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Book connects gap between rich, poor and downturn

By Tom Abate- San Francisco Chronicle
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Soaring unemployment has poured salt into a long-festering economic wound — the widening gap between rich and poor Americans, a trend that has been accompanied by a hollowing out of the middle class.

One unimpeachable view of this wage gap comes from a Federal Reserve report that examined the period leading up to the housing bust and recession and noted that "income became more 'unequally' distributed over the 1988-2006 period."

A more provocative analysis emerges from research co-written by University of California Berkeley economist Emmanuel Saez.

After studying Internal Revenue Service records since 1913, Saez found that the fraction of total income reported by the top 1 percent of tax filers peaked at 23.94 percent in 1928.

Thereafter, income for this elite group fell for decades, only to rise from the 1980s through 2007, when this top strata took in 23.5 percent of all reported income.

Former Clinton administration Labor Secretary Robert Reich, now a public policy professor at UC-Berkeley, argues that working-class incomes have stagnated for so long that ordinary consumers have lost the buying power to help pull the country out of recession.

"We have got to address this inequality, or it will derail the economy," said Reich. He proposes, in his book "Aftershock," taxing the rich to pay for training and other assistance to help Americans climb the income ladder.

Conservatives disagree

Reich's views are anathema to some conservative economists such as Alan Reynolds of the libertarian Cato Institute and Diana Furchtgott-Roth, a former Labor Department official who now advises House Republican Leader John Boehner.

Among other things, Reynolds argues that Saez's analysis overstates the income gap between top and bottom because IRS data fails to account for government payments such as food stamps, now received by millions of low-income Americans.

He also takes issue with the notion that inequality is rising — an update of Saez's IRS analysis shows that the top 1 percent of tax filers lost ground in 2008 when their share of total income fell sharply to 20.95 percent.

Given these factors, "raising taxes in a situation where unemployment is 9.6 percent is very dangerous for job creation," Furchtgott-Roth said.

But while there may not be agreement on the extent of the income gap, nor on the proper policy response, a consensus is emerging about the forces that seem to be holding down incomes for many Americans while favoring those at the top.

Douglas Holtz-Eakin, who has held various economic posts under Republican administrations, said a confluence of trends — including competition from low-wage countries — has put working people on the defensive.

"If you step back and look at what's going on in the past 20 years, there's more labor, relatively speaking, than there ever used to be, and that means returns to labor are lower," he said.

Marriage and divorce

Even marriage and divorce affect wage inequity, noted Harvard economist Richard Parker. Two professionals filing one tax return might find themselves in the top income ranks without thinking of themselves as rich, while divorce could force one or both parties in the relationship into dire straits even if they consider themselves middle class.

For the most part, however, Parker thinks that the factors pushing middle- and working-class wages down are driven by big trends over which individuals have little control.

"When I was growing up, manufacturing accounted for 40 percent of corporate profits," said Parker, who was born in 1946. "Today, finance, insurance and real estate account for 40 percent of corporate profits."

And the modern finance-driven economy doesn't spread the wealth as effectively as did its widget-making predecessor, argued Reich during an interview in his cramped Berkeley, Calif., office.

"The top 25 hedge fund managers earned an average of $1 billion each in 2009," he said.