings for the poorest fifth of Americans are also on the increase. As Ron Haskins of the Brookings Institution noted recently in *The Washington Post*, between 1991 and 2005, "the bottom fifth increased its earnings by 80 percent, compared with around 50 percent for the highest-income group and around 20 percent for each of the other three groups."

The third complicating fact is that despite years of scare stories, income volatility is probably not trending upward. A study by the C.B.O. has found that incomes are no more unstable now than they were in the 1980s and 1990s.

The fourth complicating fact is that recent rises in inequality have less to do with the grinding unfairness of globalization than with the reality that the market increasingly rewards education and hard work.

A few years ago, the rewards for people earning college degrees seemed to flatten out. But more recent data from the Bureau of Labor Statistics suggests that the education premium is again on the rise.

Fifth, companies are getting more efficient at singling out and rewarding productive workers. A study by the economists Thomas Lemieux, Daniel Parent and W. Bentley MacLeod suggests that as much as 24 percent of the increase in male wage inequality is due to performance pay.

Sixth, inequality is also rising in part because people up the income scale work longer hours. In 1965, less educated Americans and more educated Americans worked the same number of hours a week. But today, many highly educated people work like dogs while those down the income scale have seen their leisure time increase by a phenomenal 14 hours a week.

Seventh, it's not at all clear that the big winners in this economy are self-dealing corporate greedheads who are bilking shareholders. A study by Steven N. Kaplan and Joshua Rauh finds that it's not corporate honchos

who are filling up the ranks of the filthy rich. It's hedge fund managers. Or, as Kaplan and Rauh put it, "the top 25 hedge fund managers combined appear to have earned more than all 500 S.&P. 500 C.E.O.'s combined." The hedge fund guys are profiting not because there's been a shift in social norms favoring the megarich. It's just that a few superstars are now handling so much capital.

Eighth, to the extent that C.E.O. pay packets have thickened (and they have), there may be good economic reasons. The bigger a company gets, the more a talented C.E.O. can do to increase earnings. Over the past two and a half decades, the value of top U.S. companies has increased 500 percent, according to Xavier Gabaix and Augustin Landier. The compensation for the C.E.O.'s of those companies has also increased 500 percent.

Ninth, we're in the middle of one of the greatest economic eras ever. Global poverty has declined at astounding rates. Globalization boosts each American household's income by about \$10,000 a year. The U.S. economy, despite all the bad-mouthing, is chugging along. Thanks to all the growth, tax revenues are at 18.8 percent of G.D.P., higher than the historical average. The deficit is down to about 1.5 percent of G.D.P., below the historical average.

All of this is not to say everything is hunky-dory. Inequality is obviously increasing. There's evidence that global trade is producing more losers.

Instead, the main point is that the Democratic campaign rhetoric is taking on a life of its own, and drifting further away from reality. Feeding off pessimism about the war and anger at Washington, candidates now compete to tell dark, angry and conspiratorial stories about the economy.

I doubt there's much Republicans can do to salvage their fortunes by 2008. But over the long term a G.O.P. rebound can be built by capturing the Bill Clinton/Democratic Leadership Council ground that the Democrats are now abandoning. Whoever gets globalization right will have a bright future, and in the long run, the facts matter.

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