RICH, POOR, AND MORE ...... AND MORE – POINT/COUNTERPOINT PART I

Stephen L. Bakke, September 2008 and April 2011

Income, Wages, and Wealth

- ***Point:*** Wages are stagnating, the poor are getting poorer, and the overall difference between the lowest and highest incomes is becoming greater.

  Counterpoint: Income mobility continues. A recent U.S. Treasury study of income tax returns from 1996 and 2005 showed that, after controlling for inflation, 58% of the poorest group in '96 moved to a higher group by '05, with a surprising 26% to the mid or upper group, and 5% to the highest income group. Also over the decade, inflation adjusted median income actually increased by 24% and one group experienced a reduction in real income – the upper group. In 2006, eal wages rose by 2% – the second fastest in 30 years.

  According to the Congressional Budget Office, earnings for the poorest 1/5 of Americans are also on the rise over time. From 1991 through 2005, the bottom 1/5 increased its earnings by 80%, compared to approximately a 50% rise for the highest group. Each of the other three groups, those in the middle, rose by 20%.

  Now a slightly different look at IRS data. The IRS is able to provide this information by following certain taxpayers over time by social security number. This data shows that people in the bottom ½ of tax filers in 1996 had incomes increase by 91% by 2005. The top 1% saw their incomes decline by 26%. And, as stated in the earlier comparison, the average taxpayer's real income increased by 24% between 1996 and 2005.

  This IRS data follows certain taxpayers to see what happens to that group of specific taxpayers. A study by the University of Michigan supports the IRS data. Certain other statistics, e.g. census data, follow categories only and often show somewhat different results.

  A recent report stated that we have had 3 straight years in which the median income increased. Considering how median income is determined, this could only happen if there has been an increase for the lower income levels.

- ***Point:*** The middle class is disappearing.

  Counterpoint: The U.S. Treasury study showed that, after adjusting for inflation, in 1967, 8% of households had annual income of $75,000 and higher. In 2003, more than 26% did. In '67, 17% of households had $50,000 to $75,000 income, in '03 it was 18%. In '67, 22% had $35,000 to $50,000 income, and by '03 it had fallen to 15%; the $15,000 to $35,000 category fell from 31% to 25% of the total; and the lowest group, under $15,000 income, fell from 21% to 16%.

- ***Point:*** Wealth is more concentrated than at any time in history.

  Counterpoint: 100 years ago, John D. Rockefeller's wealth was over ½ % of the country's total wealth. We aren't even close today. But that is just a bit too anecdotal to be meaningful. A better example is that in 1920, the richest 1% held 40% of the country's wealth. From 1980 to the present it has remained consistent – the wealthiest 1% holding approximately 20% of the country's wealth.

- ***Point:*** Top corporate CEOs are the highest paid persons in the country.

  Counterpoint: The top ten celebrities and athletes earned an average of $116 million in 2004. The top ten CEOs? A "mere" $59 million average.

- ***Point:*** Much of our insecurity is caused by incomes becoming more volatile.

  Counterpoint: According the study by the Congressional Budget Office incomes are no more unstable now than in the 1980s or 1990s.

- ***Point:*** The elderly, as a group, are in dire economic straits. And the poorest of our population are no better off.

  Counterpoint: There are certainly too many elderly who are desperately poor. However, most of the alarming statistics presented in the press and by many politicians are greatly exaggerated and need to be examined. Correct information must be used in evaluating and reaching policy conclusions.

  The seniors citizens' earning statistics which are typically presented include only "earned income". What is omitted is "unearned income" which includes income from pensions, social security, 401K plans, and other investments – really! In fact only about 24% of what seniors' have available to live on is typically reflected in the earning statistics. You therefore have to "multiply by 4" to get the correct information.

  In similar fashion, the earnings presented for the lowest taxpayers do not give any indication of their total disposable resources. The most commonly presented statistics exclude transfer payments such as welfare payments, and subsidies for housing and medical care. As of 2001, approximately 78% of the lowest 20% of taxpayers' economic resources were cash transfers or in-kind transfers such as subsidies. You therefore have to multiply by almost 5 to get an accurate picture of their level of poverty. Is this intended to create alarm for political reasons?

- ***Point:*** Government pressures are responsible for narrowing the differences between men and women in employment, pay, or promotion.

Counterpoint: While this was one factor, there are many other factors which one must assess rather than giving government too much credit. An examination of the history of employment statistics shows that an increase in government programs seems to have an opposite affect for many professions. For example, in 1961 women's share of college faculty positions was lower than in 1930. In fact, the number of women in higher level jobs seems to be correlated more to the rise in the median age of marriage, and the rise in the median age of child bearing.

- ***Point:*** Discrimination is the leading reason for discrepancies between men and women in pay and opportunities.

  Counterpoint: Of course there are many time-worn, but generally valid, explanations including: choices of occupation, continuity of employment, domestic responsibilities. It is a supportable fact that women have chosen different occupations than men, have fewer years of experience at comparable age, and generally chose to shorten their careers.

  But one valid way to do the comparison is to make all things equal e.g. comparing never married women & men, past childbearing years, working fulltime, and working prior to affirmative action. A study with these parameters shows that women earn more than men of the same description. That is interesting, but the fact remains that married women, from any era, who had children, lagged farthest behind men in income, career advancement, or even working at all.

- ***Point:*** There has been no real progress raising our black minority from poverty.

  Counterpoint: While there is more work to do, we should not ignore the progress that has been made. In the last 40 years, the percentage of blacks living above the poverty level has risen from 65% to 80%.

- ***Point:*** Married black men suffer from higher unemployment than do whites of the same category.

  Counterpoint: Data indicates the employment rate of married black men equals the employment rate for married white men.

- ***Point:*** Even educated black women suffer from discrimination in pay compared to their white counterparts.

  Counterpoint: There is evidence that the average black woman with a college degree earns more than the average white woman with a college degree.

- ***Point:*** Black owned businesses are still struggling compared to non-minority businesses.

Counterpoint: Black-owned businesses have been shown to grow at a rate faster than white-owned businesses.

Taxes

- ***Point:*** One effective way to raise revenue without hurting the "little guy" is by raising the capital gains tax and the tax on the highest incomes.

  Counterpoint: The vast majority of middle income persons holds equity securities either directly or indirectly and pays capital gains taxes. It can be easily demonstrated that taxes on capital formation (capital gains taxes) reduces capital formation, and aggressive taxes on income reduces the incentive to work and invest – the cornerstones of our type of economy.

- ***Point:*** The Bush capital gains tax cut was ineffective and unfair.

  Counterpoint: In 2003, the rate was cut from 20% to 15%. After the rate cuts, more Americans were attracted to investments subject to capital gains and were willing to sell and declare such gains. Declared capital gains taxes have doubled since the rates were reduced. And dividend income increased at least 50% since the dividend tax rate was cut to 15% from 40%. Once again, it seems that taxes on capital formation reduces capital formation, and vise versa.

- ***Point:*** The rich don't pay much in taxes and this inequity is getting worse.

  Counterpoint: According to the Congressional Budget Office, in 2005 the richest 1% paid 39% of all income taxes; the richest 5% paid a little less than 60%; and the richest 10% paid 70%. These percentages are all up since 2000, and are substantially higher than 1990.

  Households below the median income (or ½ of all households) paid only 3% of all income taxes. The richest (1.3 million taxpayers – those with "adjusted gross income" of over $365,000) paid more income tax than all 66 million taxpayers below the median – 10 times more!

  Some information just for Minnesota: In 2005, the top 10% of households paid 55.4% of total Minnesota income taxes and 27% of sales, business and property taxes. The top 1% paid 24% of total Minnesota income taxes. The bottom 20% of households paid no Minnesota income taxes while getting back $33.5 million in refundable credits.

- ***Point:*** The "Bush tax cuts" resulted in a huge reduction in the taxes paid by the rich, while not benefiting the "little guy".

  Counterpoint: According to the Congressional Budget Office, the share of taxes paid by the top 1% increased from 37.4% in 2000 to 39.4% in 2005. The top 5%

increased even more. Therefore, despite the tax reductions of 2001 and 2003, the rich saw their share of taxes increase faster than their share of income. Why? - Partly because cuts were more beneficial (proportionately) to low and middle income households, and also because loopholes were reduced.

- ***Point:*** The democrats will pay for new / expanded programs by eliminating Bush tax cuts for the rich.

  Counterpoint: Obama's programs would lead to a spending increase of at least \$307.3 billion by some estimates. However, eliminating cuts would provide only \$60 billion annually. Even the Washington Post has recognized the implausibility of this claim.

- ***Point:*** Campaign adds state that oil companies are being offered special tax breaks by the Republicans.

  Counterpoint: As far as I can tell, corporate tax policies, as proposed, make no distinction between corporations, no matter the industry. That means that the same policies would apply across the board – i.e. nothing special for the oil companies.

Globalization and Jobs

- ***Point:*** There is rampant relocation of investment occurring in western societies.

  Counterpoint: 90% of fixed investment around the world is domestic. The largest reason for locating facilities in another country is to be near local markets, and globalization of competition is itself responsible for only a small share of job creation or destruction over the last few decades.

- ***Point:*** U.S. manufacturing output is changing and falling due to globalization.

  Counterpoint: There is research which indicates that the U.S. share of global manufacturing output is actually up since 1980. What is reshaping our employment base and manufacturing is technological not globalization. Manufacturing productivity has doubled over the last two decades. Global employment statistics show that China has lost proportionately more manufacturing jobs than the U.S. There has been a skills revolution to a greater degree than an export of jobs.

- ***Point:*** Our employment situation is suffering compared to the rest of the world, particular the Far East – largely due to the trade deficit and exporting jobs.

  Counterpoint: Since 2001, our economy has created 9.3 million new jobs, compared with 360,000 in Japan and 1.1 million in the euro zone (European Union), excluding Spain. Japan and euro zone countries had trade surpluses, while we had large and increasing trade deficits. Both Spain and the U.K., like the U.S., ran trade deficits, but they created 3.6 and 1.3 million new jobs respectively. Moreover, wages rose in the U.S., Spain and the U.K.

Housing and the Mortgage Crisis

- ***Point:*** The mortgage crisis is caused by greedy, irresponsible lenders, and naïve home buyers.

  Counterpoint: Let us not forget the government's hand in this. This is another example of unintended consequences. It was not many years ago when there was moral outrage ringing throughout the media because lenders were reluctant to lend in certain neighborhoods. Pressure was put on Congress to pass laws forcing lenders to lend to people they would not otherwise lend to and in places where they would not otherwise put their money.

  The Community Reinvestment Act of 1977 (CRA), which was subsequently strengthened in the Clinton and Bush administrations, is a federal law that mandates lenders to offer credit throughout their entire market to borrowers they would not otherwise lend to, and discourages them from restricting their credit services to higher income markets. The restricted practices are referred to as "redlining" – or limiting lending into higher risk areas and to higher risk individuals. In effect, CRA encouraged banks and thrifts to make so called "no doc" loans to customers who had no realistic ability to repay the loan. And the expanding housing bubble further encouraged this "loosy goosy" lending practice by giving false security as to housing values. That's really how the crisis all began.

  The problem started with government intervention into the financial markets, and it is now government which is ignoring their role in the problem and which is expected to save the situation.

- ***Point:*** The affordable housing problem / shortage is the result of unfair housing markets and greedy developers – and it requires government intervention in the housing market such as subsidies, rent control, etc.

  Counterpoint: The same politicians who point fingers are the same ones who most consistently promoted restrictions on building of housing. This appeared under the banners of "open space laws", "farmland protection policies", preventing "urban sprawl", and other restrictive policies on development. The unintended consequence: If you take vast amounts of land off the market you will drastically increase the price – affordable housing becomes unaffordable. Why is that so hard to understand?

  There is a demonstrable correlation in cities where an increase in these laws and policies predictably lead to significant price increases. And a reduction in government regulation is correlated directly with housing supply being able to keep up with demand.

- ***Point:*** The mortgage crisis is seriously threatening our system.

  Counterpoint: A relatively small percentage of mortgages were foreclosed in 2007. Of course these foreclosures continued into 2008, and losses seem to be concentrated in certain institutions. Credit markets are not “in great shape”, but are still fluid, inflation is mostly under control, interest rates are low, and unemployment is below historical averages. While we should worry about and pay attention to resolving these issues and not repeating the mistakes, nevertheless, the sky isn’t falling. Politicians create job security for themselves and the bureaucracy by keeping citizens in a state of crisis. The goal is to look to government to solve the problems, thereby making government even bigger.

  We are having a hard time in many quarters of our economy, but prosperity and stability come not from government and regulatory control, but from freedom to innovate, produce, and even fail. Bailouts tend to create irresponsibility.

  There is no perfect system, but we need to “get a grip” – the sky isn’t falling – the best solution and regulator is free competition, even with all its imperfections. Government problem solving tends to create many unintended consequences!

The next report includes more “Point/Counterpoint” commentary as well as my opinion and closing comments.