Remarks to Forum on Middle Class Economic Issues
Washington, D.C.
February 24, 2015

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Prospects for the American Middle Class

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Thank you for having me here today to discuss prosperity, opportunity, and the economic prospects facing the American middle class in 2015.

Simply put, the American middle class is under great strain today, and the outlook for major improvements in the near future is somewhat grim – unless we take action. This is a matter of great concern for our country. The middle class is the backbone of America's economy and its democracy. So the state of the middle class is in many ways a proxy for the state of the union.

I will spend much of my remarks discussing the interconnected factors that are undermining our middle class. These factors share a central theme: they are all related to America's startling inequality. But first, I would like to do a brief inventory of the evidence that our middle class is under so much strain.

The most obvious data point is that incomes and wages in the middle are stagnating. Median household income—half of households are above, half below—is lower today, adjusted for inflation, than it was in 1989, a quarter century ago.[2] This isn't because America's workers have failed to become more productive: since 2000, worker productivity jumped an astonishing 26%; but during the same period real wages in the private sector have increased only about 7%.[3] Dig deeper into the data and the story gets worse. Real wages for production and non-

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[2] For large segments of the American population, matters are even worse. The inflation adjusted median income of a male worker with only a high school degree has fallen by 47% from 1969 to 2009. For additional data sources and explanation of these trends, see my "Reforming Taxation to Promote Growth and Equity," forthcoming as a Roosevelt institute working paper, which is submitted along with this written testimony. Inequality is discussed in even greater detail in my 2012 book, *The Price of Inequality: How Today's Divided Society Endangers Our Future*, New York: W.W. Norton.
[3] See the Economic Policy Institute's "A Decade of Flat Wages," August 2013, available at http://www.epi.org/publication/a-decade-of-flat-wages-the-key-barrier-to-shared-prosperity-and-a-rising-middle-class/.

supervisory employees are actually lower than they were in the early 1970s,[4] despite the fact that today's workers are vastly more efficient. Full time male workers today earn lower incomes than they did 40 years ago. [5]

Consider too that fewer Americans are working. Labor force participation rates are back to the levels of the late 1970s, before women entered the work force *en masse*. This is a statistic that belies the apparent improvement in our unemployment rate in the last few months. Americans discouraged by long, fruitless searches for work—or for work that pays a decent wage—have simply given up on job hunting. These Americans aren't considered in our headline unemployment statistics, but they reflect a weakness in the labor market that is further undermining the middle class, and contributing to the stagnation of incomes.

Life is particularly hard for those middle class families striving to provide a better life for their children, or who have the misfortune of a serious illness. The cost of higher education has increased faster than inflation and certainly much faster than incomes. This is why student loan debt is, at more than $1 trillion dollars, exceeding credit card debt. Millions are in default. Americans' health care expenditures per person are the highest in the world.

Even working has become, in a sense, a burden. Lagging public infrastructure imposes a particularly high cost on working families. Public transportation is so poor in many metro areas that life without a car is nearly impossible. Inexpensive childcare is practically nonexistent. All of these mounting basic expenses—which, it bears saying, are heavily supported by government in most of the countries of the world that are as wealthy as America—represent a further drain on our middle class.

So how have we gotten to this point? And what can we do about? The answer to both questions is policy. We have chosen policies that have made the United States an unequal country. The good news is that getting out is also a matter of choice. Our predicament is not the inevitable result of economics.

Over the course of the last decades, America has achieved the distinction of becoming the country with the highest level of income inequality among the advanced countries. While there is no single number that can depict all aspects of society's inequality, matters have become worse in every dimension: more money goes to the top (more than a fifth of all income goes to the top 1%), more people are in poverty at the bottom, and the middle class—long the core strength of our society—has seen its income stagnate.

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[4] See Bureau of Labor Statisitcs data http://research.stlouisfed.org/fred2/series/ahetpi/10, adjusted for inflation.
[5] Census data.

As disturbing as the data on the growing inequality in income are, those that describe the other dimensions of America's inequality are even worse: inequalities in wealth are even greater than income, and there are marked inequalities in health, reflected in differences, for instance, in life expectancy.

But perhaps the most invidious aspect of US inequality—and the most relevant to the middle class—is the inequality of opportunity. America has become the advanced country not only with the highest level of inequality, but is among those with the least equality of opportunity—the statistics show that the American dream is a myth; that the life prospects of a young American are more dependent on the income and education of his parents than in other developed countries.

Again, this inequality is largely a result of policies. The laws of economics are universal: the fact that in some countries there is so much less inequality and so much more equality of opportunity, the fact that in some countries inequality is not increasing—it is actually decreasing—is not because they have different laws of economics. Every aspect of our economic, legal, and social frameworks helps shape our inequality: from our education system and how we finance it, to our health system, to our tax laws, to our laws governing bankruptcy, corporate governance, the functioning of our financial system, to our anti-trust laws. In virtually every domain, we have made decisions that help enrich the top at the expense of the rest.

And the inequality at the top can't be justified as "just deserts" for the large contributions that these wealthy individuals have made. If we look at those at the top, they are not those who have made the major innovations that have transformed our economy and society; they are not the discoverers of DNA, the laser, the transistor; not the brilliant individuals who made the discoveries without which we would not have had the modern computer. Disproportionately, they are those who have excelled in rent seeking, in wealth appropriation, in figuring out how to get a larger share of the nation's pie, rather than enhancing the size of that pie.

Some would argue that, nevertheless, the economy needs this inequality to continue to grow. But we now have enough data to show that this is simply not true . Greater inequality leads to lower growth and more instability. These ideas now have become mainstream: even the IMF has embraced them. The hyper-wealthy aren't job-creators—on the contrary, during the time their incomes have ballooned, we've seen our economy, including our labor market, greatly weaken, as I have already described. Their wealth hasn't trickled down—it has, for the most part, only amplified itself. What does create jobs is *demand*: when there is demand, America's firms (especially if we can get our financial system to work in the way it should, providing credit to small and medium-sized enterprises) will create the jobs to satisfy that demand. Our growing inequality is in fact weakening demand—one of the reasons that inequality is bad for economic performance.

It's not just the immediate economic outcomes that we have to worry about. This inequality carries a high price for our democracy and the nature of our society. Our democracy is undermined as economic inequality inevitably translates into political inequality.

Thankfully, though, it's not too late to extricate ourselves from these trends, restore opportunity, and strengthen again our middle class. There are policies that could reduce the extremes of inequality and increase opportunity. There is no magic bullet, but there are a host of policies that would make a difference.

Investments in decreasing inequality and increasing equality of opportunity make sense not only for our economy, but for our budget. When we invest in our children, even if we have to borrow to do so, the asset side of our country's balance sheet goes up, even more than the liability set: any business would see that its net worth is increased. In the long run, even looking narrowly on the liability side of the balance sheet, there will be improvements, as these young people earn higher incomes and contribute more to the tax base. Most of the policies are familiar: more support for education, including pre-school; increasing the minimum wage; strengthening the earned-income tax credit; giving more voice to workers in the workplace, including through unions; more effective enforcement of anti-discrimination laws; better corporate governance, to curb the abuses of CEO pay; better financial sector regulations, to curb not just market manipulation and excessive speculative activity, but also predatory lending and abusive credit card practices and to refocus our financial sector toward expanding businesses and creating jobs; better anti-trust laws, and better enforcement of the laws we have; and a fairer tax system—one that does not reward speculators or those that take advantage of off-shore tax havens with tax rates lower than those confronting honest Americans who work for a living. If we are to avoid the creation of a new plutocracy in the country, we have to have a good system of inheritance and estate taxation, and ensure that it is effectively enforced. We need to make sure that everyone who has the potential to go to college can do so, no matter what the income of his parents—and to do so without undertaking crushing loans.

A final point is that we must be careful of how we measure our progress, especially if our aim is to strengthen the middle class, as it should be. If we use the wrong metrics, we will strive for the wrong things. Economic growth *as measured by GDP* is not enough—there is a growing global consensus that GDP does not provide a good measure of overall economic performance. What matters is whether growth is sustainable, and whether *most* citizens see their living standards rising year after year.

In the past, when our country reached these extremes of inequality, at the end of the 19th century, in the gilded age, or in the Roaring 20s, it pulled back from the brink. It enacted policies and programs that provided hope that the American dream could return to being a reality.

We are now at one of these pivotal points in history. I hope we once again will make the right decisions. Congress can play a vital role in setting the country in the right direction.