Social Europe Journal

30/05/2011

Robert Reich

The Truth about the American Economy

The U.S. economy continues to stagnate. It's growing at the rate of 1.8 percent, which is barely growing at all. Consumer spending is down.

It's vital that we understand the truth about the American economy.

How did we go from the Great Depression to 30 years of Great Prosperity? And from there, to 30 years of stagnant incomes and widening inequality, culminating in the Great Recession? And from the Great Recession into such an anemic recovery?

The Great Prosperity

During three decades from 1947 to 1977, the nation implemented what might be called a basic bargain with American workers. Employers paid them enough to buy what they produced. Mass production and mass consumption proved perfect complements. Almost everyone who wanted a job could find one with good wages, or at least wages that were trending upward.

During these three decades everyone's wages grew — not just those at or near the top.

Government enforced the basic bargain in several ways. It used Keynesian policy to achieve nearly full employment. It gave ordinary workers more bargaining power. It provided social insurance. And it expanded public investment. Consequently, the portion of total income that went to the middle class grew while the portion going to the top declined. But this was no zero-sum game. As the economy grew almost everyone came out ahead, including those at the top.

The pay of workers in the bottom fifth grew 116 percent over these years — faster than the pay of those in the top fifth (which rose 99 percent), and in the top 5 percent (86 percent).

Productivity also grew quickly. Labor productivity — average output per hour worked — doubled. So did median incomes. Expressed in 2007 dollars, the typical family's income rose from about $25,000 to $55,000. The basic bargain was cinched.

The middle class had the means to buy, and their buying created new jobs. As the economy grew, the national debt shrank as a percentage of it.

The Great Prosperity also marked the culmination of a reorganization of work that had begun during the Depression. Employers were required by law to provide extra pay — time-and-a-half — for work stretching beyond 40 hours a week. This created an incentive for employers to hire additional workers when demand picked up. Employers also were required to pay a minimum wage, which improved the pay of workers near the bottom as demand picked up.

When workers were laid off, usually during an economic downturn, government provided them with unemployment benefits, usually lasting until the economy recovered and they were rehired. Not only did this tide families over but it kept them buying goods and services — an "automatic stabilizer" for the economy in downturns.

Perhaps most significantly, government increased the bargaining leverage of ordinary workers. They were guaranteed the right to join labor unions, with which employers had to bargain in good faith. By the mid-1950s more than a third of all America workers in the private sector were unionized. And the unions demanded and received a fair slice of the American pie. Non-unionized companies, fearing their workers would otherwise want a union, offered similar deals.

Americans also enjoyed economic security against the risks of economic life — not only unemployment benefits but also, through Social Security, insurance against disability, loss of a major breadwinner, workplace injury and inability to save enough for retirement. In 1965 came health insurance for the elderly and the poor (Medicare and Medicaid). Economic security proved the handmaiden of prosperity. In requiring Americans to share the costs of adversity it enabled them to share the benefits of peace of mind. And by offering peace of mind, it freed them to consume the fruits of their labors.

The government sponsored the dreams of American families to own their own home by providing low-cost mortgages and interest deductions on mortgage payments. In many sections of the country, government subsidized electricity and water to make such homes habitable. And it built the roads and freeways that connected the homes with major commercial centers.

Government also widened access to higher education. The GI Bill paid college costs for those who returned from war. The expansion of public universities made higher education affordable to the American middle class.

Government paid for all of this with tax revenues from an expanding middle class with rising incomes. Revenues were also boosted by those at the top of the income ladder whose marginal taxes were far higher. The top marginal income tax rate during World War II was over 68 percent. In the 1950s, under Dwight Eisenhower, whom few would call a radical, it rose to 91 percent. In the 1960s and 1970s the highest marginal rate was around 70 percent. Even after exploiting all possible deductions and credits, the typical high-income taxpayer paid a marginal federal tax of over 50 percent. But contrary to what conservative commentators had predicted, the high tax rates did not reduce economic growth. To the contrary, they enabled the nation to expand middle-class prosperity and fuel growth.

The Middle-Class Squeeze, 1977-2007

During the Great Prosperity of 1947-1977, the basic bargain had ensured that the pay of American workers coincided with their output. In effect, the vast middle class received an increasing share of the benefits of economic growth. But after that point, the two lines began to diverge: Output per hour — a measure of productivity — continued to rise. But real hourly compensation was left in the dust.

It’s easy to blame “globalization” for the stagnation of middle incomes, but technological advances have played as much if not a greater role. Factories remaining in the United States have shed workers as they automated. So has the service sector.

But contrary to popular mythology, trade and technology have not reduced the overall number of American jobs. Their more profound effect has been on pay. Rather than be out of work, most Americans have quietly settled for lower real wages, or wages that have risen more slowly than the overall growth of the economy per person. Although unemployment following the Great Recession remains high, jobs are slowly returning. But in order to get them, many workers have to accept lower pay than before.

Starting more than three decades ago, trade and technology began driving a wedge between the earnings of people at the top and everyone else. The pay of well-connected graduates of prestigious colleges and MBA programs has soared. But the pay and benefits of most other workers has either flattened or dropped. And the ensuing division has also made most middle-class American families less economically secure.

Government could have enforced the basic bargain. But it did the opposite. It slashed public goods and investments — whacking school budgets, increasing the cost of public higher education, reducing job training, cutting public transportation and allowing bridges, ports and highways to corrode.

It shredded safety nets — reducing aid to jobless families with children, tightening eligibility for food stamps, and cutting unemployment insurance so much that by 2007 only 40 percent of the unemployed were covered. It halved the top income tax rate from the range of 70 to 90 percent that prevailed during the Great Prosperity to 28 to 35 percent; allowed many of the nation's rich to treat their income as capital gains subject to no more than 15 percent tax; and shrunk inheritance taxes that affected only the top-most 1.5 percent of earners. Yet at the same time, America boosted sales and payroll taxes, both of which took a bigger chunk out of the pay the middle class and the poor than of the well off.

How America Kept Buying: Three Coping Mechanisms

Coping mechanism No. 1: Women move into paid work. Starting in the late 1970s, and escalating in the 1980s and 1990s, women went into paid work in greater and greater numbers. For the relatively small sliver of women with four-year college degrees, this was the natural consequence of wider educational opportunities and new laws against gender discrimination that opened professions to well-educated women. But the vast majority of women who migrated into paid work did so in order to prop up family incomes as households were hit by the stagnant or declining wages of male workers.

This transition of women into paid work has been one of the most important social and economic changes to occur over the last four decades. In 1966, 20 percent of mothers with young children worked outside the home. By the late 1990s, the proportion had risen to 60 percent. For married women with children under the age of 6, the transformation has been even more dramatic — from 12 percent in the 1960s to 55 percent by the late 1990s.

Coping mechanism No. 2: Everyone works longer hours. By the mid 2000s it was not uncommon for men to work more than 60 hours a week and women to work more than 50. A growing number of people took on two or three jobs. All told, by the 2000s, the typical American worker worked more than 2,200 hours a year — 350 hours more than the average European worked, more hours even than the typically industrious Japanese put in. It was many more hours than the typical American middle-class family had worked in 1979 — 500 hours longer, a full 12 weeks more.

Coping mechanism No. 3: Draw down savings and borrow to the hilt. After exhausting the first two coping mechanisms, the only way Americans could keep consuming as before was to save less and go deeper into debt. During the Great Prosperity the American middle class saved about 9 percent of their after-tax incomes each year. By the late 1980s and early 1990s, that portion had been whittled down to about 7 percent. The savings rate then dropped to 6 percent in 1994, and on down to 3 percent in 1999. By 2008, Americans saved nothing. Meanwhile, household debt exploded. By 2007, the typical American owed 138 percent of their after-tax income.

The Challenge for the Future

All three coping mechanisms have been exhausted. The fundamental economic challenge ahead is to restore the vast American middle class. That requires resurrecting the basic bargain linking wages to overall gains, and providing the middle class a share of economic gains sufficient to allow them to purchase more of what the economy can produce. As we should have learned from the Great Prosperity — the 30 years after World War II when America grew because most Americans shared in the nation's prosperity — we cannot have a growing and vibrant economy without a growing and vibrant middle class.

(*This is excerpted from testimony presented to the U.S. Senate Committee on Health, Education, Labor, and Pensions, on May 12.*)

This column was taken from Robert Reich's Blog. His new book 'AFTERSHOCK: The Next Economy and America's Future', was published in September 2010 by Alfred Knopf.

Related posts:

1. The Strengths and Weaknesses of American Exceptionalism
2. The Truth About the Federal Budget Deficit That Noone Is Willing to Tell
3. The Great Switch by the Super Rich

[The Truth About the American Economy (II)]

Robert Reich, Wednesday, June 1, 2011

The Stalled Recovery

The U.S. economy was supposed to be in bloom by late spring but it's hardly growing at all. Expectations for second quarter growth aren't much better than the measly 1.8 percent annualized rate of the first quarter.

That's not nearly fast enough to reduce our ferociously-high level of unemployment. The Labor Department will tell us Friday whether the jobs situation improved in May, but there's been no sign of a surge in hiring. Nor in wages. Average hourly earnings of production and non-supervisory employees – who make up 80 percent of non-government workers – are lower than they were in the depths of the recession, adjusted for inflation.

Meanwhile, housing prices continue to fall. They're now 33 percent below their 2006 peak. That's a bigger drop than recorded in the Great Depression. Homes are the largest single asset of the American middle class, so as housing prices drop many Americans feel poorer. All of this is contributing to a general gloominess. Not surprisingly, consumer confidence is also down. The recovery has stalled. It's unlikely America will find itself back in recession but the possibility of a double dip can't be dismissed.

The Problem of Demand

The problem isn't on the supply side of the ledger. Corporate profits are still healthy. Big companies continue to sit on a cash hoard. Large and middle-sized companies can easily borrow more, at low rates.

The problem is on the demand side. American consumers, who constitute 70 percent of the total economy, can't and won't buy enough to get it moving. They justifiably worry they won't be able to pay their bills or afford to send their children to college or to retire. Banks, with equal justification, are reluctant to lend to them. But as long as consumers hold back, companies remain reluctant to hire new workers or raise the wages of current ones, feeding the vicious cycle.

The timing is unfortunate. Foreign consumers won't help much even if the dollar continues to slide. Europe's debt crisis and embrace of austerity, Japan's tragedy, and China's fiscal tightening have reduced global demand. At the same time, the federal stimulus here has about run its course. The Federal Reserve is about to end its $600 billion of purchases of Treasury bills, designed to bring down long-term interest rates and make it easier for homeowners to refinance. Worse yet, state governments – starved for revenue and constitutionally barred from running deficits – continue to cut programs. Local governments are now in worse shape, laying off platoons of teachers and fire fighters.

Washington's Paralysis

Under normal circumstances, this would be the time for the federal government to take bold action to ward off a double dip. For example, it could put more cash in peoples' pockets while giving employers an extra incentive to hire by exempting the first $20,000 of earnings from payroll taxes, for a year or two. It could lend money to state and local governments. It could launch a new WPA (modeled after its antecedent during the Great Depression) to put the long-term unemployed to work on public projects. I t could amend the bankruptcy law to allow people to include their prime residences in personal bankruptcy, thereby giving homeowners more leverage to get mortgage lenders to mitigate the terms of their loans. It could enlarge and expand the Earned Income Tax Credit so that the bottom 60 percent got a wage subsidy instead of a tax bill.

But these aren't normal circumstances. America has been through a devastating recession that poked a giant hole in the federal budget. And with a presidential election coming up next year, both parties are already maneuvering for tactical advantage.
Since taking over the House of Representatives in January, Republicans have focused on cutting government spending and paring back regulations. Their colleagues in the Senate, whose leader has proclaimed his major goal to unseat President Obama, are almost as single-minded. Cynics might suspect Republicans of quietly hoping the economy stays rotten through Election Day.

Democrats, meanwhile, are behaving as if they're powerless to affect the economy even though a Democrat occupies the White House and his appointees run the federal government. They'd rather not dwell on the slowdown because they don't want to spook the bond market or add to the prevailing gloom (Jimmy Carter's ill-fated comment about the nation's "malaise" during the stagflation of the late 1970s has served as a permanent admonition for presidents to stay upbeat).
Democrats are staking their electoral hopes on continuing disarray among Republican presidential aspirants, as well as the Republicans' suicidal plan to turn Medicare, the popular health insurance system for seniors, into vouchers that would funnel money to private, for-profit insurance companies.

The result is as if Washington were on another planet from the rest of the country (many Americans would argue this is hardly a new phenomenon).
The noisiest battle in the nation's capital is over raising the statutory debt limit – a game of chicken in which Republicans are demanding, in return for their votes, caps on future federal spending while Democrats insist on preserving the possibility of tax increases on the wealthy. Countless budget analysts are combing through endless projections of government revenues and expenditures in five or ten years. Think tanks and blue-ribbon panels are issuing voluminous reports on how to tame the budget deficit in decades to come. The President, meanwhile, is trying to appear as fiscally austere as possible – keeping a lid on non-defense discretionary spending, freezing the wages of civil servants, and offering his own deficit-reduction plans.

Washington's paralysis in the face of a stalled recovery is bad news – not just for average Americans but for the world. Ironically, it also worsens America's future budget crisis because it postpones the day when the debt begins to shrink as a proportion of the GDP. Yet as the 2012 election season looms, the prospects for sensible policy seem to decrease by the day.