[**Read Part 2: Exploring The *"Myths Of Broken Capitalism"***](#)

[**Read Part 3: Capitalism Is The Worst, Except For The Rest**](#)

Over the last decade, wealth inequality in America has become a political battleground. It started with #OccupyWallStreet early in President Obama's term and has morphed into direct calls for socialistic reforms.

Is there a problem with capitalism? Does it need reform? Or, is Bernie Sanders correct when he says:

https://twitter.com/BernieSanders/status/1176481898685710337?s=20

In this three-part series, we will explore:

1. *How Capitalism Got Distorted By Wall Street*
2. *The Myths Of Capitalism.*
3. *Why Government Isn't The Answer.*
4. *The Cost Of Socialism*
5. *Why Inequality Is A Good Thing.*

Introduction

Is *"capitalism,"* as an economic system, wrong? Ray Dalio, the head of the largest hedge fund in the world, thinks so. He recently stated that wealth and income disparity was a **failure of capitalism.** He argues that capitalism is not achieving its goal of more equitably distributing the fruits of capitalism.

Ray is wrong.

Capitalism is an economic system based on the premise of property rights, the rule of law, and free markets, which allows ANY individual the opportunity to create wealth. In other words, as John Mauldin, once penned:

> *"Properly understood, it **provides a level playing field for entrepreneurs to offer goods and services that produce incomes and profits**. I don?t think equitably distributing those profits is capitalism?s role.*
>
> *Ensuring that all participants are treated fairly and, to some extent, regulating these personal and corporate endeavors is the role of society in general and government in particular.*
>
> *So when you say that capitalists are not very good at sharing profits, I would say that capitalism is not designed to do so."*

So, what type of economic system do you have when profits, goods, and services are shared on an equal basis? *"Socialism."*

Importantly, what Ray Dalio is referring to is not a problem of *"capitalism,"* it is a problem of Wall Street.

How Capitalism Got Distorted By Wall Street

Despite all of the angst surrounding the idea of capitalism, it has benefited all Americans very well. Currently, the median income for the U.S. is $59,039. If you are trying to raise a family of four on that income, it certainly doesn't make you feel very rich.

However, when compared to the rest of the world, **the byproduct of capitalism is a wealth standard far above that of any other country.**

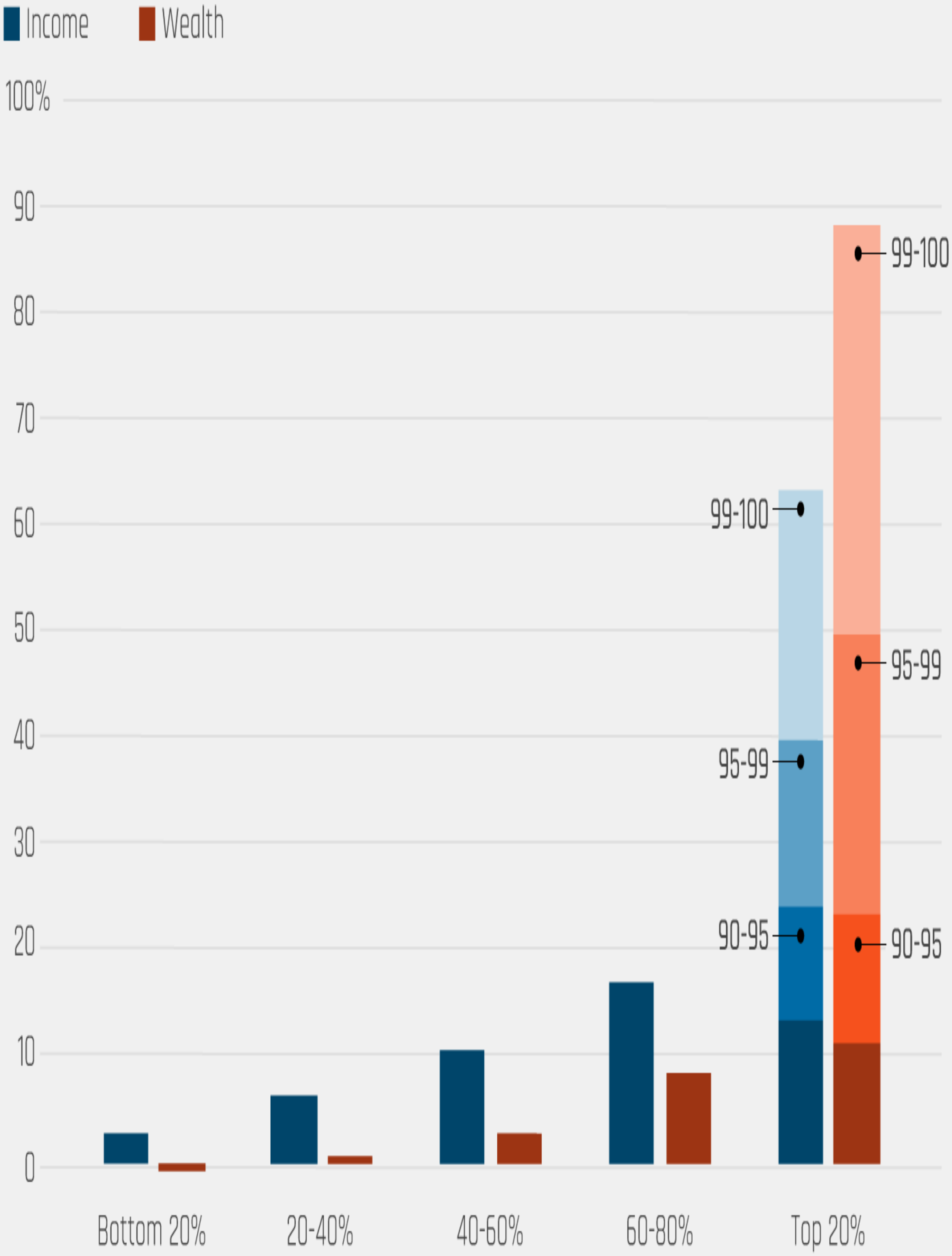
According to the Global Rich List, **a $32,400 annual income will easily place American school teachers, registered nurses, and other modestly-salaried individuals, among the global top 1% of earners.**

Nonetheless, there is little arguing that when 1% of the country controls more wealth than the bottom 80%, something certainly doesn't seem right.

> *"Wealth is distributed in a highly unequal fashion, with the wealthiest 1 percent of families in the United States holding about 40 percent of all wealth and the bottom 90 percent of families holding less than one-quarter of all wealth."* • -*Washington Center For Equitable Growth*

The distribution of income and wealth in the United States

Share of total income or wealth by quintile, 2016



Source: Authors' calculations using Federal Reserve Board, "Survey of Consumer Finances" (2017).

This division between the *"rich"* and *"poor"* has become a?*political football?*•perfectly suited for the 2019 primaries as the?*wealth gap?*•in America has become a visible chasm.

Here is what you need to be aware of.•**The debates over capitalism aren't about Mike Jones, who started an auto mechanic repair shop. Nor, are they about Annie Smith, who opened a personal training studio down the street from her home.** Mike and Annie are participating, and taking advantage of, a capitalist economy where the freedom to compete allows them to earn more wealth than simply *"working for the man."*•

Should Mike and Annie, who have taken risks as entrepreneurs, be forced to share the fruits of their 50-70 work weeks, with everyone else who did not take those risks? It's pretty obvious the answer is *"no."*•

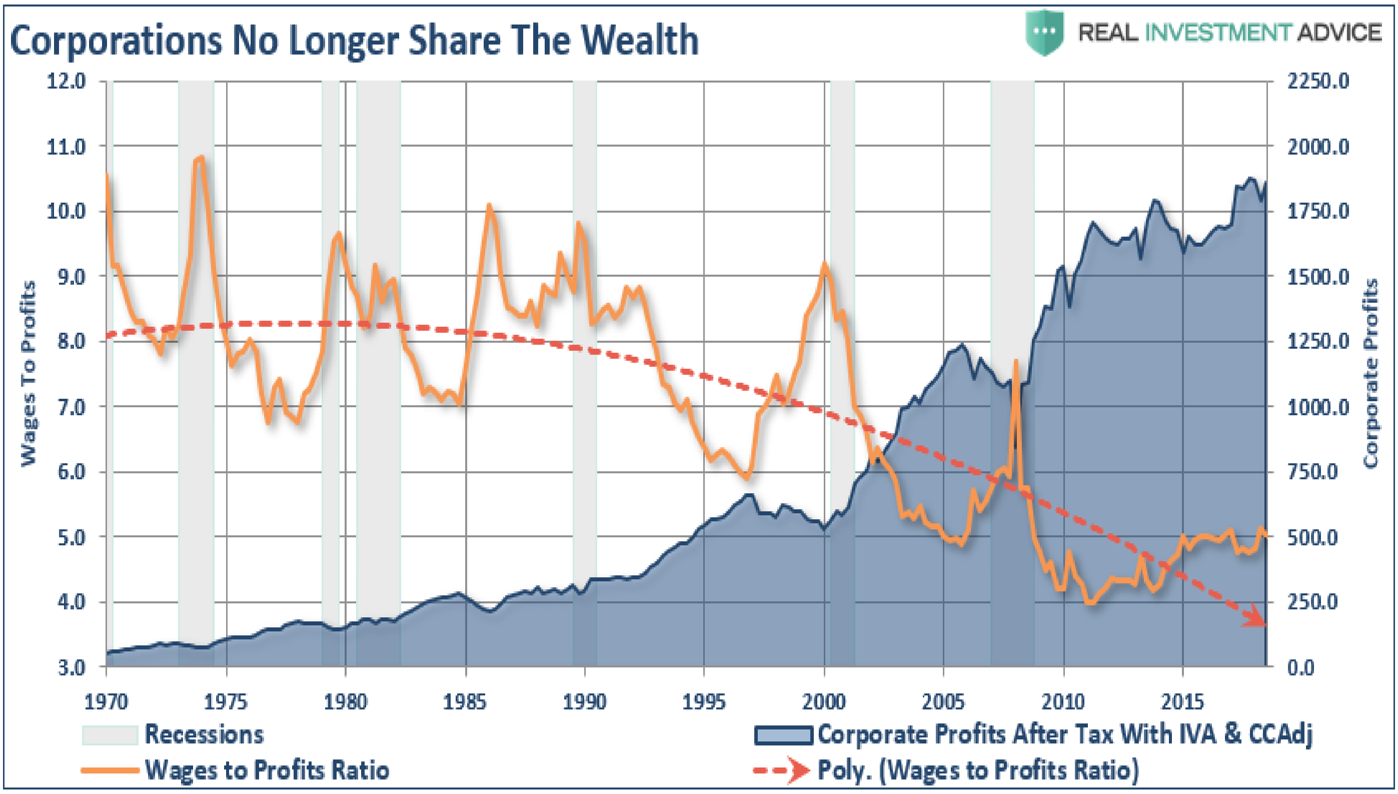
So, if *"capitalism"* at its most basic core is **NOT broken**, then what are we discussing?

The debate should be focused on the *"distortion of capitalism"* by Wall Street, and the ongoing share repurchases, which invoke images of corporate greed, inequality, and populism.

However, we should *"hate the game,"* not the *"player."*

The buyback boom began with Bill Clinton?s 1993 attempt to reign in CEO pay.•Clinton thought, incorrectly, that by restricting corporations to expensing only the first $1 million in CEO compensation for corporate tax purposes, corporate boards would limit the amount of money they doled out to CEO?s.

To Bill?s chagrin, corporations quickly shifted compensation schemes for their executives to stock-based compensation. Subsequently, CEO pay rose even higher, and the gap between profits and wages has become vastly distorted. Rising profitability, fewer employees, and increased productivity per employee has all contributed to the surging *?wealth gap?*•between the rich and the poor.



In 1982, according to the Economic Policy Institute,**the average CEO earned•50•times the average production worker.****Today, the CEO Pay Ratio is 144 times the average worker•with most of the gains a result of stock options and awards.**

You can understand why it is a political *?hot topic?* for 2020.

The debate over share repurchases came to the fore following the tax cuts in December of 2017. The bill was targeted at corporations and lowered the tax rate from 35% to 21%. The tax cut plan was•*?sold?*•the the American public[as a•*?trickle down?*plan,] and by giving money back to corporations; they would hire more workers, increase wages, and invest in America.

Unsurprisingly, it didn?t happen as the money primarily went to share repurchases.

The reality is that stock buybacks only create an illusion of profitability. Such activities do not spur economic growth or generate real wealth for shareholders, but it does provide the basis for with which to keep Wall Street satisfied and stock option compensated executives happy.

A recent study by the Securities & Exchange Commission supports this claim.

- *SEC research found that**many corporate executives**sell significant amounts**of their own shares after their companies announce stock buybacks,**•Yahoo Finance reports.*

Jesse Fried also wrote for•the WSJ:

> ***?The real problem is that buybacks, unlike dividends, can be used to systematically transfer value from shareholders to executives.***•*Researchers have*

shown that ***executives opportunistically use repurchases to shrink the share count and thereby trigger earnings-per-share-based bonuses.***

Executives also use buybacks to create temporary additional demand for shares, nudging up the short-term stock price as executives unload equity*.?*

What is clear is that•the misuse and abuse of share buybacks to manipulate earnings, and reward insiders has become problematic.

However, rather than hating capitalism, fix the legislation.

Most people have forgotten that share repurchases used to be illegal.•Via Vox:

> ***?Buybacks were illegal throughout most of the 20th century because they were considered a form of stock market manipulation****. But in 1982, the Securities and Exchange Commission passed rule* ***10b-18****, which created a* ***legal process****•for buybacks and opened the floodgates for companies to start repurchasing their stock en masse.?*

As William Lazonick via The Harvard Business Review noted, the problem is easily fixed:

> ***?If Americans want an economy in which corporate profits result in a shared prosperity, the buyback and executive compensation binges will have to end. As with any addiction, there will be withdrawal pains****.?•*

Unfortunately, given the incestuous relationship between Washington and Wall Street, there are no easy fixes, and banning share repurchases is probably a *?horse that has left the barn.?*

As Michael Lebowitz wrote in *Short Term Pain, Long Term Gain*.

> "*Executives should be incentivized to promote the long-term health of their company, the prosperity of the employees who work for it, and the communities in which the employees live and work. These objectives contrast sharply with current decision-making behavior and demands balanced investment decisions, discipline, and quite often a measure of sacrifice in the short-run."*

The important point is that•*"capitalism"* isn't broken, but there is one aspect of the system which has morphed into something no one intended.•

As you hear candidates promising to *"eat the rich,"* remember *"political narratives"* designed to win votes is not always representative of what is best for you in the long run.