

## Testimony Before the Senate Budget Committee, February 9, 2012

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Thank you for the opportunity to testify today on the important issues of inequality, mobility, and opportunity. I want to note at the outset that while I am a Fellow at the Brookings Institution, my testimony today is solely on my own behalf. Brookings does not normally take policy positions as an institution.

The facts of income inequality and mobility are nonpartisan. They are incomplete and subject to revision. But in order to guide policy, facts must be as accurately understood and conveyed as possible. Doing so is often difficult not only because the world is complicated, but because new evidence routinely appears to muddy the picture we previously managed to discern.

The facts also leave room for interpretation as to how problematic they are, but often times neutral facts are asserted as problems. Other facts are wrongly thought to be problematic only if they exhibit deterioration. But for something to be a problem, it does not have to be getting worse. On the other hand, just because something claimed to be a problem is growing more common over time does not demonstrate that it is really a problem. With these considerations in mind, let me briefly summarize the facts around income mobility and inequality in the United States.

Broadly speaking, there are three ways to think about intergenerational income mobility.<sup>1</sup> We can ask whether members of one generation end up ranked similarly to the way their parents' income ranked *them*. If parents are in the bottom fifth of households, ranked by income, how likely is it that their children will also be in the bottom fifth when they are the same age? Note that the "bottom fifth" might be a better-off group in the future than it is today. Another way to assess mobility is to see whether children tend to end up better off than their parents in absolute terms—whether they have higher incomes than their parents (after taking into account increases in the cost of living), regardless of where they or their parents ranked against their peers. Households can experience upward mobility in this sense even if their rank is no higher than that of their parents. Finally, we can consider the extent of mobility by asking how far apart children end up given how far apart their parents were. If one parent has twice the income of another, by what factor will their children's incomes differ? This last way to approach the question of mobility combines concerns about rank and absolute income gains.

The extent of mobility—in any of these senses—may be assessed in three different ways. First, we can ask whether things have gotten worse. The Administration and others on the political left have argued that income mobility has diminished over time.<sup>2</sup> However, the evidence points to very small changes since the mid-twentieth century—small enough that we do not have the technical requisites to detect

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<sup>1</sup> For an earlier summary of economic mobility in America, see my essay, "Mobility Impaired," *National Review*, November 14, 2011 ([http://www.brookings.edu/articles/2011/1109\\_economic\\_mobility\\_winship.aspx#\\_ftn10](http://www.brookings.edu/articles/2011/1109_economic_mobility_winship.aspx#_ftn10)).

<sup>2</sup> See, for instance, President Obama's December 6, 2011 speech in Osawatomie, Kansas (<http://www.whitehouse.gov/the-press-office/2011/12/06/remarks-president-economy-osawatomie-kansas>).

them confidently or consistently.<sup>3</sup> My own estimates suggest that upward mobility from poverty to the middle class among today's late twentysomethings is about what it was for the previous generation. Roughly 50 to 55 percent of those who started out poor reached the middle class by age twenty-seven.<sup>4</sup> The exception to this pattern of minimal change in mobility is that upward mobility in the absolute sense of being better off than one's parents has risen. For instance, I estimate that 47 percent of late twentysomethings today have already outpaced the incomes their parents had when the kids were 15 years old. In the previous generation, just 41 percent did. In short, if the benchmark against which we judge our mobility is past levels, we do not appear to have much of a problem.

A second way to assess our current mobility levels is to compare ourselves with other nations. In the sense of how much parental income gaps translate into future child gaps, the U.S. tends to have less mobility than most European countries and other English-speaking nations. A comparison to Canada is illustrative. Consider a man who earns twice what his neighbor earns. In Canada, that man's son can be expected to earn 25 percent more than the neighbor's son. In the U.S., the figure is 60 percent.<sup>5</sup>

However, evidence on *earnings* mobility in the sense of where parents and children rank suggests that our uniqueness lies in how ineffective we are at lifting up men who were poor as children. In other words, we have no more downward mobility from the middle than other nations, no less upward mobility from the middle, and no less downward mobility from the top. Nor do we have less upward mobility from the bottom among women. Only in terms of low upward mobility from the bottom among men does the U.S. stand out.<sup>6</sup> This distinctive pattern presents complications for accounts that explain American immobility by pointing to our policies or our economic system. Further muddying the picture is the complete lack of evidence on cross-national differences in the extent to which children outpace parents in absolute terms.

As a third way of assessing the extent of mobility in America, we can use the criterion of former Supreme Court Justice Potter Stewart, who said of a very different sort of problem, "I know it when I see it." That is, apart from the question of whether things are getting worse or how we compare to other countries, we may just believe that there is not enough mobility. That is a difficult case to make if the

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<sup>3</sup> I summarize the evidence in my critique of the president's speech—see "The President's Suspect Statistics," National Review Online, January 2, 2012 (<http://www.nationalreview.com/articles/286874/president-s-suspect-statistics-scott-winship?pg=1>).

<sup>4</sup> The estimate depends on whether people who report household incomes less than or equal to \$0 are included. "Poor" in these analyses means being in the bottom tenth of incomes; "middle class" means an income of at least half the median. Parental income is assessed at age 14 to 16, and the incomes of adult children are assessed twelve years later, at ages 26 to 28.

<sup>5</sup> See Miles Corak (2010), "Chasing the Same Dream, Climbing Different Ladders," Pew Economic Mobility Project ([http://www.economicmobility.org/assets/pdfs/PEW\\_EMP\\_US-CANADA.pdf](http://www.economicmobility.org/assets/pdfs/PEW_EMP_US-CANADA.pdf)).

<sup>6</sup> See Markus Jantti et al. (2006), "American Exceptionalism in a New Light," Institute for the Study of Labor (IZA) Discussion Paper No. 1938 (<http://ftp.iza.org/dp1938.pdf>).

question is one of sufficient absolute mobility; eighty percent of forty-year-olds before the recession were better off than their parents were at the same age.<sup>7</sup>

However, the picture, I would argue, changes if we consider the sufficiency of upward mobility in terms of where one ranks. Research conducted by my Brookings colleagues, Julia Isaacs, Isabel Sawhill, and Ron Haskins for my former colleagues at the Pew Economic Mobility Project shows that a child starting out in the bottom fifth of incomes has only a one-in-three chance of being solidly middle class (escaping the bottom two-fifths) as an adult.<sup>8</sup> She has only a 17 percent chance of ending up in the upper middle class (the top two fifths). To be sure, even failure to reach the “middle” so defined may still translate into higher living standards than the middle enjoyed in the past if there is sufficient absolute mobility. But poor children face long odds and limited opportunity if they want to be able to “grow up to be whatever they want,” to use an expressed aspiration many of us, I suspect, heard from our parents.

What about income inequality? Many on the political left, including the president’s Council of Economic Advisors chair, have argued that rising inequality has hurt the middle class and poor.<sup>9</sup> The evidence of such an impact is exceedingly thin.<sup>10</sup> In part, that is because only one kind of inequality has risen markedly. Within “the 99 percent”, inequality has grown only modestly, if at all. According to research by Richard Burkhauser and his colleagues, after taking into account the value of employer-sponsored and federally provided health insurance, the person at the 90<sup>th</sup> percentile (richer than 90 percent of Americans) has about six times the household income of the person at the 10<sup>th</sup> percentile (poorer than 90 percent of Americans).<sup>11</sup> In concrete terms, it is roughly the difference between having \$80,000 and having \$12,000 to \$15,000. The six-to-one ratio held in the early 1990s, and it was probably not much lower in the mid-1980s. It is almost certainly the case that in the late 1960s the ratio was no lower than four, and it was probably closer to five.<sup>12</sup> Furthermore, these figures do not attempt to make adjustments for the research finding that the cost of living has risen less for the poor and middle class than for upper-income households, which would make the increase in “90/10” inequality even smaller.<sup>13</sup>

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<sup>7</sup> See Julia Isaacs, Isabel Sawhill, and Ron Haskins (2008), “Getting Ahead or Losing Ground,” Brookings Institution for the Pew Economic Mobility Project

([http://www.economicmobility.org/assets/pdfs/PEW\\_EMP\\_GETTING\\_AHEAD\\_FULL.pdf](http://www.economicmobility.org/assets/pdfs/PEW_EMP_GETTING_AHEAD_FULL.pdf)).

<sup>8</sup> Ibid.

<sup>9</sup> See Alan Krueger’s January 12, 2012 speech at the Center for American Progress

(<http://americanprogress.org/events/2012/01/pdf/krueger.pdf>).

<sup>10</sup> See my critique of Krueger’s claims—“Closing Arguments in the Great Gatsby Curve Wonk Fight of 2012,” originally published at Reihan Salam’s blog, The Agenda, on National Review Online’s website

([http://www.brookings.edu/opinions/2012/0120\\_mobility\\_winship.aspx](http://www.brookings.edu/opinions/2012/0120_mobility_winship.aspx)).

<sup>11</sup> These conclusions are based on two papers coauthored by Burkhauser, one with Kosali Simon (2010), “Measuring the Impact of Health Insurance on Levels and Trends in Inequality,” National Bureau of Economic Research Working Paper 15811 (<http://www.nber.org/papers/w15811>) and one with Shuaizang Feng and Stephen P. Jenkins (2009), “Using the P90/P10 Index to Measure U.S. Inequality Trends With Current Population Survey Data,” *Review of Income and Wealth* 55(1): 166-185.

<sup>12</sup> Ibid and Jencks et al. (2010), “How Has Rising Economic Inequality Affected Children’s Educational Outcomes?” Working Paper.

<sup>13</sup> Christian Broda and John Romalis (2009), “The Welfare Implications of Rising Price Dispersion,” Working Paper.

Unlike inequality within the 99 percent, inequality between the 99 percent and the top 1 percent has risen a lot (though not just in the United States).<sup>14</sup> The top 1 percent received 24 percent of all income in 2007 compared with 10 percent in 1980. But there is very little evidence to suggest that the gains at the top have come at the expense of other Americans. Income concentration at the top fell quite a bit between 2007 and 2009, dropping down to 18 percent of all income received, but that hardly translated into gains for everyone else.<sup>15</sup> Why should increases in income concentration necessarily translate into losses for everyone else? The size of the economic pie can grow in such a way that everyone gets a bigger slice despite the top getting a bigger share of the pie.

Consider that Mark Zuckerberg, founder of Facebook, stands to make five billion dollars cashing out stock options this year.<sup>16</sup> How would the typical American end up better off if the Facebook IPO were to fall through so that Zuckerberg could not exercise his options? Or if the IPO does go through, will the typical worker be better off in 2013, because Zuckerberg will not realize the windfall he did in 2012?

American inequality levels are viscerally bracing, but one still has to make the case that they are undesirable. Consider two men, one of whom makes over 200 times the other. Should we be concerned about the poorer man? What if I told you that the two men in this example are Zuckerberg and poor Mitt Romney (who made just \$22 million in 2010)?<sup>17</sup> Romney made over 400 times the typical American household in 2010.<sup>18</sup> Should we be concerned about that household?

What really matters is how the poor and middle class are doing and how much opportunity they have. Income growth has slowed, but research by Burkhauser and his colleagues and by Bruce Meyer and James Sullivan has shown that median household income still rose by as much as 35 or even 55 percent over the last 30 years.<sup>19</sup> There were even small gains during the “lost decade” of the 2000s, prior to the Great Recession. While the gains since 2000 have more or less evaporated, that the typical household is—at worst—at the same level as in the boom years of the late 1990s is disappointing but hardly alarming. Meyer and Sullivan’s research also shows that incomes at the bottom have increased robustly over the past 30 years, contrary to what official income trends show. By 2009, the household income at the 10th percentile—the household poorer than 90 percent of the others—was only about a third lower than that of the median household in 1980, after adjusting for inflation.

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<sup>14</sup> See the World Top Incomes Database at <http://g-mond.parisschoolofeconomics.eu/topincomes/>.

<sup>15</sup> See the data compiled by Stephen Kaplan, building on the work of Thomas Piketty and Emmanuel Saez, at <https://s3.amazonaws.com/s3.documentcloud.org/documents/274723/kaplan-full.pdf>.

<sup>16</sup> Richard Waters, “Facebook chief faces tax bill of \$1.5bn,” *Financial Times*, February 3, 2012 (<http://www.ft.com/cms/s/2/6dbffbcce-4e8b-11e1-ada2-00144feabdc0.html#axzz1lljnTCNl>).

<sup>17</sup> Richard Rubin and Jesse Drucker, “Romney’s 13.9% Tax Rate Shows Power of Investment Tax Preference,” Bloomberg, January 25, 2012 (<http://www.bloomberg.com/news/2012-01-24/romney-paid-13-9-percent-tax-rate-on-21-6-million-2010-income.html>).

<sup>18</sup> Median household income in 2010 was \$49,445. See [http://www.census.gov/newsroom/releases/archives/income\\_wealth/cb11-157.html](http://www.census.gov/newsroom/releases/archives/income_wealth/cb11-157.html).

<sup>19</sup> Burkhauser, Larrimore, and Simon (2011), “A ‘Second Opinion’ on the Health of the American Middle Class,” National Bureau of Economic Research Working Paper 17164 (<http://www.nber.org/papers/w17164>) and Meyer and Sullivan (2011), “The Material Well-Being of the Poor and the Middle Class Since 1980,” AEI Working Paper 2011-04 (<http://www.aei.org/files/2011/10/25/Material-Well-Being-Poor-Middle-Class.pdf>).

Just because living standards have improved does not mean that the lives of the poor are comfortable. Meyer and Sullivan find (roughly) that the household at the 10th percentile gets by on \$20,000 a year, or under \$1,700 a month. That is hardly luxurious. For a good working definition of “insecurity,” consider the one in five household heads who reported that sometime in 2010 they worried about whether they would run out of food before they could afford to buy more.<sup>20</sup> But if the circumstances of the poor are problematic that is because of poverty, not because of inequality.

The problem with most discussions of income mobility and inequality is that they do not distinguish between good and bad mobility or between good and bad inequality. A world of perfect mobility, as the researcher/writer Reihan Salam has noted, is “one in which no matter how hard you work to provide your children with every advantage in life, they’re just as likely to sink to the bottom of the heap as to rise to the top.”<sup>21</sup> No one should find that ideal attractive; some immobility reflects behaviors we want to encourage or discourage. Similarly, in a world of perfect equality, there would be no rewards for hard work or risk. That would cripple economic growth and hurt everyone.

The issue of economic growth points to the central importance of absolute mobility—of ensuring that children do at least as well as their parents, and ideally much better. Economic growth is the best antipoverty policy we have and the best path to a prosperous middle class, as evidenced by the broad gains of the postwar boom years, to say nothing of the late 1990s. High-end inequality was flat during the former period but rising during the latter.

In the short run, the hard reality is that American consumers are wary of spending, banks wary of lending, and businesses wary of hiring. With the bursting of the housing bubble, a significant minority of the population is in the red, and their weak position is inhibiting the national confidence we need to return to pre-recession growth levels. If we had weathered a normal recession, fiscal stimulus in the form of spending or tax cuts might have been sufficient to dig out of our hole. But recessions preceded by financial crises are different. The amount of stimulus it would take to swiftly restore growth is inconceivable given the historically high deficits we face.

Thankfully, we appear to be turning a corner, so the question increasingly appears to be how to speed up the recovery rather than how to avoid a double-dip recession. The way to do so, in my view, is to facilitate private efforts to put overleveraged homeowners back in the black. That would restore consumer demand, detoxify the problematic mortgage-backed assets lingering on the books of banks, and rejuvenate lending. Importantly, it could be done in a way that did not undermine personal responsibility on the part of borrowers.

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<sup>20</sup> Coleman-Jensen et al. (2011), “Statistical Supplement to Household Food Security in the United States in 2010,” United States Department of Agriculture Economic Research Service (<http://www.ers.usda.gov/Publications/AP/AP057/>).

<sup>21</sup> Reihan Salam, “Going Nowhere,” *The Daily*, November 29, 2011 (<http://www.thedaily.com/page/2011/11/29/112911-opinions-column-mobility-salam-1-2/>).

A second easy way to promote short-term growth is not to talk down the economy. Political scientist Dan Wood and his colleagues found that the degree of optimism or pessimism in presidential speeches between 1978 and 2002 had a detectable effect on consumers' sentiment about the economy and unemployment, which in turn affected economic growth.<sup>22</sup> I worry that the interest from one side in framing this year's presidential and senate campaigns around overdrawn themes of inequality and diminished opportunity for the middle class will affect perceptions of the economy's strength.

In the longer term, economic growth will require that we get projected deficits under control. That means containing the growth of entitlement spending, through policies like the Wyden-Ryan Medicare reform proposal. It also means policies to promote innovation, entrepreneurship, and international competitiveness.

For some, it may be tempting to focus policy solely on economic growth to the exclusion of addressing limited upward mobility in terms of rank. But keep in mind all those kids who are unlikely to grow up to be whatever they want. Economic growth alone cannot be expected to increase upward mobility out of the bottom, which Indiana governor Mitch Daniels has called, "the crux of the American promise." Many children face challenging barriers to mobility. Two thirds of African American children experience neighborhood poverty rates the level of which only six percent of white children see.<sup>23</sup> It is certainly true that many parents do a poor job promoting opportunity for their children, but children do not choose their parents. As children age, they must increasingly take responsibility for decisions that limit their future opportunities. Yet who among us remembers our adolescent years as a period of peak rationality?

Policies to promote upward mobility from the bottom could take the form of investments in education, coupled with reforms to school governance and incentives to promote accountability. They might include reforms to safety net programs to encourage independence, work, marriage, and savings. More ambitiously, child savings accounts could be seeded and family contributions matched on condition that any federal contribution must be used for higher education or a wedding, available only to young adults who avoid run-ins with the law and teen parenthood, or else forfeited back to the Treasury. Senator Sessions has supported a version of child savings accounts in the past; I believe that done well, the strategy could transform the expectations and aspirations of poor children and their parents, easily paying for itself over the long run.

Once again, thank you for the opportunity to testify this morning. I look forward to answering any questions you may have.

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<sup>22</sup> B. Dan Wood, Chris T. Owens, and Brandy M. Durham (2005), "Presidential Rhetoric and the Economy," *Journal of Politics* 67(3): 627-645.

<sup>23</sup> Patrick Sharkey (2009), "Neighborhoods and the Black-White Mobility Gap," Pew Economic Mobility Project ([http://www.economicmobility.org/assets/pdfs/PEW\\_NEIGHBORHOODS.pdf](http://www.economicmobility.org/assets/pdfs/PEW_NEIGHBORHOODS.pdf)).