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The Great Wealth Transfer

It's the biggest untold economic story of our time: more of the nation's bounty held in fewer and fewer hands. And Bush's tax cuts are only making the problem worse

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Why doesn't Bush get credit for the strong economy?" That question has been asked over and over again in recent months by political pundits. After all, they point out, the gross domestic product is up; unemployment, at least according to official figures, is low by historical standards; and stocks have recovered much of the ground they lost in the early years of the decade, with the Dow surpassing 12,000 for the first time. Yet the public remains deeply unhappy with the state of the economy. In a recent poll, only a minority of Americans rated the economy as "excellent" or "good," while most consider it no better than "fair" or "poor."

Are people just ungrateful? Is the administration failing to get its message out? Are the news media, as conservatives darkly suggest, deliberately failing to report the good news?

None of the above. The reason most Americans think the economy is fair to poor is simple: For most Americans, it really is fair to poor. Wages have failed to keep up with rising prices. Even in 2005, a year in which the economy grew quite fast, the income of most non-elderly families lagged behind inflation. The number of Americans in poverty has risen even in the face of an official economic recovery, as has the number of Americans without health insurance. Most Americans are little, if any, better off than they were last year and definitely worse off than they were in 2000.

But how is this possible? The economic pie is getting bigger — how can it be true that most Americans are getting smaller slices? The answer, of course, is that a few people are getting much, much bigger slices. Although wages have stagnated since Bush took office, corporate profits have doubled. The gap between the nation's CEOs and average workers is now ten times greater than it was a generation ago. And while Bush's tax cuts shaved only a few hundred dollars off the tax bills of most Americans, they saved the richest one percent more than $44,000 on average. In fact, once all of Bush's tax cuts take effect, it is estimated that those with incomes of more than $200,000 a year — the richest five percent of the population — will pocket almost half of the money. Those who make less than $75,000 a year — eighty percent of America — will receive barely a quarter of the cuts. In the Bush era, economic inequality is on the rise.

Rising inequality isn't new. The gap between rich and poor started growing before Ronald Reagan took office, and it continued to widen through the Clinton years. But what is happening under Bush is something entirely unprecedented: For the first time in our history, so much growth is being siphoned off to a small, wealthy minority that most Americans are failing to gain ground even during a time of economic growth — and they know it.

America has never been an egalitarian society, but during the New Deal and the Second World War, government policies and organized labor combined to create a broad and solid middle class. The economic historians Claudia Goldin and Robert Margo call what happened between 1933 and 1945 the Great Compression: The rich got dramatically poorer while workers got considerably richer. Americans found themselves sharing broadly similar lifestyles in a way not seen since before the Civil War.

But in the 1970s, inequality began increasing again — slowly at first, then more and more rapidly. You can see how much things have changed by comparing the state of affairs at America's largest employer, then and now. In 1969, General Motors was the country's largest corporation aside from AT&T, which enjoyed a government-guaranteed monopoly on phone service. GM paid its chief executive, James M. Roche, a salary of $795,000 — the equivalent of $4.2 million today, adjusting for inflation. At the time, that was considered very high. But nobody denied that ordinary GM workers were paid pretty well. The average paycheck for production workers in the auto industry was almost $8,000 — more than $45,000 today. GM workers, who also received excellent health and retirement benefits, were considered solidly in the middle class.

Today, Wal-Mart is America's largest corporation, with 1.3 million employees. H. Lee Scott, its chairman, is paid almost $23 million — more than five times Roche's inflation-adjusted salary. Yet Scott's compensation excites relatively little comment, since it's not exceptional for the CEO of a large corporation these days. The wages paid to Wal-Mart's workers, on the other hand, do attract attention, because they are low even by current standards. On average, Wal-Mart's non-supervisory employees are paid $18,000 a year, far less than half what GM workers were paid thirty-five years ago, adjusted for inflation. And Wal-Mart is notorious both for how few of its workers receive health benefits and for the stinginess of those scarce benefits.

The broader picture is equally dismal. According to the federal Bureau of Labor Statistics, the hourly wage of the average American non-supervisory worker is actually lower, adjusted for inflation, than it was in 1970. Meanwhile, CEO pay has soared — from less than thirty times the average wage to almost 300 times the typical worker's pay.

The widening gulf between workers and executives is part of a stunning increase in inequality throughout the U.S. economy during the past thirty years. To get a sense of just how dramatic that shift has been, imagine a line of 1,000 people who represent the entire population of America. They are standing in ascending order of income, with the poorest person on the left and the richest person on the right. And their height is proportional to their income — the richer they are, the taller they are.

Start with 1973. If you assume that a height of six feet represents the average income in that year, the person on the far left side of the line — representing those Americans living in extreme poverty — is only sixteen inches tall. By the time you get to the guy at the extreme right, he towers over the line at more than 113 feet.

Now take 2005. The average height has grown from six feet to eight feet, reflecting the modest growth in average incomes over the past generation. And the poorest people on the left side of the line have grown at about the same rate as those near the middle — the gap between the middle class and the poor, in other words, hasn't changed. But people to the right must have been taking some kind of extreme steroids: The guy at the end of the line is now 560 feet tall, almost five times taller than his 1973 counterpart.

What's useful about this image is that it explodes several comforting myths we like to tell ourselves about what is happening to our society.

MYTH #1: INEQUALITY IS MAINLY A PROBLEM OF POVERTY.
According to this view, most Americans are sharing in the economy's growth, with only a small minority at the bottom left behind. That places the onus for change on middle-class Americans who — so the story goes — will have to sacrifice some of their prosperity if they want to see poverty alleviated.

But as our line illustrates, that's just plain wrong. It's not only the poor who have fallen behind — the normal-size people in the middle of the line haven't grown much, either. The real divergence in fortunes is between the great majority of Americans and a very small, extremely wealthy minority at the far right of the line.

MYTH #2: INEQUALITY IS MAINLY A PROBLEM OF EDUCATION.
This view — which I think of as the eighty-twenty fallacy — is expressed by none other than Alan Greenspan, former chairman of the Federal Reserve. Last year, Greenspan testified that wage gains were going primarily to skilled professionals with college educations — "essentially," he said, "the top twenty percent." The other eighty percent — those with less education — are stuck in routine jobs being replaced by computers or lost to imports. Inequality, Greenspan concluded, is ultimately "an education problem."

It's a good story with a comforting conclusion: Education is the answer. But it's all wrong. A closer look at our line of Americans reveals why. The richest twenty percent are those standing between 800 and 1,000. But even those standing between 800 and 950 — Americans who earn between $80,000 and $120,000 a year — have done only slightly better than everyone to their left. Almost all of the gains over the past thirty years have gone to the fifty people at the very end of the line. Being highly educated won't make you into a winner in today's U.S. economy. At best, it makes you somewhat less of a loser.

MYTH #3: INEQUALITY DOESN'T REALLY MATTER.
In this view, America is the land of opportunity, where a poor young man or woman can vault into the upper class. In fact, while modest moves up and down the economic ladder are common, true Horatio Alger stories are very rare. America actually has less social mobility than other advanced countries: These days, Horatio Alger has moved to Canada or Finland. It's easier for a poor child to make it into the upper-middle class in just about every other advanced country — including famously class-conscious Britain — than it is in the United States.

Not only can few Americans hope to join the ranks of the rich, no matter how well educated or hardworking they may be — their opportunities to do so are actually shrinking. As best we can tell, pretax incomes are now as unequally distributed as they were in the 1920s — wiping out virtually all of the gains made by the middle class during the Great Compression.

There's a famous scene in the 1987 movie *Wall Street* in which Gordon Gekko, the corporate predator played by Michael Douglas, tells a meeting of stunned shareholders that greed is good, that the unbridled pursuit of individual wealth serves the interests of the company and the nation. In the movie, Gekko gets his comeuppance; in real life, the Gordon Gekkos took over both corporate America and, eventually, our political system.

Oliver Stone didn't conjure Gekko's "greed" line out of thin air. It was based on a real speech given by corporate raider Ivan Boesky — and it reflected what many corporate executives, conservative intellectuals and right-wing politicians were saying at the time.

It's no coincidence that ringing endorsements of greed began to be heard at the same time that the actual incomes of America's rich began to soar. In part, the new pro-greed ideology was a way of rationalizing what was already happening. But it was also, to an important extent, a cause of the phenomenon. In the past thirty years, right-wing foundations have devoted enormous resources to promoting this agenda, building a far-reaching network of think tanks, media outlets and conservative scholars to legitimize higher levels of inequality. "On average, corporate America pays its most important leaders like bureaucrats," the *Harvard Business Review* lamented in 1990, calling for higher pay for top executives. "Is it any wonder then that so many CEOs act like bureaucrats?"

Although corporate executives have always had the power to pay themselves lavishly, their self-enrichment was limited by what Lucian Bebchuk, Jesse Fried and David Walker — the leading experts on exploding executive paychecks — call the "outrage constraint." What they mean is that a conspicuously self-dealing CEO would be forced to moderate his greed by unions, the press and politicians: The social climate itself condemned executive salaries that seem immodest.

Lately, however, we have experienced a death of outrage. Thanks to the right's well-funded and organized effort, corporate executives now feel no shame in lining their pockets with huge bonuses and gigantic stock options. Such self-dealing is justified, they say: Greed is what made America great, and greedy executives are exactly what corporate America needs.

At the same time, there has been a concerted attack on the institutions that have helped moderate inequality — in particular, unions. During the Great Compression, the rate of unionization nearly tripled; by 1945, more than one in three American workers belonged to a union. A lot of what made General Motors the relatively egalitarian institution it was in the 1960s had to do with its powerful union, which was able to demand high wages for its members. Those wages, in turn, set a standard that elevated the income of workers who didn't belong to unions. But today, in the era of Wal-Mart, fewer than one in eleven workers in the private sector is organized — effectively preventing hundreds of thousands of working Americans from joining the middle class.

Why isn't Wal-Mart unionized? The answer is simple and brutal: Business interests went on the offensive against unions. And we're not talking about gentle persuasion; we're talking about hardball tactics. During the late 1970s and early 1980s, at least one in every twenty workers who voted for a union was illegally fired; some estimates put the number as high as one in eight. And once Ronald Reagan took office, the anti-union campaign was aided and abetted by political support at the highest levels.

Unions weren't the only institution that fostered income equality during the generation that followed the Great Compression. The creation of a national minimum wage also set a benchmark for the entire economy, boosting the bargaining position of workers. But under Reagan, Congress failed to raise the minimum wage, allowing its value to be eroded by inflation. Between 1981 and 1989, the minimum wage remained the same in dollar terms — but inflation shrank its purchasing power by twenty-five percent, reducing it to the lowest level since the 1950s.

After Reagan left office, there was a partial reversal of his anti-labor policies. The minimum wage was increased under the elder Bush and again under Clinton, restoring about half the ground it lost under Reagan. But then came Bush the Second — and the balance of power shifted against workers and the middle class to a degree not seen since the Gilded Age.

During the 2000 election campaign, George W. Bush joked that his base consisted of the "haves and the have mores." But it wasn't much of a joke. Not only has the Bush administration favored the interests of the wealthiest few Americans over those of the middle class, it has consistently shown a preference for people who get their income from dividends and capital gains, rather than those who work for a living.

Under Bush, the economy has been growing at a reasonable pace for the past three years. But most Americans have failed to benefit from that growth. All indicators of the economic status of ordinary Americans — poverty rates, family incomes, the number of people without health insurance — show that most of us were worse off in 2005 than we were in 2000, and there's little reason to think that 2006 was much better.

So where did all the economic growth go? It went to a relative handful of people at the top. The earnings of the typical full-time worker, adjusted for inflation, have actually fallen since Bush took office. Pay for CEOs, meanwhile, has soared — from 185 times that of average workers in 2003 to 279 times in 2005. And after-tax corporate profits have also skyrocketed, more than doubling since Bush took office. Those profits will eventually be reflected in dividends and capital gains, which accrue mainly to the very well-off: More than three-quarters of all stocks are owned by the richest ten percent of the population.

Bush wasn't directly responsible for the stagnation of wages and the surge in profits and executive compensation: The White House doesn't set wage rates or give CEOs stock options. But the government can tilt the balance of power between workers and bosses in many ways — and at every juncture, this government has favored the bosses. There are four ways, in particular, that the Bush administration has helped make the poor poorer and the rich richer.

First, like Reagan, Bush has stood firmly against any increase in the minimum wage, even as inflation erodes the value of a dollar. The minimum wage was last raised in 1997; since then, inflation has cut the purchasing power of a minimum-wage worker's paycheck by twenty percent.

Second, again like Reagan, Bush has used the government's power to make it harder for workers to organize. The National Labor Relations Board, founded to protect the ability of workers to organize, has become for all practical purposes an agent of employers trying to prevent unionization. A spectacular example of this anti-union bias came just a few months ago. Under U.S. labor law, legal protections for union organizing do not extend to supervisors. But the Republican majority on the NLRB ruled that otherwise ordinary line workers who occasionally tell others what to do — such as charge nurses, who primarily care for patients but also give instructions to other nurses on the same shift — will now be considered supervisors. In a single administrative stroke, the Bush administration stripped as many as 8 million workers of their right to unionize.

Third, the administration effectively blocked what might have been a post-Enron backlash against self-dealing corporate insiders. Corporate scandals dominated the news in the first half of 2002 — but then the subject was changed to the urgent need to invade Iraq, and the drive for reform was squelched. With Americans focused on the war, CEOs are once again rewarding themselves at impressive — and unprecedented — levels.

Finally, there's the government's most direct method of affecting incomes: taxes. In this arena, Bush has made sure that the rich pay lower taxes than they have in decades. According to the latest estimates, once the Bush tax cuts have taken full effect, more than a third of the cash will go to people making more than $500,000 a year — a mere 0.8 percent of the population.

It's easy to get confused about the Bush tax cuts. For one thing, they are designed to confuse. The core of the Bush policy involves cutting taxes on high incomes, especially on the income wealthy Americans receive from capital gains and dividends. You might say that the Bush administration favors people who live off their wealth over people who have a job. But there are some middle-class "sweeteners" thrown in, so the administration can point to a few ordinary American families who have received significant tax cuts.

Furthermore, the administration has engaged in a systematic campaign of disinformation about whose taxes have been cut. Indeed, one of Bush's first actions after taking office was to tell the Treasury Department to stop producing estimates of how tax cuts are distributed by income class — that is, information on who gained how much. Instead, official reports on taxes under Bush are textbook examples of how to mislead with statistics, presenting a welter of confusing numbers that convey the false impression that the tax cuts favor middle-class families, not the wealthy.

In reality, only a few middle-class families received a significant tax cut under Bush. But every wealthy American — especially those who live off of stock earnings or their inheritance — got a big tax cut. To picture who gained the most, imagine the son of a very wealthy man, who expects to inherit $50 million in stock and live off the dividends. Before the Bush tax cuts, our lucky heir-to-be would have paid about $27 million in estate taxes and contributed 39.6 percent of his dividend income in taxes. Once Bush's cuts go into effect, he could inherit the whole estate tax-free and pay a tax rate of only fifteen percent on his stock earnings. Truly, this is a very good time to be one of the have mores.

It's worth noting that Bush doesn't simply favor the upper class: It's the upper-upper class he cares about. That became clear last fall, when the House and Senate passed rival tax-cutting bills. (What were they doing cutting taxes yet again in the face of a huge budget deficit and an expensive war? Never mind.) The Senate bill was devoted to providing relief to middle-class wage earners: According to the Tax Policy Center, two-thirds of the Senate tax cut would have gone to people with incomes of between $100,000 and $500,000 a year. Those making more than $1 million a year would have received only eight percent of the cut.

The House bill, by contrast, focused on extending tax cuts on capital gains and dividends. More than forty percent of the House cuts would have flowed to the $1 million-plus group; only thirty percent to the 100K to 500K taxpayers.

The White House favored the House bill — and the final, reconciled measure wound up awarding a quarter of the benefits to America's millionaires. That, in a nutshell, is the politics of income inequality under Bush.

Oh, one last thing: What about the claim that the Bush tax cuts did wonders for economic growth? In fact, job creation has been much slower under Bush than under Clinton, and overall growth since 2003 is largely the result of the huge housing boom, which has more to do with low interest rates than with taxes. But the biggest irony of all is that the real boom — the one in the 1990s — followed tax changes that were the reverse of Bush's policies. Clinton raised taxes on the rich, and the economy prospered.

A generation ago the distribution of income in the United States didn't look all that different from that of other advanced countries. We had more poverty, largely because of the unresolved legacy of slavery. But the gap between the economic elite and the middle class was no larger in America than it was in Europe.

Today, we're completely out of line with other advanced countries. The share of income received by the top 0.1 percent of Americans is twice the share received by the corresponding group in Britain, and three times the share in France. These days, to find societies as unequal as the United States you have to look beyond the advanced world, to Latin America. And if that comparison doesn't frighten you, it should.

The social and economic failure of Latin America is one of history's great tragedies. Our southern neighbors started out with natural and human resources at least as favorable for economic development as those in the United States. Yet over the course of the past two centuries, they fell steadily behind. Economic historians such as Kenneth Sokoloff of UCLA think they know why: Latin America got caught in an inequality trap. For historical reasons — the kind of crops they grew, the elitist policies of colonial Spain — Latin American societies started out with much more inequality than the societies of North America. But this inequality persisted, Sokoloff writes, because elites were able to "institutionalize an unequal distribution of political power" and to "use that greater influence to establish rules, laws and other government policies that advantaged members of the elite relative to non-members." Rather than making land available to small farmers, as the United States did with the Homestead Act, Latin American governments tended to give large blocks of public lands to people with the right connections. They also shortchanged basic education — condemning millions to illiteracy. The result, Sokoloff notes, was "persistence over time of the high degree of inequality." This sharp inequality, in turn, doomed the economies of Latin America: Many talented people never got a chance to rise to their full potential, simply because they were born into the wrong class.

In addition, the statistical evidence shows, unequal societies tend to be corrupt societies. When there are huge disparities in wealth, the rich have both the motive and the means to corrupt the system on their behalf. In *The New Industrial State*, published in 1967, John Kenneth Galbraith dismissed any concern that corporate executives might exploit their position for personal gain, insisting that group decision-making would enforce "a high standard of personal honesty." But in recent years, the sheer amount of money paid to executives who are perceived as successful has overridden the restraints that Galbraith believed would control executive greed. Today, a top executive who pumps up his company's stock price by faking high profits can walk away with vast wealth even if the company later collapses, and the small chance he faces of going to jail isn't an effective deterrent. What's more, the group decision-making that Galbraith thought would prevent personal corruption doesn't work if everyone in the group can be bought off with a piece of the spoils — which is more or less what happened at Enron. It is also what happens in Congress, when corporations share the spoils with our elected representatives in the form of generous campaign contributions and lucrative lobbying jobs.

As the past six years demonstrate, such political corruption only worsens as economic inequality rises. Indeed, the gap between rich and poor doesn't just mean that few Americans share in the benefits of economic growth — it also undermines the sense of shared experience that binds us together as a nation. "Trust is based upon the belief that we are all in this together, part of a 'moral community,' " writes Eric Uslaner, a political scientist at the University of Maryland who has studied the effects of inequality on trust. "It is tough to convince people in a highly stratified society that the rich and the poor share common values, much less a common fate."

In the end, the effects of our growing economic inequality go far beyond dollars and cents. This, ultimately, is the most pressing question we face as a society today: Will the United States go down the path that Latin America followed — one that leads to ever-growing disparity in political power as well as in income? The United States doesn't have Third World levels of economic inequality — yet. But it is not hard to foresee, in the current state of our political and economic scene, the outline of a transformation into a permanently unequal society — one that locks in and perpetuates the drastic economic polarization that is already dangerously far advanced.

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