"A Long-Run Perspective on Our Economic Challenges"

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Chairman Murray, Ranking Member Sessions, and Members of the Committee, thank you for inviting me to appear today to discuss the outlook for the nation's economy and budget. As we enter budget season, with the Great Recession growing dimmer in our rearview mirror but significant economic anxiety riding shotgun, it is important to assess where we have been and where we stand—to carefully distinguish between short- and long-run challenges and to prioritize among them. I believe that our ability to do so is hindered by misconceptions about how the middle class and poor are doing and why. Below I discuss, in turn, long run trends in the living standards of the middle class, income inequality, poverty, and economic mobility. I then turn to the policy implications of these trends in the last part of my testimony.

The Middle Class

In order to effectively address the nation's economic and budgetary challenges, it is vital to maintain a proper perspective toward them. Unfortunately, much of our public discourse is rooted in assumptions that are either ill-founded or simply wrong. These assumptions defy simple ideological characterization.

For example, George Mason University economist Tyler Cowen recently asserted that, "the income for the median or typical household has risen only slightly since 1973."[2] That is simply untrue. The median household income of Americans under age 60, for instance, rose by 30 percent between 1979 and 2007 before taking into account public transfer payments, employer-provided health coverage, or the impact of taxes. It rose by 41 percent after accounting for them.[3] That translates into an increase of nearly $22,000 for a family of four between these two business cycle peaks.

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

[2] Tyler Cowen (2014). "'GDP: A Brief But Affectionate History' by Diane Coyle and 'The Leading Indicators: A Short History of the Numbers That Rule Our World' by Zachary Karabell," *Washington Post*, February 21.

[3] These figures are from my analyses of the Census Bureau's, Current Population Survey (CPS). Incomes are adjusted for household size by dividing by the square root of the number of occupants, a standard adjustment to account for the fact that smaller households need less than larger ones. The post-tax and -transfer estimates incorporate public cash and noncash transfers, including Medicare and Medicaid, and employer-provided health benefits, as well as federal and state income taxes (before credits), the Earned Income Tax Credit, payroll taxes, and property taxes. They do not include capital gains. I adjust incomes for inflation using the Bureau of Economic

This boost in incomes has occurred primarily because of earnings gains among women. Median hourly and annual compensation among men have not fallen, though they probably rose by no more than 10 percent between 1979 and 2007.[4] Productivity growth has been much higher over this period, which many have taken to indicate that male compensation should have grown more than it did. But we lack evidence about whether the productivity of the median male worker has increased; it could very well be that productivity has risen primarily among higher-skilled workers or those in top positions (or among women, for whom median annual and hourly compensation rose 73 and 48 percent, respectively).[5]

Furthermore, pay in 1979 was probably higher among men than productivity levels justified. Hourly compensation growth actually outpaced productivity growth in the nonfarm business sector between 1940 and 1970, especially from 1940 to 1947. By 1979, hourly compensation was still significantly higher than productivity growth since 1940 would have dictated.[6]

If pay was well-calibrated to productivity in 1940 (or higher than justified by productivity), then 1970 compensation was due for a correction. That interpretation is consistent with the fall in labor's share of income that we have seen since then as well as the rise in income concentration since 1980. It would also explain the slowdown in male pay, since men were two-thirds of the fulltime workforce in 1970 and more concentrated than women in relatively high-paying jobs such as those in manufacturing.[7]

Analysis's "Personal Consumption Expenditures" deflator, the same index preferred by the Congressional Budget Office and the Federal Reserve Board.

[4] Analysis of the CPS, focusing on men between the ages of 25 and 59. "Compensation" includes earnings from wages and salary and from self-employment (including farming), as well as the value of employer provided health insurance. The median annual compensation among all such men increased by six percent from 1979 to 2007 and fell by four percent from 2007 to 2012. If I account for the increase in men who are sick or disabled or for men who could not find work by adding them in as below-median earners, the increase from 1979 to 2007 was five percent and the decline from 2007 to 2012 was eight percent. If I focus on only non-Hispanics to account for rising immigration, the increase from 1979 to 2007 was 13 percent and the decline from 2007 to 2012 was six percent. The median for non-Hispanic men after accounting for the increase in the jobless was nine percent from 1979 to 2007, and the decline from 2007 to 2012 was seven percent. For hourly compensation, I divide compensation by the usual hours worked in the previous year, as reported by respondents who worked. The median among all such men increased by seven percent from 1979 to 2007 and fell by two percent from 2007 to 2012. Adding in the nonworking men as below-median earners, the increase from 1979 to 2007 was four percent and the decline from 2007 to 2012 was five percent. Among non-Hispanics, the increase from 1979 to 2007 was 12 percent and the decline from 2007 to 2012 was two percent. The median for non-Hispanic men after accounting for the increase in the jobless was nine percent from 1979 to 2007, and the decline from 2007 to 2012 was four percent.

[5] The annual and hourly compensation increases for women are again from the CPS. Estimates for non-Hispanics or adjusting for jobless women do not change the conclusions substantively.

[6] Estimates are from the Federal Reserve Bank of St. Louis's "Federal Reserve Economic Data" (FRED) data archive. I compare the series on the nominal gross value added of the nonfarm business sector (Series A358RC1A027NBEA) to the series on nominal employee compensation in the nonfarm business sector (Series C4091C0A144NBEA and A4091C0A144NBEA). Since dividing the former by hours worked in the sector gives sector productivity while dividing the latter by hours worked gives hourly compensation, one can assess the relative growth rates of productivity and hourly compensation using these estimates.

[7] Bureau of Labor Statistics estimates of workers usually employed 35 hours or more from http://bls.gov/cps/.

One indication that the pay of male workers in 1940 was already higher than productivity levels justified is the widespread belief at the time that a single male breadwinner should have been able to support a family on his own paycheck. Since there is no reason to believe that the value added by a worker in the production process should necessarily have been an amount high enough to support a family single-handedly, the single-breadwinner ideal likely propped up male wages artificially for decades.

Over time, families became affluent enough to afford paid childcare and to purchase labor-saving appliances and processed foods. As women increasingly became dissatisfied with the homemaker role, more wives and mothers entered the workforce and worked longer hours. There was no justification for paying both husband and wife enough to raise a family single-handedly, and global competition made such overpayment that much less practical for businesses. The single-breadwinner ideal crumbled. Its collapse contributed to the subsequent stagnation in male wage growth.

That should not obscure the real household income growth experienced by the middle class in recent decades. Presumably, few families of four are indifferent between going back to 1979 living standards and having today's additional $22,000. It is true that there have been costs associated with sending two workers into the labor force, such as greater child care expenses. But it is also necessary to credit the gains experienced by women who have a degree of economic freedom denied them in generations past.

Income Inequality

While median income growth has been substantial in recent decades, it pales in comparison with the growth rates of the 1950s and 1960s. Many observers, including President Obama, have attributed this slowdown to rising income concentration, which is said to have produced gains at the top at the expense of the poor and middle class. It is certainly possible that the demise of the single-breadwinner ideal has led to disproportionate income gains at the top in recent decades. If the years since 1970 have seen an adjustment to recalibrate pay and productivity, we would expect that income gains prior to 1970 were stronger for the median household than at the top, greater at the top since then, but similar between the middle and top since 1940.

While the data is not ideal, the pattern it shows is broadly consistent with the idea of recalibration. I estimate that the household income of the middle fifth of Americans increased by 151 percent from 1940 to 1969 but by 66 percent from 1969 to 2007. The increase over the whole period was 317 percent.[8]

[8] For 1940 to 1969, I take the annual growth rate of family income from 1948 to 1969 from Economic Policy Institute tabulations of data from the Census Bureau's Current Population Survey. I then apply that growth rate to the 29 years between 1940 and 1969, assuming that the 1940-48 growth rate was the same. Since these are the years in which hourly compensation outpaced productivity, this is probably a conservative estimate of growth during this period. The figures are for the family income of families (rather than the household 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

Measuring top incomes is difficult due to a number of methodological and data issues. At the upper reaches of the income distribution, it can be difficult to determine the extent to which changes are real or simply responses to tax incentives, and these problems are much more pronounced for investment and business income than for earnings. Focusing on the earnings of the top five percent of tax returns, the increase from 1940 to 1969 was 77 percent, while from 1969 to 2007 it was 158 percent. Over the entire period, earnings income in the top five percent rose 357 percent—not much more than the increase in the median American's household income.[9]

Rising inequality, however cannot be the only explanation for the slowdown in household income growth. In the 1970s, household incomes increased only modestly throughout the income distribution—even at the top. That is to say, the growth slowdown predated the rise in income concentration. The primary cause is no mystery; productivity growth has slowed since the 1960s in industrialized countries around the world, and income growth has diminished accordingly.

It is also worth noting that because of the difficulties in measuring top incomes, the growth in and extent of income concentration has probably been overstated by the most widely cited estimates of

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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. The EPI income figures were adjusted back to nominal dollars and then inflated using the Bureau of Economic Analysis Personal Consumption Expenditures deflator for consistency with the other estimates.

For 1969 to 2007, the estimates are my own, using the Current Population Survey microdata. The figures are for 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. 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.

[9] 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 earnings 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 earnings of "tax units" (essentially, tax returns, after accounting for a small number of non-filers) rather than of families, households, or individuals. Earnings are measured before taxes are deducted, and no 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. I adjust their income figures back to nominal dollars and then inflate them using the Bureau of Economic Analysis Personal Consumption Expenditures deflator.

Thomas Piketty and Emmanuel Saez.[10] Those estimates do not represent households or individuals per se, but "tax units," which are essentially tax returns. An unmarried student with a summer job who files a tax return is a tax unit, as are a 30-year-old living with a roommate and a 50-year-old married couple. The Piketty-Saez estimates take no account of any redistribution that occurs via public transfers or taxes and do not factor in the value of employer-provided health insurance. They do not count capital gains unless they are realized and reported on tax returns. That misses the vast majority of gains middle-class families receive from selling a home. Where gains are reported, the Piketty-Saez estimates count all the gains that have accrued from holding an asset in the year that those gains are realized. Finally, changes in the tax treatment of business income and stock options also likely overstate the rise in income concentration.

While their most-cited estimates indicate that the top one percent's income share rose from 10 percent in 1979 to 24 percent in 1979, the Piketty and Saez estimates for earnings rose only from 6 percent to 12 percent. Between 1989 and 2007, the increase was just from 9 percent to 12 percent.[11] In a recent paper that attempted to address many of the shortcomings of the Piketty-Saez estimates—in particular the treatment of capital gains—Richard Burkhauser and two of his students found that income concentration actually fell between 1989 and 2007.[12] This paper is not the final word on the matter, but it demonstrates that the most-cited figures on income concentration may have serious flaws.

Poverty

What about low-income households and workers? The 20th percentile of household income is the income that is higher than in 20 percent of households but lower than in 80 percent of them. If we use the 20th percentile to look at the income of poor non-elderly Americans, it rose by 28 percent between 1979 and 2007 and was flat between 2007 and 2012.[13]

Because of the large influx of immigrants with low educational attainment and limited English proficiency, the 20th percentile has been tugged downward over time as their share of the population has grown. While it is impossible to identify foreign-born persons in the data in 1979, among non-Hispanic Americans, the 20th percentile of household income rose by 36 percent from 1979 to 2012. That amounts to an increase of nearly $13,000 for a family of four.

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[10] Alan Reynolds (2006). *Income and Wealth* (Westport, CT: Greenwood).

[11] 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.

[12] 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.

[13] Once again, this is a size-adjusted post-tax and –transfer measure. See footnote 3.

While the official poverty measure used by the Census Bureau shows little change in poverty among nonelderly Americans, it has several well-known flaws.[14] Efforts to improve on the official measure support the conclusion that low-income Americans enjoyed higher living standards in 2012 than in 1979.[15] The years between 1993 and 2000 saw the most dramatic improvement, especially among children. This was the strongest period of income growth since the 1960s and reiterates the importance of robust economic growth for reducing poverty. However, research from a team of Columbia University poverty experts suggests that child poverty would not have fallen as much during these years if not for federal taxes and transfers.[16] That suggests that the work-oriented welfare reforms of the 1990s helped to reduce poverty by encouraging low-income adults to enter the workforce.

The safety net for non-working families became less generous during these years even as it became more generous for working families. The New Deal-era Aid to Families with Dependent Children program was replaced by Temporary Assistance to Needy Families through landmark 1996 legislation, but for years before that states had been experimenting with welfare reforms through the expanded use of federal waivers under Presidents George H. W. Bush and Bill Clinton. After 1996, cash assistance was block-granted and time-limited, and work and job-search requirements were mandated. Teen mothers were required to live at home and to receive education or training to receive benefits, and states could cap the number of children who were eligible for benefits.

However, welfare reform during the 1990s included generous carrots as well as sticks in attempting to move low-income adults into work. In particular, the Earned Income Tax Credit was expanded, child care subsidies increased, and it became easier to keep health insurance benefits upon taking work, reducing the marginal tax rates faced by the non-working poor when they entered the job market.

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[14] To determine if someone is poor, the Census Bureau counts income received from private sources or from government employment and adds federal benefits if they take the form of a check—so-called “cash transfers” like the Temporary Assistance for Needy Families and Supplemental Security Income programs for poor families, Unemployment Insurance for the jobless, and Social Security for senior citizens. It compares a person’s family income—or their own income if they do not live with relatives—to a poverty line that varies depending on family size and the age of its head. The original poverty line was constructed in the mid-1960s and has been updated annually to reflect increases in the cost of living. While it was originally based in real-world analyses of what families needed to get by, it is best thought of today as an arbitrary but relatively low level of material well-being meant to be held constant over time.

The official measure does not count employer-provided benefits as income, and it does not count non-cash benefits from the federal government, such as Medicare, Medicaid, food stamps, or housing subsidies. Nor does it deduct taxes from income, which means that if the tax burden falls or the value of benefits provided through the tax code increases, improvement in living standards will be understated. But perhaps most importantly, because the official poverty line is adjusted for the cost of living every year by a measure, the “CPI-U,” that is known to overstate inflation, it represents a higher living standard than it used to, making the change in poverty look too dour.

[15] Christopher Wimer, Liana Fox, Irv Garfinkel, Neeraj Kaushal, and Jane Waldfogel (2013). “Trends in Poverty with an Anchored Supplemental Poverty Measure.” Working Paper. Available at http://socialwork.columbia.edu/sites/default/files/file_manager/pdfs/News/Anchored%20SPM.December7.pdf.

[16] Ibid.

One reason to think that it was the shift to work promotion that lowered child poverty rather than traditional expectations-free safety net programs is that the Columbia research indicates that subtracting out federal benefits and looking at pretax income does not alter the trend in child poverty much prior to the 1990s. Furthermore, in research I conducted with Harvard sociologist Christopher Jencks, we found that the 1990s expansion differed from those of the 1960s, 1970s, and 1980s in that the poverty rate for families headed by a single mother fell by more than it did among two-parent families.[17]

This story of declining child poverty merits two caveats. First, the traditional safety net probably did prevent child poverty from rising in recent years, starting with the 2000 recession and continuing through 2012. The Columbia figures indicate that poverty among children would have begun rising if not for federal benefits and the impact of tax policy. Instead, it fell a little more. Our federal safety nets should promote work, but we must be prepared to assist those who cannot find work, a delicate balancing act.

Second, liberal welfare rules may have contributed to the increase in single motherhood over time and even to the decline of work participation rates among less-skilled men. The evidence for such effects is weak, but the questions are difficult to answer convincingly. Whether welfare reform was a major factor behind the dramatic drop in teen pregnancy during and after the 1990s is an under-studied research question. One study found that welfare reform in the 1990s reduced teenage motherhood among the daughters of single or less-educated parents and encouraged them to live with a spouse or parent if they did become mothers.[18]

While the living standards of the poor have improved, the story is again less sunny for male earnings. Among working men, annual and hourly compensation at the 20th percentile were more or less flat from 1979 to 2007, though they rose by six or seven percent among non-Hispanic men. Annual compensation at the 20th percentile was about 6 percent lower in 2012 than in 1979 among non-Hispanic men.

Compounding these anemic earnings trends among workers, labor force participation among men in the bottom fifth of household incomes also fell. In 1979, 81 percent of adult men in the bottom fifth had earnings, which was already well below the 96 percent among adult men outside the bottom fifth. By 2007, however, just 72 percent of adult men in the bottom fifth of household income worked, compared with a still-strong 92 percent in the top four fifths.

Meanwhile, among women at the 20th percentile, there were strong increases in compensation. Between 1979 and 2012, annual compensation grew 134 percent, or about $10,000. That reflects an increase in hourly compensation of one-third, combined with a large increase in the number of hours worked. Nevertheless, just 55 percent of adult women in the bottom fifth of household income worked in 2007, up only from 51 percent in 1979. Among women in the top four fifths, the increase was from 70 percent to 82 percent.

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[17] Scott Winship and Christopher Jencks (2004). "How Did the Social Policy Changes of the 1990s Affect Material Hardship among Single Mothers? Evidence from the CPS Food Security Supplement." Harvard University, John F. Kennedy School of Government Faculty Research Working Paper Series, No. RWP04-027. Available at https://research.hks.harvard.edu/publications/getFile.aspx?Id=127.

[18] Robert Kaestner, Sanders Korenman, and June O'Neill (2002). "Has Welfare Reform Changed Teenage Behavior?" *Journal of Policy Analysis and Management* 22:225-248.

Economic Mobility

The belief that the American Dream has died and that intergenerational mobility has declined is widespread across the ideological spectrum. Nevertheless, a sizable academic literature consistently fails to find significant declines in mobility since the mid-twentieth century. The most common finding is a change so modest as to be statistically indistinguishable from no change at all.[19] Earlier this year, Harvard economist Raj Chetty and a team of researchers confirmed this consensus with a paper finding that children born in 1993 likely had experienced the same mobility as those born in 1971.[20] 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 more and no less mobility than did thirty year olds in the mid-1970s.[21]

Many find it difficult to believe that mobility has not declined given that inequality has increased, but we exaggerate the importance for mobility of how much one's parents—or someone else's parents—make. The link between income inequality and mobility has been greatly overstated, as I have argued elsewhere.[22]

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[19] 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 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.

[20] Raj Chetty, Nathaniel Hendren, Patrick Kline, Emmanuel Saez, and Nicholas Turner (2014). "Is the United States Still a Land of Opportunity? Recent Trends in Intergenerational Mobility," NBER Working Paper No. 19844. (Cambridge, MA: National Bureau of Economic Research). Available at http://obs.rc.fas.harvard.edu/chetty/mobility_trends.pdf.

[21] Scott Winship (forthcoming). "The Dream Abides: Economic Mobility in America from the Golden Age to the Great Recession."

[22] Scott Winship (2013). "Overstating the Costs of Inequality." *National Affairs* 15. Available at http://www.brookings.edu/~/media/research/files/articles/2013/03/overstating%20inequality%20costs%20winshi

But the fact that mobility has not fallen should provide little comfort given how limited upward mobility remains. Only thirty percent of today's adults who were raised in the bottom fifth of household incomes managed to make it into the middle fifth or higher.[23]

Economic and Fiscal Policies to Help Poor and Middle Class Americans

This review of long-term trends in household income, earnings, inequality, and mobility points to three conclusions for policy.

1. The American middle class is economically healthy, it just needs for strong economic growth to return. Robust economic growth would also be the single most beneficial influence on the living standards of the poor.

Since the fortunes of poor, middle class, and rich Americans tend to rise and fall together, and because no one has established a compelling case that rising income concentration has hurt anyone, efforts to diminish income concentration distract from the more important task of achieving broad income growth. Both the poor and middle class experienced strong income gains in the second half of the 1990s, despite rising income concentration, and the pay of women has increased notably even as income concentration has risen. A recent Brookings Institution study found that some of the cities with the most economic vitality have the highest inequality levels.[24]

To the extent that rising income concentration has come at the expense of the poor and middle class, it likely represents the result of "front-loading" long-term benefits of productivity growth in the 1940s, 1950s, and 1960s to support a gendered division of labor that most families have rejected in favor of greater affluence and personal fulfillment. If the benefits of productivity growth since 1940 had been smoothly realized between then and now, workers would today have earnings levels that match our actual ones very closely. But rather than a "Golden Age" followed by "stagnation", we would have experienced steady growth.

Successfully reducing the growth of income inequality might have unintended consequences, such as reducing economic growth. It is even possible that such an effect would be big enough to leave the poor and middle class with bigger pieces of a smaller pie, such that no one is any better off in absolute terms (despite the rich being worse off).

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p/overstating%20inequality%20costs%20winship.pdf. 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?" http://www.economics21.org/commentary/great-gastby-curve-revisited-part-1. Scott Winship and Donald Schneider (2014). "The Great Gatsby Curve Revisited: Part 2, Collapse of the Great Gatsby Curve," http://economics21.org/research/collapse-great-gatsby-curve

[23] 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.

[24] Annie Lowrey (2014). "Study Finds Greater Income Inequality in Nation's Thriving Cities," *New York Times*, New York edition, p. B3. February 20, 2014. Available at http://www.nytimes.com/2014/02/20/business/economy/study-finds-greater-income-inequality-in-nations-thriving-cities.html?_r=0.

Given the healthy state of the middle class, it is not only necessary but reasonable to implement reforms to senior entitlements so that we can tame future deficits and debt levels that threaten America's economic stability and growth. Doing so will also allow us to afford new commitments to promote the upward mobility of poor children, which will also increase productivity and growth in the long run. Absent such reforms, there will be no room in the federal budget for even our current commitments.

Other policies to promote economic growth might include:[25]

- Pairing cuts in corporate and individual investment taxes to encourage job creation with increases in federal research-and-development spending to promote innovation. Both policies would be likely to pay for themselves down the road.
- Greater high-skilled immigration to increase the stock of human capital from which our economy can draw for innovative ideas and to ensure competitive labor markets among professionals.
- Health care reform, both as part of deficit reduction (because scheduled provider cuts are unlikely to be implemented) and to prevent the excessive health care inflation that Obamacare's subsidies and mandated benefits are likely to create.

2. The experience of the 1990s shows that work-based welfare reforms can ensure that low-income Americans also benefit from growth.

Safety-net reforms that encourage work can reduce poverty by fostering initiative and lowering marginal tax rates. Welfare reform was successful by replacing a program with minimal reciprocal expectations of recipients and severe work disincentives with a social policy regime in which work clearly paid off. Yet, many of our safety-net policies still ask little of beneficiaries and retain high marginal tax rates. For most people, they serve as a temporary stopgap measure in hard times, but for others, especially during economic expansions, they become poverty traps, discouraging work, marriage, and saving. As Charles Murray long ago argued, the problem is not so much one of personal failure but that people are responding to the incentives embedded in our safety-net policies as any of us would in the same situation.

Two ideas that address the work disincentives of our sprawling and uncoordinated safety net regime have recently been offered. Oren Cass, former domestic-policy director of Mitt Romney's 2012 presidential campaign, has proposed block-granting our means-tested programs and sending them to the states as a "flex fund". The flex fund would be coupled with an expansion and reconfiguration of the work subsidies currently offered through the Earned Income Tax Credit. Senator Marco Rubio is developing a proposal along these lines, which would have the benefit of encouraging policy experimentation at the state level while increasing the incentives to work among those whose wage prospects are modest.

Relatedly, Congressman Paul Ryan, Chairman Murray's counterpart in the House, has spoken sympathetically toward the United Kingdom's new Universal Credit program. The Universal Credit packages a number of scattered safety-net programs together and delivers a simplified benefit to those who qualify. Most importantly, it is carefully designed so that the size of the credit tapers as earnings

[25] Scott Winship (2014). "Actually, We Won the War on Poverty." *Politico Magazine*. Available at http://www.politico.com/magazine/story/2014/01/war-on-poverty-conservatives-102548_full.html.

become a bigger share of household income, but in such a way as to encourage beneficiaries to work more.

These are encouraging generalizations of the 1990s welfare reform. It is worth highlighting two issues regarding work-promoting safety net reforms, however. First, while the 1990s reforms clearly reduced poverty, we lack the evidence so far—because the 1990s were not that long ago—that they increased upward mobility. If, as I have argued, more money is not enough to expand mobility, then safety net reforms may have the biggest impact on child mobility to the extent that they affect the aspirations, values, and family lives of poor children and their parents.

The decline in teen pregnancy offers a possible hint that safety-net reforms can affect behavior in a way that might promote upward mobility. In addition to promoting work through the tax code or a universal credit, it may be desirable to promote marital childbearing as well. Out of wedlock childbearing has increased markedly, and I believe we are approaching the problem from the wrong perspective. Though research overwhelmingly suggests that children who grow up with a single parent tend to have poor outcomes, it does not establish that the children would typically have done any better if their parents—their specific parents, not generalized parents with some other set of skills, values, and assets—had married or stayed married. Anyone who has seen MTV's "Sixteen and Pregnant" and the complicated lives of the show's protagonists ought to recognize that the children born to these couples have a lot working against their success regardless of whether their parents marry or not.

However, even if it were the case that the children born to single mothers face long odds regardless of their parents' marital status, by encouraging young men and women to delay childbearing until they are in a better place, policies might have an important impact on mobility rates. In that case, we would not be improving the opportunities of children in disrupted families by encouraging their parents to stay together. Instead, we would be improving child opportunities by preventing children from being born into disrupted families and encouraging childbearing among those same men and women when their lives are more conducive to successfully raising a child. Just as a work supplement can send a clear signal about the rewards for behaving in opportunity-enhancing ways, so too a married-parent credit could affect thinking at the margins when young men and women contemplate their birth timing.

A second issue related to work-based safety-net reforms is that we will always need a safety net to catch those who cannot secure stable employment. The overlap between children with low mobility prospects and children whose parents will struggle to find and keep work is likely to be substantial. One easy way to minimize the number of people who fall through the cracks is to build a counter-cyclical element into any block-grant or universal credit regime, so that the system can respond appropriately in downturns as unemployment worsens.

3. While we have reduced poverty, in part through the fifty-year war we have waged since Lyndon Johnson declared it our combatant, federal programs have failed to increase upward mobility out of the bottom, which remains stubbornly low. [26]

Encouraging economic growth will not help those parents with the worst jobs keep their kids from filling those bad jobs someday themselves. Welfare reforms may expand child opportunity, but only indirectly, and they may only reduce poverty without actually nudging mobility. Winning a war on immobility, I

[26] This discussion is drawn from my recent essay for *Politico Magazine* (op. cited), with permission.

believe, will require a program to help poor parents invest in their young children. If parents are unable to ensure their children's school-readiness and keep them on track academically, the federal government can empower them to find the help they need.

The problem is that we have astonishingly few early- and middle-childhood models that have been shown to work on a large scale. But we should nevertheless commit substantial resources to discovering successful models, even as we also commit to shuttering existing programs that have not proved effective. A system of opportunity grants for poor children would allow low-income parents to pay qualifying providers for any of a range of eligible child investment services—after-school programs, tutoring, summer enrichment programs or other strategies. Providers would have to agree to be evaluated, and consistently ineffective providers—and approaches—would be excluded from receiving grants as the evidence comes in.

This approach would be "market making" in the sense that it would incentivize the supply of child investment services and encourage parents to seek them out. Ideally, the circulation of opportunity grants in low-income communities would inspire competition among parents to ensure they are doing right by their children, potentially altering community norms and aspirations. To be sure, many—probably most—models initially would be revealed to be ineffective, but that will build consensus about the limits of what social policy can do and about the need not to waste money on approaches that do not work. And such a program would discover workable models and seed successful ventures like the KIPP schools, becoming much more obviously cost-effective in time. If the opportunity grant program succeeds, it would open up the conversation around K-12 reform as well and point to a new federal role in education.

4. We should not confuse short-term cyclical challenges for long-term structural ones.

Too often, we forget that we have just lived through the worst economic downturn since the Great Depression. Remarkably, and thanks in no small measure to a federal safety net that caught those who needed it, incomes have essentially fully recovered.[27] This is in marked contrast to the painfully slow recovery from the Depression over the 1930s and early 1940s. Unemployment levels never approached those experienced during the Depression and were not qualitatively different than in the double-dip recession of the 1980s. We are well on our way to a healthy economy, and the long-term trends discussed here suggest that our economic challenges are real but manageable.

The unique challenge of this recovery has been the historically high likelihood that someone who is unemployed will be so for a long time. The extent to which the federal safety net has exacerbated this problem or mitigated the effects of it are much in dispute. But it is no longer 2009. Unemployment rates have been declining steadily, as have jobless rates that include discouraged workers.[28] Declines in labor force participation continue long-term trends that are poorly understood but that are affected by rising

[27] Scott Winship (2013). "What Has Happened to the Incomes of the Middle Class and Poor? Part 1." Available at http://www.economics21.org/commentary/what-has-happened-incomes-middle-class-and-poor-part-1.

[28] Scott Winship (2013). "Has Unemployment Fallen for the Wrong Reason?" Available at http://www.economics21.org/commentary/has-unemployment-fallen-wrong-reason.

school enrollment and the aging of the baby boomers.[29] To the extent that we have a labor force participation problem, reforming our welfare programs—this time our disability programs—is likely to be an important part of the solution.

Extending emergency unemployment insurance benefits in 2014 would undoubtedly help many Americans, just as the availability of disability benefits does. But making safety nets more generous also carries the risk that unintended consequences will create sizable costs. Extension of benefits would cause some to postpone looking for work, and by reducing labor supply, it would keep the cost of hiring elevated above what it would otherwise be, hurting labor demand more generally.[30] North Carolina's experience ending its emergency unemployment insurance program suggests that neither the benefits nor the costs of an extension are obviously greater than the other at this point in the recovery. It may be time to focus on long-term economic and budgetary issues.

It is also tempting, given the sluggish growth in wages and widespread economic insecurity, to attempt to reduce poverty by raising the minimum wage. Here again the obvious benefits may not exceed the less obvious costs. A forty percent increase in the minimum wage over three years to a level that would be unprecedented risks hurting demand for labor.[31] If the immediate economic challenge we face is long-term joblessness, it is unclear why we would want to raise the cost of hiring the most disadvantaged workers and risk exacerbating the problem.

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[29] Scott Winship (2012). "Misunderstanding Declines in Labor Force Participation." Available at http://www.realclearmarkets.com/articles/2012/09/12/misunderstanding_declines_in_labor_force_participation_99874.html.

[30] Marcus Hagedorn, Fatih Karahan, Iourii Manovskii, and Kurt Mitman (2013). "Unemployment Benefits and Unemployment in the Great Recession: The Role of Macro Effects." NBER Working Paper 19499. (Cambridge, MA: National Bureau of Economic Research)

[31] Scott Winship (2013). "How Solid is the Case for Raising the Minimum Wage?" Available at http://www.economics21.org/commentary/how-solid-case-raising-minimum-wage