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S. HRG. 113–202

INCOME INEQUALITY IN THE UNITED STATES

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

JANUARY 16, 2014

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

86–524 WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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INCOME INEQUALITY IN THE UNITED STATES

THURSDAY, JANUARY 16, 2014

UNITED STATES CONGRESS,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to call, at 10:00 a.m. in Room 216, Hart Senate Office Building, the Honorable Amy Klobuchar, Vice Chair, presiding.

Representatives present: Brady of Texas, Campbell, Amash, Paulsen, Hanna, Carolyn B. Maloney, and Delaney.

Senators present: Klobuchar, Casey, Jr., Sanders, Murphy, Heinrich, and Lee.

Staff present: Hank Butler, Gail Cohen, Carroll Conor, Niles Godes, Colleen Healy, Christina King, Robert O'Quinn, and Patrick Miller.

OPENING STATEMENT OF HON. AMY KLOBUCHAR, VICE CHAIR, A U.S. SENATOR FROM MINNESOTA

Vice Chair Klobuchar. We are going to call this hearing to order, and I want to thank our witnesses for coming, and thank the Chairman. I think we are going to have good attendance at this hearing. And I want to thank everyone for being here this morning to discuss this very important issue about income inequality in our country.

As we will hear today, income inequality in the United States has been growing for more than three decades and is now near a record high. If history means anything, that is not good for anyone in the United States of America.

That is because 70 percent of our economy is consumer based, and if people do not have enough money to buy stuff it slows the entire economy down.

Meanwhile, as the data has shown, the top 400 people in this country have more wealth than half of America. That is why we are having this hearing today, and that is why we need to make some changes.

Now I would like to introduce our witnesses who have enormous expertise and insight on this subject.

Robert Reich is the Chancellor's Professor of Public Policy and Senior Fellow at the Blum Center for Developing Economies at the University of California at Berkeley. He served as Secretary of Labor during the Clinton Administration from 1993 to 1997. Time Magazine named him one of the 10 most effective cabinet secretaries of the 20th Century. I am laughing because I watched his movie recently and he went back through all of the Presidents he

had served under, including President Carter, and then these young students in California. He said: Maybe you don't remember. And then he added, "I also was an aide to Abraham Lincoln."

[Laughter.]

But it is the 20th Century. He has written 13 books. His new movie, "Inequality for All" that I just referred to was released last week on DVD.

Scott Winship, our next witness, is the Walter B. Wriston Fellow at the Manhattan Institute for Policy Research, where he focuses on economic mobility, living standards, and income inequality. Previously Dr. Winship was a Fellow at the Brookings Institute, Research Manager of the Economic Mobility Project of the Pew Charitable Trust, and a Senior Policy Advisor at Third Way.

Melissa Kearney is the Director of the Hamilton Project, a Senior Fellow at the Brookings Institution, and an Associate Professor in the development of economics at the Department of Economics at the University of Maryland. Previously she was an Assistant Professor at Wellesley. Her research focus is on inequality and poverty.

Aparna Mathur is a Resident Scholar at the American Enterprise Institute. Her research areas are tax policy, wages, and labor market outcomes. She has consulted for the World Bank and taught economics at the University of Maryland.

As the data is going to show today, income inequality, as I mentioned, has been growing for several decades. According to the JEC report, which I released today, since 1980 the average income for the top one percent of households, as you can see, has grown more than seven times as fast as it has for the average household.

So the average household is there in red, and you can see what has happened for the incomes for the top one percent. For the rest of America, income growth has stalled completely. The average American household earned less in 2012 than they did in 1989. The middle class is shrinking and less secure, and this hinders economic growth.

Growing inequality and low economic mobility do not reflect our values as a nation, and both are bad for the economy. At the same time, we know that it has gotten tougher and tougher because the costs have gone up. Costs of health care have gone up. The costs of college have gone up. And it has become harder to save for retirement. This has been especially true for those with less education.

Stagnant wages and rising income inequality are also associated with lower levels of economic mobility. As you can see in our report and in other reports that have been done, a lot of people are stuck at the bottom.

As the Secretary notes in his work, the United States is 64th in the world in terms of income inequality. He also points out that 42 percent of kids born into poverty in the U.S. will not get out—42 percent.

To give you some comparison, in Denmark the figure is 25 percent. In Great Britain, it is 30 percent. Now there are a number of steps our country should be taking to make sure that our economy continues to grow for everyone. Raising the minimum wage would be a good start.

At $7.25 per hour, the real value of the current minimum wage is now lower than it was in 1968 when I was 8 years old. If the minimum wage was raised to $10.10 per hour, as currently proposed in the Senate, 4.6 million people would be lifted out of poverty.

We must also invest in worker training. We have to train our workers for the jobs of today and tomorrow. Congressman Paulsen and I are from Minnesota where we have a relatively low unemployment rate. Know that we have jobs that are open today. In fact, in a recent poll in our state of manufacturers, 60 percent of them said that they do have job openings where they need workers with the skills to fill those jobs. So that is a piece of this.

Increasing the number of STEM schools is a piece of this. Supporting policies that have proven to lift people out of poverty, including emergency unemployment insurance, something we are debating right now, the earned income tax credit, and the supplemental nutrition assistance program.

Finally, we have to look at our Tax Code and make sure it is fair. I think we should implement the Buffett Rule, applying a minimum tax rate of 30 percent on people making more than $1 million a year. Fairness in the Tax Code will ensure that a secretary does not pay a higher effective tax rate than the CEO in the corner office.

It is estimated that such a rule, in addition to making the Tax Code more equitable, would raise more than $47 billion over 10 years.

In conclusion, the American economy continues to recover, adding private sector jobs for 46 straight months. Gross Domestic Product in the third quarter of 2013 grew at more than a 4 percent annual rate. We are making progress, but there is still more work to do.

Our issue today is, as we make progress, to make sure that everyone is sharing in that progress, and that we continue to make the American Dream attainable for everyone in this country.

Thank you very much, Mr. Chairman.

OPENING STATEMENT OF HON. KEVIN BRADY, CHAIRMAN, A U.S. REPRESENTATIVE FROM TEXAS

Chairman Brady. And thank you, Vice Chair Klobuchar, Committee Members, and very distinguished witnesses today.

Today the Joint Economic Committee will begin to examine the complex questions of economic inequality and mobility in the United States.

We are not all blessed with the same talents, but in America we should all have an equal chance to climb the ladder of success—driven upward by our personal initiative, and not burdened by the deadweight of a bloated government.

We know that too many families are struggling, even in a country where 9 of 10 children born to the poorest families will earn more than their parents.

Economic mobility is very much alive. In America today the children of the poorest are more likely to climb up the ladder of success than the children of the wealthy are likely to stay where they are.

Through hard work, today one in three American families live an upper middle-class lifestyle or better, more than double what it was just 40 years ago.

Astoundingly, better than one in five Americans are likely to rise to the top two percent of earners sometime during their lifetime. The American Dream is still very much alive.

Do some Americans earn more than others? Absolutely. I cannot fathom how Madonna earned $125 million last year, or how actor Johnny Depp will earn nearly a half a billion dollars from the Pirates of the Caribbean series.

We can all appreciate, though, how Mark Zuckerberg became the world's youngest billionaire launching Facebook from his college dorm room, or how Mary Kay Ash of tiny Hot Wells, Texas—frustrated with the glass ceiling in a male-dominated industry—built Mary Kay Cosmetics into an international icon with other a half a million entrepreneurs.

The real challenge that we face today is too many Americans no longer believe the ladder of success is available to them. They have lost hope that if they work hard and play by the rules tomorrow will be better than today.

And who can blame them? Thanks to the weakest, most disappointing economic recovery in a half century, millions of Americans cannot find full-time work, and millions more have simply given up looking for work. Proportionately, fewer adults are working today than when the Recession ended four years ago.

These struggling Americans have not benefitted from the White House's controversial stimulus which failed to fulfill its promise of getting them back to work by now. They watch as the Federal Reserve has pumped up Wall Street with trillions of dollars, while Main Street and middle-class families are left behind.

In the past five years, college costs have soared and energy costs have doubled. And while some Americans, no doubt, are being helped by the Affordable Care Act, millions more have been forced out of the health insurance plans they liked and are being forced to pay even more for plans that they did not want.

While President Obama should not shoulder all the blame, out of fairness he should accept—some of the responsibility for why so many Americans believe the ladder of success has been pulled from their reach.

He should not divide America further, pit one American against another based on their success, or fuel resentment and jealousy in the pursuit of political gain. That is just not an America we can be proud of.

I admit I cannot imagine how Washington bureaucrats that have never met you or even know your name can "equalize" your income. Can the same incompetent government that brought us the bungled Affordable Care Act Web site be trusted with your dreams and your children's dreams?

What we will learn from today's hearing is that respected economists disagree about the issue of economic inequality. For example, by using a definition of "income" that excludes both taxes that reduce disposable income and government programs like Social Security, Medicare, and unemployment insurance that boost it, econo-

mists Piketty and Saez found large and growing income inequality. You saw the chart earlier.

Other economists, by using a more realistic definition that considers the effects of taxes, government programs, employment-provided health insurance benefits, and the changing size of the modern family, found a very modest change in income inequality over the past 20 years.

Still other studies that measure what families actually buy and consume reveal that the ratio between the consumption of the poorest fifth and the most successful fifth of Americans remained stable for the past quarter of a century.

I hope we will agree that personal decisions affect every American's ability to make a better life. A college degree, steady work, marriage, and children within the marriage, increase the odds of climbing the ladder of success—although in our great country some have succeeded beautifully without any of those.

I also hope that we can agree that education and skills drive high wages, especially for those earning a college, graduate, or professional degree.

For example, Pew Research found that children from families in the bottom fifth of earnings have a 1 in 10 chance of climbing into the wealthiest fifth of Americans with a college degree—1 in 10 can go from the very bottom of the economic rung to the top of that ladder with a college degree. But without it, they have only a 3 percent chance.

Similarly, children from families in the second fifth have—of the bottom of the economic ladder, have nearly a 1 in 4 chance of climbing to the top rung with a college education, but merely a 9 percent chance without it.

So finally, how should the government act to help restore Americans' belief in opportunity?

We can heed the advice of President Abraham Lincoln, perhaps the greatest "equalizer" to inhabit the White House. In his message to Congress on July 4, 1861, he made clear the proper role of government in promoting economic opportunity is, quote, "to elevate the condition of men—to lift artificial weights from all shoulders—to clear the paths of laudable pursuit for all—to afford all, an unfettered start and a fair chance, in the race of life." End quote.

We must do more to "lift the artificial weights" off our poorest families and get Washington out of the way so that every American truly has "an unfettered start and a fair chance in the race of life."

I yield back, Vice Chair.

[The prepared statement of Chairman Brady appears in the Submissions for the Record on page 38.]

Vice Chair Klobuchar. Thank you, very much.

We will start with our witnesses.

Secretary Reich.

STATEMENT OF HON. ROBERT REICH, CHANCELLOR'S PROFESSOR OF PUBLIC POLICY, UNIVERSITY OF CALIFORNIA AT BERKELEY, BERKELEY, CA

Professor Reich. Vice Chair Klobuchar and Chairman Brady, and Members of the Committee:

Thank you very much for having this hearing on what the President has said is the defining challenge of our time. The Pope has said it is a moral challenge affecting countries around the world. It is not just the United States.

In the interest of brevity, I will submit my testimony for the record. I also had prepared some wonderful, dramatic slides, but in the interest of brevity I will also provide those for the record.

Let me just, in the limited time I have, talk about what is at stake. The data are not controversial. The Congressional Budget Office, the Bureau of the Census, almost every agency that has looked at the issue, almost every policy analyst and economist who has looked at the issue, has come to the conclusion that, however you divide and slice the data, inequality is growing particularly between the top and everybody else, but the entire income and wage ladder is getting so elongated that we have got three huge and growing problems.

Now I am not arguing—and I do not think anybody is arguing—a respectful argument, that we have to in any way avoid inequality, or that inequality—some inequality is not necessary or inevitable. For a growing economy, if you are going to have the right incentives, obviously there is going to be some inequality.

The issue is: Are we getting to a tipping point where the extent of inequality is harming our economy, hurting the ideal and undermining the ideal of equal opportunity, and undermining our Democracy?

And I want to argue that in all three domains we are getting to that tipping point, if we are not already over that tipping point.

In terms of the economy, Mr. Chairman, one reason that the recovery is so anemic is that 95 percent of the economic gains since the recovery started have gone to the top one percent.

There is no way that the middle class, or those aspiring to join the middle class, have enough purchasing power to keep the economy going if they are not going to have money in their pockets. They cannot go deeper and deeper into debt any longer.

It is no coincidence that the 2 years over the last 100 years where there was the most pronounced inequality in terms of the 23.5 percent of total income going to the top one percent were 1928 and 2007.

If those do not tell you something, I do not know what does. You see, in both of those eras leading up to 1928 and 2007, you had a middle class that was going deeper and deeper into debt to keep up basically with the fact that most of the gains of the economy were going to the very top.

And in both of those years, you had a kind of penultimate and unfortunate bursting in the year following of debt bubbles. We are now living with the consequence of the second of those great bursting debt bubbles.

Over the last 30 years, what has happened to the American middle class is they have coped with stagnant or declining incomes by women going into paid work, by working longer hours, and then by going deeper and deeper into debt. All of those coping mechanisms are exhausted. And so we have no choice but to face the reality now of stagnant or declining real incomes for a huge percentage of Americans.

The median household income has been dropping even as 95 percent of the gains have been going to the top.

What is a business-friendly strategy to create jobs? It is to create customers. Business executives and Wall Street traders are not job creators. The job creators in the United States are customers. And if the vast middle class and the poor do not have enough money in their pockets, they cannot be customers.

The most business-friendly thing we can do is raise the minimum wage, provide extended unemployment benefits, encourage unionization, give people the bargaining power they need to have a strong middle class and a growing middle class that includes a lot of poor people in this country. That is a business-friendly strategy.

So the first problem with inequality of the degree we are now seeing is that it robs the economy of the aggregate demand the economy needs to get out of in this case the gravitational pull of the Great Recession.

Problem number two has to do with equal opportunity. Madam Vice Chair, as you pointed out, 42 percent of Americans' kids born into poverty will never get out of poverty. That is a higher percentage than in any other advanced country.

Now there is controversy about the measure upward mobility. A lot of policy analysts and economists have come to different conclusions about the rate—that is, the velocity—of upward mobility in this country.

But even if you take the heroic assumption that the velocity—that is, the rate of upward mobility—is the same today as it was 30 or 40 years ago, which I think is very questionable, you can see logically how as the income and wealth ladder get longer and longer, even at the same rate you are not going to get very far up the ladder. And that is at the least what has happened today.

One of the charts that I show you shows the high correlation—one of the charts in my testimony—shows the high correlation between inequality and slow mobility. The nations with high inequality have the slowest upward mobility.

Problem number three has to do with the democratic process. And again, here I tread on delicate ground, or thin ice, because I do not want to be heard to in any way impugn the integrity of any Member of Congress. But we all know that money counts. And when more and more money is lodged in a smaller and smaller number of people at the top, political power inevitably gravitates upward.

As the great Justice Louis Brandeis said in the late 19th Century at a time in our history that is not all that dissimilar to what we have today in terms of the gap between the wealthy and everybody else, a time when we had robber barons and the lackeys of the robber barons literally depositing sacks of money on the desks of pliant legislators, Louis Brandeis said: We can either have great wealth in the hands of a few, or we can have a democracy, but we can't have both.

So number three, the last really important argument against high inequality is what it is doing to our democracy. In summary, there are many things that we can do. Raising the minimum wage it seems to me is critical. Enlarging the Earned Income Tax Credit is a good companion to raising the minimum wage. Minimum wage

is now 30 percent below what it was in 1968. If we simply raised it adjusted for inflation, it would be over $10. If we adjusted it relative to productivity improvements since the late 1960s, it would be $15 an hour.

But that is not all. We have got to invest in education, invest in infrastructure. We have got to strengthen unions. We have got to constrain Wall Street.

Too many of those banks are too big to jail, too big to fail, and too big to curtail.

We have got to limit the size of the big banks so that they do not do what they have already done to the American middle class and the poor. We have got to resurrect the Glass-Steagall Act—I think very, very important.

We have also got to have a tax system that is progressive. And I do not mean "progressive" in a political progressive way; I mean simply in an economic sense. If you look at the income tax, and add in the payroll tax, and add in sales taxes at the state and local level, look at the entire tax system, it is regressive. That is, the poor are paying, and the middle class are paying a higher percentage of their income than the wealthy.

Finally, let me just say there should be no debate at all over extending unemployment benefits to the long-term unemployed. Since 1970 we have never debated it. It has not been a partisan issue. We have not seen—we have not even searched for offsets. It is an emergency.

We have got 37 percent of the unemployed in this country who right now have been unemployed for more than six months; 1.3 million have run out of unemployment benefits; another 72,000 are running out of them every week. This should not be a partisan issue.

We have got to do this. And if we actually have to have an offset—and I hope we don't—I have a nomination.

The Carried Interest loophole for hedge fund managers and private equity managers, closing that would yield as much money as we need for extending unemployment benefits for some of the most disadvantaged and hardest-up families in America.

And on that upbeat note, thank you very much.

[The prepared statement of Hon. Robert Reich appears in the Submissions for the Record on page 40.]

Vice Chair Klobuchar. Thank you very much.

Dr. Winship.

STATEMENT OF DR. SCOTT WINSHIP, WALTER B. WRISTON FELLOW, MANHATTAN INSTITUTE FOR POLICY RESEARCH, NEW YORK, NY

Dr. Winship. Chairman Brady, Vice Chair Klobuchar, and Members of the Committee:

Thank you for inviting me today to discuss the topic of income inequality in America. I am going to use my time—I have also submitted written testimony that I will submit into the record, and use my five minutes to rebut as much as I can from what we heard from the Secretary, respectfully, or you can cede me 20 or 30 minutes. Barring that, I will move forward with my oral testimony.

With long-term unemployment historically high and still pervasive economic insecurity in the wake of the Great Recession, it is understandable that many Americans have grown more concerned about the Nation's levels of inequality.

Too many families struggle in poverty. Too many workers have given up on finding full-time work. And too many young adults have graduated into a weak economy that will lower their lifetime earnings.

At the same time, it is important to note that it is the fragility of the economy that lies behind concerns with inequality. Inequality was high and it was rising in the late 1990s, but because the growing economy was largely benefiting everyone, few people were worried about income concentration at the top at the time.

In long-run perspective, living standards have improved, despite what we have heard so far this morning, have improved for the poor and middle class even as income inequality has grown.

And contrary to claims that rising income inequality has hurt inequality of opportunity, the evidence of a link between the two is weak. Allow me to elaborate.

As I demonstrate in my written testimony, income inequality within the bottom 80 percent of households has grown only modestly, primarily during the 1980s, and hardly at all since then. This is Census Bureau data, so this is not anyone doing any funny business with the numbers.

Indeed, a wealth of research, including by the Congressional Budget Office, including by Emmanuel Saez, one of the folks who created the inequality measures that Vice Chair Klobuchar showed, a wealth of research indicates that earnings and income inequality between the middle class and the poor have not risen since the mid- to late-1980s. It actually includes research by my colleague Dr. Kearney.

Nor can the modest rise in middle-poor inequality be attributed to income stagnation. Average income in the middle fifth rose 66 percent between 1969 and 2007 and by 55 percent of the bottom fifth.

Congressional Budget Office figures show since 1979 increases of along the lines of 40, 45 percent for both of those groups.

It is true that this growth was much slower than the 1950s and 1960s, but for reasons I discuss in my written testimony there is little reason to think that the slowdown should be attributed to rising income concentration.

Here I will just note that the slowdown began in the 1970s before income concentration started to take off, and it affected the top one percent as well.

Even when it comes to income concentration at the top, there are good reasons to believe that the increase has been overstated, especially since the 1980s again.

The oft-cited estimates of Thomas Piketty and Emmanuel Saez, and of the Congressional Budget Office are problematic for a number of reasons that I describe in my written testimony that I am happy to elaborate on in questioning.

Earnings concentration estimates from another paper by Emmanuel Saez are less problematic and show that the top one per-

cent share rose only from 11 percent in 1989 to 13 percent in 2004, versus 14 to 20 percent in the Piketty and Saez income data.

A careful recent paper coauthored by economist Richard Burkhauser found that household income concentration at the top fell between 1989 and 2007. It is a minority view, for sure, but I give it even odds that it will actually hold up over time.

Not only has income inequality not grown as much as many suggest, but intergenerational mobility has probably not declined much, if at all, in the last three decades. To be clear, no research shows a sizeable increase in mobility since the mid-20th Century, but the most common finding is a change so modest up or down as to be statistically indistinguishable from no change at all.

In my own forthcoming research I find that today's 30-year-olds have experienced no less mobility than did 30-year-olds in the mid-1970s.

Faced with such an unsupportive research base, some proponents of the view that inequality has hurt mobility have turned to cross-national evidence, which the Secretary mentioned, a line of argument that culminated in the Obama Administration's popularization of the "Great Gatsby Curve." This chart, showing a strong statistical relationship between countries' inequality levels and the extent of mobility that their citizens enjoy, is problematic as evidence for a number of reasons that again I lay out in my written testimony, but the most damning shortcoming is that it uses a measure that by construction produces lower mobility when the growth in inequality is greater than another country's.

Recent research by economist Miles Corak, the originator of the "Great Gatsby Curve," measures mobility by focusing on the relationship between parent and child rankings. So the differences in inequality between nations do not mechanically affect mobility comparisons.

Corak finds that Sweden and the United States have the same mobility levels by this measure—repeat, the United States and Sweden have the same level of mobility by this measure. These two countries have the lowest and highest levels of inequality, respectively, in the Great Gatsby Curve. The implication is that there may be no cross-national relationship at all between inequality and mobility when the relationship is not baked in mechanically.

In closing, while upward mobility has not diminished over time, and while it has not been hurt by rising income inequality, it has nevertheless been stuck at unacceptably low levels for decades. If past patterns hold, 70 percent of poor children today will fail to make it to the middle class as adults; 4 in 10 will be mired in poverty themselves in midlife.

These are not the kind of odds that those of us solidly in the middle class would accept for our children. The American Dream is in poor health if children who grow up in the bottom can aspire only to fill the same sorts of jobs their parents did, even if better paid than their parents were.

The challenge is to identify real solutions to the problem of limited upward mobility. Fifty years after Lyndon Johnson's declaration of War on Poverty, we should establish a second front against immobility. Attacking inequality, however, is unlikely to mitigate either problem.

Thank you, very much.

[The prepared statement of Dr. Scott Winship appears in the Submissions for the Record on page 61.]

Vice Chair Klobuchar. Thank you very much.

Dr. Kearney.

STATEMENT OF DR. MELISSA KEARNEY, DIRECTOR OF THE HAMILTON PROJECT AND SENIOR FELLOW AT THE BROOKINGS INSTITUTION; ASSOCIATE PROFESSOR OF ECONOMICS, UNIVERSITY OF MARYLAND, COLLEGE PARK, MD

Dr. Kearney. Chairman Brady, Vice Chair Klobuchar, and other distinguished Members of the Joint Economic Committee:

Thank you for inviting me to participate in today's hearing on income inequality. This is an issue on which I have focused my academic research over the past decade, and also an area of focus for the Hamilton Project which I currently direct.

There are three main points I want to make about the high level of inequality we are experiencing today.

First, the trends in inequality we have witnessed over recent decades are largely the result of structural changes in the labor market that have favored the very highly skilled.

The Great Recession has exacerbated these issues, but the dominant forces were present long before the Great Recession and they likely will not go away when the economy fully recovers.

Since the late 1970s, the U.S. labor market has experienced increased demand for skilled workers, and the supply of highly skilled workers has not kept pace with the rising demand, especially among men.

The result has been that those with more than 16 years of education have seen their wages rise steadily. Those with exactly a college degree or some college have seen some improvement, but not to the same extent.

High school graduates and those with less than a high school degree experienced falling real wages through the late 1970s and 1980s. Their wages rebounded a bit in the early 1990s, and have basically remained stagnant since.

In addition to growing wage disparities, there has been a related trend of job polarization. We have seen expanded job opportunities in high skill, high wage occupations on the one hand, and low skill, low wage occupations on the other. Employment prospects for the middle skill have eroded, and this is true in both white collar and blue collar occupations.

This employment polarization is not a uniquely American phenomenon and has been experienced in Europe to at least as large a degree. This implies that there are global economic forces that have led to a restructuring of the labor market. Our main policy response should be a committed focus on skill upgrading.

Ultimately we need to equip our workforce with the skills that are demanded and rewarded in today's global economy.

Second, the growing levels of income inequality have translated into sizeable gaps in educational achievement between the children of the rich and the poor. While the racial gap has declined significantly over time, gaps between low and high income students in

terms of educational achievement have increased. This is true for K through 12 education, and college completion.

And these gaps in educational measures appear early in life. Marked differences between kids from rich and poor families appear by the time they enter kindergarten. The class of highly educated, high-income individuals are marrying one another and showering advantages on their children. That is not a problem.

The problem is that children born into the bottom half of the distribution are falling behind. Here I want to raise the issue of family structure. The diverging destinies of children from low-income and high-income homes is in part driven by the divide in race of nonmarital child bearing, and this matters.

Children from single-mother homes are five times more likely to live in poverty than children in two-parent homes. We cannot ignore this uncomfortable issue. But I also want to emphasize that the dissolution of the family should be considered a market of social and economic problems, as opposed to a primary cause.

A decrease in the economic prosperity of low-skilled and low-educated men leads to lower rates of marriage among this population. The most effective way to increase marriage rates at the bottom end of the income distribution is going to be through increased economic security for these men.

Third, income inequality has the potential to interact with poverty in ways that perpetuate disadvantage. In ongoing research with my coauthor Phil Levine I've been investigating this particular issue for some years now and have come to some striking conclusions.

Low-income youth, both males and females, are more likely to drop out of high school if they live in a place where the gap between the bottom of the income distribution and the median is wider. The same goes for rates of early nonmarital childbearing. Young women are more likely to become young unmarried mothers if the gap between the bottom and the middle is greater.

A leading explanation as to why is because inequality exacerbates the economic isolation and hopelessness that comes with being poor. Simply put, these individuals do not see promising opportunities, and so they essentially give up.

This all leads me to the conclusion that it is of the utmost urgency that we make the necessary investments to ensure that all Americans can participate productively in the global economy and be rewarded with genuine economic security.

There is no silver bullet policy prescription, but we have many policy levers available to us. The Earned Income Tax Credit has been shown to be a very important program, and has encouraged work among single mothers and led to long-term improvements of the well-being of these families and children.

SNAP, the food stamp program, is the quintessential safety net program and has proven to be responsive to weak economic conditions in exactly the way it should. Researchers have documented the long-term health and economic benefits of this program to low-income children and families.

Expanded access to higher education has been important to keep the supply of college-educated workers from falling even further behind. And there is more that we should do. We need effective inter-

vention in early childhood, including expanded access to high-quality child care and preschool. We need to keep adolescents and older teens engaged in school. For the one-quarter of American youth inclined to drop out of high school each year, we need to find ways to equip them with the skills necessary to become productive workers and citizens.

We need to think seriously about a role for vocational training and employment apprenticeship. In general, we must maintain and expand programs and policies that constitute investments in the health, education, and skills of individuals from broad swaths of the population.

Thank you for the opportunity to testify. I would be happy to take questions.

[The prepared statement of Dr. Melissa Kearney appears in the Submissions for the Record on page 73.]

Vice Chair Klobuchar. Thank you. Dr. Mathur.

STATEMENT OF DR. APARNA MATHUR, RESIDENT SCHOLAR, AMERICAN ENTERPRISE INSTITUTE, WASHINGTON, DC

Dr. Mathur. Chairman Brady, Vice Chair Klobuchar, and other Members of the Committee:

Thank you for inviting me to testify on the important issue of income inequality. The discussion of income inequality often tends to get very focused on definitional issues, and my testimony explores these in detail. But I also argue that the reason we care about income inequality is because it tells us something about the well being of people at the bottom of the income distribution.

The fundamental issue is about poverty. To this end, my testimony discusses how low-income individuals are faring today, particularly given the weak recovery of the last few years and what policies can we put in place to alleviate the problems.

To begin, let me first talk about the definitional issues. Researchers have come up with different responses to the question: Is income inequality trending up or down? On the basis of very different definitions of "income."

As per the latest 2010 data from the Congressional Budget Office, trends since 1979 suggest that households at the very top of the income distribution have increased after-tax incomes at a much faster pace than households at the bottom.

The much cited paper by economist Thomas Piketty and Emmanuel Saez confirms this trend, though it fails to account for taxes and transfers. Other economists, however, countered these results by using a different definition of income.

In a 2013 paper, Richard Burkhauser and colleagues contend that using a broader measure of income that includes accrued capital gains, income inequality has narrowed between 1989 and 2007.

The results for widening income inequality are further weakened when we use consumption as the measure of household welfare. In my own research, coauthored with Kevin Hassett, we find that consumption inequality is a lot narrower than income inequality.

Further, we document that there has been an increase in material standards of living even for low-income households, resulting in a narrowing of inequality in terms of access to everyday household appliances and electronic devices.

However, it is true that, despite these secular improvements in living conditions, the Census Bureau documents that more than 47 million people live in poverty in America today.

We are now in the 5th year of an economic recovery that does not seem like a recovery to most people in the labor market. There are more than 10 million unemployed workers, of which nearly 4 million have been jobless for longer than 27 weeks.

In addition, there are another 10 million who are either in involuntary part-time jobs, or are too discouraged to look for work. Therefore, I would argue that the focus on income inequality is somewhat misplaced.

Fundamentally, this is a problem of poverty. And when these high rates of poverty exist in an economy with low economic mobility, the problem is exacerbated.

What policies can we encourage in order to improve economic mobility and the access to high-wage, high-skill jobs that are one of the primary drivers of economic success?

Access to high-quality education and schools is extremely important as an investment into children's futures. Poor quality schooling can limit an individual's earning ability. Research has shown that the quality of local public education has improved in areas where there is more competition due to a larger number of school districts, or a greater availability of nonpublic education.

The labor market poses serious concerns about the future livelihoods of millions of unemployed workers, particularly those who are long-term unemployed.

One solution that is being proposed is the extension of unemployment benefits to the long-term unemployed. I believe that the unemployment benefit programs have to be supplemented by skills' training and greater help with matching workers to jobs.

Towards this end, workers who have been long-term unemployed should be provided skills training and placed in jobs through wage subsidy programs that allow some share of the wages to be paid by the employer and the rest to be paid by the unemployment insurance program.

This would allow employers to test and see if the match with the prospective employee is a good one, while at the same time it would allow workers to receive on-the-job training and gain experience, with the likelihood that they will be able to keep the job.

Raising minimum wages is a particularly bad idea when we think of high youth and teenage unemployment rates. Workers under age 25 make up half of those paid the federal minimum wage or less. Instead, research suggests that internship or apprenticeship programs may improve employment prospects and also boost college attendance.

Minimum wages are also not a tool to fight poverty. Less than 25 percent of minimum wage workers live at or below the poverty line, based on family cash income. An alternative to the minimum wage is the Earned Income Tax Credit Program.

The EITC arguably is one of the Federal Government's most efficient means of encouraging work and fighting poverty. As per the Census Bureau, the EITC has lifted 5.4 million people above the poverty line in 2010. While the EITC has some significant disadvantages such as the tax penalties on earners in the phase-out

range, it has been shown to encourage labor force participation for single mothers, and has lifted millions of adults and children out of poverty.

To conclude, the bulk of the evidence suggests that programs that enable people to work or transition to work are more effective at fighting poverty than simple cash assistance programs. As such, wage subsidy programs that combine skills training and tax credit programs like the EITC are a better bet today to get the unemployed back in the labor market and improve the lives of low-income individuals.

Thank you.

[The prepared statement of Dr. Aparna Mathur appears in the Submissions for the Record on page 83.]

Vice Chair Klobuchar. Thank you, very much.

Dr. Kearney, why don't we start with you. I am looking forward to seeing your research, because certainly I have seen this in my old job as a prosecutor and other places where you have these areas where there is a lot of inequality, and people see less hope. But I did want to ask you about something you did not mention.

I know you have analyzed the minimum wage recently and found that raising the minimum wage will have a ripple effect and might actually raise wages for about one-third of the workforce, about 35 million workers.

Could you tell me more about the impact of the minimum wage on workers who currently make more than the proposed minimum wage?

Dr. Kearney. Thank you for the question.

So indeed as you mentioned, the Hamilton Project has recently put out work showing that 35 million people could potentially be impacted with higher wages if the minimum wage were raised.

And what I want to emphasize here is that I think there is reasonable, or compelling academic evidence that we can—the labor market could absorb a modest increase in the current federal minimum wage, and many states and localities, given the level of wages in where they are, the labor markets there could absorb an increase in the minimum wage such that low-wage workers will receive higher wages with very modest, minimal I should say, disemployment effects.

The worry of course is if we raise the federal minimum wage, or a state minimum wage, too high—then that of course is where we need to consider the employment effects more seriously.

But I would emphasize, along with what my colleagues said, this is a policy that is sort of a first step in allowing these workers to take home higher wages. But we should think about minimum wage jobs as an entry job into the labor market, and really should focus on skill upgrading so that these people can move up the wage distribution.

Vice Chair Klobuchar. Agreed. Thank you very much.

Secretary, one of the most striking statistics in your film is the increased concentration of wealth in the country, the idea that 400 people, the top 400 people now hold the same amount of wealth as the bottom half, as 50 percent of this country.

And I thought the argument you make from that is how we traditionally got our economy moving, and why we are where we are

today, is that the wealthy, those 400 people, or even the top 1 percent, or 5 percent, can only buy one or two pair of jeans a year. Or they can only buy, you know, one or two pair of tennis shoes a year. And if you have half the country not able to do that every year, you have a huge problem in an economy that is 70 percent consumer-based.

Could you elaborate on that?

Professor Reich. Yes. Right now we have 65 percent of Americans living paycheck to paycheck. Almost all the savings in our system are coming from the very top, which ordinarily is a good thing. But we are not in ordinary times.

For one thing, it is a global economy and these savings are going around the world to wherever they can get the highest return.

For a second, we have a demand-side crisis. We do not have enough aggregate demand. And if government is embracing austerity, we are not getting the demand out of government spending.

So the vast middle class and everybody wanting to join the middle class who are poor, if they do not have enough money in their pockets, there is simply not enough demand for buying goods and services.

I mean, why is it that American companies, sitting on $1.5 to $1.7 trillion of cash, are not expanding? They are not creating new jobs.

Well, there are many responses but the major response from every survey of businesses is that they cannot justify adding jobs because they do not have enough customers. They do not have enough sales and revenues.

The reason they do not have enough customers, sales, and revenues is because the vast middle class does not have the purchasing power to justify those sales and revenues. This is something that Henry Ford understood in 1914. He doubled his factory wages, thereby creating in other factories a demand to double their wages, and thereby generating a demand for the products that his factory, Model T Fords, and other factories were producing.

It was a virtuous cycle created by companies that raised their wages. The Confederation of British Industries, just two weeks ago, urged industries in Britain to raise wages as a way of promoting economic growth.

Vice Chair Klobuchar. And one of the most striking graphs that you had was that bridge graph where you showed, right before the Great Depression, that there was this high amount of inequality, and then it got better, and then it's coming up again, and here we have what we call the Great Recession. And so, just my last question would be, as you look through history—and I think we can learn a lot from history—and you said what country can we best look at to figure out how to fix this, and you said: Our own country.

Because if you look at what we did after World War II, we did a lot to bring up the middle class and our whole economy.

Professor Reich. Yes. And here's I think a very important lesson for us that we forget. For three decades after World War II we had a recipe. We invested huge sums in education—not only K–12, but public higher education. We invested in infrastructure. The biggest infrastructure project in the history of this Nation, the National Highway Building Defense Highway Act, we had strong

unions. We regulated Wall Street. And we had a high marginal income tax that was never below 70 percent, and an effective rate, if you include all deductions and tax credits, of over 50 percent on highest income earners.

After 1981, we did just the opposite. We cut back, relatively speaking in terms of per capita as a percentage of our economy, on education, on infrastructure. We deregulated Wall Street. We had a much less progressive tax system. We essentially enabled corporations to bust unions. We have a much smaller percentage of unionized workers than we did in the 1950s.

And what do you expect when we turn our back on the successes of the first three decades after the Second World War? The net result is a huge and, with due respect to my colleague sitting next to me, the consensus, the overwhelming consensus with regard to looking at the data and understanding the data, is that inequality has been growing and we are surging to greater inequality.

And if you don't want to play a numbers game, just walk out the door.

Vice Chair Klobuchar. I think that is why we have a lot of people here today, and we will turn it over to Chairman Brady. Thank you.

Chairman Brady. Well I want to thank you all. The testimony was great that you presented, as well as the testimony today.

Secretary Reich, you will be surprised to know I agree with you. I think the majority of economic benefits in this recovery has accumulated to the wealthy, and it is by government's design that that has occurred.

The stimulus was not aimed at infrastructure. Certainly not jobs skills. It did not stimulate new job creation along Main Street. It was focused at bailing out state governments and other areas.

The Federal Reserve has pumped trillions of dollars toward Wall Street. Wall Street is roaring. Good for them. Middle Street, middle class families' Main Street, not so much.

Just consider this. Wall Street's index value has almost doubled in this economic recovery, but Main Street, middle class families, their incomes have barely budged. Think about this. In this terribly weak recovery, historically weak, the worst, frankly, in the last half-century, if it would have just been average, just C Grade, just nothing much to speak of, every family of four in America would have $12,000 more in their pocket today than they do. $12,000 more to pay utilities, $12,000 more to shop at that local business, $12,000 more to pay down student debt, or avoid it in the first place.

So I lay much of the blame and responsibility for middle class struggling with this government, and the President shares some of the responsibility, much of that, for that.

I think the problem is joblessness. I do not think income inequality is dragging down the economy. I think this weak economy is dragging down income equality.

People just are not finding good-paying jobs. Certainly this Congress and White House are not focused on that. And I think that is where our greatest effort needs to be: getting Washington out of the way to allow our small businesses to grow.

The Washington Post blogger and columnist Ezra Klein, I notice he argues inequality is not the defining issue of our time. He says joblessness is. The fact so many million Americans have given up on work, and many more are stuck in jobs and are underemployed.

So I guess, Dr. Winship, Dr. Mathur, to begin, why isn't joblessness—why isn't this poor recovery really the focus of why we should be here today? Dr. Winship?

Dr. Winship. Thanks for the question.

So I think what the Administration has done that has been unproductive has been to frame everything in this inequality frame. And I think, with all respect, the Secretary does that as well.

All of the ills of the economy are sort of laid to rest at things that progressives like to think that have worsened over time. But the bottom line is that if we could get back to the 1950s and 1960s, it is pretty clear what we need. We need the productivity growth that we had back then.

We never saw it before that. We have never seen it since. It is hard to imagine a story where inequality is the main factor behind that. And the best thing that we could do to reduce the unemployment rate to move people out of long-term unemployment into work would be to expand economic growth. And I think the way to do that is not by talking about inequality and demonizing folks at the top who are doing a lot of business investment.

I think the way to do it is to try to get some consensus around things that would grow the economy that would not be polarizing. I think we can agree on things like high-skilled immigration. I think we can agree on a deregulation agenda. I know the Chairman supports a consumption tax. I think that that would be a very pro-growth reform to pursue.

And inequality I think just is divisive. It is essentially ensuring that nothing gets done. It is using, it is using a political issue to guarantee gridlock through the rest of the President's term, and sort of hoping that with small-sized policies like unemployment insurance extension, a minimum wage which I agree with my colleague, Dr. Kearney, that a modest minimum wage might not do any damage and might actually be helpful, a 40 percent increase to an unprecedented historical level, which is what $10.10 would be, there is some dispute about what the level was in 1968 depending on how you adjust for the cost of living, $10.10 would be unprecedented, and the 40 percent increase would be something that we have not seen in a long time, in a recovery that is sort of still fragile.

I think it is just a terrible idea. We ought to stop using these divisive frames and agree on some consensus that everyone would agree would move the economy forward.

Chairman Brady. Thank you.

Dr. Mathur.

Dr. Mathur. Thank you. I would agree with Secretary Reich. You know, it is a demand problem. There are consumers out there who do not have the money to buy things. But I think the seed of all that is coming from joblessness. I mean, this is something that has happened over the course of the Recession that people do not have the money, and there does not exist enough demand. And I

think a lot of it is coming from the fact that they have lost value in their homes, and they are out in the labor market.

They do not have jobs, and they do not have the wages and the salary to earn enough income to be able to go out there and buy things. And I think, you know, the current policy is to extend let's say unemployment benefits, which are intended to help people. I think, you know, the intentions are great. I think they are intended to help people who have been out of the labor market for so long that they have little hope of finding a job.

I think we could do much more than simply extending cash assistance benefits for, you know, 72 weeks, or 99 weeks. I think after a worker has been unemployed for 4 to 5 months, they need active help in finding a job. And so coming up with a program that would actually match workers to jobs, you know, either with a subsidy program or, you know, sort of skills training, or just on-line searches of helping workers find jobs, would be much more effective than simply, you know, extending benefits, and what happens at the end of the 99 weeks when the worker is still unemployed.

Chairman Brady. Thank you. Dr. Kearney, I know my colleague from Minnesota wants to talk about the value of education and skills and climbing the economic ladder.

Secretary Reich, you were so good—are so good to be here today. Let me ask you about the minimum wage. I come from a Chamber of Commerce background, so helping create small businesses and building a business community. And I know, you know, when you force a small business with 10 workers to pay $5,000 more a worker each year, no change in productivity, no new customers, just $50,000, it may be in fact the whole profit for the year.

Not only does it discourage new hiring, it often leads to cutting workers' hours. I notice, too, that forced into that situation that small businesses will look to new workers, young workers. They are more likely to hire those who have had the advantages of a middle class family, and education, and a work ethic, and all that goes with sort of creating advantages. They are less likely to take chances on a younger worker from a poorer community, you know, that perhaps has not had those chances.

So we in effect, in my view, not only do we make small businesses make terrible decisions on hours for the workers, make it tough for them to survive, but I really think we remove the lowest rung of the ladder for especially young, minority people.

So my question to you is: As you look at income inequality, have the years that have raised the minimum wage, has that lowered income inequality in raising minimum wage over the number of years? Has that changed it? Decreased it? Shrunk it?

Professor Reich. Mr. Chairman, the last—or one of the last times I testified before this Committee was in 1995, and the subject was do we raise the minimum wage? Many members of the Committee, particularly Republican members but not exclusively, were concerned about raising the minimum wage because they were concerned about its negative effect on job growth.

At that time, I presented evidence that a raise in the minimum wage, not a gigantic raise but a substantial raise, would actually help job growth in terms of creating, as I talked about before, more

money in the hands of people who could turn around and buy stuff, and thereby have a positive multiplier effect.

Now we did an experiment——

Chairman Brady. And I don't want to interrupt, but specifically to the issue of income inequality, has raising the minimum wage shrunk the income—the difference between earnings?

Professor Reich. Well I was just about to get to the point, Mr. Chairman. In the short term what we discovered is that raising the minimum wage actually was correlated in 1996, 1997, 1998, 1999 with increases in employment, not decreases.

But in a larger—in the larger time horizon, we have not raised the minimum wage. The minimum wage is still 30 percent now below what it was in 1968. Had we merely maintained the 1968 minimum wage, adjusted for inflation, it would be today substantially above $10 an hour.

So the answer to your question, the larger scale answer to your question, is that we have not, in inflation-adjusted terms since 1968, really raised the minimum wage. In fact, the decline of the minimum wage has contributed to widening inequality particularly among women, because most minimum wage workers are women.

If we raised the minimum wage, we would get about 4.6 million people, a conservative estimate, out of poverty.

Vice Chair Klobuchar. Okay——

Chairman Brady. Excuse me, if I could give just a quick response. It just seems to me, you know, our focus should not be on raising the minimum wage; it should be getting people off it, and education and skills and better jobs is how we do it.

Vice Chair Klobuchar. Okay. Since we were citing The Washington Post blogger, I wanted to note that Bill O'Reilly has come out strong for increasing the minimum wage.

Professor Reich. Well if Bill O'Reilly has come out strongly for increasing the minimum wage, I've got to rethink my position.

[Laughter.]

Vice Chair Klobuchar. And also, just to clarify, what you are saying is that back when we had adjusted for inflation, the minimum wage in 1968 was much higher than it was today, and back then we did not have near the income inequality that we have today.

Professor Reich. Exactly. And also back then most minimum wage workers were teenagers. Today most minimum wage workers are providing a substantial part of family income. They are major bread winners.

Vice Chair Klobuchar. Okay, very good.

Chairman Brady. Without the skills.

Vice Chair Klobuchar. Senator Heinrich.

Senator Heinrich. Secretary Reich, I want to give you an opportunity to take a crack at Chairman Brady's other question, which was, is the problem inequality, is the problem joblessness, and how you see those as related.

Professor Reich. We could reduce joblessness by taking the low road in this country—and that is, reducing wages. That is pretty much what we have been doing, with essentially production workers—that is, hourly wage workers, the median hourly wage continues to drop adjusted for inflation.

Median household incomes, even including two-income earners in those households, keeps on dropping, adjusted for inflation. Now we could theoretically create more jobs by eliminating the minimum wage, people working $25 an hour, and continuing to drop real incomes.

That is not a success story. In other words, what we want in this country is more jobs, but more good jobs. Unfortunately, most of the jobs created in recent years have been in retail, restaurant, hotel, hospital, surface transportation, child care, and elder care. Jobs paying low wages, close to the minimum wage.

Most of the jobs we lost in the Great Recession paid more on average than the jobs we have gained since the recovery. So the vast middle class and the poor are on a downward escalator.

We do not want to add to that burden by simply saying, all right, the way to get more jobs is to reduce wages and benefits even further. That is a—that is a recipe for a low wage, low-skilled, low secure, insecure workforce even more than we have now.

Senator Heinrich. Well it seems like that takes us to education, which is one of the things that there is some agreement on, you know, across this panel from one side to the other. And I would love to get all of your thoughts in the limited time that is left, starting with Secretary Reich and just going down the line, on what you think in particular we can do about early childhood education to make sure that this early disparity that we see is mitigated.

And then, what we should be doing to create better policy to incentivize the sort of long-term skills and vocational training that makes sure that people are well matched to the jobs that are there.

Vice Chair Klobuchar. And that is a good question, if everyone could try to keep their answer to about a half a minute because I know the House is going to have some votes here coming up. Thank you.

Professor Reich. Senator, very quickly, there is a great deal of evidence that early childhood education pays off enormously in terms of lower dropout rates in primary and secondary school, lower social problems, more people going on to higher education. It is a good investment.

Number two, we do need to have a world class technical and vocational education track. It is ridiculous to assume that the only way into the upper middle class is through a four-year college degree. That is a conceit that is not fair to many, many of our young people. We do not have that vocational technical track.

Germany does, and that is one reason why Germans—the Germany economy, even with the huge cost of incorporating East Germany, is doing so well relative in terms of wages and productivity.

Thirdly, we need to invest in public higher education. And I can tell you from being both a professor at Harvard at one point, and now at the University of California Berkeley, one of the preeminent public higher education institutions, that there is a difference. Public higher education has much more economic diversity.

A third of my students are Pell Grant eligible. We need to help more public higher education.

Mr. Chairman, you were referring to Abraham Lincoln before, the Land Grant Institutions that President Lincoln actually insti-

gated were the Nation's first major investment in public higher education, and that was a huge benefit for the future.

Vice Chair Klobuchar. Okay.

Professor Reich. Thank you.

Vice Chair Klobuchar. Dr. Winship.

Dr. Winship. Well I think that early childhood programs need to be an important part of an opportunity agenda, actually. I think the problem is that I think, contrary to what a lot of folks who advocate for these programs say is there is not a lot of great evidence for models that consistently work, especially when you scale them up.

And I am thinking of a really interesting book by David Mulhausen at the Heritage Foundation who has evaluated all of the programs that have been randomly evaluated at the federal level across multiple sites. And it is a really depressing read.

So I think that we do not know the way to move the lever. I think we need to be prepared to make it a priority and try to discover more successful models. But paired with that, we've got to be prepared to shut down models that do not work because we are just throwing money away in that case.

Vice Chair Klobuchar. Dr. Kearney.

Dr. Kearney. Thank you. So I will start with early childhood education, and I agree with Dr. Winship completely. It is not enough to offer preschool to 4-year-olds. We need really high quality preschool, and that is a lot harder and more expensive.

K–12 education, money is not the problem. Teacher quality has been shown time and time again to be the key determinant of children's outcomes and success. And so we need high teacher quality. We need to retain good teachers, and we need to eliminate bad teachers.

Vocational training, I agree completely with Dr. Reich. It is just, you know, it is laudable that we want everyone to go get a four-year degree, but we have a quarter of our high school students dropping out of high school every year. College, four-year college, is simply not for everybody.

Perhaps it will be when they are older, but not at that time. And we need to retain those students in the educational system.

And finally on the issue of college, I would applaud the efforts of our government and policies like the Pell Grant. I think we have worked to address the issues of cost and access.

We need a larger emphasis on college completion and retention. Disadvantaged students have very low completion and retention issues. And I would need more than 30 seconds to address that.

Vice Chair Klobuchar. Thank you. Very good. Dr. Mathur.

Dr. Mathur. So I would like to echo the sentiments of my colleagues here. I think access to early—good quality early childhood education is extremely important. It is a big investment into childrens' future.

And I think, you know, the fact that we have poor quality schools, the one way around, the research suggests and models suggest, would be if we had more competition among schools. So I think, you know, even if at the early stage if people had more access to different school districts maybe, to different types of schools,

you know, that would be one way to get higher quality education at that level.

Vice Chair Klobuchar. Thank you. I want to let my colleagues ask some questions.

Mr. Paulsen.

Mr. Paulsen. Thank you, Vice Chair Klobuchar.

I appreciate hearing all of your testimony today. Let me ask you this: First of all, we all know that the essence of the American Dream is economic mobility and opportunity to succeed. There is no doubt about that.

And by most measures, Americans are better off today than they have been in past decades. And there still is significant opportunity for all individuals—including low-income individuals—to move up the economic ladder.

I want to focus some of my comments as well on education, because a couple of you touched in particular on that as part of your testimony. And in particular the skill upgrading concept you mentioned, Dr. Kearney.

Information technology has boosted the marginal productivity of highly skilled and college-educated workers. This has caused the real wages paid to these workers to increase more rapidly over time as the demand for them grew more rapidly than the supply. And at the same time, information technology directly competes with some generally less skilled and less educated workers, causing those real wages then to stagnate.

Economists have called this phenomenon skill-based technological change and estimated that it could account for a majority of the increase in income inequality both in the United States and around the world.

Dr. Kearney, I will just start with you. Would you agree that skill-based technological change is a major cause of income inequality, not only in the United States but in other countries as well?

Dr. Kearney. Yes. I am firmly in the camp among labor economists who subscribe to this notion of skill-biased technological change. But it is a nuanced view.

The computerization and information technology has certainly accentuated the skills in a positive way, increased the return to skills for the higher educated. But in the most recent decade, in the 1990s, in contrast to the 1980s, it actually did have some positive effects on the earnings of the lowest skilled, or I should say folks in the service sector. Truck drivers have better GPS systems, for example.

And where it has really hurt is right at the middle. And those are blue collar and white collar jobs that are more easy to automate, for example. Those are the jobs that have gotten hit by this skill-biased technological change.

To Chairman Brady's earlier question, I will say that while I believe that skill bias technological change and essentially the supply and demand of skills are the primary drivers of our patterns of income inequality, there is strong evidence that the erosion of the minimum wage during the 1980s contributed to the decline in low wages at the bottom during the 1980s.

Now of course in the 1990s, as I mentioned, those wages rebounded without a coterminous increase in the minimum wage.

Mr. Paulsen. And, Dr. Kearney, would you also say that education would be the most effective long-term solution to closing that growing gap between skills that employers seek and the skills that workers actually have?

Dr. Kearney. Yes. It is a focused education. It is a smart education. It is an education that is committed to STEM education, right, and educating and training the students for the jobs of today's global economy.

Mr. Paulsen. And Dr. Mathur, maybe you can add some comments, but I also wanted to ask if you actually agreed with Dr. Kearney that retaining good teachers and dropping bad teachers should be a policy that we should consider to help with education?

Dr. Mathur. Absolutely. I think, you know, the more we create high quality education, the better off people are, the better off children are.

But again, also talking about the minimum wage issue that came up, I mean the most recent research suggests that it is not sort of the single important thing that has been responsible for income inequality.

I think there is some evidence suggesting that, you know, over certain time periods the minimum wage was highly correlated with female wages, which is what it affects the most, but I think if you look at the long period starting in 1986 to 2005, there is no correlation between female wages and the increase and decline in the minimum wage. So it is not clear that that is the single smoking gun that has been responsible for the rise in income inequality.

Mr. Paulsen. Thank you, Madam Chair. I yield back.

Vice Chair Klobuchar. Thank you very much, Representative Paulsen.

Senator Sanders.

Senator Sanders. Thank you, Madam Vice Chair.

One of the interesting aspects of discussions about the economy or income inequality inside the Beltway as opposed to back home in the real world is the very different tone that we hear.

The idea that anybody could suggest that we are not seeing massive increases in income and wealth inequality is beyond my comprehension. If you go outside of the Beltway, there is no debate about that. The idea that anyone could suggest that today the economy for the middle class is anywhere near where it used to be is beyond comprehension I think for the vast majority of the American people.

The reality that we are seeing today is that the middle class in this country is disappearing. Median family income is going down. We have more people living in poverty today than at any time in the history of the United States of America. And as Secretary Reich pointed out, between 2009 and 2012, 95 percent of all new income generated in this country went to the top 1 percent.

And in terms of wealth, the situation is even worse. Maybe some of the panelists might want to defend the situation where the top 1 percent in America owns more wealth than the bottom—that the top 1 percent owns 38 percent of the wealth in this country, and the bottom 60 percent owns 2.3 percent of the wealth.

Does anybody on that panel—and I would ask that question in a moment—think that that makes moral sense, or economic sense?

Does anybody think it makes moral or economic sense that one family, the Walton family, owns more wealth than the bottom 40 percent of the American people?

Now in terms of government action, we have heard that the stimulus package presumably had no impact. Well that was not true in my State, nor was it true in America. By investing in our economy, in our kids, in infrastructure, according to the CBO, the Recovery Act, the stimulus bill created or sustained up to 3.6 million jobs, a 4.2 percent boost for GDP in the first quarter of 2010, and a reduction in the unemployment rate of up to 2.1 percent in the last quarter of 2009—at a time we needed the jobs the most.

The last point that I want to make, and I want to ask a question on this one, the Walton family is the wealthiest family in America. Does anybody on the panel think that they need significant welfare help?

And yet it turns out that they are the largest recipient of welfare in America. Because when you pay workers starvation wages, which is what Walmart does, how do the workers at Walmart, or McDonald's, or Burger King, survive? Well, they get Medicaid for their kids and for themselves.

They get food stamps. They live in government-sponsored affordable housing. So I start off with my question to Dr. Winship, and we will go down the line.

Do you think the Walton family, worth $144 billion, is in need of welfare from the middle class of this country? Or do you think maybe we should raise the minimum wage so that those workers can earn a living wage and not have to get Medicaid, or food stamps?

Dr. Winship.

Dr. Winship. Thank you, Senator.

So let me start with your earlier question about defending the wealth distribution that we have.

Senator Sanders. Well actually my question was on the Walton family. Do you think they need welfare?

Dr. Winship. So I would not use the word "welfare." I think it is stigmatizing.

Senator Sanders. Do you think their workers in large numbers should have to get Medicaid or food stamps?

Dr. Winship. What I think is that Walmart has the low prices, which——

Senator Sanders. Please answer my question.

Dr. Winship. I'm sorry, repeat the question for me?

Senator Sanders. The question is: Do you think the wealthiest family in this country, the Walton family, should have employees, large numbers of employees, who depend on government help—Medicaid, food stamps, affordable housing—in order to get by? Or should they pay their workers a living wage? And should we raise the minimum wage to make sure that they do that?

Dr. Winship. I think that we should not raise the wage above levels that's going to cause Walmart to not hire their workers. The only way that they are able to have the prices which benefit low-income people more than people up on the income distribution is by paying wages that are not as high as you or I might like.

Senator Sanders. So I'm hearing your answer to be that the middle class of this country, through increased taxes, should be subsidizing the wealthiest family in this country who are paying inadequate wages.

Secretary Reich, what is your take on that?

Professor Reich. Senator, I do not think that taxpayers in this country ought to be subsidizing the wealthiest family in this country, or any company and any corporation that is paying its workers so little that those workers, in order to have a decent living, have got to rely on food stamps, Medicaid, subsidized housing, and so on. That is a corporate welfare of the worst kind.

But more broadly, let me simply say that Walmart is the largest employer in the United States. It is paying its workers, if you include its part-time workers, on average $8.80 an hour.

Now compare that to 1955 when the largest employer in the United States was General Motors, and it was paying its workers, in today's dollars, $37 an hour.

Senator Sanders. That is a huge point. I do not have much time——

Vice Chair Klobuchar. No——

Senator Sanders. But Dr. Kearney and Dr. Mathur, if they could answer the question, should the taxpayers——

Vice Chair Klobuchar. Quickly.

Senator Sanders [continuing]. Of this country be subsidizing the——

Vice Chair Klobuchar. Thirty seconds each.

Senator Sanders. Thirty seconds is fine.

Dr. Mathur. So I don't think we should be subsidizing Walmart, but I think the workers have a choice about where they want to work. If they are choosing to work at Walmart, you know, that is their choice and we should not decide for them whether it is a good choice.

The program subsidizes workers. You know, these are poverty programs that, you know, benefits go directly to workers. So, you know, if you think that they're creating jobs and people are able to work and earn enough benefits to survive, I think that's a good thing.

Senator Sanders. Dr. Kearney.

Dr. Kearney. When Walmart came to Washington, D.C., the number of job applicants per job, there were more than dozens of people willing to take each job. I think Walmart is a brilliant innovation, and I have no beef with the Walton family.

It would be great if people could move up the wage distribution faster at Walmart and aspire to management positions, and better incomes for themselves and their children.

Vice Chair Klobuchar. Okay. Thank you.

Next, Mr. Campbell.

Mr. Campbell. I thank you very much. You know, in politics these days we want to do everything in sound bites, and we want to come up with a solution for every problem.

This issue, income inequality, mobility limitation, joblessness, whatever thing you want to deal with, is extremely complex, multifaceted and international, as many of you have mentioned.

It does not lend itself well to that. And I think we do the problem a disservice when we try to say it can be solved with a single thing, or a single solution.

I also think we do it a disservice if we use it to further divide America. If people bring it up and try and say that it is somebody against somebody else, that whenever that is used it not only does a disservice to the country but it does a disservice to solving the issue.

The third problem I think we have with this—which I am hearing on this panel, frankly—not there, here, well to some degree there—is if we use this issue to simply justify the policies that one party or the other have advocated for decades, we are not being serious. And we are also not looking for a real solution.

We are simply using the issue to justify the things we already believe, and that perhaps the other side does not believe.

So I think when we do any of those things, we are being counterproductive—and I think the issue is too important. I think it is too significant to trivialize it and reduce it in that manner.

Now that being said in the five minutes of this sound bite, I cannot engage in a thorough discussion, but I did hear some interesting things that we have not discussed much.

Secretary Reich, you mentioned about vocational and technical training and educational conceit. I do not think that is necessarily something where either party has staked out ground where they cannot move.

Dr. Kearney, you mentioned about devolution of the family and social issues. Those are difficult. I understand. They are emotional. They involve other things. But they cannot be ignored. And in one way or another people need to discuss it.

One thing I wanted to bring up is whether—you know, I have spent much more of my life in the private sector than in public, and I never worried about how much somebody else made, as long as I was making what I felt I ought to earn.

When you look at the top incomes these days—and I am not going to go into either business people or into entertainment, because that politicizes it—but I always like to bring up sports, because that tends to depoliticize the thing. And if you look at any major sport today, the players in those sports make way, way more money adjusted for inflation and anything else than they did in the 1960s and prior.

And you talk to people who were huge names in those eras and they say, well, you know, I got out just before the really big salaries came up, the really big income. That, by the way, will apply to team owners as well in some of what they do and what these teams are worth.

Why is that? Dr. Kearney, or anybody?

Dr. Kearney. Thank you for your serious attention to this very difficult and nuanced problem. I think a focus on the top 1 percent and why those folks have, you know, such enormous wages and incomes is a fascinating question. In some sense it's an academic question. Why has it become okay in a question of norms for a CEO to make so much more——

Mr. Campbell. Keep it to sports, please.

[Laughter.]

Dr. Kearney. On sports, now we have a global television market. The revenues to these sports franchises are larger, and so some would argue that they are earning it because of the value brought into the sports team, and the TV licenses, et cetera.

But I do want to say, this I think distracts us from the real policy question. Those are fun questions to talk about, right, but the bigger issue, and the one that we need to do something about is the inequality between people with different education levels. College workers make twice as much as those with a high school degree. We could do something about that.

Mr. Campbell. So is what you're saying is we should ignore that? Unfortunately, this thing has focused—a lot of people focus on the pitcher that gets $240 million.

Dr. Kearney. Of course, because it's so fascinating. It's huge.

Mr. Campbell. But it distracts from the real issue, does it not?

Dr. Kearney. I would tend to agree. I would tend to agree.

Mr. Campbell. Okay. My time is up. Thank you.

Vice Chair Klobuchar. Okay, next, Representative Maloney from the State of New York.

Representative Maloney. Thank you. It is very good to see you again, Secretary Reich. In your entire career you have shown a spotlight on the problems of income inequality, and your ideas and concern are gaining momentum I would say here on Capitol Hill. Both parties are expressing concern. Major leaders, Pope Francis has been very critical of the trickle-down economy. Warren Buffett and others.

And you testified about the way, the economy we had after World War II that lowered that gap. And actually in the Clinton years you were working hard to lower that gap. And you mentioned those long-term goals of education, infrastructure, tax structure, stronger unions, people working together.

Is there anything that we can do in the short term that would gain—that we could take advantage of this renewed urgency that we are feeling in the country to do something now? Or is it just a long-term goal? Is there something we could do right now that would help us move forward?

Professor Reich. I think there is no magic bullet. It is going to take years. There is no substitute for the public as a whole understanding the dimensions of the problem.

In the short term, I would recommend an increase in the minimum wage. I think that can be done. It would be helpful. It is not going to solve the problem entirely, but it is a major step in the right direction.

I also want to mention something with regard to the issue of divisiveness, because this is important. Even the wealthy in this country would do better with a smaller share of a rapidly growing economy, growing rapidly because the middle class and the poor had more purchasing power and therefore there was more aggregate demand than they are doing now with a large share of an economy that is barely growing.

It is not a zero sum game, in other words. And I do not think anybody up here, or anybody who has thought about this issue, sees it as a zero sum game. It should not be. It should not be even a partisan issue.

Representative Maloney. But many of my Republican colleagues have been critical of government programs. They call them trapping people in poverty. Not building their future. Not a job. But these programs, such as increasing the minimum wage, extending unemployment insurance, Medicaid, Medicare, the nutritional program. There was at one point a proposed $40 billion cut to nutrition.

Yet all of this goes back into the economy and helps move many people out of poverty, and helps increase the purchasing power. And, believe me, everyone who gets an unemployment insurance check is going to plow every single dollar back in. Every minimum wage earner is going to plow every single dollar back into the economy.

So what would your response be when the pushback on minimum wage and the extension of unemployment insurance, which you so eloquently have argued would be positive for growing our economy, how do we convince and move forward to do these things which we can do now in the short term to help the overall economy for everyone?

Professor Reich. Representative Maloney, let me just say that in my career as Secretary of Labor and before then, and since then, I have not met anyone who does not want to have a job. People want to work. They want to contribute. They want the dignity of having a job.

Right now there are three people without jobs for every job opening in the United States. It is absurd to think that under these circumstances extending unemployment benefits are deterring people from looking for work.

In fact, the only way you qualify for extended unemployment benefits is you are actively looking for work. The big problem we face right now is so many people are dropping out of the job market because they are too discouraged even to look.

Representative Maloney. My time is up. We have heard statements today that people made a choice for a minimum wage job. No one is making that choice. That is the only choice they—the only job they can find. Someone else said that people gave up their job. They did not give up their job. They wanted to work. They lost their job.

But all of the social safety net programs help provide the economy and the safety net to move forward. How would you—how would you answer the critique of the safety net as being part of answering the job growth in our country?

Vice Chair Klobuchar. Okay, we will have that answer for the record because we have a vote coming up, if that is okay, Representative Maloney, and I want to try to get our last two House Members, including Representative Delaney, in.

Representative Hanna.

Representative Hanna. Thank you. What is clear to me is that we cannot have a peaceful society as long as some young people born in poverty have a 40 to 70 percent chance of dying in poverty.

What is also clear to me is the last industrial revolution provided a lot of jobs. The automation of cognitive work has made pre-K education vital, if we are not going to have long-term structural unemployment.

Also, as Dr. Reich said, 98 percent of the jobs we have created in this country in the last 20 years are jobs that no one in this room would consider a living wage or a job they would want.

So the theme here today is education. The theme here is transcendence and how do we do that? And I do not think there is a person in either party who does not understand the value of their own education, therefore the value of that education towards others.

Is it the case that if we do not recognize the need—and Secretary Duncan has a bill out now to provide quality pre-K, quality education with competitive opportunities between schools and between teachers, et cetera, that we can ever get away from the structural—and you would have to agree that it is structural and becoming more so—how can we get away from that? And how can we create the society we want in terms of what is everyone's notion that you have an opportunity. The aspirational nature of upward mobility is in many ways as important to the peace of a society as is the reality, although not quite as much.

So I just want to know—and it is kind of answering—I am asking you to answer my question in reverse—do you think we have structural unemployment that is going to grow if we do not recognize that? And the automation of cognitive work is increasingly not matching up to employment like the industrial revolution.

Dr. Reich.

Professor Reich. Yes. We do have a structural problem. It is primarily technological. It is not entirely technological. It does have to also do with the globalization of production.

And those forces have been exerting a divisive force on the American workforce, undoubtedly. Education is critical, but I just want to suggest to this panel that, although education is critical, it is not the sole issue we have to deal with here.

Education can take us so far. But we are also seeing in this country an extraordinary degree of segregation by income in terms of where you live. And that geographic segregation has in it problems not only of education, but public services, the failure of young people to see models of adults who are ascending into professions, the failure of many of our institutions to respond to what many lower middle class, what we used to call working class, and poor people in this country need.

It is a complicated bundle of problems that have got to be addressed if we are going to maintain a strong middle class and achieve many of the other objectives that I think everybody who has spoken today shares.

Dr. Kearney. I agree with Secretary Reich completely on that.

Dr. Mathur. I agree. I think the interesting thing is that if you do any poll, I think people still believe that 40 to 50 percent of people still believe that if you work hard, you get a good education, you can still, you know, move up. It does not matter what the statistics say.

And I think reinforcing that through better education, through higher job finding rates, would be great for the economy.

Dr. Winship. I agree with you entirely, Congressman, about the importance of pre-K. I think there are a lot of useful things that could be done for higher education, but the truth is that we have

50 percent dropout rates today. A lot of that is because people are not prepared, and so I think——

Representative Hanna. But doesn't that relate to—I mean, isn't that——

Dr. Winship. Absolutely. So I think——

Representative Hanna. It is one and the same.

Dr. Winship. Yes. I completely agree. So I think to the extent that we are focusing on marginally increasing people into getting people into college, but not reducing the dropout rate, it would be much more productive if we could have an impact at the beginning.

On technology, I am more bullish there. Technology does destroy jobs, but to the extent that it does it reduces prices, which then other people—it means other people can afford to spend more, and that creates other jobs. So I actually think that there is a risk of worrying too much about that.

Representative Hanna. Thank you.

Vice Chair Klobuchar. Okay, we have one last House Member. The vote has been called.

Mr. Delaney.

Representative Delaney. Thank you very much.

And, Secretary Reich, I enjoyed your last comments. It reminded me of the book Coming Apart by Mr. Murray, which I thought summarized the segregation issue quite well.

But what I wanted to ask the panelists in there is an agreement or a consensus around what the real problem is, and what the macro solutions are.

You cannot solve a problem unless you describe it. It seems to me the big problem we have here is what was touched on throughout the testimony today, which is the effects of globalization and technology.

I think 30 years ago there were a billion people in the global world, now there's 5 [billion] active in a global economy, and computing power has grown 100,000 fold over the same period of time. And this has really helped people with great educations, and it has helped people with access to capital, which is why they are doing so well.

And it has been enormously disruptive to everyone else, which is why we have income inequality, however we want to frame these things. And so in my opinion that is the center of the center in terms of our problem.

And if we agree that that is the problem, it seems to me there are some obvious things we have to do. One, we have to realize we are in this very competitive global technology-enabled world, and we have to compete in that world. And to compete in that world we have to make, in my opinion, massive investments in our infrastructure—because it is a good investment. It creates jobs in the long term. It creates jobs in the short term.

We have to reform education to prepare people for that. We have to do the immigration reform we have discussed. We have to do tax reform so we can pay for some of these things and make sure that companies don't keep trillions of dollars overseas, and bring it back to the country.

And those four portfolio solutions, which I will describe as infrastructure, education, immigration, and tax reform, are long-tail so-

lutions. Meaning, if we did them all right now it would still take a long time before it makes a difference.

So to deal with the short-tail problem, we need government programs to keep people, give them a helping hand as we try to fix this in the long term.

So my question—really quickly, for each member—almost a "yes" or "no" answer, is: Do you agree that this is the central problem? And do you agree that this, on a macro level, without getting into the details, this portfolio of solutions, are the right solutions? And I will start with our good Secretary.

Professor Reich. Yes, I agree that the central challenges are globalization and technological change. And I also agree that the portfolio you referred to—that is, education, infrastructure, tax reform—I would describe it as toward a more progressive income tax, not just corporate tax reform.

I would also add financial reform. Because I think financial markets have gotten out of control and the burden has fallen tremendously on the middle class. But if I may, just——

Representative Delaney. I am going to switch to Dr. Winship quickly because we have to get through this, and I have to run and go vote, if you don't mind.

Professor Reich. Okay.

Representative Delaney. Thank you, Mr. Secretary.

Dr. Winship. I agree completely on education. Infrastructure to me does not feel necessarily like a sure thing for growing the economy, short term or a longer term.

I think people were disappointed in what infrastructure gave us for a bump over the last year.

Representative Delaney. But you agree with the problem being——

Dr. Winship. Globalization.

Representative Delaney [continuing]. Globalization and technology?

Dr. Winship. Absolutely. I think that is absolutely right.

Representative Delaney. And don't you think we need a more competitive portfolio of transportation, logistics, energy, communication, and educational infrastructure to compete against that backdrop?

Dr. Winship. I guess I feel like the human capital challenges that we have related to global development are much more important than the sort of physical capital

Representative Delaney. Okay, so keep going through your list of solutions.

Dr. Winship. Tax reform I think is important. We actually spend a lot of money in the Tax Code to promote upward mobility. The problem is it is sort of upside down. We subsidize a lot of purchases that people who could have afforded to make them anyway——

Representative Delaney. What about helping people as we deal with these bigger issues? Government programs to support people while——

Dr. Winship. Yes, I mean we need a safety net. I think it can promote work, and marriage, and savings a lot better than it does.

Representative Delaney. Thank you.

Dr. Kearney.

Dr. Kearney. Yes, I agree with your characterization of the problem. The four items that are issues that you have laid out I think are perfectly sensible, and I would agree with all of them.

I would amend a little bit your characterization of the safety net as merely something to support people in the short term. Well designed safety net programs are investments.

Representative Delaney. Yes, and I did not really mean to treat it that way. But we have to acknowledge that the solutions are long-tail solutions, right?

Dr. Kearney. Yes.

Representative Delaney. If we got them all right today——

Dr. Kearney. That's right.

Representative Delaney [continuing]. It would take a long time before they really had a meaningful effect on a lot of people.

Dr. Mathur. So I agree that globalization is an issue, and I think the focus on technology and the fact that, you know, some skilled workers are able to get access to those technologies and improve, that is an issue.

I think the local issue is sort of distinct also from the global—you know, what's happening in the global markets. I think we have a very challenging current labor market crisis that is not completely driven by what is happening in terms of globalization.

In terms of solution, yes, I think education is, you know, the first step towards encouraging people to, you know, make an investment in human capital and be out in the labor market.

Tax reform is important. I think government programs work if they are effectively designed——

Representative Delaney. You mean like infrastructure investment?

Dr. Mathur. I think it is a long-term solution—it might be a long-term solution.

Representative Delaney. Thank you very much.

Vice Chair Klobuchar. Thank you very much, Representative Delaney.

Senator Lee.

Senator Lee. Thank you very much, Madam Chair, and thanks to all of you for joining us today.

This past summer, the Equality of Opportunity Project released a study looking at the state of economic opportunity in the United States throughout various regions. One issue in the study looked at the geographic variation in intergenerational poverty, the question of how likely one's parents' income at the time of one's birth might be an accurate predictor of where one ends up on the economic continuum later in life as an adult.

I am pleased to say that Salt Lake City and the surrounding area in my home State of Utah out-performed every other major metropolitan region in the country in that regard in this important metric.

Children growing up in Salt Lake City, in other words, see a greater potential for economic mobility during their lifetimes than children born, really, almost anywhere else in the world.

So I would like to ask a couple of questions to kind of follow up on this. Let's start with Dr. Winship. You know, I think Utah pro-

vides an example of what success in the area of economic mobility might look like.

Could you comment on how strong institutions, robust civil society, and a successful private welfare system might factor into this equation?

Dr. Winship. Sure. Thank you for the question, Senator. I do think that when people look at the fantastic mobility rate that Salt Lake City does have, those are the things that make sense. Especially if you talk to people on the ground, I think that it is these social capital strengths that the local area has.

So among the most—among the strongest predictors of mobility in the data set that you are talking about are a number of indicators of sort of family strength and stability. Dr. Kearney raised this earlier. I think it is an important issue that we need to take seriously.

Utah fares very well on those sorts of measures. Broader social capital measures like how integrated people are into the community that they live. Even, you know, the book Bowling Alone, you know, has sort of found these correlations between even how many people are in bowling leagues and economic outcomes.

So it does seem to make a big difference. And there are these cultural components that I do not think we understand well, where you do find pockets of people that have assembled a society that seems to work. I think you find that in places where there are a lot of Scandinavians for some reason.

Vice Chair Klobuchar. Thank you.

[Laughter.]

Dr. Winship. That's right.

Senator Lee. Because they like to bowl?

Dr. Winship. I have not established an empirical link between the two, but you do sort of tend to find similar outcomes among Swedish Americans, Norwegian Americans, and looking at actually in Norway and Sweden. I do not think it is well understood yet.

Senator Lee. What about policies encouraging robust hiring and providing strong incentives for work?

Dr. Winship. Well I think incentives for work are very important, and I think you are seeing a lot of energy among some prominent conservatives such as yourself, Senator Rubio, Congressman Ryan, around reforming our safety net programs to fix the disincentives that we currently have to make it clear to folks that taking work will benefit them.

And in fact to do that in a way where taking work does not necessarily benefit them under today's systems. We have these incredibly high marginal tax rates where the argument is not that the poor are receiving these benefits or are bad people somehow, they are behaving as you and I would behave faced with the same incentives.

There is very little reason in a lot of these programs to actually look for work and take that job when you are going to lose all these benefits. So I think the exciting thing among some of the proposals on the right is to think very seriously about poverty, but also to remedy these disincentives that are not good for anyone.

Senator Lee. It is a nice segue to the question I was going to ask to Dr. Mathur. There is some consensus that our federal wel-

fare system is clunky and poorly designed, uncoordinated phase-outs of means tested programs where individuals with modest incomes may see astronomical effective marginal tax rates are part of the problem.

Would you agree with the fact that they are a part of the problem? And what do you think we ought to do about that?

Dr. Mathur. I think there is truth in the fact that even though let's say the Earned Income Tax Credit Program, which has really high marginal tax rates in the phase-out, says people who are earning higher incomes are suddenly faced with extremely high marginal tax rates.

You know, those do create a disincentive to work, or at least to put in more hours. It might be an hour's impact. So I think, you know, designing those better, or designing them so that people do not face these huge disincentives to work could actually go a long way towards getting more people into the labor market, and sort of keeping them there.

Senator Lee. These, in other words, create effectively poverty traps in which people feel compelled not to do that which might be for their long—inure to their long-term benefit, but in the short term they might face penalties. And if we could coordinate these phase-outs so that they are more carefully designed——

Dr. Mathur. Absolutely.

Senator Lee [continuing]. We could avoid those.

Dr. Mathur. You could avoid those situations.

Senator Lee. I see my time has expired. Thank you, Madam Chair.

Vice Chair Klobuchar. And thank you, Senator Lee, for being willing to discuss this issue. We may not agree on every solution—the two of us chair, or co-chair the Antitrust Subcommittee of Judiciary, so we have worked on a lot of things together, and I think it is a nice end here.

I think we have had a civil hearing. We have approached an issue, as Secretary Reich and I were discussing before this hearing, there are a number of Republicans that are being willing to talk about this issue this time, which I think is really important as we go forward.

I did want to note, Senator Lee, I was checking out our report. This is now my time to hawk our products. Secretary Reich has a movie out that is on DVD, right? What is the name of it?

Professor Reich. It is called "Inequality for All."

Vice Chair Klobuchar. "Inequality for All."

Professor Reich. iTunes, DVD, On Demand.

Vice Chair Klobuchar. And coming out on Netflix?

Professor Reich. Late February.

Vice Chair Klobuchar. Very good. And then we have a report for the Joint Economic Committee on the Democratic site here on Income Inequality In The United States. It is not as exciting as the movie, but pretty good, right here. And I was looking as you were talking about Salt Lake City, and in fact this is supported by our report. We looked at the quintile, the lowest-income quintile, lowest 20 percent, and the chances of reaching the highest quintile. And in fact of the 13 States that are 10 percent or higher, Utah is one of the highest. I will also note that Minnesota is in the group.

And I would also note that California is in the group, interestingly enough. And the highest one is, can anyone guess? In what state do you have the best chance of going, right now, at this moment in time from the bottom 20 percent to the highest 20 percent? North Dakota, with all of the energy work that is being done there.

So that is at 18.3 percent. So I think that being said, the fact that we only have 13 states that you have about a 1 in 10, 1 in 11 average chance of going from that quintile to the top is still a reason to be concerned.

One of the things I did want to end here with is that there was some talk of people trying to divide over this issue. I do not think that is what Senator Lee is trying to do. I do not think that is what Chairman Brady was trying to do. And I think that this is an issue that we must address in our country.

We may have some disagreements on what exactly the data shows, but I think we know there is a problem. And I think we clearly have some disagreements on the solutions, but I am looking for some common ground here. And I really appreciated the tone of the witnesses and how we were able to approach this issue. And I am actually quite excited to be working on it.

So the record is going to stay open for five business days for any Member who wishes to submit an additional statement or any additional questions.

Thank you very much to our witnesses. The hearing is adjourned.

(Whereupon, 11:49 a.m., the hearing was adjourned.)

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF HON. KEVIN BRADY, CHAIR, JOINT ECONOMIC COMMITTEE

Vice Chair Klobuchar, Committee Members, and distinguished witnesses, today the Joint Economic Committee will begin to examine the complex questions of economic inequality and mobility in the United States.

We're not all blessed with equal talents, but in America, we should all have an equal chance to climb the ladder of success—driven upward by our personal initiative, and not burdened by the deadweight of a bloated government.

We know that too many families are struggling, even in a country where nine of ten children born to the poorest families will earn more than their parents.

Economic mobility is very much alive. In America today the children of the poorest are more likely to climb up the ladder of success than the children of the wealthy are likely to stay where they are.

Through hard work, today one-in-three American families live an upper middle-class lifestyle or better—more than double what it was just forty years ago.

Astoundingly, better than one-in-five Americans are likely to rise to the top two percent of earners sometime during their lifetime. The American Dream is still very much alive.

Do some Americans earn more than others? Absolutely. I can't fathom how entertainer Madonna made $125 million last year, or how actor Johnny Depp will earn nearly a half billion dollars from the Pirates of the Caribbean series.

We all can appreciate, though, how Mark Zuckerberg became the world's youngest billionaire launching Facebook from his college dorm room, or how Mary Kay Ash of tiny Hot Wells, Texas—frustrated with the glass ceiling in a male-dominated industry—built Mary Kay Cosmetics into an international icon with over a half million entrepreneurs.

The challenge that we face today is too many Americans no longer believe the ladder of success is available to them. They've lost hope that if they work hard and play by the rules, tomorrow will be better than today.

And who can blame them? Thanks to the weakest, most disappointing economic recovery in a half century, millions of Americans can't find full-time work, and millions more have simply given up looking for work. Proportionately fewer adults are working today than when the recession ended over four years ago.

These struggling Americans have not benefited from the White House's controversial stimulus, which failed to fulfill its promise of getting them back to work by now. They watch as the Federal Reserve has pumped up Wall Street with trillions of dollars, while Main Street and middle-class families are left behind. In the past five years, college costs have soared and energy costs have doubled. While some Americans, no doubt, are being helped by the Affordable Care Act, millions more have been forced out of the health insurance plans they liked and are being forced to pay even more for plans they didn't want.

While President Obama should not shoulder all the blame, out of fairness he should accept some of the responsibility for why so many Americans believe the ladder of success has been pulled from their reach. He should not divide America further, pit one American against another based on their success, or fuel resentment and jealousy in the pursuit of political gain. That's not an America we can be proud of.

I admit I can't imagine how Washington bureaucrats that have never met you or even know your name can "equalize" your income. Can the same incompetent government that brought us the bungled Affordable Care Act Web site be trusted with your dreams and your children's dreams?

What we'll learn from today's hearing is that respected economists disagree about the issue of income equality. For example, by using a definition of income that excludes both taxes that reduce disposable income and government programs like Social Security, Medicare, and unemployment insurance that boost it, economists Piketty and Saez found large and growing income inequality. Other economists, by using a more realistic definition that considers the effects of taxes, government programs, employment-provided health insurance benefits and the changing size of the modern family, found a very modest change in income inequality over the past twenty years. Still other studies that measure what families actually buy and consume reveal that the ratio between the consumption of the poorest fifth and the most successful fifth of Americans remained stable over the past quarter century.

I hope we will agree that personal decisions affect every American's ability to make a better life. A college degree, steady work, marriage and children within the marriage increase the odds of climbing the ladder of success—although in our great country some have succeeded with none of these.

I also hope we can agree that education and skills drive high wages, especially for those earning a college, graduate or professional degree. For example, Pew re-

search found that children from families in the bottom fifth of earnings have a one-in-ten chance of climbing into the wealthiest fifth of Americans with a college degree, but only a three-percent chance without it. Similarly, children from families in the second fifth have nearly a one-in-four chance of climbing to the top rung with a college education, but only a nine-percent chance without it.

Finally, how should the Federal Government act to help restore Americans' belief in opportunity?

We can heed the advice of President Abraham Lincoln—perhaps the greatest "equalizer" to inhabit the White House. In his message to Congress on July 4, 1861, he made clear the proper role of government in promoting economic opportunity is "to elevate the condition of men—to lift artificial weights from all shoulders—to clear the paths of laudable pursuit for all—to afford all, an unfettered start and a fair chance, in the race of life."

We must do more to "lift the artificial weights" off our poorest families and get Washington out of the way so that every American truly has "an unfettered start and a fair chance in the race of life."

Income Inequality in the United States

Robert B. Reich

Testimony before the Joint Economic Committee, United States Congress

January 16, 2014

Vice Chair Klobuchar, Chairman Brady and Members of the Committee,

My name is Robert Reich. I am currently Chancellor's Professor of Public Policy at the Goldman School of Public Policy at the University of California at Berkeley, and Senior Fellow at the Blum Center for Developing Economies at the University. Thank you for giving me the opportunity to testify before this Committee today on a troubling phenomenon that's been increasing for over thirty years: widening inequality of income -- and, in consequence, of wealth, upward mobility, and political power in the United States.

I have been studying this issue for much of the last three decades, written a number of books on the subject, and sought in various ways to address it under three presidents, most recently as Secretary of Labor under President Clinton. I have even gone so far as to help make a movie about it, entitled "Inequality for All," which is just out on DVD, iTunes, and On Demand, should any of you or your staffs wish to take a look.

I should say at the outset that some inequality is inevitable, if not necessary. If an economy is to function well, people need incentives to work hard and innovate. The question is not whether inequality is good

or bad. It is at what point inequality becomes so wide as to pose a serious threat to economic growth, to our ideal of equal opportunity, and to our democracy. I believe we are reaching that tipping point, or have already reached it.

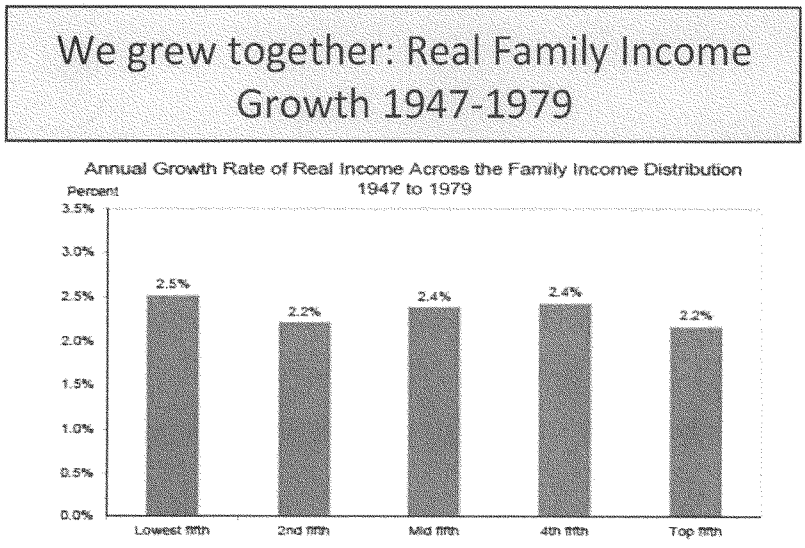
The data

Most data are prone to different interpretations, but the data on widening inequality are remarkably and disturbingly clear. The Congressional Budget Office has found that between 1979 and 2007, the onset of the Great Recession, the gap in income -- after federal taxes and transfer payments – more than tripled between the top one-percent of the population and everyone else. The (after-tax, after transfer) income of the top one-percent increased by 275 percent, while it increased 18 percent for the bottom quintile of the population, incomes and less than 40 percent for the middle three quintiles.

The gap has continued to widen in this recovery. According to the Census Bureau, median family and median household incomes have been falling, adjusted for inflation, while the income of the wealthiest 1 percent has soared by 31 percent. My colleague Emmanuel Saez has calculated that 95 percent of all economic gains since the recovery began have gone to the top 1 percent. Figures 1A and 1B contrast what's happened to the upper, middle, and lower fifths of the population in two periods, from 1947 to 1979, and from 1979 to 2010. Figure 2 shows how much income has flowed to the top 1 percent between 1916 and 2009.

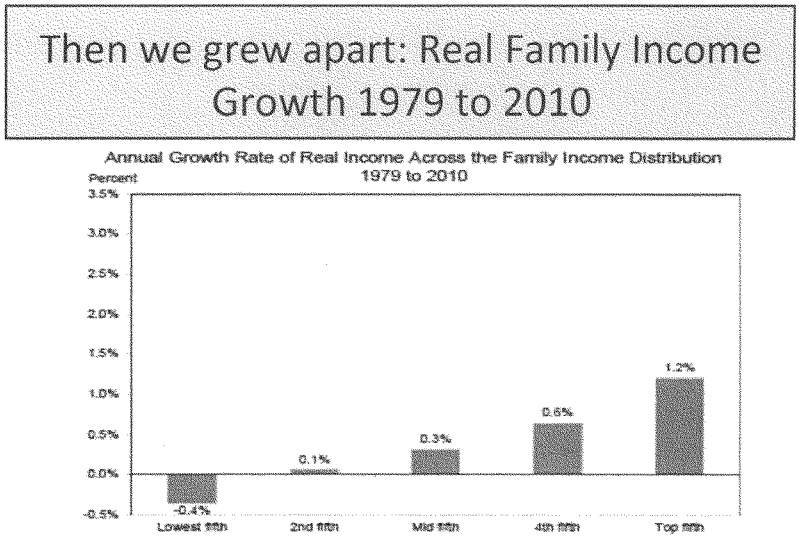
Wealth has become even more concentrated than income. An April 2013 Pew Research Center report documents that between 2009 and 2011, the mean net worth of households in the upper 7 percent of the wealth distribution rose by an estimated 28 percent, while the mean net worth of households in the lower 93 percent dropped by 4 percent.

Figure 1A



Source: Alan Krueger, President's Council of Economic Advisors, The Rise and Consequences of Economic Inequality, 2012

Figure 1B



Source: Alan Krueger, President's Council of Economic Advisors, The Rise and Consequences of Economic Inequality, 2012

The threat to economic growth

In the United States, consumer spending accounts for approximately 70 percent of economic activity. If consumers don't have adequate purchasing power, businesses have no incentive to expand or hire additional workers.

Because the rich spend a smaller proportion of their incomes than the middle class and the poor, it stands to reason that as a larger and larger

share of the nation's total income goes to the top, consumer demand is dampened. If the middle class is forced to borrow in order to maintain its standard of living, that dampening may come suddenly -- when debt bubbles burst.

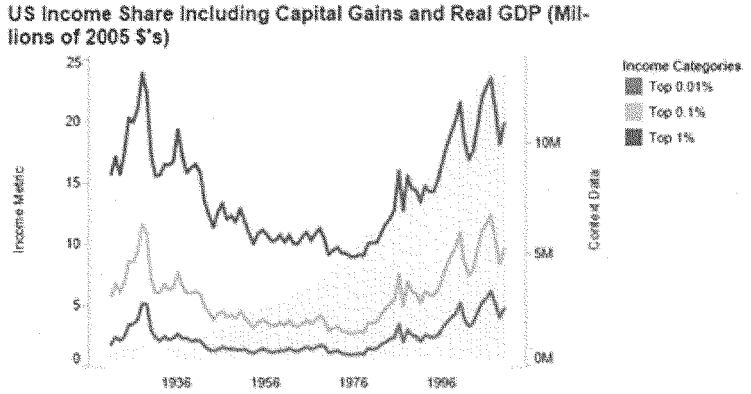
Consider what happened in 1929 and 2008. Figure 2 shows that the two peak years of inequality over the last century -- when the top 1 percent garnered more than 23 percent of total income -- were 1928 and 2007. Figures 3 and 4 show that each of these periods was preceded by substantial increases in borrowing, which ended notoriously in the Great Crash of 1929 and near meltdown of 2008.

The anemic recovery we are now experiencing is in my view directly related to the decline in median household incomes after 2009, coupled with the inability or unwillingness of consumers to take on additional debt and of banks to finance that debt -- wisely, given the damage wrought by the bursting debt bubble.

We cannot have a growing economy without a growing and buoyant middle class. We cannot have a growing middle class if almost all economic gains go to the top 1 percent.

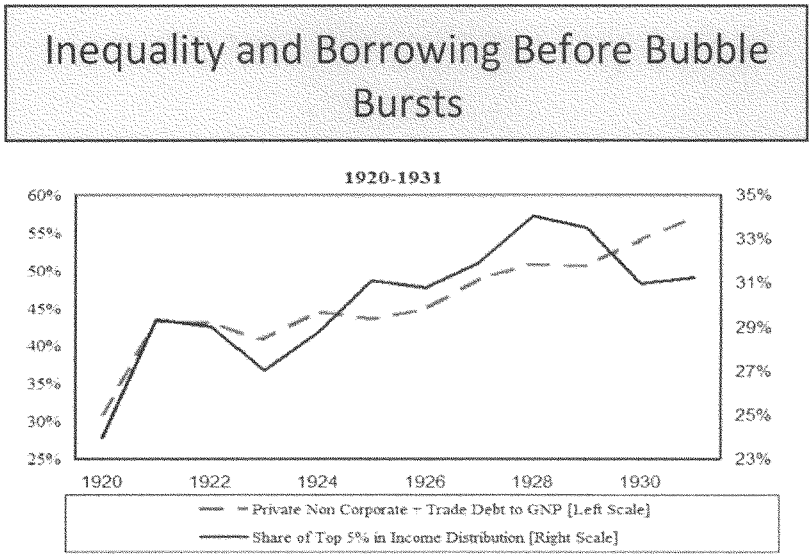
Figure 2

Share of total income going to top 1%, top .1%, and top .01%



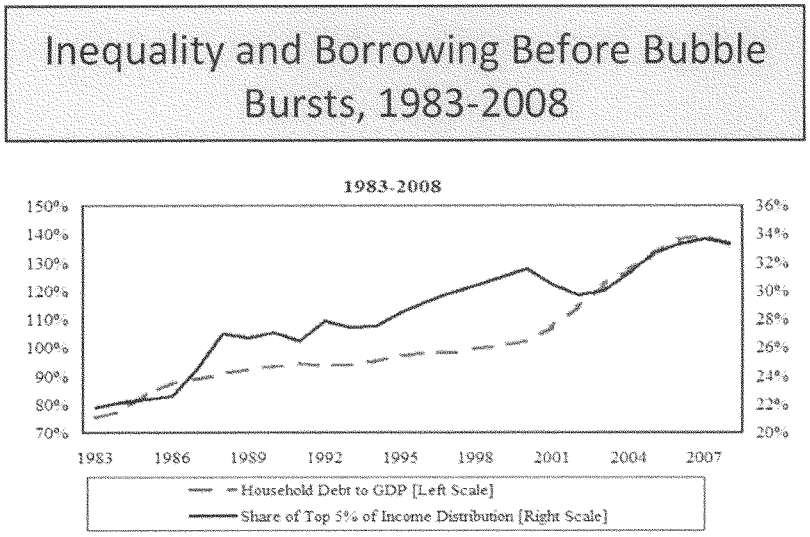
Source: Saez & Piketty (2012)

Figure 3



Source: "Inequality, Leverage, and Crisis," Michael Kumhof and Romain Ranciere, 2010.

Figure 4



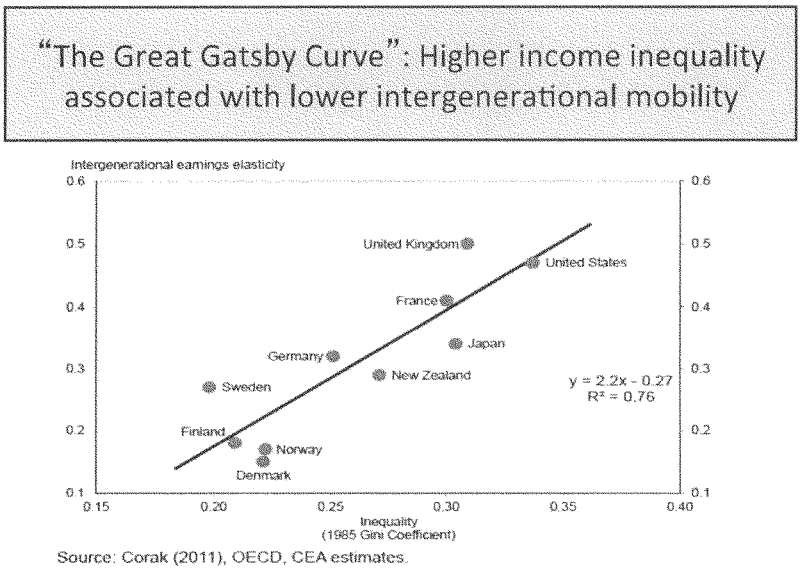
Source: "Inequality, Leverage, and Crisis," Michael Kumhof and Romain Ranciere, 2010.

The threat to equal opportunity

Widening inequality also challenges the nation's core ideal of equal opportunity, because it hampers upward mobility. High inequality correlates with low upward mobility, as you see in Figure 5.

But has widening inequality reduced upward mobility? The studies are not conclusive because the velocity of upward mobility is difficult to measure. But even under the unrealistic assumption that it is no different today than it was thirty years ago, it's easy to understand how widening inequality hampers upward mobility. Because the distance between the bottom rungs and top rungs of the income ladder is much greater now, anyone ascending it at the same speed as before will necessarily make less progress up the ladder.

Figure 5



Source: Corak (2011), OECD, CEA estimates.

The threat to our democracy

The connection between wide inequality and the undermining of democracy has been long understood. As the great Supreme Court justice Louis Brandeis said in the late nineteenth century, when America faced a similar degree of inequality as it does now -- an era characterized by urban squalor as well as robber barons whose lackeys literally deposited sacks of money on the desks of friendly legislators -- "we may have a democracy, or we may have great wealth concentrated in the hands of a few, but we cannot have both."

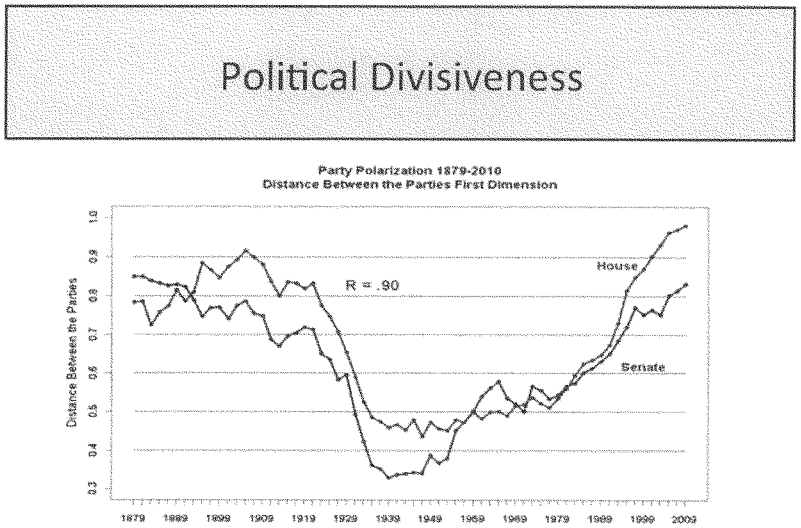
When money flows upwards, political power tends to follow. I do not mean by this to question the integrity of any elected official. But no member of today's House of Representatives or Senate is entirely immune from this phenomenon.

The threat to our democracy also comes from the political divisiveness and polarization that also accompanies high levels of inequality, as seen in Figure 6, which is a measure developed by political scientists of the distance between median Republican and median Democratic roll-call votes on a range of key economic issues. As you can see, political partisanship, as measured in those median voting patterns of members of both parties, almost directly tracks the level of inequality. I don't think it a coincidence that the shape of the graph in Figure 6 is almost the same as the shape of the graph in Figure 2, measuring the share of the nation's income going to the top 1 percent.

What accounts for this high correlation? Let me suggest that when large numbers of Americans are working harder than ever but getting

nowhere, and see most economic gains going to a small group at the top, they suspect the game is rigged -- that government and the wealthy (including big corporations) are somehow in cahoots, conspiring against the rest. Some of these people can be persuaded that the culprit is big government; others, that the blame falls on the wealthy and big corporations. The result is more partisanship, fueled by anti-establishment populism on both the right and the left of the political spectrum.

Figure 6



Source: Poole and Rosenthal (2012), VOTEVIEW (http://voteview.com/blog/?p=221)

Why this has happened

Between the end of World War II and the late 1970s, the U.S. median wage grew in tandem with American productivity. Both roughly doubled in those years, adjusted for inflation.

But after the late 1970s, while productivity continued to rise at roughly the same pace as before, wages began to flatten. See figure 7.

In part, this was due to the twin forces of globalization and labor-replacing technologies that began to hit the American workforce like strong winds -- accelerating into massive storms in the 1980s and 1990s, and hurricanes since then.

Containers, satellite communications technologies, and cargo ships and planes radically reduced the cost of producing goods anywhere around the globe, thereby eliminating many manufacturing jobs or putting downward pressure on other wages. Automation, followed by computers, software, robotics, numerically-controlled machine tools, and widespread digitization, further eroded jobs and wages.

These forces didn't erode all incomes, however. In fact, they added to the value of complex work done by those who were well-educated, well-connected, and fortunate enough to have chosen the right professions. Competition for the lucky few perceived to be the most valuable saw their pay skyrocket.

But that's only part of the story. Instead of responding to these gale-force winds with policies designed to upgrade the skills of Americans, modernize our infrastructure, strengthen our safety nets, and adapt the

workforce -- and pay for much of this with higher taxes on the wealthy -- we did the reverse. We began disinvesting in education, job training, and infrastructure. We began shredding our safety nets. We made it harder for many Americans to join unions. In fact, the decline rise and decline in unionization directly correlates with the rise and decline of the portion of income going to the middle class (see Figure 8). And we reduced taxes on the wealthy.

We also deregulated. Financial deregulation in particular made finance into the most lucrative industry in America -- as it had been in the 1920s. Here again, the parallels between the 1920s and recent years are striking, reflecting the same "bridge" pattern we've seen before. See Figure 9.

Other advanced economies have faced the same gale-force winds but have not suffered the same inequalities as has the United States, because they have helped their workforces adapt to the new economic realities -- leaving the United States as the most unequal of all advanced nations by far.

Figure 7

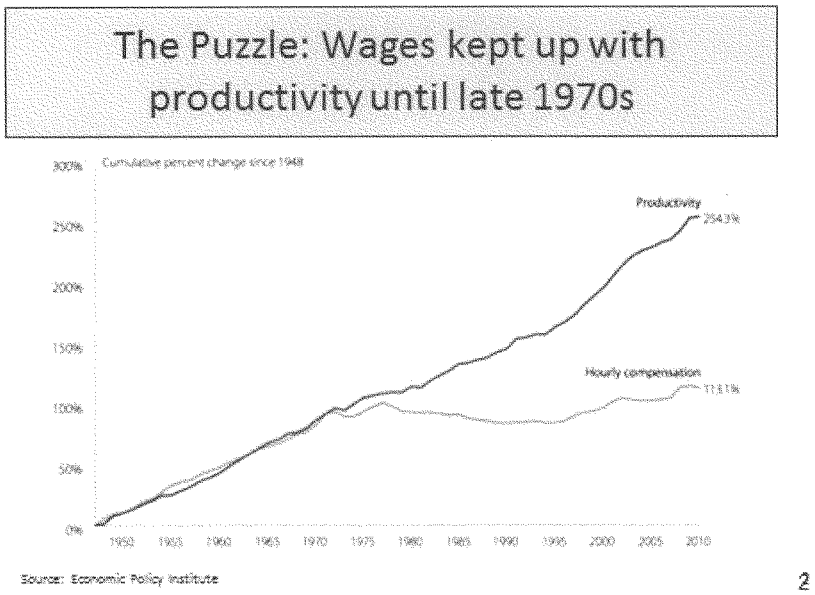
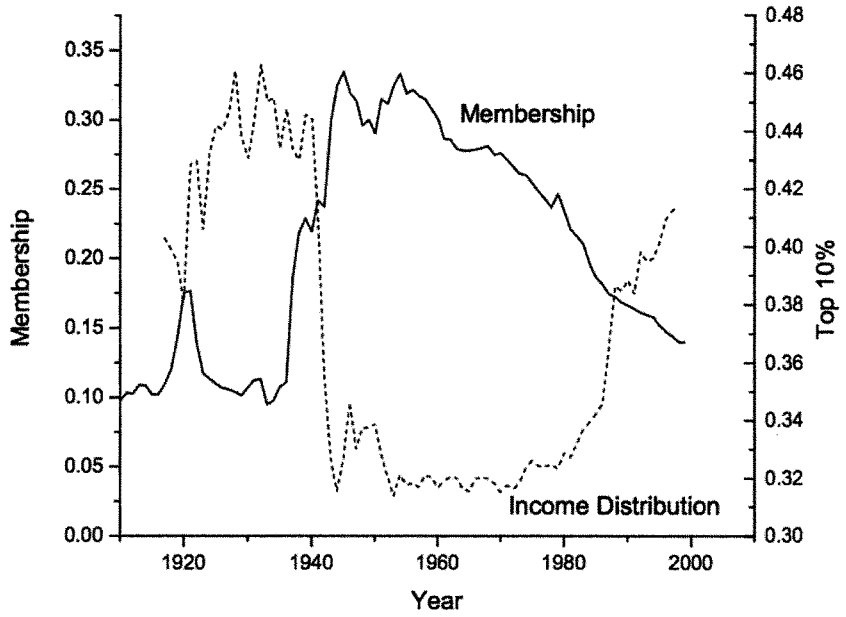
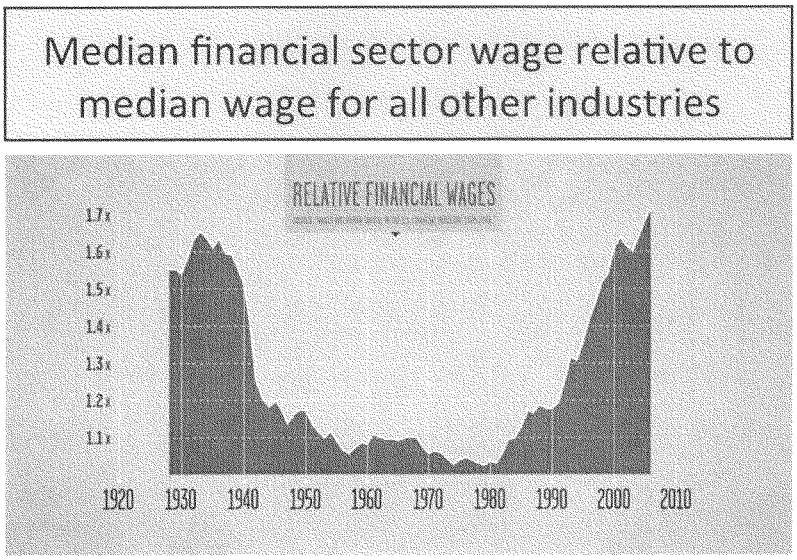

The Puzzle: Wages kept up with productivity until late 1970s
Cumulative percent change since 1948
300%
250%
200%
150%
100%
50%
0%
Productivity
254.3%
Hourly compensation
1948
1953
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
Source: Economic Policy Institute
2

Figure 8



Source: Census Bureau, Current Population Survey, and Hirsch et al. "Estimates of Strength of Union Density by State"

Figure 9



Source: T. Philippon, "Wages and Human Capital in U.S. Financial Industry", (2012)

What to do

There is no single solution -- no magic bullet -- to reversing widening inequality. But I'd recommend six policies in particular:

1. *Make work pay.* The fastest-growing categories of work are retail, restaurant (including fast food), hospital (especially orderlies and staff), hotel, child care, and elder care. But these jobs tend to pay very little. A first step toward making work pay is to raise the federal minimum wage

to at least $10 an hour, and expand the Earned Income Tax Credit. No American who works full time should be in poverty.

2. *Unionize low-wage workers.* As we've seen, the rise and fall of the American middle class correlates almost exactly with the rise and fall of private-sector unions, because unions gave the middle class the bargaining power it needed to gain a fair share of the gains from economic growth. We need to reinvigorate unions, beginning with low-wage service occupations that are sheltered from global competition and from labor-replacing technologies. Lower-wage Americans deserve more bargaining power.

3. *Invest in education* -- from early-childhood through world-class primary and secondary schools, affordable public higher-education, good technical education, and lifelong learning. Education should not be thought of as a private investment; it is a public good that helps both individuals and the economy overall. Yet for too many Americans, high-quality education is unaffordable and unattainable. Every American should have an equal opportunity to make the most of herself or himself.

4. *Invest in infrastructure.* Many working Americans -- especially those in the lower rungs of the income ladder -- are hobbled by an obsolete infrastructure that generates long commutes to work, excessively high home and rental prices, inadequate access to the Internet, insufficient sources of power and water, and unnecessary degradation of the environment. Every American should have access to an infrastructure suitable to the richest nation in the world.

5. *Pay for much of this by raising taxes, especially on the wealthy.* Between the end of World War II and 1981 -- then the wealthiest

Americans were getting paid a far lower share of total national income -- the highest marginal federal income tax rate never fell below 70 percent, and the effective rate (including tax dedications and credits) hovered around 50 percent. But with Ronald Reagan's tax cut in 1981, and then George W. Bush's tax cuts of 2001 and 2003, taxes on top incomes were slashed, and tax loopholes favoring the wealthy, widened. The implicit promise -- sometimes made explicit -- was that the benefits of such cuts would trickle down to the broad middle class and even to the poor. As has been shown, however, nothing trickled down. At a time in American history when the after-tax incomes of the wealthy continue to soar, while median household incomes are falling, and when we must invest far more in education and infrastructure, it seems appropriate to raise the top marginal tax rate, and close tax loopholes that disproportionately favor the wealthy.

6. *Constrain Wall Street.* The financial sector has added to the burdens of the middle class and the poor through excesses that were the proximate cause of an economic crisis in 2008, similar to the crisis of 1929. Even though capital requirements have been tightened and oversight strengthened, the biggest banks are still too big to fail, or jail, or curtail -- and therefore capable of generating another crisis. The Glass-Steagall Act, separating commercial from investment-banking functions, should be resurrected in full, and the size of big banks should be capped.

7. *Get big money out of politics.* Finally, but not the least, we must limit the political influence of the great accumulations of wealth that are now threatening our democracy and drowning out the voices of average Americans. The Supreme Court's decision in Citizens United vs. Federal Election Commission must be reversed -- either by the Court

itself, or by Constitutional amendment. In the meantime, we must move toward public financing of elections -- for example, with the federal government providing candidates in general elections for House and Senate and for the presidency two dollars for every dollar raised from small donors.

It will take a movement

I would begin by raising the minimum wage. But I'm not so unrealistic as to believe other measures designed to reverse widening inequality will be enacted any time soon. I've served in Washington, and know how difficult it is to get anything done unless the broad public understands what's at stake and actively pushes for reform. That's why we need a movement against economic inequality and in favor of shared growth – a movement on a scale similar to the Progressive movement at the turn of the last century that fueled the first progressive income tax and antitrust laws, the women's' suffrage movement that got women the vote, the labor movement that helped animate the New Deal of the 1930s and fueled the great prosperity of the first three decades after World War II, the Civil Rights movement that achieved the landmark Civil Rights and Voting Rights Acts, and the environmental movement that spawned the Environmental Protection Act and other critical legislation.

Time and again, when the situation demands it, America has saved capitalism from its own excesses. We put ideology aside, and do what's necessary. No other nation is as fundamentally pragmatic. We will

reverse the trend toward widening inequality eventually. The question is how much damage will have been done to our economy, our democracy, and our ideal of equal opportunity in the meantime.

Thank you.

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Choosing Our Battles: Why We Should Wage a War on Immobility Instead of Inequality

Testimony before the Joint Economic Committee, U.S. Congress, Washington, D.C.
January 16, 2014

Scott Winship[1]
Walter B. Wriston Fellow, Manhattan Institute for Policy Research

Chairman Brady, Vice Chair Klobuchar, and Members of the Committee, thank you for inviting me to appear today to discuss the topic of income inequality in America. With long-term unemployment historically high and still-pervasive economic insecurity in the wake of the Great Recession, it is understandable that many Americans have grown more concerned about the nation's levels of inequality. Too many families struggle in poverty, too many workers have given up on finding fulltime work, and too many young adults have graduated into a weak economy that will lower their lifetime earnings.

At the same time, it is important to note that it is the fragility of the economy that lies behind concerns over inequality. Inequality was high and rising during the late 1990s, but because the growing economy was largely benefitting everyone, few people were worried about income concentration at the top. As the economy continues to recover and unemployment continues to fall, concern about inequality will recede.

As I will show, in long-run perspective, living standards have improved for the poor and middle class even as income inequality has grown. In part, that is because inequality has increased less than most analysts suggest. Furthermore, there is little compelling evidence that the gains at the top have reduced income growth lower down. And contrary to claims that rising income inequality has hurt inequality of opportunity, the evidence of a link between the two is weak. In part, that is because intergenerational mobility has not declined much—if at all—as income inequality has grown.

However, if intergenerational mobility is no worse today than it was decades ago, nor is it any better. We should not be satisfied as a nation with the limited upward mobility facing poor children today, and fifty years after Lyndon Johnson's declaration of war on poverty, we should establish a second front against immobility. Attacking income inequality, however, is unlikely to reduce poverty or to promote equal opportunity; emphasizing it is, in fact, a distraction from the task at hand.

[1] The views expressed in this testimony are those of the author alone and do not necessarily represent the views of the Manhattan Institute.

The increase in income inequality has been overstated, and the rise in incomes among the poor and middle class have been understated.

During the 1950s and 1960s, incomes in America rose dramatically, and more among the poor and middle class than among the rich. Beginning in the 1970s, income growth slowed, and it has remained sluggish for poor and middle class Americans relative to this earlier "Golden Age." However, as shown in Figure 1, inequality within the bottom 80 percent has grown only modestly, primarily during the 1980s, and hardly at all since the 1980s.[2]

Indeed, a wealth of research indicates that earnings inequality and household income inequality between the middle class and poor has not risen since the mid-to-late 1980s.[3] This literature includes a paper on earnings trends coauthored by University of California-Berkeley economist Emmanuel Saez, whose "top one percent" income concentration estimates have been cited ubiquitously. It also includes a book by economist and University of Wisconsin chancellor Rebecca Blank, who oversaw the Census Bureau at the start of the Obama presidency, as well as a report by the Congressional Budget Office.

Nor can the modest rise in middle-poor inequality be attributed to income stagnation: average income in the middle fifth rose 66 percent between 1969 and 2007 and 55 percent in the bottom fifth. It is true that rising work among married women has contributed to this income growth. However, median male earnings did not *fall* between 1969 and 2007, so it is not the case that married women in the middle class increasingly took jobs to prevent family income from falling.[4] Indeed, in industrialized nations around the world, women have become more interested in work for the fulfillment it provides, increasingly earning postsecondary degrees, delaying marriage, and delaying and reducing childbearing. Work has risen most among women with the best-educated husbands, not among wives of lower-skilled men, who are likely to have more employment problems and lower wages.[5] The decisions of married women to work have become less sensitive to husband's earnings over time, not more.[6] While the hours

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[2] See the appendix for methodological details.

[3] David H. Autor, Lawrence F. Katz, and Melissa S. Kearney (2008). "Trends in U.S. Wage Inequality: Revising the Revisionists." *Review of Economics and Statistics* 90(2): 300-323. Jonathan Heathcote, Fabrizio Perri, and Gianluca Violante (2010). "Unequal We Stand: An Empirical Analysis of Economic Inequality in the United States, 1967-2006." *Review of Economic Dynamics* 13(1):15-51. Christopher Jencks, Ann Owens, Tracey Shollenberger, and Queenie Zhu (2010). "How Has Rising Economic Inequality Affected Children's Educational Outcomes?" Unpublished paper. Available at http://www.hks.harvard.edu/inequality/Seminar/Papers/Jencks11.pdf. Wojciech Kopczuk, Emmanuel Saez, and Jae Song (2010). "Earnings Inequality and Mobility in the United States: Evidence from Social Security Data Since 1937." *Quarterly Journal of Economics* 125(1): 91-128. Rebecca M. Blank (2011). *Changing Inequality* (Berkeley: University of California Press). Congressional Budget Office (2013). "The Distribution of Household Income and Federal Taxes, 2010." Available at http://www.cbo.gov/publication/44604.

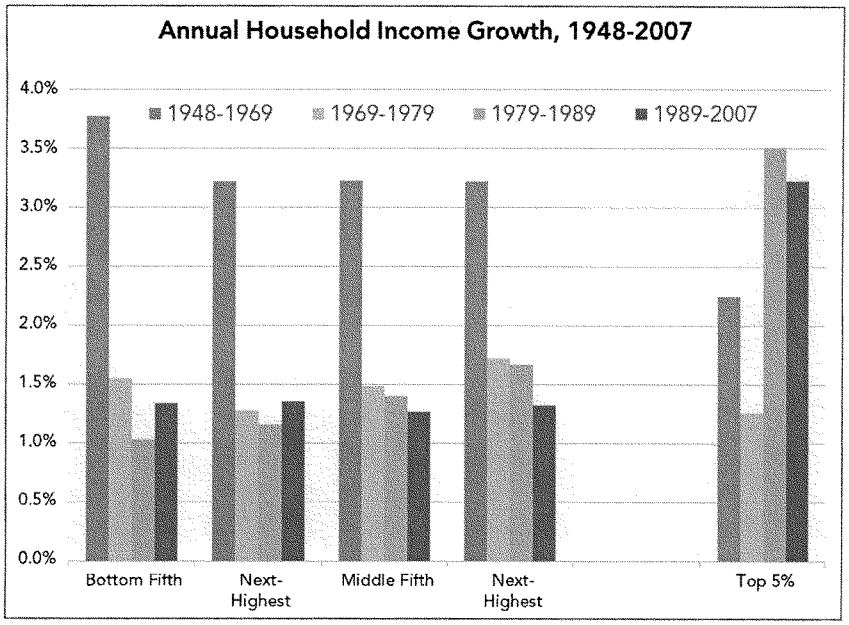
[4] Scott Winship (2013). "Men's Rising Earnings." (Washington, DC: The Brookings Institution). Available at http://www.brookings.edu/research/articles/2013/07/01-mens-rising-earnings.

[5] Ellen R. McGrattan and Richard Rogerson (2008). "Changes in the Distribution of Family Hours Worked Since 1950." *Frontiers of Family Economics* 1: 115-138.

[6] Francine D. Blau and Lawrence M. Kahn (2007). "Changes in the Labor Supply Behavior of Married Women: 1980-2000." *Journal of Labor Economics* 25: 393-438.

of married men have declined over the long run, those of single men have not, suggesting that husbands have become more economically comfortable, not less.[7]

Figure 1.



Note: For methodological details, see the appendix.

Even when it comes to income concentration at the top, there are good reasons to believe that the increase has been overstated, particularly since the 1980s. The oft-cited estimates of Saez and French economist Thomas Piketty indicate that the share of income received by the top one percent rose from

[7] John A. Knowles (2013). "Why Are Married Men Working So Much? An Aggregate Analysis of Intra-Household Bargaining and Labor Supply." *Review of Economic Studies* 80: 1055-1085.

10 percent to 24 percent between 1979 and 2007, reaching an all-time high (see Figure 2).[8] But there are several problems with those figures:[9]

- They look at incomes before taxes and do not include government transfers or employer-provided fringe benefits. CBO figures that remedy these issues indicate the top one percent's share grew from 9 percent in 1979 to 19 percent in 2007 before taking taxes into account and from 7 percent to 17 percent after taxes. From 2000 to 2010, it *fell* from 15 percent to 13 percent.[10]
- They exclude non-taxable capital gains (the vast majority of housing gains), exclude all capital gains until an asset is sold, and then include the lifetime gains from an asset in the year it is sold. The CBO figures share this problem. In 2007, 20 percent of realized capital gains were on assets that had been held for 20 years or more, 41 percent were on assets held for ten years or more, and 60 percent were on assets held for five years or more.[11] That means that often income from capital gains counted as being received in the previous year actually accrued year-to-year for decades. The Piketty/Saez estimates that do not include capital gains show an increase in the top share from 8 percent to 18 percent between 1979 and 2007.[12] CBO pretax estimates after excluding capital gains suggest an increase from 7 percent to 14 percent.[13]
- The estimated trends are affected by changes in the taxation of stock options and businesses incorporated under different parts of the code. These and other tax-code changes greatly complicate the measurement of top incomes. Earnings concentration figures from another paper coauthored by Saez avoid business incorporation issues but switch from households to

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[8] See the spreadsheet at http://elsa.berkeley.edu/~saez/TabFig2012prel.xls, tab "Table A3". These are updated figures from Thomas Piketty and Emmanuel Saez (2003). "Income Inequality in the United States, 1913-1998." *Quarterly Journal of Economics* 118(1): 1-39.

[9] For a good overview, see Alan Reynolds (2006). *Income and Wealth* (Westport, CT: Greenwood).

[10] See the "Supplementary Data" spreadsheet at http://www.cbo.gov/publication/44604, tab "3. Household Income". Note that the CBO estimates rank people on the basis of size-adjusted household income rather than ranking tax units on the basis of tax-unit income (as in the Piketty/Saez data). The rankings are also based on pretax income; ranking people on post-tax income might produce different post-tax estimates. On the 2000 to 2010 trend see Gary Burtless (2014). "Income Growth and Income Inequality: The Facts May Surprise You." Brookings Institution. Available at http://www.brookings.edu/research/opinions/2014/01/06-income-gains-and-inequality-burtless.

[11] Phillip Armour, Richard Burkhauser, and Jeff Larrimore (2013). "Levels and Trends in United States Income and Its Distribution: A Crosswalk from Market Income Towards a Comprehensive Haig-Simons Income Approach." Presentation at the Society of Government Economists Fall Meeting, November 6, 2013.

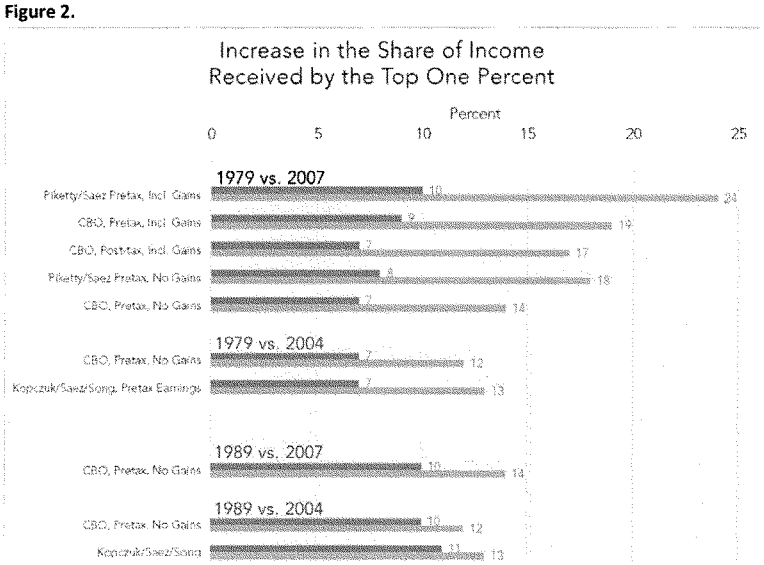
[12] See the spreadsheet at http://elsa.berkeley.edu/~saez/TabFig2012prel.xls, tab "Table A1".

[13] See the "Supplementary Data" spreadsheet at http://www.cbo.gov/publication/44604, tab "6. Income Source Before-Tax Inc". Note that the percentiles rank people on the basis of their income including capital gains, and I then subtract out the gains for the top one percent and bottom 99 percent. Estimates ranking people on the basis of their income excluding capital gains might produce somewhat different results but are unavailable.

individuals and are available only through 2004.[14] They show the top one percent's share rising from 7 percent to 13 percent from 1979 to 2004.[15] About one-third of this increase came between 1986 and 1988 in the wake of major tax reform legislation. That legislation resulted in more income from the exercise of stock options showing up on W-2 forms (and thus appearing in the Saez data).

- A recent paper by Cornell University economist Richard Burkhauser and two of his students, Phillip Armour and Jeff Larrimore attempted to address most of these problems—in particular the treatment of capital gains.[16] It found that the share of income received by the top five percent *fell* between 1989 and 2007. The CBO pretax estimates after excluding capital gains suggest an increase from just 10 percent to 14 percent over this period. Saez's estimates for earnings show an increase from 11 percent to 13 percent from 1989 to 2004.

Figure 2.



[14] Wojciech Kopczuk, Emmanuel Saez, and Jae Song (2007). "Uncovering the American Dream: Inequality and Mobility in Social Security Earnings Data Since 1937." National Bureau of Economic Research Working Paper 13345. Available at http://www.columbia.edu/~wk2110/bin/mobility-full.pdf.

[15] See data series at http://www.columbia.edu/~wk2110/uncovering/old/Figure2B-UpperEarningsShares.csv. The sample excludes most non-profit and government workers, workers with under roughly $2,500 in 2004 dollars, and workers younger than eighteen or older than seventy. It also excludes self-employment earnings.

[16] Phillip Armour, Richard V. Burkhauser, and Jeff Larrimore (2013). "Levels and Trends in United States Income and Its Distribution A Crosswalk from Market Income Towards a Comprehensive Haig-Simons Income Approach." National Bureau of Economic Research Working Paper 19110.

The case that any increase in the share of income received by the top has come at the expense of the middle class or the poor is weak.

The increase in income concentration at the top is regularly blamed for the slowdown in the incomes of the poor and middle class, but the case rests on fragile grounds. As Figure 1 shows, income growth began to slow in the 1970s, before the run-up in income concentration gathered steam. It did so around the industrialized world—the primary culprit was slower productivity growth. In the U.S., inequality between the poor, middle class, and rich fell during the 1970s, and the decade was not especially generous to the top. Since the 1970s, the incomes of Americans at the top and bottom of the ladder have risen and fallen together over time, and if the large losses experienced by the top during the Great Recession did not help the poor and middle class, it stands to reason that the large gains at the top during expansionary periods may not have hurt them.

A number of researchers have conducted naïve analyses purporting to show that absent rising inequality, the incomes of the poor and middle class would be thousands of dollars higher today. Even if we ignore the data problems noted above that likely overstate growth in income concentration, these analyses still must assume that the size of the economic pie would have grown the same amount (or more) in the absence of rising inequality. However, if, for instance, we had kept top marginal tax rates at their high 1970s levels, entrepreneurs might not have worked as hard, investors may not have taken as much risk, and the economy might have grown less than it did. The poor and middle class could have received bigger slices of a smaller pie.

For instance, CBO data indicate that the middle fifth's share of after-tax income fell from 16.5 percent in 1979 to 14.3 percent in 2007. The estimates suggest that if its share of after-tax income had stayed at the 1979 level and overall income growth had stayed the same, then middle-class households would have had an average income $9,000 higher in 2007 than what they actually received.

However, imagine that the rising inequality we experienced actually raised overall income growth. In that case, preventing inequality from rising would have lowered income growth correspondingly. If the increase in inequality between 1979 and 2007 expanded the size of the economic pie by 15 percent (0.5 percent per year), then holding the middle class at its 1979 share of income would have left it no better off than it actually was in 2007. The middle class's share of the economic pie would have been maintained, but the pie would have been smaller.

Is it credible to think that rising income concentration between 1979 and 2007 might have raised income growth by 15 percent? As a crude check, consider that the top one percent's after-tax income share in the CBO data rose from 7 percent to 11 percent from 1979 to 1989. Rough estimates from one study suggest that that four-point increase in the top's share, sustained for 18 years, raised gross domestic product by 9 percent in 2007.[17] The further increase in the top one percent's share from 11

[17] Dan Andrews, Christopher Jencks, and Andrew Leigh (2011). "Do Rising Top Incomes Lift All Boats?" *B.E. Journal of Economic Analysis & Policy* 11(1).

percent to 15 percent between 1989 and 2000 would have raised GDP by another 3 percent in 2007, bringing the total to 12 percent.

If the increase in the top one percent's share raised aggregate household income by 12 percent, then preventing that share from rising by leaving income shares at their 1979 levels would have left the middle fifth not $9,000 richer but $1,500 richer. However, preventing the top one percent's share from rising might not have left the middle fifth's share at its 1979 level; perhaps the middle fifth's share would still have fallen while households between them and the top one percent would have increased their share. If the middle fifth's share would have fallen from 16.5 percent in 1979 to just 16.1 percent in 2007, then combined with the smaller size of the economic pie, the middle fifth would have been no better off for having restrained the top one percent's share.

Perhaps rising inequality increased aggregate incomes by less than 12 percent between 1979 and 2007. If rising inequality raised aggregate household income by 8 percent instead, then the middle class would have been no better off restraining the top one percent's share if their own share had fallen from 16.5 percent to just 15.5 percent.

These back-of-the-envelope calculations demonstrate how rising income concentration might not have hurt income growth at the bottom or in the middle if it increased the size of the economic pie enough. It is true that not all research finds that inequality increases economic growth. But contrary to many assertions, the academic literature offers little support for the idea that inequality *harms* growth. The most-cited study, by International Monetary Fund economists, finds slower recovery from economic downturns in countries with high inequality levels, but its boosters generally fail to note that only developing nations are examined.[18] In recent years, no fewer than three reports from the liberal Center for American Progress concede that the evidence fails to show an inequality-growth connection.[19]

Of course, if income concentration rises and growth does not, that means that the incomes of the poor and middle class will be lower than they would have been in the absence of rising inequality. I am aware of only one paper that directly examines whether inequality affects income growth lower down. Cross-national comparisons by sociologist Lane Kenworthy indicate that countries with a larger increase in the top one percent's share of income have median income gains no lower than countries where the top's

[18] Andrew G. Berg and Jonathan D. Ostry (2011). "Inequality and Unsustainable Growth: Two Sides of the Same Coin?" International Monetary Fund Discussion Note. Available at http://www.imf.org/external/pubs/ft/sdn/2011/sdn1108.pdf.

[19] Heather Boushey and Adam Hersh (2012). "The American Middle Class, Income Inequality, and the Strength of Our Economy: New Evidence in Economics." Available at http://www.americanprogress.org/issues/economy/report/2012/05/17/11628/the-american-middle-class-income-inequality-and-the-strength-of-our-economy/. Jared Bernstein (2013). "The Impact of Inequality on Growth". Available at http://www.americanprogress.org/issues/economy/report/2013/12/04/72062/the-impact-of-inequality-on-growth/. David R. Howell (2013). "The Great Laissez-Faire Experiment: American Inequality and Growth from an International Perspective." Available at http://www.americanprogress.org/issues/economy/report/2013/12/04/80408/the-great-laissez-faire-experiment/.

gains are smaller.[20] This finding is consistent with the premise that economic growth has benefitted from rising inequality in the way I have outlined above, leaving poor and middle class households with a smaller share of a bigger economic pie and no worse off for it.

The case that any increase in income inequality has reduced equality of opportunity is weak.

A running theme of President Obama's administration over the past two years has been the deep connection between income inequality and inequality of opportunity. This theme taps into an intuition captured by the evocative but ultimately misleading metaphor suggesting that if the rungs of the economic ladder grow further apart it becomes more difficult to climb. In truth, how unequal the rewards are to different economic destinations and how unequal are the chances to reach those destinations comprise two distinct features of a nation's political economy. High income inequality is compatible with both high and low inequality of opportunity. Whether rising income inequality affects inequality of opportunity is an empirical question that hinges on the relationship of parental income to child outcomes and on how the incomes of rich, middle class, and poor parents change over time.

As I have already summarized, one reason why rising income inequality might not have diminished equality of opportunity is that the former has not grown much across the broad swath of poor and middle class families. And even if income concentration at the top has increased, there is another empirical result that casts severe doubt on claims that this type of inequality has reduced opportunity: intergenerational mobility has probably not declined much—if at all—in the past three decades.

The academic literature on intergenerational income mobility fails to reach consensus regarding trends. No research shows a sizable increase in mobility since the mid-twentieth century, but the most common finding is a change so modest as to be statistically indistinguishable from no change at all.[21] This

[20] Lane Kenworthy (2013). "Has Rising Inequality Reduced Middle-Class Income Growth?" in *Income Inequality: Economic Disparities and the Middle Class in Affluent Countries*, edited by Janet C. Gornick and Markus Jäntti. Stanford University Press. Available at http://www.u.arizona.edu/~lkenwor/2013hasrisinginequalityreduced.pdf.

[21] Robert T. Reville (1996). "Two Essays on Intergenerational Earnings and Wage Mobility." Doctoral Dissertation, Brown University.; Mary Corcoran (2001). "Mobility, Persistence, and the Consequences of Poverty for Children: Child and Adult Outcomes." In Sheldon H. Danziger and Robert H. Haveman, eds. *Understanding Poverty* (New York and Cambridge, MA: Russell Sage Foundation and Harvard University Press).; David I. Levine and Bhashkar Mazumder (2002). "Choosing the Right Parents: Changes in the Intergenerational Transmission of Inequality—Between 1980 and the Early 1990s." Federal Reserve Bank of Chicago Working Paper 2002-08. Available at http://www.chicagofed.org/digital_assets/publications/working_papers/2002/wp2002-08.pdf.; Angela R. Fertig (2003). "Trends in Intergenerational Earnings Mobility in the United States." *Journal of Income Distribution* 12: 108-130.; Yunju Nam (2004). "Is America Becoming More Equal for Children? Changes in the Intergenerational Transmission of Low- and High-Income Status." *Social Science Research* 33: 187-205.; Susan E. Mayer and Leonard M. Lopoo (2005). "Has the Intergenerational Transmission of Economic Status Changed?" *Journal of Human Resources* 40(1): 169-185.; David J. Harding, Christopher Jencks, Leonard M. Lopoo, and Susan E. Mayer (2005). "The Changing Effect of Family Background on the Incomes of American Adults." In Samuel Bowles, Herbert Gintis, and Melissa Osbourne Groves, eds. *Unequal Chances: Family Background and Economic Success* (New York and Princeton, NJ: Russell Sage Foundation and Princeton University Press).; Tom Hertz (2007). "Trends in the

tendency is all the more striking because the vast majority of these studies use a mobility measure that mechanically declines if income inequality accelerates, even if the relationship between child and parent income *rankings* stays constant. In my own forthcoming research, I find that today's thirty year olds—who experienced rising income inequality between the middle class and poor during early childhood and have witnessed rising income concentration at the top through their entire lives—have experienced no less mobility than did thirty year olds in the mid-1970s.

Faced with such an unsupportive research base, some proponents of the view that inequality has hurt mobility have turned to cross-national evidence, a line of argument that culminated in the Obama Administration's popularization of the "Great Gatsby Curve".[22] This chart, showing a strong statistical relationship between countries' inequality levels and the extent of mobility their citizens enjoy, has been used to project that today's children will experience less mobility than earlier generations.

However, the nations in the Gatsby chart differ in myriad ways that could be driving the inequality-mobility link. Kenworthy noted that Scandinavian countries have low inequality and high mobility but also distinctive education policies; it could be that these policies produce high mobility and that the low inequality levels are incidental.[23] Perhaps nations' cultures determine both how strongly they combat unequal opportunity and how unequal they are willing to let adult incomes become. In this scenario, the Great Gatsby Curve primarily might reflect deep-seated preferences for more or less state intervention, with inequality per se having no causal impact on mobility. My colleague Jim Manzi even found that the relationship between a country's population size and its mobility was as strong as the inequality-mobility correlation.[24]

The relationship between inequality and mobility across countries also fails to recur looking across labor markets in the United States. Income concentration at the top does not predict lower mobility across

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Intergenerational Elasticity of Family Income in the United States." *Industrial Relations* 46(1): 22-50.; Chul-In Lee and Gary Solon (2009). "Trends in Intergenerational Income Mobility." *Review of Economics and Statistics* 91(4): 766-772; and Deirdre Bloome and Bruce Western (2011). "Cohort Change and Racial Differences in Educational and Income Mobility." *Social Forces* 90(2): 375-395.

[22] Alan B. Krueger (2012). "The Rise and Consequences of Inequality in the United States," Remarks at the Center for American Progress, January 12, 2012. Available at http://www.americanprogress.org/wp-content/uploads/events/2012/01/pdf/krueger.pdf.

[23] Lane Kenworthy (2012). "Inequality, mobility, opportunity." Blog post available at http://lanekenworthy.net/2012/01/31/inequality-mobility-opportunity/.

[24] Jim Manzi (2012). "The Great Gatsby, Moby Dick, and Omitted Variable Bias." National Review Online blog post available at http://www.nationalreview.com/corner/290053/great-gatsby-moby-dick-and-omitted-variable-bias-jim-manzi.

over 700 local labor markets, and inequality across the middle of a labor market's population has no relationship to mobility across the 100 largest metropolitan areas.[25]

Finally, it is worth emphasizing that the Great Gatsby Curve uses the conventional measure of mobility that mechanically indicates lower mobility when the growth in income inequality is greater. If nations with high inequality have experienced high *growth* in inequality, they will mathematically have lower mobility than other nations even if the relationship between parental income ranking and child income ranking is the same across countries. In other words, a relationship between inequality and mobility is to some extent baked into the Great Gatsby Curve. Recent research indicates that when mobility is measured using an indicator that focuses solely on parent and child income *rankings*, Sweden and the United States have the same mobility levels.[26] These two countries had the lowest and highest levels of inequality, respectively, in the Great Gatsby Curve. The implication is that there may be no cross-national relationship between inequality and mobility when the relationship is not baked into the mobility measure itself.

While rising income inequality has not hurt opportunity, and opportunity has not grown more unequal, upward mobility remains far too limited.

Income inequality has become a convenient bogeyman for a host of economic problems that are real and that demand our attention. Promoting economic growth and reducing joblessness should be at the top of our list of immediate priorities, goals that are not effectively advanced in Washington (or New York) by decrying inequality levels.

Equally important over the long run is ensuring the vitality of the American Dream. A divisive populism that casts income inequality as the source of all our problems may make for effective politics, but it will not show the way toward expanded opportunity for children facing long odds of economic success. Upward mobility has not diminished over time, but for decades it has been stuck at unacceptably low levels. If past patterns hold, 70 percent of poor children today will fail to make it to the middle class as adults. Four in ten will be mired in poverty themselves in midlife.[27]

The fact that mobility is no worse than in the past—perhaps even no worse than in Sweden—is hardly reason to shrug it off. These are not the kind of odds those of us solidly in the middle class would accept for our children. Kids do not pick their parents, childhood communities, genes, or schools, and they do not choose the time and place into which they are born. The American Dream is in poor health if

[25] Scott Winship and Donald Schneider (2013). "The Great Gatsby Curve Revisited, Part 1: Does More Inequality Correspond with Less Economic Mobility Across Local Job Markets?" Manhattan Institute. Available at http://www.economics21.org/commentary/great-gastby-curve-revisited-part-1.

[26] Miles Corak, Matthew J. Lindquist, and Bhashkar Mazumder (2013). "A Comparison of Upward and Downward Intergenerational Mobility in Canada, Sweden, and the United States." Working paper.

[27] Pew Economic Mobility Project (2012). "Pursuing the American Dream: Economic Mobility Across Generations." Available at http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pursuing_American_Dream.pdf.

children who grow up in the bottom can aspire only to fill the same sorts of jobs as their parents hold, even if they will be better paid in those jobs.

The challenge is to identify real solutions to the problem of limited upward mobility. Democrats look skeptically when Republicans express interest in mobility. Ultimately, Republicans will and should be judged on deeds and not words. Expanded opportunity cannot be done on the cheap. However, by framing our mobility challenge as primarily a problem of income inequality, Democrats evade hard policy realities. Immobility is not primarily a problem of some parents having more money than others. For that matter, policies to invest in the human capital of children and to promote opportunity-enhancing behaviors among disadvantaged parents and children have a lousy track record. It will be hard work *discovering* how to expand upward mobility. The task is not well served by pretending that income redistribution would solve our problems.

Appendix: Methodological Details for Figure 1

For income growth between 1948 and 1969 for the bottom 80 percent, estimates come from Economic Policy Institute tabulations of data from the Census Bureau's Current Population Survey. The figures indicate annual change in the family income of families (rather than the family income of individuals). Household income data only go back to 1967, and while family income growth was probably stronger than household income growth from 1948 to 1969, using the former as a proxy for the latter is unlikely to distort the basic trend. "Income" includes cash transfer income from federal programs (such as Social Security, Unemployment Insurance, Supplemental Security Income, and Temporary Assistance for Needy Families) but does not include non-cash benefits from employers or government (such as health insurance, food stamps, or housing subsidies). These sources of income were relatively unimportant prior to the 1970s; Medicare and Medicaid were enacted in 1965 and the food stamp program expanded nationally only in the early 1970s. Incomes are measured before taxes. See Economic Policy Institute (2012). "Mean family income, by income group" [data table]. *The State of Working America*. Washington, D.C.: Economic Policy Institute. http://www.epi.org/files/2012/data-swa/income-data/Mean%20family%20income,%20by%20income%20group.xlsx.

For income growth within the bottom 80 percent between 1969 and 2007, the estimates are my own, using the Current Population Survey microdata. I show changes in the household income of households (rather than the family income of families or the household income of individuals). Since households became smaller over time as marriage and fertility declined and more people chose to live independently, I adjust income for household size. From 1979 forward it is possible to make other improvements. I add to income noncash federal benefits such as food stamps, Medicaid, and Medicare, and employer-sponsored health benefits. Because there are two different ways of valuing Medicaid and Medicare, which produce very different growth estimates for the bottom fifth, I average across the two approaches for each year before computing income growth. I also use estimates in the CPS data to

account for federal and state income taxes (before credits, except that the Earned Income Tax Credit is included in 1989 and 2007), payroll taxes, and property taxes. As with the EPI estimates, capital gains are excluded from these figures. Following the Congressional Budget Office, I also drop households with negative incomes, because such households experienced business or investment losses and are likely to have considerable wealth from which to draw down. Some households with business losses that left them with low but non-negative incomes remain in the data.

The Current Population Survey cannot be used to validly produce estimates of income growth for the richest Americans, so for estimates of top-five-percent income growth across the entire 1948-to-2007 period, the figures of Thomas Piketty and Emmanuel Saez are used. These estimates indicate the change in the mean income of "tax units" (essentially, tax returns, after accounting for a small number of non-filers) rather than of families, households, or individuals. Income is measured before taxes are deducted, and no government or employer benefits are included. See Thomas Piketty and Emmanuel Saez (2007). "Income and Wage Inequality in the United States, 1913-2002." In A.B. Atkinson and Thomas Piketty, eds., *Top Incomes Over the Twentieth Century: A Contrast Between European and English-Speaking Countries* (Oxford: Oxford University Press). Updated figures at http://elsa.berkeley.edu/~saez/TabFig2012prel.xls. The figures cited here are from their series that excludes capital gains, for consistency with the other data sources in the chart.

All income figures were adjusted back to nominal dollars and then inflated using the Bureau of Economic Analysis Personal Consumption Expenditures deflator. Periods are chosen to begin and end with a business cycle peak to ensure comparability.

Testimony before the Joint Economic Committee

"Income Inequality in the United States"

January 15, 2014

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Associate Professor of Economics, University of Maryland
Research Associate, National Bureau of Economic Research

Chairman Brady, Vice Chair Klobuchar, and other distinguished members of the Joint Economic Committee, thank you for inviting me to participate in today's hearing, "Income Inequality in the United States." This is an issue on which I have focused my academic research over the past decade and also an area of focus for The Hamilton Project, which I currently direct. Following my oral testimony, I would be happy to take questions.

I. INTRODUCTION

As you are aware, as this is the topic of today's hearing, inequality has increased dramatically in the United States during recent decades. To frame this in a different way, in contrast to earlier periods in our nation's history, the economic growth experienced since 1975 has not translated into shared prosperity. Consider the period of national economic prosperity between 1947 and 1975. This was a period of strong economic growth in which the growth in family income was roughly the same across the income distribution -- families in the bottom 20 percent saw their income grow by 90 percent, as compared to 86 percent for families in the top five percent. In sharp contrast, between 1975 and 2010, income gains were vastly different across families at different points in the income distribution, with each higher income group witnessing a greater increase in family income. Families in the bottom 20 percent of the income distribution saw their income increase by a mere 3.7 percent while those in the top five percent saw an average income gain of 57 percent.[1]

The phenomenon of growing inequality is indeed real, but what does that mean and how should we approach this challenge? There are three main points I want to make about the high level of inequality we are experiencing today:

1. First, the trends in inequality we have witnessed over recent decades are largely the result of structural changes in the labor market that have favored the very highly skilled. There are growing gaps in wages and employment opportunities for those with at least a college education as compared to those without, and there is no reason to think that these labor market forces will be reversed any time soon. The Great Recession has exacerbated these issues, but the dominant forces were present long before the recession and they will remain even when the economy recovers.

2. Second, the growing levels of income inequality have translated into sizable gaps in educational achievement between the children of the rich and the poor. As the rich amass greater shares of the nation's wealth, the children of these families enjoy even greater advantages relative to their less economically advantaged peers. This has the potential to perpetuate societal divides and erode social mobility. We must meet these structural challenges with a concentrated effort to invest in future generations.

[1] *Source:* Russell Sage Foundation Chartbook of Social Inequality: http://www.russellsage.org/node/3430.

3. Third, income inequality has the potential to interact with poverty in ways that perpetuate disadvantage and exacerbate intergenerational transmission of poverty. If those at the bottom of the income distribution view middle class life as increasingly out of reach, they might forgo the mainstream climb to economic success, perpetuating the cycle of poverty and inequality.

I will now expand briefly on these three main points, all of which lead me to the conclusion that it is of the utmost urgency that we make the necessary investments so that all Americans have the skills and ability to compete in a global labor market. We must ensure that broad swaths of the population are not left behind but rather, can participate productively in the economy and be rewarded with genuine economic security.

II. INEQUALITY TRENDS AND THE RETURNS TO SKILL

For some decades now, the U.S. labor market has experienced increased demand for skilled workers. Since the late 1970s and early 1980s, the supply of highly-skilled workers has not kept pace with the rising demand for skilled workers, especially among men. The result has been a sharp rise in the inequality of wages.

Since the mid-1970s, those with the highest levels of education – more than 16 years – have seen their wages rise steadily. Those with exactly a college degree or some college have seen some improvement, but the increase in their wages has not kept up with those with more advanced education. High school graduates and those with less than a high school degree saw their real wages fall through the late 1970s and 1980s, but rebound a bit in the early 1990s. Their wages have remained fairly stagnant since then (see Autor, Katz, Kearney, 2008).

Furthermore, as previous Hamilton Project work has emphasized, if we consider that the labor force participation rate among less-educated men has fallen over the same time period, the economic position of the "median male" appears to have eroded by even more than a focus on wages implies.[2]

A second, related trend is what labor economists have referred to as a "polarization" of job opportunities in the United States (Autor, Katz, Kearney, 2008b). The U.S. labor market has witnessed expanding job opportunities in high-skill, high-wage occupations on the one end, and low-skill, low-wage occupations on the other. Employment prospects for middle-skill, white collar workers in white-collar occupations -- clerical, administrative, and sales occupations – have weakened, as have those for middle-skill, blue-collar jobs in production, craft, and operative occupations. These trends have led to declining earnings and declining labor force participation rates among individuals with less than a four-year education, in particular, men. Increasingly, individuals who previously worked in these fairly well-paying sectors are now working in low-paying service industries.

[2] http://www.hamiltonproject.org/papers/trends_reduced_earnings_for_men_in_america/

This employment polarization is widespread across industrialized economies. It is not a uniquely American phenomenon and has occurred in Europe to at least as large a degree (Goos, Manning, and Salomons, 2009; Autor, 2010.) This implies that there are global economic forces that have led to a restructuring of the labor market. It is important to acknowledge that while the large share of income accruing to the top one percent is striking, trends in inequality are not simply reflecting something peculiar at the very top of the distribution. The more relevant issue for public policy is the growing gap between those with high levels of skills and education and the rest of the population.

We need policies that focus on the disparities across education and skill groups and in particular, on ways to upgrade the earnings capacity of the majority of Americans, in particular those at risk of falling into an intergenerational trap of poverty. Ultimately, we need to equip our workforce with the skills that are demanded and rewarded in today's global economy.

III. INCOME GAP BETWEEN FAMILIES AT THE TOP AND THE BOTTOM OF THE INCOME DISTRIBUTION

This experience of rising income inequality has led to sizable income gaps in experience and achievement between children at the top and bottom of the income distribution. This class of highly-educated, high-income individuals are marrying one another, and showering advantages on their children. There is nothing alarming about that per se. The problem is that children born into the bottom half of the distribution are falling behind. As those near the bottom of the socio-economic distribution fall farther behind their more advantaged peers in terms of resources and opportunities, their chances of moving up on the socio-economic ladder are threatened. A recent Hamilton Project policy memo, "Thirteen Economic Facts about Social Mobility and Education," clearly highlights these trends in a very accessible way.

In terms of the specific issue of education gaps, we see that it appears early in life and persists through to differences in college completion rates. By age four, children in the highest income quintile score, on average, in the 69th percentile on tests of literacy and mathematics, compared to children in the lowest income quintile who score in the 34th and 32nd percentile, respectively (Waldfogel and Washbrook 2011).

Scholars and policy makers have increasingly come to appreciate the importance of both cognitive and non-cognitive skills (cf. Heckman, Stixrud, and Urzua, 2006) and that many of these skills are developed early in life. This has led to an emphasis on early childhood interventions. When we talk about early childhood environments, we need to think about both preschools and home environments. Numerous studies have shown that higher-educated, higher-income parents spend more time with their kids, and more time in educational activities in particular (e.g., Guryan, Hurst and Kearney, 2008; Kalil, Ryan and Corey, 2012).

It is also important to note that these income gaps in educational performance have grown over time. Trends in student achievement – as measured by math and reading test scores – reveal that while the racial gap has declined significantly over time, gaps between low and high-income students have increased (Reardon, 2011).

Importantly, this growing gap does not appear to be attributable to widening inequality itself. Rather, the data indicate that the increase in the income gap is driven by the increased attainment of families above the median income level (Reardon, 2011). And by the time these students reach college, many from low-income and disadvantaged backgrounds just don't have what it takes to persist and graduate from college. Work by Bailey and Dynarski (2011) documents a growing income-based gap in college completion.

To be clear, this growing gap in educational performance is not a result of eroding support for public education. In fact, recent empirical evidence finds that the opposite occurs. Various researchers have shown that in areas with greater levels of local income inequality, public school spending increases (Boustan et al., 2012; Corcoran and Evans, 2012; Gordon 2013).

Rather, this is about diverging attainment largely driven by the kids at the top of the income distribution benefiting from numerous advantages that are simply increasingly out of reach for those from the middle and the bottom. Princeton Sociologist Sara McLanahan has called attention to the "diverging destinies" of children from low-income, often single-parent homes, and their more economically advantaged peers. Research has shown that the divide in marriage rates between those of lower and higher economic classes has amplified the disparities for children. Poor children are much less likely to have access to the incomes, family and friendship networks, and time investments from two stably married parents than their rich parents, and this perpetuates their heightened likelihood of ending up poor (McLanahan, 2004).

Whereas children who were born to the most-educated women are gaining resources, in terms of parents' time and money, those who were born to the least-educated women are losing resources. This is largely driven by the divergence in the rates at which these women are having marital versus non-marital births. The rise in non-marital birth rates cannot be ignored. Study after study has shown that children born into two-parent families have tremendous benefits. One especially stark difference is in rates of poverty. Census data show that the rates of poverty are five times as high among children headed by a single female head of household (31 percent), as compared to children living in married-couple families (6.3 percent) (DeNavas-Walt, Proctor, and Smith 2013).

Furthermore, differences in family structure exacerbate income inequality. More educated, higher-income couples have much higher rates of marriage and lower rates of divorce. The Pew Research Center finds that in 2010, nearly two-thirds of Americans with college degrees were married, and only 47 percent of those with a high school degree or less were married. In the 1960s, the odds of being married were just about equally likely across the education distribution at around 70 percent (Cohn et al., 2011).

On this issue of family structure, we see the feedback effect from declining economic opportunities, in particular for men. A decrease in the economic prosperity of men lead to lower rates of marriage among disadvantaged populations (Wilson, 1987). This further hinders the well-being of children in low-income families. The dissolution of the family is appropriately considered a marker of social and economic problems, as opposed to the cause.

IV. INTERACTION OF INCOME INEQUALITY AND POVERTY

The above section focused on the fact that families are diverging in ways that leave kids in the bottom half of the income distribution at a clear and distinct disadvantage.

A separate question is whether income inequality itself affects the economic decisions and outcomes for those near the bottom of the income distribution. To be clear, this is not about income gaps, but about how being poor could actually be worse if one lives in a more unequal place, say, by increasing rates of social and economic isolation. The question is whether the behaviors and outcomes of economically disadvantaged individuals are different based on the level of inequality.

There is a recent body of evidence about the interaction effects between being poor and living in a more unequal place, where inequality appears to negatively affect those who are near the bottom of the distribution. It means as bad as it is to be poor, it is even worse to be poor in a more unequal place. My coauthor Phil Levine and I have been investigating this question for the past few years and have come to some striking conclusions (Kearney and Levine, 2013a and 2013b). Plenty of previous work has documented that correlations showing that places that are more unequal tend to have worse social outcomes, such as higher rates of teen childbearing and lower rates of high school completion. But it is crucial to figure out whether income inequality is actually *causing* these worse social outcomes. Our research suggests that when it comes to two important issues – educational attainment and young, non-marital childbearing -- it does.

We find that economically disadvantaged youth – both males and females – are more likely to drop out of high school if they live in a place where lower-tail income inequality is greater. This means that when the gap between the bottom of the income distribution (as captured by the 10th percentile) and the median is wider, economically disadvantaged youth are more likely to drop out of high school. In a related study, we find strikingly similar results showing that economically disadvantaged girls and young women are substantially more likely to become unmarried mothers if they live in a place where lower-tail income inequality is greater.

These findings are consistent with the view that economic despair or economic marginalization can lead individuals to simply drop out of the mainstream climb to economic success. Simply put, these individuals do not see promising opportunities, and so they essentially give up. We cannot let this happen. This will lead us to an extremely unproductive cycle of the intergenerational transmission of poverty.

Rates of social mobility have, to date, remained fairly constant in the United States. Given labor market and demographic trends, this is a relief. But, as usual, the devil is in the details and rates of social mobility vary tremendously across the United States. A fascinating new study (Chetty, Hendren, Kline, and Saez, 2013.) shows that in that some cities – such as Salt Lake City and San Jose –rates of mobility are comparable to countries with the highest rates of relative mobility, such as Denmark. Other cities – such as Atlanta and Milwaukee – have lower rates of mobility than any developed country for which data are currently available.

These researchers document that differences across places in the level of upward mobility are not explained by differences in average income levels, economic growth rates, or the concentration of income in the top 1 percent. They also demonstrate that the differences across places is not directly due to race at the individual level: geography matters regardless of race.

Factors that do appear to be strong correlates of local area social mobility rates include levels of income inequality, measures of economic and racial residential segregation, K-12 student test scores and high school dropout rates, social capital indices, and rates of single parenthood. Areas with a smaller middle class and areas with sizable residential segregation by income class have lower rates of upward mobility. Areas with higher rates of social mobility tend to be characterized by higher student test scores (controlling for income levels), lower dropout rates, and higher spending per student in schools. The authors highlight that two of the strongest correlates of mobility rates are the fraction of religious individuals (a positive relationship) and the share of children raised by single parents (a negative relationship). These correlations are fascinating, but the research is not yet at the point of being able to identify the actual causes of social mobility. This is a crucial area for research going forward.

The bottom line is that inequality exacerbates the economic marginalization that comes with being poor. This has important implications for social mobility and potentially for understanding variation in social mobility across places in the United States. We see that places with high levels of income inequality and income segregation have lower rates of social mobility. These areas of the United States should caution us about what will happen if we allow income inequality to continue on its current path, with all the social, economic, and cultural polarization that comes along with it. There is the real threat that low rates of social mobility will become the norm in the United States. We will become a nation where those who are born poor will find it increasingly difficult to engage productively in mainstream economic life, and so they will remain poor, and their children will remain poor. This flies into the face of the American Dream and a nation built on the promise that you can move up the income distribution through hard work and ingenuity.

V. CONCLUSION

In summary, trends in income inequality have been largely driven by structural labor market trends that have favored the highly skilled and highly educated in terms of both higher wages and increased job opportunities. Those with less than a college degree have really seen their job opportunities erode, and their wages remain stagnant. Marriage patterns have amplified these differences for family income, with the highly educated marrying each other, amassing income and wealth, and investing a great deal of financial and other resources into their children.

The worry is that without effective and targeted policies, the less-advantaged will fall behind and we will see a damaging feedback effect – with those born in the bottom of the income distribution increasingly stuck there, dropping out of the mainstream climb to educational and economic success.

There is no silver bullet for conquering the challenge of inequality in the United States, but we have many policy levers available to us and many possibilities for investing in our future generations. The fact that rates of social mobility have remained roughly constant in the face of these global labor market forces that have so disproportionately rewarded the highly educated is a testament to the effectiveness of policies that work against them.

- The Earned Income Tax Credit has been shown to be a very important program that has encouraged work among single mothers and led to long-term improvements in the well-being of families and children.

- SNAP (the food stamp program) is the quintessential safety net program and has proven to be responsive to weak economic conditions in exactly the way a true safety net program should be. Researchers have documented the long-term health and economic benefits of this program to low-income children and individuals (Almond, Hoynes, Schanzenbach, 2011; Hoynes, Schanzenbach, Almond, 2012). A recent Hamilton Project paper by Diane Whitmore Schanzenbach highlights opportunities to strengthen SNAP.

- Expanded access to higher education has been important to keep the supply of college educated workers from falling even further behind the demand, which has yielded large benefits to individuals and also kept the earnings inequality from rising by even more than it has. Again, The Hamilton Project has released a series of papers in the last six months offering policies for expanding college access and affordability that could be considered.

And we need to do more.

- We need effective intervention in early childhood, perhaps most importantly expanded access to high quality child care and preschool.

- We also need programs aimed at decreasing the prevalence of non-marital births and improving the home environment and parenting practices of poor families.

- We need to keep adolescents and older teens engaged in school. For the one-quarter of American youth inclined to drop out of high-school, we need to find ways to equip them with the skills necessary to become productive workers and citizens. We need to think seriously about a role for vocational training or employment apprenticeships.

In general, we must maintain and expand programs and policies that constitute investments in the health, education, and skills of individuals from broad swaths of the population. These types of investments are crucial if we are to remain a nation of shared prosperity where economic security is the reward for anyone who is willing to work hard and provided for those who are truly unable.

Thank you for the opportunity to testify. I would be happy to take questions at this time.

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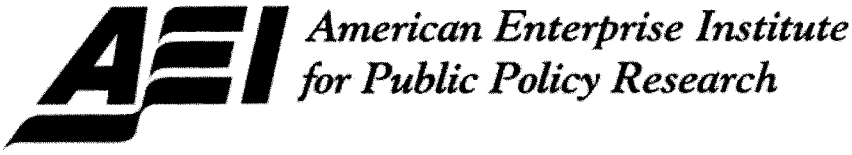

Statement Prepared for the Joint Economic Committee Hearing on

Income Inequality in the United States

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Thursday, January 16, 2014

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

I. Introduction

Simply defined, income inequality is the gap between the incomes or earnings of individuals at different levels of the income distribution. A typical way to measure income inequality is to first define how we measure income for a particular household, and then divide households into equal sized groups to compare households at the top of the distribution with households at the bottom or middle of the distribution. Several reports and papers in recent times have argued that there has been an increase in income inequality over the last two to three decades, while others counter that inequality is in fact narrowing by some measures. What is often lost in this back and forth is the focus on the poor, because a change in the income distribution across all households says little about how people are faring in absolute terms at the bottom of the distribution.

The first point made by this testimony is that the issue of income inequality is often complicated by the fact that different studies often provide vastly differing results on the magnitude of the problem since income is not consistently measured across these studies. Second, the testimony questions whether income is in fact the best way to measure increases in inequality. Most economists would agree that consumption is a better measure than income of household welfare since individuals are better able to smooth consumption over their lifetimes than incomes. This happens because while incomes may be low in the extremes of the age distribution and high in the prime working years, individuals can smooth consumption by borrowing in the low-income years and saving in the high-income years. In addition, many redistributive policies support consumption for low-income households and provide transfer payments to them. As a result, consumption is both a better predictor of lifetime or permanent incomes *and* reflects the impact of government transfer programs on household welfare.

While one can argue endlessly about the exact magnitude of the problem, the real issue is not whether the top of the income distribution has incomes that are ten times higher than the bottom, but whether low and middle income people in America are enjoying a decent standard of living. The unfortunate reality is that millions of people in America are living in poverty and facing the very harsh consequences of the worst recession in recent history. As per the latest report from the Census Bureau, 15 to 16 percent of the population can be defined as living in poverty in 2012. That translates to more than 47 million people.[1] We are now in the fifth year of an economic

[1] Current Population Reports, "The Research Supplemental Poverty Measure Nov, 2013. http://www.census.gov/prod/2013pubs/p60-247.pdf

recovery that does not seem like a recovery to most people in the labor market. There are 10.4 million unemployed workers, of which 3.9 million have been jobless for longer than 27 weeks.[2] In addition, there are another 10 million who are either in involuntary part-time jobs, or discouraged workers. Further, youth and teenage unemployment rates are above 16 percent. Therefore, the focus on income inequality is somewhat misplaced. Fundamentally, this is a problem of poverty.

When high rates of poverty exist in an economy with low economic mobility, the problem is exacerbated. The purpose of this testimony is to summarize some ideas that might help policymakers address the current economic crisis facing families and provide them opportunities to be productive participants in the labor market and rebuild their lives. This testimony however argues that while trying to equalize outcomes for families by attempting to equalize incomes may be an impossible goal, equalizing opportunities for individuals by providing access to good schools and good jobs may be more attainable and realistic.

In the next section, I describe the studies and data on income inequality trends. In Section III, I focus on consumption inequality. In section IV, I discuss economic mobility issues. Section V puts forth some policy suggestions and Section VI concludes.

II. Income Inequality Data and Research

In a recent December 2013 report, the Congressional Budget Office divided all U.S. households into five groups of equal size (quintiles), on the basis of their before-tax income.[3] The CBO definition of before-tax income is composed of labor income, business income, capital gains, capita income (excluding capital gains), income received in retirement for past services and other sources of income. It also includes government transfers to these households. Government transfers are cash payments and in-kind benefits from social insurance and other government assistance programs. As per this report, in 2010, households in the lowest quintile (bottom 20 percent) received 5.1 percent of all before-tax income, or about $24,100 per household. Those in the middle fifth received 14.2 percent or $65,400 per household. Households in the top quintile received 51.9 percent or about $239,100 per household. In other

[2] http://www.bls.gov/news.release/empsit.nr0.htm
[3] Congressional Budget Office, "The Distribution of Household Income and Federal Taxes, 2010." Dec, 2013. http://www.cbo.gov/sites/default/files/cbofiles/attachments/44604-AverageTaxRates.pdf

words, households in the top income quintile received an income share that was ten times that for the lower income quintiles.

The corresponding numbers for after-tax income are 6.2 percent for the bottom quintile, 15.4 percent for the middle quintile and 48.1 percent for the top quintile.

It is important to note that both the tax code and the transfer system work towards increasing the share of income earned by the lower income groups. As per the same CBO report, households in the lowest quintile received 36.2 percent of the total benefits from Social Security and Medicare (averaging $14,200 per household), households in the middle quintile received 16.7 percent of those benefits and those in the highest quintile received 11.4 percent of the benefits. Other transfers-including unemployment benefits, payments from Supplemental Nutrition Assistance Programs, and benefits from Medicaid and Children's Health Insurance Program-go even more disproportionately to households in the lower portion of the income distribution. Households in the bottom quintile received 47 percent of benefits from other transfers, households in the middle quintile received 13.3 percent of those benefits and those in the highest quintile received 6.2 percent.

The federal tax system is also progressive. Households in the top quintile paid 68.8 percent of all federal taxes, households in the middle quintile paid 9.1 percent and those in the bottom quintile paid 0.4 percent of federal taxes.

When we consider trends from 1979, households in the bottom quintile experienced an increase of 49 percent in real after-tax income between 1979 and 2010. After-tax incomes for the middle three quintiles in 2010 averaged 40 percent higher than in 1979. For the 81st to 99th percentile, the growth was 65 percent and for the top 1 percent, household income grew 201 percent above 1979 levels.

While the CBO data are reliable and unbiased, one question that plagues the research on income inequality is the lack of a common definition of income. A recent co-authored paper by economists Thomas Piketty and Emmanuel Saez (2013) finds trends similar to the CBO.[4] They claim that the share of income going to the top 1 percent of the population has more than doubled from 9 percent in 1976 to 20 percent in 2011. In other words, the top tail of the distribution now enjoys an ever-larger slice of the pie than it has historically done so. Piketty and Saez (2012,

[4] Facundo Alvaredo, Anthony B. Atkinson, Thomas Piketty, Emmanuel Saez. "The Top 1 Percent in International and Historical Perspective." NBER Working Paper No. 19075. May, 2013. http://www.nber.org/papers/w19075

2013) [5] use pre-tax pre-transfer income data from the tax records of filers and include realized capital gains. Thus, they fail to account for transfer payments like Social Security, Medicare, food stamps etc. In addition, it is also worth noting that by focusing on reported taxable incomes, their data are biased by the fact that taxable incomes respond to changes in tax rates.

Other economists however counter these results by using a different definition of income. In a 2013 paper, economists Philip Armour, Richard Burkhauser and Jeff Larrimore contend that by some measures, the growth in incomes at the top has been significantly lower than in incomes at the middle and bottom, such that the income share of the top quintile declined between 1989-2007 while the share of the bottom quintiles increased.[6] These economists argue that the true measure of income should focus on the Haig-Simons definition of income. In other words, we need to include accrued capital gains on which are defined as increases or decreases in the value of capital assets every year, irrespective of whether the capital gains are realized or not. Neither the Piketty and Saez paper, nor the CBO, include accrued capital gains though they do account for realized taxable capital gains.

In a recent paper, economist Greg Mankiw (2013) posits that perhaps inequality is not a problem as long as the compensation of the top 1 percent reflects their contribution to society—the "just deserts" principle.[7] If returns to high income individuals reflect largely their economic contributions to society, then taxing high incomes in a confiscatory fashion may be equally unjust.

Hence it would appear that after decades of research on income inequality, we are still unsure of the extent of income inequality, and even whether to view it as a problem, due to the lack of a consistent definition of what constitutes income and what that income represents.

I believe that the real focus of inequality research is not so much about whether the rich are doing better than the poor, but about how low income households are faring and have fared over the last few decades. In the next section, I discuss an alternative approach to measuring inequality that focuses on trends in consumption rather than income.

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[5] Emmanuel Saez and Thomas Piketty, "Striking it Richer: The Evolution of Top Incomes in the United States." 2012 http://elsa.berkeley.edu/~saez/saez-UStopincomes-2012.pdf

[6] Philip Armour, Richard V. Burkhauser, Jeff Larrimore. "Levels and Trends in United States Income and Its Distribution A Crosswalk from Market Income Towards a Comprehensive Haig-Simons Income Approach." NBER Working Paper No. 19110. June, 2013. http://www.nber.org/papers/w19110

[7] N. Gregory Mankiw, "Defending the One Percent. " 2013. http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.27.3.21

III. Consumption Inequality

One thing economists agree upon is that consumption is a better measure of well-being than income. What we buy and consume with our income directly adds to our utility and happiness, and also has a direct impact on our standard of living. Individuals are also better able to smooth consumption rather than income over their lifecycle. While a retired, older individual has low levels of current income, he can still enjoy a high standard of living due to lifetime savings and other forms of wealth. A student with low current incomes can borrow to finance education and household expenses in the hope of earning high incomes in the future from a relatively well-paying job. So one reason why income and consumption are de-linked is the possibility of borrowing and saving. In fact, it is probably rational to assume that at least some part of a poor or low-income family's consumption is being sustained by indebtedness. However, another reason for the mismatch between income and consumption is likely the tax and transfer system. Many redistributive policies support consumption for low income households and provide transfer payments to them. As we discussed previously, most studies of income inequality are unable to get at these transfer payments.

Consumption inequality has also been extensively studied in the literature, though perhaps not as much as income inequality. Results from these papers are also mixed. Krueger and Perri (2005) find that while income inequality increased during the period 1980-2003, consumption inequality did not.[8] However, Blundell and colleagues (2008) show that income and consumption inequality diverged between the 1970s and the 1990s.[9] Other papers find that income and consumption inequality have tracked each other closely since the 1980s.[10] In general, the data used in these studies comes from either the Consumer Expenditure Survey (CEX) or the Panel Study of Income Dynamics. There are two problems with using the CEX to measure consumption inequality, however: measurement errors and a lack of information on the

[8] Dirk Krueger, Fabrizio Perri. "Does Income Inequality Lead to Consumption Inequality? Evidence and Theory," Aug 2005. http://economics.sas.upenn.edu/~dkrueger/research/consinc.pdf

[9] Richard Blundell, Luigi Pistaferri, Ian Preston. "Consumption Inequality and Partial Insurance." American Economic Review 2008, 98:5, 1887–1921. http://www.ucl.ac.uk/~uctp39a/BBP%20AER.pdf

[10] Orazio Attanasio, Erik Hurst, Luigi Pistaferri. "The Evolution of Income, Consumption, and Leisure Inequality in The US, 1980-2010." NBER Working Paper No. 17982. Apr, 2012. http://www.nber.org/papers/w17982

consumption of durable goods. Several authors, including Attanasio et al (2012)[11] and Aguiar and Bils (2011)[12], have attempted to account for the measurement errors in this data, by using techniques that enable them to predict expenditures for the less well-measured items by using information on better-measured items. While we do not criticize or applaud their approach, it does imply that in order to get anything meaningful from the CEX data for measurement of inequality, authors need to rely heavily on modeling assumptions and non-standard approaches, as opposed to simply using the raw data.

Precisely for these reasons, in a study that I co-authored with Kevin Hassett, not only did we work with the CEX data but we also supplemented our analysis with the use of the Residential Energy Consumption Survey (RECS) data.[13] The CEX provides a good overview of nondurables' consumption by American households. In 1984, households in the top income quintile accounted for 37 percent of total expenditures, while households in the bottom quintile accounted for 10 percent. Hence the ratio of top to bottom consumption was 3.7. In 2010, that ratio increased to 4.4. The gap was widest in 2005 when the share of consumption for the top was 39 percent relative to 8 percent at the bottom. In the most recent recession, it appears that households at the bottom increased their share by 1 percentage point while the share at the top either declined or remained steady. In the 2001 recession, the ratio declined as well, suggesting that recessions work towards a more even distribution. On average, over the entire period, the ratio is 4.3 with a standard deviation of 0.22. Therefore, using this measure, we find that consumption inequality has increased only marginally over time.

If we compare these trends in consumption to trends in income using the Current Population Survey data, which is widely used for research on income inequality, we find that the story is strikingly different. As per our analysis, in 1984, pre-tax incomes at the top were more than 11 times incomes in the bottom quintile. In 2010, that ratio rose to 15.4. The average for the entire period is 13.5. Clearly, inequality using annual incomes is significantly higher than when we use consumption, and it has tended to widen over time.

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[11] Attanasio et al. "The Evolution of Income, Consumption, and Leisure Inequality in the US, 1980-2010." Apr, 2012.

[12] Mark A. Aguiar, Mark Bils. "Has Consumption Inequality Mirrored Income Inequality?" NBER Working Paper No. 16807. Feb, 2011. http://www.nber.org/papers/w16807

[13] Kevin A. Hassett and Aparna Mathur, "A New Measure of Consumption Inequality," AEI Economic Studies, June 2012

As mentioned earlier, the CEX is not a good source of data on durable goods consumption. Therefore, we worked with the RECS data as well. This survey has questions on household use of appliances such as microwaves, dishwashers, computers, printers and other data. What we find is that the access of low-income Americans – those earning less than $20,000 in real 2009 dollars – to these devices has increased. The percentage of low-income households with a computer rose to 47.7% from 19.8% in 2001. The percentage of low-income homes with six or more rooms (excluding bathrooms) rose to 30% from 21.9% over the same period. Similar increases can be documented for appliances like air-conditioners, dishwashers, microwaves, cell phones and other household items.

In general, we find that people at all income levels now have access to many more material possessions than they did in the 1980s. Moreover, there has been a narrowing of the gap between high and low income classes in terms of ownership of these items. It is hard to argue against the improvement in the standard of living that has accompanied these trends.

Hence, the standard narrative that rising income inequality has somehow hurt the middle and lower income classes is not supported by data. Policies aimed at redistributing incomes from the top to the lower income classes have certainly been responsible for part of this trend. However, we would caution against using this argument for raising marginal tax rates at the top to levels seen in the 1970s. In another co-authored piece,[14] my colleagues and I argue that the Diamond and Saez solution to inequality[15] —a marginal tax rate of 73 percent —is based on unrealistic assumptions relating to how individuals would respond to high tax rates. Their modeling of the optimal rate assumes a "more equality is better" social welfare function and assigns no social value to the marginal dollar of consumption for the rich. Most importantly, it ignores the long-run behavioral responses and consequences of having marginal tax rates that are over 50 percent. In the article, we show that while these assumptions work well in theoretical models that are aimed at catering to an audience of professional economists, these should not be used as the basis of real world public policy formulation.

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[14] Aparna Mathur, Michael R. Strain, Sita Nataraj Slavov. "Should the top marginal income tax rate be 73 percent?" Tax Notes. Nov, 2012. http://www.aei.org/article/economics/fiscal-policy/taxes/should-the-top-marginal-income-tax-rate-be-73-percent/

[15] Peter Diamond and Emmanuel Saez. "The Case for a Progressive Tax: From Basic Research to Policy Recommendations." *Journal of Economic Perspectives. Volume 25, Number 4. Fall 2011. Pages 165–190.* http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.25.4.165

Whether the explanation for improvement in living standards lies in redistribution policies and the growth of the safety net, or technological improvements that allowed prices of electronics and other durable goods to drop, or real improvements in productivity and wages, the bottom line is: people are better off today than they were twenty or thirty years ago. Households are consuming more and the typical low income household possesses many more appliances and gadgets that have traditionally been considered the preserve of the rich, than at any time in history.

Hence consumption data paint a strikingly different picture of household welfare than income inequality studies would suggest. Again, the studies in this section do not attempt to suggest that poverty does not exist-only that the magnitude of the problem may be overstated if we only focus on income data.

IV. Income Mobility

Another issue that frequently comes up in discussions relating to income inequality is income mobility. The idea is that the problems associated with income inequality may be partly offset if there is sufficient economic mobility. In a 2011 public opinion poll, the Pew Charitable Trusts found that 80 percent of Americans identified factors such as hard work, personal ambition and access to education as key drivers of upward mobility. However, most studies suggest that economic mobility i.e. the movement of individuals from lower to higher quintiles is fairly low.

Bradbury and Katz (2002) study transitions between income quintiles across successive one-decade intervals and find that a worker in the top or bottom 20 percent of the income distribution has a 50 percent chance of remaining in that quintile one decade later.[16] On the other hand, there is only a 3 percent chance somebody will move from the bottom to the top or from the top to the bottom. In contrast, they find a large amount of churning among the middle three quintiles, which is to be expected given the year-to-year volatility in earnings. Gottschalk and Danziger (1997) find similar results looking at two-decade spans.[17] They also find no upward trend in

[16] Katharine Bradbury and Jane Katz, "Are lifetime incomes growing more unequal? Looking at new evidence on family income mobility." 2002. http://www.bostonfed.org/economic/nerr/rr2002/q4/issues.pdf

[17] Peter Gottschalk & Sheldon Danziger. "Family Income Mobility -- How Much Is There and Has It Changed?," Boston College Working Papers in Economics 398, Boston College Department of Economics, 1997. http://ideas.repec.org/p/boc/bocoec/398.html

mobility that would mitigate increased cross-sectional inequality. If anything, they find that mobility has decreased in the last 20 years.

Another interesting issue is that of intergenerational mobility. In a completely egalitarian society, one might expect there to be little connection between a parent's income and that of their children. On the other hand, if human capital is transmitted strongly from parents to their children, then income might be persistent across generations. The literature on income mobility generally cannot distinguish these effects. It can only quantify mobility across generations. Solon (1999)[18] and Bowles and Gintis (2002)[19] provide extensive reviews of the literature on intergenerational mobility. Hertz (2005) studies mobility among income quintiles across generations.[20] He confirms the results from Solon and Bowles and Gintis that the intergenerational correlation in income is approximately 0.4. Moreover, he finds that this result is largely driven by black families. In general, the literature suggests that a person who begins life with a low income is likely to stay that way, and this has changed little over the years.

More recent research for the Pew Foundation suggests that the truth is that 70 percent of Americans raised in the bottom two quintiles will never make it even to the middle quintile.[21] However, there are certain factors that do enable people at the bottom to be upwardly mobile. The first is human capital. College-graduates, dual-earner families and people who did not experience unemployment, were more likely to move up. In particular, 86 percent of college graduates, 84 percent of dual-earner families and 64 percent of people who were continuously employed left the bottom income quintile. By contrast, only 55 percent of non-college graduates, 49 percent of single earner families and 34 percent of people who experienced unemployment moved up from the bottom quintile.

Another important mobility factor highlighted by the study is higher savings, wealth and home equity. Those who left the bottom of the income ladder had six times higher median liquid savings, 8 times higher median wealth and 21 times higher median home equity than those who remained stuck at the bottom. This suggests that families with savings, for example, may be better able to make human capital investments that promote economic mobility, such as higher

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[18] Gary Solon, "Intergenerational mobility in the labor market," 1999. http://ideas.repec.org/h/eee/labchp/3-29.html
[19] Samuel Bowles and Herbert Gintis, "The Inheritance of Inequality," July 2012. http://www.umass.edu/preferen/gintis/intergen.pdf
[20] Tom Hertz, "Understanding Mobility in America," Apr 2006. http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.107.5196&rep=rep1&type=pdf
[21] The PEW Charitable Trusts. "Moving on up." Nov, 2013. http://www.pewstates.org/uploadedFiles/PCS/Content-Level_Pages/Reports/2013/Moving_On_Up.pdf

education or job training, and those experiencing income gains may have more flexibility to save and build wealth, which in turn can support economic security.

This is true across generations as well. Pew research also shows that parental savings can have a significant impact on upward mobility. The parents of those who moved up from the bottom quintile had almost doubled the median wealth of the parents of those who remained at the bottom.

Another factor highlighted by the Pew study is the importance of location.[22] In many American communities, families with relatively high incomes tend to live in more affluent neighborhoods while those with relatively low incomes tend to live in less affluent neighborhoods. Across America there is substantial variation in the degree to which the high and low income neighborhoods are segregated from each other. In the New York Metro area for example, there is a much higher degree of segregation resulting in concentrated pockets of wealth and poverty, relative to Bedford, Ma which has fewer neighborhoods of concentrated wealth or poverty. Between 1970 and 1990, there has been steady growth in the degree of neighborhood segregation in a majority of metropolitan areas. The Pew study finds that the more economically segregated a metro area is, the less economically mobile its residents are. This is a new finding in the area of economic mobility and this analysis is one of the first empirical tests of the theory that, in highly unequal areas, there is additional mechanism aside from family background or resources, by which economic advantage and disadvantage can be transmitted from parents to children, leading to lower overall levels of economic mobility. For example, Boston has lower economic segregation relative to other metro areas and higher economic mobility, while New York has high segregation and low mobility.

The findings of this research on economic mobility as well as our earlier discussion on income inequality have important policy implications, which we discuss in the next section.

V. Policy Suggestions

Rising income inequality has been attributed to a number of factors. In a recent review of the papers on this topic, Dew-Becker and Gordon (2008) ascribe a relatively small role to the decline

[22] The PEW Charitable Trusts. "Mobility and the Metropolis." Dec, 2013. http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Mobility-and-the-Metropolis.pdf

of unionization in the increase in inequality starting in the 1970s. This is particularly true for females.[23] They similarly ascribe a small role to trade and immigration. While minimum wages have often been offered as the single biggest explanation for rising inequality, the authors contend that this is unlikely to be true. While there is some correlation between the real minimum wages for women and income inequality for women, there is hardly any response in this inequality measure to an increase in the minimum wage over the period 1989 to 1997 and its subsequent decline in 2005. Further minimum wage changes are hard to disentangle from other institutional factors such as unionization.

The authors do find an important role for skill-biased technical change. In other words, the idea is that with the increasing use of computers and computing technologies in the workplace, there was an increasing wage premium associated with college graduates who were able to use these technologies easily. This widened income inequality starting in the 1980s (Claudia Goldin and Lawrence Katz, 2008) as the demand for skilled college graduates increased.[24] Therefore, one policy implication from this is that we need to invest more in college education, skills training and vocational programs for people who lack these skills and therefore are unable to find jobs.

Access to high quality education and schools is extremely important as an investment into children's futures. Poor quality schooling can limit an individual's earning ability.[25] Research by some economists has shown that the quality of local public education is improved in areas where there is more competition due to a large number of school districts or a greater availability of nonpublic education.

The labor market poses serious concerns about the future livelihoods of the millions of unemployed workers, particularly those who are long-term unemployed and those who are fresh out of college hoping to get their first job and pay off their student loans. One solution that is being proposed is the extension of unemployment benefits to the long-term unemployed. I believe that the unemployment benefit programs have to be supplemented by skills training and greater help with matching workers to jobs. It is simply not enough to keep extending benefits if

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[23] Robert Gordon and Ian Dew-Becker, "Controversies about the Rise of American Inequality: A Survey." April, 2008. http://www.nber.org/papers/w13982.pdf?new_window=1

[24] Claudia Goldin and Lawrence Katz, "The Future of Inequality: The Other Reason Education Matters So Much." 2008. http://ideas.repec.org/p/hrv/faseco/4341691.html

[25] Martin Feldstein, "Income Inequality and Poverty." Oct, 1998. http://www.nber.org/papers/w6770.pdf?new_window=1

at the end of the benefit period, the worker is still unemployed. The goal of any such program should be to train the worker to transition to a new job, rather than to simply provide cash benefits to allow them to meet their basic needs. For a worker who stays unemployed for more than 6 months, the likelihood of finding a job is extremely low and is unlikely to improve without active help. Towards this end, workers who have been long-term unemployed should be provided training and then placed in jobs through wage-subsidy programs that allow some share of the wages to be paid by the employer and the rest to be paid by the unemployment insurance program. This would allow employers to test and see if the match with the prospective employee is a good one, while at the same time it would allow workers to receive on the job training and gain experience with the likelihood that they will be able to keep the job.

Katz (1998) presents some evidence indicating that the Targeted Jobs Tax Credit, the major wage-subsidy program for the economically disadvantaged between 1979 and 1994, did boost employment of disadvantaged youths, and discusses evidence indicating positive and persistent program impacts from Jobs Training Partnership Act when the training was combined with job search assistance, especially for adult female welfare recipients.[26,27] This leads him to conclude that wage subsidies combined with training and job development assistance can help disadvantaged adults, but based on the evidence on stigma and low utilization, to express more skepticism (while still suggesting modest benefits) of other narrowly-targeted, stand-alone programs. Coupling such programs with training and job search assistance may reduce problems associated with stigma and hence increase the benefits of wage subsidies.

Another idea along the same lines is work-sharing.[28] Work sharing arrangements whereby workers continue to be employed for a few hours at their job while claiming unemployment benefits for the remaining hours could work as well.

Raising minimum wages is a particularly bad idea when we think of high youth and teenage unemployment rates.[29] Workers under age 25 make up half of those paid the federal minimum

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[26] Lawrence F. Katz, "Wage Subsidies for the Disadvantaged." NBER Working Paper No. 5679. July, 1996. http://www.nber.org/papers/w5679,

[27] Also see the Capitol Hill Times, "Wage subsidy outsmarts a $15 Minimum." Jan, 2014. http://www.capitolhilltimes.com/2014/01/wage-subsidy-outsmarts-15-minimum/

[28] http://www.edd.ca.gov/pdf_pub_ctr/de8714bb.pdf

[29] Further, there is substantial evidence to suggest that there are negative employment effects, particularly for low-skilled workers of raising minimum wages. A recent 2009 paper by David Neumark suggests that employers often take back the increases that come with higher minimum wages in future years by forgoing the usual nominal wage increases that would have happened.

wage (or less). Among employed teenagers paid by the hour, about 21 percent earned the minimum wage or less.[30] One option is encouraging vocational training and apprenticeship programs for youth, as happens in Germany. Neumark (2009) reviews different school-to work programs and finds that internship/apprenticeship programs encourage employment and also boost college attendance.[31]

Minimum wages are also not a tool to fight poverty. By some estimates, less than 25 percent of minimum wage workers live below the poverty line based on family cash income.[32] An alternative to the minimum wage is the Earned Income Tax Credit program. The EITC arguably is one of the federal government's most efficient means of encouraging work and fighting poverty. As per the Census Bureau, the EITC lifted 5.4 million people above the poverty line in 2010. The $60 billion program pays low-income workers a wage supplement in the form of a tax credit that can be worth more than $5000 a year to a family with two children. However, the EITC also has some significant disadvantages. One, the program is not particularly well run. As a new report by the IRS inspector general notes, at least one of every five EITC dollars in 2012 was improperly awarded. That's $11.6 billion. This does not account for those who got less than they were entitled to, or those who did not apply because they did not know that they were eligible for the EITC.[33] Another issue is that the phase-out range of the EITC imposes significant tax penalties on earners. However, it has been shown to encourage labor force participation for single mothers, and has proven to be an effective anti-poverty program.

VI. Conclusion

The purpose of this testimony is to highlight issue of income inequality. Economists have tended to measure income inequality in different ways leading to a mixed picture of what has been happening to the gap between the rich and the poor over the last couple of decades. A review of these papers finds that some authors contend that income inequality has grown, while others find that income inequality may in fact have narrowed down over time. Another set of

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[30] http://www.bls.gov/cps/minwage2012.htm

[31] David Neumark, 2009. "Alternative Labor Market Policies to Increase Economic Self-Sufficiency: Mandating Higher Wages, Subsidizing Employment, and Increasing Productivity," NBER Working Papers 14807, National Bureau of Economic Research, Inc. http://ideas.repec.org/p/nbr/nberwo/14807.html

[32] A back of the envelope calculation by my colleague Abby McCloskey suggests that raising the minimum wage would affect slightly less than 2 percent of the population in poverty.

[33] http://www.treasury.gov/tigta/press/press_tigta-2013-33.htm

papers has focused on consumption as a measure of economic well-being and documented trends in consumption inequality. These papers again yield differing conclusions about consumption for the rich has fared relative to consumption of the poor. My own research finds that consumption inequality has remained fairly constant over the last few decades. Further, it documents an increase in standards of living for people at the very bottom of the income distribution. These improvements in living standards are likely a consequence of the tax and transfer system, wherein low income households have been the beneficiaries of redistribution efforts. However, it is also a consequence of significant price declines in technology items like computers and printers, driven by market competition and research and development efforts.

Despite these improvements in living standards, it is well documented that more than 47 million people live in poverty today in America. Moreover, the recent recession has further caused a decline in employment rates and earning potential of families. Towards the end of this testimony, I provide some policy suggestions that might help alleviate some of these issues. The testimony argues that while minimum wages and unemployment benefits may be the preferred strategies currently employed by policy makers, these may not be the most effective means. Unemployment benefits combined with job and skills training programs as well as wage subsidies to get the long-term unemployed back in the labor market may be more efficient. At the same time, improving the targeting and efficiency of programs such as the EITC, which create the right incentives, in terms of encouraging work, may be extremely important as well. For youth, school-to-work programs that encourage apprenticeships and internships have been shown to be successful as well.

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