Even Among the Richest of the Rich, Fortunes Diverge

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YES, we know the economic fortunes of the 99 percent and 1 percent have diverged over the last three or four decades. But the fortunes of the 1 percent and the 0.1 percent, or the 0.01 percent, or the 0.001 percent, have diverged even more. Economists have taken to calling it "fractal inequality." It is not just that the rich have pulled away from the average American. It is that the richer you are, the more you have pulled away.

Consider some data from the World Top Incomes Database, put together by researchers at institutions including the Paris School of Economics and the University of California, Berkeley. It found that in 2012, the average household in the bottom 90 percent of the income distribution earned about $30,997. For the average household in the top 1 percent, the figure is $1,264,065, and for the top 0.1 percent, about $6,373,782.

Put another way, our 0.1 percent household made about 206 times, and our 1 percent household about 41 times, what our average household did. That gap has yawned over time. In 1990, for instance, the same multiples were 87 and 21. In 1980, they were 47 and 14.

To understand how that has happened, it helps to understand who the 1 percent and the 0.1 percent are. A broad range of professions are represented — artists and doctors and inheritors, lawyers and miners and university professors. But about two in five income earners who make it into the top 0.1 percent in a given year are executives, managers or supervisors. And one in five comes from the world of finance.

For that reason, the extremely rich tend to cluster in big cities that are financial centers or home to corporate headquarters — New York, Los Angeles, San Francisco, Chicago, Washington and Houston. (The coasts are overrepresented, the Midwest underrepresented.) They are much more likely than the 99 percent to have a graduate degree or a college education. Just 8 percent of the 1 percent has a high-school education or less, versus nearly 40 percent of the 99 percent.

Management has always been overrepresented among top earners, of course. What has changed is what they are paid. About 70 percent of the increase in income going to the top 0.1 percent from 1979 to 2005 comes from increasing pay for executives and financial services professionals, researchers estimate.

One study by the Economic Policy Institute, a left-of-center research group based in Washington, found that compensation for chief executives swelled about 725 percent in real terms from 1978 to 2011. At the same time, worker compensation increased just 5.7 percent. The ratio of chief executive compensation to worker compensation has grown to 209-to-1 in 2011 from 18-to-1 in 1965. By just about any measure, earnings for executives are near their highs, achieved during the stock-market bubble that occurred around the millennium.

Not all of that increased compensation for managers is because of improving performance, either. The growth of earnings for executives has outpaced growth in the stock market or in corporate earnings, by a wide margin.

So why are executives making so much? Researchers point to a few causes. Executives seem to have managed to co-opt passive corporate boards to extract fatter and fatter compensation packages, for one.

"Boards have not been operating at arm's length from the executives whose pay they set," Lucian A. Bebchuk and Jesse M. Fried of Harvard Law School contend in an exhaustive study of the phenomenon. "The constraints imposed by market forces and shareholders' power to intervene are not tight enough to prevent such deviations."

And according to a study by Charles M. Elson and Craig K. Ferrere of the University of Delaware, boards tend to benchmark compensation against what other firms are giving out, rather than their firm's own earnings, or share price, or some other yardstick. Company A wants to give Executive A more money than Company B is giving Executive B. But Company B wants to give more than Company A, too. The net effect is for salaries to swell higher and higher among all firms.

But the recession has shined a bright light on executive compensation practices. As part of the Dodd-Frank law, regulators are considering a rule that would require public companies to disclose the ratio of executive earnings to rank-and-file worker earnings. Needless to say, many business and financial-industry lobbyists are staunchly against it. "To the extent the information is used by investors at all, it is likely to be misleading and thus will be harmful to them," the Center on Executive Compensation contends. "These useless and potentially harmful disclosures will, however, come at great cost" in data collection. (The estimate is $200 million a year for all publicly traded companies.) The Securities and Exchange Commission is expected to decide on the rule this year.

Earnings have also taken off toward the stratosphere in the world of finance, helping account for much of the rest of the rise of the 1 percent. Wall Street has gotten bigger and richer over time, even after accounting for the dot-com bust and the financial crisis.

The Princeton economist Burton G. Malkiel has found that the world of finance swelled to about 8.3 percent of the economy in 2006 from 4.9 percent in 1980. It shrank during the crash, but has rebounded during the recovery. As finance has grown, and with its profit margins remaining fat, compensation for financiers has grown. Earnings for financial industry professionals, measured as a share of the overall economy, are at a high, at around 9 percent, Thomas Philippon of New York University has found.

There's one further trend that has helped the 0.1 percent take off from the 1 percent, too. The higher a household is on the income scale, the more likely it is that a big chunk of its earnings come from investments rather than wages. Managers at Wall Street firms tend to take home options and shares, for instance, and chief executives often get stock as part of their compensation packages.

That makes earnings at the very top of the income scale more variable than earnings lower down at the 1 percent level or 50 percent level. The busts are bigger, but the booms are bigger, too.

With the market near its inflation-adjusted high and the housing market recovering, that means swelling incomes for households in those tiptop percentages. The average earnings in the top 0.01 percent, for instance, boomeranged from $38.9 million in 2007 to $20.7 million in 2009, before soaring back up to $31 million in 2012.

Earnings are also much less steady at the top: A hedge funder who gets a nine-figure payday one year might earn only a fraction of that the next. Consider some Internal Revenue Service statistics on the top 400 taxpayers in each year from 1992 to 2008.

All in all, 3,672 people made it on the list over the 17 years studied. Only four made it on the list in all 17 years. More than 2,600 only made it once. But income gets stickier lower down the income scale. An earner in the 1 percent has a one-in-four or one-in-three chance of staying there for all of the next five years.

There's also a good chance that their children will make it into the 1 percent, too — or at least that they will not fall too far down the income ladder. Families with very high and very low incomes tend to see the most stickiness in earnings from generation to generation. Research by the Canadian economist Miles Corak, for instance, has found that about 25 percent of the sons of fathers in the top 10 percent of earners were in the top 10 percent themselves.

For now, it is a very good time to be very, very rich. The 1 percent are doing well. The 0.01 percent — they're doing even better.