

**RISING INEQUALITY AND MIDDLE CLASS STAGNATION: A Growing Threat To
American Democracy and Economic Prosperity**

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Thank you Senator Warren and Congressman Cummings for bringing us together to discuss this most important topic.

I begin with an observation. The nation's growing concern with inequality is not against inequality per se. Americans accept inequality as a necessary platform to provide economic opportunity and incentives for efficient allocation of talents and skills. Americans generally favor structuring institutions so the opportunity to amass large wealth flourishes. The fact that incomes are rising at unprecedented rates among the upper reaches of the income distribution would not evoke concern among most Americans if the standards of living among the middle-class and below were also improving. However, living standards for the middle class are stagnating and for some Americans even deteriorating.

Contemporary inequality has the distasteful odor of a winner-loser economy. An economy governed by a political-economic system that, for several decades now, rewards income elites who gain at everyone else's expense. With the exception of the late 1990s, middle class versions of the American Dream have been deferred instead of flourishing. Winner-loser inequality harbors deadly implications for the health of our economy and democratic institutions. Rising incomes at the top accompanied by stagnation and deterioration for middle and lower income households concentrates too much political power at the top. It also undermines the middle class purchasing power on which our prosperity rests.

Globalization's Pressure on the Supply and Demand for Labor.

The winner-loser inequality threatening our society is indicative of a dramatic shift in the manner by which market and political institutions are allocating rewards. The shift is due to a combination of economic forces *and* political *choices*! During the last several decades, nearly all economic and political forces have put downward pressure on the demand for labor at middle and low quintiles of the wage distribution. Gathered under the convenient umbrella term globalization, the factors behind the lagging demand for such labor are well known even if their relative importance is not. Computer driven

technological change replacing labor with machines, cheap imports produced by low-wage foreign workers, and out-sourcing have each reduced the demand for domestic workers. Contemporaneous with downward pressure on the demand for labor, other factors have put outward pressure on labor supply. Perhaps the most important factor expanding the supply of labor at lower wages than would otherwise have occurred is the decline of unions due to the weakened demand for domestic labor *and* vigorous anti-union activities of both corporate America and government.

However, winner-loser inequality is not simply the effects of global market trends over which the nation has little control. For several decades, our political system has promoted winner-loser inequality by emphasizing policies that favor corporate profits and high-income high wealth households at the expense of the middle class. Perhaps the two most obvious indicators of government's complicity in winner-loser inequality are its policies toward the minimum wage and income taxes. A minimum wage whose purchasing power has deteriorated to pre-1980 levels combined with four huge tax cuts since 1980 favoring high income, and especially capital gains, accompanied by runaway deregulation of industry easily differentiate the emphasis behind government policy before and after the late 1970s.

Proponents of these policies have promised growth and prosperity with each tax cut and deregulation. However, experience shows, trickle-down to the middle-class promises of tax-cuts for the rich merely enrich the rich. Rather than increasing investment in capital and infrastructure that increases labor productivity and wages, deregulated financial institutions and markets, combined with low capital gains taxes have driven up returns to nonproductive assets distorting incentives in financial markets and creating debacles such as the recent housing bubble and Great Recession. Unprecedented current profits hide substantial long-term social costs.

Facts of Winner-Loser Inequality

A few simple facts are sufficient to substantiate the dangerous trend of inequality and the failure of the tax-cut low-wage policies. Observing trends over approximately the last three and a half decades from 1980 to 2013, in 2013-inflation-constant-dollars:

- The share of household income received by the middle 60% of households fell from 51.7% to 45.8%, while the share to the top 20% increased from 44.1% to 51%

You heard me right, the top 20% of households receives more than half of all household income. Moreover, gains of higher income households at the expense of the middle class were even more pronounced at the highest and lowest income levels.

- The share received by the top 5% of households rose from 16.5% to 22.2%
- The Share received by the bottom 20% fell from 4.2% to 3.2%.

The pronounced redistribution of income from the bottom and middle sectors of the distribution to households at the top can only occur if incomes are growing much faster at the top.

- The mean income of the 20% of households exactly in the *middle* of the distribution grew less than one-third of one-percent per annum from \$47,645 to \$52,322;
- The mean income of the top 5% grew almost 7 times more per annum virtually exploding from \$187,023 to \$322,343.

For middle class households, income is almost completely composed of wages. Because the wages of men at the middle of the wage distribution actually deteriorated, middle class households were able to see even these very small gains only because of the well-known increase in labor force participation of women (especially married women).

- Between 1979 and 2014, median wages of full-time year round-workers have stagnated. Weekly wages of men declined from a 1979 peak of \$952 to \$871 in 2014; women's weekly

wages increased from \$593 to \$719, but have changed little during the past decade. During 2014 both men's and women's median wages show modest increases.

These developments bode very badly for middle class retirement prospects

- The top 20% of households in the income distribution hold about 72% of total savings in retirement accounts.
- Most Americans approaching retirement have little or nothing saved in retirement accounts. In 2010, 40 percent of families in their peak saving years (age 55–64) had nothing saved in retirement accounts and 10 percent had \$12,000 or less according to data from the Federal Reserve Survey of Consumer Finances.

Why Is Winner-Loser Inequality Bad for the Economy

The middle class forms the numerical and cultural backbone of our economic and political institutions. As the slow recovery from the Great Recession demonstrates, a middle class with stagnant incomes puts severe downward pressure on macroeconomic demand for goods and services. Consumption demand underpinned by millions of middle class households with adequate disposable income is an essential key to our prosperity. The economy cannot thrive without this demand. The top 5 or 10 percent income households are too small in number to replace healthy middle class demand. Furthermore, increased exports could provide the needed demand only if inequality in our wage structure increases even more dramatically creating a nation of haves and have-nots that will threaten our democratic institutions in ways to horrible to contemplate.

Policy Recommendations

Minimum wage--Our first policy priority should be to increase the minimum wage. An increase in the minimum wage will have immediate effects on the well-being of many lower income households. Moreover, through its upward pressure on employers' relative wage structure, an increase in the minimum wage will benefit middle class households above minimum wage levels.

Tight Labor Market -- We must also pursue tight labor markets with unemployment below 5%.

Tax reform – It is time for a serious discussion about subsuming unemployment and social security taxes within the general income tax both for persons and corporations. Removing these taxes from employers' wage bill should have a positive effect on both employment and wages. Moreover, if the transfer into the general income tax is done in a manner introducing greater progressivity into the overall tax system, the change will also increase middle class paychecks. This transfer can be accomplished with minimal change in existing administration of social security and unemployment systems by maintaining the same accounting system as is now used with individuals' paychecks. Both employees and employers will have paper accounts as they do now, but the funds paying for the programs will be earmarked funds from the income tax.