The New York Times
nytimes.com

PRINTER-FRIENDLY FORMAT SPONSORED BY SU

July 19, 2006

TALKING POINTS

The Rise of the Super-Rich

By TERESA TRITCH

The gap between rich and poor is unfortunately an old story.

It is the stuff of parables and literature. It is a force in social history and political economy, from electoral campaigns to reform movements and revolutions.

But in the United States today, there's a new twist to the familiar plot. Income inequality used to be about rich versus poor, but now it's increasingly a matter of the ultra rich and everyone else. The curious effect of the new divide is an economy that appears to be charging ahead, until you realize that the most of the people in it are being left in the dust. President Bush has yet to acknowledge the true state of affairs, though it's at the root of his failure to convince Americans that the good times are rolling.

The president's lack of attention may be misplaced optimism, or it could be political strategy. Acknowledging what's happening would mean having to rethink his policies, not exactly his strong suit.

But the growing income gap — and the rise of the super-rich — demands attention. It is making America a less fair society, and a less stable one.

I. The Growing Divide

Anyone who has driven through the new neighborhoods filled with "McMansions" that have arisen near most cities, or seen the brisk business that luxury stores are doing, has an anecdotal sense that some Americans are making a lot of money right now.

But there is no need to rely on anecdotal evidence.

Thomas Piketty, of the École Normale Supérieure in Paris, and Emmanuel Saez of the University of California at Berkeley recently updated their groundbreaking study on income inequality(pdf), and their findings are striking.

The new figures show that from 2003 to 2004, the latest year for which there is data, the richest Americans pulled far ahead of everyone else. In the space of that one year, real average income for the top 1 percent of households — those making more than $315,000 in 2004 — grew by nearly 17 percent. For the remaining 99 percent, the

average gain was less than 3 percent, and that probably makes things look better than they really are, since other data, most notably from the Census Bureau, indicate that the average is bolstered by large gains among the top 20 percent of households. In all, the top 1 percent of households enjoyed 36 percent of all income gains in 2004, on top of an already stunning 30 percent in 2003.

Some of the gains at the top reflect capitalism's robust reward for the founders of companies like Microsoft, Google and Dell. But most of it is due to the unprecedented largesse being heaped on executives and professionals, in the form of salary, bonuses and stock options. A recent study done for the Business Roundtable(pdf), a lobbying group for chief executives, shows that median executive pay at 350 large public companies was $6.8 million in 2005. According to the Wall Street Journal, that's 179 times the pay of the average American worker. The study is intended to rebut much higher estimates made by other researchers, but it does little to quell the sense that executive pay is out of whack. As the Journal's Alan Murray pointed out recently, the study's calculation of executive pay is widely criticized as an understatement because, as a measurement of the median, it is largely unaffected by the eight or nine-digit pay packages that have dominated the headlines of late.

Rich people are also being made richer, recent government data shows, by strong returns on investment income. In 2003, the latest year for which figures are available, the top 1 percent of households owned 57.5 percent of corporate wealth, generally dividends and capital gains, up from 53.4 percent a year earlier.

The Center on Budget and Policy Priorities, a Washington think tank, compared the latest data from Mr. Piketty and Mr. Saez to comprehensive reports on income trends from the Congressional Budget Office. Every way it sliced the data, it found a striking share of total income concentrated at the top(pdf) of the income ladder as of 2004.

• The top 10 percent of households had 46 percent of the nation's income, their biggest share in all but two of the last 70 years.

• The top 1 percent of households had 19.5 percent (see graph).

• The top one-tenth of 1 percent of households actually received nearly half of the increased share going to the top 1 percent.

These disparaties seem large, and they are. (Though the latest availabe data is from 2004, there are virtually no signs that the basic trend has changed since then.) The top 1 percent held a bigger share of total income than at any time since 1929, except for 1999 and 2000 during the tech stock bubble. But what makes today's disparities particularly brutal is that unlike the last bull market of the late 1990's — when a proverbial rising tide was lifting all boats — the rich have been the only winners lately. According to an analysis by Goldman Sachs, for most American households — the bottom 60 percent — average income grew by less than 20 percent from 1979 to 2004, with virtually all of those gains occurring from the mid- to late 1990's. Before and since, real incomes for

that group have basically flatlined.

The best-off Americans are not only winning by an extraordinary margin right now. They are the only ones who are winning at all.

The result has been, as Andrew Hacker, a political science professor at Queens College, has observed in a recent article in the New York Review of Books, "more billionaires, more millionaires and more six-figure families."

As income has become more concentrated at the top, overall wealth has also become more skewed. According to the latest installation of a survey(pdf) that the Federal Reserve has conducted every three years since 1989, the wealthiest 1 percent of Americans accounted for 33.4 percent of total net worth in 2004, compared to 30.1 percent in 1989. Over the same period, the other Americans in the top 10 percent saw their share of the nation's net worth basically stagnate, at about 36 percent, while the bottom 50 percent accounted for just 2.5 percent of the wealth in 2004, compared to 3.0 percent in 1989.

II. A Brief History of Income Inequality

While it has long been the case that the rich do better than everyone else, it has not always been true that, in the process, the poor get poorer and the middle class gets squeezed. In post-World War II America, between 1947 and the early 1970's, all income groups shared in the nation's economic growth. Poor families actually had a higher growth in real annual income than other groups.

Part of the reason was a sharp rise in labor productivity. As workers produced more, the economy grew and so did compensation — wages, salaries and benefits (see graph). This link between productivity gains and income gains was not automatic. Government policies worked to ensure that productivity gains translated into more pay for Americans at all levels, including regular increases in the minimum wage and greater investment in the social safety net. Full employment was also a government priority. And, of course, unions were strong back then, giving workers bargaining power.

From the mid-1970's until 1995, the trend reversed. The gap between the rich and poor widened at a rapid clip. The upper echelons — generally the top 20 percent of American households — experienced steady gains, while families in the bottom 40 percent were faced with declining or stagnating incomes.

The growing divide coincided with a slowdown in productivity growth and a reversal in the government policies that had been promoting income equality. Legislators balked at raising the minimum wage and the earned income tax credit, a feature of the tax code that rewards the working poor by ensuring that work pays better than welfare. During the "supply side" era in the 1980's, fostered by the policies of Ronald Reagan, taxes became less progressive. The goal of full employment was eclipsed by a focus on inflation fighting that remains to this day.

As trade began to play an ever bigger role in the American economy, manufacturing jobs diminished and labor unions declined, reducing workers' clout in setting compensation. Regulatory laxness reached its apex in the fiscal disaster of the savings and loan meltdown, which drained public resources from socially and economically useful programs and polices.

The trend toward increasing inequality was interrupted, briefly, in the late 1990's. Productivity growth rebounded, and for a half decade, all income groups participated in the prosperity. Even then, the richest Americans had the best run, propelled largely by stock market gains. In fact, when the stock market hit its all time high in 2000, post-war income concentration also peaked.

But government policies of the day helped to ensure that the lower rungs also had a boost. Clinton-era welfare reforms are often cast as a success story of market-based incentives. But in fact, they were supported by a big increase in the earned income tax credit to help solidify the transition from welfare to work. At the same time, budget deficits were conquered by shared sacrifice — a mix of tax increases and spending cuts affecting all groups. The combination of economic growth and fiscal discipline spurred robust hiring and, if it had endured, could also have strengthened the Social Security safety net by allowing the government to pay down its debts.

That seems like ancient history now. Nearly everyone's income fell in 2001 and 2002, due to the bursting of the Internet bubble in 2000, recession in 2001 and the ensuing jobless recovery.

In the last few years, though, the trend toward inequality has reasserted itself — with a vengeance.

III. Inequality During the Bush Years

For the last few years, the tide has been rising again, but most boats have been staying where they are, or sinking. One key reason is that the link between rising productivity and broad economic prosperity has been severed. Take another look at this graph. During the years that George W. Bush has been in the White House, productivity growth has been stronger than ever. But the real compensation of all but the top 20 percent of income earners has been flat or falling. Gains in wages, salaries and benefits have been increasingly concentrated at the uppermost rungs of the income ladder.

The Bush administration would like you to believe that the situation will correct itself. Most recently, the new Treasury secretary, Henry M. Paulson, Jr., reiterated the administration's viewpoint at his confirmation hearing in June when he said that "economic growth, job growth, productivity growth, hopefully will be followed by increases in wage income."

Well, hoping certainly won't make it so.

Neither will growth alone. As the post-World War II history of income inequality illustrates, productivity

improvement is only one piece of the prosperity puzzle. The economic health of most American families also depends greatly on what government does. If it merely “gets out of the way,” inequality is bound to persist and — if recent results are any indication of future performance — worsen.

The Bush administration, though, has not even done anything as benign as get out of the way. The policies it has pursued — affirmatively and aggressively — have widened the gap between rich and poor.

A. The Tax Wedge

Tax cuts are the most obvious example. The Urban Institute-Brookings Institution Tax Policy Center computed the combined effects of tax cut legislation from 2001, 2003 and 2006. The tax cuts’ contribution to the income gap was significant.

In 2006, the average tax cut for households with incomes of more than $1 million — the top two-tenths of 1 percent — is $112,000 which works out to a boost of 5.7 percent in after tax income. That’s considerably higher than the 5 percent boost garnered by the top 1 percent. It’s far greater than the 2.5 percent increase of the middle fifth of households, and fully 19 times greater than the 0.3 percent gain of the poorest fifth of households.

The disparities are driven by tax cuts that overwhelmingly benefit the most affluent. In 2006, for instance, a tax cut took effect that allows high income households — those with incomes above $200,000 — to take bigger write offs for their children and other expenses, like mortgage interest on a second home. And increasingly, tax cuts are aimed at allowing America’s wealthiest families to amass dynastic wealth — estates to transfer from one generation to the next virtually untouched by taxes. The most obvious example is the gradual reduction in the estate tax that is scheduled through 2010 (and regular attempts to abolish the estate tax altogether). Another huge, though lesser noted example, is the law passed last May allowing all Americans to shelter money in a tax-favored Roth I.R.A. Under previous law, Roths had been off limits to wealthy Americans, precisely because the government did not want to help people amass big estates under the guise of saving for retirement. That sound principle has now been turned on its head.

B. The Assault on Programs for the Poor and Middle Class

Tax cuts are not the only policies widening the gap between the rich and other Americans. Earlier this year, President Bush signed into law a measure that will cut $39 billion over the next five years from domestic programs like Medicaid and food stamps, and $99.3 billion from 2006 to 2015.

The president and the Republican Congress have also done harm to the finances of the poorest Americans — and to the notion of basic fairness — by not increasing the federal minimum wage — it has been $5.15 since 1997 While C.E.O. salaries have been soaring, the take-home pay of waitresses and janitors has been hit hard by inflation.

The Bush administration has also been trying, with mixed success so far, to pursue other policies that would have the effect of shifting money to the rich. The most ominous is its often-repeated desire to "address our long-term unfunded entitlement obligations." That's code for making tax cuts for the wealthy permanent while cutting Social Security, which has for 70 years been a major factor in keeping Americans financially secure in their old age.

In 2004, over the objections of Congress, the administration overturned time-and-a-half regulation for overtime. For a brief period after Hurricane Katrina, the president suspended by executive proclamation the law that requires federal contractors to pay workers the locally prevailing wage, until Congress objected. For three months after Katrina, the Labor Department suspended the law requiring federal contractors to have an affirmative action hiring plan — an invitation to discrimination and, as such, to income inequality.

C. The Too-Easy Answer

When confronted with evidence of growing income inequality, Bush administration officials invariably say the answer is more and better education. "We are starting to see that the income gap is largely an education gap," said Trent Duffy, a White House spokesman, in a typical retort last January when tax data showed an increasing concentration of wealth among the highest-income Americans.

Education is critically important to individuals, society, the economy and democracy itself, and deserves strong government support. But it is neither a satisfactory explanation, nor a remedy, for today's income inequality.

There is a strong correlation between one's level of education and one's earning power. The Bush administration is assuming that the correlation will continue to hold in an ever more globalized economy. Writing in the March/April issue of Foreign Affairs, Princeton economist Alan S. Blinder, a former vice-chairman of the Federal Reserve, explains why that view may be mistaken:

> "Other things being equal, education and skills are, of course, good things; education yields higher returns in advanced societies, and more schooling probably makes workers more flexible and more adaptable to change. But the problem with relying on education as the remedy for job losses is that 'other things' are not remotely close to equal. The critical divide in the future may instead be between those types of work that are easily deliverable through a wire (or via a wireless connection) with little or no diminution in quality and those that are not. And this unconventional divide does not correspond well to traditional distinctions between jobs that require high levels of education and jobs that don't."

There is already evidence that the benefits of education are not as straightforward as many people seem to believe they are. In his review of "Inequality Matters," a collection essays commissioned by Demos, a public policy research and advocacy organization, Mr. Hacker, the Queens College political science professor, cited findings from the Bureau of Labor Statistics to show that many college graduates now hold jobs that once required only a high school diploma. Today, according to the bureau, 37 percent of flight attendants have completed college, as have 35 percent of tour escorts, 21 percent of embalmers, and 13 percent of both security guards and casino dealers. Mr. Hacker notes that more people are expected to earn college degrees in preparation for well-paying

professions. “But we cannot expect the economy will automatically create better-paid positions to match the cohort acquiring higher education,” he writes.

Underscoring the point, the Bush administration's own Economic Report of the President in 2006 shows that average annual earnings of college graduates fell by 5 percent from 2000 to 2004. In those four years, the difference between the average yearly pay of a college graduate and a high school graduate shrank from 93 percent to 80 percent.

Education is vital. But as Mr. Blinder put it, it “is far from a panacea.”

IV. The Future of Income Inequality

The fast-growing gap between the rich and poor and middle-class Americans is not something that has just happened. The Bush policies are an attempt to dismantle the institutions and norms that have long worked to ameliorate inequities — progressive taxation, the minimum wage, Social Security, Medicaid and so on. The aims that can’t be accomplished outright — like cuts in Social Security — are being teed up by running deficits that could force the shrinkage of government programs, even though the public would not likely condone many such cuts unless compelled to by a fiscal crisis.

Such policies are grounded in an ideology that began taking shape some 30 years ago, when economic policy makers began to disdain the notion of harnessing and protecting society’s collective potential in favor of crafting incentives to align individuals’ interests with those of the market. This campaign has gone by many names — “starve the beast,” or “repeal the New Deal.” Economist Jared Bernstein of the Economic Policy Institute, a Washington think tank, calls that approach “you’re on your own,” or YOYO, and has written a book calling for a new way, dubbed “we’re in this together,” or WITT. (Click here for excerpts from “All Together Now: Common Sense for a Fair Economy,” by Jared Bernstein.)

At issue, in economic terms, is the tradeoff between equality and efficiency: It can be difficult to divide the economic pie more equally without reducing the size of the pie. But it’s not impossible, and doing so is crucial for widespread prosperity. A fair and well-functioning economy will always involve some inequality, which acts a motivator and can be explained by differences in risk-taking, ability and work intensity. But inequality is generally deemed to be dangerous — socially, economically, (and, perhaps, politically) — when it becomes so extreme as to be self-reinforcing, as many researchers suggest is currently the case.

The problem now is that most any attempt to reduce inequality — even a measly increase in the minimum wage — is rejected as misguided. And policies that under one set of economic conditions might allow for a justifiable modicum of inequality are pursued beyond all reason. For instance, the rationale for the tax cuts in 2001 was to return the budget surplus that Mr. Bush inherited from President Clinton. The rationale for the tax cuts in 2002 and 2003 and 2006 was to stimulate the economy. The surplus has long since been replaced by big deficits, the

jobless recovery ended three years ago and inequality is on the rise. But tax cutting that overwhelmingly benefits the rich continues because, we're told, failure to keep cutting taxes would, somehow, shrink the pie. As Mr. Bernstein of the Economic Policy Institute has put it: "Economics, once an elegant and sensible set of ideas and principles devoted to shaping outcomes for the betterment of society, has been reduced to a restrictive set of ideologically inspired rules devoted to an explanation of why we cannot take the necessary steps to meet the challenges we face."

Hear, hear.

Lela Moore provided research for this article.

Copyright 2006 The New York Times Company

Privacy Policy | Search | Corrections | XML | Help | Contact Us | Work for Us | Site Map