America's New Robber Barons

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With early Tuesday's abrupt evacuation of Zuccotti Park, the City of New York has managed—for the moment—to dislodge protesters from Wall Street. But it will be much harder to turn attention away from the financial excesses of the very rich—the problems that have given Occupy Wall Street such traction. Data on who is in the top 1 percent of earners further reinforces their point. Here's why.

Though the situation is often described as a problem of inequality, this is not quite the real concern. The issue is runaway incomes at the very top—people earning a million and a half dollars or more according to the most recent data. And much of that runaway income comes from financial investments, stock options, and other special financial benefits available to the exceptionally rich—much of which is taxed at very low capital gains rates. Meanwhile, there has been something closer to stagnation for almost everyone else—including even for many people in the top 20 percent of earners.

This may seem counterintuitive at first. After all, analysts have long painted a picture of growing inequality over the past few decades in which the top quintile's share of the national income has risen while the share of the other 80 percent has fallen. But almost all the gains for the top 20 percent was for the top 1 percent. And half of that is accounted for by a tiny group within the top percent—those earners in the top 0.1 percent. Meanwhile, for the four quintiles below the 80 percent level, the share of total income fell significantly. For those from the 80th to the 99th percentile, the share rose only slightly (a little more rapidly as you go higher up).

In other words, Occupy Wall Street's claim that "We are the 99 percent" is dead on right.

So it's worth knowing who is in that group of very rich with runaway incomes. Several news reports in recent weeks have cited a seminal 2010 study that uses IRS tax returns to find out who belongs to the top 0.1 percent. The authors deserve mention because they are often left out when their results are cited: Jon Bakija of Williams College, Adam Cole of the US Treasury, and Bradley Heim of Indiana University. This was not a Treasury study, however, but a private if scholarly one.

One key finding of the study is that three out of five of those in the top 0.1 percent of tax filers are executives or managers of financial and non-financial companies. Overall, more are from non-financial companies. Does this partly exonerate Wall Street, suggesting it is really Main Street where the problem lies?

In fact Bakija, Cole and Heim's analysis shows the opposite: it turns out that much of the increase in wealth of non-financial executives was also tied to the rise in stock prices. Keeping in mind that stocks options appear as wages in the data, it seems Wall Street itself was often a main source of income growth for "non-financial" managers as well. (Lawyers were another large category of tax payers in the top 0.1 percent, and though there is not direct data for this, one can

fairly assume that many of those in corporate firms made a lot of money from the booming business on Wall Street.)

Next, think about how these executives managed their businesses. If they wanted a big pay check they had to orient their strategies to push up their stock prices—that is, often to appeal to the financial fads and fashions of the day. These strategies typically have included cutting labor costs and R&D in order to boost short-term profits. This delighted their advisers on the Street. Stock investors soon loved nothing better than consistent increases in quarterly profits, and not coincidentally, stock options accounted for an ever-growing proportion of executive pay over the past thirty years. We used to say once that Wall Street worked for business, but over the past thirty years business has come to work for Wall Street.

It is just as interesting to explore the factors that the authors found out probably did not cause the surge at the top. Economists typically posit sophisticated technologies (often related to digitalization) as a source of growing inequality: because these technologies require better educated and smarter workers, those who have mastered them are rewarded handsomely. But there was no surge at the very top in other nations like Japan or in Western Europe, which also adopted the same technologies.

Similarly, some have argued that globalization led to higher incomes at the top because skilled workers can sell themselves globally at ever higher salaries. Again, however, such skilled workers have not seen a surge at the very top in Europe or Japan.

One reason for the discrepancy between the US and other countries is that boards of directors in the US are especially willing to give their CEOs and other high level executives big raises and generous stock options. Lucian Bebchuk of Harvard has done a lot of research on this so-called "governance" issue. Meantime, as Bebchuk's work shows, shareholder influence over executive compensation is far too weak. And there is also the issue of culture itself. America—with its admiration for the self-made man—tolerates high remuneration for the men and women at the top and lower wages in the middle and the bottom. Culture likely matters.

But when we put it all together, compensation tied to stock options along with unusually high profits by financial firms, much of which was passed on to their executives, seems to be the overriding factor. This is probably now the main driver of what we call income inequality in America and what we should more accurately call runaway incomes at the very top.

One other major point requires some attention. This runaway at the top is different from other periods of great inequality, like the late 1800s. Back then, the Robber Barons may have kept money due to monopoly advantages and their power over workers. All the while they were adding to GDP by building oil and steel giants, railroads, and mass production companies from chewing gum to cars.

Today's people at the top exploit workers in somewhat different ways. There is constant pressure to keep wages down by CEOs in order to push up stock prices. This is the modern-day Robber Baron equivalent. Corporate takeover and leveraged buyouts have had the same effect: they build up cash flow by cutting expenses in order to pay off the debt they took on for their huge

acquisitions. This is how Wall Street helps creates a culture in which it is considered okay for a company to fire workers while giving its CEO a giant raise.

But much else of what happens on Wall Street has nothing to do with the real economy, except to waste hundreds of billions of misdirected savings that are plowed back into useless speculation and casino-like gambling by the very rich on trades among themselves. As we have seen, it was this kind of reckless trading that fueled the credit crisis and the collapse of investment houses like Lehman in 2008. The way to deal with this is more serious regulation, including restrictions on the amount of leverage buyout artists and privatizers are allowed to take on. And since we are talking about outrageously high incomes at the very top, higher taxes on the highest earners also make very good sense because much of that income was not reflecting real contributions to the economy—in fact, it was arguably doing just the opposite.

So Occupy Wall Street is right: the financial firms are much to blame for runaway incomes at the top. Yet understanding the nature of inequality in America should place the focus where it truly belongs, on the other 99 percent. Wages have by and large stagnated in America. The real problem is that America's job machine is broken. Wall Street is partly but not entirely responsible for this. And policies to adjust this—persistent fiscal stimulus, substantial public investment in infrastructure and industry, a lower dollar to the yen, a higher minimum wage, and direct job creating programs like the New Deal's Works Progress Administration—are what's needed. If we do not begin to develop such policies, we will not have only the problem of runaway incomes for the few at the very top, but a large and growing part of the population—some of which is highly skilled and educated—that is cut off from the economy altogether.