Social Democratic Capitalism

LANE KENWORTHY

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America Is Underachieving

A good society will ensure a decent standard of living for its least well-off. It will reduce people's vulnerability to large income declines and large unanticipated expenses. It will aggressively curtail inequality of opportunity. And it will ensure that economic growth is broadly shared among the population rather than confined to those at the top.

The United States isn't doing as well as it should in meeting these challenges. The incomes and living standards of Americans at the bottom of the socioeconomic ladder are too low. Too many Americans experience significant income declines from year to year or month to month, and too many are vulnerable to a large unanticipated medical expense. Too few who grow up in disadvantaged circumstances are able to reach the middle class. And too few see their boat lifted when the economic tide rises.

A Decent Floor

The United States has done less well by its poor than a number of other affluent nations. The reason is straightforward. Like their counterparts abroad, America's least well-off have been hit hard by shifts in the economy since the 1970s, but whereas some countries have ensured that government supports rise as the economy grows, the United States hasn't.

Think of the income distribution in the United States as a ladder with five rungs, each of which holds 20 percent of the population. Among the 25 million households on the bottom rung, the average income as of 2016 was just $22,000.[1]

Income data are never perfect. However, these data, compiled by the Luxembourg Income Study, are quite good. They include earnings, government cash and near-cash transfers, and other sources of income. Tax payments are subtracted. These data give us a pretty reliable picture of the incomes of American households.

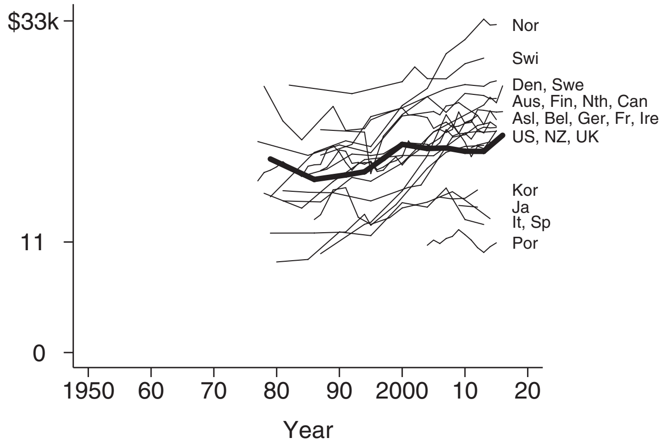

Figure 6.1 10th-percentile household income. Posttransfer-posttax household income. The incomes are adjusted for household size and then rescaled to reflect a three-person household, adjusted for inflation, and converted to US dollars using purchasing power parities. "k" = thousand. Data sources: Luxembourg Income Study; OECD. Thick line: United States. "Asl" is Australia; "Aus" is Austria.

Figure 6.1 puts this in comparative context. It shows that, despite America's affluence, household income at the 10th percentile of the income ladder—the middle of the bottom 20 percent—is lower in the United States than in many other wealthy nations. It's only a little below some of the other countries, but $5,000 to $10,000 below the leaders. That's a sizable difference.

What if we look at a more direct measure of living standards, such as material hardship? Two OECD researchers, Romina Boarini and Marco Mira d'Ercole, have compiled material deprivation data from surveys in various nations.[2] Each survey asked identical or very similar questions about seven indicators of material hardship: inability to adequately heat one's home, constrained food choices, overcrowding, poor environmental conditions (noise, pollution), arrears in payment of utility bills, arrears in mortgage or rent payments, and difficulty making ends meet. Boarini and Mira d'Ercole create a summary measure of deprivation by averaging, for each country, the shares of the population reporting deprivation in each of these seven areas. As Figure 6.2 indicates, the United States fares just as badly on this measure.[3]

How Poor Are the Poor?

Are low-income Americans genuinely poor? Most have clothing, food, and shelter. Many have a car, a television, heat and air conditioning, and access to medical care.[4] But making ends meet on an income of $22,000 is a challenge.

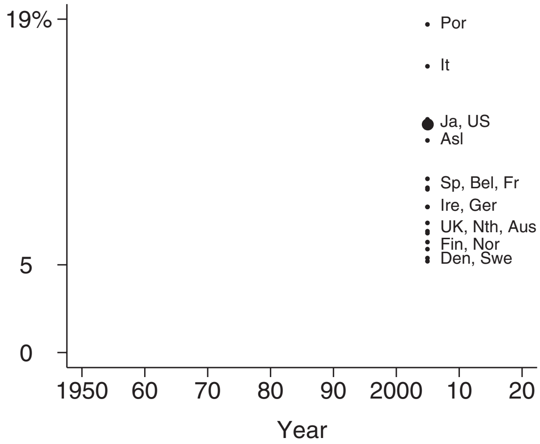

Figure 6.2 Material hardship. Average of the deprivation rates (share of households experiencing deprivation) in the following seven areas: inability to adequately heat home, constrained food choices, overcrowding, poor environmental conditions such as noise and pollution, arrears in payment of utility bills, arrears in mortgage or rent payment, difficulty in making ends meet. Measured in 2005. Data source: OECD, *Growing Unequal?*, 2008, pp. 186–88, using data from the Survey on Income and Living Conditions (EU-SILC) for European countries, the Household Income and Labour Dynamics in Australia survey (HILDA) for Australia, and the Survey of Income and Program Participation (SIPP) for the United States. Large dot: United States. "Asl" is Australia; "Aus" is Austria.

That comes out to $1,833 a month. If you spend $700 on rent and utilities, $350 on food, and $250 on transportation, you're left with just $533 each month for all other expenses. It's doable. Tens of millions of Americans offer proof of that. But this is a life best described as "scraping by."[5]

There are important caveats. First, since $22,000 is the average among these 25 million households, about half have an income above this amount, and for them making ends meet will be a little easier. But it still won't be easy. And the other half have incomes below the $22,000 average. Some solo adults make do with an income of $10,000 or $5,000. Some families with one or more kids get by on $15,000 or even less. About 1 percent of families with children and 4 percent of those without children have, for at least three months during a year, an income of less than $2 a day—an astonishingly low amount.[6] (That includes food stamps [Supplemental Nutrition Assistance Program, or SNAP], EITC payments, and housing support.) As Kathryn Edin, Luke Shaefer, Matthew Desmond, and others have documented, some of these Americans live in abysmal conditions and engage in demeaning or dangerous activities in order to subsist.[7]

Second, some of these households have assets that reduce their expenses or provide a cushion in case expenses exceed income in a particular month or year. Some, for example, own a home outright and therefore have no rent or mortgage payments. But many aren't saved by assets. Approximately 26 percent of

Americans are "asset poor," meaning they don't have enough assets to replace their income for at least three months.[8]

Third, these data very likely underestimate the true incomes of some households at the bottom. The data come from a survey in which people are asked what their income was in the prior year. People in low-income households tend to underreport their income, perhaps out of fear that accurate disclosure will result in loss of a government benefit they receive.[9]

A fourth caveat is that some of these 25 million households have a low income for only a short time. Their income may be low one year because the wage earner leaves her job temporarily to have a child, is sick, or gets laid off. By the following year, the earner may be back in paid employment. Some low earners are just beginning their work career. Five or ten years later, their earnings will be higher, or perhaps they will have a partner whose earnings add to household income. On the other hand, some who move up the economic ladder will later move back down. Shuffling in and out of poverty is common. Using a data set known as the Panel Study of Income Dynamics (PSID), which tracks the same set of households over time, Mark Rank, Thomas Hirschl, and Kirk Foster calculate that 10 percent of Americans spend ten or more years with an income below 1.5 times the US government's official poverty line (about $18,000 for a single adult and $37,500 for a household of four as of 2017) between the ages of twenty-five and sixty.[10]

Fifth, some of these households are made up of immigrants from much poorer nations. They are better off than they would have been if they had stayed in their native country, though that doesn't change the fact that they are scraping by.

How much should these qualifiers alter our impression of low-end living standards in the United States? It's difficult to say. Suppose the truly poor constitute only half of the bottom fifth. That's still 10 percent of American households, quite a large share for a nation as rich as ours.

Since the early 1990s the Survey of Income and Program Participation (SIPP) has asked a representative sample of Americans about their living conditions. Here's what the most recent survey, in 2011, found for households in the bottom fifth of incomes:

- 54 percent don't have a dishwasher.
- 47 percent don't have a computer.
- 31 percent don't have a clothes washer.
- 22 percent report two or more of the following: unmet essential expenses, unpaid rent or mortgage, unpaid utilities, disconnected utilities, disconnected phone, insufficient amount of food to eat, didn't see a doctor when needed, didn't see a dentist when needed.
- 11 percent say their neighborhood is unsafe.[11]

Americans with incomes in the lowest income quintile are much more likely than those with higher incomes to experience stress, worry, and sadness, as Figure 6.3 shows.

Perhaps we should measure low income in another way. We could, for example, identify the minimum income needed for a decent standard of living and then see how many households fall below this amount. A team of researchers at the Economic Policy Institute did this, estimating "basic family budgets" for metropolitan and rural areas around the country and calculating the share of families with incomes below these amounts in 1997–1999.[12] They concluded that approximately 29 percent of US families could not make ends meet. More recently, researchers for United Way have calculated household "survival budgets" in six states—California, Connecticut, Florida, Indiana, Michigan, and New Jersey—as of 2012. Their estimates for a family of four range from $46,000 in Indiana to $65,000 in Connecticut, and they find that 35 percent or more of the households in each of the six states had an income below the needed amount.[13] Researchers with Wider Opportunities for Women and the Center for Social Development at Washington University have calculated basic-needs budgets for various household types as of 2013. They estimate that to meet basic expenses, a single adult needed, on average, about $30,000, and a household with two adults and two children needed about $71,000. According to their calculations, 45 percent of American households fell below the threshold.[14]

This helps us understand a striking finding in a 2014 study by the Federal Reserve. Among 5,000 American adults asked how they would pay for a

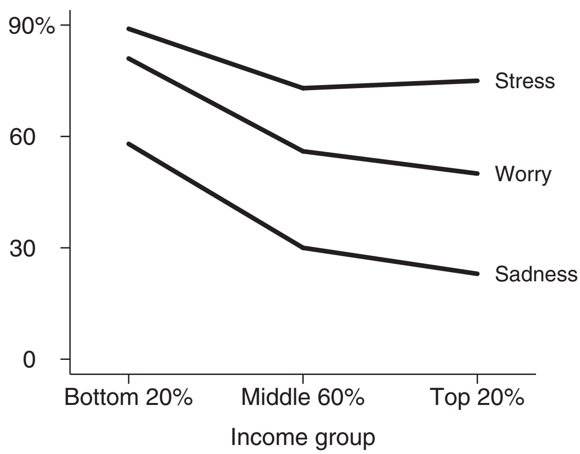

Figure 6.3 Income and psychological well-being. Share of respondents who say they experienced a given emotion yesterday. 2008–2013. Data source: Carol Graham, *Happiness for All? Unequal Hopes and Lives in Pursuit of the American Dream*, Princeton University Press, 2017, figure 4.1, using Gallup data.

hypothetical emergency expense totaling $400, 37 percent said they would be unable to pay for it with cash or money in their bank account.[15]

How Do Rich Countries Lift Up the Poor?

Historically, economic growth has tended to benefit all households, and that continues to be the case in many of the world's developing nations.[16] But the fruits of economic growth don't automatically trickle down to everyone. In many affluent countries, a host of developments over the past generation—economic globalization, the proliferation of computers and robots, shareholder obsession with short-term profits, union decline, and more—have reduced the likelihood that economic growth will boost the incomes of the least well-off.

Figure 6.4 shows that the United States has been particularly ineffective at lifting up the poor since the late 1970s. Many other rich democracies achieved larger increases in the incomes of low-end households (vertical axis) despite smaller increases in GDP per capita (horizontal axis).[17]

Why is that? We often think of the trickle-down process as one in which economic growth produces rising earnings via more work hours and higher wages. But in many of these countries, the earnings of low-end households have increased little since the late 1970s. Instead, it is increases in government transfers that have tended to drive increases in incomes.[18]

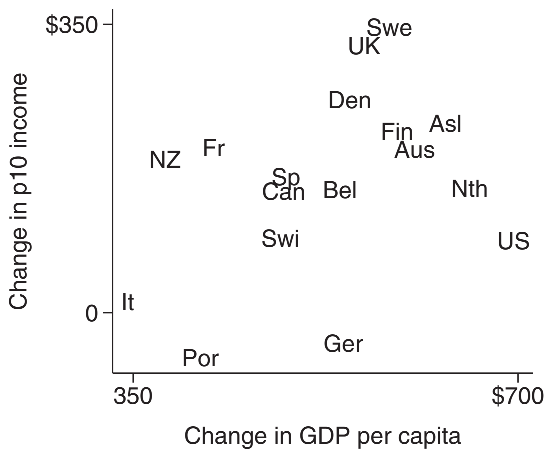

Figure 6.4 Economic growth and 10th-percentile household income growth. Change is per year, over the period 1979–2015. Because the actual years vary somewhat depending on the country, change is calculated by regressing household income or GDP per capita on year. Household incomes are posttransfer-posttax, adjusted for household size (the amounts shown are for a household with three persons). Household incomes and GDP per capita are adjusted for inflation and converted to US dollars using purchasing power parities. Ireland and Norway are omitted; both would be far off the plot in the upper-right corner. Data sources: OECD; Luxembourg Income Study. "Asl" is Australia.

Sometimes increasing government transfers requires no explicit policy change, as benefit levels tend to rise automatically as the economy grows. This happens when, for instance, pensions, unemployment compensation, and related benefits are indexed to average wages. Increases in other transfers, such as social assistance, typically require periodic policy updates. That's true also of tax reductions for low-income households.

In the United States, only one of our main government transfer programs, Social Security, is structured in such a way that benefit levels automatically increase when the economy grows. Social Security retirement benefits are indexed to average wages, so they have tended to rise more or less in concert with GDP.

Unemployment benefit levels are determined by state governments. In many instances, the benefit level is a "replacement rate," which means the payment is a certain fraction of the unemployed person's former wage or salary. Because real wages in the bottom half of the distribution have not increased in the past several decades, unemployment benefits for Americans in low-wage jobs have failed to keep up with growth in the economy. Other programs, such as the Earned Income Tax Credit (EITC), the Supplemental Nutritional Assistance Program (SNAP, formerly called the Food Stamp Program), Social Security Disability Insurance (SSDI), and Supplemental Security Income (SSI), are indexed to prices. This means they keep up with inflation, but not with economic growth. Temporary Assistance for Needy Families (TANF, formerly AFDC) payments are determined by state policy makers; there is no automatic increase, not even for inflation. AFDC-TANF benefit levels have fallen in inflation-adjusted terms for nearly half a century.

If most of the poorest Americans were Social Security recipients, the United States probably would be a good bit higher on the vertical axis in Figure 6.4. But in the United States, as in many other countries, many of the least well-off aren't retirees.[19] The fact that most of our other government transfers have only kept up with inflation rather than with the economy, coupled with the decline in AFDC-TANF benefits, is a key cause of slow income growth at the bottom in the United States.

Should we bemoan the fact that employment and earnings haven't been the key trickle-down mechanism in recent decades? Not necessarily. At higher points in the income distribution, they do play more of a role.[20] But for those at the low end there are limits to what employment can accomplish. Some people have psychological, cognitive, or physical conditions that limit their earnings capability. Some are constrained by family circumstances. At any given point in time, some will be out of work due to structural or cyclical unemployment. And some are retirees. We surely can do better at helping able adults get into (or back into) employment, but we shouldn't pretend that paid work is a realistic route to guaranteeing rising incomes for everyone.[21]

Why So Little Progress for America's Poor?

Let's look more closely at over-time developments in the United States. Figure 6.5 shows average income among the bottom fifth of US households between 1979 and 2016. It increased by about $3,500. That's a small improvement for a period of nearly four decades, especially given that for much of this time the American economy was growing at a healthy clip.[22]

Why has this happened? There are two main sources of income for low-end households: earnings and government transfers. And there are two main ways for households to increase earnings: more employment (increasing work hours or adding a second earner) and higher wages. So progress for the poor depends on increases in wages and/or employment and/or government transfers.

Low-end wages rose steadily from the mid-1940s through the end of the 1960s. We don't have reliable data for this period on wages at the 10th percentile, but a substitute indicator is the statutory minimum wage. As Figure 6.6 shows, the minimum wage (adjusted for inflation) increased sharply in the 1940s, 1950s, and 1960s and then decreased a bit in the 1970s. Since then it has been flat, as has the 10th-percentile wage level.

The pattern for employment is similar. Here a good measure is the average number of employment hours among low-income working-age households, shown in Figure 6.7. In the 1980s and 1990s, hours rose during periods of economic growth, but they then decreased so precipitously during recessions

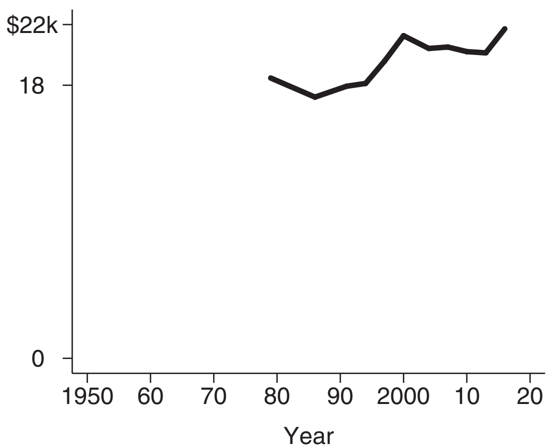

Figure 6.5 Average income of households in the bottom 20 percent. Posttransfer-posttax income. The income measure includes earnings, government cash and near-cash transfers, and other sources of cash income. Tax payments are subtracted. The incomes are adjusted for household size and then rescaled to reflect a three-person household. The incomes are in 2016 dollars; inflation adjustment is via the CPI-U-RS. Data source: Luxembourg Income Study, series dhi.

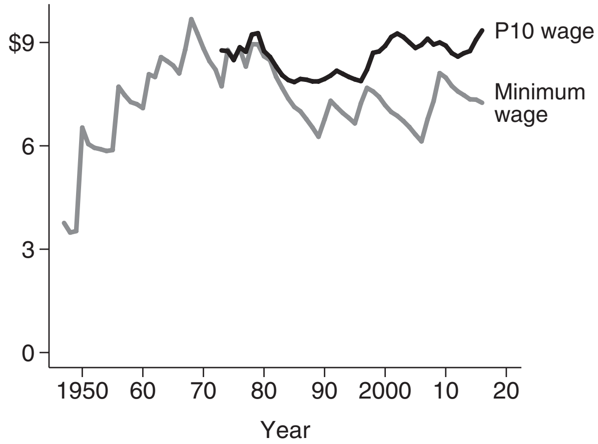

Figure 6.6 Low-end wages. The wage levels are in 2016 dollars; inflation adjustment is via the CPI-U-RS. Data sources: US Department of Labor; Economic Policy Institute, "Wages by Percentile."

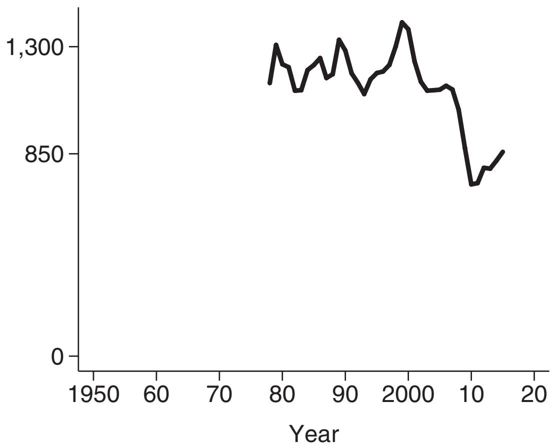

Figure 6.7 Employment hours in low-income households. Average annual hours worked in working-age ("head" aged 25–64) households in the bottom quintile of the pretransfer-pretax income distribution. Data source: calculations by Keith Bentele using Current Population Survey data (IPUMS March Extracts).

that there was little or no net gain. In the 2001–2007 upturn, economic growth produced no rise in the country's overall employment rate[23] or in average employment hours for low-end households. Hours then fall sharply during the great recession in 2008–2010, and they remain well below their 1979 level.

As a result of these two trends since the 1970s—flat wages and flat or declining employment—low-end households have seen little increase in inflation-adjusted earnings. Figure 6.8 shows that market income among households on

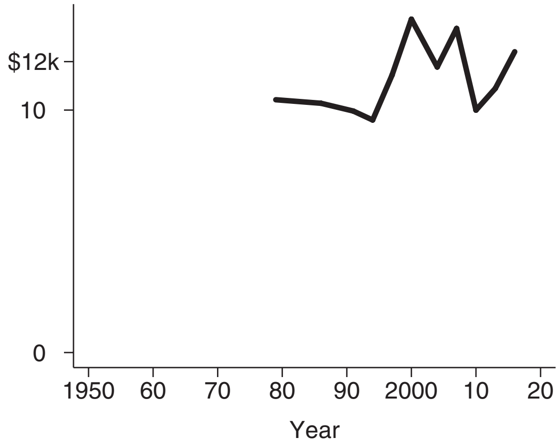

Figure 6.8 Average market income of households in the bottom 20 percent. Pretransfer-pretax household income among households in the bottom fifth of posttransfer-posttax incomes. The incomes are adjusted for household size and then rescaled to reflect a three-person household. The incomes are in 2016 dollars; inflation adjustment is via the CPI-U-RS. Data source: Luxembourg Income Study.

the bottom fifth of the income ladder increased between 1979 and 2016, but only slightly.

With wages and employment failing to increase, we're left with government transfers. As I noted in the previous section, this has been the key source of rising low-end incomes in a number of other affluent countries, but less so in the United States. Social Security benefits increased, as did the Earned Income Tax Credit. But social assistance (AFDC-TANF) coverage and benefit levels decreased.[24] Figure 6.9 shows the difference between market (pretransfer-pretax) income and disposable (posttransfer-posttax) income for households on the bottom fifth of the income ladder. Government transfers have helped America's poor, adding $7,000 to $10,000, on average, to their incomes. And they've played a particularly important role in propping up incomes during economic downturns. But their relatively small increase since the late 1970s, coupled with stagnant wages and stagnant employment, means there has been little rise in the incomes of low-end households.[25]

The United States could have done better. An instructive comparison case is the United Kingdom. Like the United States, its public insurance programs are moderately generous, and it too was governed in the 1980s and early 1990s by a conservative party devoted to rolling back the welfare state. In 1997 a New Labour government was elected, headed by Tony Blair and Gordon Brown, and a year later Prime Minister Blair committed the government to ending child poverty in the UK within a generation. That led to a raft of policy initiatives that significantly boosted incomes among Britain's least well-off.[26] As Figure 6.10

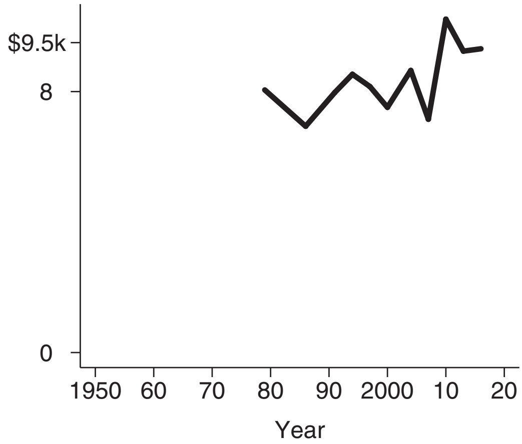

Figure 6.9 Net government transfers to households in the bottom 20 percent. Average posttransfer-posttax income minus average pretransfer-pretax income among households in the bottom fifth of posttransfer-posttax incomes. The incomes are adjusted for household size and then rescaled to reflect a three-person household. The amounts are in 2016 dollars; inflation adjustment is via the CPI-U-RS. Data source: Luxembourg Income Study.

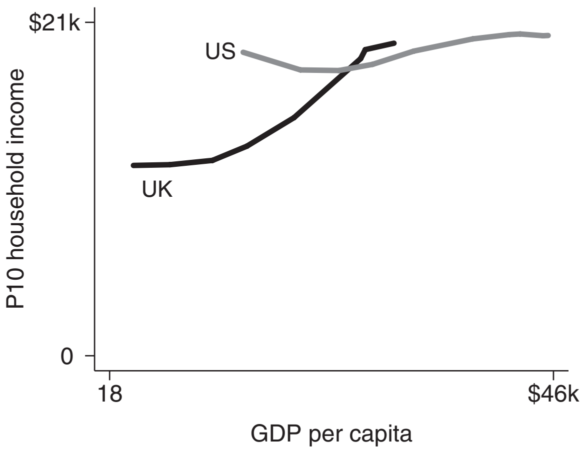

Figure 6.10 GDP per capita and 10th-percentile household income in the US and the UK. The data points are years, from 1979 to 2013. The lines are loess curves. Household incomes are posttransfer-posttax, adjusted for household size and then rescaled to reflect a three-person household. Household incomes and GDP per capita are adjusted for inflation using the CPI and converted to US dollars using purchasing power parities. "k" = thousand. Data sources: OECD; Luxembourg Income Study.

shows, household income at the 10th percentile rose much more in the UK than in the United States, despite similar increases in per capita GDP.

What about the argument that overly-generous social policy is the cause of slow income growth for the poor? According to this argument, economic growth has failed to boost employment because government benefits reduce the incentive for Americans with limited skills to take a low-paying, not-very-satisfying job.[27] This hypothesis is inconsistent with three key pieces of evidence. First, social assistance benefits in the United States—mainly AFDC-TANF and food stamps—have never been particularly generous, and their generosity has decreased steadily since the mid-1970s.[28] Second, we see in Figure 6.7 above that in the 1980s and 1990s employment hours in low-end households did rise quite sharply in years when the economy was growing. Ironically, it was in the period from 2001 to 2007, after incentives for employment were significantly enhanced by the 1996 welfare reform, that we see no rise in work hours during an economic growth phase. The demographic group that was the focus of welfare reform, poor single mothers with children, did experience a jump in employment hours and consequently in market incomes during this period.[29] However, more employment for this group didn't translate into more employment for America's poor overall. Third, the cross-country evidence suggests that countries with generous social policies have done just as well on employment and economic growth as those, like the United States, that have a smaller public safety net.[30]

The core of America's strategy for alleviating poverty over the past generation has been to encourage more paid work among the poor by making sure that government transfers aren't very generous. This strategy has not been a success, in part because during this same period the economy has changed in ways that make it more difficult for people at the low end of the labor market to get more work hours and/or rising wages.

The experience of other rich democratic nations suggests that the social democratic approach would be more effective. Increase benefit levels, and ensure that they rise over time in concert with growth of the economy. Encourage employment by providing an array of services and supports—paid parental leave, good-quality low-cost childcare and preschool, training and job placement assistance, and individualized monitoring and cajoling. Ensure that wages, too, rise over time. In the Nordic countries this is achieved by strong unions; in the United States, where unions are much weaker, it must be done via the statutory minimum wage.

Income Security

To be economically secure is to have sufficient resources to cover your expenses. One key, which we've just looked at, is to have a decent income. But that may not suffice if you experience a sizable income decline or a large unanticipated expense.

Americans care a good bit about the stability of their income and expenses. The Pew Research Center and the U.S. Financial Diaries Project have each asked a sample of low- and middle-income Americans "Which is more important to you: financial stability or moving up the income ladder?" In both surveys, two-thirds or more chose financial stability.[31]

Though we don't have hard data to confirm it, from the mid-1940s through the mid-1970s the incidence of large income drops and large unanticipated expenses very likely decreased for most Americans. Incomes grew steadily for most households, reducing the share with low income and facilitating the purchase of private insurance. More Americans became homeowners, thereby accumulating some assets. And a raft of new government laws and programs—limited liability law, bankruptcy protection, Social Security old-age benefits, unemployment insurance, the statutory minimum wage, AFDC (Aid to Families with Dependent Children, which later became TANF), Social Security disability benefits and Supplemental Security Income (SSI), Medicare and Medicaid, food stamps, the EITC, and disaster relief, among others—provided a safeguard against various financial risks, from business failure to job loss to poor health to old age.[32]

Since the 1970s, America's economy and society have changed in ways that are likely to have reduced income security.[33] Competition among firms has intensified as manufacturing and some services have become internationalized. Competitive pressures have increased even in sectors not exposed to competition from abroad, such as retail trade and hotels, partly due to the emergence of large and highly efficient firms such as Walmart and Amazon. At the same time, companies' shareholders now demand constant profit improvement rather than steady long-term performance.

These shifts force management to be hypersensitive to costs and constraints. One result is less job security, as firms restructure, downsize, move offshore, or simply go under. Another is enhanced management desire for flexibility, leading to greater use of part-time and temporary employees and irregular and unstable work hours. This increases earnings instability for some people and may reduce their likelihood of qualifying for unemployment compensation, paid sickness leave, and other supports. Employers also have cut back on the provision of benefits, including health insurance and pensions.

Private insurance companies are subject to the same pressures. And they now have access to detailed information about the likelihood that particular persons or households will get in a car accident, need expensive medical care, or experience home damage from a fire or a hurricane. As a result, private insurers are more selective about the type and extent of insurance coverage they provide and about the clientele to whom they provide it.[34]

Family protections against income instability also have weakened. Having a second adult in the household who has a paying job (or can get one) is a valuable asset in the event of income loss, but the share of American households with two adults has decreased, particularly among those with less education and income.[35]

The period since the 1970s also has witnessed commitments by some prominent American policy makers to ensure that, in Bill Clinton's expression, "the era of big government is over." Apart from AFDC-TANF, America's social programs haven't shrunk or disappeared. But they haven't increased very much.[36]

A survey in 2007 found more than 25 percent of Americans saying they were "fairly worried" or "very worried" about their economic security, and a similar survey in 2016 found 23 percent of Americans saying they feel "not financially secure." According to the latter poll, 17 percent are frequently anxious about their financial situation and 30 percent lose sleep over it.[37]

What do the data tell us about the incidence of large income declines and unanticipated expenses in the United States?

Large Income Decline

A large income decline can be problematic even if it is temporary. Consider two households with the same average income over ten years. In one, the income is consistent over these years. The other experiences a big drop in income in one of the years, but offsets that drop with higher-than-average income in one or more later years. The latter household may be worse off in two respects. First, a loss tends to reduce our happiness more than an equivalent gain increases it.[38] Second, a large decline in income may force a household to sell assets, such as a home, in order to meet expenses. Even if the income loss is ultimately offset, the household may be worse off at the end of the period due to the asset sell-off.

It turns out, however, that income declines often aren't temporary. Stephen Rose and Scott Winship have analyzed data from the Panel Study of Income Dynamics (PSID) to find out what subsequently happens to households experiencing a significant income decline.[39] According to their calculations, among households that experience a drop in income of 25 percent or more from one year to the next, about one-third do not recover to their prior income level even a full decade later.

There are various reasons for this. Some people own a small business that fails and don't manage to get a job that pays as much as they had made as entrepreneurs. Others become disabled or suffer a serious health problem and are unable to return to their previous earnings level. Still others are laid off, don't find a new job right away, and then suffer because potential employers view their jobless spell as a signal that they are undesirable employees. And some are a product of early death of a partner; about 10 percent of American twenty-five-year-olds won't live to age sixty-five, and 30 percent of Americans don't have life insurance.[40]

So income decline is a problem for those who experience it. How many Americans are we talking about? Several researchers have attempted to estimate the frequency of sharp income drops. Rose and Winship find that in any given year, 15 to 20 percent of Americans experience an income decline of 25 percent or more from the previous year.[41] Using a different data source, the Survey of Income and Program Participation (SIPP), Winship estimates that during the 1990s and 2000s approximately 8 to 13 percent of households suffered this fate each year.[42] A study by the Congressional Budget Office matches data from the Survey of Income and Program Participation (SIPP) with Social Security Administration records and gets a similar estimate of approximately 10 percent during the 1990s and 2000s.[43] A team of researchers led by Jacob Hacker uses a third data source, the Current Population Survey (CPS), covering the mid-1980s through 2012, and comes up with an estimate of 15 to 20 percent.[44]

These estimates vary, but not wildly. In any given year, approximately 10 to 20 percent of working-age Americans will experience a severe income drop.

Has the incidence of large year-to-year income decline increased over time? Yes, according to calculations by Jacob Hacker's team and by Scott Winship. These estimates, shown in Figure 6.11, suggest a rise in sharp year-to-year income decline of perhaps three to five percentage points since the 1970s or the early 1980s.[45] This isn't a massive increase, but it might cumulate into a more substantial one.

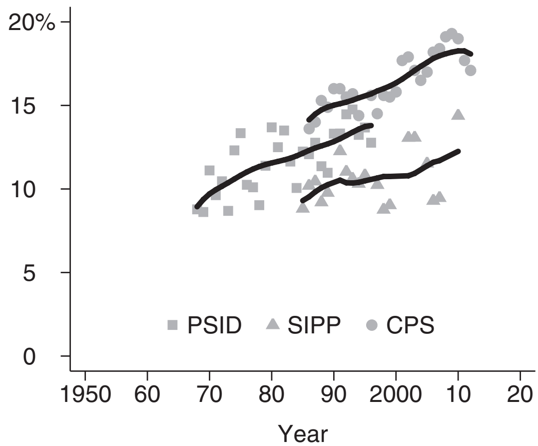

Figure 6.11 Households experiencing an income decline of 25 percent or more from one year to the next. The lines are loess curves. PSID and SIPP: posttransfer-pretax income, for households with a "head" aged 25–54. PSID is the Panel Study of Income Dynamics. SIPP is the Survey of Income and Program Participation. Data source: Scott Winship, "Bogeyman Economics," *National Affairs*, 2012, figure 1. CPS: posttransfer-pretax income, for households of all ages. CPS is the Current Population Survey. Data source: Economic Security Index.

What's the bottom line? In my read, the data tell us that sharp declines of income among working-age American households are relatively common and that their incidence has increased over the past generation.

We need to keep in mind that some of these declines are voluntary. A person may leave a job or cut back on work hours to spend more time with children or an ailing relative. A couple may divorce. Someone may quit a job to move to a more desirable location without having another job lined up. Still, we don't know what portion of income drops are voluntary, and I don't think we should presume that most are.

How should we assess the trend? One perspective is to view it as unavoidable. The American economy has changed since the 1970s. It's more competitive, flexible, and in flux. Even though this is bad for some households, it can't be prevented unless we seal the country off from the rest of the world and heavily regulate our labor market. In this view, we should be happy that the increase in income volatility hasn't been larger.

A different take is disappointment. There are ways to insure against income decline. We could have improved our porous unemployment compensation system, added a public sickness insurance program, and created a wage insurance program so that someone who loses a job and gets a new, lower-paying one receives some payment to offset the earnings loss. We could have done more, in other words, to offset the impact of economic and family shifts.

Figure 6.12 offers cross-country rationale for this view. It shows the average year-to-year income decline of households in which an individual experiences a large (20 percent or more) decrease in earnings. In the United States the average drop in income is 28 percent. In most other rich nations it is smaller, and in some it is *much* smaller. The cross-country difference owes partly to the likelihood of having a second employed person in the household whose earnings cushion the loss and partly to the scope and generosity of public insurance programs that compensate for lost earnings.

Month-to-Month Income Variability

Income instability isn't solely a problem if it occurs across years. Instability *within* a year—from month to month—also can put a strain on households, particularly if their income is low or moderate. As Jonathan Morduch and Rachel Schneider put it, "Without a steady income, planning is much more complicated, and accumulating savings for unexpected expenses—not to mention major purchases such as a car or down payment on a home, or college or retirement—is quite difficult. At a more basic level, uncertainty about how often and how much income will arrive each month adds to the challenge of creating a basic spending plan for how to buy groceries and pay household bills."[46]

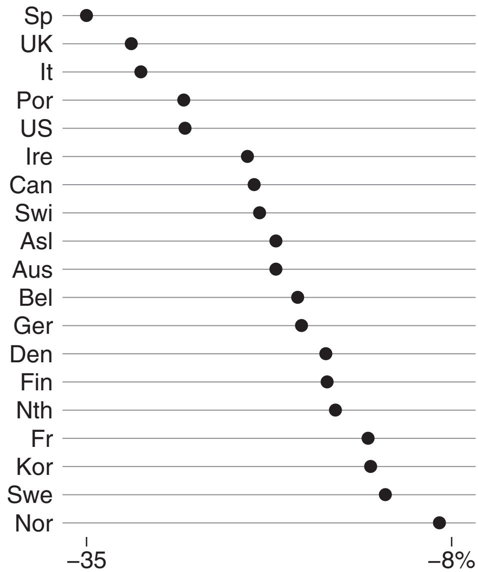

Figure 6.12 Household income decline. Average year-to-year household disposable income decline for households in which an individual experiences an earnings decline of 20 percent or more. 2005–2010. Data source: Boris Cournède, Paula Garda, Peter Hoeller, and Volker Ziemann, "Effects of Pro-Growth Policies on the Economic Stability of Firms, Workers and Households," OECD Economic Policy Papers 12, 2015, figure 18, using CNEF, ECHP, EU-SILC, and OECD data.

For some households, employment and/or work hours vary from month to month as one or more adults in the household moves between jobs or takes time off due to sickness or family constraints. And some jobs—seasonal ones, temp work, "platform economy" positions—are inherently irregular.[47] Even when employment is stable, pay can vary. This has always been true for taxi drivers and waitresses, but uncertain pay is no longer exceptional. Recent studies estimate that 2.6 percent of employed Americans are on-call workers, 1.5 percent are temp agency workers, 3.1 percent are workers provided by contract firms, and 0.5 percent are workers who provide services through online intermediaries such as Uber and Task Rabbit. Around 10 percent have irregular or on-call shifts.[48] As many as 33 percent engage in freelance work of various kinds.[49]

The U.S. Financial Diaries Project collected detailed cash flow and financial data from 237 low- and middle-income families over the course of a year. On average, about one-third of the income of these families came from a job without a regular wage or salary. In 40 percent of these families, one or both adults worked more than one job. Among those with low income, about half reported that it was difficult to predict what the household's income would be during the month.[50]

Large month-to-month income fluctuations are much more common among Americans in the lowest fifth of incomes than among those with middle incomes.[51] Households deploy myriad strategies to deal with unsteady income: working an additional job, borrowing from a credit card or money lender, borrowing from family or friends, paying some bills but not others, pawning possessions, selling blood, selling drugs.

Large Unanticipated Expense

A sharp drop in income causes economic insecurity because we may have trouble meeting our expenses. A large unanticipated expense can produce the same result.

In the United States, the most common large unexpected expense is medical. About one in ten Americans doesn't have health insurance. Others are underinsured, in the sense that they face a nontrivial likelihood of having to pay out of pocket for healthcare if they fall victim to a fairly common accident, condition, or disease.

Of course, many of the uninsured and underinsured won't end up with a large healthcare bill. And some who do will be able to pay it (due to high income or to assets that can be sold), or will be allowed to escape paying it because of low income or assets, or will go into personal bankruptcy and have the debt expunged. Yet in a modern society, we should consider most of the uninsured and some of the underinsured as economically insecure, in the same way we do those with low income or unstable income.[52] They are living on the edge to a degree that should not happen in a rich nation in the twenty-first century. After all, every other affluent democracy manages to provide health insurance for all of its citizens without breaking the bank.

This form of economic insecurity decreased sharply with the spread of employer-provided private health insurance after World War II and then with the creation of Medicare and Medicaid in the mid-1960s. As Figure 6.13 shows, the share of Americans without private health insurance fell steadily from the mid-1940s until the mid-1970s. But then it leveled off, and in the 1980s it began rising. The share without either public or private insurance was essentially flat from the mid-1970s until full implementation of the Affordable Care Act (ACA) beginning in 2014.

The ACA is expected to eventually reduce the uninsured share to perhaps 6 to 8 percent. That would be a substantial improvement in economic security, but it will still leave us well short of where we could be, and where every other affluent nation has been for some time.[53]

Figure 6.13 understates vulnerability to a large medical expense in two respects. First, these data capture the average share of Americans who are

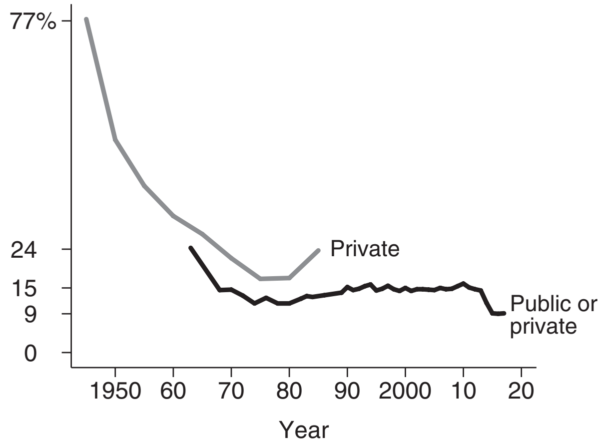

Figure 6.13 Persons without health insurance. Share of the population. 1964: Medicare and Medicaid created. 1998: S-CHIP enacted. 2010: Affordable Care Act passed. Data sources: Michael A. Morrisey, *Health Insurance*, 2nd edition, 2013, exhibit 1.2; Council of Economic Advisors, "Methodological Appendix: Methods Used to Construct a Consistent Historical Time Series of Health Insurance Coverage," 2014, using data from the National Health Interview Survey and other surveys.

uninsured at a given point during a year. (This share is very similar to the share who are uninsured throughout the entire year.[54]) If we instead ask how many are uninsured at *any* point during a year or two, the figure is larger. The Lewin Group has estimated that during the two-year period of 2007 and 2008, 29 percent of Americans lacked health insurance at some point.[55]

Second, it isn't only the uninsured who are insecure. Some Americans have a health insurance policy that is inadequate.[56] One in ten Americans lacks health insurance, but six in ten say they worry a great deal about the availability and affordability of healthcare.[57] Out-of-pocket expenses allowed by insurance plans sold on the national health insurance exchanges can be as high as $13,700 a year for a family.[58] In a survey by the Commonwealth Fund, 29 percent of American adults aged 19 to 64 who had health insurance throughout the year reported that they had outstanding medical debt, had trouble paying medical bills, were contacted by a collection agency for unpaid medical bills, or had to alter their way of life in order to pay medical bills.[59] And a survey by the Kaiser Foundation and the *New York Times* found that "while insurance may protect people from having medical bill problems in the first place, once those problems occur the consequences are similar regardless of insurance status. Among those with medical bill problems, almost identical shares of the insured (44 percent) and uninsured (45 percent) say the bills have had a major impact on their families."[60]

About one-quarter of Americans who file for bankruptcy do so mainly because of a large medical bill.[61] Personal bankruptcy filings increased steadily from 1980 through the mid-to-late 2000s. Since 2010 they have decreased, perhaps in part because of the expansion in health insurance via the Affordable Care Act.[62]

Wealth as a Backstop?

A large income decline or a large unanticipated expense will be less problematic for a household that has assets it can use to replace the lost income or to pay the expense. But several pieces of evidence suggest that this helps only a small share of Americans who experience these types of economic insecurity.

First, the bottom 40 percent of Americans have virtually no wealth. From 1983 (the first year of reliable data) through 2007, average net worth among this group was just $2,000. In 2010, 2013, and 2016, the three most recent years in which data were collected, it was *negative* $10,000.[63] Second, studies regularly find that about one in four Americans don't have enough wealth to replace 25 percent of their income.[64] Third, the Economic Security Index team headed by Jacob Hacker has calculated the share of Americans who experience an income drop from one year to the next of 25 percent or more *and* who don't have enough liquid assets to cover that loss. According to their estimates, taking wealth into account does reduce the incidence of this type of insecurity, but only by one percentage point.[65]

Equality of Opportunity

Americans believe in equal opportunity. Surveys consistently find 90 percent of the public agreeing that "our society should do what is necessary to make sure that everyone has an equal opportunity to succeed."[66] This level of support is rare.[67] It suggests policy makers ought to put equality of opportunity at or near the top of the list of goals they pursue.

True equality of opportunity is unattainable. Equal opportunity requires that each person has equivalent skills, abilities, knowledge, and noncognitive traits upon reaching adulthood, and that's impossible to achieve. Our capabilities are shaped by genetics, developments in utero, parents, siblings, peers, teachers, preachers, sports coaches, tutors, neighborhoods, and a slew of chance events and occurrences. Society can't fully equalize, offset, or compensate for these influences. In fact, if we think about it carefully, few of us would want equal opportunity, as it would require massive intervention in home life and probably also genetic engineering. Moreover, if parents knew everyone would end up with the same skills and abilities at the end of childhood, they would have little incentive to invest effort and money in their children's development, and that would result in a lower absolute level of capabilities for everyone.

What we really want is for each person to have the most opportunity possible. We should aim, in Amartya Sen's helpful formulation, to maximize people's capability to choose, act, and accomplish.[68] Pursuing that goal requires providing greater-than-average help to those with less advantageous circumstances or conditions. That, in turn, would move us closer to equal opportunity, even if, as I've just explained, full equality of opportunity isn't attainable.

Americans have tended to believe that ours is a country in which opportunity is plentiful. This view became especially prominent in the second half of the nineteenth century, when the economy was shifting from farming to industry and Horatio Alger was churning out rags-to-riches tales.[69] It's still present. On the night of his election in 2008, Barack Obama, the country's first African American president, began his victory speech by saying "If there is anyone out there who still doubts that America is a place where all things are possible . . . tonight is your answer."

There's more than a grain of truth in this sentiment. One of the country's major successes in the past half century has been its progress in reducing obstacles to opportunity stemming from gender and race. Today, women are more likely to graduate from college than men and are catching up in employment and earnings.[70] The gap between whites and nonwhites has narrowed as well, albeit less dramatically.[71]

When we turn to family background, however, the news is disappointing. Americans growing up in less advantaged homes have far less opportunity than their counterparts from better-off families, and this opportunity gap hasn't narrowed in recent decades. If anything, it may have widened.

Family Background and Unequal Opportunity

There is no straightforward way to measure opportunity, so social scientists tend to infer from outcomes, such as employment or earnings. If we find that a particular group fares worse than others, we suspect a barrier to opportunity. It isn't ironclad proof, but it's the best we can do. To assess equality of opportunity among people from different family backgrounds, we look at relative intergenerational mobility—a person's position on the income ladder relative to her or his parents' position.[72]

Think of the income distribution as a ladder with five rungs, with each rung representing a fifth of the population. In a society with equal opportunity, every person would have a 20 percent chance of landing on each of the five rungs and hence a 60 percent chance of landing on the middle rung or a higher one. The reality is quite different. An American born into a family in the bottom fifth of incomes between the mid-1960s and the mid-1980s has roughly a 30 percent chance of reaching the middle fifth or higher in adulthood, whereas an American born into the middle fifth has a 66 percent chance of ending up in the middle fifth or higher and one born into the top fifth has an 80 percent chance.[73]

Figure 6.14 offers a more precise way to see the degree of inequality of opportunity. It uses data from a large sample of Americans born since 1970 and their parents. On the horizontal axis is the parents' income rank—their income relative to the incomes of other parents. On the vertical axis is the average income ranking of the children of those parents when the children are in young adulthood. The dot farthest to the left, for instance, shows the average income rank of children whose parents were in the lowest income percentile.

In a society with perfectly equal opportunity, the data points in this chart would form a flat line—children's income position in adulthood would, on average, be the same no matter what their parents' income position was. Instead we see a line that slopes sharply upward. Among people whose parents were on the bottom rungs of the income ladder, the average income ranking in young adulthood is relatively low. Among those whose parents were in the middle, the average is in the middle. And persons whose parents' income was at the high end tend to end up at the high end themselves.

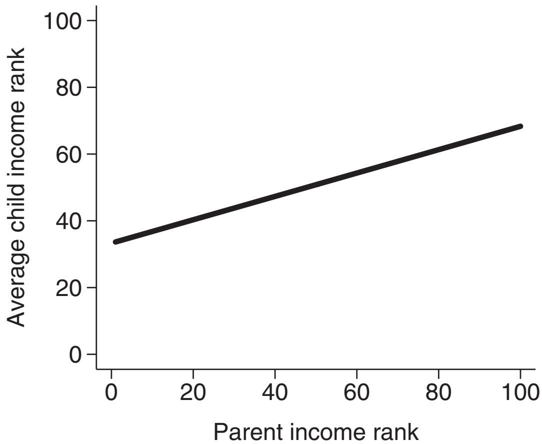

Figure 6.14 Children's income rank by their parents' income rank. Horizontal axis: Parents' household income rank when the child is in her or his late teens, in 1994–2000. Vertical axis: Child's average household income rank at age 31–37, in 2014–2015. The sample is children born in the years 1978–1983. The income data are from tax filings merged with Social Security records. Data source: Raj Chetty, Nathaniel Hendren, Maggie R. Jones, and Sonya R. Porter, "Race and Economic Opportunity in the United States: An Intergenerational Perspective," Working Paper 24441, National Bureau of Economic Research, 2018, online appendix figure 1. The slope is .35.

There is some movement. Among children whose parents were in the lowest income percentile, the average ranking is the 33rd percentile. That means some end up at the bottom, some end up in the middle, and perhaps a few end up even higher. Similarly, among children whose parents were at the top of the income distribution, the average income ranking is around the 68th percentile, which means many of them don't stay at the very top. Even so, the correlation between parents' income position and children's income position is quite strong.

The causes of this stark inequality of opportunity are multiple and interlinked, from genes to family structure to parenting to household income to neighborhood to schooling and more.

Children in low-income homes tend to start behind right from birth, due to differences in genetics and developments in utero.[74]

Poorer children are less likely to grow up in a home with both of their original parents, and kids from single-adult households tend to fare worse on a host of outcomes, from school completion to staying out of prison to earning more in adulthood.[75]

Low-income parents aren't able to spend as much on goods and services aimed at enriching their children, such as music lessons and other extracurricular activities, travel, and summer camp.[76]

Parents with less education and income tend to read less to their children and provide less help with schoolwork. They are less likely to set and enforce clear rules and routines. And they are less likely to encourage their children to aspire to high achievement in school and at work. Low-income parents also are more likely to be anxious and stressed, which may affect the general home atmosphere and hinder their ability to provide emotional support to their children.[77]

Children in low-income families are more likely to grow up in neighborhoods with high crime, with few employed adults, and with weak institutions and organizations (civic groups, churches, sports leagues).[78]

In the prekindergarten years, children of affluent parents often attend high-quality education-oriented preschools, while kids of poorer parents are more likely to be left with a neighborhood babysitter who plops them in front of the television.[79]

Elementary and secondary schools help to equalize opportunity, and as disparities in funding across public K–12 school districts have diminished, they've become more effective at doing so. Yet large differences in the quality of schools persist, and the poorest neighborhoods still tend to have weaker ones.[80]

The equalizing effects of college are striking. Among Americans whose family incomes during childhood were in the bottom fifth but who get a four-year college degree, 53 percent end up in the middle fifth or higher, which is pretty close to the 60 percent chance they would have with perfectly equal opportunity.[81] But children from poor backgrounds are less likely than others to enter and complete college, partly because they lag behind at the end of high school, partly because college is so expensive, and partly because many colleges don't have adequate supports in place.[82]

When it comes time to get a job, the story is no better. Low-income parents tend to have fewer valuable connections to help their children find good jobs.[83] Some people from poor homes are further hampered by a lack of English language skills. Another disadvantage for the lower-income population is that in the 1970s and 1980s, the United States began incarcerating more young men, including many for minor offenses. Having a criminal record makes it more difficult to get a stable job with decent pay.[84] A number of developments, including technological advances, globalization, a loss of manufacturing employment, and the decline of unions, have reduced the number of jobs that require limited skills but pay a middle-class wage—the kind of jobs that once lifted poorer Americans into the middle class.[85]

Finally, not only do those from better-off families tend to end up with more schooling and higher-paying jobs. They also marry (or cohabit with) others like themselves, which magnifies the impact of gaps in skills, jobs, and pay among individuals.[86]

Has the Opportunity Gap Widened?

From the mid-1800s to the 1970s, differences in opportunity based on family circumstances decreased.[87] As the farming-based US labor force shifted to manufacturing, many Americans joined the paid economy, allowing an increasing number to move onto and up the income ladder. Elementary education became universal, and secondary education expanded. Then, in the 1960s and 1970s, school desegregation, the outlawing of discrimination in college admissions and hiring, and the introduction of affirmative action opened economic doors for many Americans.

What has happened since the 1970s? It's too soon to tell, as most Americans born after the 1970s are still relatively young, making it difficult to know where on the income ladder they will end up. But there is reason to suspect that America's progress in reducing inequality of opportunity based on family background has stalled, and perhaps even reversed. A few trends favor enhanced mobility: racial discrimination has continued to decrease, health insurance coverage for the poor has expanded due to changes in Medicaid in the 1980s and the late 1990s, we removed lead from gasoline beginning in the 1970s, violent crime has decreased sharply since the early 1990s, and in many states the gap in school funding between low-income districts and high-income districts has been reduced. However, a number of the key determinants of attainment—family structure, parents' income, parenting styles and behaviors, education, employment and earnings, and partner selection—have moved in a direction that is likely to have widened the opportunity gap.[88]

The collapse of the two-parent family has been most pronounced among parents with less than a college education. The same appears to be true of parental instability, which some experts believe is more consequential for children than the number of parents in the home.[89]

Inequality in incomes has increased since the 1970s.[90] Over the same period we've seen a rise in inequality of families' expenditures on their children, particularly between the top and the middle.[91]

With the advent of the modern intensive-parenting culture, class differences in parenting styles and traits seem to have increased.[92]

As care of preschool-age children has shifted from stay-at-home mothers to out-of-home providers, it's likely that the gap in the quality of care and education received by low-income kids versus high-income kids during these years has widened.

According to data compiled by Sean Reardon, the gap in average test scores between middle-school children from high-income families versus low-income families has risen steadily. Among children born in 1970, those from high-income homes scored, on average, about three-quarters of a standard deviation higher on math and reading tests than those from low-income homes. For children born in 2000, the gap has grown to one and a quarter standard deviations. Most of the increase in the test score gap, according to Reardon, has occurred between children from high-income families and those from middle-income ones.[93]

Households with different incomes increasingly live in different communities, as residential segregation by class has increased. Education and income gaps in participation in schools, civic organizations, churches, and other institutions have widened. And compared to their higher-income peers, children from low-income families have become less and less likely to participate in school-based extracurricular activities, from clubs to band to sports teams.[94]

The gap in college completion also has widened. College completion has increased among all groups, but the lower the parents' income, the smaller the rise.[95]

Finally, Americans increasingly tend to marry or partner with someone who has similar educational attainment.[96] This shift toward greater marital homogamy is likely to have further reduced the chance that someone starting at the bottom will end up in the middle or higher.

Though it's too early to draw a confident conclusion about whether equality of opportunity has changed since the 1970s, some studies have attempted to do so. Five conclude that equality of opportunity, measured as relative intergenerational income mobility, hasn't changed.[97] Three others, however, conclude that it has declined.[98]

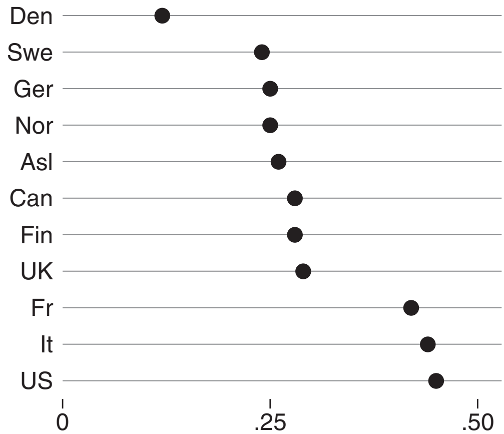

Figure 6.15 Inequality of opportunity in 11 rich nations. Correlation between the earnings of parents and those of their children. A larger correlation indicates less relative intergenerational mobility and hence less equality of opportunity. Data source: John Ermisch, Markus Jäntti, and Timothy Smeeding, eds., *From Parents to Children: The Intergenerational Transmission of Advantage*, Russell Sage Foundation, 2012, figure 1.1.

How Does the United States Compare to Other Affluent Countries?

From 1865 to 1970, the United States probably had more relative intergenerational mobility than other rich countries. But that may no longer be the case. Figure 6.15 shows the degree of earnings mobility in the United States and ten other countries according to one set of estimates. Along with Italy and France, the United States has the least mobility. On the other hand, two recent studies find no difference in mobility between the United States, Canada, Sweden, and Germany.[99]

These calculations are limited by the fact that they focus on the *earnings* of the parent (father) and the child. This is a partial, and potentially misleading, indicator of household income. Moreover, this causes these studies to leave out Americans who grow up in a single-mother household—a group that includes a nontrivial share of those on the lowest rung of the income ladder. Learning from other countries' experiences is an important tool for improving policies and institutions. We need more and better data on intergenerational mobility.[100]

Shared Prosperity

In a good society, those in the middle and at the bottom ought to benefit significantly from economic growth. When the country prospers, everyone should prosper.[101] I examined the least well-off earlier in this chapter. Now let's take a look at households in the middle.

America's Great Decoupling

Figure 6.16 shows median household income in the United States and other affluent democratic nations since the late 1970s. Middle-class households in the United States are richer than their counterparts in most other countries. But they are below Norway and Switzerland, and their income has increased only modestly since the 1970s, so other nations have been catching up.[102]

Is the slow growth of household incomes in the middle since the late 1970s due to slow growth of the economy? Figure 6.17 suggests that the answer is no. The figure shows trends since the late 1940s in GDP per capita along with three indicators of income in the middle. Each series is displayed as an index set to equal 1 in 1947. In the period between World War II and the mid-to-late 1970s, economic growth was good for Americans in the middle. As GDP per capita increased, so did family income at the 80th percentile, the 50th percentile (the median), and the 20th percentile. Indeed, they moved virtually in lockstep. Since the 1970s, however, household income has become decoupled from economic growth. As the economy has grown, relatively little of that growth has reached households in the middle, particularly those in the lower-middle.[103]

We also can see the decoupling of middle incomes from economic growth if we compare across countries. Figure 6.18 shows change in median household income by change in GDP per capita in the United States and thirteen other rich democratic nations since the late 1970s. Median income increased less in the United States than in most of the other nations. That's not because the US

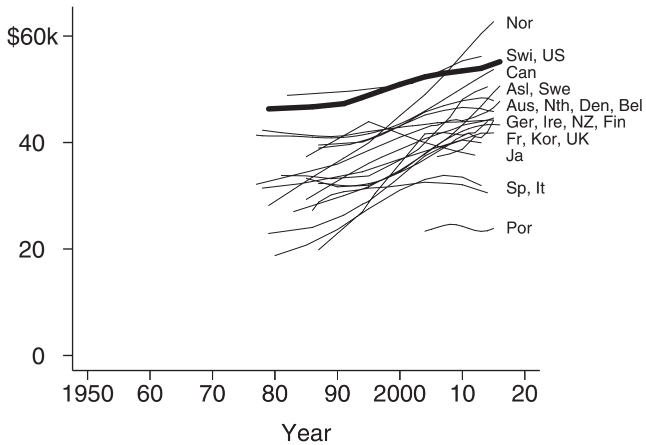

Figure 6.16 Median household income. Posttransfer-posttax household income. The incomes are adjusted for household size and then rescaled to reflect a three-person household, adjusted for inflation, and converted to US dollars using purchasing power parities. "k" = thousand. Data sources: Luxembourg Income Study; OECD. Thick line: United States. "Asl" is Australia; "Aus" is Austria. The lines are loess curves.

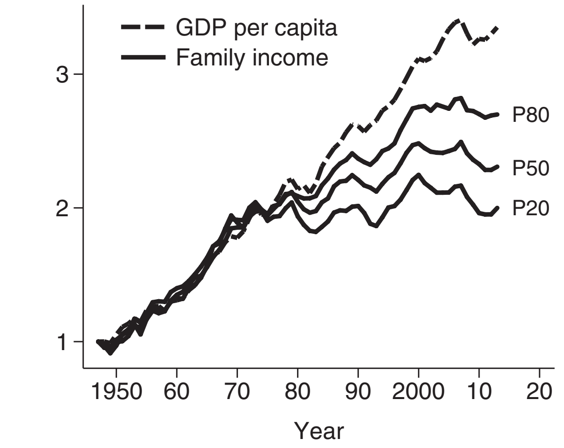

Figure 6.17 GDP per capita and middle-class family income. Each series is displayed as an index set to equal 1 in 1947. Inflation adjustment for each series is via the CPI-U-RS. P20 is the 20th percentile on the income ladder; P50 is the 50th percentile (median); P80 is the 80th percentile. The family income data are posttransfer-pretax. Data source for GDP per capita: Bureau of Economic Analysis, "National Income and Product Accounts Tables," table 1.1.5. Data source for family income: Census Bureau, "Historical Income Data," tables F-1, F-5.

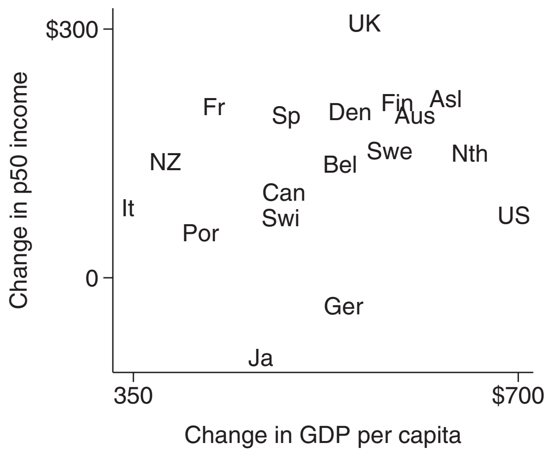

Figure 6.18 Economic growth and median household income growth. Average per-year change, 1979 to 2015. Because the actual years vary somewhat depending on the country, change is calculated by regressing household income or GDP per capita on year. Household incomes are posttransfer-posttax, adjusted for household size (the amounts shown are for a household with three persons). Household incomes and GDP per capita are adjusted for inflation and converted to US dollars using purchasing power parities. Ireland and Norway are omitted; both would be far off the plot in the upper-right corner. Data sources: OECD; Luxembourg Income Study. "Asl" is Australia; "Aus" is Austria.

economy grew less rapidly; in fact, its increase in per capita GDP was comparatively large. The problem is that less of America's economic growth reached middle-class households.[104]

High and rising top-end income inequality looks to have been a key cause of the decoupling of middle-class household income growth from economic growth. Figure 6.19 shows that the share of household income going to those in the top 1 percent decreased slowly during the decades after World War II, but since the late 1970s it has increased sharply.

How do we know this has contributed to slow income growth for middle-class households? First, the two are arithmetically related. If the top 1 percent get a large share of the household income, less of the income growth is available for households in the middle. The top 1 percent's large share could conceivably come at the expense of the near-rich or the poor rather than at the expense of the middle. It also is possible that a high level of top-end income inequality will yield faster economic growth, so that its large (and perhaps rising) share of the pie is offset by rapid expansion of the pie. But these are mere possibilities. In the United States, income inequality does not appear to have increased economic growth.[105] Nor does it seem to have come at the expense of the poor.[106]

Second, the timing fits. As Figure 6.17 above shows, during the period from the end of World War II through the 1970s, when top-end income inequality was moderate and declining, income growth in middle-class households kept pace with growth of the economy, whereas after 1979, when top-end income

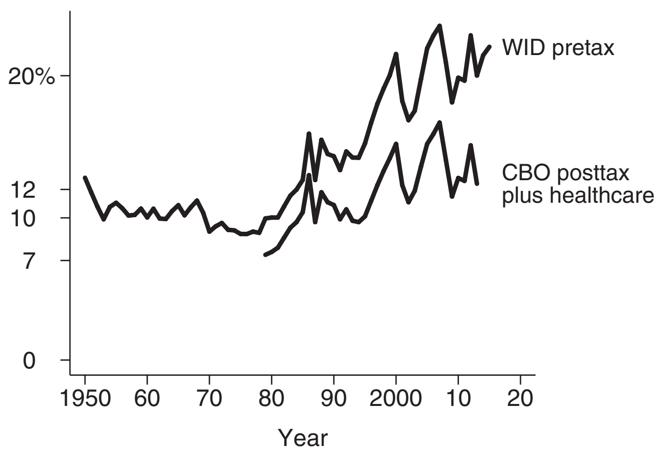

Figure 6.19 Top 1 percent's income share. Top 1 percent's share of income. Income data includes capital gains. Data sources: World Inequality Database (WID); Congressional Budget Office (CBO). The "WID pretax" data can be considered an upper-bound estimate of the top 1 percent's share. The "CBO posttax plus healthcare" is a lower-bound estimate.

inequality was high and rising, income growth for middle-class households lagged well behind economic growth.

Third, a key hypothesized causal path, wages, has moved as the hypothesis predicts. Figure 6.20 shows an estimate of wages in the top 1 percent and in the bottom 90 percent going back to the mid-1940s. Since the late 1970s, wages for Americans at the top of the distribution have grown very rapidly, faster than GDP per capita, while wages for those in the middle have grown very slowly. In addition, among the rich nations for which we have data on wage trends, the United States has had the slowest growth at the median.[107]

What else besides income inequality might have caused slow income growth in the middle? One alternative possibility is a fall in the share of value-added in the economy that goes to labor. That share did fall, but the decline was fairly minor, and smaller than in many other rich nations.[108]

Another possibility is that a growing portion of compensation has gone to nonmonetary benefits such as healthcare. However, the share of employee compensation accounted for by nonwage benefits has been essentially flat since the late 1970s, so this is likely to have played at most a very small role.[109] Healthcare costs have increased, but the share of employees covered by an employer healthcare plan has fallen, and employer contributions to pensions have decreased.

How much income has the post-1979 inequality-driven decoupling cost middle-class American households? Figure 6.21 offers an estimate. The solid line is actual median household income. The dashed line shows what the trend in median household income would have been had it kept pace with GDP per

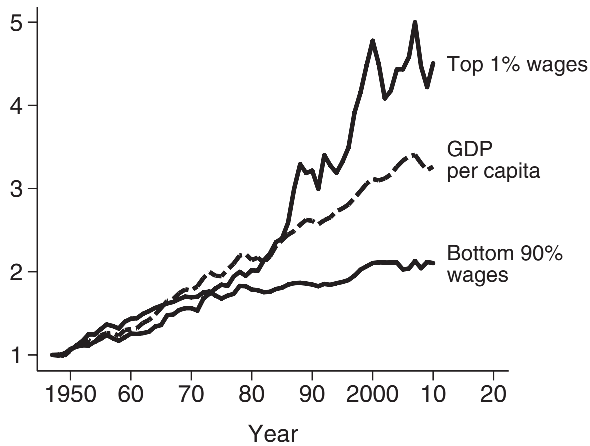

Figure 6.20 GDP per capita and wages. Each series is displayed as an index set to equal 1 in 1947. Inflation adjustment for each series is via the CPI-U-RS. Data source for GDP: Bureau of Economic Analysis, "National Income and Product Accounts Tables," table 1.1.5. Data source for wages: Lawrence Mishel et al., *The State of Working America*, 12th edition, wages dataset.

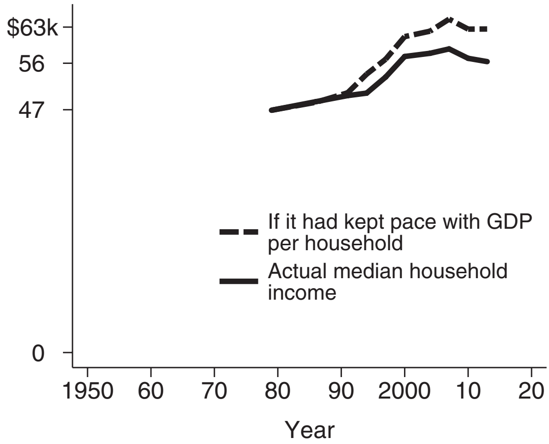

Figure 6.21 How much income has decoupling cost the median US household? Posttransfer-posttax income, in 2015 dollars. Inflation adjustment for each series is via the CPI-U-RS. "k" = thousand. Data source for median and mean household income: Luxembourg Income Study. Data source for GDP: Bureau of Economic Analysis, "National Income and Product Accounts Tables," table 1.1.5. Data source for number of households: Census Bureau, "Historical Income Data," table H-5.

household. Using GDP per household rather than GDP per capita (person) adjusts for the fact that the number of households has increased faster than the number of persons since the late 1970s.[110] The actual median household income was $47,000 in 1979 and $56,000 in 2016. Had it kept pace with GDP per household since 1979, median household income would instead have been around $63,000.

"It's Better Than It Looks"

In the view of some, this picture of slow middle-class income growth is too pessimistic. They argue that incomes or broader living standards actually have grown relatively rapidly, keeping pace with the economy.[111] Let's consider several versions of this view.

1. The income data miss upward movement over the life course. The income data shown in Figures 6.17 and 6.21 are from the Current Population Survey, which each year asks a representative sample of American adults what their income was in the previous year. But each year the sample consists of a new group; the survey doesn't track the same people as they move through the life course.

If we interpret Figures 6.17 and 6.21 as showing what happens to typical American families over the life course, we will conclude that they see very little increase in income as they age. That's incorrect. In any given year, some of those with below-median income are young. Their wages and income are low because they are in the early stages of the work career and/or because they are single. Over time, many will experience a significant income rise, getting pay increases or partnering with someone who also has earnings, or both. Figures 6.17 and 6.21 miss this income growth over the life course.

Figure 6.22 illustrates the point. The lower line shows median income among families with a "head" aged twenty-five to thirty-four. The top line shows median income among the same cohort of families twenty years later, when their heads are aged forty-five to fifty-four. Consider the year 1979, for instance. The lower line tells us that in 1979 the median income of families with a twenty-five-to-thirty-four-year-old head was about $58,000 (in 2013 dollars). The data point for 1979 in the top line looks at the median income of that same group of families twenty years later, in 1999, when they are forty-five to fifty-four years old. This is the peak earning stage for most people, and their median income is now about $91,000.

In each year, the gap between the two lines is roughly $33,000. This tells us that the incomes of middle-class Americans tend to increase substantially as they move from the early years of the work career to the peak years.

Should this reduce our concern about the over-time pattern shown in Figures 6.17 and 6.21 above? No, it shouldn't. Look again at Figure 6.22. Between the mid-1940s and the mid-1970s, the median income of families in

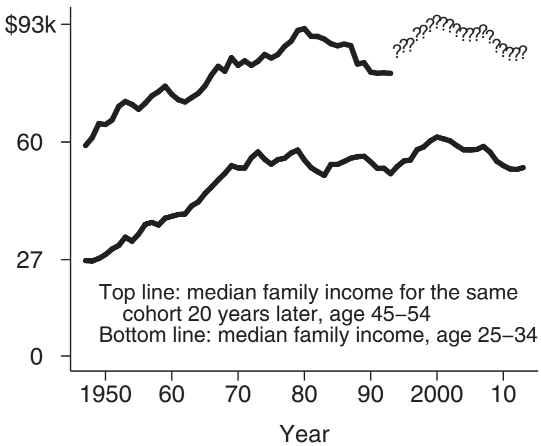

Figure 6.22 Median income within and across cohorts. For each year, the lower line is median income among families with a "head" aged 25–34 and the top line is median income for the same cohort of families twenty years later. In the years for which the calculation is possible, 1947 to 1993, the average increase in income during this two-decade portion of the life course is $32,500. The data are in 2013 dollars; inflation adjustment is via the CPI-U-RS. "k" = thousand. Data source: U.S. Census Bureau, "Historical Income Data," table F-11.

early adulthood (the lower line) rose steadily. In the mid-1940s median income for these young families was around $27,000; by the mid-1970s it had doubled. Americans during this period experienced income gains over the life course, but they also tended to have higher incomes than their predecessors, both in their early work years and in their peak years. That's because the economy was growing at a healthy clip and the economic growth was trickling down to Americans in the middle.

After the mid-1970s, this steady gain disappeared.[112] From the mid-1970s to 2010s the median income of families with a twenty-five-to-thirty-four-year-old head was flat. They continued to achieve income gains during the life course. (Actually, we don't yet know about those who started out after the mid-1990s, as they're just now beginning to reach age forty-five to fifty-four. The question marks in the chart show what their incomes will be if the historical trajectory holds true.) But the improvement across cohorts that characterized the period from the mid-1940s through the 1970s—each cohort starting higher and ending higher than earlier ones—disappeared.

Income for many Americans rises during the life course, and this is indeed hidden by charts such as Figures 6.17 and 6.21. But that shouldn't lessen our concern about the decoupling of household income growth from economic growth that has occurred over the past generation. We want improvement not just within cohorts, but also across them.

2. Demographic changes. The size of the typical American household has been shrinking since the mid-1960s, when the "baby boom" ended. Some will therefore say we don't need income growth to be so rapid any more. But this shrinkage in household size probably shouldn't alter our interpretation of slow income growth. Incomes have become decoupled from economic growth because a large and rising share of economic growth has gone to households at the top of the ladder. Yet household size has decreased among the rich too; they don't need the extra income more than those in the middle and below do.

Also, more people are in college or retired. The income data in Figures 6.17 and 6.21 are for families with a "head" aged fifteen or older. The share of young Americans attending college has increased since the 1970s, and the share of Americans who are elderly and hence retired has risen. These two developments have reduced the share of families with an employed adult head. However, this doesn't account for the slow growth of family income relative to the economy. The trend in income among families with a head aged twenty-five to fifty-four, in the prime of the work career, is very similar to that for all families.[113]

A third demographic change is that immigration into the United States began to increase in the late 1960s. The foreign-born share of the American population, including both legal and illegal immigrants, rose from 5 percent in 1970 to

13 percent in 2015.[114] Quite a few have come with limited labor market skills and little or no English, so their incomes tend to be low. For many such immigrants, a low income in the United States is a substantial improvement over what their income would be in their home country, so if this accounts for the divorce between economic growth and median income growth over the past generation, perhaps we shouldn't worry. But immigration actually is a relatively small part of the story. The rise in median family income for non-Hispanic whites, which excludes most immigrants, has been only slightly greater than the rise in median income for all families shown in Figures 6.17 and 6.21.[115]

3. *Consumption has continued to rise rapidly*. Some consider spending a better indicator than income of people's standard of living. Even though the incomes of middle- and low-income Americans have grown slowly, they may have increased their consumption more rapidly by drawing on assets (equity in a home, savings) and/or debt.

But that isn't the case. According to the best available data, from the Consumer Expenditures Survey (CES), median family expenditures rose at the same pace as median family income in the 1980s, 1990s, and 2000s.[116]

4. *Wealth has increased sharply*. Income and consumption growth for middle-income Americans may have lagged well behind growth of the economy, but was that offset by rapid growth of wealth (assets minus debts)?

Yes, it was, but only temporarily. We have data on wealth from the Survey of Consumer Finances (SCF), administered by the Federal Reserve every three years. Figure 6.23 shows the trend in median household wealth along with the trend in median household income. The wealth data are first available in 1983. What we see is a sharp upward spike in median wealth in the second half of the 1990s and the first half of the 2000s. The home is the chief asset of most middle-class Americans, and home values jumped during this period. But then the housing bubble burst and median wealth fell precipitously, erasing all of the gains.[117] And for those who lost their home during the crash, things are even worse than what is conveyed by these data.[118]

Even before the bubble burst, not everyone benefited. Of the one-third of Americans who don't own a home, many are on the lower half of the income ladder. For them, the rise in home values in the 1990s and 2000s did nothing to compensate for the slow growth of income since the late 1970s.

5. *There have been significant improvements in quality of life*. A final variant of the notion that income data understate the degree of advance in living standards focuses on improvements in the quality of goods, services, and social norms. It suggests that adjusting the income data for inflation doesn't do justice to the enhancements in quality of life that have occurred in the past generation.[119]

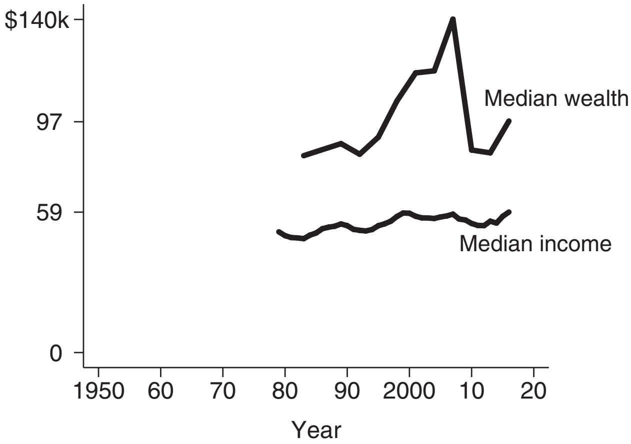

Figure 6.23 Median household income and median household wealth. 2016 dollars. "k" = thousand. Median wealth: Household net worth, calculated as assets minus liabilities. Data source: Urban Institute, "Nine Charts about Wealth Inequality in America," using Survey of Consumer Finances data. Median income: Posttransfer-pretax household income. Data source: US Census Bureau, "Historical Income Tables."

Fewer jobs require hard physical labor, and workplace accidents and deaths have decreased. Life expectancy rose from seventy-four years in 1979 to seventy-nine years in 2015. Cancer survival is up. Infant mortality is down. An array of new pharmaceuticals now help relieve various conditions and ailments. MRIs, CT scans, and other diagnostic tools have enhanced physicians' ability to detect serious health problems. Organ transplants, hip and knee replacements, and LASIK eye surgery are now commonplace. Violent crime has dropped to pre-1970s levels. Air and water quality are much improved.

We live in bigger houses; the median size of new homes rose from 1,600 square feet in 1979 to 2,400 in 2017. Cars are safer and get better gas mileage. Food and clothing are cheaper. We have access to an assortment of conveniences that didn't exist or weren't widely available a generation ago: personal computers, printers, scanners, microwave ovens, TV remote controls, digital video recorders, digital cameras, five-blade razors, home pregnancy tests, home security systems. Product variety has increased for almost all goods and services, from cars to restaurant food to toothpaste to television programs.

We have much greater access to information via the Internet, Google, travel guides, mapping apps and GPS, smartphones, and tablets. We have a host of new communication tools: cell phones, voicemail, email, Skype, Facebook, Twitter, Instagram. Personal entertainment sources and devices have proliferated: cable TV and streaming video, high-definition televisions, home entertainment systems, the Internet, MP3 players, CD players, DVD players, Netflix, satellite radio, video games.

Last, but not least, discrimination on the basis of sex, race, and more recently sexual orientation have diminished. For women, racial and ethnic minorities, and LGBTQ Americans, this may be the most valuable improvement of all.

There is no disputing these gains in quality of life. But did they occur because income growth for middle- and low-income Americans lagged well behind growth of the economy? In other words, did ordinary Americans need to sacrifice income growth in order to get these improved products and services?

Some say yes. They point out that returns to success soared in fields such as high tech, finance, entertainment, and athletics, as well as for CEOs. These markets became "winner-take-all," and the rewards reaped by the winners mushroomed. For those with a shot at being the best in their field, this increased the financial incentive to work harder or longer or to be more creative. According to the argument, this rise in financial incentives produced a corresponding rise in excellence—new products and services and enhanced quality.

Is this correct? To begin, consider the case of Apple and Steve Jobs. Apple's Macintosh, iPod, iTunes, MacBook Air, iPhone, and iPad were so different from and superior to anything that preceded them that their addition to living standards isn't likely to be adequately measured. Did slow middle-class income growth make this possible? Would Jobs and his teams of engineers, designers, and others at Apple have worked as hard as they did to create these new products and bring them to market in the absence of massive winner-take-all financial incentives?

It's difficult to know, but Walter Isaacson's comprehensive biography of Steve Jobs suggests that he was driven mainly by a passion for the products, for winning the competitive battle, and for status among peers.[120] Excellence and victory were their own reward, not a means to the end of financial riches. In this respect Jobs mirrors scores of inventors and entrepreneurs over the ages. So while the rise of winner-take-all compensation occurred simultaneously with surges in innovation and productivity in certain fields, it may not have caused those surges.

For a more systematic assessment, we can look at the preceding period—the 1940s, 1950s, 1960s, and early 1970s. In these years the incomes of ordinary Americans grew at roughly the same pace as the economy and as incomes at the top. Did this squash the incentive for innovation and hard work and thereby come at the expense of broader quality-of-life improvements?

During this period the share of Americans working in physically taxing jobs fell steadily, as employment in agriculture and manufacturing was declining. Life expectancy rose from sixty-five in 1945 to seventy-one in 1973. Antibiotic use began in the 1940s, and open-heart bypass surgery was introduced in the 1960s.

In 1940, only 44 percent of Americans owned a home; by 1970 that jumped to 64 percent. Home features and amenities changed dramatically, as the following list makes clear. Running water: 70 percent in 1940, 98 percent in 1970. Indoor flush toilet: 60 percent in 1960, 95 percent in 1970. Electric lighting: 79 percent in 1940, 99 percent in 1970. Central heating: 40 percent in 1940, 78 percent in 1970. Air conditioning: very few (we don't have precise data) in 1940, more than half in 1970. Refrigerator: 47 percent in 1940, 99 percent in 1970. Washing machine: less than half in 1940, 92 percent in 1970. Vacuum cleaner: 40 percent in 1940, 92 percent in 1970.

In 1970, 80 percent of American households had a car, compared to just 52 percent in 1940. The interstate highway system was built in the 1950s and 1960s. In 1970 there were 154 million air passengers, versus just 4 million in 1940. Only 45 percent of homes had a telephone in 1945; by 1970 virtually all did. Long-distance phone calls were rare before the 1960s. In 1950, just 60 percent of employed Americans took a vacation; in 1970 that had risen to 80 percent. By 1970, 99 percent of Americans had a television, up from just 32 percent in 1940. In music, the "album" originated in the late 1940s, and rock-n-roll began in the 1950s. Other innovations that made life easier or more pleasurable include photocopiers, disposable diapers, and the bikini.

The Civil Rights Act of 1964 outlawed gender and race discrimination in public places, education, and employment. For women, life changed in myriad ways. Female labor force participation rose from 30 percent in 1940 to 49 percent in 1970. Norms inhibiting divorce relaxed in the 1960s. The Pill was introduced in 1960. Abortion was legalized in the early 1970s. Access to college increased massively in the 1960s.

Comparing these changes in quality of life is difficult, but I see no reason to conclude that the pace of advance, or of innovation, has been more rapid in recent decades than before.[121]

The bottom line? Yes, there have been significant improvements in quality of life in the United States since the 1970s. But that shouldn't lessen our disappointment in the fact that incomes have been growing far more slowly than the economy.

"It's Worse Than It Looks"

Rather than understating the true degree of progress for middle- and low-income Americans, the income trends shown in Figures 6.17 and 6.21 above might overstate it.[122]

1. Income growth is due mainly to the addition of a second earner. The income of American households in the lower half has grown slowly since the 1970s. But it might not have increased at all if not for the fact that more households came to have two earners rather than one. From the 1940s through the mid-1970s, wages rose steadily. As a result, the median income of most families, whether they had one earner or two, increased at about the same pace as the economy. Since then, households with a single adult have seen no income rise at all.[123]

It's important to emphasize that most of this shift from one earner to two has been voluntary. A growing number of women have sought employment as their educational attainment has increased, discrimination in the labor market has dissipated, and social norms have changed. The transition from the traditional male-breadwinner family to the dual-earner one isn't simply a product of desperation to keep incomes growing.

Even so, as more two-adult households have both adults in employment, more are struggling to balance the demands of home and work. Good-quality childcare and preschool are expensive, and elementary and secondary schools are in session only 180 of the 250 weekdays each year. The difficulty is accentuated by the growing prevalence of long work hours, odd hours, irregular hours, and long commutes. By the early 2000s, 25 percent of employed men and 10 percent of employed women were working 50 or more hours per week.[124] And 35 to 40 percent of Americans were working outside regular hours (9 a.m. to 5 p.m.) and/or days (Monday to Friday).[125] Average commute time rose from 40 minutes in 1980 to 50 minutes in the late 2000s.[126]

2. The cost of some key middle-class expenses has risen much faster than inflation. The income numbers in Figures 6.17 and 6.21 are adjusted for inflation. But the adjustment is based on the price of a bundle of goods and services considered typical for American households. Changes in the cost of certain goods and services that middle-class Americans consider essential may not be adequately captured in this bundle. In particular, because middle-class families typically want to own a home and to send their kids to college, they suffered more than other Americans from the sharp rise in housing prices and college costs in the 1990s and 2000s. Moreover, as middle-class families have shifted from having one earner to two, their spending needs may have changed in ways that adjusting for inflation doesn't capture. For example, they now need to pay for childcare and require two cars rather than one.[127]

Consider a four-person family with two adults and two preschool-age children. In the early 1970s, this family probably would have had one of the adults employed and the other staying at home. By the 2000s, it's likely that both were employed. Here is how their costs for these big-ticket expenses might have differed.[128] Childcare: $0 in the early 1970s, $12,500 in the mid-2000s. Car(s): $5,800 for one car in the early 1970s, $8,800 for two cars in the mid-2000s. Home mortgage: $6,000 in the early 1970s, $10,200 in the mid-2000s. When the children reach school age, the strain eases. But when they head off to college it reappears; the average yearly cost of tuition, fees, and room/board at public four-year colleges rose from $6,500 in the early 1970s to $12,000 in the mid-2000s.[129]

To recap: Since the 1970s, incomes have risen slowly for the broad middle of American households, despite sustained growth in the economy. With the top 1 percent getting a larger and larger portion, household income growth for the middle has become decoupled from economic growth. America's middle class is fairly well off by comparative and historical standards, but it could, and should, be even better off.

Some of the most commonly voiced solutions won't do the trick. Reversing key economic shifts such as trade, technological advance, the shift from manufacturing to services, and immigration is neither likely nor desirable. Turning firms away from their shareholder value orientation would be difficult. Revitalizing unions is a very tall order. But we have other options. A tighter labor market would put more pressure on employers to raise wages. A public subsidy, such as a revised Earned Income Tax Credit, could supplement middle-class earnings. And enhanced government support for key services and insurance programs—early education, college, health insurance, sickness insurance, paid parental leave—would reduce big-ticket expenses for households and facilitate greater employment by parents and other caregivers.

We Can Do Better

In the past generation, ordinary Americans have had less economic security, less opportunity, and less income growth than they should in a country as prosperous as ours. We can do better. In the next chapter I explain how.