BREAKAWAY WEALTH
THE PAY BUBBLE

Income gap widens as executives prosper

Rising compensation at the top is at root of increasing inequality

BY PETER WOHLISKEY

It was the 1970s, and the chief executive of a leading U.S. dairy company, Kenneth J. Douglas, lived the good life. He earned the equivalent of about $1 million today. He and his family moved from a three-bedroom home to a four-bedroom house, about a half-mile away, in River Forest, Ill., an upscale Chicago suburb. He joined a country club. The company gave him a Cadillac. The money was good enough, in fact, that he began to turn down raises. He said making too much was bad for morale.

Forty years later, the trappings at the top of Dean Foods, as at most big U.S. companies, are now much more lavish. The current chief executive, Gregg L. Engles, ages 10 times as much in compensation as Douglas did, or about $10 million in a typical year. He owns a $6 million home in an elite suburb of Dallas and 64 acres near Valo, Col., an area he frequently visits. He belongs to as many as 40 golf clubs. While Douglas’s office sat on the second floor of a milk distribution center, Engles’s stylish new headquarters occupy the top nine floors of a 48-story Dallas office tower. When Engles leaves town, he takes the company’s $10 million Challenger 604 jet, which is largely dedicated to his needs, both business and personal.

The evolution of executive granulism — from very comfortable to almost jet-setting — echoes one of the primary reasons that the gap between those with the highest incomes and everyone else is widening.

For years, statistics have depicted growing income disparity in the United States, and it has reached levels not seen since the Great Depression. In 2008, the last year for which data are available, for example, the top 0.1 percent of earners took in more than 10 percent of the personal income in the United States, including capital gains, and the top 1 percent took in more than 20 percent. But economists had little idea who these people were. How many were Wall Street or sports stars? Entrepreneurs? Economics could only speculate, and debates over what is fair stalled.

Now a mounting body of economic research indicates that the rise in pay for company executives is a critical factor in the widening income gap.

The largest single chunk of the highest-income earners is what turns out, are executives and other managers in firms, according to a landmark analysis of tax returns by economists Jon Bakija, Adam Cole and Bradley T. Heim. These are not just executives from Wall Street, either, or from companies in every relatively mundane fields such as the milk business. It is mostly the top 0.1 percent of earners who make about $1.7 million or more, including capital gains. Of those, 51 percent were executives, managers and supervisors at non-financial companies, according to the analysis, with nearly half of them deriving most of their income from their ownership in privately held firms. An additional 28 percent were at financial firms or financial professionals at any sort of firm. In all, nearly 60 percent fall into one of those two categories.

Other recent research, moreover, indicates that executive compensation at the nation’s largest firms has roughly doubled in real terms since the 1970s, even as pay for the remaining 99 percent of America has stagnated.

This trend held at Dean Foods. Over the period from the ’70s until today, while pay for Dean Foods chief executives was rising 30 times over, wages for the unionized workers actually declined slightly. The biggest wages for the people who process, pasteurize and package the milk at the company’s dairies declined by 9 percent in real terms, according to union contract records. It is now about $22 an hour.

• Do people bitch because Engles makes so much? Yeah. But there’s nothing you can do about it,” said Bob Good, 61, a former school sports doctor who is a past president of a Dean Foods plant in Harvard, Ill, and runs an auction business on the side. “My family bought my cap and gown. These companies have the idea that the only people that matter to the company are the ones at the top.

Through a spokesman, Engles declined to be interviewed. Company officials threatened to call the police as a reporter was interviewing workers outside one of its dairies.

Defenders of executive pay have argued that today’s chief executives are worth more because, among other things, companies are larger and more complex.

But critics question why so much of the growth in income should go to the wealthiest. “When Douglas died, the Dean Foods chief from the ’70s, died in 2007,” said one. “And someone who worked for him was quoted as saying that his father viewed wages in part as a moral issue. If his father had seen how much executives were making today, Douglas said, he’d be ‘shaking his head in grief. My dad just thought that after a while, what else would you need the money for?’

Inherent inequality

Inequality is compounded by capital gains. In theory, at least, “the invisible hand,” or market system, sets compensation for head workers into pursuits that are the most productive to society. This produces inequality but leads to a more efficient economy.

As a result, economists have noted, there is an inherent tension in market-oriented democracy because while society aims to endow each person with equal political rights, it allows very unequal economic outcomes.

“American society proclaims the worth of every human being,” economist Arthur M. Okun, former chairman of the Council of Economic Advisers, wrote in his 1975 book on the subject, “Equality and Efficiency.” Yet the economy awards “prizes that allow the big winners to feed their pets better than the losers can feed their children.”

Americans have been uneasy about the income gap at least since the 30s, according to polls. Repeated surveys by the National Opinion Research Center since 1977 have found that 60 percent or more of Americans agree or strongly agree with the statement that “differences in income in America are too large.”

The unease arises from the fear that extremes of wealth can unfairly reduce the economic opportunities and political rights of everyone else, according to sociologists. The wealthy, for example, can afford better private schools for their children or acquire political might by purchasing campaign advertising or making campaign donations. Moreover, as millions struggle to find jobs in the wake of the recession, the notion that the very wealthiest are gaining ground strikes some as unfair.

“Americans think income inequality is excessive and have done so consistently for years,” said Leslie McCall, a sociologist at the University of North Carolina at Chapel Hill.

Executive Compensation 2010

How do the region’s chief executives stack up when it comes to their pay? For an answer, Capital.com examined Executive Compensation, an executive compensation research firm, to analyze the annual pay of CEOs at 100 of the area’s largest public companies.

Equilar examined the compensation totals for the chief executives serving as of the close of the companies’ most recent completed fiscal year ended on or after March 31, 2010, which means in some cases an executive may have since moved on. So consider this listing a snapshot in time.

The highest paid execs in the Washington area

For a list of the most highly compensated company executives in the Washington area, go online to washingtonpost.com/sunday/economy/ or pick up a copy of Monday’s Capital Business.
Inequality in the United States has grown steadily since the 1970s, following a flat period after World War II. In 2008, the wealthiest 10 percent of earners took in almost the same amount of income as the rest of the country combined.

The income gap between the wealthy and the rest of the country has grown along with dramatic increases in CEO pay.

Growing share of income for the rich

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The top 0.1 percent of the population (those making about $1.7 million or more) saw the sharpest increase in income share, taking home 2.6% of the nation's earnings in 1976 and 10.4% in 2008.

In 2005, the top 0.1 percent of earners in the U.S. made upwards of about $1.7 million, including capital gains. Forty-one percent of these roughly 140,000 families had a household income greater than $1 million, even after taxes.

Defenders of executive pay argue, among other things, that the rising compensation is deserved because firms are larger today. Moreover, this group says, more packages today are based on stock and options, which pay more when the chief executive is successful.

Critics, on the other hand, argue that executive salaries have jumped because corporate boards were simply too generous, or more broadly, because greed became more socially acceptable.

Again, in settling these arguments, economists were hampered by a lack of data, particularly any that might give some historical perspective.

At that, not until economists Carola Frydman and Robert S. Rosen of MIT's Sloan School of Management and Warren E. Miller of the Federal Reserve Board analyzed data dating from 1956 — an exhaustive task because of the lack of computerized records going back that far — that the longer-term trends became clear.

What the research showed is that while executive pay at the largest U.S. companies was relatively flat in the '50s and '60s, it began a rapid ascent sometime in the '70s. As it happens, this was about the same time that income inequality began to widen in the United States, according to the Saez figures.
More important, however, the finding that executive pay was flat in the 1970s and '80s, when firms were growing, appears to contradict the idea that executive pay should naturally rise when companies grow.

This is a "challenge for the market story," Pfdulman said. So what has happened since the '70s that has sent executive pay upward?

While no company over this period of time — from the 1970s to today — can be considered completamente simple, Dean Foods offers a better comparison than most because fundamentally it hasn't changed.

The dairy business is still the root of the company; it was on the Fortune 500 by the late '70s and remains there today. It grew then and more recently through acquisition.

Moreover, both chief executives — Douglas and Engles — could boast records of growing the company and profit.

From 1970 to 1979, while Douglas was the chief executive, sales at Dean Foods tripled and profit increased tenfold, to $0.8 million, according to company records. Similarly, from 2000 to 2009, sales at what would be Dean Foods had roughly doubled, and so had profits, to $225 million. (Engles became chief executive after the company he led bought Dean Foods in 2001 and adopted its name.)

Yet there are vast differences in the way the two men were paid, even when you adjust for the effects of inflation.

In the late '70s — 1977, 1978 and 1979 — Douglas made $1 million annually in today's dollars. The largest part of that was a salary; some came from a long-term incentive based on the stock price that would not mature until he retired.

By contrast, in the late 2000s — 2007, 2008 and 2009 — Engles averaged $10.6 million annually, most of it in stock and options awards and other incentive pay, according to proxy statements. After 2009, which was a particularity bad year, Engles's compensation dropped to $4 million in 2010. If profit returns, so will his higher earnings.

The case of Dean Foods appears to bolster the argument that executive compensation moves with company size: Dean Foods' profit in 2009 was roughly 10 times what it was in 1979, adjusted for constant dollars. Engles's compensation has averaged 10 times that of Douglas.

"It's a different company today," company spokesman Jamieson Schuler said. He declined to comment further.

But some economists have offered an alternative, difficult-to-quantify explanation: that the social norms that once reined in executive pay have disappeared. This new attitude, according to this view, was reflected in epigrammatic form by the 1987 movie "Wall Street," which made famous the phrase "greed, for lack of a better word, is good." Americans were growing more comfortable with some extremes in pay, Parfit for the stars on Wall Street, in the movies and in pro sports were rising.

But back in the '70s, something was holding executive salaries back. Harold Geneen, the president of ITT, then one of the nation's largest companies, told Forbes in 1976 that while he might be worth six times as much to the company as he was making, he hadn't tried to get a raise.

"No one moved up then, and I didn't dare do it alone," he explained.

Over at Dean Foods, Kenneth Douglas was likewise resistant to making more. Most years, board members at Dean Foods wanted to give Douglas a raise. But more than once, Douglas, a former FBI agent who literally married the girl next door, refused.

"He would object to the pay we gave him sometimes — not because he thought it was too little; he thought it was too much," said Alexander J. Vogl, a member of the Dean Foods board at the time and the chair of its compensation committee. "He was afraid it would be bad for morale, him getting a big bump like that."

"He believed the reward went to the shareholders, not to any one man," said John P. Finney, another former board member. "Today we get cults of personality around the CEO, but then there was not a cult of personality."

Outside one of the Dean Foods dairies recently, the workers at the plant for the most part only rolled their eyes when asked about Engles's salary. But they spoke admiringly of Douglas.

"People back then thought enough was enough," said Leon Smith, 62, who maintains the machines at the plant.

Some were reluctant to criticize Engles to a reporter. Others defended him.

"You're king of the hill, and you get paid for that," said Ray Kavanaugh, 61, who operates a filler at the dairy. "He's worth it if he keep the company making money."

The employees said they only occasionally dwell on Engles's riches, anyway. Their primary focus is on making ends meet, they said.

Joe Bopp, 55, said he has a second job taking care of a cemetery during the summer months, mowing the grass and digging graves.

"Twenty-three dollars an hour sounds like a lot of money," he said. "But when you pay $4 a gallon for gas and $3.29 for a gallon of milk, it goes away real fast."
BREAKAWAY WEALTH

The "Lake Wobegon effect" lifts CEOs' pay

Peer benchmarking" enriched Amgen chief as firm's fortunes faded

BY PETE WORMSER

THOUSAND OAKS, Calif.—As the board of Amgen convened at the company's headquarters in March, chief executive Kevin W. Sharer seemed an unlikely candidate for a raise.

Shareholders at the company, one of the nation's largest biotech firms, had voted 2 percent on their investment in 2010 and 7 percent over the past five years. The company had been forced to close or curtail projects, trimming the workforce from 20,000 to 12,000. And Sharer, a 63-year-old former Navy ensign, was already earning a salary of money—about $13 million in the previous year, plus such perks as two corporate jets.

The board decided to give Sharer a raise. It boosted his compensation to $32 million annually, a 27 percent increase, according to the company report.

"Why?"

The company board agreed to pay Sharer more than chief executives in the industry—with a compensation "value closer to the 25th percentile of the peer group," according to a 2013 regulatory filing.

This is how it's done in corporate America. At Amgen and at the vast majority of large U.S. companies, boards pay cash, except in rare cases. ex-ecutives at levels equal to or above the median for executives at similar companies.

The idea behind setting executive pay this way, known as "peer benchmarking," is to keep talented executives from leaving for other firms.

But the practice has long been controversial because, as critics have pointed out, every company tries to keep up with or exceed the median pay for executives, even those with similar responsibilities.

The result is that companies are paying their executives more than they otherwise would, according to recent studies. And in some cases, the compensation spiral upward, regardless of performance. Few if any corporate boards consider their executive teams to be below average, so the result is known as the "Lake Wobegon" effect.

It wasn't until recently, however, that its pervasiveness and impact on executive pay became clear.

Companies have long laid the way they set executive pay, but in late 2010, the Securities and Exchange Commission began compiling company documents to disclose the specifics of how they paid their top executives.

Since then, researchers have found that about 50 percent of major U.S. companies set executive pay targets above the median of their peer group. This creates the kinds of circumstances that drive pay upward.

Moreover, the jump in pay because of peer benchmarking is significant. A chief executive's pay is more influenced by what his or her peers earn than by the company's performance, according to a 2013 study by the New York University Stern School of Business.

"The practice is also driven by the fact that executive pay has been rising for years," said Joseph L. Peppard, professor of management at the Stern School.

At Amgen, for example, four of the six members of the board came from the biotech and pharmaceutical industries, according to John Bjork of Texas Christian University.

"Peer benchmarking has a significant influence on CEO pay," Bjork said. "Basicly, you can't have every executive paid above the median without raising the bar.

"All the other kids have one" pay gap between what workers and top executives make helps explain why Amgen's pay targets are higher than those of its competitors. In 2011, the company was paying the same compensation as "friends of the board," according to the United States is reaching levels un- seen since the Great Depression.

Since the 1990s, median pay for executives at the nation's largest companies has continued to grow, even after adjusting for inflation, according to researchers. By the same period, however, the median pay for a typical non-supervisory worker has dropped by about $10,000, according to Bureau of Labor Statistics.

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Amgen acted desperate at a time it did not need to be desper-
ted," said stock analyst Douglas<br>Christopher. "It allowed them to<br>say, 'Look, we have a third prod-
uct, but at a massive price.'

There was another bit of turbu-

teness, too. According to the Los

Angeles Times, at about the same
time, Sharer had a romantic relat-

ionship with a married Amgen<br>vice president. "Senior executives"<br>tried to persuade him to end the<br>relationship, but he didn't until the<br>employee left the company in<br>2006, according to the newspaper.

The company continued to grow<br>during Sharer's early tenure, and<br>more recently, the company has<br>boosted greater earnings per<br>share. But by 2006, the growth<br>that once distinguished Amgen<br>had begun to taper off.

In 2008, Forbes magazine<br>named him among the country's<br>most overpaid bosses because the<br>company's returns had dipped 4 percent annually over six years while he ear-

ned an average of $12.3 million.

The lack of enthusiasm was<br>more even noticeable among the<br>people who know about Amgen —<br>insiders. Companies are required to<br>report when their officials sell<br>stock. Since 2005, the ratio of share-
sales to purchases has been 12 to 1, according to Bloomberg data re-

viewed last fall by Christopher.

Under peer benchmarking,<br>however, even when shareholders<br>lose, executives can win.

Risk can creep into the process<br>in several ways. At Amgen, it be-
gan with the choosing of "peers."

Amgen selected 31 companies in<br>the biotech/pharmaceutical<br>field, which seems natural enough. But most of the compa-

nies on the list are far larger than Amgen. Amgen's revenue in 2010<br>was $15 billion; the median re-
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venue of its peer companies was $40 billion, according to Equilar.

The practice of choosing peers<br>that boost pay is common. Studies<br>by Faulkender, Bizzari and ISS Cor-

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ing purposes, companies tend to<br>choose larger firms or firms with<br>more highly paid chief executives.

Moreover, the peer group also<br>includes companies that are<br>closer to Amgen. ISS proxy advisory<br>services has pointed out that, in<br>addition to the compensation for<br>their own CEO, Amgen also pays<br>the median compensation for<br>their entire peer group.

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Amgen to restructure business<br>unit — and that its pervasiveness and impact<br>on executive compensation may be below average, so the result has<br>been "furious" about what Sharer was earning.

"Obviously," said one woman who used to work at the Thousand<br>Oaks facility, "only some people matter."

According to the Los Angeles Times, at about the same time, Sharer had a romantic relation-

ship with a married Amgen vice president. "Senior executives" tried to persuade him to end the relationship, but he didn't until the employee left the company in 2006, according to the newspaper.

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Risk can creep into the process in several ways. At Amgen, it began with the choosing of "peers."

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The practice of choosing peers that boost pay is common. Studies by Faulkender, Bizzari and ISS Corporate Services have shown that when choosing "peers" for pay-setting purposes, companies tend to choose larger firms or firms with more highly paid chief executives. Maybe even more significantly, however, the Amgen compensation committee also decided that Sharer, despite being at a smaller company, should earn stock compensation at the 75th percentile of peers. This is critical because stock compensation tends to be the largest component of executive pay.

The company has said that stock compensation serves as a good incentive; the more stock he owns, the more reason he has to try to boost the company's value. Moreover, the company says, to receive the $2 million in reported compensation, Sharer must reach an array of goals with the company, so much of his pay is "at risk."

But how much is his pay really in doubt? Most of the stock compensa-
tion Sharer is slated to receive as a long-term incentive is contingent not on the company's financial performance but simply on whether Sharer remains at the company, ISS proxy advisory services has pointed out. Moreover, the reported compensation figure of $2 million is based on the company's projections of "probable" financial outcomes.

As a result, Sharer has earned raises while shareholders have lost money. In 2010, Amgen's shareholder return was minus 3 percent. In 2009, shareholder returns were minus 9 percent.

In both years, Sharer received significant pay increases, even though Amgen's "peer" companies made gains for shareholders, according to Equilar.

"He's basically done nothing for the company," Silverman said. "And he still gets raises."

Sharer has tried to cut costs, however, pushing out workers at plants around the country at its headquarters in Thousand Oaks, in West Greenwich, R.I., and Long-
The Washington Post

TUESDAY, DECEMBER 27, 2011

BREAKAWAY WEALTH

Congress looks less like rest of America

As income inequality increases, so does political polarization

BY PETER WHORISKEY

Butler, Pa. — One day after his shift at the steel mill, Gary Myers drove home in his 10-year-old Pontiac and told his wife he was going to run for Congress.

The odds were long. At 34, Myers was the shift foreman at the “hot mill” of the Amsco plant here, he had no political experience and little or no money, and he was a Republican in a district that tilted Democratic.

But standing in the dining room, still in his work clothes, he said he felt voters deserved a better choice.

Three years later, he won. When Myers entered Congress, in 1975, it wasn’t nearly so unusual for a person with few assets beside a home to win and serve in Congress. Though lawmakers on Capitol Hill have long been more prosperous than other Americans, others of that time included a barber, a pipe fitter and a house painter. A handful had even organized into what was called the “Blue Collar Caucus.”

But the financial gap between Americans and their representatives in Congress has widened considerably since then, according to an analysis of financial disclosures by The Washington Post.

Between 1984 and 2009, the median net worth of a member of the House more than doubled, according to the analysis of financial disclosures, from $240,000 to $725,000 in inflation-adjusted 2009 dollars, excluding home equity.

Over the same period, the wealth of an American family has declined slightly, with the comparable median figure sliding from $20,600 to $20,500, according to the Panel Study of Income Dynamics from the University of Michigan.

The growing financial comfort of Congress relative to most Americans is consistent with the general trends in the United States toward inequality of wealth: Members of Congress have long been wealthier than average Americans, and in recent decades the wealth of the wealthiest Americans has outpaced that of the average.

In 1984, the 90th percentile of U.S. families had holdings worth six times the median family’s; by 2009, the 90th percentile was worth 12 times the median family, according to the University of Michigan study, a longitudinal panel survey. These figures include home equity.

This growing inequality, not surprisingly, is seen in Congress. Not only has the median wealth increased, but the proportion of representatives who have little besides a home has shrunk. In 1984, 82 percent of representatives who were millionaires had little besides a home, compared with 60 percent today.

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Gary Myers rides his bike in Sebastian, Fla. In the 1970s, he was a GOP congressman from Pennsylvania.
The Washington Post
TUESDAY, DECEMBER 27, 2011

Rep. Mike Kelly, a Pennsylvania
Republican elected in 2010, is advised by staff
member Tricia Casacio at a
meeting of the House Committee
on Education and the Workforce.

one in five House members had
zero or negative net worth exclud-
ing home equity, according to the
disclosures; by 2009, that number
had dropped to one in 12.

Another possible reason for the
weakening of Congress is that
running a campaign has become
much, much more expensive, making it
more likely that wealthy people, who
can donate substant-
ially to their own campaigns, gain
office.

Since 1976, the average amount
spent by winning House candi-
dates quadrupled in inflation-ad-
justed dollars, to $1.4 million, ac-
cording to the Federal Election
Commission.

For example, Myers’s first win-
nning campaign, in 1974, cost
$33,000, according to federal elec-
tion records. That’s about
$146,000 in current dollars, or
one-tenth the current average.

To make do, his wife held coffee
klatches and improvised bro-
phies with markers and index
cards.

“Each one had different colors
and designs my mom made — and
we used them for the mailings,”
recalled Myers’s son, Mark. “I
sold cards.

“Each of the boys was in charge
of some area of the dealership,”
recalled Pat Collins, who worked
for a year at the dealership in
the ’70s. She is now the director of
the Butler County Historical Society.

“Mike’s life was — the whole
story. The Kellys had the dealership, but
those kids were not put above anybody else. They worked.”

“I used to sweep up the ga-
rage, wash cars for his dad,” said
Art Bernardi, Kelly’s old football
coach at Butler High School, where Kelly excelled. “I’m sure
he had a lot more than the average
guy. But he doesn’t live a fancy life. He acts like someone who works
at the mill or whatever.”

In 1979, Kelly married Victoria
Phillips, an heir to the oil fortune.

Kelly has been critical of the
bank bailouts, too. But he declined
to say whether he favored the
government’s $50 billion bailout of
General Motors, which ben-
efited his auto dealership. Had
GM gone out of business, it would
have deprived Kelly of cars to sell
at his Chevrolet-Cadillac dealer-
ship, reducing his inventory to
nearly zero.

Kelly’s life at the car dealership
influences much of his political
outlook:

* On unemployment. Asked
how long the government should
pay jobless benefits, Kelly suggests
that checks from the government
keep some of the unemployed
from returning to work. He inter-
views some of the jobless for open-
ings at the dealership.

“They say, ‘When are you look-
ing to hire somebody?” I say, ‘Right
now — that’s why we have an ad in
the paper.’ They say, ‘Well, I still
have about six weeks left on my
unemployment. Will you still be
looking for somebody then?’ ”

Kelly shrugs.

“For a couple of days, I made it
hard for people to make a
decision to move forward,” he said.

* On the estate tax, which he
would like to repeal. “The death
tax doesn’t make sense to me. I
would like to think that after I’ve
worked all my life I could pass
something on and not have to
worry about a government that already
overtaxed me my whole life when taking it one day!”

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ment. He was a shift foreman with engineering responsibilities, and each day he wore a work shirt, jeans and work boots.

He had grown up poor. His father, a bricklayer, had a drinking problem, he said, and his mother, a schoolteacher, largely raised Myers and his three siblings. At 9, Myers recalls working at his grandfather’s nine-table restaurant, washing dishes for 10 cents an hour. As a teenager, he started a business mowing lawns and eventually set his eyes on getting one of the co-op jobs at the steel mill, which allowed him to earn a bachelor’s degree in mechanical engineering at the University of Cincinnati.

He recognized that his run for Congress might seem presumptuous. “When it started getting around and the fellas down at work heard about it, I thought people might say stuff — you know, down there you stub your toe and they ridicule you,” Myers said. “I suppose some people probably thought, ‘What’s that Myers think he’s doing?’ But no one said anything. I was very grateful.”

He didn’t know much about running a campaign, and it was largely improvised by his wife, Elaine. She organized small gatherings and offered him tips on public speaking — when she noticed people’s feet started shuffling, she flashed him a sign to move on to another subject.

He lost his first election but was encouraged by the narrow margin of defeat. He ran again in 1974 and won. On the day after his election, a Pittsburgh television station asked him to come be a guest on a news show. Myers told them he couldn’t come because he had worn out both of the family cars during the campaign. The station agreed to send a car for him.

In Washington, Myers in most ways hewed to the Republican line: He voted at times to hold down the government’s debt, for example, and voted against raising Social Security taxes.

But like Kelly, he brought to bear his life experiences. As might be expected of an engineer, Myers had a scientific cast of mind, according to his staffers at the time, demanding research and numbers to inform his views. But with the steel mills in his district struggling, he was also keenly aware of the problems facing thousands of workers. On issues relating directly to workers, Myers sometimes broke with the party majority.

He supported, for example, a hike in the minimum wage, then $2.30 an hour. He supported an amendment expanding a program that extends unemployment and other benefits to workers adversely affected by trade. He voted for a $4 billion boost to a public works jobs program pushed by President Jimmy Carter.

“I think he realized that good people sometimes fall on hard times,” said James Kunder, who as a young Harvard graduate just out of the Marines worked as an aide to Myers in the ’70s. “He wouldn’t have been elected from that district at that time if he didn’t exude some of that spirit.”

Today, amid the debates on tax rates on the wealthy, he suggests raising the marginal income tax rate on the very highest incomes to 45 percent.

Near the beginning of his second term, Myers stunned his staff and many in his district by announcing that he would not run for a third term, which it appeared he could have easily earned. He said he wanted to spend more time with his kids. He returned to the mill, taking a pay cut from the $57,500 that members of Congress then earned. Back in Butler, he coached his son’s baseball team and helped start a soccer program at the high school.

Today, when asked about the effect of wealth on members of Congress, Myers is characteristically detached. “I guess I could see where someone who made a lot from personal risk-taking and business initiative could have a different outlook. Even if people come with biases, I’m not sure they’re evil biases. I don’t have any problem with someone who has a lot of money. But I don’t have any doubt that my perspective was different from someone who had more money.”

whiskey@gwwashingtonpost.com
Tax policy feeds gap between rich, poor

Both parties protect capital gains rate that has uneven benefits

BY STEVEN MUPSON AND JIA LYNN YANG

The K Street office of Mark Bloomfield, president of the American Council for Capital Formation, is full of knickknacks collected in three decades of lobbying for cutting the capital gains tax.

The coffee table has campaign buttons that read “Capital Gains — Better Jobs.” One wall displays a blow-up cartoon retracing the steps that led President Jimmy Carter to reluctantly sign a cut in the capital gains tax rate. On a shelf sits a framed, handwritten note from President George W. Bush in December 2003 that says: “Dear Mark, I got your treatise on taxes — many thanks. I will look it over with keen interest. Merry Christmas.”

For the very richest Americans, low tax rates on capital gains are better than any Christmas gift. As a result of a pair of rate cuts, first under President Bill Clinton and then under Bush, most of the richest Americans pay lower overall tax rates than middle-class Americans do. And this is one reason the gap between the wealthy and the rest of the country is widening dramatically.

The rates on capital gains — which include profits from the sale of stocks, bonds and real estate — should be a key point in negotiations over how to shrink the budget deficit, some lawmakers say.

“This is something that should be on the table,” said Rep. Chris Van Hollen (D-Md.), one of 12 members on the congressional “supercommittee” tasked with reducing the deficit. “There’s no strong economic rationale for the huge gap that exists now between the rate for wages and the rate for capital gains.”

Advocates for a low capital gains rate say it spurs more investment in the U.S. economy, benefiting all Americans. But some tax experts say the evidence for that theory is murky at best. What is clear is that the capital gains tax rate disproportionately benefits the ultra-wealthy.

Most Americans depend on wages and salaries for their income, which is subject to a graduated tax so the big earners pay higher percentages. The capital gains tax turns that idea on its head, capping the rate at 15 percent for long-term investments. As a result, anyone making more than $346,500 a year in wages and salary is taxed at a higher rate than a billionaire is taxed on untold millions in capital gains. While it’s true that many middle-class Americans own stocks or bonds, they tend to stash them in tax-sheltered retirement accounts, where the capital gains rate does not apply. By contrast, the richest Americans reap huge benefits. Over the past 20 years, more than 80 percent of the capital gains income realized in the United States has gone to 5 percent of the people; about half of all the capital gains have gone to the wealthiest 0.1 percent.

“The way you get rich in this world is not by working hard,” said Marty Sullivan, an economist and a contributing editor to Tax Analysts. “It’s by owning large amounts of assets and having those things appreciate in value.”

Republicans have led the way in pressing for low capital gains tax rates, but they have been able to rely on a significant bloc of Democratic allies to prevent an increase and to protect the preferential treatment of money earned through investments over money earned through labor.

President Obama and leading Democrats want to allow the tax cuts passed under Bush to expire. That would raise the capital gains tax rate from 15 percent to 20 percent. But that would still be lower than the rate under President Ronald Reagan — who raised the tax in 1986.

“Capital gains … veers onto theology for Republicans, but it has always been a bipartisan issue,” Bloomfield said.

A poll this spring by the non-profit Public Religion Research Institute showed that Americans, by a 2-to-1 margin, think the wealthy should pay more taxes than the middle class and the poor.

Billionaire Warren Buffett has become one of the loudest and most frequently cited proponents of the wealthy paying more in taxes.

“The truth is, I have never had it so good in terms of taxes,” Buffett said in an interview with
Charlie Rose. “I am paying the lowest tax rate that I’ve ever paid in my entire lifetime. Now that’s crazy, you know. And if you look at Forbes 400, they are paying a lower rate, counting just their personal income, than the secretary or whomever around their office, on average.”

How the wealthiest Americans managed to get Congress to treat money differently from salaries or wages involved a variety of lobbying strategies, economists and lawmakers.

“Capital gains is economics, theology and politics wrapped together,” Bloomfield said. The Greenspan effect

The theory justifying low capital gains taxes was first developed by economic philosophers but none as influential as Alan Greenspan, the former Federal Reserve chairman who was treated as an economic oracle of sorts.

Greenspan said capital gains taxes made people reluctant to move out of one investment and into other, more-promising ones. In 1997, just as the Greenspan effect was taking hold, House Speaker Newt Gingrich (R-Ga.), said at the Cato Institute on July 16, 1998, “If you really wanted the most wealth created over the next 20 years, you would have a zero rate, which is a tax on job creation.”

Other GOP lawmakers formed the Zero Capital Gains Caucus, with 92 House members and 15 senators. The group’s chairman, Rep. David Dreier (R-Calif.), said on his Web site: “Federal Reserve Chairman Alan Greenspan has said we should reduce it. So what are we waiting for?”

The group included many members of the powerful tax-writing House Ways and Means Committee. One was Rep. James Otto “Jari” McCreary (R-La.). He formed the Committee for the Preservation of Capitalism, a political action committee that he used to give money to candidates favoring lower capital gains rates.

Secretary Treasury Robert Rubin wasn’t enthusiastic, but Clinton, seeking compromises with Congress, agreed to cut the capital gains rate to 20 percent.

“My iron is that Reagan got rid of the preferential rates for capital gains and let them put them back in,” Sullivan said.

These changes drove down the overall tax rate paid by the wealthy. In 1996, before the capital gains cut under Clinton, millionaires paid an effective rate of 30.8 percent. By 2007, it was 22.1 percent.

Many tax experts contest the benefits of a low capital gains rate. Jane Gravelle, a tax expert at the Congressional Research Service, says a rate cut could generate more government revenue in the next year or two as investors take ad- vantage of lower rates or a rising stock market, the initial bump in tax revenue would get smaller and the government would collect more overall if it kept the rate higher.

“Lower capital gains rates are not a comment for this story. But while he and his allies agree that capital gains would save and reinvest their gains, thus spurring economic growth, other analysts say that result is not clear.”

“Lower capital gains [taxes] are a mixed bag even if you’re just looking at efficiency,” said Leon Bien, a professor of public finance at Boston University and former head of tax analysis at the Treasury Department. “It might encourage more risk-taking, but it also creates huge opportunities for shelters aimed at converting ordinary income to capital gains. People would make investments only because of the tax benefits.”

“Moreover, in the current financial crisis, it’s not clear that an absence of risk-taking would improve the entrepreneurial activity and capital formation,” he added.

Back from Greenspan

After Greenspan stepped down in 2001, his former clients felt that they had lost their mentor. “Greenspan’s effect had run its course,” saidファン・ズァウゼン, a former Romney deputy who led the Treasury Department’s Office of Tax Policy.

“Back then, it was pretty clear that Greenspan was the gardener, that he knew what to do,” said a former Treasury official. “But now, without him, there is no one with that kind of experience.”

Greenspan had been a mentor to many top lawmakers, including Robert P. Casey Jr. (Pa.), who was part of the powerful tax-writing Senate Finance Committee.

In 1997 congressional testimony, Greenspan said that the capital gains tax is “essentially a tax on saving and investing,” the letter said, adding that the economy was too “fragile.”

But the Greenspan effect was dead. “I don’t think Greenspan would have supported the bill,” said Susan V. Kehoe, a senior tax analyst at Moody’s Analytics. “Raising taxes on capital gains would have raised taxes on private-equity profits. Dozens of lobbyists rushed to the bill.”

Now House majority leader, Pelosi had found herself central in the tax debate and is still curbed by the financial industry.

“Leader Cantor believes in lower tax rates across the board for the wealthy, then there’s no political will to raise the capital gains tax and that’s something he wants to happen,” said Rep. Jim McDer- mott (D-Wash.), who has spoken out repeatedly on income inequality.

This summer, Sen. Patty Mur- ray (D-Wash.) pushed Republicans for “defending the most generous tax cut that middle-class Americans have enjoyed in 60 years.” Yet last year she joined three other Senate Democrats — Mark R. Warner (Va.), Robert P. Casey (Pa.) and Jeanne Shaheen (N.H.) — and GOP Sen. Scott Brown (Mass.) in voting to exempt venture capital firms from any capital gains tax increase, saying in a joint letter that it would hurt “job cre- ation and innovation.” The bill, which would have spent the added revenue in part to extend unemployment benefits, later failed.

Spokesperson forway, who is a co-chair of the congressional debt-reduction supercommittee, declined to comment.

“You need some advantage of capital gains to increase the incentive to save and in- vest,” Warner said. “It’s just a tremendously popular item with political contributors. It’s something that directly impacts every wealthy household in America.”

Some lawmakers who have backed low tax rates on capital gains have later been hired by the financial industry.

After leaving Congress, McCr- ery, for example, joined the lobby- ing firm Capitol Counsel, where one of his major clients in 2010 was the Alliance for Savings and Investment, a coalition that includes the Business Roundtable, the Fi- nancial Services Forum and AT&T.

McCrery said he hopes to rep- resent them again. Preferential treatment of capital gains “will encourage risk-taking, capital formation and therefore investment and job creation and…the kinds of things we have valued in this country in terms of people doing their own businesses,” he said.

But others said that regardless of the economic arguments, the steady cutting of the capital gains tax rate reflects the political power of the rich, who are more likely to contribute to politicians and benefit from the work of lobbyists.

In other words, inequality of wealth can lead to inequality of representation.

“Capital gains taxes is actually pretty foreign to the experience of most voters,” said Jacob Hacker, a political science professor at Yale University and co-author of the book “Winner-Take-All Politics.” “These are things that are only a concern for those who itemize (their tax returns), which most Americans don’t.”

The 400 richest taxpayers in 2008 reported 66 percent of their income in the form of capital gains and 8 percent from salary and wages. The rest of the country reported 5 percent in capital gains and 72 percent in salary.

The result, Hacker says, is that the lobbying winds up being lop- sided, too.

“The amount of lobbying that low capital gains rates receive from the deep-pocketed interests that have the most at stake is enormous,” Hacker said. “There’s very little representation on the other side.”

“Don’t forget” he added, “that members of Congress themselves, particularly senators, are even more likely to be sympathetic to the argument for low capital gains rates.”

**Reality check**

**Answers to key questions about taxes**

There are a lot of numbers being thrown around in the debate over who pays what in taxes. These graphics examine what's behind those numbers.

- Have taxes kept up with wealth?
- Who doesn't pay federal taxes?
- Do rich people pay a lower tax rate?
- Who really benefits from tax breaks?
- Why do boats get tax breaks?