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Top 1% of earners get 20% of the money

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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 UC 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 - who account for about 70 percent of all economic activity - have lost the buying power to pull the country out of recession.

"We have got to address this inequality, or it will derail the economy," said Reich, who will speak at the Commonwealth Club Tuesday evening about the plan he proposes in his new book, "Aftershock," to tax 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 like 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.

On the defensive

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.

Stanford economist Michael Boskin, who has held many Republican policy posts, said that while precise measures are impossible, it is likely that income spreads have widened. He thinks the proper policy response is to improve education and training to help workers boost their income potential.

Boskin's view is shared by Sean Randolph of the Bay Area Council Economic Institute, a corporate-backed public policy group that has tracked income inequality.

"This has been a trend in major cities around the world," he said. Cities attract corporate headquarters staffed by marketing, engineering, science and finance execs, he said. And they tend to outsource manufacturing and similar midskilled, high-salaried jobs that had sustained the middle class.

"There is a very large pool of folks who are locally based who may not have the education and the skills to move up the income ladder," 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 office.

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

Class warfare?

Such rhetoric may smack of class warfare, but it wasn't so long ago that former Citigroup analyst Ajay Kapur cited Saez's findings to bolster his argument that the United States had become what he dubbed a "plutonomy" - an economy driven by the spending of its wealthy elites.

"At the heart of plutonomy is income inequality," Kapur wrote in 2005, adding, "The rich are getting richer; they dominate spending. Their trend of getting richer looks unlikely to end any time soon."

In Books: A review of Robert Reich's new book, "Aftershock." **N1**

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