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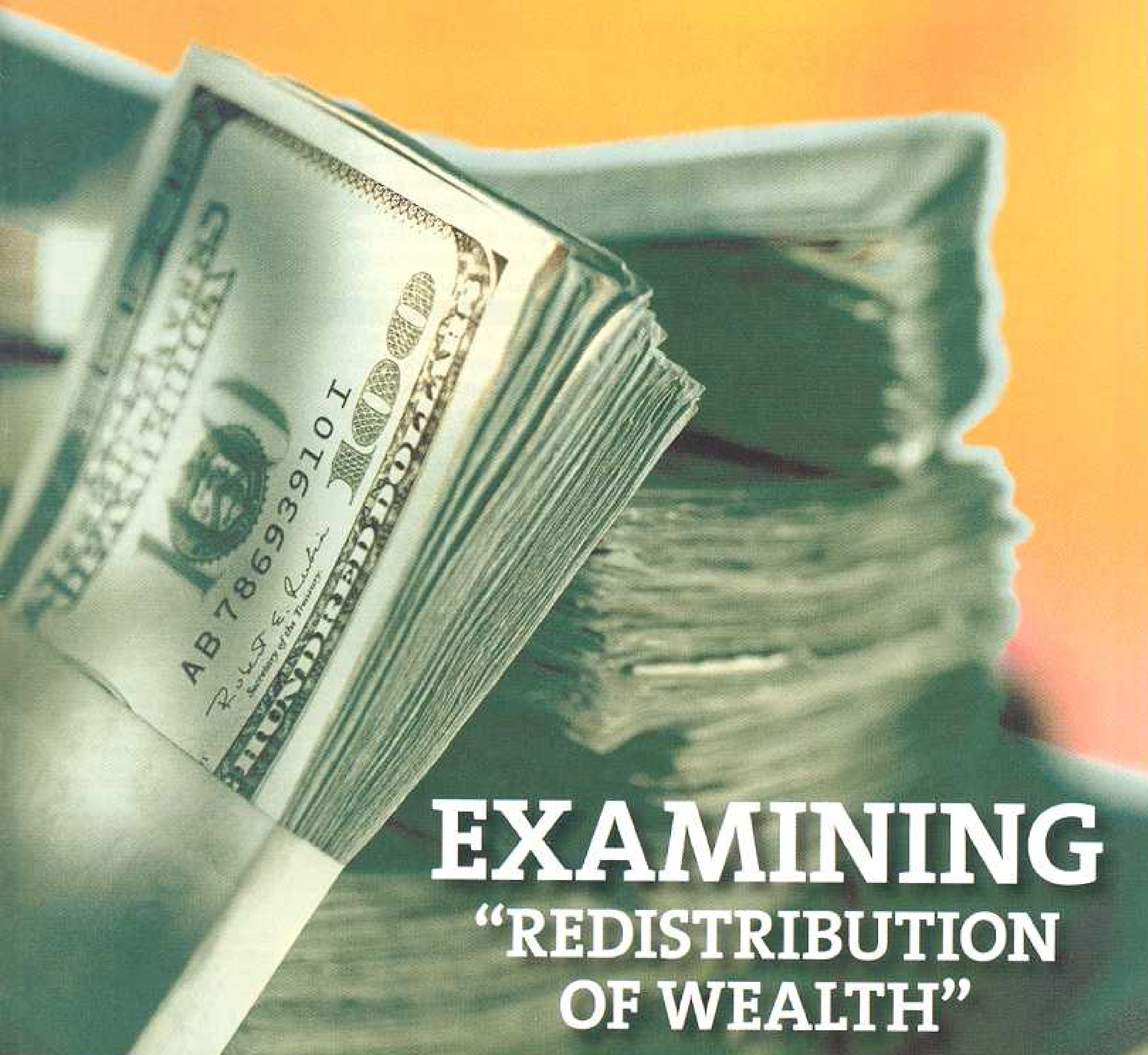

EXAMINING "REDISTRIBUTION OF WEALTH"

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Examining "Redistribution of Wealth"

By Jeff Kolnick and Doug Anderson

Redistribution of wealth was all the rage following a five-minute encounter between then presidential candidate Barak Obama and Ohio plumber Joe Wurzelbacher on October 12, 2008. Candidate Obama told Wurzelbacher that "my attitude is that if the economy's good for folks from the bottom up, it's gonna be good for everybody…I think when you spread the wealth around, it's good for everybody."[1] From that point on redistributionism was back in vogue.[2]

In September, even before the encounter with "Joe the Plumber," candidate Obama was confronted with the charge of redistribution of wealth when interviewed by commentator Bill O'Reilly. When discussing Obama's plan to raise the top marginal rate for federal income taxes from the current 35 percent to 39 percent, the rate paid under the Clinton administration, O'Reilly stated: "you're taking the wealthy in America and the big earners, OK, you're taking money away from them and you're giving it to people who don't. That's called income redistribution. It's a socialist tenant [sic]. Come on, you know that. You went to Harvard."[3] Obama's clear pronouncement that he favored a modest increase in tax rates for the wealthy was perhaps the best publicized part of his agenda.

Wealth Distribution in the United States

Because wealth, or net worth, reflects life cycle savings and can be passed from one generation to the next, it tends to be more concentrated than income. Although a rentier class comparable to that of the Gilded Age has yet to reconstitute itself, the concentration of wealth at the top is still striking. The top 10 percent of Americans

held 71.2 percent of total wealth in 2004, while the top 1 percent alone held a larger proportion of wealth (34.3 percent) than the bottom 90 percent (28.7 percent).[4] Putting this disparity in dollar terms, researchers at the Washington-based Institute for Policy Studies observe that "the richest 1 percent of Americans currently hold wealth worth $16.8 trillion, nearly $2 trillion more than the bottom 90 percent."[5]

Wealth inequality is also growing. "Over the 1962–2004 period," report the authors of the Economic Policy Institute's (EPI) *State of Working America 2006–07*, "the wealth share held by the bottom 80 percent shrunk by 3.8 percentage points, and that 3.8 percent share of wealth shifted to the top 5 percent of households." The wealth held by the wealthiest 1 percent was 125 times median wealth in 1962, but 190 times the median in 2004.[6] For the super-rich who make *Forbes Magazine's* annual list of the 400 wealthiest Americans, the expansion of wealth has been particularly dramatic. In the 11 years between 1995 and 2006, this group saw its total wealth more than double from $470 billion to $1.25 trillion.[7] At the same time, the personal saving rate of Americans overall—one indicator of wealth among the 80 percent who work for wages—has declined precipitously since 1982, dropping into negative territory (-1.1 percent) in 2006.[8] "Approximately one in six households," according to the EPI, "had zero or negative net wealth" in 2004.

Clearly, the evidence shows that the redistribution of wealth can move from the bottom to the top or, as "Joe the Plumber" and Bill O'Reilly feared, from the top toward the bottom. There are several ways that nations address the distribution of wealth. The most important of them are labor laws, tax policy and social programs. It is difficult to imagine a completely neutral policy of wealth distribution.

Labor Law

Almost certainly the most effective government program for the redistribution of wealth has been the reform of labor law. Two significant reforms, the 1935 National Labor Relations Act and the 1938 Fair Labor Standards Act, did more to create the American middle class than any other efforts. Together these acts created conditions for workers to effectively organize unions, guaranteed a minimum wage and the protection of the 40-hour work week, and greatly restricted child labor. Previous to these acts, violence almost always accompanied labor organizing, and federal regulation of the labor market in terms of hours or working conditions was minimal.[9]

Beginning with the landmark 1950 United Auto Workers (UAW) General Motors contract, often referred to as "The Treaty of Detroit," workers made significant concessions over the frequency of strikes in exchange for guaranteed cost of living adjustments; permanent wage adjustments based on a percentage of corporate income earned as a result of increased worker productivity; improved health, pension, vacation benefits; and, ultimately, supplemental unemployment payments designed to minimize the uncertainty associated with seasonal layoffs. These victories for organized labor became the standard for tens of millions of working families in the auto, steel, meat packing, construction, transportation, and countless other industries, whether protected by union contracts or not. For more than a generation they served as a social contract where wealth was shared more evenly. A working class became a middle class, and conditions were created where the nation could favorably address some of its most difficult problems associated with discrimination.

The core of this redistributive model was to create conditions whereby workers could bargain to capture more of the wealth generated by improved worker productivity. Consider these figures: between 1947 and 1973, a period of high union density, worker productivity and median worker income both doubled. In the 25 years between 1980 and 2005, a period of rapidly declining union density, worker productivity increased by 71 percent, while the median compensation of U.S. workers (wages and benefits) increased only 19 percent. During those same years the top 1 percent of earners (about 1.4 million tax filers) increased their share of national income from 8.2 percent to 17.4 percent.

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The ability of workers to gain a share of the wealth created from improved productivity requires the power that comes from collective bargaining. The "Treaty of Detroit" was signed at the peak of union strength, and the subsequent decline in the share of national wealth going to workers coincides with the decline in union density associated with the period after 1980. Union density peaked between 1945 and 1954 when around 35 percent of workers were union members. By 1983, it had slipped to 20.1 percent and, in 2001, not even 10 percent of U.S. nonagricultural private sector workers were union members.[10]

The recent debate in Congress over the auto industry bailout stalled over demands to require additional concessions from the UAW in exchange for government-backed loans to Chrysler and GM. One of the first bills that the 111th Congress will consider is a proposed labor initiative called The Employee Free Choice Act which, if passed, will make it much easier for unions to gain recognition. There is strong debate in the

United States over the future of organized labor precisely because unions have a track record of directing some of the wealth generated from improved productivity into the pockets of labor. If the government creates conditions favorable for unions, wealth is distributed from the top to the bottom. If government supports conditions favorable for an open shop, wealth migrates from the bottom to the top.

Income Taxes

After labor law, the greatest tool available to government for redistributing wealth is tax policy. In 1913, the 16th Amendment to the Constitution legalized the federal income tax. Since then, there has been much tinkering with the income tax as a way of distributing wealth. One clear measure of this use is provided by the National Taxpayers Union. In 2006, the top 10 percent of tax payers, those with adjusted gross incomes of nearly $109,000, paid almost 71 percent of the federal income tax while the top 1 percent of income earners, those with adjusted gross incomes of nearly $389,000, paid almost 40 percent. Clearly the wealthy contribute the bulk of the income tax revenue that flows to the U.S. Treasury.[11]

However, while the rich pay approximately 71 percent of the income tax, they pay far less than others as a percent of their income and net worth. The best known source of this view of tax collection is billionaire investor Warren Buffet. In an October 2007 interview with Tom Brokaw, Buffet admitted to paying only 17.7 percent when he combined the payroll tax (Social Security and Medicare) and income tax, while his office staff paid on average no less than 39.2 percent of their total income. This disparity is due to the low rates on dividends and capital gains (15 percent tax rate) and the fact that Buffet paid payroll tax on only about $97 thousand of his $66 million for the year.[12] In contrast, most workers pay the 15.3 percent payroll tax on all their income. Workers who make less than the cap on payroll taxes, i.e., more than 90 percent of all workers, contribute to total tax revenue an amount greater than their

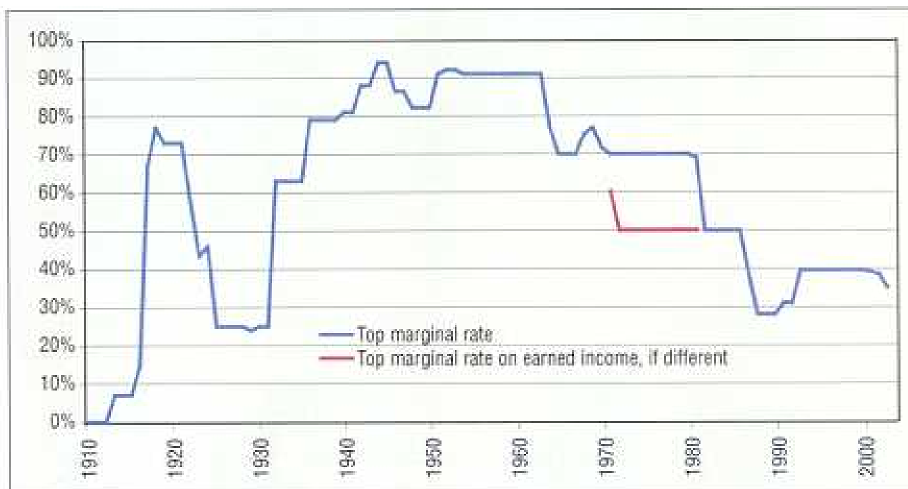

Figure 1: Highest marginal income tax rates since 1913[14]

29 percent share of income tax receipts. Payroll taxes generate a little more than one-third of federal tax revenue (up from a sixth in 1960), and approximately half this amount comes from the bottom 80 percent of income earners. The richest 1 percent of taxpayers contributes only 4.8 percent of revenue generated by payroll taxes.[13]

Marginal income tax rates in the United States have varied widely, but since 1988 we have been in a prolonged period of low taxation. For most of the 95 years we have been taxing income, the highest marginal rate remained above 70 percent; for only 35 of those years has it been below 50 percent. In only 14 years has the top marginal rate dipped below the current 35 percent.

While this data is limited, it reveals that the United States sustained massive economic growth in a period of very high marginal income taxation. Between 1940 and 1970, a period of economic expansion unprecedented in world history, the top marginal income tax rate never dipped below 70 percent. This was also a period of unprecedented public investment in roads, sewers, utilities, schools, higher education, and military spending.

One of the best examples of using income tax policy to redistribute wealth is the Earned Income Tax Credit (EITC). Begun in 1975 as a small part of an economic stimulus package, the EITC was an attempt to provide a cushion for low wage workers and their families that, despite their labor, fell below the poverty line. The program was made permanent in 1978 and has been greatly expanded since. The 1993 expansion extended a small credit to low income families without children. Since 1998, the EITC has surpassed all other welfare transfer programs in the United States and is exceeded only by the dependent exemption as a cost measure for federal income tax collection. In 2003, 19.3 million families received $34.4 billion from the credit. The redistribution idea behind the EITC is perfectly transparent. People who earn income through labor but remain poor are refunded tax dollars on the assumption that working people should not be impoverished.[15]

Social Programs

Another significant redistributive program is Social Security, begun in 1935.[16] Social Security is usually thought of as a safety net for the elderly, but from its start it contained a raft of other benefits, including disability and survivor benefits, aid to dependent children and unemployment benefits. The decision to provide federally mandated old-age pensions resulted mainly from a crisis of impoverished elderly people. The other benefits resulted from genuine need during the depression as well as a belief, largely held at the time, that even during periods of deep economic crisis those who had jobs bore some responsibility for those who could not work or who had lost a breadwinner. Here the redistribution is both generational in

the case of the elderly and from those who are working toward those who cannot. In the case of Social Security, the redistributive effect is not tied to wealth but is, as the name implies, social. Indeed, in 2008, the payroll tax associated with Social Security is capped at $102,000 of earned income, while leaving untaxed all dividends or other investment income. Wages earned beyond the cap are not taxed for Social Security.

Social Security is commonly understood as a way to prepare for an individual's retirement, and thus the debate in recent years has focused on privatization plans for the old age pensions. In reality, the idea behind the pensions has always been about the generational responsibility of younger workers to care for those already in retirement. Thus, any attempt to privatize the program, and remove the redistributive aspect of it, would leave a giant fiscal hole as money is taken from current retirees and distributed to those still working. This problem is often referred to as a "transition cost" and, if fully funded, would amount to many hundreds of billions of dollars. To make it plain, in 1999, American workers paid $396.4 billion in Social Security payroll taxes, while the government paid out benefits of $334.4 billion. If significant dollars were spent saving for individual retirement accounts, current retirees would not have any money to help them in their golden years. Coming up with the money to pay for these "transition costs" is a problem privatizers seldom discuss.[17]

Conclusion

What began as a late summer conversation between a presidential candidate and a plumber has reinvigorated a long debate: what is the role of government in distributing the wealth of nations? Since 1913, for 95 years, we have been in the business of redistribution. The question is, do we use as a model the high taxation, liberal labor policy and high public investment of Truman, Eisenhower, Kennedy, Johnson, Nixon, Ford and Carter, or the low taxation, hostile labor policy and low public investment of Harding, Coolidge, Hoover, Reagan, the Bushes and Clinton, or should we move in some entirely new direction? The time for debating redistribution is over; the time for deciding how we redistribute is upon us. ■

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Endnotes

1. ABCNews.com: http://blogs.abcnews.com/politicalpunch/2008/10/spread-the-weal.html, accessed Nov. 29, 2008.

2. There is a long history associated with the discourse on wealth and its distribution. Significant sources range from the religious to the philosophical. It was debated in ancient times and remains a topic of heated disagreement today.

3. The O'Reilly Factor, Transcript of September 9, 2008, show. http://www.foxnews.com/story/0,2933,419703,00.html, accessed December 2, 2008.

4. Economic Policy Institute, *State of Working America 2006–07.*

5. John Cavanagh and Chuck Collins, "The Rich and the Rest of Us," *The Nation*, June 11, 2008.

6. Economic Policy Institute, *State of Working America, 2006–07.*

7. Arthur B. Kennickell, "Currents and Undercurrents: Changes in the Distribution of Wealth, 1989–2004," Federal Reserve Board, Jan. 30, 2006.

8. Bureau of Economic Analysis, National Income and Product Accounts, Table 2.1. Personal Income and Its Disposition.

9. Many of the provisions in the NLRA were preceded in 1933 by Section 7(a) of the National Industrial Recovery Act. David Brody's, *Workers in Industrial America: Essays on the Twentieth Century Struggle*, 2nd edition (1993) remains deeply informative.

10. Frank Levy and Peter Temin, "Inequality and Institutions in 20th Century America," Massachusetts Institute of Technology Department of Economics Working Papers Series, May 2007. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=984330, accessed December 1 2008; Teresa Ghilarducci, "The New Treaty of Detroit: Are Voluntary Employee Benefit Associations Organized Labor's Way Forward, or the Remnants of a Once Glorious Past?" October 2007, http://www.law.harvard.edu/programs/lwp/VEBASGhilarducci.pdf accessed December 1, 2008; Ian Graham, "It Pays to Be Union, U.S. Figures Show," http://www.ilo.org/public/english/dialogue/actrav/publ/128/3.pdf, accessed December 12, 2008.

11. National Taxpayers Union, "Who Pays Income Taxes?" http://www.ntu.org/main/page.php?PageID=6, accessed December 2 2008.

12. http://www.cnbc.com/id/21553857, accessed December 15, 2008.

13. The payroll tax consists of 2.9 percent for Medicare, a 6.2 percent worker contribution to Social Security, and a 6.2 percent employer match. However, according to the Urban Institute and Brookings Institution Tax Policy Center, "most economists believe that the employer's share is fully offset by reduced wages and thus the entire economic burden of the tax ultimately falls on workers" ("Tax Topics: Payroll Taxes"). http://www.taxpolicycenter.org/taxtopics/Payroll-Taxes.cfm Accessed December 18, accessed December 18, 2008.

14. Top US Marginal Income Tax Rates, 1913–2003, Truth in Politics, http://www.truthandpolitics.org/top-rates.php?print=yes#fn-1, accessed December 2, 2008. For detailed data on all tax brackets during 1913-2008, see "Federal Individual Income Tax Rates History, Income Years 1913–2008," http://www.taxfoundation.org/files/federalindividualratehistory-20080107.swf, accessed December 29, 2008.

15. Steve Holt, "The Earned Income Tax Credit at 30: What We Know," The Brookings institution Research Brief, February 2006.

16. The GI Bill was another stunningly successful social program that redistributed wealth.

17. Two nice places to start on this debate: The Congressional Budget Office, "Social Security Privatization: Experiences Abroad," January 1999, http://www.cbo.gov/doc.cfm?index=1065&type=0&sequence=1, accessed December 2, 2008; and Jeffrey A Miron and Kevin M Murphy, "The False Promise of Social Security Privatization," Bastait Institute Publication, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=270245, accessed December 2, 2008.