Paul:

I have a few comments on your October 20 New York Times piece. Two apologies in advance. These comments were prepared at various times (whenever I had 10 minutes or so), so they are disjointed. Second, they are not meant to be as caustic as they might seem. These comments are, of course, personal to me and do not reflect the views of my firm or its clients.

Comparing levels of current individual wealth with that of J.P. Morgan is unfair. It is difficult, unfortunately, to show this quantitatively, because the argument quickly becomes mired in the complexities of changes in the value of the dollar, the lack of a federal income tax, and differences in enterprise structure, governance and accounting. But, just by way of example, J.P. Morgan and a small group of fellow financiers successfully intervened to mitigate the Panic of 1907. Even though this group had some assistance from the Treasury, this intervention manifested levels of personal wealth without parallel today. No small group of individuals today has sufficient wealth to have any material affect on a 39% short term decline in the value of equities.

You then suggest an increase in income inequality is somehow linked to "the current wave of corporate scandal", and you imply that "the imperial C.E.O." and "concentration of income at the top" are somehow related. This is sloppy thinking, at best. Any increased income disparity over time predates the recent accounting scandals at a few, high-profile companies. There are over 9000 active publicly traded companies. Whatever the magnitude of ill-gotten gains of the perpetrators of these few frauds, they did not measurably contribute to any increased income disparity. Similarly, whatever you may believe about compensation of corporate C.E.O.s, these executives are so few in number that their compensation contributes little, if anything, to the magnitude of any increased income disparity.

I am personally very conservative and I do not disagree that income levels of many Americans have not increased at the same rate as those of a more limited group. I would also agree that there was a short term compression in income levels across society during the decades immediately following World War II. The "decompression" we are experiencing now is not a "good thing" or a "bad thing". It is a market economy thing. Many American workers simply were grossly overpaid in the decades following World War II.

Your recollection that blue collar workers often had incomes comparable to those of some white collar workers is accurate. I was one of those blue collar workers. In the early 1970s, I held an unskilled, union job (basically, loading freight) that paid four times the minimum wage to start. An acquaintance was a junior mechanical engineer at the company and he had to moonlight driving a tractor trailer on the weekends to make ends meet. That was ridiculous. My labor was worth nothing close to what I was paid. His was worth much more. These artificial market distortions were achieved through protectionist trade policy and collective bargaining agreements. That is how the compression was maintained for thirty years

Globalization has, for better or for worse (and, I would argue, for better), re-valued labor and, in general, has forced reduction of artificially high compensation levels. You harp on C.E.O. compensation, but their numbers are relatively few and every society will have a few individuals – sports figures, entertainment stars and, yes, corporate C.E.O.s - who will receive excessive compensation, largely because of "cult of personality" phenomena. But, increased income disparity cannot be explained by these, relatively few individuals. Instead, it is the result of a more accurate assessment of the value of labor in the global marketplace and, more specifically, market recognition of the importance of education as a value differentiator.

On the other hand, allegations like yours ignore the relative fairness and integrity of our tax system. (Note that I said "relative.") Over the last twenty or thirty years, tax law and regulation have increasingly closed loopholes that were formerly used to provide "stealth compensation" to whole classes of corporate executives. In the past, executives received significant untaxed "perks" that effectively supplemented their income such as company cars, extravagant expense accounts, club memberships, lavish entertainment, etc.

In the U.S., such things have been significantly curtailed. The executives may still receive such "bennies", but they pay tax on them. While there are some exceptions, the lifestyles of most corporate executives have not improved as much as the increase in their incomes would suggest. What has happened is that executives have demanded increases in cash compensation to maintain the standard of living they enjoyed previously after either procuring the "bennies" on their own with after-tax income, or paying the tax on "bennies" the company continues to provide. Our executive compensation system has become more transparent.

In attempting to make your case for increased income disparity, you reference the CBO study based on income tax data. The existence of such a study presumes a relatively valid correlation between the tax data and actual income. In Europe (and in the U.S. 30 years ago), such a study would be laughable. The taxable income of many executives in Europe bears little relation to the actual value of what they receive from the company. Company cars, vacations at company expense, company-subsidized housing, personal use of company aircraft, and lavish entertainment at company expense with very liberal expense account policies are all still common outside the U.S. (One company I worked for – not in the beverage business - had the largest wine cellar in Europe.)

You fairly consistently confuse the concepts of income and wealth. There is, of course, some correlation between them, but there are many people in our country who have significant wealth, without significant income. The reverse is also true. There are people with significant incomes who do not have significant wealth (many entertainment and sports figures, for example). To some extent, the lack of correlation between income and wealth is attributable to tax avoidance, and to some extent it is attributable to attempts to preserve wealth across generations. But, whatever its origins, it is material.

I believe the globalization and "skill biased" hypotheses are well supported, although I do not feel the need to allocate recent income trends between the two. And, I do not necessarily accept that skill bias is necessarily related to what we call "technology", but that's a debate for another day. You are preoccupied with a very small number of people. You harp on C.E.O. compensation, but their numbers are relatively few and every society will have a few individuals – sports figures, entertainment stars and, yes, corporate C.E.O.s - who will receive excessive compensation, largely because of "cult of personality" phenomena. There were superstar comedians in the 1950s – Jackie Gleason and Milton Berle come to mind. And, today there are "stand up" comedy clubs in every major city that serve the same role as the "borscht belt."

During World War II, government controlled wages because of the labor shortage that resulted from induction of millions of work force members into military service. When the war ended, wages did not immediately rise because the number of people returning to the workforce kept wage pressures down. At the conclusion of the war, the United States was the only country with significant industrial capacity, and that remained true for at least a decade. Domestic labor unions and corporations used this period to entrench themselves with collective bargaining agreements and trade barriers to sustain their positions as long as possible and they succeeded for another twenty years. So, it is not hard to understand how the income compression that began during World War II could be maintained for twenty or thirty years.

Meanwhile, I think that C.E.O. salary levels can be explained as the consequence of the closing of tax loopholes, a belief that the economic incentives of CEOs should be aligned with those of the corporation, and a "cult of personality" phenomenon.

Let me address the first and third factors before turning to the second. As the tax-free "bennies" that came with executive service have been taken away or subjected to tax, executive candidates have simply demanded an increase in compensation to maintain the same standard of living. This is another way to view your claim that CEOs imposed voluntary limits on their compensation as part of a prevailing corporate culture that wanted to avoid "outrage." You are, to some extent, correct. In the 1960s, the CEO had the company buy the Gulfstream, because it would have been an outrage if his salary was sufficient for him to buy one for himself. As regards the "cult of personality" phenomenon, I think the best proof is found in the vast differentials between what the C.E.O. Is paid as compared with what his immediate subordinates are paid. (I'm sure you think they're paid too much as well, but that is beside the point.)

Aligning the economic incentives of executives with those of the corporation is probably the biggest contributor to the growth of executive income. This is an idea that is probably unwise for a number of reasons. First, it is very hard to do. Too often firms perform well or badly because of factors beyond the control of the executives. It is also very hard to establish who, in fact, contributed to a particular success or failure. Second, proponents of this concept forget that it creates perverse incentives. To the extent that executives can enrich themselves at corporate expense, the profit that is sacrificed is shared by all of the shareholders. This problem was first recognized by Berle and Means back in 1932. Finally, aligning the economic incentives of the executive and the corporation usually turns out to be a "heads I win, tales they lose" proposition. During times when the firm does well, the executive is rewarded with bonuses and profits on the exercise of stock options. During periods when the firm does poorly, the executive receives stock options at a stock price that reflects this poor performance. When the company turns around, the the appreciation in the value of the low priced options is often greater than the value of the bonuses and stock option exercise profits that would have been received had the firm done well to begin with.

So, even if executive compensation has become excessive, this excessive compensation is not the result of a change in social norms or some kind of moral failure. It is simply the effect of changes in tax law, a misguided theory on improving financial performance of the firm by attempting to align executive incentives with firm incentives, with a significant "rock star" premium.

I do not think you can support your suggestion that executive compensation has grown because the CEOs appoint "the members of the corporate board that determines their compensation and control many of the perks that board members count on." While CEOs do have a lot of influence on who serves on corporate boards, compensation for board membership is, for most board members, almost trivial. I cannot imagine that the typical member of a corporate board would compromise him or herself for $40 or $50 thousand a year.

To the extent that, during the 1960s, America's great corporations behaved more like socialist republics than "cutthroat capitalist enterprises" and our top executives acted more like public-spirited bureaucrats than captains of industry, American productivity and competitiveness suffered and we paid (and in some industries are still paying) a significant price. And, these "socialist republics" run by "public-spirited bureaucrats" ravaged the environment, exploited workers in the Third World, sold products without regard to minimal standards of safety, and otherwise generally did not acquit themselves with distinction. There is nothing inherently wrong with capitalist enterprises (which, properly operated, are by definition "cutthroat") or "captains of industry".

We learned two things in the 1960s and 1970s. First, and foremost, that capitalism is the greatest force for the improvement of the human condition that mankind has yet known. Second, that government must establish programs to internalize into the capitalist firm all of the costs of production and minimize macroeconomic externalities. So long as there are internalization rules equally applied (a "level playing field"), mankind will achieve the greatest benefit by allowing "cutthroat" capitalist enterprises, run by their "captains" to operate freely.

You discuss "a cover article in Fortune is titled ''You Bought. They Sold.'' ''All over corporate America,'' reads the blurb, ''top execs were cashing in stocks even as their companies were tanking. Who was left holding the bag? You.'' If "top execs" were "cashing in stocks" (which I assume primarily means exercising in-the-money options) they were doing no more than monetizing the portion of their compensation paid as stock options. All of these transactions are public, readily available for free to anyone with an Internet connection. Anyone who believed that exercise by an executive of the options he was granted meant that the stock price was likely to fall could sell right along with him. [Of course, if the executive knew based on material information received in his executive role, that the stock was going to fall, he could not sell. He would have to sit and watch the value of his options decline until the material information was disclosed to the public and they knew as much as he did.] Nobody was left holding a bag they did not want to hold.

Your thought that if the rich get more, that leaves less for everyone else is radical, because it is not "simply a matter of arithmetic" and is not true. Your conception of our economy as a zero sum game is erroneous. You should know that a rising tide, indeed , raises all boats (some perhaps more than others).

Your data purporting to show, once again, a dramatic increase in "income" at the "top" in fact suggests something else. Increases in middle class incomes have been modest because of the effects of globalization, and while I will accept your data as accurate, I am somewhat surprised to see any increase in middle incomes at all. Globalization is a necessary development, both economically and morally, but its short term impacts on our society are going to be severe.

Southeast Asia, particularly China, is where Japan was 60 years ago. South America is further behind. Africa is a basket case. If we want our children to leave in a peaceful world, we have to bring the rest of the world into the First World economic system. The same is true if we want our children and grandchildren to live in a growing and successful economy. The markets of the Third World have greater growth potential than our domestic market. In the short term, however, the labor value differentials will limit income growth for the middle class, probably significantly.

Ultimately, of course, the "corporations" of which you are so critical have every incentive to see Third World incomes increase, because that is the only way that the populations in those countries will be able to afford to buy the goods the corporations are selling. That's what Henry Ford discovered when he started paying his workers $5 per day back in the 1920s.

The arguments for lack of concern about income inequality – "small share of the total" and "redistribution damages incentives" – are no less true just because income distribution across society is changing. [You say that we no longer have a middle class society, but that seems to me inconsistent with your assertions that income is growing at the very, very top. It seems to me more accurate to say that we still have the society we always have had, except that a few people at the very, very top are increasing their incomes at a rate greater than everybody else.]

I think that your focus on increased incomes for a few highly paid individuals is a distraction that really is not very important. What is important is that the revaluation of labor that globalization is forcing is going to limit income growth across broad sectors of our society, and there will be an ever greater income disparity between the deciles or quintiles (not fractions of 1%) who have sufficient education to provide value for their labor and the deciles and quintiles who do not. There is nothing we can – or morally should – do to change this trend other than to see that Third World incomes rise as quickly as possible over time (without, either intentionally or unintentionally, doing things that cause them not to rise at all – like insisting that every Third World country must immediately meet environmental and labor standards that took 200 years for us to achieve).

A few comments about Sweden: Its population is small and homogeneous. Size does matter. You could not duplicate the Swedish model on the US scale, any more than General Electric could be run as a general partnership like a law firm (even assuming the partners had the capital). There are also a few societal characteristics – a very high homicide rate in certain groups in the US urban underclass – that skew the life expectancy statistics. And, anticipating your rejoinder, these societal characteristics are not solely a consequence of relative poverty. Yes, reducing poverty would help, but it is not the total solution.

I agree that the transactions that formed the basis of the recent scandals at a number of companies - special-purpose entities, mark-to-market, round-tripping, etc. - were designed to benefit corporate insiders. They were designed to enable the corporate insiders to keep their jobs in the face of ridiculous demands for ever improving financial performance. Anyone with the most fundamental understanding of corporate finance recognized that Enron and Worldcom could not possibly have experienced growth at the rates they did without taking on significant risk. If management was greedy, the shareholders were greedier and now that economic reality (and your "simple arithmetic") have brought astronomical stock prices down to the point where they are merely silly, everyone is scrambling to blame someone else.

I wanted to buy Worldcom at one time, but I could never justify the price. I also never bought Intel or Microsoft. Commodity businesses cannot consistently sustain valuations at an earnings yield significantly in excess of the risk free rate. Anyone with the most cursory acquaintance with the disciplines of finance and economics knows that. Management may contribute to valuation distortions, but cannot be seen as the cause of them.

Regarding ideology: The fact that Republicans want to limit taxes and social spending does not mean they do not want to help the poor. The impacts on incentives of the redistribution schemes we have tried to date have been relatively marginal, but so has their impact on quality of life for the poor. Any scheme that would redistribute enough income to materially improve quality of life for the poor would be economic suicide.

And, whether you choose to recognize it or not, it is being achieved through our capitalist economy. As recently as 40 years ago, significant percentages of our population did not have indoor toilets or running water. Caloric malnutrition was a serious problem. Now, too many of those at the lowest end of our income distribution scale are obese. Obesity among the poor is not a problem in the Third World. Last summer I heard of a proposal to appropriate $100 million to help the poor pay their air conditioning bills. (A proposal I thought silly, but it isn't that much money and if it helps avoid deaths as occurred in Chicago a few years ago, OK.) Outside of the US, referring to obese people with cars, color TV, indoor plumbing, heat in the winter and air conditioning in the summer as "poor" is seen as unbelievably insensitive.

On "tax cuts": The Bush "tax cut" did not go to the top 1% of the income distribution. It did not go to anybody. I suggest that there was no "tax cut". Yes, the federal government made changes that reduced my taxes, but the state simply raised my taxes by a similar amount. Government consumes the highest level of GDP (or GNP, I do not know what the right measure is) that is possible without causing unacceptably large adverse effects on the economy generally. The state cannot raise my taxes. Not because I cannot or will not pay, but because their economic models show that any increase in taxes will adversely affect spending, employment, etc. The only way that the state can take more is if the federal government takes less. Cutting federal taxes has no benefit to the "rich" (considered in the aggregate, of course). It simply shifts power from Washington to the states. There are many of us who think that is not a bad thing.

As for the estate tax, your data supports repeal. You harp on the astronomical incomes of people at the top and then say that the estate tax was paid by estates with a minimum value of $5 million and an average of $17 million, with a large portion of it paid by a small number of estates with an average value of $20 million.

Unless all these high income earners you are worried about have somehow achieved immortality, I would have thought the averages would be much higher than this. If the estate tax is primarily paid by people who over their entire lives have accumulated only $20 million, where are all those people who make multiples of that each and every year? Where are the Bill Gates of our society?

The guy with $20 million is the family business. He's the guy with a manufacturing plant with 30 employees. He owns a couple of auto dealerships. He inherited a 200 acre farm in Somerset County, New Jersey. He is illiquid. He pays 55%. (I will not even deal with the poor slub with only $5 million. It does not take much of a business to be worth $5 million.)

The truly wealthy do not pay significant estate tax. They pay it, but since they have liquid assets, the share of their estates that are subject to the tax is very small. I have structured my affairs so I will pay little or no estate tax (and I would be shocked if you have not done the same). I have liquid assets that can be put into various trusts and other vehicles to minimize the impact of the estate tax. The (relatively) small businessman cannot do this.

Now, just as you concede that there are economic arguments that support repeal of the estate tax, I will concede that there are potential "dynastic" concerns and impacts on charitable giving to consider. We need an honest debate on this issue, not one based on the premise that the estate tax is paid by the very rich (even if those who pay it may seem rich to those who do not know better).