

Democrats Target Wealth Gap And Hope Not to Hit Economy

*Divide Between Rich and Poor
Continues to Widen;
Spurs 'Robin Hood' Plans
Can Growth Benefit Workers?*

By David Wessel

By almost every measure, the gap between winners and losers in the American economy has widened over the past 20 years. In this month's election, anxiety about that gap was not far behind voter anger over Iraq and congressional corruption in driving Democrats to victory. "We will make our economy fairer" vowed House Democrats, in a campaign manifesto.

Now they're in a position to try, raising a big question: What can Democrats do to resist inequality in a way that doesn't choke off economic growth? Can government slice the economic apple more evenly without shrinking it?

Today's inequality reflects a confluence of forces. Technology is increasing employers' appetite for some skilled workers, while diminishing it for assembly-line workers in auto and textile factories. Imports and outsourcing are doing the same. Schools aren't graduating enough of the workers in short supply, such as engineers. Immigration is contributing to a glut of others, visible wherever day laborers gather hoping for work. Unions are atrophying. Corporate boards, hedge funds and sports teams are increasingly willing to write super-sized paychecks to a chosen few.

At the extremes, some politicians (not all of them Democrats) believe the benefits of a globalizing, high-tech economy are outweighed by the costs to U.S. workers. They would build a fence around the U.S. to reduce immigration or erect tariff barriers to imports. Even at the Democratic middle -- where the virtues of technology and globalization are prized -- proposals to reduce inequality range widely. They include interceding in the market to raise pay at the bottom or limit it at the top, pushing "Robin Hood" take-from-the-rich tax policies, improving shock absorbers that protect workers when their employers crash, extending health and retirement plans to workers without them and spending more to promote education from pre-K through college.

Meddling With the Market

High on Democrats' to-do list is lifting the federal minimum wage. It's been steady at \$5.15 an hour since 1997, while consumer prices have risen 25%. Although many

economists warn a higher minimum wage means fewer jobs, the 1990s suggest that boosting the minimum wage can boost incomes of those at the bottom. But its potential to shrink the gap between the wealthiest and poorest wage-earners is limited, especially when wages at the top are soaring far away from the middle and bottom.

Limiting pay at the top has proven tough. A 1993 law that discouraged tax deductions for executive salaries above \$1 million is widely regarded as a bust. "Executives responded by rewarding themselves with millions of dollars worth of stock options" instead of big salaries, lament former Clinton aide Bruce Reed and Chicago Rep. Rahm Emanuel, a key strategist in the Democrats' win, in their pre-election book calling for "a new social contract for the 21st century." They go on, "This time we should approach the problem from the other direction and require companies that provide stock options to their executives to provide stock options to every worker."

That's unlikely to become law. But Barney Frank, the Massachusetts Democrat in line to chair the House Financial Services Committee, vows to push legislation that would force companies to provide more and clearer details of CEO pay, devise policies to recapture incentive pay if earnings are later restated, and require shareholder approval of "golden parachute" payments to dismissed executives. Mr. Frank says he plans hearings into a "fundamental" economic question: "How do you do a better job of sharing overall economic growth with the average worker?"

Few Democrats would block employers from laying off workers or closing factories, as is often done in Europe. But several newly elected Democrats, particularly from the beleaguered Midwest, vow to **slow the flood of imports** and rethink the pacts that President Bush has been negotiating to lower trade barriers.

There also is strong support among Democrats for **strengthening American labor unions** to try to tilt the balance in the labor market more toward workers. A bill co-sponsored by 215 House members and 43 senators, would, among other things, require employers to recognize a union after a majority of workers sign cards asking for representation instead of secret-ballot votes.

Robin Hood

A popular alternative among Democrats is to **champion the market -- that is, allow it to direct people and money to best use -- and then tax the rich to give more to the poor.** Enlarging the earned-income tax credit, viewed by many economists as a smart alternative to a higher minimum wage, is an option likely to figure in Democratic tax deliberations. The credit offers up to \$4,536 to a family with two or more children to offset payroll taxes that the working poor pay. And it offers a cash bonus if the credit exceeds taxes paid, rewarding low-wage workers without raising employers' costs.

But **most of the focus is on taking more from the top.** Many Democrats would let at least some of Mr. Bush's income-tax cuts expire in 2010 or roll them back. Many favor preserving the estate tax, which Republicans target for abolition. New House Speaker

Nancy Pelosi has vowed to restore a 1990s rule requiring new spending to be offset by spending cuts or tax increases; upper-income taxpayers are the sure target.

The Senate Finance Committee, with the blessing of both parties' leaders, is circulating a list of ways to **shrink the "tax gap"** between taxes owed and taxes actually paid. Most are aimed at upper-income taxpayers, such as requiring stock brokers to report not only the price a client got for shares, but also the original purchase price paid.

Boosting taxes on upper-income Americans would reduce disparities and provide revenues for other attacks on inequality. Raising the top two tax rates, now 33% and 35%, by a single percentage point would yield \$90 billion over five years, the Congressional Budget Office estimates.

Another favorite **Democratic target is the lower tax rate -- a maximum of 15% -- on capital gains and dividends.** The administration says the lower rates have strengthened the stock market and the economy. Some Democrats say they're unfair. "We must end the Republicans' war on work, which taxes a millionaire at a lower rate for his stock trades than it taxes the wages his secretary earns for placing the call to his broker," wrote Rep. Emanuel and Mr. Reed. Also under discussion, often in conversations about ways to shore up Social Security, is increasing the ceiling -- now set at \$94,200 -- on wages subject to the Social Security payroll tax.

Republicans as prominent as Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke recently have warned in speeches of **risks posed by widening inequality.** But **many conservatives fear taxing the rich in response would reduce incentives for innovation, entrepreneurship and education -- and thus reduce economic growth to the detriment of all. Their counsel: Try to lift incomes of the poor and middle class, and don't worry if the rich do even better.**

Democrats **argue that the 1990s proved that raising taxes on upper-income Americans can produce lots of revenue and coincide with a very strong economy.** Republicans counter that the 2000s show tax cuts propel the economy and can coincide with surging tax revenues. Both arguments exaggerate the ability to isolate tax rates from other economic crosswinds. But the fundamental disagreement is over the extent to which higher taxes discourage work, savings and investment. "The market is not so good at spreading the gains. We need an activist government that pursues broad-based growth," says Mr. Reed.

Shock Absorbers

One direct response to workers' anxiety is expanded government programs to cushion the fall of those who lose jobs in today's rapidly changing economy. "Better preparation before adverse events happen and more...assistance after bad events occur" would both help workers and "diminish political demands for growth-reducing policies, such as protectionism," says Peter Orszag, who heads the Hamilton Project, a think tank spawned by former Treasury Secretary Robert Rubin to find way to promote "broad-based economic growth" and "economic security."

Targeted federal programs, created to lure congressional votes for free-trade pacts, now reach few people. There's a tax credit to help those who lose jobs due to imports buy health insurance. And there's wage-loss insurance, which offers cash to eligible workers dislocated by imports to compensate for taking lower-paying jobs. Inequality foes would greatly expand such programs.

Lori Kletzer of the University of California at Santa Cruz and Howard Rosen of the Peterson Institute for International Economics in Washington, for instance, would offer eligible dislocated workers up to half the difference between weekly earnings at their old and new jobs, up to \$10,000 a year. This isn't cheap: They put the price tag at between \$2.6 billion and \$4.3 billion a year, financed through general tax revenues or an expanded payroll tax.

Universal Coverage

An alternative, albeit expensive, is to close the gap between those with **health insurance and a retirement-savings plan** (on top of Social Security) and those without. About 25% of people in households with incomes below \$25,000 lack any health insurance, even government provided. Among the over-\$75,000 crowd, only 8.5% are without insurance. About 45% of full-time workers on private payrolls aren't offered private retirement savings plans of any sort at work.

Gene Sperling, a former Clinton aide who published a 300-page "economic strategy for shared prosperity" last year, preaches to Democrats: "Simply voting yes [on trade pacts] and getting 5,000 more people on Trade Adjustment Assistance is a losing strategy. With control, Democrats can envision a more expansive social compact might make people less fearful about the pace of change and globalization."

Finding a politically palatable and affordable way to make **health insurance** universally available has been impossible, so far. Mr. Bush has pushed tax credits to help more people buy insurance on their own, and dangled rule changes and low-premium, high-deductible policies to encourage small firms to offer coverage. Although some Democrats still drool over proposals for government health insurance for all, others prefer piecemeal approaches. Among them: Allowing businesses with up to 100 employees tax credits to buy insurance through a government-sponsored pool modeled on the Federal Employee Health Benefit Plan, which gives federal workers a choice of private health insurance plans.

On **retirement savings**, outside the contentious Social Security debate, Democratic and Republican centrists are inching toward similar proposals, described differently. Mr. Sperling is pushing a "universal 401(k)" to which employees, employers and, in some cases, the government would contribute, a cousin to the private accounts Mr. Bush wanted to carve out of Social Security. Increasingly prominent Democratic Sen. Barack Obama cites it favorably in his new book, "The Audacity of Hope" and Ms. Pelosi backs

a similar proposal. It would, in essence, narrow tomorrow's inequality by encouraging Americans to save more in their working years.

Education

Improving education is the feel-good solution, seen across the political spectrum as a way to promote growth and equality simultaneously. "The economy increasingly rewards education and skills," says Edward Lazear, chairman of Mr. Bush's Council of Economic Advisers. "We would not want it any other way. However, inequality in skills and education levels means inequality in income." His fix: Improve public schools for the disadvantaged through the No Child Left Behind Act and foster competition among schools.

Democrats are focused on doing more to help Americans pay for college, especially important since the typical college grad earns 45% more than the typical high-school grad. Ms. Pelosi's platform calls for making up to \$12,000 a year in college tuition tax-deductible -- or the equivalent in a \$3,000 tax credit -- as well as cutting interest rates on student loans and increasing the maximum Pell Grant for low-income students to \$5,100 from \$4,050.

A coalition that spans the political spectrum is pushing more government support of Pre-K education. The case: Low-income children are behind when they arrive at kindergarten and never catch up; spending more on them sooner would have a big payoff.

One political problem: Education has a long fuse. It can take a generation to see results.

In the end, government can do only so much, especially given Americans' traditional ambivalence toward big government and European-style social welfare programs. "It's not hard to think of government policies with redistributive aspects," says Mr. Sperling, the former Clinton adviser. "What gets hard is to say: Here's my vision for how the private sector is going to create jobs that lead to a strengthening, not a hollowing out, of the middle class."

Americans want government to protect their current jobs and tell them where their next job -- and their children's jobs -- will come from. "But government is not good at that," Mr. Sperling says.

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