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It's time to address the wealth gap

Income inequality is nothing new in this country. But the disparity between the haves and have-nots is widening, and policymakers need to take action. At stake: our long-term economic success.

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Mitt Romney's run for the presidency has highlighted the widening gulf between the nation's haves and have-nots.

As a founder in the 1980s of Bain Capital - among the nation's most prominent private-equity firms - Romney became extremely wealthy. As his tax returns show, he continues to receive tens of millions of dollars each year in returns on his investments.

As Romney rightly argues, he has nothing to apologize for - his success reflects his talent and gives him real credibility when discussing the economy. He has had hands-on experience managing a range of companies in many different industries.

But his wealth highlights America's growing income and wealth disparities, problems that surely get worse unless policymakers - a group that could include Romney - pay attention.

There's nothing new about income inequality in America. Even when the gap was at its smallest 50 years ago, households in the top 20 percent of the income distribution took home more than 40 percent of the nation's income. Those in the bottom fifth received a meager 4 percent. Unfortunately, this gulf has widened, with the top 20 percent of households now getting more than half the income.

The differences are even more striking when it comes to spending. Those in the top 5 percent of the income distribution, earning well more than $200,000 a year, account for a full third of all consumer spending. This is about the same share as is spent by households in the bottom half. In other words, the top 5 percent spends as much as the bottom 50 percent.

For a while, the large mass of households not in that top 5 percent managed to keep up their spending by borrowing more. During the housing bubble in the mid-2000s, Americans tapped their rapidly appreciating homes for hundreds of billions of dollars, through home-equity loans and cash-out refinancings.

This led to financial disaster, pushing many of these households into foreclosure. When the current crisis finally ends, several years from now, about 10 million families will have lost homes.

Driving the income and wealth gap is the inexorable globalization of our economy. America now competes head-on with the rest of the world.

If you have few skills and little education, you face a big problem in the form of billions of similar workers in China, South America, and Eastern Europe. You are thus a have-not.

If you are a highly educated and talented - maybe a corporate CEO or a rock star - you can sell to a much larger global market. You are a have.

Technology is reinforcing this trend, as automation and computerization replaces those with fewer skills. E-readers such as Amazon's Kindle helped kill off the bookseller Borders, eliminating all those jobs in its retail stores.

At the same time, those with the necessary skills to use the new technologies are doing well: Think about how much the software engineers who designed the Kindle, or the marketers who figured out how to sell it, or even the authors writing books for it, are earning.

Private-equity firms such as Bain Capital are in the middle of this creative destruction process. They raise funds from investors - public-employee pension funds are among the biggest - buy troubled companies, and try to fix them. The companies go through wrenching change as they shed activities that are no longer globally competitive or technologically relevant, and expand in areas that are.

This is a painful process, particularly for the have-nots, but it makes the broad economy stronger. Creating jobs isn't on a private-equity firm's to-do list, but a healthier economy eventually creates more jobs.

Private-equity firms generally do well for their investors, and often even better for themselves. Which brings up a sore point: These firms benefit from a very significant and dubious tax break. Typically, private-equity firms keep 20 percent of the profits they generate with investors' money. Thanks to the "carried interest" loophole in the tax code, this money is taxed at a low capital-gains rate of 15 percent rather than at much higher ordinary-income rates.

Romney's low effective tax rate of less than 14 percent is due in part to this loophole.

Given the nation's growing income chasm, policymakers need to consider these types of loopholes when addressing the federal government's long-term fiscal problems.

Reducing future budget deficits will require cutting government spending and increasing tax revenue. All Americans will share in this burden, but given the current financial stress facing the have-nots, most of the responsibility must fall on the haves.

Some will see this as a matter of fairness, but as an economist, I view it more as a question of long-term economic success.

The meaning of the Occupy Wall Street and even the tea-party movements is that too many are being left behind. The resulting frustration could constrict or reverse the forces that are raising all our living standards, namely globalization and technological progress. Our economy will not flourish unless we all can enjoy its success.

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http://articles.philly.com/2012-01-29/news/30676133_1_wealth-gap-income-haves-and-have-nots