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# Some Thoughts on Inequality from a Classical Liberal Perspective

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Mikayla Novak's new book is a welcome addition to several ongoing conversations in the intellectual world. First, it brings some important ideas and perspectives to the debate over inequality. Second, it makes a strong and ultimately persuasive case that classical liberal scholars should not be simply dismissing concerns about inequality and should, instead, be finding ways to explore its causes and effects using our set of analytical tools. Finally, she attempts to add to that set of tools by discussing inequality using Richard Wagner's "entangled political economy" framework. One of the strengths of the book is that she is an excellent interpreter of Wagner's framework and offers some concrete examples of how it can be applied to the theoretical and policy issues surrounding inequality. I believe it is the first attempt to engage in this sort of extended and detailed application of Wagner's ideas. All three of these are valuable endeavors and Novak mostly succeeds in making her case.

What I would like to do in this essay is two things. First, I want to address a few minor concerns I have about the book itself. I then want to use the book as a launching point to talk about four issues related to inequality that are not treated in depth in the book, but are ones I believe are crucial for classical liberals to address if we are going to make real contributions to the broader discussion. Specifically, I will have more to say about:

1. the role of fairness with respect to inequality
2. the importance of considering the regressivity of various forms of inequality
3. the way in which income mobility is relevant for our concerns about inequality
4. whether consumption inequality is a better metric than income or wealth inequality.

My comments on those four areas do not provide any easy answers to questions about just how much inequality has grown in recent years, nor what, if anything, classical liberal scholars might suggest we do about it. Rather, I raise them as issues that need to be a significant part of any dis-

cussion of inequality and that classical liberals are well-positioned to address.

## THOUGHTS ON NOVAK'S APPROACH

As I suggested above, perhaps the most important strength of the book is that it takes inequality seriously from a classical liberal perspective. And it takes both the problems of inequality and the possible growth in inequality seriously not just as myths that need to be busted by classical liberalism, but as real issues that classical liberal scholars should be confronting. Too often, classical liberal treatments of inequality either attempt to deny that inequality is growing in the way that critics of that growth claim or they argue that all changes in inequality are benign. Both positions are unlikely to be persuasive to those who think inequality is, in fact, growing, and that either that growth or inequality *per se* are socially problematic. They should be unpersuaded by both arguments because there are good reasons to believe that at least some sorts of inequality are problematic and that some of those sorts of inequality are growing. Novak is to be complimented for starting from the premises that inequality of some sorts might be getting worse and that some of that worsening inequality is a problem.

Though Novak does not always phrase it this way, one of the themes running through her argument is that concerns about inequality have to be addressed within the larger context of economic growth and, especially, how such growth affects the least well-off. From the start, she grapples with the distinction discussed at some length in my work with Vincent Geloso (Geloso and Horwitz 2017) between socially beneficial (or at least benign) and socially harmful causes of inequality. For example, demographic factors such as divorce might explain some of the growth in measured inequality, as more frequent divorce means more two-income households splitting into two households each with less income. Similarly, an increase in low wage workers via immigration would increase measured inequality, as would increasing returns to innovation. The question is whether

those causes of inequality are problematic. To the degree that immigrants earn better wages here than in the countries they left, and that the benefits of innovation are widely dispersed in better living standards, including and often especially for the least well-off, then these sources of inequality should not trouble us. Any policies we might undertake to offset those changes in inequality would do much more harm than good because of their negative effects on growth and other desirable economic changes. By contrast, socially harmful causes of inequality are ones that are the focus of Novak's attention. Are there causes of inequality that also undermine economic growth? Are there causes of inequality that are regressive in their redistributive effects? Would eliminating these sources of inequality be consistent with maintaining the institutional framework associated with classical liberalism? In other words, are some of the causes of inequality because modern entangled political economies have strayed from the principles of classical liberalism?

Note that this last question does not imply that a classical liberal world of limited government, the rule of law, respect for private property and markets, and sound money would be one in which various forms of inequality did not exist. To the contrary, as our good/bad distinction above suggests, many of the desirable things we expect from market economies (e.g. innovation) will bring inequality in their wake. The question is a very Rawlsian one: under what sorts of economic systems will inequalities work to the benefit of the least well-off, or at least promote generalized economic growth that all can partake in? Disentangling the benign or beneficial inequalities that emerge from generalized economic growth or demographic changes from those inequalities that undermine growth or harm the least well-off is the key to a sophisticated understanding of the economics of inequality. Novak gets this distinction and much of her book is devoted to trying to understand what sorts of policies cause the problematic growth in inequality and what we might do to reverse those forms of inequality while not undermining the processes that produce benign changes in inequality. I believe this is the best way to approach inequality from a classical liberal perspective.

The critical question for Novak's book in particular is how helpful the entangled political economy perspective is in forwarding the classical liberal analysis of inequality. I am a fan of Wagner's work, and I think the notion of "entanglement" is useful as a way to distinguish really-existing economies from models in which the analyst assumes that the political sector acts independently and exogenously

on the economy. Seeing political action in markets as arising endogenously from actors within the larger nexus of exchange has always been at the core of public choice theory. It forces us to rethink a number of things at the conceptual level, e.g., whether describing government action as "intervention" doesn't just assume away the entanglement that Wagner emphasizes.

What I am not totally persuaded by is that the entangled political economy approach adds real value over traditional market process and public choice perspectives on inequality. Two examples from Novak's book illustrate the strengths and weaknesses. I think the language of "dyadic" and "triadic" exchanges is very helpful for understanding what's happening when we use the political process as a means for advancing our interests. Market exchanges are dyadic in that they involve two parties, while the essence of political action is that they involve three parties: taxpayers or others providing resources, those who receive those resources, and the party that forces the transfer to happen. Unlike dyadic exchanges, triadic exchanges are not assured to benefit all parties for reasons that traditional public choice theory has laid out. This language enables us to see more clearly what is ultimately happening when the political process is invoked, and nicely captures the endogeneity of political action as well as the long-standing insight that politics is also a form of exchange. Novak puts this to good use in examining the ways in which poor public policy has exacerbated inequality.

What was less helpful, I would argue, are the Wagner-style diagrams. I found myself working pretty hard to understand what those nodal-network diagrams were trying to illustrate, and I'm not sure it helps to clarify the issues Novak is addressing to make readers work that hard. I don't think this was a problem with her explanations of the diagrams, but more a problem of the diagrams themselves. I am skeptical of whether the benefits here are worth the costs, but perhaps other readers found them less of a barrier.

I do have one final complaint about the book that I raise somewhat hesitantly, but that concerns me about how influential the book will be. I found this a difficult book to read for another reason. The writing style is full of passive voice expletive constructions, often with one or more per paragraph. It makes sentences unnecessarily long and forces the reader to have to figure out who or what the subject is in ways that detract from the argument. This is particularly important when Novak is dealing so well and so thoroughly with so many sources. Sentences that begin "It is

argued by many that...” force the reader to wait until the end to find out who is doing the arguing, and by that point, the meat of the sentence has faded into the past. Perhaps this too was not a problem for other readers, but it was so pervasive throughout the book that I worry it will raise the costs of dealing with the very important arguments Novak is making.

These small concerns aside, Novak has given us an excellent overview of the literature on inequality and has offered a way of approaching these issues that enables us to separate the benign and desirable forms of inequality from the problematic ones. She has laid down a path for classical liberal social scientists to follow, even if we do not find all of the pieces of the entangled political economy framework the most useful way to do so. Her careful and thoughtful work also raises a number of questions for future research. She also did not have the space to pursue several strands of the inequality argument in additional detail. In the next section, I want to point to the issues I think need further consideration as people build upon the work she has done here.

## SOME QUESTIONS FOR FURTHER RESEARCH

One of the first things a classical liberal approach to inequality is going to need to do is to clarify the distinction between the “good” and “bad” kinds of inequality. As my use of quotation marks suggests, those are not the ideal terms to use given their lack of precision about what is good or bad about either kind of inequality. One option is to emphasize the role of liberty in either option, as Novak does by using “liberty-consistent” and “liberty-inconsistent” in a few places. Although that is more specific, I do think that it suffers from being normative in a way that might not be persuasive to those who would see “liberty” in a variety of alternative and complex ways. One option that might capture the same idea is to distinguish good from bad in terms of their regressivity. The “bad” forms of inequality are those that harm the absolute material well-being of the poor, especially when those same trends toward inequality also benefit the rich. Upward absolute redistribution of income or wealth is the marker of “badness”. To the extent that classical liberalism is right that liberty-consistent policies lead to a general increase in wealth, including for the least well-off, then those policies would be fine as the growth in inequality they might generate will not involve an absolute loss for the poor. By the same token, policies that attempt to substitute triadic exchanges for dyadic ones through po-

litical action will often cause the sort of regressive redistribution that might characterize “bad” growth in inequality.

One advantage of the emphasis on regressivity is that it gives classical liberals a way to judge good and bad without equating it to a specific set of policies or ideological position. If it turns out that a particular piece of political action does not generate regressive inequality growth, then classical liberals would have no reason to reject it, at least in terms of concerns about inequality. (They might have other reasons for wishing to do so.) This consequentialist approach that focuses on the effects of policies and inequality on the poor avoids the need to make *a priori* judgments about particular policies. It is very much consistent with the “bleeding heart libertarian” approach that has grown in influence in recent years, e.g. Tomasi (2012). An explicit attempt to bring together the bleeding heart libertarians’ combination of Hayek and Rawls with an entangled political economy approach to inequality might prove to be very fruitful. Linking the concerns about inequality to other work by classical liberal scholars might also prove to have important synergies. Two that first come to mind are the Hayekian emphasis on economic coordination as the criterion of success, and Deirdre McCloskey’s (2006) work on the bourgeois virtues, especially her history of the way “trade tested betterment” has improved the lives of the middle class and poor.

A second line of research that could be explored more deeply is the relationship between inequality and fairness. Novak touches on this in several places, including citing the fascinating study by Starmans, Sheskin, and Bloom (2017) that found experimental evidence that people will accept greater inequality if they believe the process that produced it was fair. Our concerns for fairness tend to trump any abstract concern for equality.

In a recent paper (Horwitz 2018), I explore some of these issues. I argue there that in economic interactions, the relevant notion of fairness might be whether or not people are equal before the law. That is, if the law treats everyone as having the same rights and opportunities, then it may be perceived as fair. If so, then whatever outcomes it produces, regardless of the degree of inequality involved, will be deemed morally acceptable. In Novak’s terms, this notion of fairness is “liberty-compatible”. So if it is true that people are okay with inequality as long as it was produced by a process they deem fair, and, if it’s also true that the relevant notion of fairness is equality before the law, it would seem that inequality becomes a concern for people when processes aren’t fair because people aren’t being treated equally.

We can see this to some degree in the way in which people who claim to care about inequality often treat the CEOs and owners of companies they like. Do people think the high incomes made by executives at Apple are problematic? My sense is that they generally don't, perhaps because they understand that we have made them rich by purchasing their products, which have given us enormous benefits in return. They see that market process as being fair, perhaps because the nature of the voluntary exchanges and mutual benefit are there to be seen, even if they don't understand all that well the underlying institutional prerequisites, including equality before the law. Where this line of argument gets more difficult is when we talk about more abstract goods and services, such as the financial industry. It is easy to justify the riches of tech executives when you hold their very useful products in your hand, but it's harder to see the fairness and mutual benefit of abstract financial transactions, even if we assume an unhampered market process. One implication for classical liberals is that perhaps we want to shift our discussions of inequality to be more about fairness.

One way we could do that, and it is hinted at in Novak's book, is to engage the left's language of privilege. When economic actors use the power of the state to benefit themselves or harm their competition, they are acquiring a privilege that others do not have. We would do much for clarity in such discussions if we referred to "rent-seeking" as "privilege-seeking" instead, as that is more clearly what is happening when taxi companies ask for regulation to eliminate or handicap competition from ride-sharing companies. Framing triadic exchanges in terms of privilege allows classical liberals to take advantage of the importance of fairness by arguing for the unfairness of this sort of privilege. Such an approach is also consistent with important arguments in the history of liberalism, especially those in the 19<sup>th</sup> century who explicitly saw themselves as opponents of privilege, whether granted to capital or labor (Hart 2016). Finally, to the degree that such privileges are more easily obtained by those who already have significant wealth and power, they will tend to work against the interests of the least well-off. That is, privilege-seeking behavior in an entangled political economy is often regressive, especially to the degree it limits new entrants who have lower-cost, more convenient options for consumers, as is the case with the ride-sharing firms. If people believe that privilege is unfair and that harming the poor is unfair, then framing classical liberal objections to inequality in terms of those policies that provide privileges and thereby generate regressive redistributions of wealth

seems like it is not only good political economy but also effective rhetoric.

Too often, the common understanding of increasing inequality is that the rich are getting richer and the poor are getting poorer. Of course, rising inequality requires only one of those to be true, and not both. But this perception of what rising inequality means suggests that there are two factors related to inequality that deserve additional attention: the role of income mobility and the absolute condition of the poor.

There is not an extensive discussion of income mobility in Novak's book, but I think it is really important to raise it in the context of inequality. To the degree that the critics of rising inequality believe that the same people and households who are poor in one year are poorer in later years, raising the issue of mobility is a necessary counterweight. I cannot review the large and ongoing debate about the degree of income mobility in the US, but two things seem to be clear. First, the degree of household mobility across income quintiles does seem to have fallen a bit over the last couple of decades. Second, despite that, there is still significant mobility, as even the most conservative and recent estimates suggest that 50% or more of households who are poor in a given year are out of the lowest quintile within 6 or 7 years. The percentage of households that remain stuck in long-term poverty, while still too large, is much closer to zero than 100%. And children are able to do better than their parents in significant numbers (Winship 2015). In my experience writing and lecturing on these issues for a decade or more, there are a good number of people who think that rising inequality means that it's very difficult to get out of poverty, and they are pleasantly surprised to see even the most conservative of the mobility estimates. I think their concern is also tied to the discussion of fairness: if the possibility of starting poor and becoming richer is still attainable to a substantial number of people, then that is an indication that the system is reasonably fair and that measured inequality is less of a concern. Rising inequality that is happening alongside real "churn" in who is rich and poor is less troubling than when rising inequality is making the same people richer and poorer.

This point also suggests why focusing on the regressivity of various forms of privilege-seeking is important. Policies that limit the upward mobility of the least well-off can be framed as both unfair and contributors to rising inequality. It's a way for classical liberals to argue for a less hampered market and appeal to people's justifiable concerns about particular kinds of increases in inequality.

It is also worth noting that we should expect to see a decline in mobility as societies get richer. Increasing wealth expands the range of each quintile, and that means that it is harder for a given increase in income to be sufficient to move from one quintile to the next. Think of an expanding accordion. The same increases in income year after year as part of generalized growth will become progressively less likely to lead to increases in measured mobility in terms of quintile movements. Some of the stagnation in mobility may be a statistical artifact of rising wealth across the board.

It's also important for classical liberals to talk about the absolute condition of the least well-off. As Deirdre McCloskey (2010) and others have pointed out, the most stunning fact of the last 200 years is the incredible increase in human living standards, especially for the poor. These gains are also very clear in the more narrow timeframe of the last 40 or 50 years that are the focus of many critics of rising inequality. The first point to make is that increases in measured income inequality are completely compatible with increasing living standards for the poor. If income is growing for everyone, but growing more for those at the top than at the bottom, we have both rising inequality and rising living standards for all. If there is also a significant degree of mobility in that situation, then it is not at all clear what the degree of harm of rising income inequality really is. Discussions of inequality must include the question of the absolute condition of the poor as it forces us to confront the question of whether it is inequality per se that troubles us, or whether it is an increasing depth or duration of poverty that does. Those concerned about inequality need to answer the question of why we should be concerned about growing inequality if it is accompanied by increases in the living standards of the poor.

A second aspect of the relationship between inequality and poverty is the question of how we are measuring the material well-being of people and households. Most studies focus on income (or perhaps wealth) inequality. However, income and wealth arguably only matter because they enable us to consume the goods and services that provide our standard of living. One way of looking at inequality is to ask what a typical poor household is able to consume compared to a typical rich household and then track changes in that difference over time. In Horwitz (2015), I compare the percentages of poor American households who own various home appliances (including cars) between 1984 and 2005 and then the 2005 data against the percentage of all American households who did so in 1971. The results show that

not only have the percentages of households below the poverty line who own those items increased in almost all cases (one exception being telephones, thanks to the advent of cell phones), but that poor households in 2005 were more likely to contain those items than was the average US household in 1971. Poor Americans today are, in consumption terms, richer than the average household was in 1971. In other research, I show (Horwitz 2009) that the gap between rich and poor households in terms of their likelihood of owning those items narrowed in almost all cases during the early 2000s. More recent and broader studies of consumption inequality also indicate that it has fallen in even more recent periods (Attanasio and Pistaferri 2016).

One way to see this reduction in inequality is to realize that even relatively poor Americans have access to air conditioning, indoor plumbing, refrigeration, car and air travel, and smartphones and the internet in ways that differ from the rich only in terms of quantity and quality. Bill Gates' house and the houses of Americans below the poverty line contain most of the same things. Gates just has more of them and his are likely of higher quality. That is, we have gone from a society of a few "haves" and many "have nots," to a society of many "haves" and a few who "have more and better". This narrowing of consumption inequality is frequently overlooked in popular discussions of inequality, but classical liberals should stress it as a way of showing the real gains of the least well-off even as measured income inequality has risen. At the end of the day, what we really care about are the goods and services that people are able to consume to improve their well-being. That is the measure that should matter.

Mikayla Novak's book makes a compelling case for a more thorough and respectful treatment of inequality by classical liberals. Although I'm not totally persuaded that all the elements of the entangled political economy approach add value, I am open to being convinced otherwise. What she has done, however, is ask all of the right questions and begin a conversation that I think can go in a number of very interesting and productive directions. I also think her approach, especially if extended in some crucial ways, can allow classical liberals to enter the broader debate over inequality that continues among public intellectuals. There are solid theoretical and empirical grounds for classical liberals to be concerned about particular causes of inequality and we bring distinct insights to those conversations. Novak's book is a very good start on what I hope will be a very fruitful research program for classical liberalism.

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