

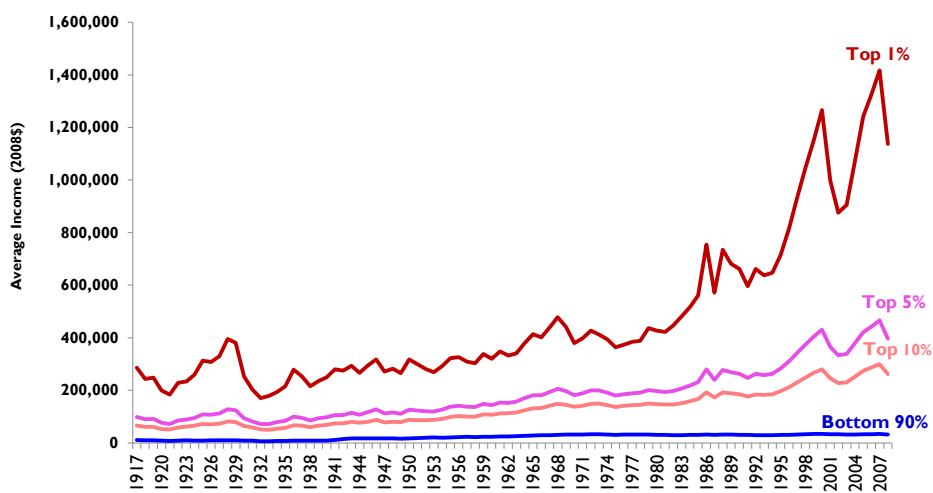
December 7, 2011

I thank the Committee and Assembly member Dickinson for this opportunity to discuss the exceedingly important issue of inequality. Since I became an economist I've been writing and speaking on this topic. The Economic Policy Institute—a Washington DC think tank where I once worked full-time and am currently a research associate—has been sounding the alarm on inequality for the past 25 years. I believe it is one of the most critical issues of our day. But, it is only lately that current political and popular discourse has intently focused on the subject. I am going to address several questions today. First, what is the extent of inequality and what are the long run trends? Second, is inequality a problem? Lastly, what is the role of California state policies?

To start, there is a plethora of statistics out there that document the degree of inequality that exists. I've chosen two figures one for the U.S and one for CA as illustrations. Trends in California generally follow those in the United States. The first figure (Figure 1) shows with no uncertainty the large and growing gap in incomes between those at the top and everyone else. In 2008, the top one percent averaged well over a million dollars of *after-tax* income while the average income for those in the bottom 90% was just over thirty-one thousand (\$08).

Figure 1

The very rich are pulling away



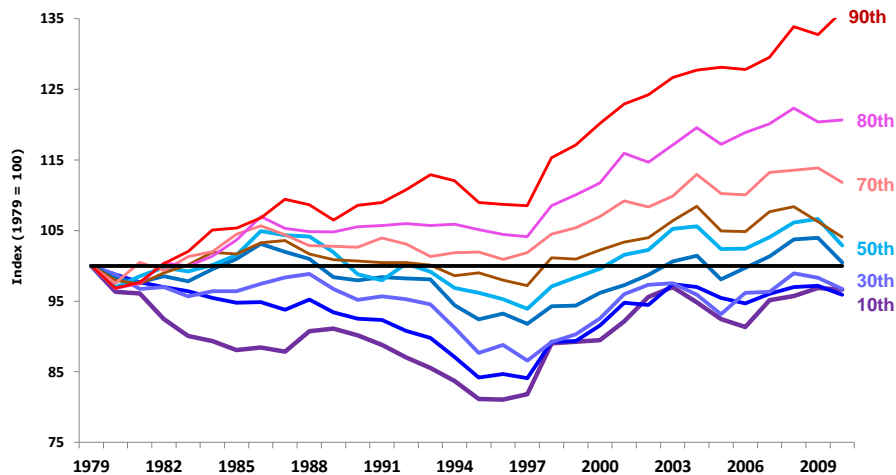
Note: U.S. After-tax income.
Source: Piketty, T. and Saez, E., The World Top Incomes Database.

The volatility of incomes for those at the top is due to stock market fluctuations—and since the Great Recession stocks are up while incomes are down. Thus the divergence is one again expected to grow during this extended weak recovery.

Figure 2 illustrates wage trends in California over the last three decades at different percentiles. Income (above) includes all sources while wages are earnings from a job—and typical workers live mostly off of their wage income. Here we see that wage growth of top earners or those above the 90th percentile—meaning that 90 percent of all workers fall below this category—had wage gains of 37% over the last three decades. Conversely, the wages of low and average workers (the bottom 50%) have seen their wages stagnant or fall compared to similar workers in 1979.

Figure 2

CAs widening wedge of wage inequality



Source: Economic Policy Institute's analysis of CPS data pre-tax wages for California.

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Stagnating and falling wages have occurred as workers are being asked to pay more and more for health care and retirement benefits—if they even have them at all. A system that pays workers less and at the same time leaves them more and more on their own will not foster a healthy middle class. YoYo or 'your on your own' economics simply is not working for the majority of workers. It is why we have many workers with paychecks and a food card and the 'working poor'.

The highest degree of inequality concerns wealth. The triennial Survey of Consumer Finances (SCF) is one of the best sources for data on wealth in the U.S. And, of course the well known Forbes 400 list estimates the worth of the wealthiest amongst us. If we look at both the SCF and the Forbes 400 we can glean some interesting insights.

In 2007 (the most recent SCF) the cumulative wealth of the Forbes 400 was \$1.54 trillion or roughly the same amount of wealth held by the entire bottom fifty percent of American families. This is a stunning statistic to be sure.

Upon closer inspection, the Forbes list reveals that 88 of the 400 reside in California—each worth at least a billion dollars and cumulatively the CA 88 are worth almost \$300 billion. The 2010 SCF data that is slated for release spring of 2012 will almost certainly show a further widening of the wealth gap given that corporate profits, stocks and CEO pay have all recovered while housing values & equity (the lion's share of wealth for average Americans), wages and family incomes have yet to turn around.

Suffice it to say that wages, family incomes and wealth—by any measure are vastly unequal and the gaps are widening and will only be exacerbated by present economic conditions and policies.

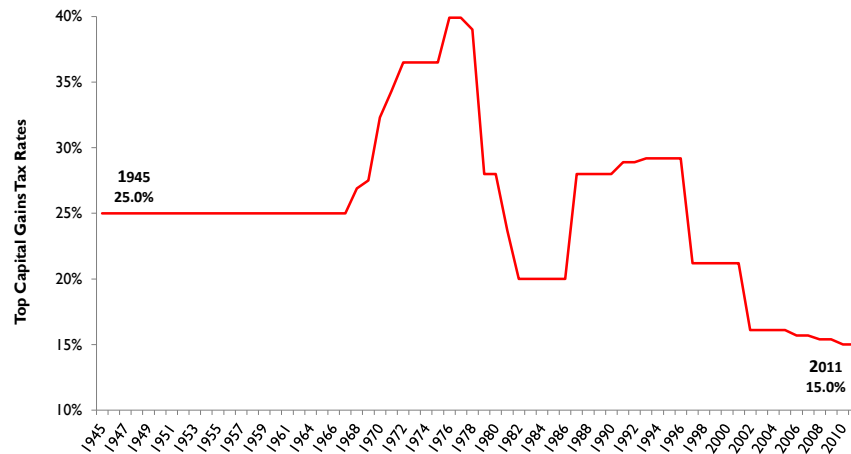
So, is inequality a problem? Well, inequality on its face isn't necessarily bad. We live in a diverse economy in which most Americans believe hard work, innovation and risk should be rewarded—and this means that some people will become rich. Most American's do not begrudge riches—especially if a rising tide lifts all boats. But when the riches of a few are at the expense of the many—then we have a problem. When our political process and policies are controlled by the wealthy—then we have a problem beyond the economy. When hard work is in fact not rewarded for average workers and when extremely risky behavior such as that displayed recently by bankers is rewarded then our economic system is simply broken. It seems this is where we are today in the United States.

Furthermore, recent research (Berg and Ostry 2011) has shown that a certain degree of equality is necessary for economic efficiency and sustained growth. In other words, perverse inequities hinder economic growth. Note that the rich would still be very rich—maybe more so—with a smaller slice of a growing economic pie. Today they have a huge slice of an economic pie that shrunk at an alarming rate during the recession and is now just barely growing. During good times and bad—a large and robust middle class is crucial.

Inequality is also a problem given that the wealthy and corporations (they are people too) are able to avoid paying their fair share in taxes and thus starve our governments of needed funds to promote all that is just and fair in an economy as rich as ours. Yes, they pay a large part of all taxes—but they have most of the money—and historically their effective tax rates have been declining as marginal rates are very low and more importantly the federal tax rate paid on capital gains—a large part of income for the wealthy—is at an all time low as illustrated in Figure 2—at just 15% it is why the top 400 richest people in the U.S. paid just 16.6% in taxes and why Warren Buffet paid a lower tax rate than his administrative assistant.

Figure 3

Work Vs. a call to your broker



Source: Citizens for Tax Justice

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The United States is the richest country in the world—incredibly CA has the 8th largest economy in the world—an extremely rich state by any measure. The cuts in public sector spending and what they mean for the future of California are incalculable. It is shameful that the greatness of CA—its educational system once the envy of the world now ranks so low on U.S. outcomes on just about every measure—such as 43th on per pupil spending. Our education system continues to deteriorate from policies such as Prop. 13 and now the fallout from the Great Recession. Which brings me to my third inquiry regarding policy.

In general, the Federal government must lead the way to reverse the decades of increased inequality. This didn't just 'happen'—it is the result of policies. The government needs to foster a climate where those who play by the rules, get up everyday and go to work can make a good living, provide for their families, get ahead and have a dignified retirement.

A short list would include: the Fed fulfilling its pledge to full employment; implement a financial transactions tax; overturn Citizens United; tax policies made more progressive and loopholes closed; worker rights and bargaining power must be reconstituted; the Employee Free Choice Act should be passed; the NLRB needs to have real authority and mechanisms to ensure that workers are protected to freely organize unions and subsequently negotiate contracts in a timely fashion. And, free trade must be made fair trade.

For the state of California, a short list would include:

- ▶ More progressive state income tax structure
- ▶ Institute progressive inheritance, gift & estate taxes
- ▶ Revisit Prop 13
- ▶ Institute an oil severance tax
- ▶ Invest heavily in K-12 and higher education
- ▶ Strengthen job quality
- ▶ Index the minimum wage
- ▶ Get rid of enterprise zones
- ▶ Strengthen project labor agreements
- ▶ California bid preferences
- ▶ Institute a rainy day fund
- ▶ Close corporate loopholes

Let's just look at the first item—California's income tax. The top bracket kicks in at just over \$48,000 then an extra 1% kicks in after \$1 million. Given that there are many people with incomes between \$48k and \$1m along with many making millions—more tax brackets should be implemented at higher incomes—and taxes decreased for lower incomes. For example, \$100,000 is taxed at 6.9% while ten times that amount \$1 million is taxed at just 9.06%—this doesn't make sense.

A second policy example. The rich are getting more and more of their wealth from investments and most investments are taxed at just 15% at the Federal rate and capital gains in California are taxed as income at the same rates as just mentioned—so at most 10.3% in California. Given that the 88 Californians in the Forbes 400 are worth \$300 billion the rate should be much, much higher.

It will not be easy to reverse the skewed inequalities that exist in the U.S. or CA and the burden cannot be all on the wealth but that is where we can start given how well they have done. A growing robust economy will go a long way. Education is certainly a key and if we can level the playing field for workers we may start to see a reversal.

In the mean time, we must first get our workers back to work, stop instituting austerity measures that are only making things worse and make sure extremely profitable corporations are paying their fair share of taxes to the U.S. and make sure they are not being rewarded for taking jobs off shore.

We've got to get serious about reversing the long term trend of the ever increasing concentration of income and wealth into the hands of a few at the expense of the many. At stake is nothing less than our economy and quite possibly our democracy.

Thank you for your time and attention to this important topic.