Comments of Jared Bernstein, Congressional Forum, 2/24/15

As we meet today, by many measures the US economy is reliably growing and the job market is finally tightening up. Yet, for too many families, growth remains a spectator sport, something they read about in the paper, hear elites reference on the news, yet see far too little of in their own economic lives.

This phenomenon is not new. As I show in my presentation, median compensation has diverged sharply from productivity growth for decades. Nor, as I stress in my comments, is this outcome solely the result of benign-sounding or inevitable forces, such as "globalization," or "technology." It is much the result of policy, both in terms of omission and commission. That's important, because it implies that better policy—where "better" means policies that will reconnect growth and middle-class prosperity—can make a real difference in the lives of the millions of families who've been on the wrong side of the inequality divide for decades.

--The wage/productivity story has a long term and near term dimension.

Long-term: As the figure shows, for years prior the mid-1970s, the compensation of the typical worker rose at the rate of overall productivity growth. Since then, productivity has more than doubled while real compensation at the median is only up about 9%.

Near-term: Though the job market has significantly improved and unemployment is close to the rate considered by the Federal Reserve and the CBO to be commensurate with full employment, nominal wage growth has been flat, at around 2% (as has price growth; see figure).

Both of these cases reveal deep deficits in worker bargaining power that have developed since the 1970s. As I stress below, this inequality-induced "wedge" between growth and most workers earnings is related to factors such as the absence of full employment, persistent trade deficits, and the increased share of economic activity devoted to finance, often referred to as "financialization."

--***The rise of finance*** in the midst of income and wealth concentration is one reason the US economy is stuck in an "economic shampoo cycle:" bubble, bust, repeat. Moreover, these trends interact in important ways that have led to a highly damaging cyclical pattern.

As shown in the schematic in slide 3, inequality contributes to middle-class income stagnation while wealth accumulates at the top of the scale. As the wealthy accumulate, the supply of loanable funds grows and its cost falls. The middle class borrows, increasing their debt-to-income ratio, and as they do so, their demand for financial services rises. That sector increases, but it is under-regulated. Thus, a bubble forms and when it bursts, we have the onset of deleveraging and a sharp reversal in the wealth effect, leading to recession.

--***The rate of economic mobility***—meaning the extent to which people and families end up in different parts of the income scale than where they started out—has neither sped up nor slowed down in recent years. However, compared to other advanced economies, mobility is low in this country and, of course, inequality is high. Low levels of mobility in the US are evident in what mobility researchers call "stickiness in the tails:" the fact that significant shares of children from households at the top and bottom of the income scale tend to remain in their same relative income position as adults.

For example, 70% of children born into the bottom quintile of the income distribution (at or below the 20th percentile) remain below the middle quintile as adults, and 63% of children born into the top quintile remain above the middle quintile as adults. Only 4% are able to make it all the way from the bottom to the top, and only 8% drop all the way from the top to the bottom.

Immobility is greater for African-Americans. Reeves shows that half of black children “born into the lowest fifth of the earnings distribution remain there at age 40.” He also finds far more downward mobility among blacks than whites, and as the slide shows, far less wealth holdings.

As inequality rises, barriers to opportunity, and thus mobility, arise. The next figure shows two important examples: college indebtedness by income class, and the rising inequality of “enrichment” expenditures on children. Other examples include increased residential segregation and the direct effects of low income and poverty. For example, research shows that poverty in childhood is associated with suboptimal cognitive development, poor health, difficulties in school, and lower employment and earnings in adulthood.

As opportunity barriers arise with higher levels of income inequality, I have serious concerns that future rates of mobility will be even lower than today’s.

--***Government policies*** have played a role in the trends shown so far, including:

--fiscal austerity measures that have slowed our economic recovery—research finds that US austerity measures reduced real GDP growth by 1.5 percentage points in 2013;

--declines in the real value of the federal minimum wage;

--erosion of other labor standards, including overtime regulations (salary threshold for non-exempt workers), the rise of misclassification of regular workers as self-employed, and the lack of prosecution of “wage-theft”;

--a titled playing field against collective bargaining;

--inaction against international competitors who manage currency values to boost their trade surpluses and our deficits;

--imbalances in the tax code that give preferential treatment to non-labor income;

--underinvestment in infrastructure and other public goods.

--***While inflation, on average,*** has risen relatively slowly in recent years, some of the key components of the middle-class consumption basket have grown much more quickly than average. The next two figures show this as regards specific components of education spending, and aggregate education spending as well as health care costs. These cost dynamics place great pressure on the family budgets of middle- and low-income families.

--***The inability of the federal government to make critical investments in the future***—investments with the potential to boost mobility, opportunity, and growth—is partly a function of the conservatives’ insistence on no new revenues. Tax reform that broadens the base to lower rates is also blocked by vested interests unwilling to give up favored treatment through the tax code. And note that such reforms are typically pitched as revenue neutral, thus maintaining the squeeze on new investments.

Most of the tax expenditures that narrow our tax base disproportionately benefit the wealthy, including lower rates on capital gains, interest deductibility, offshoring/deferring income, “step-up basis” (non-taxation of inherited capital gains), and more.

Moreover, evidence consistently shows that contrary to “trickle-down” arguments, such tax breaks have little impact on investment, productivity, jobs, or growth.

Broadening the tax base by closing these inequality-increasing tax break, and doing so in a revenue-positive manner would provide significant resources to invest in breaking down opportunity barriers that result from our high levels of economic inequality.