From Ha-Joon Chang, <u>23 Things They Don't Tell You About Capitalism</u>

# Thing 3
# Most people in rich countries are paid more than they should be

## *What they tell you*

In a market economy, people are rewarded according to their productivity. Bleeding-heart liberals may find it difficult to accept that a Swede gets paid fifty times what an Indian gets paid for the same job, but that is a reflection of their relative productivities. Attempts to reduce these differences artificially – for example, by introducing minimum wage legislation in India – lead only to unjust and inefficient rewarding of individual talents and efforts. Only a free labour market can reward people efficiently and justly.

## *What they don't tell you*

The wage gaps between rich and poor countries exist not mainly because of differences in individual productivity but mainly because of immigration control. If there were free migration, most workers in rich countries could be, and would be, replaced by workers from poor countries. In other words, wages are largely politically determined. The other side of the coin is that poor countries are poor not because of their poor people, many of whom can out-compete their counterparts in rich countries, but because of their rich people, most of whom cannot do the same. This does not, however, mean that the rich in the rich countries can pat their own backs for their individual brilliance.

Their high productivities are possible only because of the historically inherited collective institutions on which they stand. We should reject the myth that we all get paid according to our individual worth, if we are to build a truly just society.

## *Drive straight on . . . or dodge the cow (and the rickshaw as well)*

A bus driver in New Delhi gets paid around 18 rupees an hour. His equivalent in Stockholm gets paid around 130 kronas, which was, as of summer 2009, around 870 rupees. In other words, the Swedish driver gets paid nearly fifty times that of his Indian equivalent.

Free-market economics tells us that, if something is more expensive than another comparable product, it must be because it is better. In other words, in free markets, products (including labour services) get paid what they deserve. So, if a Swedish driver – let's call him Sven – is paid fifty times more than an Indian driver – let's call him Ram – it must be because Sven is fifty times more productive as a bus driver than Ram is.

In the short run, some (although not all) free-market economists may admit, people may pay an excessively high price for a product because of a fad or a craze. For example, people paid ludicrous prices for those 'toxic assets' in the recent financial boom (that has turned into the biggest recession since the Great Depression) because they were caught in a speculative frenzy. However, they would argue, this kind of thing cannot last for long, as people figure out the true value of things sooner or later (*see Thing 16*). Likewise, even if an underqualified worker somehow manages to get a well-paid job through deceit (e.g., fabricating a certificate) or bluffing in an interview, he will soon be fired and replaced, because it will quickly become apparent that he does not have the productivity to justify his wage. So, the reasoning goes, if Sven is getting paid fifty times what Ram



is paid, he must be producing fifty times more output than Ram.

But is this what is really going on? To begin with, is it possible that someone drives fifty times better than another? Even if we somehow manage to find a way to measure quantitatively the quality of driving, is this kind of productivity gap in driving possible? Perhaps it is, if we compare professional racing drivers like Michael Schumacher or Lewis Hamilton with some particularly uncoordinated eighteen-year-old who has just passed his driving test. However, I simply cannot envisage how a regular bus driver can drive fifty times better than another.

Moreover, if anything, Ram would likely be a much more skilled driver than Sven. Sven may of course be a good driver by Swedish standards, but has he ever had to dodge a cow in his life, which Ram has to do regularly? Most of the time, what is required of Sven is the ability to drive straight (OK, give or take a few evasive manoeuvres to deal with drunken drivers on Saturday nights), while Ram has to negotiate his way almost every minute of his driving through bullock carts, rickshaws and bicycles stacked three metres high with crates. So, according to free-market logic, Ram should be paid more than Sven, not the other way round.

In response, a free-market economist might argue that Sven gets paid more because he has more 'human capital', that is, skills and knowledge accumulated through education and training. Indeed, it is almost certain that Sven has graduated from high school, with twelve years of schooling under his belt, whereas Ram probably can barely read and write, having completed only five years of education back in his village in Rajahstan.

However, little of Sven's additional human capital acquired in his extra seven years of schooling would be relevant for bus driving (*see Thing 17*). He does not need any knowledge of human chromosomes or Sweden's 1809 war with Russia in order to drive his bus well. So Sven's extra human capital cannot explain why he is paid fifty times more than Ram is.

The main reason that Sven is paid fifty times more than Ram is, to put it bluntly, protectionism – Swedish workers are protected from competition from the workers of India and other poor countries through immigration control. When you think about it, there is no reason why all Swedish bus drivers, or for that matter the bulk of the workforce in Sweden (and that of any other rich country), could not be replaced by some Indians, Chinese or Ghanaians. Most of these foreigners would be happy with a fraction of the wage rates that Swedish workers get paid, while all of them would be able to perform the job at least equally well, or even better. And we are not simply talking about low-skill workers such as cleaners or street-sweepers. There are huge numbers of engineers, bankers and computer programmers waiting out there in Shanghai, Nairobi or Quito, who can easily replace their counterparts in Stockholm, Linköping and Malmö. However, these workers cannot enter the Swedish labour market because they cannot freely migrate to Sweden due to immigration control. As a result, Swedish workers can command fifty times the wages of Indian workers, despite the fact that many of them do not have productivity rates that are higher than those of Indian workers.

## *Elephant in the room*

Our story of bus drivers reveals the existence of the proverbial elephant in the room. It shows that the living standards of the huge majority of people in rich countries critically depend on the existence of the most draconian control over their labour markets – immigration control. Despite this, immigration control is invisible to many and deliberately ignored by others, when they talk about the virtues of the free market.

I have already argued (*see Thing 1*) that there really is no such thing as a free market, but the example of immigration control



reveals the sheer extent of market regulation that we have in supposedly free-market economies but fail to see.

While they complain about minimum wage legislation, regulations on working hours, and various 'artificial' entry barriers into the labour market imposed by trade unions, few economists even mention immigration control as one of those nasty regulations hampering the workings of the free labour market. Hardly any of them advocates the abolition of immigration control. But, if they are to be consistent, they should also advocate free immigration. The fact that few of them do once again proves my point in *Thing 1* that the boundary of the market is politically determined and that free-market economists are as 'political' as those who want to regulate markets.

Of course, in criticizing the inconsistency of free-market economists about immigration control, I am *not* arguing that immigration control should be abolished – I don't need to do that because (as you may have noticed by now) I am not a free-market economist.

Countries have the right to decide how many immigrants they accept and in which parts of the labour market. All societies have limited capabilities to absorb immigrants, who often have very different cultural backgrounds, and it would be wrong to demand that a country goes over that limit. Too rapid an inflow of immigrants will not only lead to a sudden increase in competition for jobs but also stretch the physical and social infrastructures, such as housing and healthcare, and create tensions with the resident population. As important, if not as easily quantifiable, is the issue of national identity. It is a myth – a necessary myth, but a myth nonetheless – that nations have immutable national identities that cannot be, and should not be, changed. However, if there are too many immigrants coming in at the same time, the receiving society will have problems creating a new national identity, without which it may find it difficult to maintain social cohesion.

This means that the speed and the scale of immigration need to be controlled.

This is not to say that the current immigration policies of the rich countries cannot be improved. While any society's ability to absorb immigrants is limited, it is not as if the total population is fixed. Societies can decide to be more, or less, open to immigrants by adopting different social attitudes and policies towards immigration. Also in terms of the composition of the immigrants, most rich countries are accepting too many 'wrong' people from the point of view of the developing countries. Some countries practically sell their passports through schemes in which those who bring in more than a certain amount of 'investment' are admitted more or less immediately. This scheme only adds to the capital shortage that most developing countries are suffering from. The rich countries also contribute to the brain drain from developing countries by more willingly accepting people with higher skills. These are people who could have contributed more to the development of their own countries than unskilled immigrants, had they remained in their home countries.

### *Are poor countries poor because of their poor people?*

Our story about the bus drivers not only exposes the myth that everyone is getting paid fairly, according to her own worth in a free market, but also provides us with an important insight into the cause of poverty in developing countries.

Many people think that poor countries are poor because of their poor people. Indeed, the rich people in poor countries typically blame their countries' poverty on the ignorance, laziness and passivity of their poor. If only their fellow countrymen worked like the Japanese, kept time like the Germans and were



inventive like the Americans – many of these people would tell you, if you would listen – their country would be a rich one.

Arithmetically speaking, it is true that poor people are the ones that pull down the average national income in poor countries. Little do the rich people in poor countries realize, however, that their countries are poor not because of their poor but because of themselves. To go back to our bus driver example, the primary reason why Sven is paid fifty times more than Ram is that he shares his labour market with other people who are way more than fifty times more productive than their Indian counterparts.

Even if the average wage in Sweden is about fifty times higher than the average wage in India, most Swedes are certainly *not* fifty times more productive than their Indian counterparts. Many of them, including Sven, are probably less skilled. But there are some Swedes – those top managers, scientists and engineers in world-leading companies such as Ericsson, Saab and SKF – who are hundreds of times more productive than their Indian equivalents, so Sweden's average national productivity ends up being in the region of fifty times that of India.

In other words, poor people from poor countries are usually able to hold their own against their counterparts in rich countries. It is the rich from the poor countries who cannot do that. It is their low relative productivity that makes their countries poor, so their usual diatribe that their countries are poor because of all those poor people is totally misplaced. Instead of blaming their own poor people for dragging the country down, the rich of the poor countries should ask themselves why they cannot pull the rest of their countries up as much as the rich of the rich countries do.

Finally, a word of warning to the rich of the rich countries, lest they become smug, hearing that their own poor are paid well only because of immigration control and their own high productivity.

Even in sectors where rich country individuals are genuinely more productive than their counterparts in poor countries, their productivity is in great part due to the system, rather than the individuals themselves. It is not simply, or even mainly, because they are cleverer and better educated that some people in rich countries are hundreds of times more productive than their counterparts in poor countries. They achieve this because they live in economies that have better technologies, better organized firms, better institutions and better physical infrastructure – all things that are in large part products of collective actions taken over generations (*see Things 15 and 17*). Warren Buffet, the famous financier, put this point beautifully, when he said in a television interview in 1995: 'I personally think that society is responsible for a very significant percentage of what I've earned. If you stick me down in the middle of Bangladesh or Peru or someplace, you'll find out how much this talent is going to produce in the wrong kind of soil. I will be struggling thirty years later. I work in a market system that happens to reward what I do very well – disproportionately well.'

So we are actually back to where we started. What an individual is paid is *not* fully a reflection of her worth. Most people, in poor and rich countries, get paid what they do only because there is immigration control. Even those citizens of rich countries who cannot be easily replaced by immigrants, and thus may be said to be really being paid their worth (although they may not – *see Thing 14*), are as productive as they are only because of the socio-economic system they are operating in. It is not simply because of their individual brilliance and hard work that they are as productive as they are.

The widely accepted assertion that, only if you let markets be, will everyone be paid correctly and thus fairly, according to his worth, is a myth. Only when we part with this myth and grasp the political nature of the market and the collective nature of individual productivity will we be able to build a more just society in which historical legacies and collective actions, and not just individual talents and efforts, are properly taken into account in deciding how to reward people.