Some Observations

Concerning

Wealth Distribution in the United States, and World Wide

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Although the assigned topic is "Wealth Distribution in the United States and the World", I will begin by focusing on world poverty – a somewhat narrower topic. I have chosen to do so in deference to a recently published book that offers a new and meaningfully different approach to alleviating the plight of the poorest.

Banerjee & Duflo, two MIT professors, collaborated to write *Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty.*[1] The book, published this past year, was named Business Book of the Year by Financial Times. It is the product of fifteen years of empirical study, of conversations with, listening to, and seeking understanding of the poor.

The authors focus on the world's poorest. In the fifteen countries where most of the poor live, the average poverty line is 16 Indian rupees per person, per day. People who live on less than that are considered to be poor by the government of their own countries. Sixteen rupees equals 36 U.S. cents, based upon the exchange rate when the book went to press. Adjusted for the lower consumer prices in developing countries, this would purchase some 99 cents of goods in the United States. This is the amount which 13 percent of the world's population – some 865 million people according to the authors – must rely upon to provide all their everyday needs other than housing.

The authors conclude that programs to alleviate poverty have been frustrated by three "I's" – inertia, ideology and ignorance.

Most of all, anti-poverty programs have failed due to an inadequate understanding of poverty: Ingrained perceptions drive the way in which governments and non governmental organizations structure financial and humanitarian assistance -- an all too typical "We know what's best for you" hubris.

As one reviewer noted, two outstanding strengths of the book are the virtues of patience and humility: constantly listening to what the poor have to say about their lives, seeking to understand; eschewing grandiose solutions in favor of strategies to improve lives. Those strategies must incentivise people who ignore available birth control, health screening and vaccinations. They point out that the poorest make the most of such talent as they have: Securing their family's sustenance requires more skill, will power and commitment. They make sophisticated calculations – but often misplaced decisions – under grim circumstances. The pressure of time – gathering sustenance for today's existence – prevents a parent from taking a child to a free immunization camp. The small barriers, the little mistakes that seem inconsequential to us, loom large in the lives of those who have very little.

By the same token, the authors assert that understanding the people and the barriers that stymie them, permits small yet meaningful steps to overcome the root causes of poverty. The appeal is for ideas, not just money. Another reviewer has said "Their overall approach is Bottom of the Pyramid meets Freakonomics – 'leave the large questions aside and focus on the lives and choices of poor people' and why interventions by governments or NGOs do/don't work."[2]

Perhaps the greatest contribution that Banerjee and Duflo make is the welcome and sobering break from all the partisan rhetoric. Their willingness to drive deeper into issues that have either been ignored or glossed over by uninformed guess work, is a refreshing approach that invites new ideas.

Wealth Distribution

Returning to the topic of "wealth distribution", we may find that our inquiry would be more profitable if, instead of concentrating on the symptoms, it were directed toward how we might better respond to those in need. In addition to alleviating their immediate distress, how can we empower them to garner a larger piece of the pie?

Conversations respecting wealth distribution are adorned with high-sounding phrases such as "social justice" and "equity" and "equality" – terms reminiscent of the French revolution. However, viewed in the abstract, the issue is in many instances essentially one of envy of another's material store. The dissatisfied of the United States certainly possess a less compelling ethical claim than the person who lives on 15 rupees – 99 cents of American purchasing power – each day. Recognizing this places the matter in proper perspective.

That is not to say that existing extremes should be ignored.

The issue exists and is more in vogue now than when the topic was assigned: As such, it may rightly be confronted. It is, like the issue of world poverty, clouded by considerable political rhetoric that obfuscates rational analysis. Meaningful dialogue is further hampered by imprecise and ill-defined terms. The terms "income" and "wealth" are often used interchangeably. For example, a recent headline in a local paper declared "Wage Gap Widens in Congress: Lawmakers' Salary Dwarfs Constituents."[3] The text of the article dealt entirely with net worth. It noted that the financial disclosures reported by members of Congress reflected an increase of 2 ½ times the accumulated wealth reported 25 years earlier. During this period the median wealth of "the American family" had declined slightly. Contrary to the headline, wages and salaries are not addressed in the text. In a similar vein, the term "millionaire" once referred to one who had accumulated a million dollars of resources: Today the term connotes a person having an income of a million or more dollars per year.

Quantify it how you wish – net worth, gross income, disposable net income, stash, moola , loot – the topic has considerable currency in society. The Occupy movement that began on Wall Street and spread to other locales, has given prominence to the subject of wealth distribution. According to a recent poll, 61% believe that the gap

between wealthy people and the rest of the population is much larger than it has been in the past. However, in an item captioned *The Myth of 'Record-High' Inequality*, the Wall Street Journal has noted that based on 2009 data, inequality is less than it was prior to the current recession. The IRS reported that in 2007 people making more than $500,000 accounted for 27% of U.S. income. In 2009, their share fell to 14%.[4]

It is fairly obvious that economic disparity will be at the forefront in the upcoming presidential campaign. This past November, Ohio voters rejected a referendum that proposed repeal of the state's law permitting collective bargaining by public employees. The following day the Vice-President made an appearance in Euclid, Ohio where he spoke to a group of workers assembled in a fire station, stating "you fired the first shot", in what he termed a revolution in defense of economic interests of the middle-class[5]. The discontent that emerged as the Occupy Movement will be leveraged by the political process.There is little doubt that Americans by and large vote their pocketbook: It is the campaigning politician's function to convince the voter how plump, or how lean, his pocketbook may be – or, perhaps more aptly, how the opposition has fattened the wallet of his neighbor. There is hay to be made in what Lee Cooperman of Omega Advisors terms "the polarizing vernacular of political militancy."[6] How can we sift the grains of truth from the waves of hyperbole?

How do we Quantify Wealth?

For purposes of this paper, I have chosen to focus on income, rather than accumulated wealth, or net worth. The reasons are several. First, information respecting personal income is more readily available. Second, there are major differences among studies of personal wealth; many exclude personal residences, for example. And some significant forms of wealth – such as closely held business interests and unfunded deferred compensation – are notoriously difficult to value. Third, most of the hyperbole abroad in the land is expressed in terms of income inequality. And lastly, but most importantly, net worth is a mere abstraction that matters little to a very large portion of

of society which lives pay check-to-pay check, whether by necessity or as a result of undisciplined consumption.

That being said, we must consider both what the income data indicates and just how reliable a metric reported income is, in terms of income distribution.

According to some sources 20% of all income went to the top 1% of the population in 2008. And over half that income was garnered by the top one, one hundredth of a percent – those with incomes of $1.7 Million or more.

Another source, the U.S. Census Bureau, determined that median household income stagnated, increasing a scant 18% over the 30 year period ended in 2006. But, data compiled by the Commerce Department's Bureau of Economic Analysis determined that income ***per person*** rose 80% during that term. At first blush this suggests a great disparity in how that income was distributed among households. The figures are widely cited to demonstrate that middle America has been bypassed as household income – especially wage income – stagnated while expenses increased, driving the middle class further into debt. But, on further analysis one is inclined to side with the former British Prime Minister, Disraeli, who said "There are three kinds of lies: lies, damned lies and statistics." Some further refinement is needed, since there is lack of agreement on what constitutes "income" and, as we consider trends, how numbers are adjusted to account for inflation. Statistical presentations are incomplete and conflicting.

The Federal Reserve Bank of Minneapolis published a study in 2008 which attempted to reconcile the conclusions to be drawn from the divergent statistics emanating from the Census Bureau and those of the Bureau of Economic Analysis.[7] This study determined that –

- The price index used by the Census Bureau overstates inflation, thereby

understating income gains.

- The changing makeup of households defies meaningful comparison over the extended 30 year term and understates the median increase of what the study terms "most household types".

- The Census Bureau definition of "income" excludes several of the rapidly growing sources of income.

There is no one measure of inflation that is accepted by economists. In its reconciliation, the Minneapolis Study substituted a widely used Bureau of Economic Analysis inflation index for Consumer Price Index used by the Census Bureau. This changed the reported 18% gain in median household income to 26% -- a step up of 44%.

The evolving composition of households is a highly dynamic variable. During the thirty year period ended in 2006, the incidence of married-couple households declined from roughly two-thirds to one half. The median income of married-couple households increased by 42% -- compared to the 26% for all households. This is hardly surprising: Consider the impact if all married householders were to divorce: The number of households formerly of this group would double, and their combined incomes would be spread over double the number of households. But, the study also acknowledged that within married households the larger gains inured to the top income groups. For married households with children, the increase realized by the 25th percentile group was approximately half that of the 75th percentile.

Now it is the third factor -- what is and is not included as "income" – that accounts for a greater part of the discrepancy. The Census Bureau narrowly defines income to consist solely of adjusted gross income as reported for income tax purposes – principally cash receipts. It ignores non-wage compensation, such as employer paid health care benefits and retirement plan contributions: Elective deferrals which reduce reported compensation by employee contributions to tax favored retirement savings

such as 401(k) and 403(b) plans are also excluded. Transfer payments such as Medicaid, food stamps and energy assistance are likewise omitted from the Census Bureau calculation of overall receipts. The effect is that of diminishing the denominator of the fraction and thus overstating the portion or percentage inuring to upper income groups. Both non-wage benefits and transfer payments have been some of the most rapidly escalating personal resources within recent decades. And the omission of elective salary deferrals further distort results:

- It reduces the amount reported as wages;
- And, due to the dollar limitation on deferrals, the amount excluded represents a proportionately greater reduction of income of lower bracket taxpayers;
- The results are further skewed since the investment income and gains earned by this source of savings is tax deferred and not reported as current income of the person who owns the retirement account.

In contrast to the Census Bureau numbers, most but not all these sources are taken into account as "income" in the data compiled by the Bureau of Economic Analysis. While the Census figures show a 65% increase in per capita income over the thirty year term, inclusion of the omitted sources results in an 80% increment in income per person.

The study concludes that the middle 50% of households experienced gains ranging from 35% to 65% during the 30 year period analyzed. While outsized gains were realized by the extremely rich, middle America did not fare poorly but achieved an enhanced standard of living.

The Minneapolis Federal Reserve study focused on the composition of income data. However compiled and adjusted, the numbers do not speak for themselves. They cannot be viewed in a vacuum. The statistics merely reflect the results. The surrounding

circumstances – those which influenced the results recorded by the data – must be considered in determining the inferences properly drawn from that data.

For example, the top 1percent group's share of reported income jumped from 9.1% to 13.2% in the two year period of 1987 and 1988.[8] Why this sharp and substantial increase? Very simply, there was a dramatic shift of business income from corporate tax returns to individual returns. This was prompted by the 1986 Tax Reform Act which, over the two year period, reduced the top individual income tax rate from 50% to 37.5% in 1987 and 28% in '88. In that two year window shareholders of an immense number of corporations elected to switch the companies to "S Corporations", which would function as pass-though entities, with business earnings taxed at the individual shareholder level rather than the corporate level. Thus, the taxable income that was formerly reported on corporate returns instead appeared on the individual returns of the shareholders. The spurt resulting from the shift of business income to individual returns was more dramatic among upper income groups who then, as now, derive a relatively large portion of their income from business interests. However, this shift was merely a reporting phenomenon, with no meaningful reallocation of wealth from one segment of the population to another.

Certain of the income components have changed markedly in recent years. Capital gains reported in the bullish markets prior to the downturn that began in 2008 influenced the income distribution gleaned from tax returns. More recent data demonstrates the significance of the particular time period that is selected for statistical analysis. During the last week of the recently departed 2011, the Internal Revenue Service released the Statistics of Income drawn from 2009 income tax returns. Net capital gain income, which had decreased 50% in 2008, dropped an additional 50% in 2009, reaching the lowest levels since 1994.

Although wages and salaries declined, the inflation adjusted amounts remain at

the 2006 level. On the other hand, business income from partnerships and S corporations declined for the third consecutive year. The disparate fluctuation in the capital gain and business income components of income fall more heavily on the upper income groups and will no doubt impact future compilations of income distribution.

While income distribution is less skewed than many widely published sources postulate, it cannot be denied that extremes do exist. Executive compensation is typically targeted. A Washington Post article says that executive pay has increased four-fold since the 1970's, though no supporting data is offered to substantiate this assertion. [9] Whatever the rate of increase, the absolute dollar amounts of total benefits paid CEO's are in some instances dazzling, if not overwhelming. Yet, to a public saturated with the widely publicized contracts garnered by professional athletes, perhaps the corporate largesse goes unheeded. Some economists theorize that social norms have indeed changed, and that the public is either tolerant of , or more likely, fatalistically immune to excesses. Conventional systems of corporate governance are thought to be inadequate to rein in executive compensation. Fund managers and institutional investors who control large blocs of voting stock, corporate directors to whom the executives are accountable, and the Wall Street investment bankers whom they depend on to float security issues, are more often than not a part of the same culture and themselves enjoy substantial compensation and perquisites. As such, they are considered loathe to put a damper on executive benefits. But if that be the case, and management is overpaid, it is the investor who is the less – not the wage earner. Referring to the Wall Street crowd, one commentator has wryly observed that the saying in lower Manhattan is : "you can search in vain for the customer's yachts."

Much of what I have said, and so much more that is prattled by the media and disseminated across the internet, is founded on the assumption that all are motivated by nothing more than self-interest. I personally believe that as a people our vision of idealism – the aspiration to a higher good – has dimmed considerably. And I despair of

that.

This past summer I enjoyed the cross-cultural experience of attending a Hindu wedding ceremony. The verbal elements of the ritual were spoken in Sanskrit, but the celebrant explained -- for the benefit of the English speaking friends of the groom – the various elements of the ceremony. At one point the bridal couple takes seven steps together, around the sacred fire. The third solemnizes their promise to each other to increase their wealth by righteous and proper means. This is preceded by the four circumlocutions around the fire – the Mangalfera. Each time they stop to touch with their toe a stone in the path – symbolizing obstacles they will overcome together. The four rounds stand for what are represented to be the four basic human goals:

> righteousness; monetary accomplishment; energy and passion in life; and liberation from everything in life.

The groom leads the first three rounds, signifying his contribution in helping the union attain the first three goals. The final round is led by the bride and signifies their continual journey toward spiritual liberation.[10]

This is a refreshingly enlightened view of wealth. It is ethical, indeed desirable, to pursue and enjoy wealth as the reward of honest toil – and yet not be captivated by it, instead aspiring to transcendent priorities.

That said, India, where the Hindu faith has predominated, has perhaps the most extreme disparity in wealth, with millions who exist in abject poverty. Perhaps there is a disconnect between the privilege of wealth and the obligation of philanthropy.

In our culture philanthropy is understood by many to be an ethical concomitant of wealth. It gives recognition to the inescapable differences in fortune, and tempers wealth disparity by voluntarily sharing, be it to relieve poverty or to provide for the public good in various other ways.

The recent *Statistics of Income* published by the IRS reflect an 8.3% decline in charitable deductions claimed for the year 2009 – bringing the reported charitable giving to its lowest point since 1998. This is not, however, out of line with the decrease in adjusted gross income. It must also be recognized that the income tax data fails to provide a comprehensive view of charitable giving: It tracks only the itemized charitable deductions and does not take into account contributions by the large number of taxpayers who do not itemize deductions. Furthermore, it ignores testamentary transfers and bequests which are a significant source of charitable revenues. Yet the income tax data does suggest that upper income groups are responsive to their philanthropic responsibility. The top tier – those with adjusted gross income of $10 Million or more – accounted for 10% of the total amounts reported as having been given to charity.

The future of philanthropy is uncertain. Our concept of "charity" is far removed from the "acts motivated by love of fellow creatures" which is the origin of the term and the essence of philanthropy. Moreover, for many individuals the concept of duty has been largely displaced by the assumption that public welfare programs will fill the void. "Let the government take care of it" is a common attitude that is inculcated by expanded welfare programs that go beyond sustenance to provide flat screen TV's and other amenities that a large segment of the public consider "over the top". On the other hand, this reaction may in reality be a flimsy excuse for those who, preoccupied with envy of others, choose to weave a cocoon of self-interest that defies sharing.

Private philanthropy is challenged not only by apathy, but by those who would displace it by a governmental system of allocating beneficence. They view the private sector as inefficient both in administering and in choosing recipients of philanthropic resources. In other words, the money doesn't go where they think it should. This is *one* of the forces behind the effort to eliminate the charitable deduction which federal law has historically allowed for income, gift and estate tax purposes.

Allocation of resources by the state is the essence of a socialistic or communistic

system. Socialists, as a rule, assert that allotting each person the product of his work is unjust. Instead, they say the model should be that of work according to ability and pay according to need. That formula has been put to the test in numerous communal societies. Plato postulated an idyllic state in which the ruling class engaged in communal living. Sir Thomas Moore, borrowing from Plato, wrote the book entitled *Utopia* and thus gave us the generic term assigned communal societies.

Utopian socialists have established numerous communities. Some have had an illustrious, albeit brief, existence. Robert Owen's idyllic community of New Harmony, located on the shores of the Wabash River in Posey County, Indiana, was an outgrowth of the enlightenment period. It was a short lived disaster.

Unlike Owen's secular experiment, the communal societies bound by spiritual ties had a bit more staying power. The Shaker communities, Ephrata, the Oneida community, the Amana colonies and others sought to emulate the first century Christian community in Jerusalem, that sold all individual possessions, held all things in common, and gave to any who had need.[11] But, it would be a short time until the apostle Paul decreed "The one who is unwilling to work shall not eat." [12] The latter day collectives that were spiritually connected also had their day in the sun; but the sun set.

Neither ethical nor spiritual bonds proved sufficient to transcend individual cravings. The constraints of governmental authority have also proved inadequate to sustain collectivism, as demonstrated by the recurrent economic failures and ultimate collapse of the soviet union. In short, there is no evidence that such a system can succeed. Despite that failure, some academics maintain that Marxist socialism is the ethically and politically essential structure of a civilized world order.[13] Even if that much is assumed, there is no evidence that such a system can succeed.

Is the American system badly broken? Are incomes and accumulated wealth so badly skewed as to deny a significant segment of the public a reasonably comfortable standard of living? If so, how does it survive?

Perception is important. Many economists, as well as those from other branches of

the social sciences, believe that the public will tolerate wealth disparity for so long as the system is perceived to be fair. The primary element of fairness, in this context, is social and economic mobility. The term "meritocracy" is sometimes used to describe the American ideal of an order within which each individual may advance by his personal merit. Some claim that this opportunity has diminished if not vanished. Should that scepticism become the majority view, the system as we have known it is in jeopardy. And if it is worth salvaging, that alone is sufficient reason to set the record straight respecting income distribution. The Minneapolis Federal Reserve Bank report concludes that policies and arguments based upon an assumed stagnation of middle class gains are not well founded, and that greater emphasis could well be placed on polices that promote economic growth and those targeting deeply rooted poverty. And, in all events, policy makers – and I would add voters – should base decisions on an accurate assessment of how the economy has impacted people's lives.

1. Banerjee & Duflo, Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty (Pub. Affairs, NY 2011).

2. Duncan Green, From Poverty to Power; www.oxfamblogs.org

3. Fort Wayne Journal-Gazette, Dec. 27, 2011.

4. Wall Street Journal, Nov. 11, 2011.

5. The Columbus Dispatch, Nov. 16, 2011.

6. Weidman, *The 1% Has Found Its Moses*, Wall Street Journal, Dec. 8, 2011

7. Fitzgerald, *Where Has All the Income Gone? Middle American incomes rise substantially even while inequality increases.* The Region (Sept.2008); www.minneapolisfed.org/publications.

8. Reynolds, *Has U.S. Income Inequality Really Increased?*, Policy Analysis (Cato Inst., Jan. 8, 2007).

9. Whoriskey, Executives prosper as income gap rises, Washington Post, June 21, 2011.

10. A comprehensive explanation of the fuller components of the ceremony is found at www.redhotcurry.com/culture/hindu.

11. The Bible (New Testament)Acts 2:44.

12. Ibid, 2 Thessalonians 3:10.

13. See, Phillips, Guest Lecture, Illinois State Univ., at http://english.illinoisstate.edu/strickland/495/utopia.html.