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This Just In: Wall St. People Really DO Make Too Much Money

by **ADAM DAVIDSON**

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I had a fascinating lunch and interview with economist Ariell Reshef. The interview will be on the podcast next week, but I thought some folks might enjoy reading his paper (feel free to skip the Greek-letter math formulas) that, he says, shows actual mathematical evidence that Wall Street folks really do make too much money.

OK, OK, I know that most of you don't need any proof. You're already convinced.

But Reshef is an academic. He can't just say he's convinced. He has to show the proof.

So, how does he do it?

At the core of economic thinking is the idea that in a functioning market, prices generally land at the most efficient equilibrium. Put more simply: things are worth whatever the market says they are worth. This goes for Wall Street bonuses as much as it does for apples or SUVs.

Using this argument, an economist might say that Wall Street folks are paid exactly what our economy deems they are worth.

Reshef says that's nonsense and that people who believe that are "nuts."

I'll try to summarize the core of the argument:

- Reshef says that the market price is accurate only when there is a truly functioning market. Prices are generally not at the right (or, in economics language, "equilibrium") point if there's a monopoly (just think of your local cable company) or if there isn't enough information about the thing being sold (think of used cars—the seller knows a lot more than the buyer, so the price probably doesn't reflect the real value).

- He says finance is not a monopoly, but it's close. It's very hard for new firms to compete with a handful of big banks.

- Information definitely doesn't flow all that freely out of finance. Frankly, nobody understands many of the products they sell.

- Put that all together, and, Reshef argues, you get a badly functioning market with prices far from their natural, equilibrium point.

- Reshef says things got a lot worse with increasing deregulation in the 1980s and 1990s, which allowed the existing banks to grab more market share and create increasingly complicated products.

- All of this created a situation where Wall Street professionals were able to take increasingly large commissions for themselves.

- Just think of there were only five massive companies in the US that sold the vast majority of used cars and if most people who bought a used car were not able to actually inspect or understand the quality of the thing. Seems pretty likely that used car prices would go way up and used car salesmen would make a lot more money, doesn't it?

- When someone is able to make more money than they would in a truly free market, economists call it a "rent." Obviously, they are using rent differently than we do with apartments and the like. It's the extra amount of money that someone gets not because they've earned it but because they've found some way of excluding others from competing with them.

- Reshef says the rent finance folks earn is big and getting bigger every year.

- Many Wall Street folks and some economists would take issue with Reshef. They'd say that finance became more complicated not because of evil money-grubbing, but because the world became more complicated, more intertwined. Computers and the internet allowed finance to move much more quickly and to spread to far more corners of the economy and the globe. They'd say, sure, the last two years sucked, but we've had 25 years of great growth in the US and in many parts of the financially-integrated world after 1980. They'd argue that finance folks get paid more because they bring more value to the world, they have to be smarter, quicker, more creative. They don't get some unfair rent, they are earning their dough.

- Reshef says, effectively, sure, that's all true. Finance folks might truly earn more than they did in the 1950s when Wall Street was a comparatively sleepy, low-tech business. But, even so, they earn WAY more than can be explained by increased skill and value.

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