

United States Senate

Budget Committee

Hearings on Widening Inequality of Income and Wealth in America

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**Testimony of Robert B. Reich
Chancellor's Professor of Public Policy,
University of California, Berkeley
Former U.S. Secretary of Labor**

Mr. Chairman and members of the Committee,

Thank you for giving me the honor and opportunity of testifying before you this morning on one of the central challenges this nation faces beyond the pandemic – widening inequality of income and wealth.

Even before the pandemic, America had the widest inequalities of income and wealth in a century, wider than any other developed nation. The median wage has barely budged for 40 years, adjusted for inflation, even though the economy was almost three times larger. The richest one-tenth of one percent has almost as much wealth as the bottom 90 percent put together. And more than half of Americans are earning so little they have no choice but to live paycheck to paycheck.

The pandemic itself has revealed the starkness of American inequality. Over the past year, while the working class and poor have taken it on the chin, America's 660 billionaires – major beneficiaries of the December 2017 tax cut – have together become \$1.3 trillion richer. This would be enough for them to give every American a \$3,900 check and still be as rich as they were before the pandemic.

The American Rescue Plan just enacted is an important step in the right direction. It provides a vital boost not just to the poor but also to much of the working middle class – increasing the incomes of Americans in the lowest quintile by 20 percent; those in the second-lowest, 9 percent; those in the middle, 6 percent.

Yet it seems doubtful that continued redistributions on this scale can themselves reverse America's growing inequalities of income and wealth or intensifying insecurities faced by most workers. Redistributing economic gains to the bottom 60 percent in the hope of balancing the economy is like trying to bail out a giant sinking ship in which the majority now finds itself, even as yachts become stupendously larger and fancier. It is important to keep bailing, but we must also repair the ship and restructure the waterway.

To understand what must be done, it's important to understand what has happened.

Why the Standard Explanation for Widening Inequality is Inadequate

For the past thirty years, I have offered in articles, books, and lectures an explanation for why average working people in advanced nations like the United States have failed to gain ground and are under increasing economic stress.¹ Put simply, globalization and technological change have made most of us less competitive. The tasks we used to do can now be done more cheaply by lower-paid workers abroad or by computer-driven

¹ See Reich, *The Work of Nations*, Knopf (1991).

machines. This has exerted downward pressure on the wages of the working class and the poor, disproportionately Black and Latinx workers who are also burdened by systemic racism.

My solution -- and I'm hardly alone in suggesting this -- has been an activist government that raises taxes on the wealthy, invests the proceeds in excellent schools and other means people need to become more productive, redistributes to the needy, and fights employment discrimination. The recommendations have been vigorously opposed by those who believe the economy will function better for everyone if government is smaller and if taxes and redistributions are curtailed.

While the explanation I offered three decades ago for what has happened is still relevant -- and indeed has become a standard explanation² -- I've come to believe it overlooks a critically important phenomenon: *the increasing concentration of political power in a corporate and financial elite that has been able to influence the rules by which the economy runs, and the steady weakening of the countervailing power of average workers.*

The initiatives I recommended thirty years ago, while still useful, are in some ways beside the point because they take insufficient account of the government's more basic role in setting the rules of the economic game.

Worse yet, the ensuing debate over the merits of the "free market" versus an activist government has diverted attention from how the market has come to be organized *differently* from the way it was a half-century ago, and why its current organization is failing to deliver the widely shared prosperity it delivered then.

The standard explanation has allowed America to cling to the meritocratic tautology that individuals are paid what they're "worth" in the market, without examining the legal and political institutions that define the market. As such, it has lured many into believing nothing can or should be done to alter what people are paid because the "market" has decreed it -- that working-class and poor people must either settle for lower wages and less security or get more education and better skills.

Yet this cannot be the whole story because it fails to account for much of what we have experienced. For one thing, it doesn't clarify *why the transformation occurred so suddenly*. From the end of World War II until the late 1970s, the median wage in America rose in tandem with productivity gains. In fact, those in the bottom quintiles gained greater ground, on average, than those in the top.

But then gains in the median wage and productivity began to diverge: Starting in the late 1970s, the median wage stagnated, when adjusted for inflation, while productivity gains continued to grow. And most of the gains from growth began going to the top. Yet

² See, for example, Gouldin and Katz, *The Race Between Education and Technology*, Harvard University Press (2008)

globalization and technological change did not suddenly arrive at America's doorstep in the late 1970s and early 1980s. What else began happening then?

Nor can the standard explanation account for *why other advanced economies facing similar forces of globalization and technological change did not succumb to them as readily as the United States.*

In 1980, the top 1 percent's share of total income was about 10 percent in both Western Europe and the United States. But since then, the two have sharply diverged. By 2016, the top 1 percent in Western Europe had about a 12-percent share of income, compared to 20 percent in the United States. And in the U.S., the bottom 50 percent's income share fell from more than 20 percent in 1980 to 13 percent in 2016.³

Why have globalization and technological change widened inequality in the United States to a much greater degree than in Europe?

Nor can the standard explanation account for *why the compensation packages of the top executives of big companies has soared from an average of 20 times that of the typical worker 40 years ago to 320 times today.*⁴ Or why the denizens of Wall Street, who in the 1950s and 1960s earned comparatively modest sums, are now paid tens or hundreds of millions annually. Are they really "worth" that much more now than they were worth then?

The Increase in Corporate Power

A deeper understanding of what has happened to American incomes over the last 30 years requires an examination of changes in the organization of the market. These changes stem from a *dramatic increase in the political power of large corporations and Wall Street to change the rules of the market to enhance their share of economic gains, and a simultaneous decline in the countervailing power of the working middle class to maintain their share.*

This transformation has amounted to a distribution upward, but not as "distribution" is normally defined. The government did not tax the working middle class and poor and then transfer the proceeds to the rich. The upward distribution happened indirectly – *inside* the market -- as the laws and rules organizing the market began to change. The result has been what might be called a *pre-distribution* upward. Some examples:

³ *World Inequality Report*, United Nations Department of Economic and Social Affairs (2018).

<https://wir2018.wid.world/files/download/wir2018-summary-english.pdf>

⁴ "CEO Compensation Surged in 2019 to \$21.3 million," Economic Policy Institute, 2020.

<https://www.epi.org/publication/ceo-compensation-surged-14-in-2019-to-21-3-million-ceos-now-earn-320-times-as-much-as-a-typical-worker/>

Antitrust laws have been relaxed. This has meant large profits for a handful of companies have gained significant market power -- over network portals and platforms (Amazon, Facebook, and Google); over the nation's seed corn and fertilizer (Monsanto, DuPont-Dow); over America's air transit (American, United, Delta, Southwest); broadband (Comcast, AT&T, Verizon); pharmaceuticals (Johnson & Johnson, Pfizer, Merck); aerospace (Lockheed Martin, Boeing, General Dynamics, Raytheon); health insurance (UnitedHealth, Anthem, Aetna, and Humana); and finance (JPMorgan, Goldman Sachs, Bank of America, Morgan Stanley, Citigroup).

This market power has meant either higher prices or reduced services for consumers, or lower pay for suppliers, contractors, and workers. It has also meant more political power for these giant firms over the rules of the game, as I shall explain.

Intellectual property rights have been enlarged. This has created windfalls for pharmaceuticals, high tech, biotechnology, and many entertainment companies, which now preserve their monopolies longer than ever. The consequence, here again, has been higher prices (Americans pay more for the pharmaceuticals than do the citizens of any other developed nation), and lower pay for suppliers, contractors, and workers.

Financial laws and regulations have been eroded. Restrictions imposed in the 1930s on interstate banking, the intermingling of investment and commercial banking, and on banks becoming publicly held corporations, were jettisoned in the 1980s and 1990s -- spawning junk-bond financing, unfriendly takeovers and the notion that corporations exist solely to maximize shareholder value, and, eventually, a wave of financial gambling that ended with the financial crisis of 2008. The Dodd-Frank Act, enacted in its wake, has also been eroded. The Trump administration instituted major rollbacks of key rules and regulations to protect consumers and prevent many of the abuses that were at the heart of the financial crisis.⁵

Bankruptcy laws have been loosened for large corporations but tightened for homeowners and college graduates laden with student debt. Airlines and major manufacturers have used bankruptcy or the threat of bankruptcy to abrogate labor contracts and demand wage concessions -- too often leaving workers and communities stranded. Troubled banks and financial institutions have been bailed out. But bankruptcy protection has been withdrawn from homeowners saddled with mortgage debt and from graduates laden with student debt. The result has been to shift the risks of economic failure onto the backs of taxpayers and of average working people.

Tax laws have created ever-larger loopholes for the partners of hedge funds and private-equity funds, special favors for the oil and gas industry, lower marginal income-tax rates on the highest incomes, and reduced estate taxes on great wealth.

⁵ "No, Dodd-Frank Was Neither Repealed Nor Guttled. Here's What Really Happened," Brookings, May 25, 2018. <https://www.brookings.edu/research/no-dodd-frank-was-neither-repealed-nor-guttled-heres-what-really-happened/>

Securities laws have been relaxed to allow more trading of confidential information, as well as buybacks of corporate shares. CEOs have used such buybacks to boost share prices when they cash in their own stock options.

Corporate subsidies have increased for oil and gas companies, as well as for Wall Street banks.

Contract laws have been altered to require mandatory arbitration before private judges selected by big corporations.

The minimum wage has lost about 10 percent of its value to inflation since it was last raised in 2009.

All these changes in the rules of the game have resulted in upward *pre-distributions* inside the market toward big corporations and financial firms and to their executives and shareholders, and away from average working people.

The Decline of Worker Countervailing Power

Meanwhile, corporate and Wall Street executives have used their increasing power to prevent the wages of most workers from rising in tandem with productivity gains, in order that more of the gains go into corporate profits. Higher corporate profits have meant higher returns for shareholders and, directly and indirectly, higher pay for the executives themselves.

Workers worried about keeping their jobs have been compelled to accept this transformation without fully understanding its roots. There are several reasons for the declining bargaining power of American workers:

Trade agreements have encouraged American companies to outsource jobs abroad. “Free trade” agreements over the last several decades have increased protections for American intellectual property and American financial assets, at the insistence of big U.S. corporations and Wall Street. But they have accorded American workers less protection, often undermining their jobs and wages.

Relatively high levels of unemployment have made workers less secure, reducing their bargaining power. The Great Recession, whose proximate causes were the bursting of housing and debt bubbles brought on by the deregulation of Wall Street, hurled millions of Americans out of work. Between 2010 and 2020, fiscal policy was less stimulative than it would be had Congress been more interested in moving toward full employment than in reducing budget deficits. The pandemic of 2020 initially threw some 20 million Americans into joblessness; today the economy has 9.5 million fewer jobs than it did before the start of the pandemic, and an additional 4 million people are estimated to have left the labor force altogether.

Shredded safety nets and disappearing labor protections have also reduced workers' security, undermining their bargaining power. The public policies that emerged during the New Deal and World War II had placed most economic risks squarely on large corporations through strong employment contracts, along with Social Security, workers' compensation, 40-hour workweeks with time-and-a-half for overtime, unemployment insurance, and employer-provided health benefits (wartime price controls encouraged such tax-free benefits as substitutes for wage increases). Added to these were Medicare and Medicaid, in 1965.

But over the last four decades, many of these safety nets have frayed. Unemployment insurance, for example, is now typically available to fewer than a third of workers who lose their jobs. Corporations have cut their payrolls by outsourcing abroad, utilizing part-time workers, and shifting to contract workers – all of which further shredded safety nets and undermined workers' bargaining power. Full-time workers who had put in decades with a company could find themselves without a job overnight -- with no severance pay, no help finding another job, and no health insurance. Even before the crash of 2008, the Panel Study of Income Dynamics at the University of Michigan found that over any given two-year stretch in the two preceding decades, about half of all families experienced some decline in income.

The growing tendency of corporations to misclassify workers as “independent contractors” – even when workers' jobs and earnings are effectively controlled by the corporation -- has stripped workers of more protections. Uber and Lyft spent some \$200 million on California Proposition 22 in order to change state law to allow them to classify their workers as contractors – another example of how corporate wealth translates into political influence to alter the rules of the game. The move has saved these and similar corporations many additional millions of dollars because they are no longer required to pay Social Security, workers compensation, overtime, unemployment insurance, or a minimum wage. These costs have been transferred onto their workers, instead.

Not the least, the declining bargaining power of workers is a consequence of the demise of labor unions. Fifty years ago, when General Motors was the largest employer in America, the typical GM worker earned \$35 an hour in today's dollars. Today, America's largest employer is Walmart, and the typical entry-level Walmart worker earns less than \$15 an hour.

This does not mean the typical GM employee a half-century ago was "worth" more than twice what the typical Walmart employee today is worth. The GM worker was not better educated or motivated than the Walmart worker. The real difference was that GM workers a half-century ago had a strong union behind them that summoned the collective bargaining power of all autoworkers to receive a fair share of company revenues for its members. Because *more than a third of workers across America's private sector belonged to a labor union*, the bargains those unions struck with employers raised the wages and benefits of non-unionized workers as well. Non-union firms knew they would be unionized if they did not come close to matching the union contracts.

Today's Walmart workers do not have a union to negotiate a better deal. They are on their own. And because *only 6.4 percent of today's private-sector workers are unionized*, most employers across America do not have an incentive to match union contracts. This can put unionized firms at a competitive disadvantage.

Public policies have enabled and encouraged this fundamental change. Currently, 28 states have adopted "right-to-work" laws, which hobble labor unions. The National Labor Relations Board, for many years understaffed and overburdened, has barely enforced collective bargaining. Corporations facing union organization drives have used a variety of tactics to harass and intimidate workers, most of them illegal under the National Labor Relations Act of 1935, but the Board has few resources or tools to enforce the law. At most, workers who are illegally fired for their union activities get back pay -- a mere slap on the wrist of corporations that have violated the law. The result has been a race to the bottom.

The Consequence of the Increasing Imbalance of Power

Given the increasing power of large corporations and the decreasing power of workers it is not surprising that corporate profits have increased as a portion of the total economy while wages have declined.

Those whose income derives directly or indirectly from profits -- corporate executives, Wall Street traders, and shareholders -- have done exceedingly well. The Walmart heirs alone have more wealth than the bottom 42 percent of Americans combined. Those whose income depends primarily on wages, have not.

Before the 1980s, the main driver of profits and the stock market was economic growth. It was a virtuous cycle: Demand for goods and services generated more jobs and higher wages, which in turn stoked demand for more goods and services.

But since the late 1980s, the major means by which corporations have increased profits and stock prices has been by keeping payrolls down. Studies show that *prior to 1989, economic growth accounted for most of the stock market's gains. Since then, most of the gains have come from money that would otherwise have gone into the pockets of workers.*⁶

All this has made the rich even richer. *The richest 1 percent of American households now own 50 percent of the value of stocks held by American households. The richest 10 percent own 92 percent.*⁷ But it has had the opposite effect for everyone else. More and

⁶ Greenwald, Lettau, Ludvigson, "How the Wealth Was Won: Factors Shares as Market Fundamentals," NBER Working Paper, April 22, 2019

⁷ Federal Reserve Board, Goldman Sachs Global Investment Research, 2019.

more of the total economy is going into profits and high stock prices benefiting those at the top, while less and less is going into worker wages and salaries.

It has become a vicious cycle: As more of the nation's income flows to large corporations and Wall Street and to those whose earnings and wealth derive from them, their influence over the rules of the market has grown -- which in turn enlarges their share of total income and wealth. As less of the nation's income flows to average workers because of the weakening of labor unions and other sources of countervailing power, their influence over the rules of the market declines -- which causes the playing field to tilt even further against them.

What Must Be Done

The underlying problem, then, is not that most Americans are "worth" less in the market than they had been, or that they have been living beyond their means. Nor is it that they lack enough education to be sufficiently productive.

The more basic problem is that *the market itself has become tilted ever more toward moneyed interests that have exerted disproportionate influence over it, while average workers have lost bargaining power to receive as large a portion of the economy's gains as they commanded in the first three decades after World War II.*

As a result, the compensation of most American workers has not kept up with what the economy could otherwise provide. To attribute this to the impersonal workings of the "free market" is to disregard the growing power of large corporations and the financial sector over the organization of the market, and the declining *countervailing* power of American workers.

Under these circumstances, education and retraining are no panacea. Nor can we hope to reverse the scourge of widening inequality through mere redistributions. Reducing inequality requires reversing the upward distributions *within* the rules of the market. It necessitates confronting the increasingly imbalanced *pre-distribution* of income and wealth.

To do this requires that economic and political power be rebalanced – that the power of average workers be increased relative to the power of large corporations and very wealthy individuals. While the economy is not a zero-sum game in which gains to the working middle class and poor can only come at the expense of economic elites, power *is* a zero-sum game. It is impossible for the working class and poor to gain more power without economic elites losing it. And the working middle class and poor will not enjoy substantial economic gains unless and until they gain more power.

Rebalancing power over the rules of the economy requires, among other things, (1) more vigorous use of antitrust to mitigate the growing

concentrations of corporate economic and political power; (2) substantially higher taxes on growing accumulations of income and wealth at the top; (3) stronger labor protections to enable workers to join together in order to gain higher wages, benefits, and more job security; and (4) greater restrictions on the use of private and corporate wealth to influence political decisions.

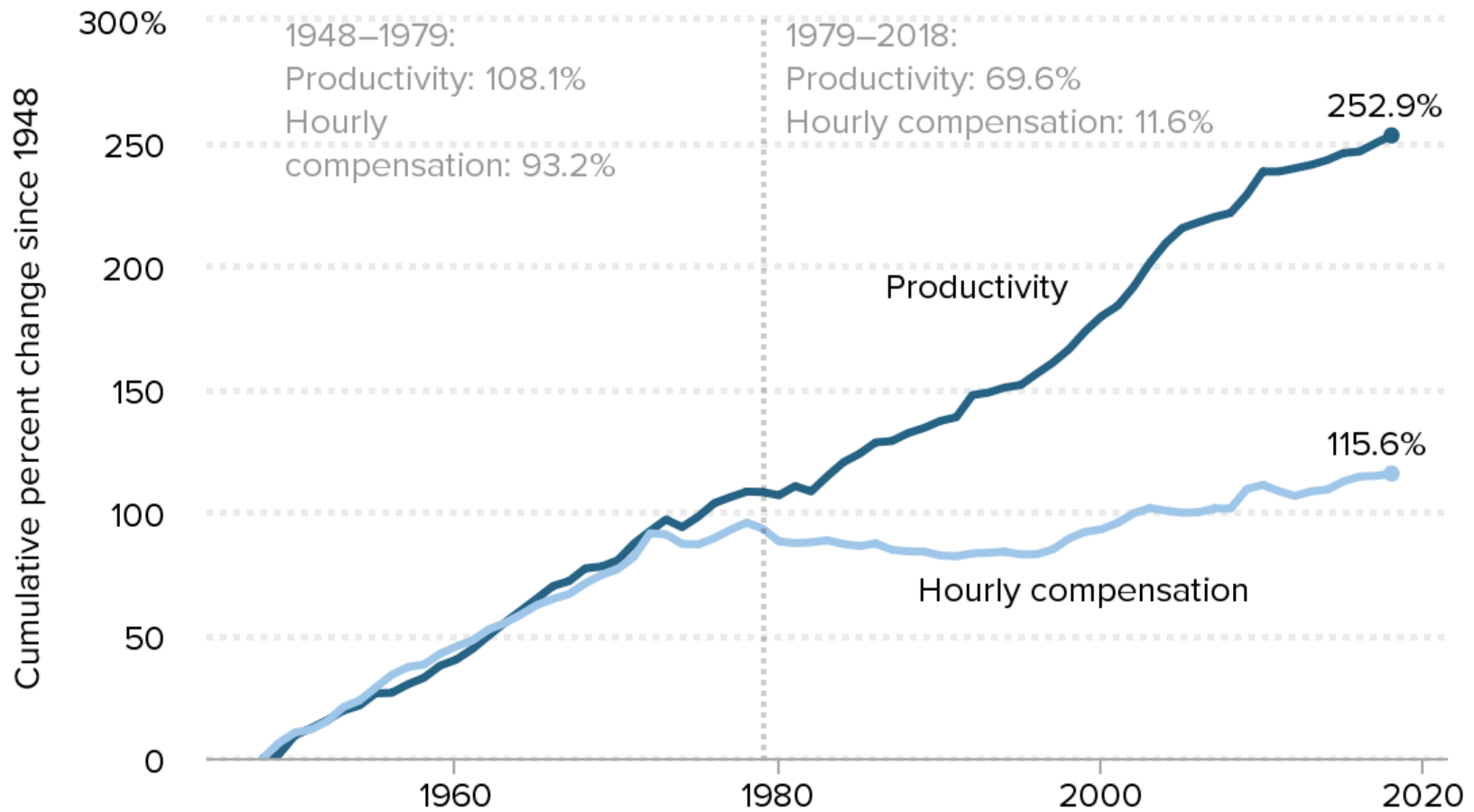
How to begin? It's a classic "chicken-and-egg" dilemma: such rebalancing is possible only if power begins to be rebalanced. Ultimately, the trend toward widening inequality in America will be reversed only when the vast majority, whose incomes have stagnated and whose wealth has failed to increase, join together to demand fundamental changes in the rules.

This rebalancing may be starting to occur right now. I believe we are at a point in history similar to where we were some hundred twenty years ago, when the ravages and excesses of the Gilded Age spawned what became known as the Progressive Era – when reformers in and outside government took the lead in saving American capitalism from its own excesses. The most important political competition over the next decades will not be between the right and left, or between Republicans and Democrats. It will be between a majority of Americans who have been losing ground, and an economic elite that has failed to recognize or respond to the growing distress.

What Happened (in 10 slides)

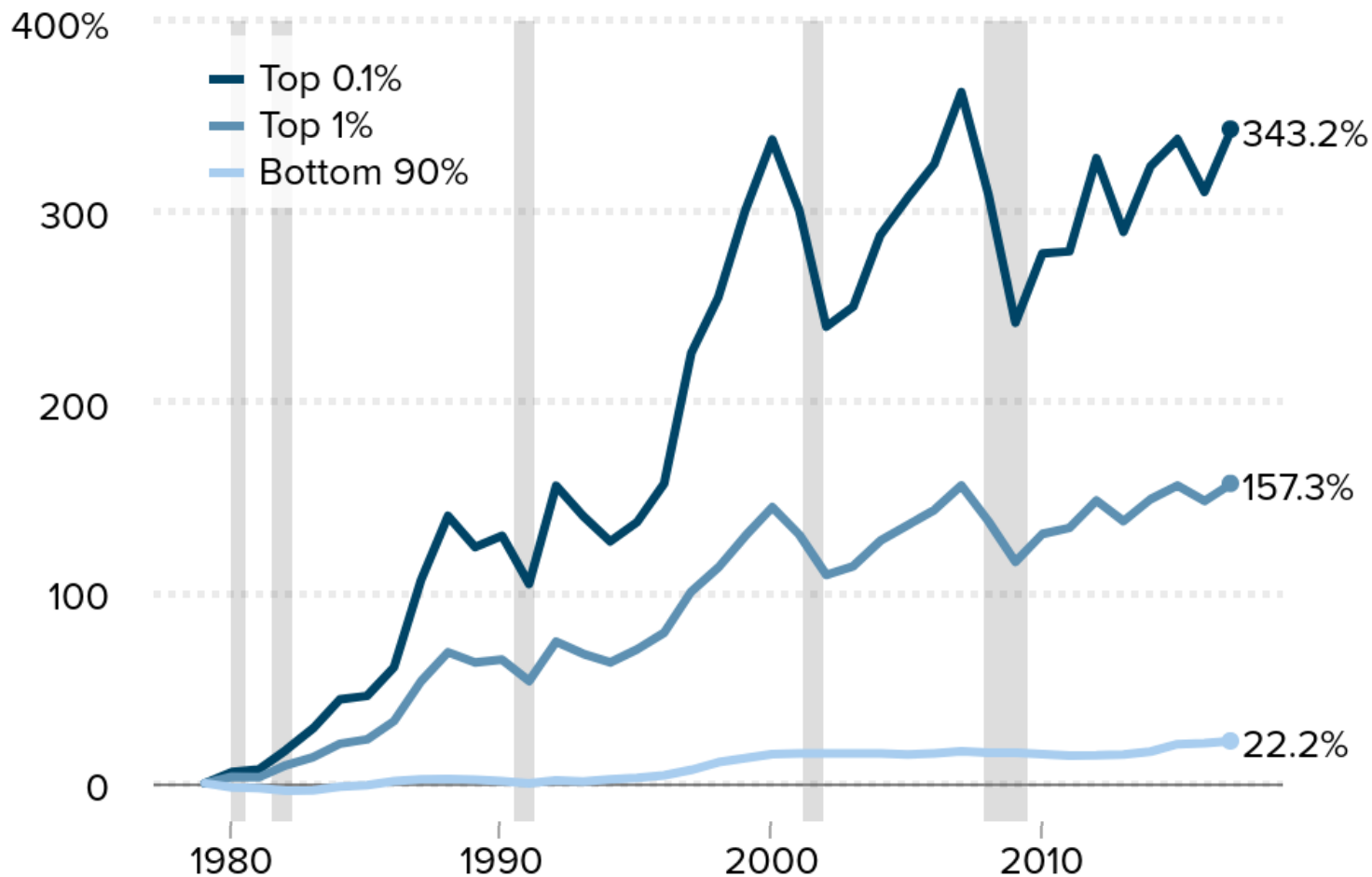
Robert Reich

Hourly wage gains (bottom two-thirds) stopped matching productivity gains



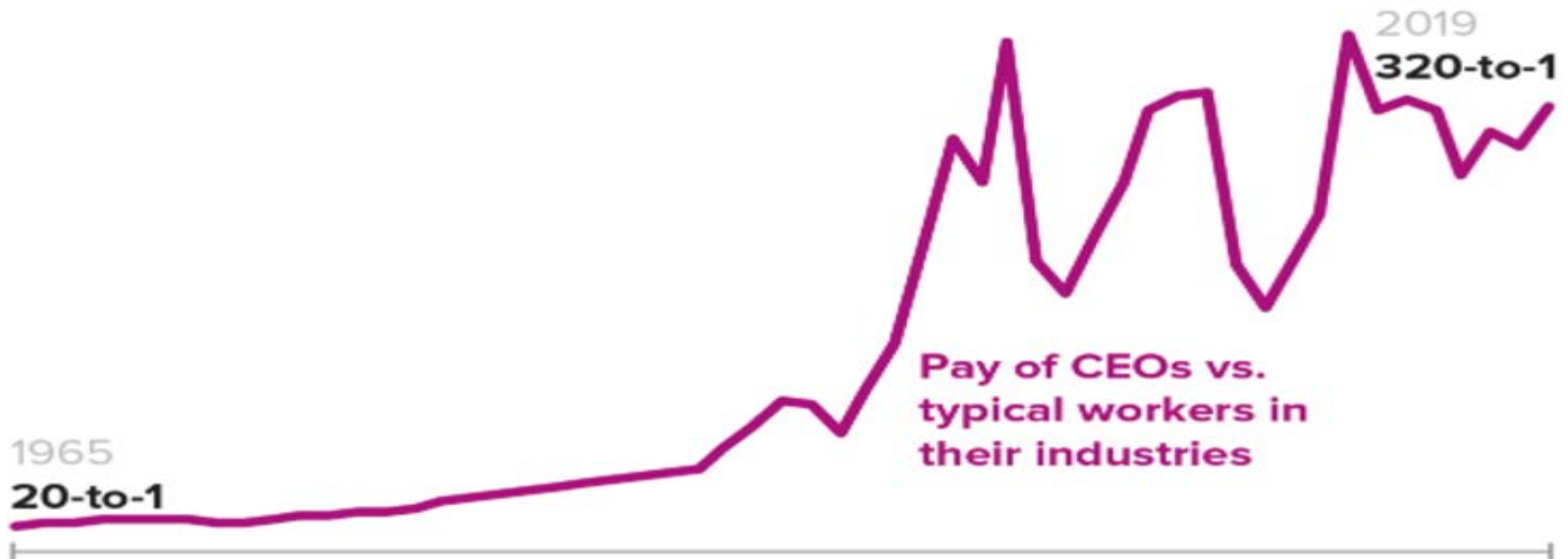
Increasingly, economic gains have gone to the top

Cumulative percent change in real earnings by earnings group, 1979-2017



CEO Pay

The CEO-to-worker compensation ratio has skyrocketed since 1965.

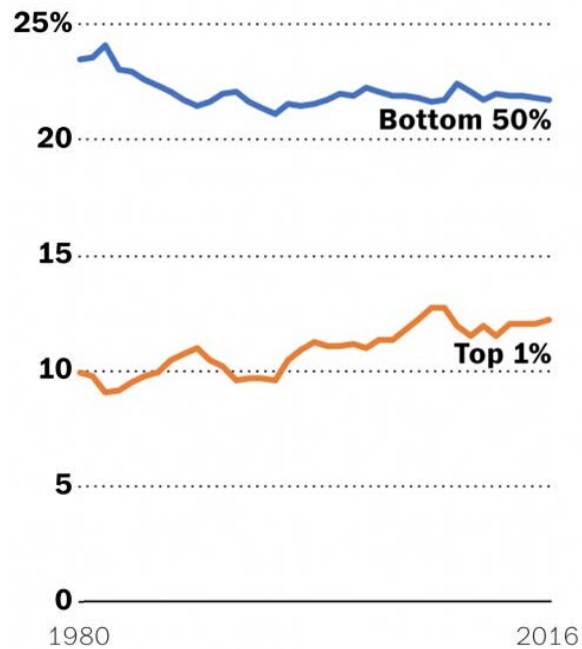


This didn't happen in other developed nations. Why not?

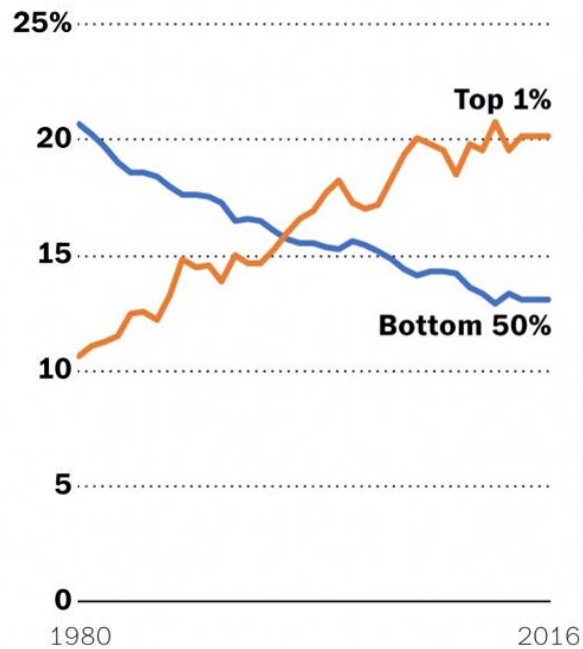
American exceptionalism

Top 1% vs. bottom 50% national income shares in the US and Western Europe, 1980-2016

Western Europe



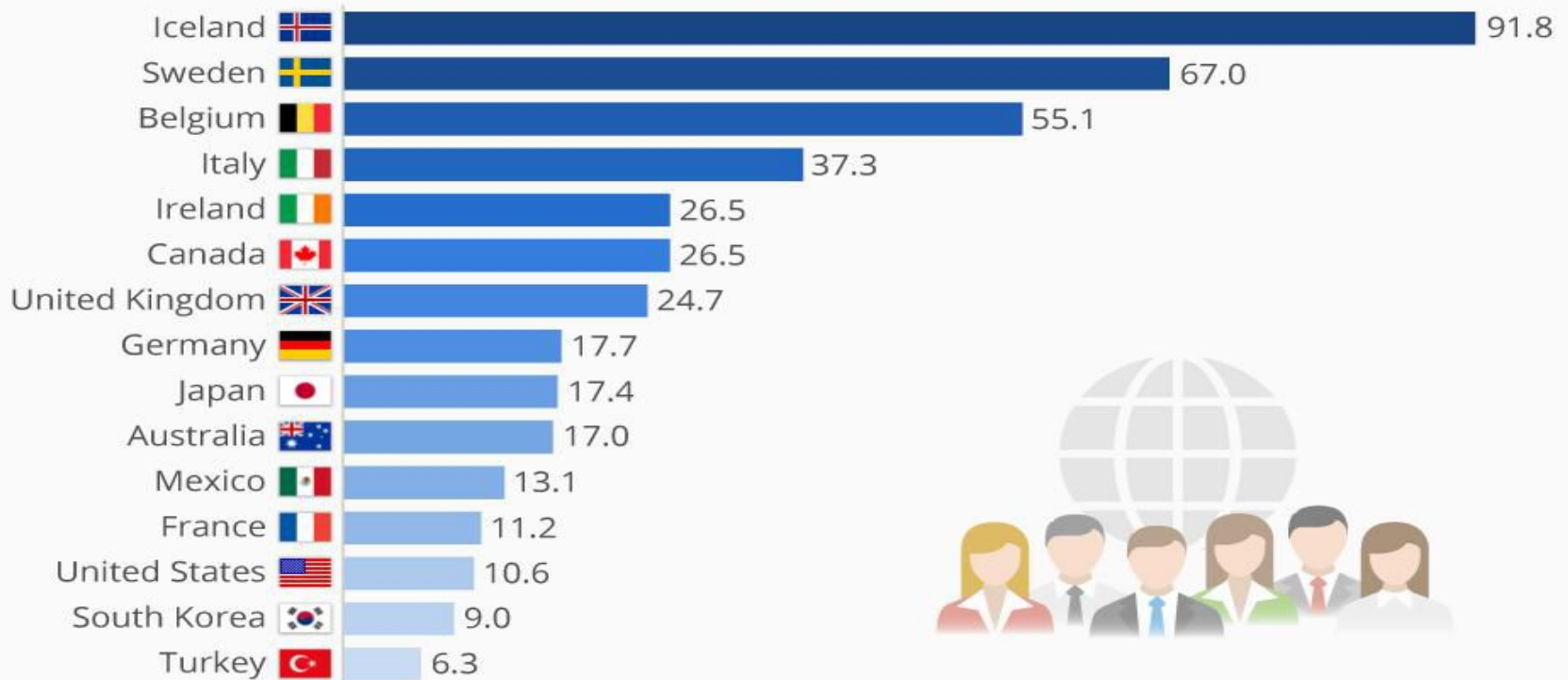
United States



Labor union membership in U.S. versus other developed nations

The State Of The Unions

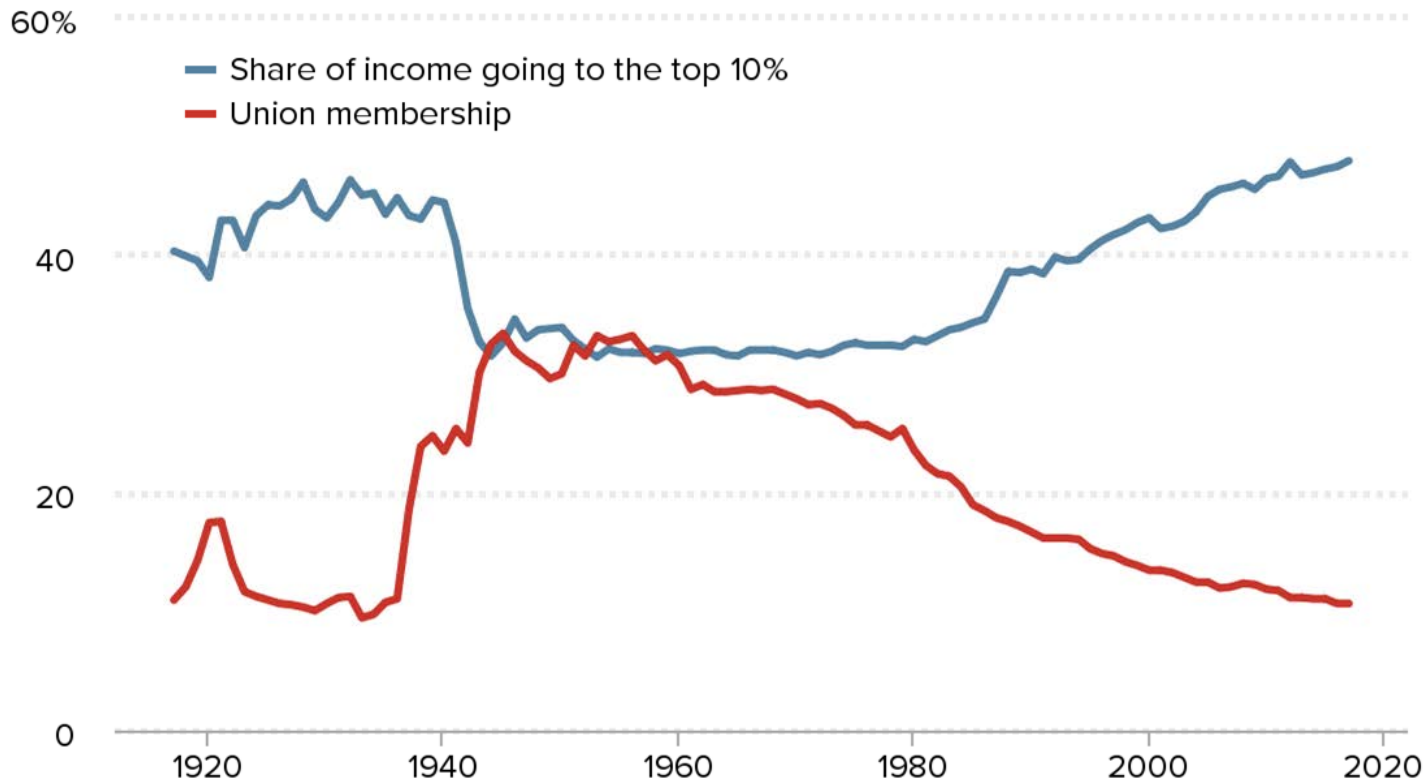
Labor union membership as a percentage of total employees



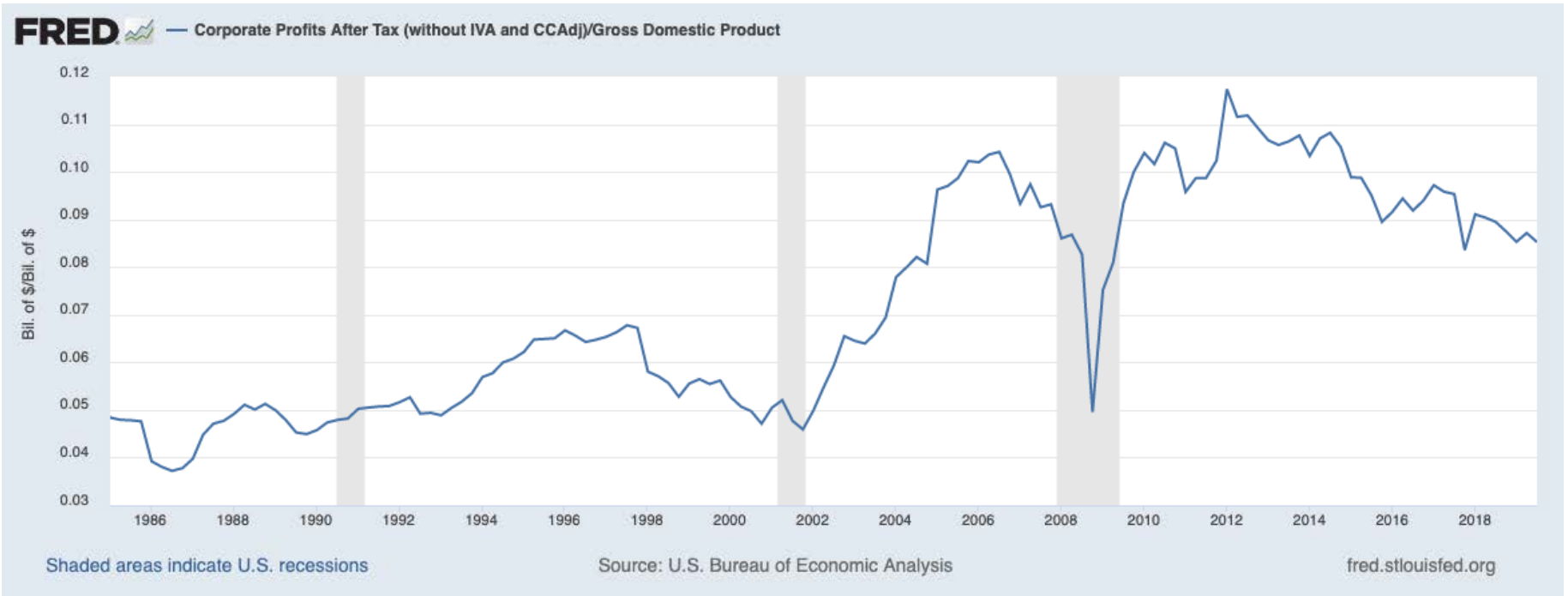
Union membership in U.S. and share of total income going to top 10 percent

As union membership declines, income inequality rises

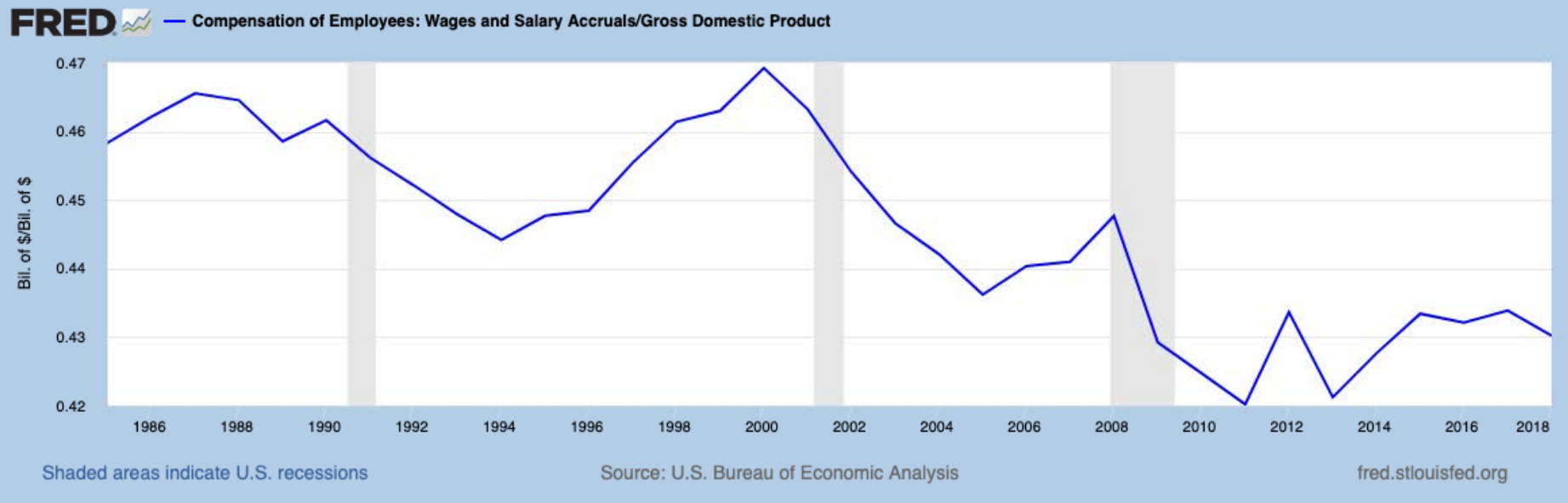
Union membership and share of income going to the top 10%, 1917–2017



Corporate profits have risen as a percent of GDP

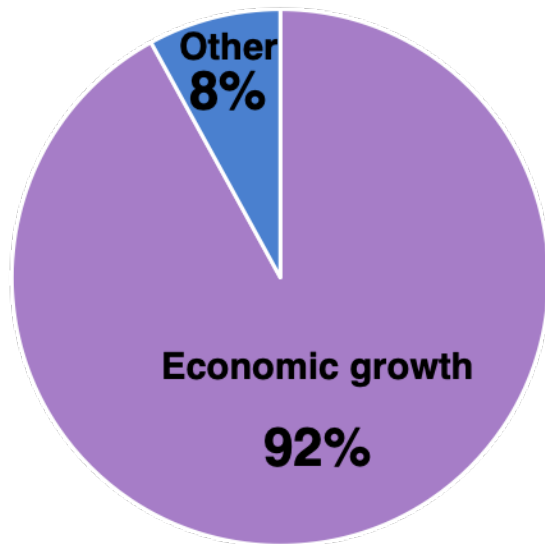


Wage and salary income has dropped as a percent of GDP

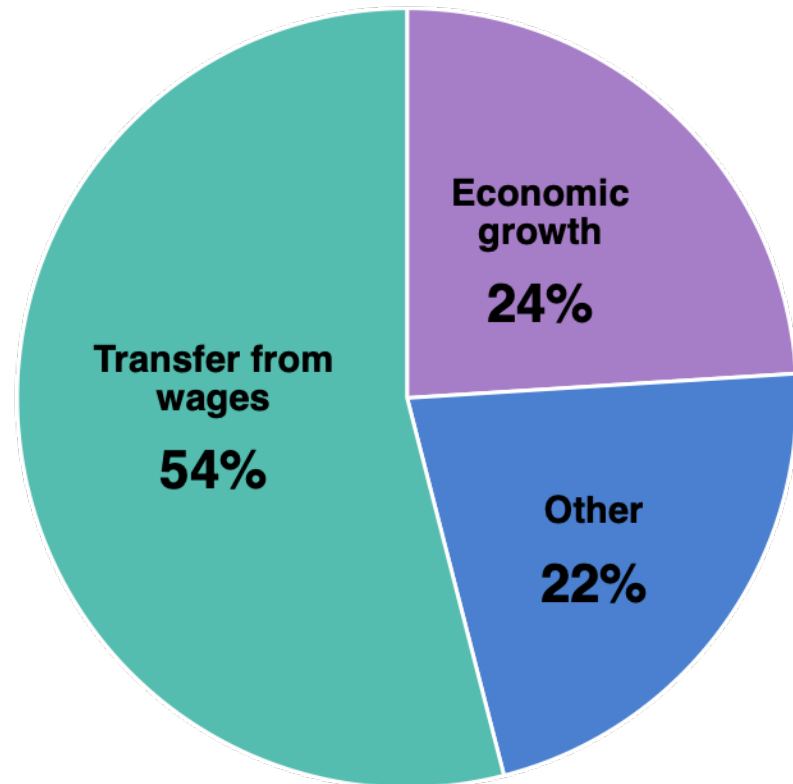


Increasing portion of shareholder wealth now comes from what used to go to wages

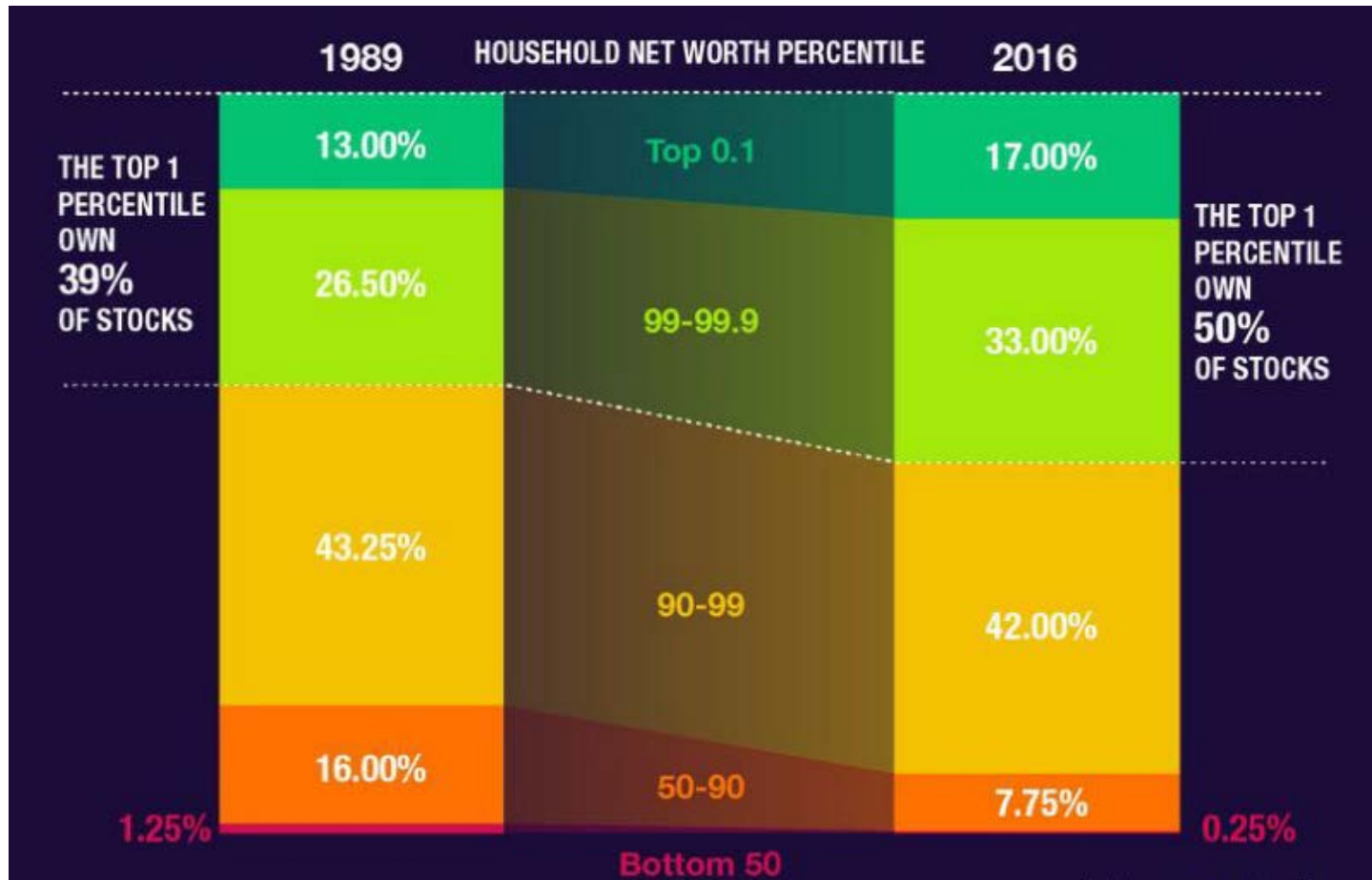
1952-1988



1989-2017



Richest 1% own half of the U.S. stock market, richest 10% own over 90 percent.



Source: Federal Reserve Board, Goldman Sachs Global Investment Research