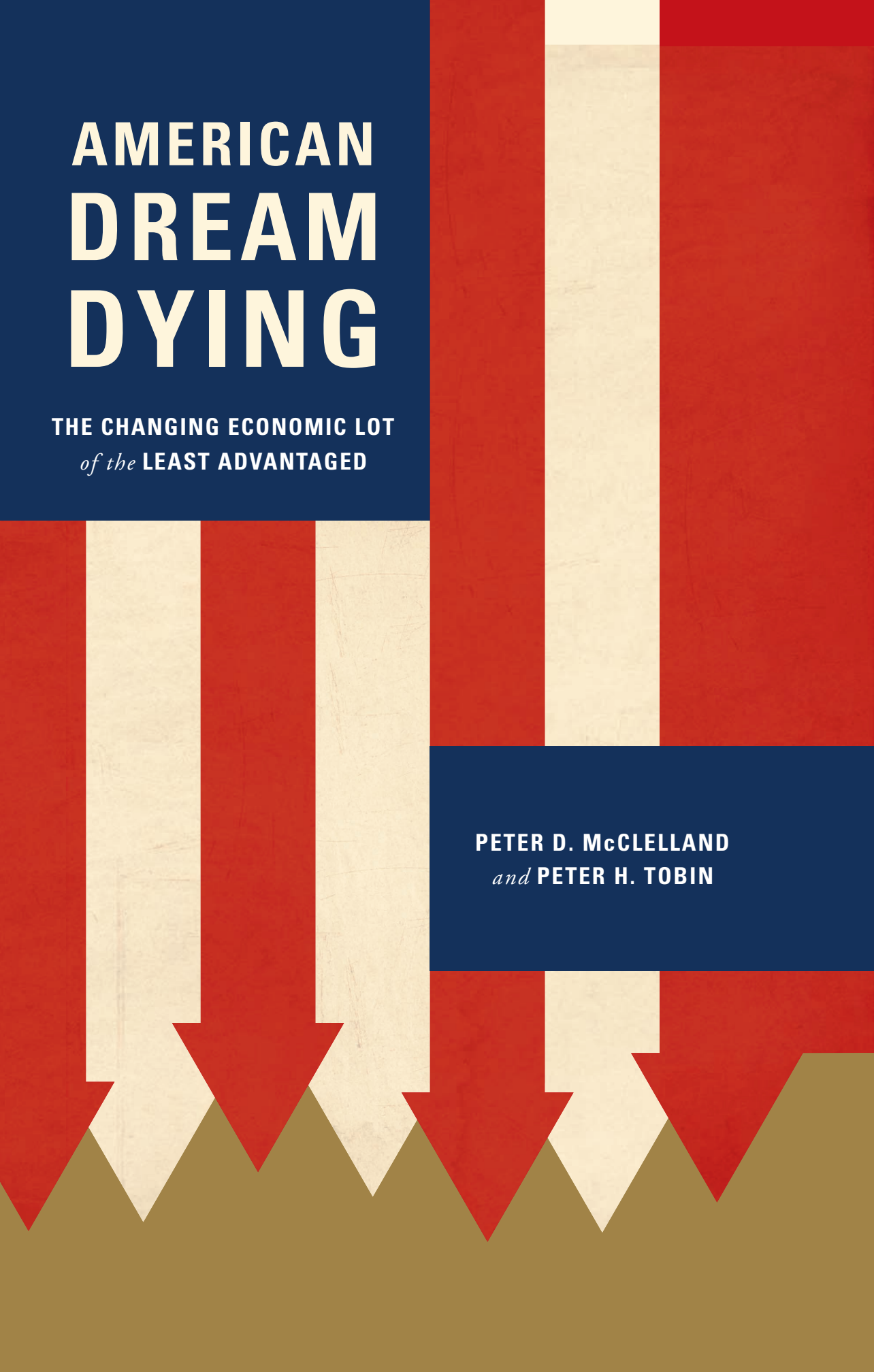
AMERICAN
DREAM
DYING
THE CHANGING ECONOMIC LOT
of the LEAST ADVANTAGED
PETER D. McCLELLAND
and PETER H. TOBIN

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The Changing Economic Lot of the Least Advantaged

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PREFACE

This work is based upon two premises. The first is that the pervasiveness and persistence of the withering of the American Dream across this country is a story with which few Americans are familiar. Under this heading they are familiar with recent difficulties of the middle class, but know little about how the Dream has been disappearing over the last three decades for those lower down the income scale. The second premise is that this latter story can only be told using aggregate data, not anecdotes. From the reader it asks a little and a lot. The text is short, free of jargon, and easily covered in a few hours. For many readers, however, the careful scrutiny of a succession of graphs will be an unfamiliar and demanding task. The key word in the previous sentence is "careful." Only with such scrutiny can the magnitude of the transformation under way be fully grasped. With that grasp will come, at a minimum, a sense of profound unease if not outright alarm. Or such is the hope of the authors.

The text was written by Peter McClelland. The graphs and bar charts were designed by Peter Tobin.

INTRODUCTION

How curious is the evident indifference of most Americans to the looming domestic crisis that, should it occur, will probably disrupt the social fabric of this nation more than the Great Depression of the 1930s. The development at issue is the fading of the American Dream for growing numbers of the population. The reader may protest that problems with the American Dream are clearly topics of contemporary concern, as evidenced in the recent presidential campaign. The focus of accompanying popular discussions and debates, however, has largely been confined to recent and prospective developments that threaten the economic welfare of the middle class. Almost always missing have been two crucial aspects of a larger set of interconnected problems. One is an awareness that those toward the bottom of the income distribution have become far more vulnerable than those in the middle to economic trends imperiling the American Dream. The other is that the trends in question have been evident in this country for decades. Admittedly, a vast professional literature exists on two related topics: (1) social and economic problems of the poor, and (2) growing income inequality in this country since the mid-1970s. Our focus is somewhat different. It consists of (a) identifying the key economic components of the American Dream as revealed by recent polls, and (b) tracing the trend in those components as revealed by relevant data. For the latter investigation, "the least advantaged" will be variously defined as the bottom 10, 20, or 25 percent, depending upon the lowest division available in the numerical series being examined.

At its core, the American Dream has always been about possibilities. During the past thirty years, the economic possibilities for an ever-larger number of Americans have been significantly altered in alarming ways as the domestic economy has been radically transformed. The causes of this

transformation are poorly understood, but the effects are evident to all: the flattening out of real wage and income growth for those in the middle; the decline of real wages and income for those at the bottom (save for a brief five-year period at the end of the 1990s); and the rising insecurity for both as job markets become more volatile and adequate health and pension coverage becomes more difficult to acquire. Reread that list. Their collective implication is that possibilities at the very core of the American Dream—economic advancement and financial security—are disappearing for growing numbers of those in the labor force. Many in the middle class may accordingly be forced to scale back the hopes included in their particular version of the Dream. For those at the bottom, however, the end result may be the loss of hope itself, and the abandonment of belief in *any* version of the American Dream. The key question then becomes this: What impact will such developments have on the social fabric of this country?

The answer is far from clear, but the question is surely of the first importance. Until the recent economic and financial crises, the problem was seldom addressed seriously or even raised by major political figures or the mainstream media. The economic fate of the middle class has now taken center stage, but the long history of difficulties of those toward the bottom of the economic ladder tends to be added as an afterthought, if added at all. Why have so many of the citizenry remained largely indifferent to the changing lot of the least advantaged?

Part of the explanation is undoubtedly the mind-numbing nature of the data tracking relevant trends. Wages, family incomes, modifications of employer-sponsored health and pension plans, shifting job possibilities across various production and service sectors—these are but a few items from a list so lengthy that its mere enumeration tends to make the eyes glaze over. Another difficulty is the persistent wrangling among the experts about the causes of trends revealed by the data. Consider the rising inequality of wages paid to workers in America, one of the most dramatic developments of the past thirty years. In their explanations of this growing divergence, economists still cannot agree which causes mattered most. If their arguments are accompanied by labor market models and econometric analysis—as the best of them invariably are—the end result tends to be largely unintelligible to the general public. What matters most to most Americans is not rising inequality of wages or incomes per se, but a decline in equality of opportunity. The key empirical evidence of the latter would be a pronounced reduction in economic mobility, particularly for those on the lowest rungs of the economic ladder. Available data to measure such mobility are both limited and imperfect. Expert analysis of these numbers

suggests that economic mobility in this country in recent decades has almost surely not increased and quite possibly has declined. Such tentative conclusions are not the stuff of which eye-catching headlines can be made. Here, then, is yet another reason for popular unconcern. The one measure sure to generate widespread interest in the fate of the American Dream—an unambiguous and sharp decline in economic mobility—is simply not available. Last, but hardly least, discussions of empirical trends related to the fate of the American Dream tend to be disjointed. Bits and pieces are scattered about the literature, but almost never is an effort made to bring the various strands together for an overview assessment.

The latter is the main objective of this book, with two caveats. First, the data presented represent the bare minimum required, and deliberately so. The end result is a numerical overview of the problem stripped to the bare essentials. The picture that emerges is both stark and worrisome. Second, our primary concern will be to elaborate what has happened in American labor markets, but not why. Discussions of causation will therefore be kept to a minimum. The modest goal will be to summarize the major causal factors emphasized in the technical literature, noting which debates remain unresolved, and how that lack of resolution does or does not impair the ability to make forecasts about the future.

One final cautionary note. This work is brief, but the stakes are huge. If the American Dream is indeed withering for a growing number of Americans and that trend persists, the increasing gulf between economic reality and the hopes embedded in the Dream could force a refashioning of widely held beliefs about what this nation is or ought to be. The prospect of such a refashioning surely warrants, in Jefferson's phrase, the ringing of a firebell in the night.

1

PROBLEMS OF DEFINITION

Often used but seldom defined, "the American Dream" is a concept encompassing a number of priorities crucially important for the majority of Americans. Perhaps the best guides to its multiple meanings are the polls deliberately crafted to elicit popular opinion on the topic. The results of such surveys for our purposes can usefully be divided into two broad categories: economic and noneconomic. The latter tends to be a relatively short list, consisting of a handful of commonly shared goals, such as "living in freedom," "having a family," or "living in an open society in which everyone has an equal chance."[1] Notice that the goals, like the Dream, have a number of possible interpretations, including "having a family." The economic goals commonly included in the concept of the American Dream also comprise a relatively short list. Some are static objectives or have connotations of a fixed target: owning a home, "financial security," and getting a "good" education (the recipients of that education ideally to include both parents and their children and, in most cases, "good" to include attending college). The main dynamic economic targets are a rising standard of living and upward mobility. The former does not necessarily imply the latter. A rising tide may lift all boats but leave those elevated in the same position relative to each other. Both ambitions are consistent with the frequently expressed wish of "doing better than one's parents."[2] So, too, is the idea that "if you work hard and play by the rules, you can live a solid middle class life."[3] Upward mobility ambitions, when explicitly stated, usually feature some variant of the Horatio Alger story line—for example, the chance "to rise from clerk or worker to president of a company."[4]

The condition popularly viewed as indispensable for achieving almost all of these economic goals is equality of opportunity—yet another concept central to American ideals but difficult to define. The opportunity in

question is the chance to participate in the multiple markets of a capitalist system. The difficult assignment is to explain how such opportunities can be made equal. Explorations of the meaning of "equality" in this context often resort to the metaphor of a race. The market is the racecourse, and incomes earned are the prizes. The notion of equality then becomes linked to the requisite conditions for fairness in the race. The beliefs of most Americans on this topic, although diverse and seldom clearly specified as an interconnected whole, tend to coalesce around the following ideas:

1. Would-be contestants should be reasonably equal at the starting line.
2. On the racecourse, participants should be treated in a reasonably equitable manner, in the sense that unfair advantages and unfair handicaps are relatively rare.

If both of these conditions hold, the common inference is:

3. Prizes tend to be rewarded for meritorious behavior, most notably hard work, thrift, and foresight (although luck may also play a role).

These three beliefs, in turn, imply:

4. The resulting distribution of prizes (or incomes earned) is reasonably fair or just.

Not all Americans carry around in their heads a set of beliefs exactly as articulated above. In many cases, the relevant beliefs are vaguely formed at best, and the connections among them are often not carefully thought through. The issue of importance here is what their responses might be if pressed repeatedly to clarify their answers to the following questions.

1. What are the minimum requirements for a reasonable degree of equality of opportunity to exist?
2. Is the present income distribution in America reasonably fair? If so, why? And what do you mean by "reasonably"?

The hypothesis is that, in response to such verbal proddings, what would emerge in the majority of cases would be closely akin or identical to the set of ideas as formulated above.[5]

That formulation is sure to strike philosophers as appallingly vague. Consider, they might argue, equality at the starting line. This is obviously impossible to achieve, given that the capabilities of would-be contestants are strongly influenced by heredity and environment. Those with a superabundance of brain cells or coming from an enriched family background are likely to have an edge on those who are less gifted or from broken homes. On the racecourse, perfect equality of treatment is similarly elusive. For example, some will gain advantage through family and social contacts, while the distortions produced by monopolistic power will affect the outcomes in some markets but not in others. As for the role of meritorious behavior in determining who wins what, earnings are also crucially affected by luck, and the relative importance of the two (merit and luck) is impossible to determine. How, then, can the rewards of the market system be considered in any sense fair or just?

To arguments such as these, Americans for the most part are monumentally indifferent. Rigor in reasoning and perfection in results generally do not rank high among their aspirations. By temperament, they are pragmatists, not perfectionists. Whenever an array of real-world developments appear to undermine equality of opportunity, they prefer to focus on those defects that realistically can be identified and then lessened or removed.

Perfect equality at the starting line, they readily concede, is impossible to achieve. Given that impossibility, their pragmatic response in their search for improvements has been mainly focused on providing a public education that is free and equal for all. The implicit premise seems to be that—with a few exceptions—other sources of inequality are either tolerable or intractable, and thus can be comfortably ignored. (How free education can be made in some sense equal is a puzzle that has yet to be resolved.)

As for conditions on the racecourse, the concerns of most Americans are similarly pragmatic. The important task, as commonly conceived, is to identify specific inequities that strike the lay observer as blatantly unfair, such as discriminatory practices or the exploitation of monopoly power by the few who have it to the detriment of the many who do not. The task of identifying such reprehensible behavior and designing the means to moderate or eradicate it they generally are content to leave to legislators and government agencies responsible for making the marketplace a more equitable arena.

Finally, they are not troubled by the philosopher's point (impossible to deny) that luck as well as merit—and occasionally reprehensible behavior—determine market outcomes, and the relative importance of each in most instances is impossible to ascertain. The popular article of faith

is that rewards are strongly correlated with meritorious behavior (such as the exercise of industry, frugality, and foresight). The market system is then judged, not perfectly fair, but fair enough, provided that the two conditions previously noted hold; namely, that both at the starting line and on the racecourse a reasonable degree of equality exists among competitors. When actual inequities are identified, the common reaction is not to question the intrinsic fairness of the race, but rather to focus upon mitigating or removing the defects in question.

Notice in passing that what has long puzzled the extreme Left becomes considerably less puzzling: why most Americans are not instinctively indignant about the growing inequality of wages and income in this country. The belief system outlined above implies that *any* income distribution can be presumed to be fair, provided that the conditions central to the belief system noted do in fact hold, or "roughly" hold, or are perceived to hold to a "reasonable" degree.

The key arguments made thus far reduce to this. First, the American Dream is not about idle wishes, but about hopes that are perceived to have a reasonable chance of being achieved. Second, the hopes embedded in the Dream take many forms, but they invariably include three economic aspirations: a rising standard of living, financial security, and upward mobility. The American Dream minus these components is no more easily imagined than is *Hamlet* without the Prince of Denmark. Third, underlying the economic hopes noted is a set of premises seldom made explicit concerning the nature of the market system in this country. These concern the pervasiveness of equality of opportunity, the intrinsic fairness of the economic race, and a strong correlation between the exercise of such meritorious virtues as industry, frugality, and foresight and the distribution of rewards. Indeed, such premises are what make the economic hopes embedded in the Dream a realistic expectation. If the economic race were viewed as rigged, or if rewards were determined by luck alone, why should any rational American believe in the Dream?

Consider now the likely consequences if the facts of economic life were persistently inconsistent with the hopes embedded in the Dream. Those who "work hard and play by the rules" and yet experience stagnant or declining real incomes and rising financial insecurity at some point would surely lose faith in the Dream and at least question, if not jettison, those beliefs that collectively imply that the income distribution generated by the market is intrinsically fair, or reasonably so. Available evidence suggests that such a scenario is not beyond the realm of possibility. Many in this country seem to sense that all is not well with the American Dream. That

awareness, as revealed by polls, usually indicates a growing tension between deep-rooted optimism and rising apprehensions.

Economic concerns readily surface in virtually every survey designed to tap perceptions on this topic. A poll conducted in 1998 found that two-thirds of those surveyed believed that the Dream was "harder to achieve now than a generation ago" and "will be harder still a generation from now."[6] In 2004, a similar survey recorded similar results. Over two-thirds agreed with the statement that the Dream was becoming "more difficult for average people to obtain" and "much harder for young families to achieve."[7] A second 2004 poll posed essentially the same question in a slightly different way. Those surveyed were asked whether (a) "compared to your parents' generation" and (b) "compared to 10 years ago," it was easier or harder "for Americans today to achieve the American Dream." To both questions, six out of ten responded "harder."[8] The linkage between merit and reward is also becoming suspect. A 2006 survey put the matter this way: "If you work hard and play by the rules," you can count on "having [or] living . . . a solid middle class life." Ninety percent of those polled believed that this statement was true twenty-five years ago, but only 49 percent believed the same is "true today."[9]

Such doubts do not come easily to a people known for their optimism. The very phrase "the American Dream" is peculiarly American. ("The French Dream" or "the Japanese Dream" ring strangely in the ear.) This propensity for hopefulness was apparent in all of the polls cited. For example, while two-thirds of those surveyed in 2004 were convinced that the Dream was becoming more difficult for "average people" or "young families" to achieve, roughly two-thirds were also convinced that (a) they "personally [were] living the American Dream," (b) the Dream could be realized by "all or most people in this country," and (c) their children would "have a fair shot at it."[10] A similar ambivalence was evident in the responses to a statement posed by the 2006 poll: "America is the land of opportunity, but people are not living the [American] Dream." Eighty-one percent of those surveyed agreed.[11]

National polls, however comprehensive, are merely rough indicators of popular perceptions of the facts. But what are the relevant facts? More specifically, what evidence can be marshaled to indicate the extent to which the economic hopes embedded in the American Dream are fading for growing numbers of the population? That question concerns, first and foremost, the trends in three variables: (1) standard of living, (2) financial security, and (3) upward mobility. Subsequent analysis will focus on how

these variables have changed for the average American family and for those at the bottom of the economic ladder.

Changes in the standard of living of any group can reasonably be approximated by changes in income corrected for inflation (or as economists prefer to say, changes in "real" income). Income, in turn, for most Americans is significantly dependent upon wages. Accordingly, chapter 2 will examine trends in both.

The trend in financial security is far more difficult to document. Ultimately, it is a personal judgment based upon a number of variables, all of which concern present and future income and expenses. The troublesome word is "future." Even if we could identify all of the relevant variables that affect the individual's perception of financial security, we usually cannot predict with confidence how most of those variables will change in future years. We can, however, examine recent trends in those economic series that crucially affect the security assessments of most Americans. Several come immediately to mind. Has the availability of adequate pension coverage and health insurance changed significantly, and for the worse, in the last few decades? Have jobs and incomes, on the average, become more volatile? And what has been the trend in that ultimate indicator of financial insecurity, personal bankruptcies? Evidence addressing questions such as these will be presented in chapter 3.

Documenting the trend in economic mobility is a perfectly straightforward task, at least in theory. All that is required is a comprehensive data set that tracks the economic fortunes of a representative sample of Americans over several generations. Changes in mobility will then be indicated by the changing rate at which those in the sample move up or down the economic ladder. A decline in equality of opportunity—or a rise in inequality of opportunity—would be signaled in a fall in the rate at which those in, say, the bottom quintile move up to higher quintiles. At least in theory. In practice, as noted in the introduction, available data are limited, and analysts remain divided on whether the numbers in question indicate that mobility in recent decades has been basically unchanged or declined marginally. Both interpretations will be discussed in chapter 4.

At this point the discussion seems threatened by an empirical dead end. The evidence on trends in standard of living and the major variables affecting financial security imply a marked decline in the possibility of achieving the American Dream for many in this country. But the bottom line that matters most to most Americans is missing: unambiguous evidence of a major decline in upward mobility, particularly by those at or near the bottom of the economic ladder. Indirect evidence can nevertheless be mar-

shaled that speaks to both questions: the waning of the American Dream in general, and the declining prospects for upward mobility in particular. The mobility question can be addressed under three headings:

1. To what extent is marketplace success becoming ever more dependent upon the level of education of would-be participants?
2. Do the trends in public school education (K–12) imply that, at the end of high school, America's youths are becoming less well prepared with the requisite skills for ascending the economic ladder?
3. If a college degree is becoming more important for gaining access to higher-paying jobs, do the trends in college costs and available financial aid imply that postsecondary education at such institutions is an option becoming progressively less feasible for children from families at the lower end of the income distribution?

These and related questions will be the focus of chapter 5. The fundamental finding is that the implication of present education trends for the future upward mobility of those at the bottom of the economic ladder is disturbing in the extreme.

To this point, the emphasis has been on evidence that the American Dream is a waning possibility for growing numbers of Americans. More narrowly, our concern has been to show a troubling coalescing of negative influences by examining the trends in the three economic variables at the core of the American Dream: standard of living, financial security, and upward mobility. What of the future?

Forecasting tends to be a tricky business, particularly in this case. The starting point is obviously an understanding of the causal forces that crucially affect the three economic variables noted. Which causal forces mattered and to what extent is regrettably still a subject of dispute among the experts. An imperfect way around this difficulty is to examine the likely trend in all of the major causes in dispute. If almost all of these are likely to persist or worsen, and if the likely trend in the remaining few is to become, at best, only marginally better, then the obvious (albeit tentative) inference is that the waning of the Dream is almost certain to persist and may possibly get worse. The elaboration of the causes and the investigation of their likely trends in the near future are the principal assignments of chapters 6 and 7. The conclusion implied by the analysis is that the waning of the Dream in recent decades is almost certain to continue.

Finally, what might be done to make a bad situation better? Any policy option that would require a massive increase in federal spending will be

devilishly difficult to implement. The reason is simple: The federal deficit is presently huge and sure to increase. Chapter 8 explains why.

The last chapter examines some of the criticisms likely to be voiced against the evidence, analysis, and conclusion of this work. What the chapter will not consider are policy proposals designed to alleviate or remedy the many difficulties contributing to the waning of the Dream. Any remedy is sure to be imperfect, and such imperfections are a likely target for those who would denigrate or dismiss the main theme of this work. Its primary task, as noted at the outset, is to sound a warning. The first step to solving a problem of such magnitude and urgency is to acknowledge its existence.

2

STANDARD OF LIVING

The measure economists commonly use to estimate changes in standard of living is the change in output per capita (or gross domestic product per capita) or alternatively, income per capita, both variables corrected for inflation. (On the nature of that correction, more in a minute.) The hidden assumption is that, for any given country in any given year, the value of the output created is roughly equivalent to the incomes earned by those who created the output—or national income equals national output.[1] The assumption for this chapter—and for the rest of this study—is that changes in a family's income are a good approximation of changes in that family's standard of living. In what follows we shall also investigate changes in wages for the simple reason that, for most income groups, wages are a major source of income. The lower down the income scale the wage earner is, the more his or her income is likely to be largely determined by wages received.[2] This helps to explain why those searching for the causes of the growing American income inequality focus much of their attention on the causes of growing wage inequality, of which more in chapter 7.

In sum, a rising standard of living is a core component of the economic goals embedded in the American Dream, and the trend in any given family's income is a good approximation for the trend in that family's standard of living. What is the evidence that this aspect of the American Dream has been significantly eroded in recent decades for many in this country?

Before turning to that question, we need to clear away a bit of intellectual underbrush concerning:

- how inflation is measured
- the difference between the mean and the median as a measure of the average

Those familiar with both are urged to skip the next two sections and go directly to "Income Growth."

CORRECTING DATA FOR INFLATION

Even the title of this section tends to make the eyes glaze over. But the importance of the correction procedures about to be considered cannot be overstated. All of the numbers in this chapter (and many elsewhere) are expressed in "inflation-adjusted" or "real" dollars. This is crucial. Consider an extreme case. Suppose that, in a given year, total output and thus total income remain unchanged while the price level doubles. If no correction is made for inflation, the data imply a huge leap forward in living standards during the year in question. Once the numbers are corrected for inflation (in this case, reduced by half), the resulting dollar totals for income and output remain virtually unchanged, implying that the average standard of living of the citizenry has not improved at all.

But how can changes in the "general price level" be gauged with any accuracy? The solution commonly adopted by economists is to construct a price index, conceding at the outset that the end result will be, at best, a reasonable approximation for changes in the collective price level of certain goods incorporated into the price index. In this study, we shall rely exclusively on the Consumer Price Index, or CPI.[3] It is constructed in three steps. First, "typical" urban consumers are identified.[4] Second, the "market basket" of goods and services consumed by such individuals in a year is estimated by sampling the actual spending patterns of urban consumers. Finally, the value of this market basket is calculated for successive years. The annual rise in the basket's value should provide a reasonably good indicator of how much the "general price level" has risen for the typical consumer. The quotation marks merely underscore the obvious: The end result is an estimate, with no pretensions to exactitude.[5]

An example may help to clarify the arithmetic involved. Suppose that the CPI for the year 2007 is 3 percent higher than the CPI for 2006. If the average family income in America in actual (or "nominal") dollars was $46,000 in 2006 and $50,000 in 2007, the difference between the two numbers—$4,000—overstates the "real" gain in the average standard of living of American families. To correct for inflation, we need to reduce the 2007 income figure by 3 percent—or reduce $50,000 to $48,500. Then the difference between the inflation-adjusted income of 2007 ($48,500) and the actual income of 2006 ($46,000) indicates by how much "real"

income has advanced in twelve months—in this case, by $2,500 (not $4,000).

Some readers may be inclined to dismiss this correction procedure as much ado about very little. After all, inflation in the past decade has been quite moderate by American postwar standards, by and large ranging between 2 percent and 3 percent per year. But the long-run impact of such modest numbers is far from trivial. Consider two workers, Tom and Harry. Both begin working at the same time. Both work for thirty years. During that time period, inflation averages 3 percent a year. In the same three decades, wages paid to Tom also increase by 3 percent per year, while Harry's wage rate remains unchanged. Over the period in question, Tom's inflation-adjusted or real wage remains unchanged. What about Harry? An annual inflation rate of 3 percent, because of compounding, will result in the price level doubling in roughly twenty-four years. By the end of thirty years, then, the purchasing power of the dollars that Harry is earning (unchanged in actual or "nominal" terms) has fallen by more than half. If wages are his only source of income, then his standard of living has fallen by more than half. The example merely underscores the central point: To gauge whether the real value of income or wages is actually rising, all dollar figures must be expressed in inflation-adjusted terms.

MEAN OR MEDIAN AS A MEASURE OF THE AVERAGE

Nine males are chosen at random from your local high school. What is their average height? The procedure that usually springs to mind is: (1) measure the height of each student, (2) add the results, and (3) divide by nine. The end result is the mean height of the students in question. The procedure for measuring the median height is quite different. It consists of two steps: (1) line up all nine students in descending order of height, the tallest at one end, the shortest at the other, and then (2) measure the height of the student in the middle, or the one in fifth place when counting from either end of the line. That student's height will be the median.

Why do studies of changing income and wages almost always prefer using the second procedure to calculate a measure of the average? A second (and much used) example suggests the answer. Nine patrons are sitting in a bar. How should the average income of this group be calculated? Suppose that both measures—the mean and the median—give identical results of $40,000. Now assume that into the same bar walk Bill Gates and a homeless person. The median income will not change. Line up all eleven

patrons from the highest income earner to the lowest, and the person in the middle—who has an equal number of higher income recipients on one side and lower income recipients on the other—*has not changed*. The addition of Bill Gates to one end of the line and a homeless person to the other leaves the median income at $40,000. Now consider what happens to the mean. Given the presence of Gates, the average income as measured by the mean will rise by hundreds of thousands of dollars, even though the actual income of all initial nine bar patrons has not changed by so much as a nickel. Which measure, then, better captures what is happening to the average or typical bar patron? The problem, of course, is how the addition of Bill Gates distorts the mean as a measure of the average. If a huge increase occurs at the top of any distribution while the rest of the distribution remains relatively unchanged, the arithmetic mean will always give the false impression of gains by those in the middle, whereas the median will not.

A similar problem has arisen in recent decades as the income distribution in America has been radically altered. Those in the middle—the typical or average American family—have experienced very modest growth in real income, as we shall shortly see. At the same time, the incomes of the top 10 percent have been growing significantly faster; that of the top 1 percent, faster still; while the incomes of the top 0.1 percent have been growing by leaps and bounds. Our main goal for this chapter is to gauge what is happening to the standard of living of the average American family. The problem with the mean as a measure of the economic fate of those in the middle is that it is distorted upward by the extraordinary income growth rates of those at the very top. Accordingly, all of the graphic illustrations to follow will illustrate what is happening to the median (although a measure of the mean may also be included).

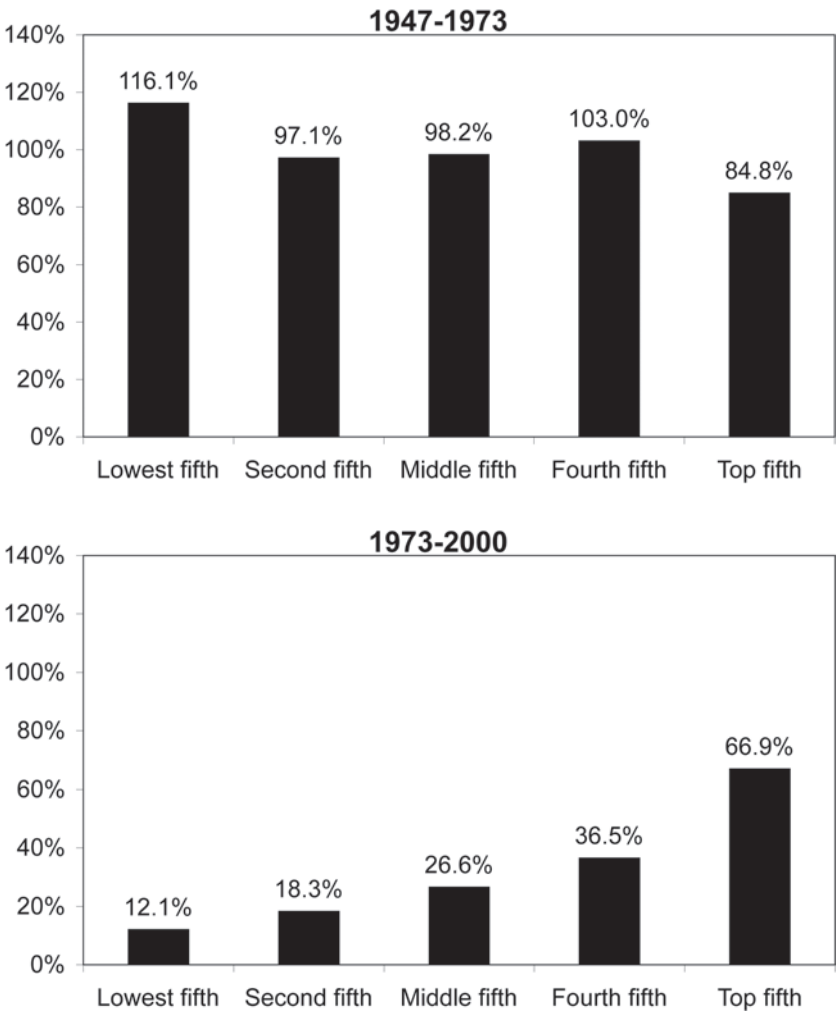
INCOME GROWTH

Starting in the mid-1970s, something went terribly wrong with the American economy. The causes are still a subject of dispute, but the effects on standard of living growth rates are readily apparent. The income growth of the average family slowed dramatically. For the bottom 10 percent, family income actually declined—not just for a few years, but for decades.

To see the broad outlines of this stunning shift in the nation's economic fortunes, look at figure 2.1. The bars for the top chart were calculated as follows: (1) all family income data for the period 1947–1973 were

corrected for inflation (or converted to real terms); (2) all families were divided into five equal income groups; and (3) the total income growth for each family group between 1947 and 1973 was expressed in percentage terms. The same three steps for the period 1973–2000 produced the bars in the bottom chart.

Figure 2.1. Real family income growth by quintile, 1947–1973 and 1973–2000[a]



[a]2005 CPI-U-RS adjusted dollars.

Source: Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2006/2007* (Ithaca, N.Y.: ILR Press, 2007), 57.

Two developments fairly leap from the page when the two charts are considered together:

1. During the immediate postwar era (1947–1973), the family incomes of all five groups grew so rapidly that by 1973 incomes (*corrected for inflation*) were roughly twice what they had been in 1947. Moreover, the largest income growth was recorded by those at the bottom, and the smallest by those at the top (116.1 percent and 84.8 percent, respectively).
2. During the twenty-seven years that followed (1973–2000), *all* of the growth rates slowed dramatically. Notice how the bars ascend from left to right. The lower the family income group, the smaller the total growth in their income. Indeed, that of the bottom fifth barely budged—up 12.1 percent in twenty-seven years, compared with a growth of 116.1 percent in the previous twenty-six years.

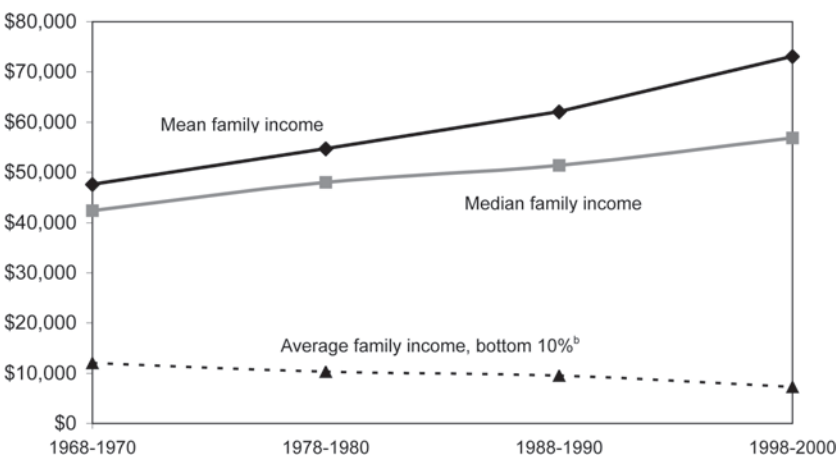
President Kennedy made famous the metaphor that a rising tide lifts all boats. The lift in our case is provided by economic growth, and the Kennedy characterization clearly applies to the 1947–1973 period. But in the twenty-seven years that followed, the upward thrust slackened dramatically. All boats continued to rise, but—to strain the metaphor—yacht owners did reasonably well while those with rowboats gained far less, and those too poor to own a boat benefited very little. The unsurprising result was a persistent rise in income inequality. However—and the point cannot be emphasized too strongly—the increase in American income inequality per se is *not* the focus of this study. Our concern, as explained in chapter 1, is with those economic variables at the core of the American Dream: standard of living, financial security, and upward mobility.

Now shift the focus from family income growth by quintiles over two long periods to the annual trends of two different groups since 1970: those in the middle and those in the bottom 10 percent. As figure 2.2 illustrates, the growth of the income of the typical family was somewhat larger when measured by the mean than was the case when measured by the median. What is striking is how modest the growth in median family income was over the course of three decades. At the beginning of the period, median family income measured $42,371. Thirty years later, it had grown to $56,870, or by 34 percent (both dollar figures corrected for

inflation).[6] Moreover, much of this can be attributed not to rising wages but to working more hours. For example, the real income of couples with children in "the middle-income fifth" grew 24 percent between 1979 and 2000. But these couples, on the average, were also working five hundred hours more per year in 2000. Without the added earnings from such labor, the income of this group would have expanded by a meager 5 percent in a twenty-one-year period.[7] As a device for raising family income, working more hours cannot continue to increase indefinitely. When this upward impetus becomes negligible, the income growth of families in the middle of the income distribution is sure to slow to a snail's pace unless other sources of growth materialize.

Finally, note the fate of the bottom 10 percent. Figure 2.1 indicates that families in the bottom 20 percent on the average experienced a slight rise in income over the twenty-seven-year period 1973–2000. Figure 2.2 indicates that those in the bottom 10 percent experienced a real decline (from $12,071 in 1970 to $7,262 in 2000).[8] The poor, in short, got poorer

Figure 2.2. Real family income, 1968–2000[a]



[a]2005 CPI-U-RS adjusted dollars.
[b]Bottom decile source used averages of three years of data to mitigate business cycle effects.
Source: Author's analysis of bottom decile family income data from Chulhee Lee, *Rising Family Income Inequality in the United States, 1968-2000: Impacts of Changing Labor Supply, Wages and Family Structure*, NBER Working Paper 11836 (Cambridge, Mass.: National Bureau of Economic Research, 2005), 30, and mean and median family income data from U.S. Census Bureau, "Current Population Survey Historical Income Tables—Families, (Table) F-7 Type of Family, All Races by Median and Mean Income: 1947 to 2005," www.census.gov/hhes/www/income/histinc/incfamdet.html.

in absolute terms. Put another way, over a three-decade period, the standard of living of those on the lowest rung of the economic ladder moved in exactly the opposite direction from that predicted by the American Dream.

If all of the evidence presented in figures 2.1 and 2.2 is combined, two questions come immediately to mind. What caused this radical decline in American economic growth beginning roughly in the mid-1970s? And why was the impact of slowing growth spread so unevenly across the different income groups of this nation?

The answer to the first, in a nutshell, is that we do not know. Economists can list a number of factors that contributed to the slowdown during this period, such as the decline in the rate of American saving, increased government regulations raising the costs of doing business, and too little expenditure on research and development. But a list of probable causes is not a satisfactory answer, at least not for economists. What they want is a model indicating how much of the total decline in economic growth can be attributed to each of the causal factors noted. And such a model they simply do not have. More cautiously, no model proposed—and there have been many—has gained widespread acceptance within the economics profession. The search for a rigorous and comprehensive explanation of the shift in growth so evident in figure 2.1 is therefore doomed to fail, at least for the moment. A partial explanation might nevertheless be available if (1) the trend in wages during the same time period is investigated, and (2) some explanation of wage trends observed can be wrested from the professional literature. The first is the main assignment for the remainder of this chapter. The second will be taken up in chapter 7.

The rationale for shifting from family income to wages earned is that the latter is usually a major contributor to the former.[9] As noted previously, the further down the income scale, the more important the contribution of wages to total income is likely to be.

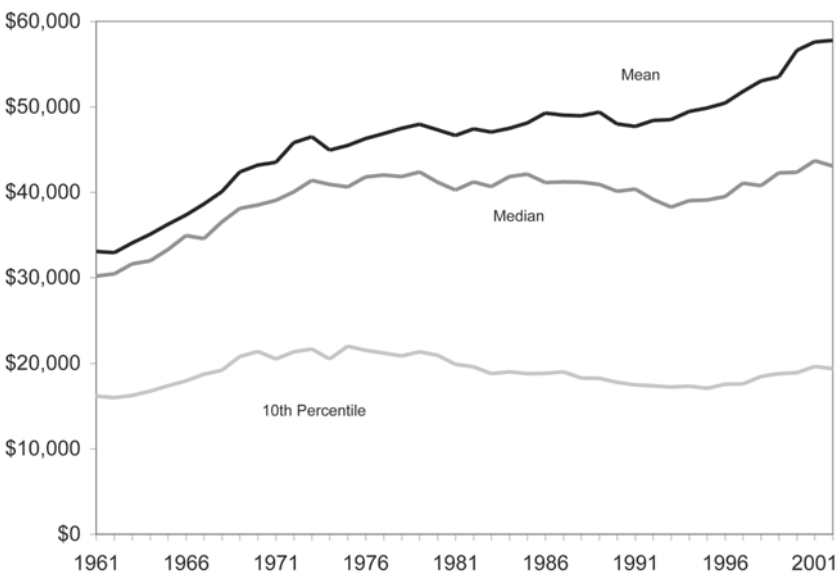
Figures 2.3A and 2.3B depict the trends in inflation-adjusted wages for males and females between 1961 and 2000.[10] Notice four things:

1. Mean wages for both groups rose more than median wages, as we would expect from the previous discussion about how these two averages are measured.
2. Between the mid-1970s and the year 2000, median real wages for men virtually flattened out,[11] while those for women grew mod-

estly from $23,670 to $32,304, or by 36 percent over a twenty-five-year period.

3. Consistent with the trend illustrated in figure 2.2, the real wages of those at the bottom of the economic ladder changed very little. For men, the wages of the bottom 10 percent fell from $22,023 in 1975 to $19,382 in 2000. Female workers in the bottom 10 percent fared slightly better, their wages rising from $13,088 to $15,678 in the same time period. As the income data for the bottom 10 percent would lead us to expect, during the quarter-century ending in 2000, the wage gains of the women ($2,590) were slightly less than the wage losses of the men ($2,641).
4. Despite the differential in their respective growth rates—women gaining modestly while men gained little or fell behind—the gap in favor of male earnings remained quite pronounced.

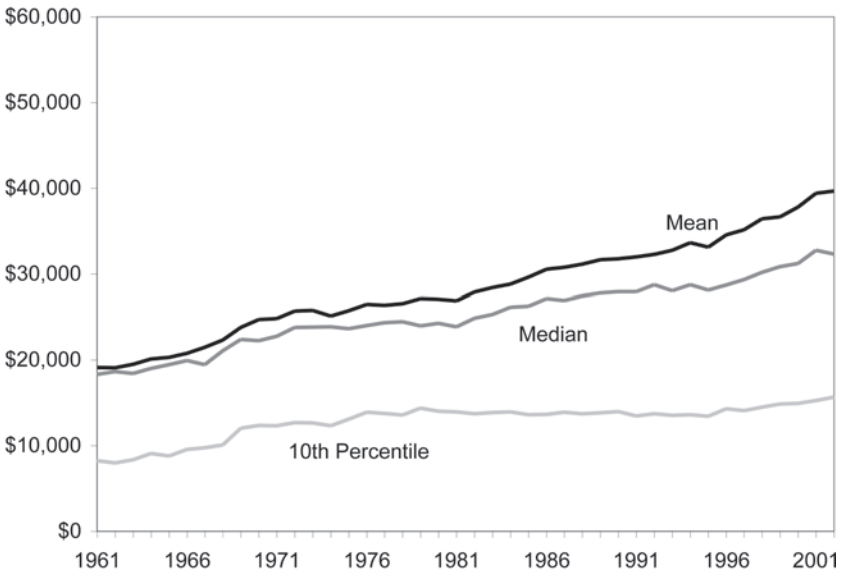
Figure 2.3A. Real wages of full-time, full-year men, 1961–2002[a]



[a]2005 National Income and Product Accounts (NIPA) Personal Consumption Expenditure adjusted dollars.

Source: Zvi Eckstein and Eva Nagypál, *The Evolution of U.S. Earnings Inequality: 1961–2002*, Federal Reserve Bank of Minneapolis Quarterly Review, Vol. 28 (December 2004), and data files from www.faculty.econ.northwestern.edu/faculty/nagypal/Qrproject.

Figure 2.3B. Real wages of full-time, full-year women, 1961–2002[a]



[a]2005 National Income and Product Accounts (NIPA) Personal Consumption Expenditure adjusted dollars.

Source: Zvi Eckstein and Eva Nagypál, *The Evolution of U.S. Earnings Inequality: 1961–2002,* Federal Reserve Bank of Minneapolis Quarterly Review, Vol. 28 (December 2004), and data files from www.faculty.econ.northwestern.edu/faculty/nagypal/Qrproject.

The implications of our analysis thus far are both ominous and self-evident. Beginning in the mid-1970s, growth in the standard of living of the average American family slowed dramatically, while that of families at the bottom either stagnated (the bottom 20 percent) or declined (the bottom 10 percent). Such evidence bodes ill for the purchase of the American Dream on the hearts and minds of the nation's people, particularly the least advantaged. Similar trends in financial security also seem likely to weaken that purchase, as chapter 3 will document in detail.

3

FINANCIAL SECURITY

"Standard of living" is a relatively easy concept to grapple with. "Financial security" is not. Changes in the first can reasonably be approximated by changes in real income per capita or per family, or so economists believe. But what measure can be used to gauge changes in financial security? Anyone who is now or has been a member of the workforce is familiar with the problem. At bottom, financial security involves some subjective minimum income, below which a given individual does not want to fall. A Wall Street broker no doubt has in mind a higher number than a custodian. The difficulty for both is that the flow of income they can expect in the future is the product of a number of variables, some of which are difficult to predict. Given this array and that uncertainty, the best we can do in a study such as this is to examine recent trends in those variables most important in determining the financial security of all but the very rich. As was true in chapter 2, the picture that emerges, particularly for those near the bottom of the economic ladder, is one that features both storm clouds on the horizon and a downpour well begun.

HEALTH INSURANCE

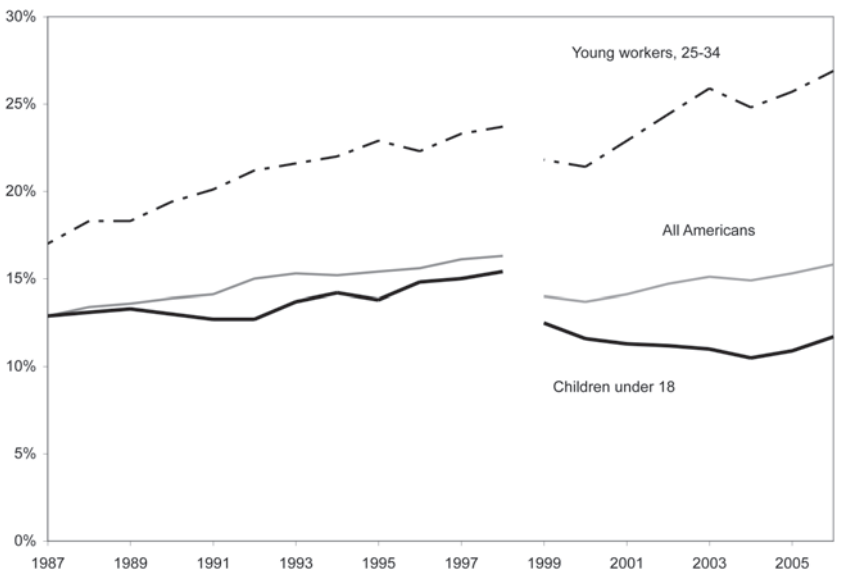
The larger backdrop to developments in this section and the next on pensions can be quickly summarized. During World War II, mainly because of government constraints on granting pay increases, many companies in America initiated or expanded health and pension coverage for their workers. In the postwar era, such benefits came to be regarded by many as something of a social contract. The dominant belief was roughly this: You work diligently and remain loyal to the company, and the company will look after you. At some point in the next half-century, the commitment of companies to this notion of

a social contract began to fade. Just when is hard to say, but one major cause was the growing intensity of competition.

"Globalization" is one of those words frequently used but seldom defined. At bottom, it concerns the progressive integration, on an international scale, of markets heretofore quite separate, or, at best, loosely linked. With that growing integration came growing competition. The private sector accordingly was under constant pressure to cut back on workers' fringe benefits of every sort. To cite but one example, General Motors simply could not afford to continue to provide health benefits for its employees that added $1,500 to the price of every car.

This background helps to explain the trends observable in figure 3.1. The break in each line signals that the U.S. Census Bureau changed the way

Figure 3.1. Percentage of Americans without health insurance, by age, 1987–2006[a]



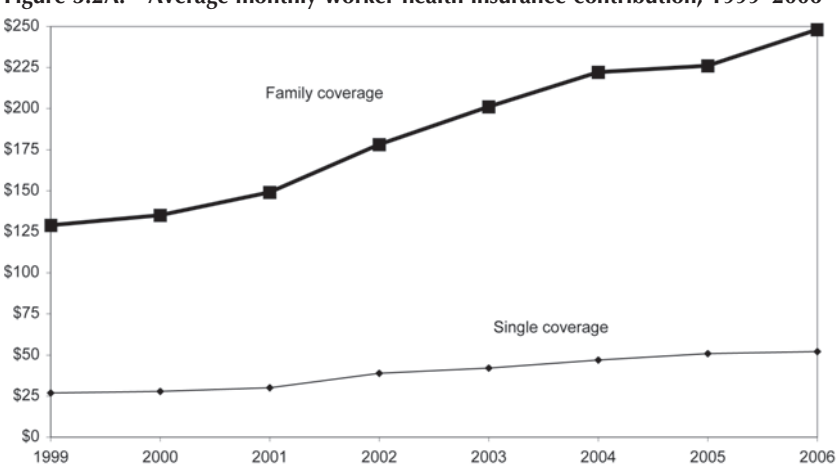
[a]The 1999–2006 estimates reflect the results of new follow-up verification questions that were asked of people who responded "no" to all questions about specific types of health insurance coverage in order to verify whether they were actually uninsured. This change increased the number and percentage of people covered by health insurance, bringing the Current Population Survey more in line with estimates from other national surveys. Due to this change, data beginning in 1999 are not consistent with earlier data.

Source: 1999–2006 data from U.S. Census Bureau, "Current Population Survey Historical Health Insurance Tables, (Table) HIA-2 Health Insurance Coverage Status and Type of Coverage, All Persons by Age and Sex: 1999 to 2006"; 1987–1998 data from "(Table) HI-7 Health Insurance Coverage Status and Type of Coverage by Age: 1987 to 2005," www.census.gov/hhes/www/hlthins/historic/index.html, and additional information from Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica Smith, *Income, Poverty, and Health Insurance Coverage in the United States: 2006*, U.S. Census Bureau, Current Population Reports, P60-233 (Washington, D.C.: U.S. Government Printing Office, 2007), 19.

it calculated health care coverage in 1999. A reasonable approximation of the long-term trend in coverage can nevertheless be estimated by assuming that actual coverage changed little where the breaks appear. Graphically, this amounts to mentally shifting downward each line to the left of the break until it is approximately level with the first point plotted to the right of the break. The pattern that emerges from such a shifting is not surprising. During the eighteen years ending in 2005, the percentage of all Americans without health insurance has been gradually drifting upward, while the coverage of children has somewhat improved since the end of the 1990s. This latter development is largely due to the passage in 1997 of the State Children's Insurance Program (variously referred to as CHIP, S-chip, or Schip).[1] The trend that interests us the most is the upward surge in the percentage of young workers not covered. Is this a sign of things to come?

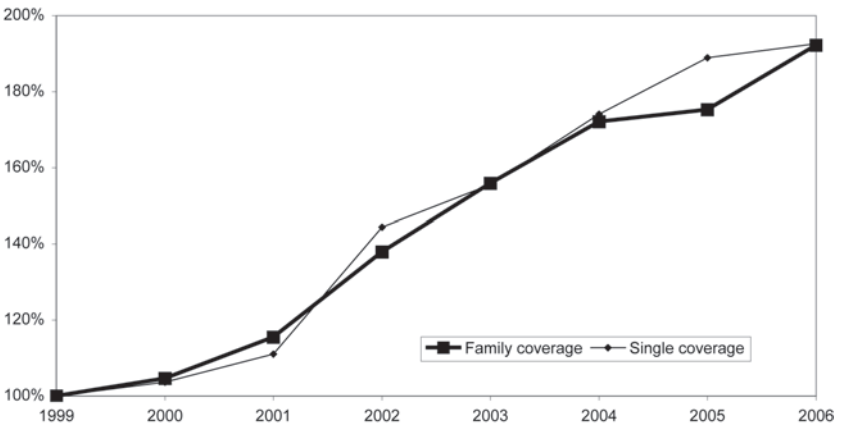
The data of figures 3.2A and 3.2B suggest that almost certainly it is, barring government action to reverse the trend. Health insurance, like dining at the Ritz, is available to all. The problem is that its cost puts coverage out of reach for millions of Americans. Figure 3.2A illustrates (1) how rapidly those costs have been rising and (2) how the human eye can be deceived. The upward trend in family coverage at first glance appears to be significantly greater than that of single coverage. This mistaken first impression is easily corrected by referring to figure 3.2B, in which plotted points represent the cost of each kind of coverage as a percentage of its actual cost in 1999. In the seven-year period ending in 2006, the cost of coverage in both cases almost doubled.[2]

Figure 3.2A. Average monthly worker health insurance contribution, 1999–2006[a]



[a]All dollar figures expressed as a percentage of 1999 dollar contribution.
Source: Gary Claxton et al., *Employer Health Benefits 2006* (Menlo Park, Calif.: Kaiser Family Foundation, 2006), 61, and author's analysis of Claxton.

Figure 3.2B. Percentage change in monthly worker health insurance contribution, 1999–2006[a]



[a]All dollar figures expressed as a percentage of 1999 dollar contribution.
Source: Gary Claxton et al., *Employer Health Benefits 2006* (Menlo Park, Calif.: Kaiser Family Foundation, 2006), 61, and author's analysis of Claxton.

The lack of health insurance coverage in this country is thus appropriately viewed as a product of soaring costs. Consider again the evidence in figure 3.2B, but now in the context of the income data presented in the previous chapter. For most Americans, the cost of health insurance is rising at a pace that exceeds by a wide margin the growth rate of their income. The inevitable result is a growing number who simply cannot afford whatever health insurance options are available.

One option designed to offer coverage to those between jobs is provided by the 1986 Consolidated Omnibus Reconciliation Act, or COBRA. For a family of four, premiums start at $700 a month. According to a recent study, 93 percent of those who lose their jobs regard COBRA coverage as too expensive to afford.[3] Similar difficulties are lurking in the universal health coverage made available to Massachusetts residents initiated in the last few years. Enthusiasm for that program became markedly tempered when insurance companies publicized estimates of what the associated costs would be: for a single worker, $380 a month or $4,560 a year. "Is it sensible policy," asked *Newsweek* columnist Robert Samuelson, "to force workers with a $30,000 income—about triple the poverty line—to spend nearly a sixth of their budget on health insurance?"[4]

Nationwide, rising health insurance costs have been shown to be linked to declining enrollment in health care plans.[5] A similar surge in dental costs has led to similar results. For the first time in half a century,

the percentage of Americans with untreated cavities is on the rise.[6] The costs of being uninsured are also rising. Since the early 1980s, the number of medical-related bankruptcies is estimated to have increased by more than 2,000 percent.[7] Bankruptcy is not the only risk. According to a recent study in the *Annals of Internal Medicine*, those with a chronic disease, such as diabetes or high blood pressure—who comprise roughly one-third of all those uninsured—seldom get adequate care, and as a result "many face early disability and death."[8]

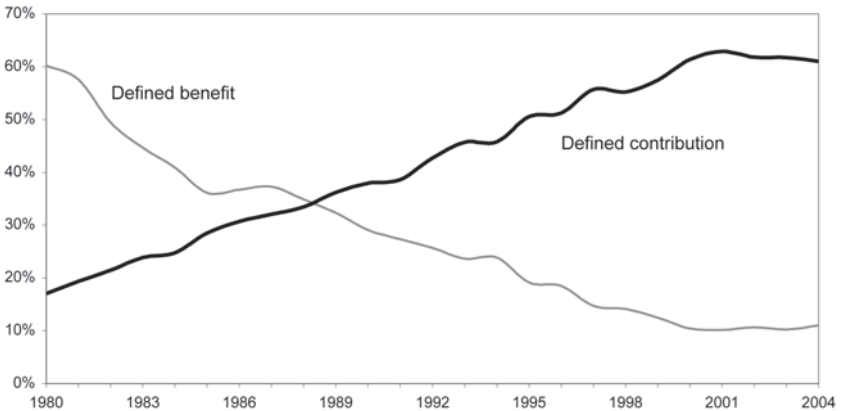
This persistent trend of annual large increases in medical costs has also strained the capacity of companies to make employer-subsidized insurance programs available to their workers. The associated problems are aptly summarized by the owner of three small companies in Fresno, California: "The premium keeps going up and, even worse, the insurance companies keep decreasing the benefits."[9] Pressured by growing international competition in a multitude of markets, decision makers in the business community have reacted exactly as economic theory (or common sense) would predict. Some now refuse to offer subsidized health insurance to any of their employees. Others who previously supplied it have ceased to do so. The share of workers receiving this fringe benefit from their employer has declined from roughly three out of four in the 1970s to one out of two today.[10] About half of all small businesses in America do not offer health insurance plans to their workers.[11] Businesses that continue to offer such plans are under constant pressure to shift more of the associated expenses onto their workers by raising co-payments and deductibles.[12] Another related problem rarely mentioned is the declining availability of employer-sponsored health insurance for retirees. Only one-third of large firms (firms with two hundred or more employees) now offer such coverage, compared to two-thirds as recently as 1988.[13]

In sum, the claim that millions of Americans are without health insurance is not quite to the point. What they lack is *affordable* health insurance. If the rate of increase in medical costs continues to far outstrip the rate of increase in the income of most families—as surely it will—this is a problem destined to get worse, not better, barring government intervention on a massive scale.

PENSIONS

Analyses of America's pension problems usually begin with the trends illustrated in figure 3.3. The broad pattern would seem above dispute. During the

Figure 3.3. Participation rates in defined-benefit vs. defined-contribution pension plans, 1980–2004[a]



[a]Estimated participation rates under defined-benefit and defined-contribution plans for private wage and salary workers with pension coverage. Addition of percent of workers with both types of plan sums to 100%, not shown because in recent years, this number has been relatively unchanged. (Both for 1980 = 23%, 1992 = 31%, 2004 = 28%.)

Source: Author's analysis of 1980–2003 data from Marric Buessing and Mauricio Soto, *The State of Private Pensions: Current 5500 Data* (Chestnut Hill, Mass.: Center for Retirement Research at Boston College, 2006), Appendix Table E4, and 2004 data from Alicia H. Munnell, Kelly Haverstick, and Geoffrey Sanzenbacher, *Job Tenure and the Spread of 401(k)s* (Chestnut Hill, Mass.: Center for Retirement Research at Boston College, 2006), 1.

last quarter-century, defined-benefit plans have plummeted while defined-contribution plans have risen sharply. The first order of business is to explain the difference between the two. The second is to explore the implications of these trends for the financial security of pension holders.

The central issue is risk: What kind is it, and who takes it? The most readily intelligible way to answer those two questions is to minimize detail and focus on essentials. What follows is only a broad outline of two basic schemes that have many variations.[14]

Suppose that you are twenty-five years old and plan to work for forty years before retiring. You have two options. During those forty years, you and your employer (or in some cases, your employer alone[15]) will set aside money each month, thereby building a fund to finance your retirement years. Whichever pension plan you choose, assume that the monthly contributions will be the same. Under a defined-benefit plan, as the name implies, upon retirement your employer will pay you a fixed amount each month for the rest of your life. How large that amount will be usually depends upon two variables: your length of service with the company and your average salary over either the highest salary years or the final years of employment.[16] A defined-contribution plan, on the other hand, is just

that: The amount set aside by you and your employer is specified but the control of the resulting fund that builds over time is yours (not your employer's). How much you will have to finance your retirement years will depend upon how wisely you invest the money accumulating in that fund, most commonly in the form of a 401(k) plan, which allows contributions to it to be tax-deferred.[17]

Which plan would you prefer? Economists are prone to emphasize a particular advantage of defined-contribution schemes: their portability. Workers who change jobs can (a) leave their funds with the old employer (where they continue to grow), (b) roll the funds over into an Individual Retirement Account,[18] or (c) transfer them to the new employer's pension program. By contrast, defined-benefits plans are typically not portable. When a worker moves from one company to another, his or her pension benefits are frozen at the level they had reached with the previous employer. Moreover, these benefits are usually very low during the first few years with a new company. Only after a specified time period, which can be substantial, do they begin to rise rapidly. The implied long-term commitment of the worker to the company, in turn, may make the company more willing to invest in the worker's training and skill development. Such benefits from a long-term commitment to a single employer have limited appeal to a workforce on the move. A 2006 survey found that six out of ten workers had switched from one job to another, four out of ten had switched at least twice, and nearly half expected to change careers in the future.[19]

The trends outlined in figure 3.3 would therefore seem to signal a change for the better, as defined-contribution plans become the norm and defined-benefit plans the exception. Lost in the welter of details about two fundamentally different pension possibilities is the focus of this chapter: financial security. Any pension plan must address two related problems: (1) how to build a fund while actively employed that will ensure a flow of income after retirement and (2) how long that flow must be maintained until the pension recipient dies. The first is crucially dependent upon the second. For any given level of monthly pension payments, the longer the recipient lives, the larger the fund must be. Under a defined-benefit plan, the risks associated with both are borne by the employer.[20] Under a defined-contribution plan, those risks are shifted to the employee. The gyrations of the stock market over the past few years are an unwelcome reminder of how large that risk can be, even for those knowledgeable in the ways of Wall Street. The key issue for our purposes is how successfully workers are likely to manage building their

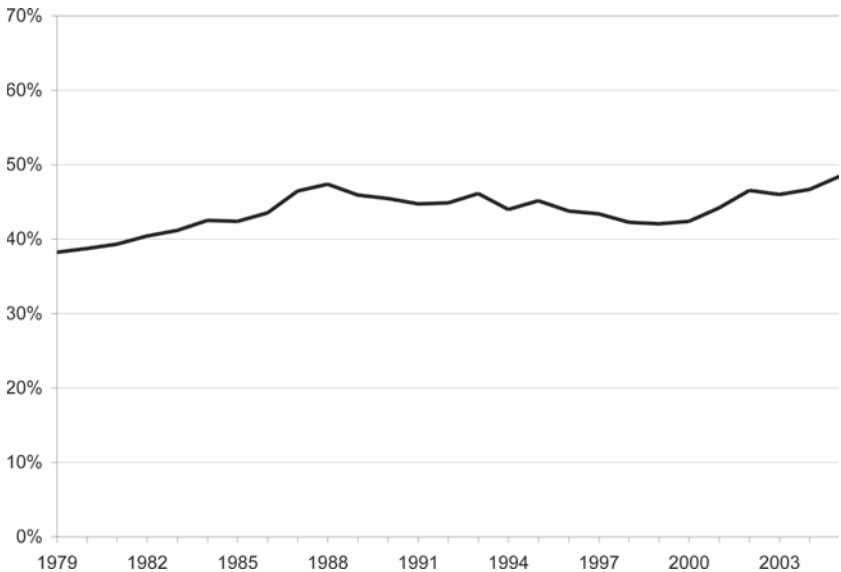
own pension fund and investing the proceeds from the fund's inception until they retire.

The evidence is not encouraging. Some workers do not bother to enroll in 401(k) plans, even when they are eligible to do so and contributions will be made by their employer.[21] Many who do participate set aside so little that the resulting retirement fund is capable of generating only a small fraction of their preretirement income.[22] This seems to be particularly true for those at the bottom of the income distribution. A "substantial fraction" of that group are accumulating few assets, and consequently, upon retirement will "find themselves largely dependent on government benefits."[23] Contributing to this shortfall is a limited willingness to preserve what has been saved. Nearly half of all workers cash out their 401(k)s when moving from one job to another.[24] Lastly, but of the first importance, is how wisely whatever money is building in a pension fund will be invested. Knowledge required includes likely returns on a variety of asset possibilities, interest rates, tax rates, and inflation. Will most pension holders be equal to the challenge? Two pension experts concede that "many observers have their doubts."[25] One of those observers put the problem this way: "Many workers have little idea how to manage these sophisticated investments and will lose—or have already lost—a large part of their holdings."[26] Zvi Body, a professor of finance at Boston University, was more blunt: "The vast majority of people who are going to be [enrolled] in 401(k) plans have not got a clue about how to invest their money."[27]

From the analysis thus far, two inferences would seem to follow. First, within the private sector, defined-contribution plans are the wave of the future. Second, by shifting risk from employers to employees, these plans have made those subject to this shift by definition less financially secure.

What about those who have not enrolled in any private pension plan? Figure 3.4 rarely appears in discussions of this sort. It is a sobering reminder of a pervasive economic vulnerability. Roughly half of the workers in this country have no protection against poverty in old age beyond assistance available from the government plus personal savings accumulated during working years, including any assets that they have managed to acquire. The further down the economic ladder the prospective retiree is, the more likely he or she is to have few assets. Accordingly, many "are likely not only to face a lower standard of living when they retire, but also to find themselves largely dependent on government benefits."[28] These benefits themselves remain uncertain to the extent that the future of the Social Security Trust Fund remains uncertain.

Figure 3.4. Percentage of full-time workers, aged twenty-five to sixty-four, without pensions, 1979–2005



Source: Author's analysis of 1979–2004 data from Alicia H. Munnell and Pamela Perun, *An Update on Private Pensions* (Chestnut Hill, Mass.: Center for Retirement Research at Boston College, 2006), 2, and Center for Retirement Research at Boston College, *Pension Sponsorship and Participation, 1979–2004*, "Frequently requested data" Excel file, crr.bc.edu/frequently_requested_data/frequently_requested_data.html, and author's analysis of 2005 data from Patrick Purcell, *Pension Sponsorship and Participation: Summary of Recent Trends* (Washington, D.C.: Congressional Research Service, 2006), CRS-6.

In sum, with private pensions or without, a growing number of workers in this country have good reason to be worried about their financial security beyond retirement.

UNEMPLOYMENT

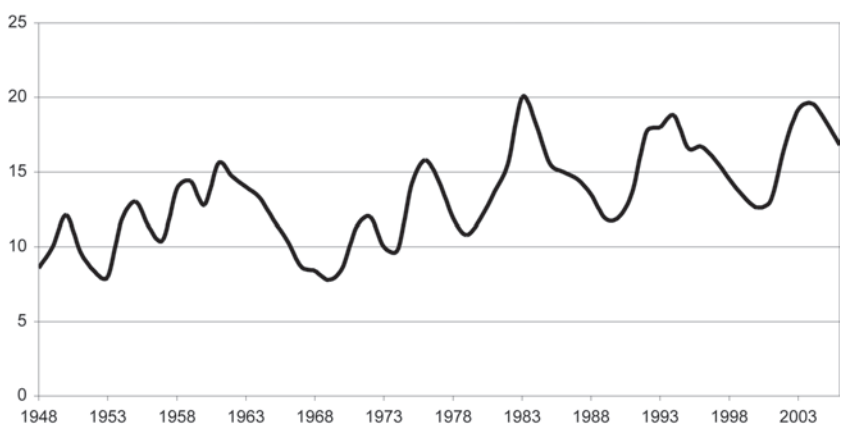
Whenever this topic is raised in the context of business cycle discussions, some analysts invariably accentuate the positive—namely, that in recent years, American recessions have become less frequent and somewhat shorter than had previously been the case during the post–World War II period (ignoring the most recent recession, which is to ignore quite a lot). From 1982 to 2007, the economy slumped only twice—once in 1990 and a second time in 2001—for a total of sixteen months.[29] This relatively placid period has been characterized by many economists as the "era of Great Moderation."[30]

Figures 3.5 and 3.6 portray labor market developments during these same twenty-five years from a more pessimistic point of view. The two graphs combined indicate that, since the end of World War II, the number of weeks workers have been unemployed on the average (i.e., ignoring cyclical swings) has slowly risen, while the percentage of unemployed receiving unemployment insurance has gradually declined. In figure 3.6, the stunning revelation is not the trend of the line but its height. For half a century, less than half of the unemployed have actually received unemployment insurance payments. Currently, that number is closer to four out of ten. Those who typically do not qualify for such benefits include most part-time workers, temporary workers, and people who are self-employed. All three categories are a growing share of the labor force. In addition, many states disallow unemployment benefits for workers enrolled in school or training programs. For all who do not qualify, the loss of a job involves a drop in income unmitigated by government compensation for being out of work.

INCOME VOLATILITY

The characterization of the quarter-century ending in 2007 as the "era of Great Moderation" fosters the expectation that the volatility of income will have declined since 1982. At the household level (however income is measured), this clearly has not happened.[31] The great debate is whether volatility has increased

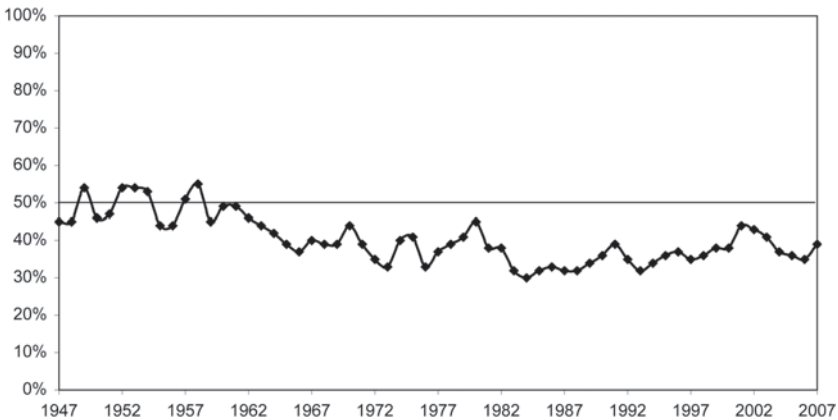
Figure 3.5. Average weeks unemployed,[a] 1948–2006



[a]Persons sixteen years and over, annual data.

Source: U.S. Department of Labor, Bureau of Labor Statistics, "Current Population Survey, Household Data: Table A-9. Unemployed persons by duration of unemployment," www.bls.gov/webapps/legacy/cpsatab9.htm.

Figure 3.6. Percentage of unemployed receiving unemployment insurance,[a] 1947–2007



[a]Commonly called the "Standard Recipiency Rate," this rate is calculated by the Department of Labor by dividing (1) the number of regular unemployment insurance program claims filed weekly with state programs by (2) the total number of unemployed as counted in the Bureau of the Census's Current Population Survey. The above rate is an upper bound for the percentage actually receiving claims because some claims are denied.

Source: U.S. Department of Labor Employment and Training Administration Chartbook Result, "Regular Program Insured Unemployment as a Percentage of Total Unemployment: Data from 1950 to 2007," www.doleta.gov/unemploy/chartbook.cfm, and 1946–1949 data from D. C. Wittenburg et al, *Literature Review and Empirical Analysis of Unemployment Insurance Recipiency Ratio,* Final Report prepared by the Lewin Group for U.S. Department of Labor Unemployment Insurance Service Division of Research and Policy Contract Number: K-6826-8-00-80-30 under subcontract to Rutgers University, June 18, 1999, www.workforcesecurity.doleta.gov/dmstree/op/op99/op_07-99.pdf.

or remained roughly the same since the early 1980s. But volatility of what? Some studies focus upon household income measured various ways. Others narrow the focus to wage earnings only. One of the more recent examples of the former using "the most inclusive measure of earnings available" concludes that (a) volatility has increased; (b) this finding is consistent with many other studies; and yet (c) still other studies, using different measures of household receipts, claim their data demonstrates that volatility has essentially remained unchanged in recent decades.[32] Among the latter group is a highly regarded investigation of wage earnings by the director of the Congressional Budget Office. His major finding is that "over the past 20 years" earnings volatility "shows little change . . . for both men and women."[33]

The elephant in the room is the *size* of current volatility, irrespective of its historical trend. The data in table 3.1 indicate the magnitude of the swings in wage earnings during the single year 2003. Focus on the second and third columns and add horizontally the pair of numbers for any age group. What immediately becomes apparent is that at least one-third of all workers in every age group saw their wage earnings go up or down by 25

Table 3.1. Percentage of workers whose wages[a] changed by at least 25 percent, and by 50 percent or more, in 2003

	Total Wage Earnings			
	Fell by at least		*Rose by at least*	
Age Group	*50% Drop*	*25% Drop*	*25% Rise*	*50% Rise*
20–29	16.4	23.7	32.6	24.8
30–39	13.8	19.9	22.2	16.2
40–49	11.9	17.1	17.8	12.8
50–59	13.1	18.6	14.2	10.3
All[b] (22–59)	13.6	19.5	21.3	15.7

[a]Total wage earnings include wages and salaries, tips, and other forms of compensation. They exclude self-employment earnings and deferred compensation. Workers without any earnings in the previous calendar year are included, and their percentage change in earnings is coded as 100.
[b]Orszag calculated the "All" category beginning with age twenty-two instead of age twenty to reduce the effect of the college-to-work transition on overall earnings variability.
Source: P. R. Orszag 2007: 7.

percent or more. Now consider the evidence in the first and last columns. The same addition indicates that, again for every age group, more than one in five experienced a rise or fall in wage earnings of 50 percent or more. Such evidence portrays a world of wildly swinging annual receipts that will astonish only those not part of that world. Such swings may or may not have become more pronounced over the past three decades. What is abundantly clear from contemporary data is that, for a sizeable segment of the labor force, pronounced gyrations in wage earnings are the rule, not the exception.

DEBT AND BANKRUPTCY

A drop in income does not necessarily force a drop in consumption. A given standard of spending can be maintained by dipping into savings or borrowing. The question that concerns us is whether both of these options, particularly taking on more debt, undermine financial security. During the past three decades, the propensity of American consumers to take on more debt has markedly increased (at least until recently). The question typically asked is whether it has increased too much. The response typically given is to refer to the data in figures 3.7A and 3.7B. The ability to repay debt depends upon income earned and assets held. Both figures track a ratio over time. The numerator in both cases is the same: total consumer debt. What is striking about the trend of both measures is their steady rise over the past quarter-century. Admittedly the ratio of debt to assets fell in the 1990s as

the stock market boomed and housing prices rose. But notice how quickly after 2000 the old upward trend of previous decades was reestablished. And finally, notice what a continuous rise implies. In figure 3.7A, for every dollar of income earned the amount of debt has risen 86 percent since 1985. In figure 3.7B, for every dollar of assets owned, the amount of debt has increased 40 percent during the same time period.

One reason for the general rise in debt is the increased access to credit made possible in recent decades by a host of innovations in financial markets. Some of these were merely modifications in the terms of an old credit instrument: the credit card. In the fifteen-year period beginning in 1989, the increasing reliance upon this form of debt by families in the lowest income quartile is striking. (See figure 3.8.) Viewed in a positive light, such increasing availability of, and reliance on, an expanding number of credit options by American families, particularly those in the lower income bracket, has "strengthened their ability to smooth consumption in the face of income shocks."[34] Viewed in a negative light, at least some of these innovations enabled unscrupulous lenders to trap the financially naive into taking out loans that would subsequently strain the capacity of the borrower to repay. The lower the income, the greater the strain, or so one might suspect.

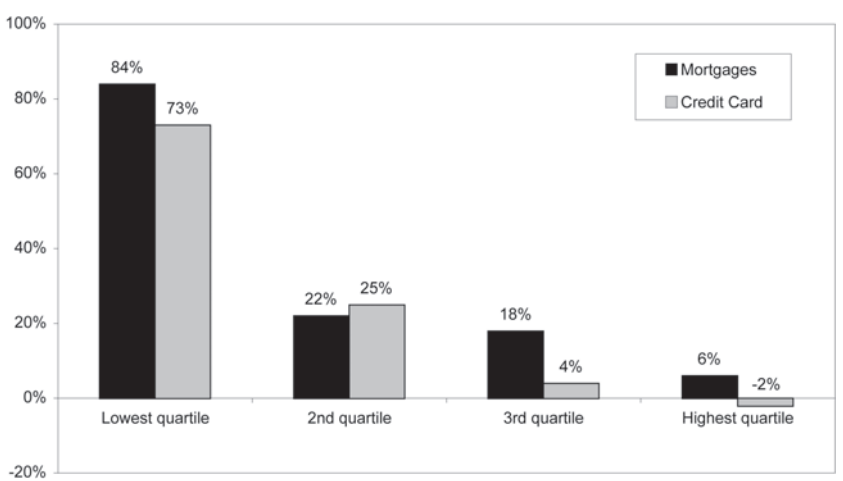
Figure 3.7A. Household debt-to-income ratio, 1952–2007

Source: Data supplied to author by Michael Shenk, Federal Reserve Bank of Cleveland.

Figure 3.7B. Household debt-to-asset ratio, 1952–2007

Source: Data supplied to author by Michael Shenk, Federal Reserve Bank of Cleveland.

Figure 3.8. Rate of increase in proportion of households with debt, by household income and debt type, 1989–2004



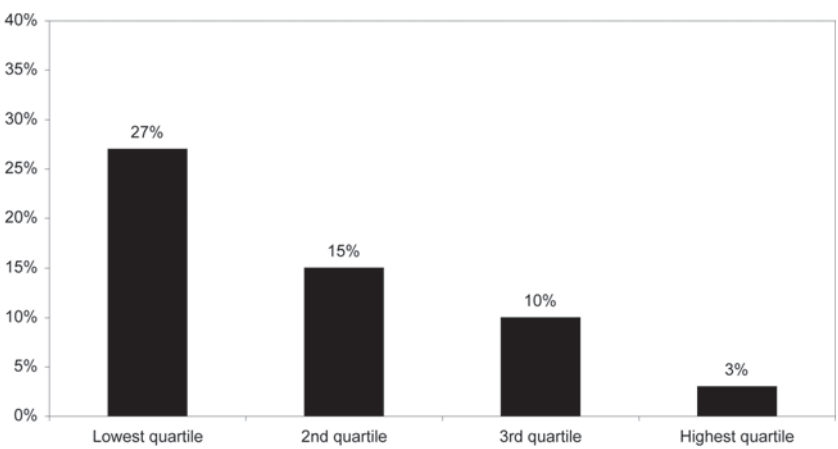
Source: Matt Fellowes and Mia Mabanta, *Borrowing to Get Ahead, and Behind: The Credit Boom and Bust in Lower-Income Markets* (Washington, D.C.: The Brookings Institution, 2007), 5.

Figures 3.9A and 3.9B lend credence to those suspicions. "Getting in over your head" with respect to debt is a propensity evident in all income groups. But since the end of the 1980s, this behavior has been particularly prevalent among those in the lowest quartile. Nor are such difficulties surprising, given the evidence of widespread indifference to, or ignorance of, relevant financial information. A 2007 survey found that

> four in ten American credit-card holders do not pay the full amount due every month on the credit card they use most often, despite the punitive interest rates charged by credit-card companies. Nearly one-third said they had no idea what the interest rate on their credit card was.[35]

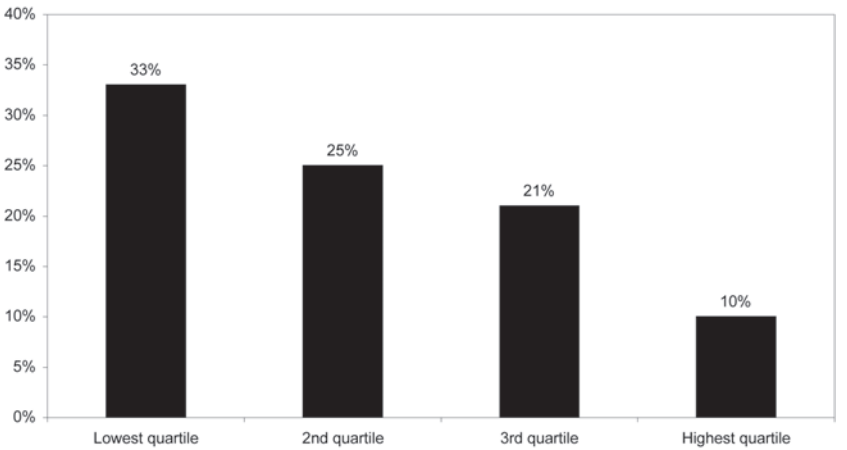
The most telling indicator of unwise borrowing is personal bankruptcy. As illustrated in figure 3.10, the number of consumer (as distinct from business) bankruptcies per one thousand households more than quadrupled between the mid-1980s and 2005. One reason for this rapid increase has been medical-related bankruptcies. Those lacking adequate health insurance are simply overwhelmed by the cost of a major illness. Another is the restructuring of the credit marketplace for low-income consumers. Here "innovative and zealous firms have lured unsophisticated shoppers by the hundreds of thousands into a thicket of debt from which many never emerge."[36] Unfortunately, since 2005 the statistical continuity of this series has been disrupted by new laws making the declaration of personal bankruptcy far more difficult.

Figure 3.9A. Proportion of borrowers paying more than 40 percent of their income on debt payments, by household income, 2004



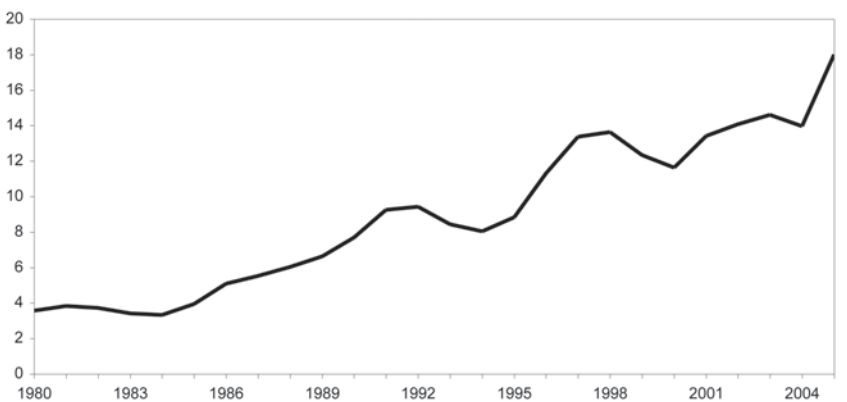
Source: Matt Fellowes and Mia Mabanta, *Borrowing to Get Ahead, and Behind: The Credit Boom and Bust in Lower-Income Markets* (Washington, D.C.: The Brookings Institution, 2007), 7.

Figure 3.9B. Proportion of borrowers who fall behind on payments, by household income, 2004



Source: Matt Fellowes and Mia Mabanta, *Borrowing to Get Ahead, and Behind: The Credit Boom and Bust in Lower-Income Markets* (Washington, D.C.: The Brookings Institution, 2007), 7.

Figure 3.10. Consumer bankruptcies per one thousand households, 1980–2005[a]



[a]The Bankruptcy Abuse Prevention and Consumer Protection Act became effective October 17, 2005, and greatly reduced the number of consumer bankruptcies in 2006 by making it harder to file Chapter 7 personal bankruptcy, among other changes. Due to these changes, more recent data are not consistent with pre-2005 data.

Source: Consumer bankruptcy yearly totals from the American Bankruptcy Institute, www.abiworld.org, and based on Administrative Office of the U.S. Courts data. Number of U.S. households from U.S. Census Bureau, "Current Population Survey Families and Living Arrangements Historical Tables, (Table) HH-1 Households, by Type: 1940 to Present," www.census.gov/population/www/socdemo/hh-fam.html.

HOUSING

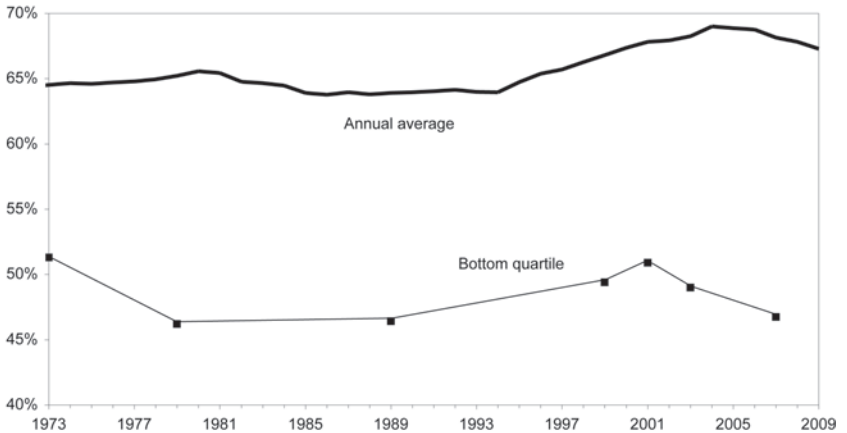
For those toward the bottom of the income distribution, does the purchase of a house increase or decrease their financial security? The answer is far from clear.

That the question even warrants consideration is somewhat curious. Homeownership, as economists invariably emphasize, "is by far the single most important way families accumulate wealth."[37] Moreover, the very structure of mortgage payments—one a month until the debt is paid off—amounts to a forced saving plan for those who otherwise might not be willing to set aside a comparable amount on a regular basis. This is perhaps especially true for those whose incomes are relatively low.[38] In recent years, innovations in financial markets have included new ways to enable people of limited means to purchase a house, who otherwise would probably not qualify to get a mortgage through regular banking channels. Such changes help to explain the rise in homeownership rates illustrated in figure 3.11. Notice that, compared to the "average" for all Americans, homeownership rates for the bottom quartile (a) peaked slightly earlier, (b) fell more steeply, and (c) ended up well below rates achieved in the early 1970s. To the extent that owning a home is part of the American Dream, those whose income puts them in the bottom 25 percent, as a group, are worse off now than they were during the Nixon years.

Lurking behind the trend in ownership rates in recent years was the development of a new debt instrument called a subprime mortgage. The puzzle is the extent to which that innovation undermined the financial security of the least advantaged. Before this question is addressed, a brief explanation is in order concerning what a "subprime" mortgage is. This is not an easy task. The term is seldom defined by those who use it beyond noting the obvious: that such loans are made to borrowers with a low credit score. But how low is low enough? Perhaps the best way to approach the answer is to examine the main requirements of a conventional or "prime" mortgage. There are three:

1. The borrower provides a down payment (in the conventional markets of a decade ago, often 20 percent of the current market value of the property being purchased).
2. A documented flow of the monthly income of the borrower is provided to the lender so the latter can assess the ability of the mortgage recipient to meet monthly payments. (The Federal Housing

Figure 3.11. Homeownership rates by income, 1973–2009[a]



[a]Annual average calculated from national quarterly homeownership rates available for 1973–2008, and first quarter homeownership rate for 2009. Bottom quartile data available only for selected years: 1973, 1979, 1989, 1999, 2001, 2003, and 2007.

Source: Author's analysis of national quarterly homeownership rates from U.S. Census Bureau, "Housing Vacancies and Homeownership (CPS/HVS) Historical Tables, (Table) 14 Homeownership Rates for the U.S. and Regions," www.census.gov/hhes/www/housing/hvs/hvs.html. Bottom quartile data for 1973 from Lawrence Mishel, Jared Bernstein, and Heather Boushey, *The State of Working America 2002/2003* (Ithaca, N.Y.: Cornell University Press, 2003), Table 4.12; 1979–2003 bottom quartile data from Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2006/2007* (Ithaca, N.Y.: ILR Press, 2007), Table 5.11; 2007 bottom quartile data from author's analysis of U.S. Census Bureau, Current Housing Reports, Series H150/07, "American Housing Survey for the United States: 2007" (Washington, D.C.: U.S. Government Printing Office, 2008), Tables 3-12 and 4-12.

Administration's guideline is that those payments should not exceed 31 percent of the net [or after-tax] income of the borrower.)

3. The borrower has a "good" credit history, in the sense that it is relatively free of other significant debts and previous defaults.

At their best, subprime mortgages failed to meet one or more of these three. At their worst, they met none. The latter came to be known as NINJA loans "because the borrower had No Income, No Job, and No Assets."[39]

Why, then, would any lender be willing to make such risky loans? The answer is that those who made the initial loans avoided the risk and made a profit by selling such mortgages to other investors. What was essentially an extremely unsound I.O.U. was sliced and diced and repackaged with bits and pieces of other debt instruments and then sold to a third party who (a) had no clear understanding of the multiple risks included in the package and (b) bought the package anyway.[40] This rise in the "securitization" of mortgages was part of a series of innovations in financial markets that were extremely complex—so much so that they befuddled even many who

worked on Wall Street. The resulting labyrinthine network of procedures and debt instruments is fortunately not relevant for this study.[41] Our focus is confined to the original borrowers who, in many instances, were persuaded to take out a mortgage beyond their means.

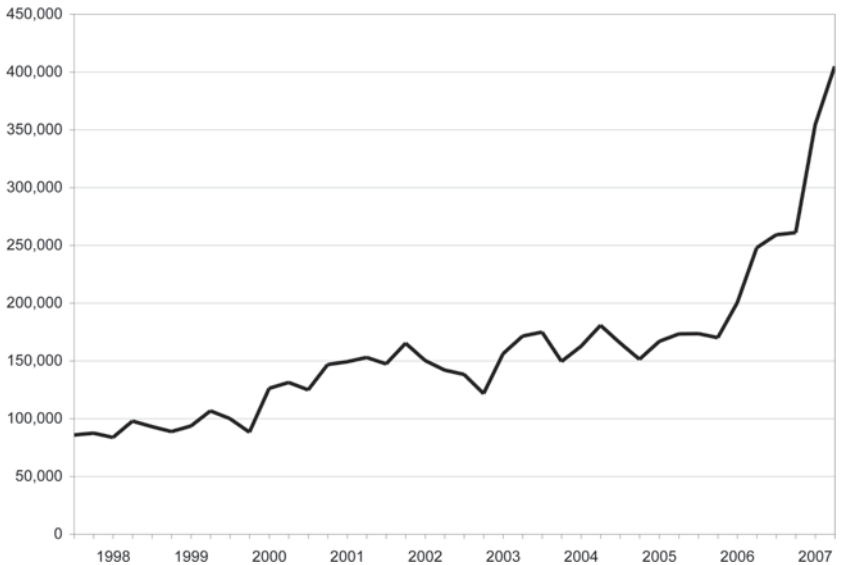
The great surge in subprime mortgages is relatively recent, beginning in 2003.[42] As this market developed, in many instances lenders circumvented the criteria of a regular mortgage in a manner designed to both entice and mislead prospective borrowers. Down payments were greatly reduced or waived altogether. Documentation of the borrower's income sources was intentionally slipshod or nonexistent, as were the checks on the would-be borrower's credit history. In addition, lenders offered "teaser" interest rates well below market rates for the first two or three years, after which they would increase dramatically.[43] In extreme cases of this general ploy, required monthly payments during the first few years often covered only the interest due (rather than interest plus part of the principal, as would be the case for a regular mortgage).[44] The normally staid *Economist* characterized the resulting debt instruments as "financial snake oil" peddled to the unwary by the unscrupulous.[45] To those considering a mortgage but apprehensive about the evident mismatch between their present monthly income flow and the prospective surge in mortgage payments several years hence the answer was always the same: Home prices will go up, and you can sell the house and make a profit or refinance at a lower rate.[46]

In sum, as the subprime mortgage market evolved, the progressive easing of lending requirements enticed an ever-larger number of the financially naive to borrow and bet that housing prices would continue to appreciate.

When the housing bubble burst in 2006, foreclosures rates shot up. (See figure 3.12.) The rise in foreclosures, in turn, added to the stock of unsold houses, creating further pressure for home prices to decline. What began as a modest wave of mortgage defaults soon became a tsunami of foreclosures numbering in the millions.

A second symptom of growing financial insecurity came hard upon the heels of the first. The persistent decline in the price of houses resulted in a growing number of mortgage holders finding themselves "under water," in the sense that the market value of their house was less than the amount owed on their mortgage. Those homeowners now in this position had initially purchased a house by taking out a mortgage with hopes of adding to their assets. Now with the "negative equity" of being under water, all they had accomplished was adding to their debt. This increment in debt, of course, could be cancelled by stopping payments on their mortgage and

Figure 3.12. Number of loans entering foreclosure quarterly, 1998–2007



Source: The Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2008* (Cambridge, Mass.: The Joint Center for Housing Studies of Harvard University), 2008, Figure 3. Original figure 3 data supplied by Daniel T. McCue. Figure 3 reprinted and adapted with permission from the Joint Center for Housing Studies of Harvard University. All rights reserved.

forcing a foreclosure. That action, however, would have devastating implications for the credit rating of the borrower. Foreclosure would become a permanent part of that person's credit history, and taking out another mortgage would be precluded for seven years.[47]

Which brings us to the question we began with: For those toward the bottom of the income distribution, during the past two decades as their homeownership rates first rose and then fell, did the purchase of a house increase or decrease their financial security? The answer depends upon (a) the extent to which the members of this income group were subsequently forced into foreclosure or (b) the extent to which they are currently "under water," a condition signaling that the acquisition of property has merely pushed them deeper into debt.

Direct evidence is difficult to come by. But consider the indirect evidence. As of 2004, when the major surge in subprime lending was barely a year old, of those in the bottom income quartile, a quarter needed more than 40 percent of their income to meet debt payments (figure 3.9A) and a third had fallen behind in making those payments (figure 3.9B). The wide swings in wages previously documented (table 3.1) imply that a sudden and

significant drop in income is commonly experienced by low-income households. Such a decline, in turn, is almost sure to compromise the capacity to meet sizable monthly mortgage payments. Long before the current financial upheavals and economic downturn, a study of low-income households in the 1980s found that homeownership was an "incredibly fluid category with many families moving in and out of homeownership several times over the course of their lives."[48] The main reasons for these households giving up on ownership and reverting to renting were that unsurprising duo of (1) a fall in household earnings (usually because of unemployment or divorce) and (2) initially taking on high mortgage payments relative to their income.[49] During the last few years, the first has been exacerbated by the worst recession since World War II, and the second, by the development of the subprime market. Finally, notice that those with low incomes tend to be among the least educated in America (of which, more in chapter 5). The absence of education makes for greater financial naïveté, and thus a limited capacity to assess any subprime contract designed by the devious to mislead the gullible with multiple pages of fine print, and the (usually specious) promise of a large financial gain for a small initial outlay.[50]

The extent to which these developments have disproportionately affected those at the bottom of the economic ladder cannot be ascertained from available data. For all of those affected, the immediate future remains bleak. In December of 2008, a highly regarded mortgage market analyst predicted that foreclosures in America would total slightly more than eight million over the next four years.[51] The Obama administration has advanced a number of proposals designed to make a bad situation better for a variety of participants in the mortgage market. Whether these proposals will significantly reduce foreclosures below the levels forecast remains in doubt as this book goes to press.

SUMMING UP

The overarching concern of this study is not whether Americans, in some collective sense, are becoming less financially secure.[52] Rather our concern is whether, for large segments of the population toward the bottom of the income distribution, the American Dream is fading rapidly, both in their perception and in fact. One vital component of that Dream is financial security. The difficulty of documenting how well those at the bottom are doing under this heading is that, as noted at the beginning of this chapter, financial security is the product of many variables of different relevance to

different people. That said, for those at or near the bottom—and for many further up the economic ladder—every single statistical series examined in this chapter is a source of concern. Theirs is a world in which pension plans provided by employers are in decline, and those that remain are increasingly shifting the associated risks from employer to employee; where the rapid rise in health care costs is making health insurance progressively more difficult to afford and already out of reach for millions; where only four in ten can qualify for unemployment insurance when out of work; where gyrations in wage earnings are so pronounced that one in five can expect a drop of 25 percent or more in any given year; and finally, where mounting indebtedness has become the norm, and ability to repay is being undercut both by developments examined in this chapter and by the recent downturn in the economy. In the years immediately ahead, most of the variables portrayed in this chapter's figures and in table 3.1 are likely to change little or get worse. If a growing number of Americans are coming to believe that financial security is a goal beyond their reach, who can blame them?

4

MOBILITY

Economic and social mobility, as previously noted, is one of the core concepts—arguably *the* core concept—of the American Dream. The statistical trends examined thus far include, for those on the lower rungs of the economic ladder, a sharp decline in real income growth and changes in a variety of variables that collectively suggest a significant increase in financial insecurity. A reasonable inference based upon such data is that upward economic mobility is slowing down. This in turn would imply that inequality of opportunity is on the rise—a trend which, if verified, would provoke a firestorm of condemnation in the media and from politicians of every stripe. In fact, statements by both groups on this subject by and large have been noticeably muted. The first question is why economic mobility and equality of opportunity are so central to American beliefs about economic justice. The second is why, despite that importance, so little has been written and said about these topics in recent decades.

MOBILITY AND THE AMERICAN DREAM

The very word "dream" connotes sanguine possibilities that are exceptional. The word has helped to shape perceptions of America, here and abroad, that often accentuate how exceptional the opportunities are in this country, particularly (but not exclusively) economic opportunities. This is an old idea. In 1838, Edward Everett told a Boston audience:

> The paths which lead to [wealth] are open to all; the laws which protect it are equal to all; and such is the joint operation of the law and the

> customs of society, that the wheel of fortune is in constant revolution, and the poor, in one generation, furnish the rich in the next.[1]

Throughout the nineteenth century, most Americans regarded such rhetoric as a reasonable characterization of the world they knew. (Even Marx conceded that in the United States social classes were "in constant flux."[2]) Lincoln had similar views: "The hired labor of yesterday labors on his own account today, and will hire others to labor for him tomorrow. Advancement—improvement in condition—is the order of things in a society of equals."[3] For this state of flux to be both possible and admirable requires two assumptions commonly made, then and now. Lincoln touched upon both while president. Noting his own rise from humble beginnings, he assured his countrymen (or at least, those who were male and white) that "through this free government" they had "an open field and a fair chance for your industry, enterprise and intelligence; that you may all have equal privileges in the race of life, with all its desirable aspirations."[4]

The first assumption is that the race of life, including competition for prizes in the marketplace, is in some sense "fair." This does not require perfect equality of opportunity, a condition difficult to define and impossible to achieve. Some inequalities are inescapable, including those generated by the accidents of heredity and the luck of the parental draw. Americans by and large have always been untroubled by such complexities. What they deem undesirable and unacceptable is the presence of inequalities of opportunity that are both egregious and amenable to reduction or removal by public policies.[5] If currently the race of life, in this sense, were widely perceived as becoming markedly unfair, the call for government action would be both pervasive and vociferous.

The second assumption is lurking in Lincoln's endorsement of "industry, enterprise and intelligence." Stated in stilted terms familiar to philosophers, prizes won in a "reasonably fair" economic race must be strongly correlated with the willful exercise of meritorious virtues, such as industry, frugality, and thrift. Barack Obama made the same point in more colloquial terms: "Through pluck and sweat and smarts, each of us can rise above the circumstances of our birth."[6] But to achieve that rise the individual must exercise those virtues. Obama's list is somewhat longer than Lincoln's, including "drive, discipline, temperance, and hard work."[7] His bottom line underscores (as Lincoln's does by implication) the linkage between meritorious behavior and market payoffs:

> The legitimacy of our government and our economy depend on the degree to which these values are rewarded, which is why the values

> of equal opportunity and nondiscrimination complement rather than impinge on our liberty.[8]

Such assumptions, values, and beliefs go to the heart of the collective hopes embedded in the American Dream. The most devastating piece of evidence that the Dream has been fading in recent years would be growing inequality of opportunity as indicated by growing immobility of those at the bottom of the economic ladder. Much is therefore at stake in the efforts of the experts to measure changes in economic mobility over the past three decades.

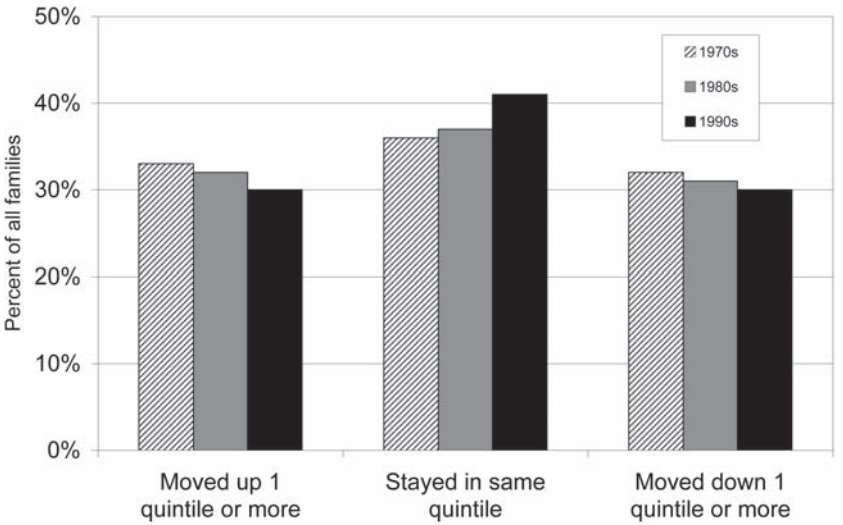
MEASUREMENT PROBLEMS

If the goal is to track the changing economic fortunes of specific individuals over time, the requisite data ideally must be generated by following given individuals through the course of their working years. The Panel Study of Income Dynamics (PSID) does exactly that. Initiated in 1968 by the Survey Research Center at the University of Michigan, this study annually gathers information[9] from the same individuals who collectively constitute a sample of roughly 7,500 families. The reader may arch an eyebrow at the prospect of inferring mobility for all Americans from a sample so small. The standard response consists of two points. First, only the tracking of a given set of individuals over time will provide information on mobility achieved (up or down). Second, the PSID sample is the only American data set that does this. The most demanding of the experts, to put the point in guarded terms, view the findings of other mobility studies based upon other data as somewhat suspect.

Our first difficulty, then, is a shortage of reliable evidence as we try to establish whether economic mobility has improved or worsened over the past three decades. Our second difficulty is the absence of agreement among the experts concerning which trends are indicated by the PSID data. Some argue that mobility between generations has declined "slightly," while others claim that it has remained "roughly" the same. All agree that it has not increased.[10]

Those encountering this debate for the first time will be struck by the timidity of the phrasing. "Roughly the same" or "slightly declining" are unlikely to provoke outbursts of indignation from the people or the politicians. The basic inferential problem is evident in figure 4.1. The bars presented there are taken from one of the more thorough of recent studies using PSID data. The incomes of all families in the PSID sample were divided into five groups

Figure 4.1. Family mobility across three decades, 1970s, 1980s, and 1990s



Source: Katherine Bradbury and Jane Katz, "Are Lifetime Incomes Growing More Unequal? Looking at New Evidence on Family Income Mobility," *Federal Reserve Bank of Boston Regional Review*, Q4 (2002), 3–5.

or quintiles (bottom fifth to top fifth). For a given decade, the bars indicate the percentage of families that (a) moved up one quintile or more, (b) moved down one quintile or more, or (c) stayed the same (i.e., the family at the end of the decade was in the same quintile as it was ten years earlier). Focusing upon these bar charts, ask yourself whether (according to the bars) economic mobility changed significantly between 1970 and 2000. The percentage of families moving up fell slightly, the percentage moving down declined slightly, and the percentage of those who did not move at all increased modestly, particularly in the 1990s. Such findings merely underscore that the experts have a point: Any close scrutiny of PSID data seems to yield conclusions that must be phrased in tentative terms. Because this is the only data set that all the experts agree is adequate for addressing the puzzle of whether mobility has changed, our quest to solve that puzzle decisively by using direct evidence would seem to be thwarted by a statistical fog bank.

Can indirect evidence be marshaled that indicates upward mobility for those at the bottom is becoming significantly more difficult? The next chapter will attempt to argue that there is.

5

EDUCATION AND MOBILITY

An argument of growing fashionability, particularly on the Left, is that education in general and a college education in particular are becoming progressively more important in reaching higher rungs on the economic ladder. Put another way, pulling yourself up by your own bootstraps (but minus a college degree) is becoming increasingly harder to do. Further, the costs of attending college are rising far more rapidly than are the family incomes of those in the lowest quartile or quintile. As *New York Times* columnist Bob Herbert characterized the problem:

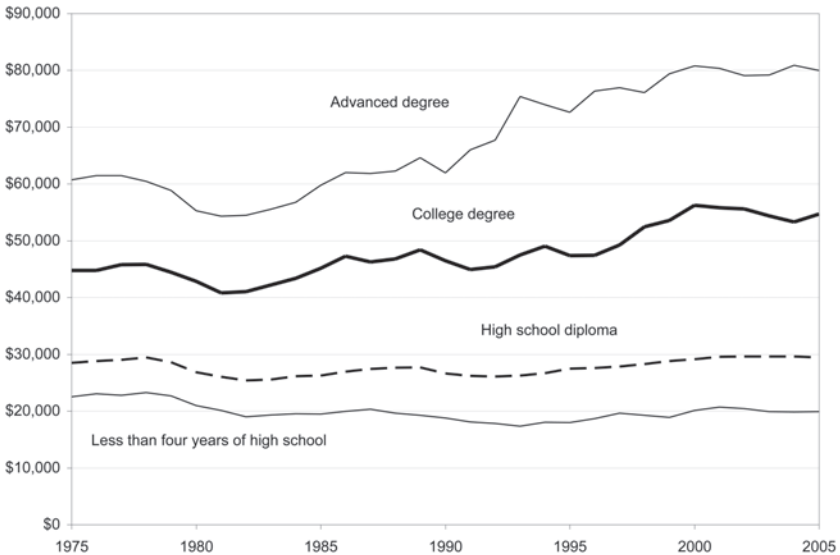
> One of the weirder things at work these days is the fact that we're making it more difficult for American youngsters to afford college at a time when a college education is a virtual prerequisite for establishing and maintaining a middle-class standard of living.[1]

Inequality of opportunity is on the rise, the argument concludes, because access of the economically disadvantaged to a college education is in decline. But is it true? More carefully, what does the evidence suggest about the merits of the argument?

BENEFITS

Almost all discussions about the economic benefits of higher education begin with the data displayed in figure 5.1. In the last thirty years, the "earnings gap" has been widening between those with more education and those with less.[2] That growing differential is rather modest between the bottom two lines (those with high school versus those without). It is quite

Figure 5.1. Real average earnings[a] by educational attainment, 1975–2005



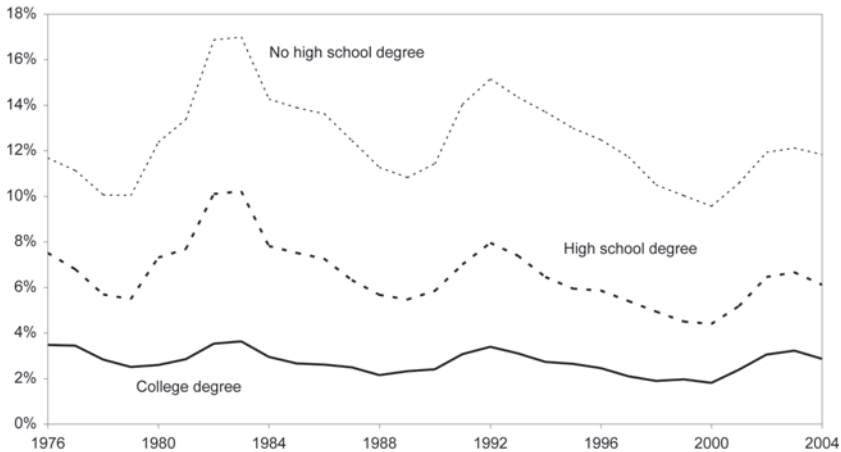
[a]For workers eighteen years and over, mean earnings in 2005 dollars, adjusted for inflation using the Consumer Price Index, All Urban Consumers (CPI-U), U.S. city average, annual average, ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.

Source: Author's analysis of U.S. Census Bureau, "Current Population Survey Historical Tables: Educational Attainment, (Table) A-3 Mean Earnings of Workers 18 Years and Over, by Educational Attainment, Race, Hispanic Origin, and Sex, 1975 to 2005," www.census.gov/population/www/socdemo/educ-attn.html.

pronounced between these two lines and "college degree" and between "college degree" and "advanced degree."

The unsurprising inference is that, as a determinant of earnings, education matters. What is surprising is how much it matters. A lively debate continues among economists concerning which gaps are narrowing or widening, and why.[3] For our purposes, the disturbing development lies elsewhere. It is the trend of the bottom two lines. The reader's first response may be: But there is no trend—both lines are relatively flat. That flatness *is* the trend, and a troubling one. What these two lines demonstrate is that the real (or inflation-adjusted) earnings of *all* workers who lack a college degree has remained substantially unchanged *for thirty years*.[4] Expressed on a per worker basis, virtually all of the increments in earnings made possible by economic growth over the last three decades have been scooped up by those with college or advanced degrees. Today, more than ever before in our history, as Bill Clinton noted in 1997, "education is the fault line between those who will prosper in the new economy and those who will not."[5]

Figure 5.2. Unemployment rates by education, 1976–2004



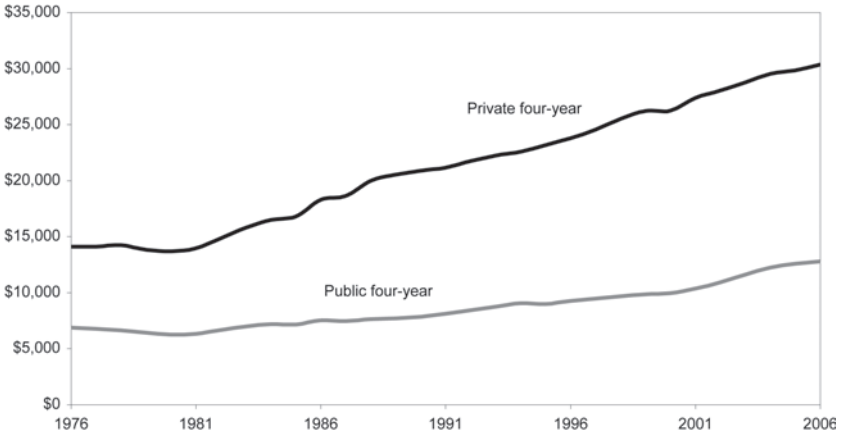
Source: Rob Valletta and Jaclyn Hodges, "Age and Education Effects on the Unemployment Rate," *Federal Reserve Bank of San Francisco Economic Letter*, Number 2005-15 (July 15, 2005), and data files supplied by Rob Valletta.

One way not to prosper is to be unemployed. Worthy of note but often overlooked in discussions of the "earnings gap" is the "unemployment gap." As indicated in figure 5.2, the less educated the worker, the greater the chances that he or she will be out of work. Thus, for example, irrespective of whether the economy is booming or in a slump, those lacking a high school degree are roughly four times as likely to be unemployed as those with a college degree. But this is a secondary worry. The main concern is the lack of upward movement over thirty years in the real earnings of those without a college degree.

COSTS

The static nature of real earnings of the less educated contrasts sharply with the trend in costs of becoming more educated. For those who seek access to the halls of higher learning at the nation's colleges and universities, the price tag for admission has been steadily rising. Since the early 1980s, the annual cost of tuition plus room and board (corrected for inflation) at both public and private institutions has roughly doubled,[6] as illustrated in figure 5.3. As was the case with health insurance, the question this trend raises is the extent to which a postsecondary education is becoming less affordable for a growing number of Americans. For those without a college degree, whose

Figure 5.3. Real annual college cost,[a] 1976–2006[b]



[a]Average Published Tuition + Fees + Room and Board (TFRB) charges at four-year institutions (enrollment-weighted), 2006 CPI adjusted dollars.

[b]Academic years listed as the earlier of the two years; for example, academic year 2006–2007 listed as 2006.

Source: The College Board, *College Pricing Tables & Charts.xls*: 1987–1988 to 2006–2007 data from *Annual Survey of Colleges*, The College Board, New York, weighted by full-time undergraduate enrollment; 1976–1977 to 1986–1987 data from *Integrated Postsecondary Education Data System (IPEDS)*, U.S. Department of Education, National Center for Education Statistics, weighted by full-time equivalent enrollment, www.collegeboard.com/press/releases/150634.html.

real earnings have been stagnant for the past thirty years, the answer would seem obvious. But rising college costs have become a problem reaching well beyond the least advantaged. As noted in chapter 2, the growth rate of family income for most Americans fell far short of doubling in the years since 1980.

ACCESS

What may appear to lower-income families to be financially out of reach can become a viable option with sufficient aid from public and private sources. Given that college costs have been rising at a more rapid rate than most incomes, the critical question is whether available aid has increased fast enough to make up the difference.

In the case of Pell Grants, the answer is unambiguously in the negative. As figure 5.4A makes clear, the maximum (inflation-adjusted) grant per student has changed little since the early 1980s.[7] This in turn means that over the past quarter-century, Pell Grants have covered an ever-smaller share of rising college costs, as illustrated in figure 5.4B. That trend is far

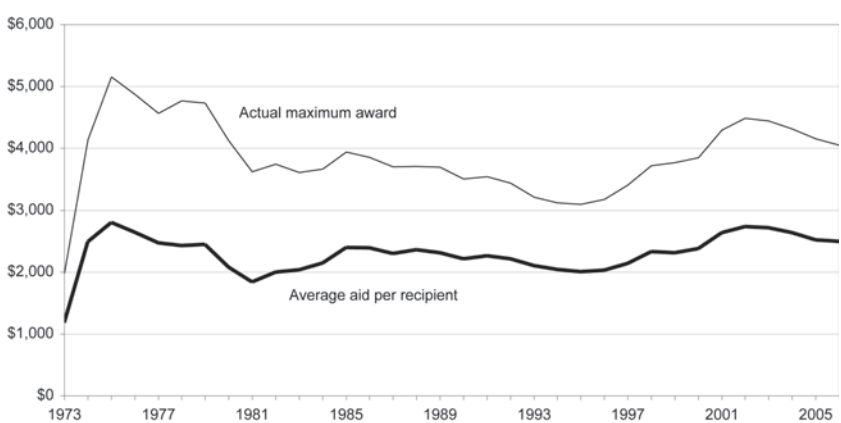
from trivial. Totaling more than $12 billion annually, these federal grants are the nation's largest scholarship program.[8] Moreover, state-sponsored aid programs at public universities have not been able to pick up the slack. Here, too, available funding has been under pressure. The implications of that pressure were glumly summarized in January 2008 by the provosts of eleven public universities:

> Over the past quarter century . . . public universities like ours have been in the grip of a funding vise: Strained state budgets have brought significant funding decreases at the same time that we are trying to serve more students and hold the line on tuition increases.[9]

The net result is that, on a per-pupil basis, state spending for higher education is at a twenty-five-year low.

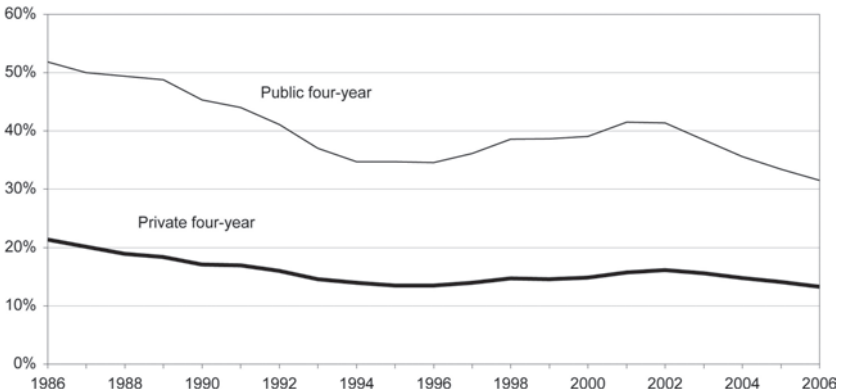
It should therefore come as no surprise that in a recent *New York Times*/CBS poll, 70 percent of parents surveyed were "very concerned" about how they were going to finance a college education for their children.[10] They are right to be worried. The requisite outlays are almost always the second largest family expense, exceeded only by housing. For example, consider average college costs (public or private) for two years, 1992 and 2003. Subtract all financial aid, and then express the resulting net cost as a percentage of family income. The numerical results

Figure 5.4A. Real[a] maximum and average federal Pell Grant awards, 1973–2006[b]



[a]2006 CPI-U adjusted dollars.
[b]Academic years listed as the earlier of the two years; for example, academic year 2006–2007 listed as 2006.
Source: Sandy Baum and Patricia Steele, *Trends in Student Aid 2007* (New York: The College Board, 2007), 18, and data supplied by Patricia Steele, The College Board.

Figure 5.4B. Real[a] maximum Pell Grant as a percentage of tuition and fees and room and board at four-year colleges and universities, 1986–2006[b]

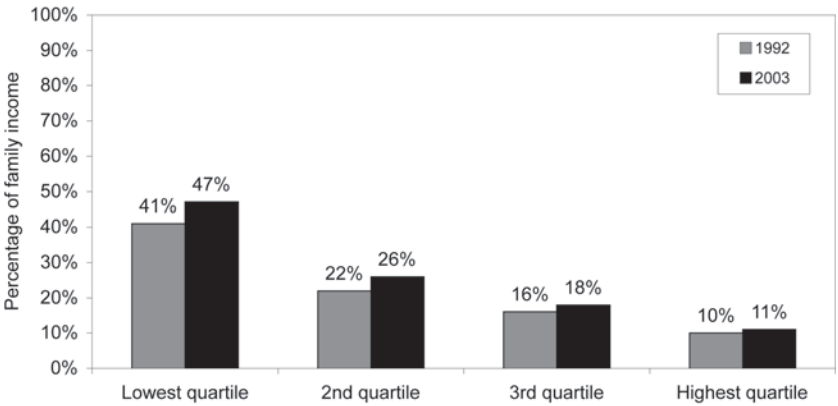


[a]2006 CPI-U adjusted dollars.
[b]Academic years listed as the earlier of the two years; for example, academic year 2006–2007 listed as 2006.
Source: Sandy Baum and Patricia Steele, *Trends in Student Aid 2007* (New York: The College Board, 2007), 18, and data supplied by Patricia Steele, The College Board.

are displayed in figures 5.5A and 5.5B. For every income quartile, the percentage of family income needed to cover net college costs has risen between 1992 and 2003. Predictably, that percentage declines as family income increases. The important question is how large that percentage must be before the requisite outlay for attending college is viewed by the family's decision makers as prohibitive. For the lowest-income quartile, a higher education—at either a public or private institution—has become alarmingly expensive, barring the availability of large family assets, which seems highly improbable, or massive loans (or loans almost sure to be regarded as massive by low-income families).

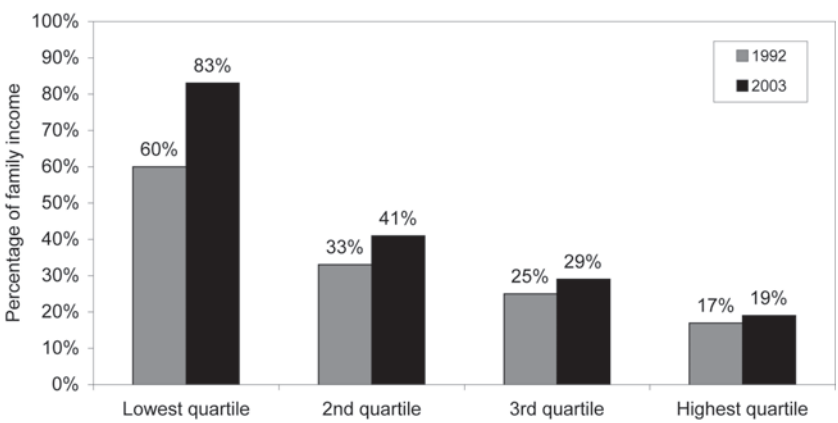
Beginning in the mid-1990s, the supply of government-subsidized student loans began to fall far short of demand. Those seeking to finance a college education were therefore forced in ever-greater numbers to find lending sources in the private sector (banks and other private lending companies). In the ensuing decade, student loans from these nongovernmental sources virtually exploded. Consider the bars in figure 5.6. In the ten years ending in 2006, private lending to finance undergraduate education in constant dollars increased almost tenfold, from $1.5 billion to $14.5 billion. Problems of imperfect information—or borrower gullibility—have arisen in this market not unlike those encountered in the subprime mortgage market. As summarized by *Business Week*:

Figure 5.5A. Percentage of family income (by income quartile)[a] needed to cover net college costs after grant aid, public four-year colleges, 1992 and 2003[b]



[a]Lowest quartile: $0–$34,000; second quartile: $34,000–$62,000; third quartile: $62,000–$94,000; highest quartile: $94,000+.
[b]Data for academic years 1992–1993 and 2003–2004.
Source: U.S. Department of Education, *A Test of Leadership: Charting the Future of U.S. Higher Education* (Washington, D.C.: U.S. Department of Education, 2006), 11.

Figure 5.5B. Percentage of family income (by income quartile)[a] needed to cover net college costs after grant aid, private four-year colleges, 1992 and 2003[b]



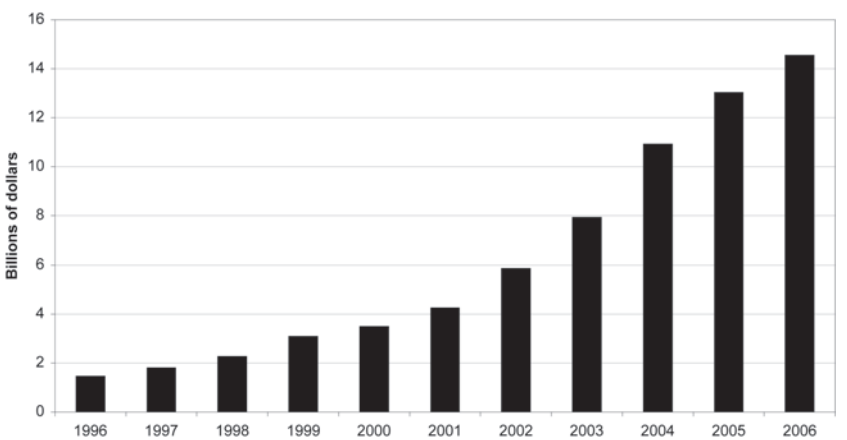
[a]Lowest quartile: $0–$34,000; second quartile: $34,000–$62,000; third quartile: $62,000–$94,000; highest quartile: $94,000+.
[b]Data for academic years 1992–1993 and 2003–2004.
Source: U.S. Department of Education, *A Test of Leadership: Charting the Future of U.S. Higher Education* (Washington, D.C.: U.S. Department of Education, 2006), 11.

> Many borrowers describe the loan process as opaque, saying schools and lenders don't explain interest rates or postgraduation payments. Some borrowers say they were unaware that private loans are different from less expensive federally insured loans.[11]

Illustrating the propensity of the uninformed to be hoodwinked is the case of a forty-seven-year-old who sought retraining in college because he had lost his job as a machine operator. The school (American Intercontinental University) "guided him" to a lending source that he later discovered was charging 18.1 percent.[12]

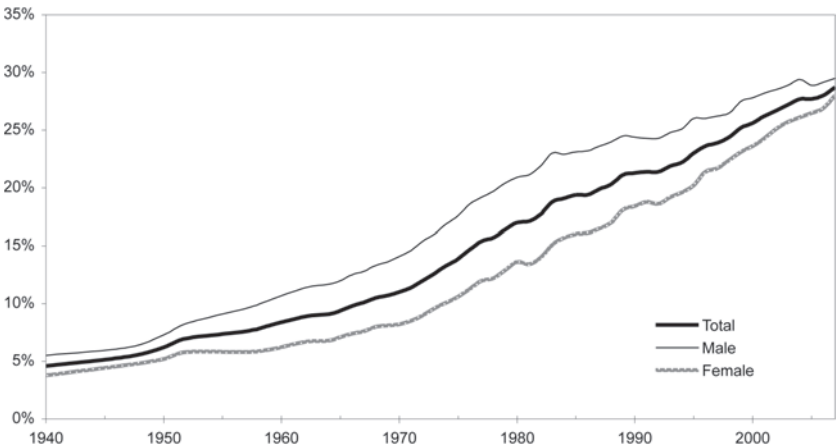
Some readers may object that this pessimistic picture is overdrawn. Since 1940, they might point out, the percentage of Americans completing college has steadily risen, and continues to rise. The heavy line in figure 5.7 proves them right. But notice where that line ends. In 2006, roughly 30 percent of all adults in this country had completed college. Combine this information with the data in figure 5.1. If three out of ten workers have a college degree, seven out of ten do not.[13] For the latter group, real earnings have stagnated for thirty years. To escape that economic fate increasingly requires a college degree, while the cost of acquiring a college degree is becoming progressively less affordable for an ever-larger number of families in this country.

Figure 5.6. Real[a] private lending to finance undergraduate education, 1996–2006[b]



[a]Nonfederal loans only, 2006 CPI adjusted dollars.
[b]Academic years listed as the earlier of the two years; for example, academic year 2006–2007 listed as 2006. No data on nonfederal borrowing are available prior to the mid-1990s from the College Board because the extent of such programs prior to the mid-1990s was not considered significant.
Source: The College Board, 2007 Student Aid Tables and Charts.xls, Table 2, professionals.collegeboard.com/data-reports-research/trends/student-aid-2006.

Figure 5.7. Percentage of Americans[a] who have completed college, 1940–2007



[a]Age twenty-five years and over.

Source: U.S. Census Bureau, "Current Population Survey Historical Tables: Educational Attainment, (Table) A-2 Percent of People 25 Years and Over Who Have Completed High School or College, by Race, Hispanic Origin and Sex, Selected Years 1940 to 2006," www.census.gov/population/www/socdemo/educ-attn.html.

That last statement is subject to one minor qualification. In recent years, the cost of attending a handful of the most elite institutions of higher learning has been dramatically cut. Princeton led the way in 1998, when it replaced loans with grants for low-income students. But Harvard captured most of the headlines, beginning in 2004, when its president announced that almost all costs would be covered by the university for any student whose family earned less than $40,000. What followed was something of a bidding war among approximately three dozen of America's best colleges and universities. Incentives offered to prospective freshmen included in some cases free tuition, in others, grants to replace loans, or even coverage of virtually all costs for those whose family earnings fell below some designated maximum.[14] (Not to be outdone, Harvard raised that maximum to $60,000 and then introduced significant aid for most families making less than $180,000.) The end result: "In less than five years, the entire tuition and financial aid system at the nation's top colleges has been overhauled."[15]

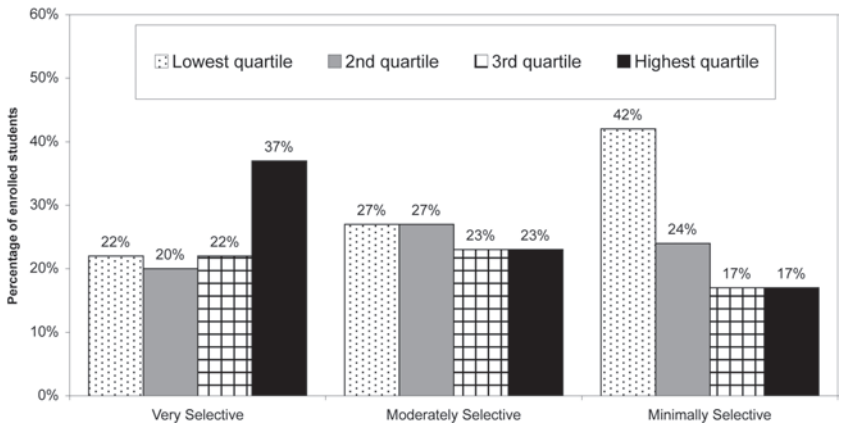
What is perhaps easily overlooked is that excluded from this bidding competition were the vast majority of the nation's institutions of higher learning, for the simple reason that they lacked the resources to compete. Three-quarters of American college students are educated in public institutions, which, as previously noted, have been subjected to a financial squeeze

for some time. The remaining 25 percent attend private institutions, at which (except for the wealthy few) tuition has been steadily rising precisely because these institutions do not have endowments large enough to generate the revenue needed to cover their own steadily rising expenses. Arguably the most striking example of this mismatch in wealth is the fact that the *annual* return on Harvard's endowment now exceeds the *total* endowment assets of all but six universities, including several of its Ivy League rivals. Moreover, all of the Ivy League schools combined educate less than 1 percent of the country's college students. In short, this recent and radical overhauling of the cost of attending a few elite institutions has had a major impact on a minuscule percentage of students pursuing postsecondary education. Or, in the words of Sandy Baum, an economist who oversees the College Board's annual report on college costs, "The number of students going to these schools is tiny. It's not going to make a dent in educational opportunity."[16]

The general mismatch in wealth between private and public colleges and universities is already having an adverse effect on educational opportunity. Over the past decade, endowments of private institutions continued to grow until abruptly reversed by the recent plunge in the stock market. When the economy and the stock market recover—as they invariably do after a cyclical downturn—the upward trend in the endowments of private institutions is almost sure to resume. The same cannot be said for public institutions where, even before the recent financial crises and economic downturn, funding in real terms was tending to level off or decline. "Policymakers seem to have concluded that flat funding is all that public higher education can expect from the state," contends Ronald Ehrenberg, who directs Cornell's Higher Education Research Institute.[17] From the many postsecondary institutions strapped for funds, the wealthy few can bid away distinguished faculty and their research grants. "Public schools are being drained for the benefit of the ultra-elite," lamented the chancellor of the University of California at Berkeley. "The further you project into the future, the more frightening it becomes."[18] That prospect does not bode well for college students from low-income families. As figure 5.8 illustrates, they now constitute by far the largest group attending four-year colleges and universities ranked "minimally selective" by the National Center for Education Statistics.

Finally—and far more worrisome—is the dropout rate of college students from low-income families. According to a 2001 study, only 54 percent of these earned a degree within six years of enrolling in four-year programs offered by institutions of higher learning. (See figure 5.9.) The comparable number for students from high-income families is slightly better than three out of four. The implications of these surprisingly high dropout rates for aggregate growth will be considered in chapter 6.

Figure 5.8. Income distribution[a] of families within private four-year colleges and universities, by admissions selectivity,[b] 2003–2004

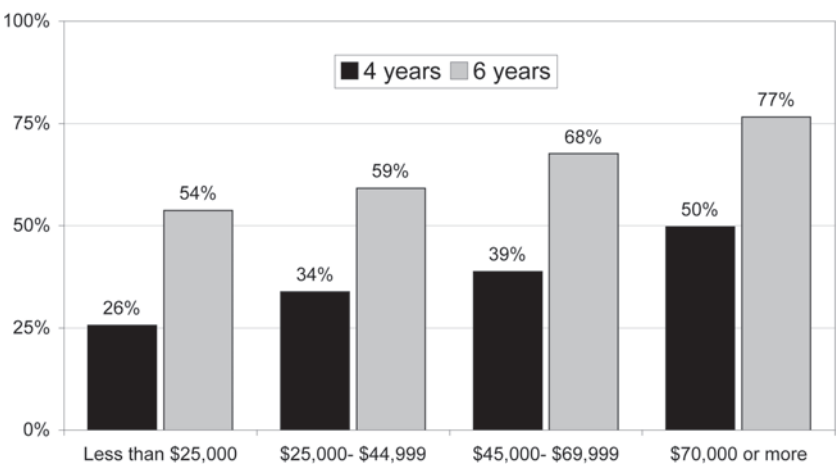


[a]Income categories are based on 2002 quartiles of families in U.S. Census Bureau data with heads of households ages forty-five through fifty-four. Low income is less than $40,000, low-middle income (second quartile) is between $40,000 and $69,999, middle-high income (third quartile) is between $70,000 and $99,999, and high income is $100,000 and higher. Components may not sum to 100 percent due to rounding.

[b]Selectivity is defined according to an index developed by the National Center for Education Statistics based on average SAT/ACT scores and percentage of applicants accepted.

Source: Sandy Baum and Patricia Steele, *Trends in Student Aid 2007* (Washington, D.C.: The College Board, 2007), 20.

Figure 5.9. Four-year and six-year bachelor's degree completion rates[a] by family income,[b] 2001



[a]Percentage of student's beginning at four-year institutions in 1995–1996 with a bachelor's degree goal, who completed a bachelor's degree at any four-year institution by June 2001.

[b]Family income of student as of 1994.

Source: Lutz Berkner, Shirley He, and Emily Forrest Cataldi, *Descriptive Summary of 1995-96 Beginning Postsecondary Students: Six Years Later*, NCES 2003-151 (Washington, D.C.: U.S. Department of Education, National Center for Education Statistics, 2002), Table B.

CONCLUSION

The previous chapter began with a question: Is the upward economic mobility of those at the bottom of the income distribution slowing down? The present chapter shifted the focus and changed the question. The data in figure 5.1 make clear what analysts have been claiming for years—namely, that to achieve a rising standard of living and a chance at upward mobility requires a college degree, at least for the majority of workers in this country. The question then became: For those at the bottom of the income distribution, has the likelihood of getting such a degree declined significantly over the past three decades?

For the population as a whole, that possibility has expanded dramatically. In the mid-1970s, roughly 11 percent of adult Americans[19] had a college degree. By 2007, that number had more than doubled. Over the same time period, was the percentage of students from low-income families receiving college degrees on the rise or in decline? A lack of data precludes a straightforward answer. But indirect evidence is troubling. The inflation-adjusted costs of attending institutions of higher learning has steadily risen, while both student aid and government-subsidized student loans have failed to keep pace. Family income growth of those with the least has also failed to keep up, and by a wide margin. By 2002, the annual net outlay (costs minus aid) needed to attend public institutions was equal to roughly half of family income for those in the bottom quartile. (At higher-priced private institutions, it was 83 percent.) Whether the net effect for the least advantaged has been a significant decline in upward mobility is not clear. What is clear is that higher rungs on the economic ladder are becoming increasingly difficult to reach for those with only a high school degree or less.

What of the future? This question must now be expanded to include all three components of the American Dream that are the subject of this work: standard of living, financial security, and upward mobility. The answer for each of them will crucially depend upon two developments: (1) how rapidly gross domestic product, or total output, will expand; and (2) how the income generated in creating that output will be divided among the various factors of production—specifically, how that division will affect the economic fortunes of those for whom the American Dream is becoming ever more elusive. The first will be explored in the next chapter. The second will be taken up in chapter 7.

6

THE FUTURE: AGGREGATE GROWTH

This chapter takes a simple approach to a complex problem. The issue is what the trends will be in the years ahead in three variables: standard of living, financial security, and upward economic mobility. A detailed investigation of the prospects for each would be an appropriate topic for a book. Our modest objectives are (1) to note the close dependence of all three on growth in real gross domestic product per capita and (2) to elaborate three causal forces looming in the future sure to have a major negative effect on GDP growth possibilities. The goal is not to demonstrate that real GDP per capita is destined to decline. Rather it is to underscore that achieving sustained growth in the decades immediately ahead is likely to become significantly more difficult. The slower the growth, the less likely it becomes that our three key variables will improve significantly for millions of Americans.

Consider, first, the dependence of the three on economic growth (defined as a sustained rise in real GDP per capita). Imagine two Americas two decades hence. In one, economic growth has remained essentially stagnant for twenty years. In the other, average annual growth in real GDP per capita has increased at the same rate as that achieved in the 1990s (roughly 2 percent a year).[1] In the first, the average standard of living has stagnated by definition. ("Average standard of living" is equivalent to real GDP per capita.) In a no-growth economy, significant improvements in financial security or upward mobility would seem unlikely, but not impossible given a sufficient number of extreme assumptions, including, perhaps, massive government intervention in education, health insurance, unemployment insurance, and pension coverage. To concede that the assumptions must be extreme is to acknowledge that significant improvements are unlikely. In short, the future trend in economic growth is of the utmost importance for

improving many of the causal forces that determine financial security and upward mobility.

Now consider the likely trend in these same three variables in an America in which economic growth over the next two decades roughly matches that of the 1990s. The average standard of living (again, by definition) will rise at the same rate as real GDP per capita. The increases in real output will generate increases in the incomes of those creating that output, which could help make private pensions larger, health insurance more affordable, and paying off debt more feasible. Rising incomes (other things being equal) would generate more tax revenues, increasing the ability of federal and state governments to consider programs likely to improve financial security. Rising incomes and rising tax revenues could also be used to make college more affordable and government aid to education more generous. Both, in turn, should improve the chances of those at the bottom for upward economic mobility.

This thought experiment involving two sharply different growth paths for America illustrates a simple point: Future trends in the main economic variables embedded in the American Dream are crucially dependent on the future trend in real GDP per capita. We shall confine our investigation to three particular developments that in concert are sure to exert strong negative pressures on the trend of GDP in the next few decades. Whether these, in turn, will be more than offset by other causal factors stimulating growth is for us a moot point. What matters is to show—in no uncertain terms—that those causal factors favoring growth will need to be exceptionally strong if GDP is to grow significantly in the years ahead.

MEASURES THAT MATTER

The first order of business is to explain the relationship between output growth, the labor force participation rate, and output per worker-hour. Those familiar with all three are encouraged to go directly to the next section, "Looming Impediments to Growth."

The average standard of living in America will improve (as previously noted) if real or inflation-adjusted GDP per capita grows. For the latter to occur, at least one of two things must happen. First, the percentage of the population who are working could rise. If, for example, more women who previously stayed at home now join the workforce, the amount of output they create will constitute an addition to total output, or GDP.[2] The same thing will happen if the percentage of those working beyond the age of

sixty-five increases. In short, a rise in the percentage of the population working (or included in the labor force participation rate) will raise total output. A decline will lower output.

Now shift the focus from the percentage of those working to how productive the average worker is. The standard measure of that productivity is the total output created in a year (or GDP), divided by the total number of hours worked by all those in the labor force. The result is output per worker-hour. Anything that raises output per worker-hour will increase total output, and—if the population remains unchanged—will therefore raise the average standard of living.

In sum, we can raise real GDP per capita either by (a) having a larger percentage of the population working or (b) increasing the output that each worker creates.

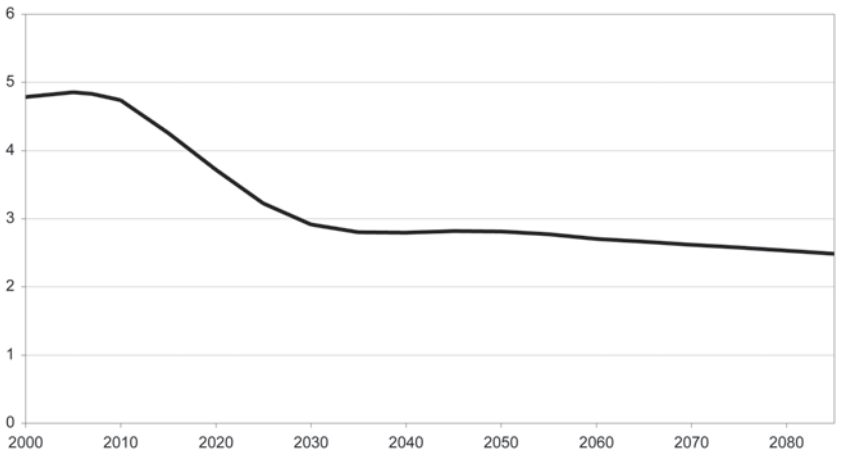
LOOMING IMPEDIMENTS TO GROWTH

What follows is by no means a comprehensive list of all the prospective causal forces that could slow the rise of real GDP in this country during the years ahead. The three about to be considered are nevertheless among the most worrisome—arguably *the* most worrisome. Two of the three are commonly considered in any forecast of U.S. economic growth. The third, while crucial, is often omitted; when included, it is rarely given the close scrutiny it deserves.

Labor Force Participation

The problem under this heading is repeatedly raised by economists, politicians, and the media. The worry is what will happen when the baby boomers, that atypically large cohort of the population born between 1946 and 1964, leave the labor force and retire. When this generation grew up and went to work, the percentage of all adults in America's labor force rose substantially. Now that trend is about to be reversed as aging baby boomers retire. The impact of this departure on the nation's labor force participation rate is suggested by figure 6.1. The line is a common variant of the labor force participation rate, with "presumed workers" in the numerator (those twenty to sixty-four in age) and "presumed" retirees in the denominator (those sixty-five and older).[3] The numerator undoubtedly includes some who have dropped out of the labor force, and the denominator, some who are still working. But the trend displayed—dipping sharply in the next two

Figure 6.1. Recent and current dependency ratios,[a] and Social Security Administration projections to 2085



[a]Ratio of the population at ages twenty through sixty-four to the population at ages sixty-five and over.
Source: Author's analysis of Social Security Administration, *The 2008 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* (Washington, D.C.: U.S. Government Printing Office, 2008), Table V.A2, Intermediate Cost Projections, www.socialsecurity.gov/OACT/TR/TR08/trLOT.html.

decades—still can serve as a reasonable approximation of the problem that lies ahead.[4] That problem, in a nutshell, is that (a) the number of workers *per* retired person is destined to drop from roughly five to one to three to one, and thus (b) the average standard of living of *all* Americans must inevitably decline unless the productivity of those still working is significantly increased. Is the latter likely? Two problems of the present are sure to make gains in worker productivity more difficult to achieve in the future. One is comparatively minor, and the other, of the first importance. The more serious of the two will be considered first.

Labor Force Quality

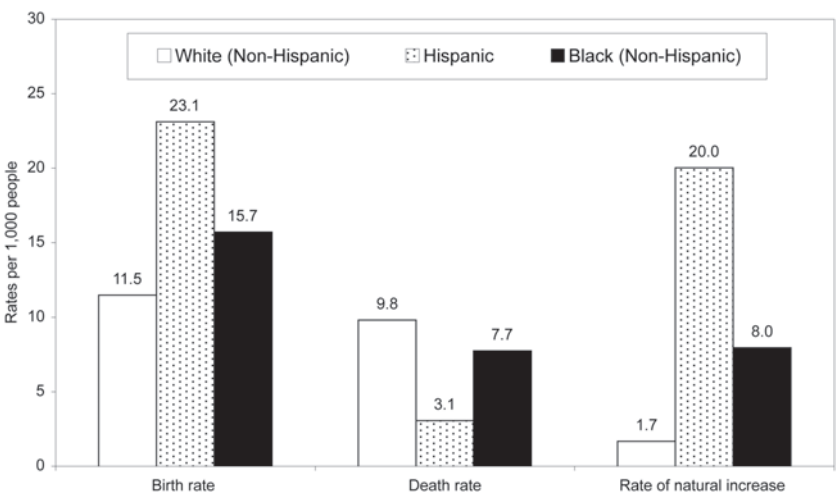
The issue to be investigated is what is likely to happen to the quality of the American workforce in the next few decades. The analysis begins with two numerical observations and two simple arithmetic inferences.

The rate of natural increase (birth rate minus death rate) is markedly different for America's three largest races. What some will find surprising is how large that differential is. As illustrated in figure 6.2, the Hispanic population is currently growing at two-and-a-half times the rate of the black population, which in turn is growing almost five times as fast as the white (non-Hispanic) population. Now consider current evidence on educational

attainment by race for the age cohort twenty-five to twenty-nine, or those who are slightly older than college students. The percentage of those graduating from high school is slightly higher for whites than blacks—94 percent versus 88 percent—but the Hispanic graduation rate is far behind both at 65 percent. (See figure 6.3.) Rounded off, these comparisons demonstrate that about nine out of every ten white and black high school students graduate, but only two out of every three Hispanics. As noted in chapter 5, the educational achievement offering the biggest economic payoff is a college degree. The percentage of white students graduating from college (36 percent) is slightly less than double the comparable percentage for blacks (20 percent), and three times the comparable percentage for Hispanics (12 percent).

Two inferences follow. The first involves the extrapolation of rates of natural increase. If the current differentials among these three races persist, then the American population by 2050 will be radically transformed. (See figure 6.4.) The percentage of Hispanics will roughly double, blacks will remain about the same, and whites will decline from roughly two out of three to one out of two. The second inference merely combines this demographic forecast with the data in figure 6.3. If the differentials in educational attainment by

Figure 6.2. Birth rates,[a] death rates, and rates of natural increase, by race,[b] 2005

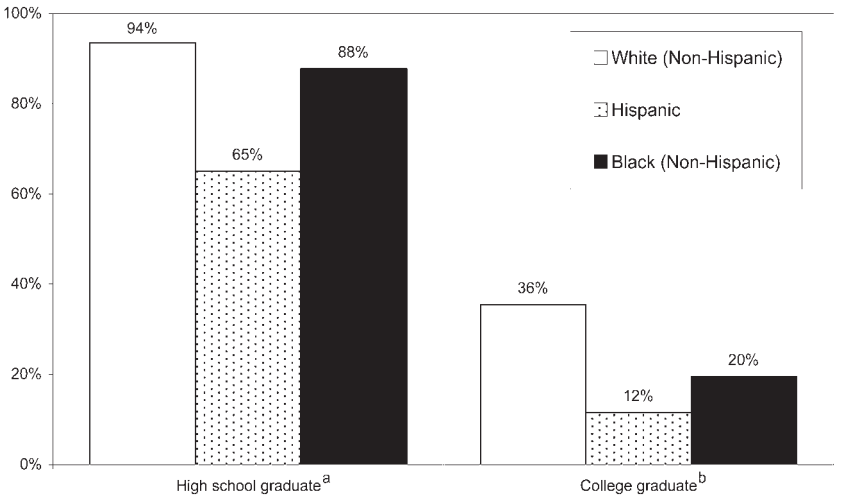


[a]Birth rates and death rates are per one thousand population in specified group. Rate of natural increase equals birth rate minus death rate.

[b]Non-Hispanic Asian or Pacific Islander birth and death rates were not available from this source. The rates for Asian or Pacific Islander (including those ethnically Hispanic) are birth rate, 16.5; death rate, 3.1; rate of natural increase, 13.4.

Source: Author's analysis of Joyce A. Martin et al., "Births: Final Data for 2005," *National Vital Statistics Reports* 56, no. 6 (Hyattsville, Md.: National Center for Health Statistics, 2007), Tables 1 and 5, and Hsiang-Ching Kung et al., "Deaths: Final Data for 2005," *National Vital Statistics Reports* 56, no. 6 (Hyattsville, Md.: National Center for Health Statistics, 2008), Tables 1 and 5.

Figure 6.3. Educational attainment, ages twenty-five to twenty-nine, by race and ethnicity, 2007



[a]"High school graduate" includes persons who graduated from high school with a diploma as well as those who completed high school through equivalency programs, and those with "some college." "Some college" includes persons who have participated in postsecondary education, including those who have attained an associate's degree, but who have not attained a bachelor's degree. The real earnings gap between "high school graduate" and "some college" is minimal. (See source for figure 6.1.)

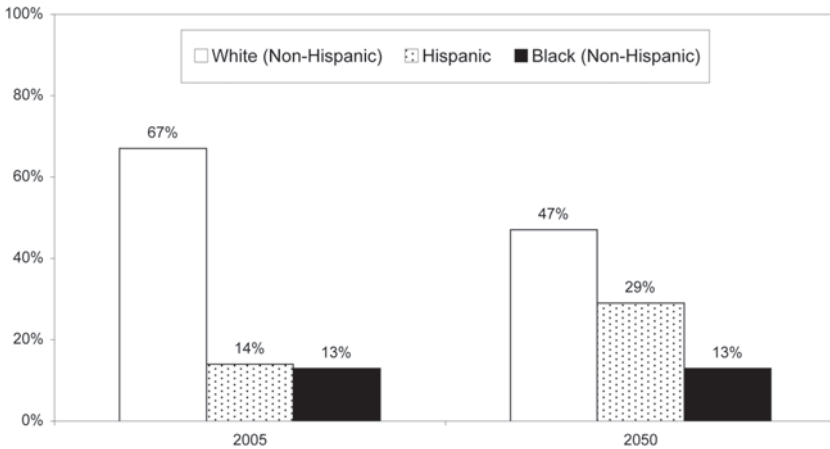
[b]"College graduate" refers to a person who has attained at least a bachelor's degree and includes those who have attained advanced degrees.

Source: T. D. Snyder, S. A. Dillow, and C. M. Hoffman, *Digest of Education Statistics 2007* (Washington, D.C.: National Center for Education Statistics, U.S. Department of Education, 2008), Table 8.

race persist (note that this clause begins with "if"), then the average quality of the United States labor force will continually decline in the decades ahead. That statement has nothing to do with racism. It has everything to do with arithmetic. The racial mix of new entrants into the workforce should roughly match what the racial mix of babies was when these new entrants were born. Although worker productivity is not exclusively a function of educational attainment, the two are closely correlated and will probably become even more closely linked as the relative demand for skilled workers continues to rise in the globalized economy of the twenty-first century. The quality of the labor force, in turn, is one crucial determinant of future economic growth. The implication is that all Americans have a vested interest in improving the educational attainment of all races. If present differentials persist, then sooner or later the average standard of living in this country will be under pressure to decline, and the United States will become a second-rate economic power.

The policy implication is also clear: The education of our youth must be substantially improved. The problem is that the wheels are coming off the American educational system.

Figure 6.4. U.S. population by race[a] and ethnicity, actual and projected, 2005 and 2050



[a]The Asian (non-Hispanic) population was 5 percent in 2005 and is projected to be 9 percent in 2050. American Indian/Alaskan Native not given in source.

Source: Jeffrey S. Passel and D'Vera Cohn, *U.S. Population Projections: 2005–2050* (Washington, D.C.: Pew Research Center, 2008), 9.

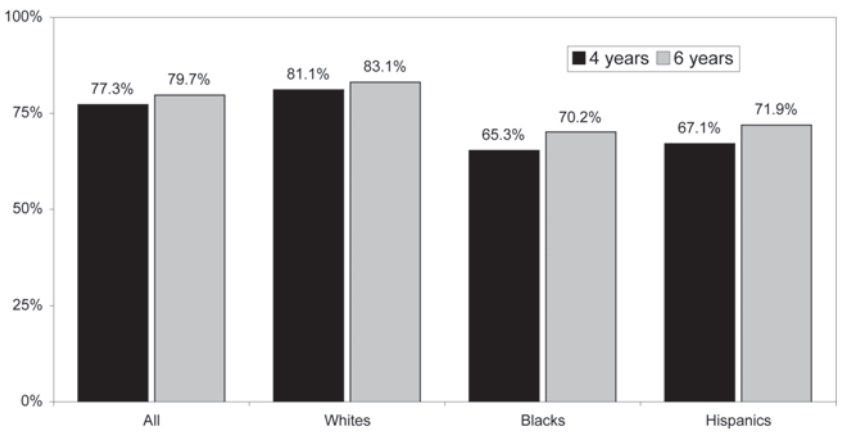
Imagine that the U.S. military has two training bases for army recruits. Civilians accepted by the first learn only the simplest of skills required to function as a soldier. Those graduating from the program can fire a rifle and drive a truck, but cannot drive any sophisticated military vehicle and lack the rudimentary computer skills to aim and fire technically sophisticated weaponry. Accordingly, they tend to be assigned to menial jobs well behind any zone of combat. The second training camp takes in a subset of graduates from the first and raises the level of their skills such that they can perform almost any military task and thus can be assigned to almost any unit in the army, including intelligence assessment, vehicle repair, and manning advanced weapons systems. Of civilians accepted by the first training camp, only 80 percent graduate. Of those graduates accepted by the second training camp, only 60 percent become fully trained soldiers capable of confronting twenty-first-century military challenges.

The same attrition rates actually exist in the current American educational system. Roughly one in five students fails to graduate from high school, and of those who subsequently enter college, four out of ten do not receive a bachelor's degree. The graphing of this simple set of numbers

in figures 6.5 and 6.6 is designed to hammer home a point that too few Americans seem to grasp. As regrettable as the size of the high school dropout rate is, the dropout rate at four-year colleges is almost twice as great. The first is arguably more worrisome than the second. *New York Times* columnist Bob Herbert suggests why.

> An American kid drops out of high school every 26 seconds. That's more than a million every year, a sign of big trouble for these largely clueless youngsters in an era in which a college education is crucial to maintaining a middle-class quality of life—and for the country as a whole in a world that is becoming more hotly competitive every day.[5]

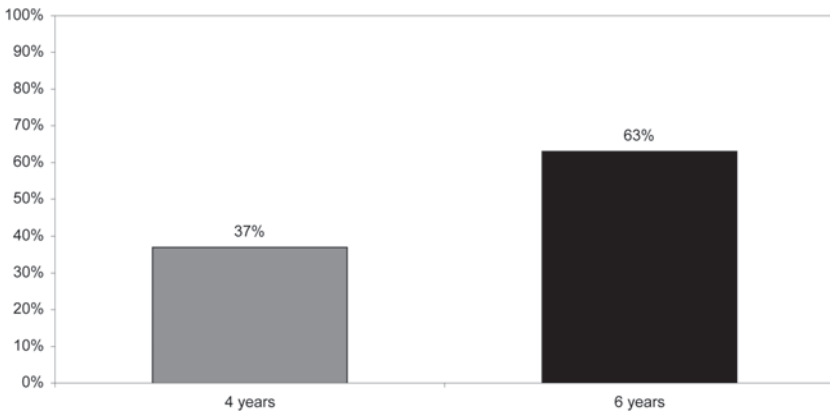
Figure 6.5. Four-year and six-year regular diploma high school completion rates[a] by race/ethnicity, circa 1994



[a]There is an ongoing controversy about high school completion rates because recent, unbiased data are not available. Heckman and LaFontaine (see source below) have attempted to compensate for the variety of biases plaguing available data sets, and their report, although not ideal, is the best and most thorough currently available. These graphs show the percentage of students who were in the eighth grade in the spring of 1988 who received a regular diploma on time (1992) and by two years after normal graduation time (1994). Data are from the National Education Longitudinal Study of 1988 (NELS: 88) and include adjustments for some sampling biases in the NELS noted by Heckman and LaFontaine. NELS is often considered the gold standard in high school completion studies because it followed individual students and verified survey responses against independently obtained transcript records. Heckman and LaFontaine have shown a small secular decline (about 4 percent) in high school graduation rates consistent across all major data sources over approximately the past forty years, which is due to reduced graduation rates for males across all races. More recent data from 2003 analyzed by these authors, not available in four- and six-year breakdowns, are based on the National Longitudinal Survey of Youth (1997), which followed a cohort of Americans since 1997 whose ages ranged from nineteen through twenty-three in 2003, and also included transcript checking. This analysis gives a cohort high school diploma rates as follows: all (77.5 percent), whites (80.2 percent), blacks (69.1 percent), and Hispanics (72.3 percent).

Source: James J. Heckman and Paul A. LaFontaine, *The American High School Graduation Rate: Trends and Levels,* NBER Working Paper 13670 (Cambridge, Mass.: National Bureau of Economic Research, 2007), Table I and III, and Web Appendix.

Figure 6.6. Four-year and six-year bachelor's degree completion rates of four-year college entrants, 2001[a]



[a]Based on students who entered four-year institutions in academic year 1995–1996 with the goal of earning a BA. The four-year rate includes those who completed in forty-eight months or less after they first enrolled. The six-year rate is the percentage that completed a BA at any postsecondary institution by the end of academic year 2000–2001. Completion rates varied by institution type, as indicated below.

First institution type and highest offering	Bachelor's degree completion rate at any 4-year institution	
	In 4 years or less	6-year total
Public 4-year	26%	57%
Non-doctorate-granting	21%	49%
Doctorate-granting	29%	62%
Private not-for-profit 4-year	55%	73%
Non-doctorate-granting	51%	70%
Doctorate-granting	62%	79%

Source: Lutz Berkner, Shirley He, and Emily Forrest Cataldi, *Descriptive Summary of 1995–96 Beginning Postsecondary Students: Six Years Later*, NCES 2003-151 (Washington, D.C.: U.S. Department of Education, National Center for Education Statistics, 2002), Table B.

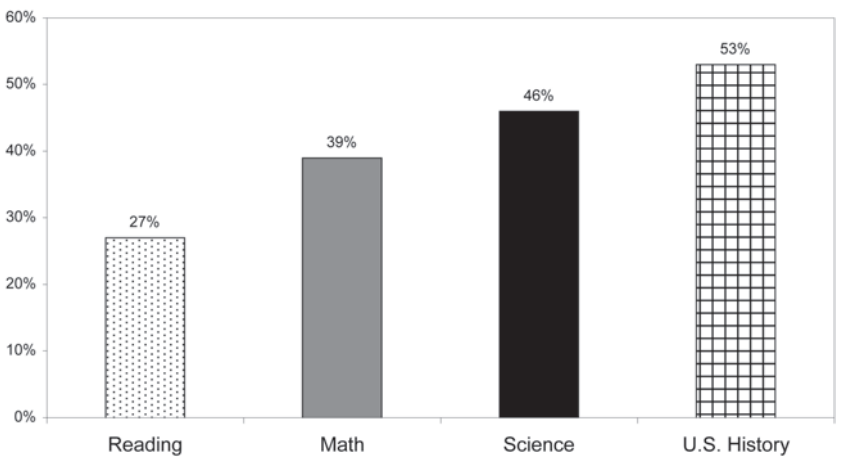
Noting that America has "one of the highest secondary school dropout rates in the industrialized world," Allan Golston, president of U.S. programs for the Bill and Melinda Gates Foundation, characterized the situation as "actually pretty scary."[6]

The problems of our educational system run much deeper than a high attrition rate in both high schools and colleges. Probably the most important is suggested by Bob Herbert's reference to "clueless." This disparaging characterization signals an inability of many to demonstrate a grasp of "the

basics" in national tests on a variety of subjects, as indicated in figure 6.7. But how limited must abilities be to qualify as below "basic"? A formal answer can be found by pursuing the sources to figure 6.7. A less formal approach is to note the results from a variety of surveys on a variety of subjects. The following examples merely indicate the tip of an iceberg of colossal proportions.[7]

- A 2008 survey of seventeen-year-olds on historical knowledge found that
  - fewer than half could place the Civil War in the correct half-century
  - almost 20 percent did not know who our enemy was in World War II

Figure 6.7. Below basic reading,[a] math, science, and history performance of U.S. high school seniors, 2005[b]



[a]Functional illiteracy is defined by McGuinness and others as performing "below Basic" on the National Assessment of Education Progress (NAEP) reading test. For definitions of "Basic," see Donahueand 2007: 11 and 18, Grigg 2006: 36, and Lee 2007: 27.

[b]NAEP results are not available in all subjects, for twelfth graders, every year. Reading, math, and science below Basic percentages are from 2005 and U.S. history results are from 2006.

Source: Functional illiteracy definition from Diane McGuinness, *Early Reading Instruction* (Cambridge, Mass.: MIT Press, 2004), 349. Reading and math performance from W. Grigg, P. Donahueand, and G. Dion, *The Nation's Report Card: 12th-Grade Reading and Mathematics 2005*, NCES 2007-468 (Washington, D.C.: U.S. Department of Education, National Center for Education Statistics, 2007) 1, 11, and 18. Science performance from W. Grigg, M. Lauko, and D. Brockway, *The Nation's Report Card: Science 2005*, NCES 2006-466 (Washington, D.C.: U.S. Department of Education, National Center for Education Statistics, 2006), 1 and 36. U.S. history performance from J. Lee and A. Weiss, *The Nation's Report Card: U.S. History 2006*, NCES 2007-474 (Washington, D.C.: U.S. Department of Education, National Center for Education Statistics, 2007), 9 and 27.

  - roughly one in four could not identify Adolf Hitler (10 percent thought he was a munitions manufacturer)
  - one in three did not know that the Bill of Rights guarantees freedom of speech and religion.[8]
- A 2006 survey of adults on scientific knowledge found that
  - 27 percent did not know that the earth circles the sun in a year
  - 18 percent thought that the sun orbits the earth (and a further 7 percent "didn't know" which circles which).[9]
- A 2008 nationwide writing test for twelfth graders found that only one in four were "proficient" writers.[10]
- Consistent with the previous finding, a 2004 survey of "business leaders" found that slightly more than one-third of employers reported that "one-third or fewer of their employees, both current and new, [possessed] the writing skills [that] companies value."[11]
- In 2006, the National Assessment of Adult Literacy reported that only 31 percent of college-educated Americans were "prose literate," meaning that "they could fully comprehend something as simple as a newspaper story."[12]

If the focus is shifted from the capacities and complaints of those surveyed to the productivity of the economy, the question that naturally arises is how such deficiencies affect workplace performance. One answer provided by two economists can be summarized in three words: low labor quality.

> Roughly 40 percent of prime working-age Americans cannot interpret instructions from a simple appliance warranty, take and use information from a bar graph depicting source of energy and year, or calculate the total cost of purchased items from an order form in a catalogue. Only about five percent can . . . use information in a table to complete a graph, or determine total costs including shipping on an order form for items in a catalogue.[13]

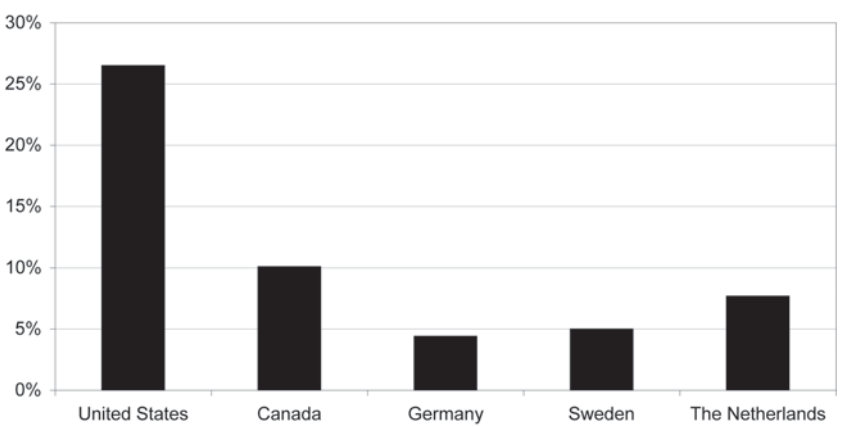
At some point in any discussion of the deficiencies of the American educational system, the topic almost certain to be raised is how well our students perform relative to their counterparts in other countries. Yet again, there are problems with the data. The reader's eyes may start to glaze over, but in this case, unnecessarily. Only three points need to be emphasized. First, the international comparison commonly encountered is likely to be some variant of the following:

> In math and science . . . our fourth graders are among the top students globally. By roughly eighth grade, they're in the middle of the pack. And by the twelfth grade, U.S. students are scoring generally near the bottom of all industrialized countries.[14]

Second, on close inspection the data leading to these observations do not compare "apples to apples," which is a polite way of saying that the underlying evidence is too flawed to support conclusions of the sort cited.[15] Third, a different data set does support the contention that, confronted with relatively simple mathematics questions, our youth (ages sixteen to twenty-five) do significantly worse than those of a similar age in other advanced industrial countries, including the four noted in figure 6.8. But we did not need international comparisons to conclude that in mathematics—and science and reading and U.S. history—a large percentage of our high school seniors perform poorly, as illustrated in figure 6.7.

The prevalence of such limited capabilities among a large percentage of our youth is worrisome on many counts. Our concern has been, and remains, those factors likely to impede the economic growth of the United States in the future. Princeton economist and Nobel laureate

Figure 6.8. Proportion of sixteen- to twenty-five-year-olds lacking minimal quantitative skills,[a] by country, 1994



[a]Proportion of sixteen- to twenty-five-year-olds performing at quantitative level 1, which means that they were not able to correctly perform tasks at level 2 and above. Quantitative level 2 is defined as: "Tasks in this level typically require readers to perform a single arithmetic operation (frequently addition or subtraction) using numbers that are easily located in the text or document. The operation to be performed may be easily inferred from the wording of the question or the format of the material (for example, a bank deposit form or an order form)."

Source: Organisation for Economic Co-operation and Development and Statistics Canada, *Literacy, Economy and Society: Results of the first International Adult Literacy Survey* (Ottawa: Statistics Canada, 1995), 44, and Table B-11c, 154.

Paul Krugman put his finger on the heart of the problem from the standpoint of the students: "We are failing to provide nearly one-third of our young people with even the minimal education required to be functioning citizens and workers in a global economy."[16] The National Center on Education and the Economy noted the implications of this failure for America's capacity to compete: "If we continue on our current course, and the number of nations outpacing us in the education race continues to grow at its current rate, the American standard of living will steadily fall relative to those nations, rich and poor, that are doing a better job."[17] This may strike the reader as extreme, until one realizes that the claim concerns relative growth rates, not absolute levels. Bill Gates made a similar point in language that is extreme: "When I compare our high schools to what I see when I'm traveling abroad, I am terrified for our workforce of tomorrow."[18]

Deteriorating Capital Infrastructure

Compared with the two previous factors likely to inhibit economic growth—a decline in labor force participation and a prospective worsening in the quality of the workforce—the deterioration of the nation's capital infrastructure will strike many readers as belonging in the category of "also ran." But of all the possible causal factors likely to impair the prospects of economic growth in the future, aside from the two already noted, this one is among the most important, and certainly among the most often cited.

Any investigation of the subject must address three questions: (1) what is included under capital infrastructure, (2) how much has it deteriorated (or how much would it cost to fix), and (3) why is fixing it important for economic growth. None of the three is easily answered.

Consider the first. In their discussions of infrastructures, a variety of analysts provide a variety of lists, often markedly different in length. The following includes many (but by no means all) of the types of infrastructure considered to be in disrepair or overcrowded or both:

- airport facilities
- roads and bridges
- railways
- canals
- loading facilities at the nation's ports
- mass transit systems
- systems designed to provide drinking water

- systems designed to remove wastewater and solid waste (sewage systems)
- dams
- schools
- power transmission systems (the national power grid)

What do they have in common that warrants labeling them as "capital infrastructure?" That is another way of asking: How should "capital infrastructure" be defined?

The word "capital" is easy enough, referring as it does to "produced means of production." Every item on the list has to be created, and once created, is used to produce other things (as distinct from being consumed, as is the case for consumer goods).

The problem is defining "infrastructure." Economists may respond: "the enabling sector of an economy, sometimes called social overhead capital."[19] "Enabling" is a helpful start. Each of the items on the above list provides a service for a large number of potential users. Often they require a sizeable investment of dollars to create and maintain, and sometimes pose a considerable risk in terms of future payoffs. Partly for such reasons, some segments of the nation's capital infrastructure may be operated by the government, but others will be privately owned. Toll roads in this country were initially private and only later became public. For the service they provide, some facilities will levy a direct charge (as is true of subway systems), while others may be free to users and paid for by taxes (for example, public schools and local roads). The common denominator for everything considered to be infrastructure therefore seems to be that they are expensive capital items (or produced means of production) that provide a vital service to a large number of users—"vital" in the sense that it is hard to imagine an advanced industrial economy functioning well without them.

The question of the dollar amount required to "fix" the nation's infrastructure has no clear answer, in part because what counts as infrastructure has no clear boundary. The fashionable number to cite in this context is the $1.6 trillion estimate made by the American Society of Civil Engineers in 2005.[20] This is a useful indicator of the magnitude of the problem. The actual dollar figure, however, is appropriately regarded as a rough approximation of the funds needed, a cautionary qualification that becomes self-evident when the fifteen individual sectoral estimates that sum to $1.6 trillion are examined in detail.

What seems indisputable is that much of the capital infrastructure of this country is overstrained or in disrepair or both. Evidence is easily marshaled in support of that contention, as illustrated by the following:

- A 2008 report by the National Surface Transportation Policy and Revenue Study Commission noted that, since 1980, highway traffic in the United States has nearly doubled, while highway capacity has remained virtually unchanged. ("In technical terms, vehicle-miles traveled are up nearly 100 percent, while lane-miles are virtually the same."[21])
- A recent study by Pennsylvania's Transportation Funding and Reform Commission noted that 23 percent of that state's bridges (about 6,000) were "structurally deficient" and more than six thousand miles of state-owned roads were in "poor" condition.[22]
- On August 1, 2007, the bridge carrying Interstate 35W over the Mississippi River collapsed, killing thirteen people and injuring more than a hundred. What failed to make most headlines was a report two years earlier that more than 25 percent of the nation's bridges were rated "structurally deficient or functionally obsolete."[23]
- That same report (the previously mentioned national survey by the American Society of Civil Engineers) also claimed that more than 3,500 of the nation's dams were "unsafe" and nearly half of the 257 locks on the nation's inland waterways maintained by the U.S. Army Corps of Engineers were "functionally obsolete."[24]

The bill to fix the entire infrastructure, as previously noted, is undoubtedly large but somewhat vague. So are the benefits. What difference would it make to the growth of GDP if America's present capital infrastructure remained as it presently is for the next ten years? What would the cost be in terms of foregone output if many dams continue to be "unsafe" and many schools remain overcrowded and in disrepair? Or consider the claim of conservative columnist David Brooks that "the U.S. transportation system is in a shambles and will require major new projects."[25]

The costs of such a large-scale enterprise can be reasonably approximated with the help of engineers and accountants. The economic benefits, however, remain elusive. A causal linkage can be readily discerned between overcrowded highways, speed of delivery, and higher transportation costs. The *Economist* elaborates some of the mechanisms:

> Better transport helps farmers to get their produce to cities, and manufacturers to export their goods overseas. Countries with the lowest transportation costs tend to be more open to foreign trade and so enjoy faster growth.[26]

The World Bank is willing to go further. It tries to quantify the multiple causal linkages between improvements in infrastructure in general and the resulting

gains in real output. "A one percent increase in a country's infrastructure stock," they estimate, "is associated with a one percent increase in the level of GDP."[27] The words "associated with" instead of the more decisive "will result in" convey the underlying uncertainties of such an estimate.

Two points would seem reasonably clear: (1) much of America's current capital infrastructure is in need of repair; and (2) demand for the services of this system are sure to rise, in part because of population growth and the forces of globalization that make for increasingly close ties among the world's many markets. For example, highway traffic in the United States is expected to continue to grow at 2 or 3 percent a year.[28] As of 2035, the Department of Transportation estimates that the demand for all transportation services in this country will have risen by 92 percent, or roughly doubled.[29]

The newly elected president of the United States has vowed to make improving the nation's capital infrastructure a top priority.[30] What remains to be seen is how much of what he promises to do will actually get done.

CONCLUSION

Economic growth, or a sustained rise in real GDP per capita, is a function of many variables other than the three considered thus far. Technological change, by itself, may provide an upward thrust to GDP growth that could more than offset the downward pull generated by falling labor force participation, the erosion of worker quality, and the inadequacies of the nation's capital infrastructure. The main concerns of this chapter reduce to two. First, if the average American standard of living is to rise substantially in the years ahead, the causal forces favoring growth will need to be powerful enough to more than offset the negative forces considered here. If the favorable merely offset the unfavorable, the result will be stagnation. Second, if a significant rise in aggregate growth does not occur, then the withering of the American Dream is almost certain to persist.

Even with strong growth, for those toward the bottom of the income distribution, that Dream may continue to wither for reasons examined in the next chapter.

7

THE FUTURE: DISTRIBUTION

THE PROBLEM AND THE APPROACH

The previous chapter was concerned with forecasting the growth of total output in the years ahead. The present one is concerned with how the income generated in the production of that output will be distributed. Or to use a metaphor popular with economists, if total output is viewed as a pie, we are about to shift from forecasting the size of the pie to forecasting how the slices will be divided up. Our focus will be not the entire income spectrum, but rather the likely trend of income received by those for whom the American Dream is a fading possibility. As a first approximation, the central issue can be put in terms of the lines in figure 5.1. Will the two at the bottom (real earnings of those with only a high school degree and those lacking that degree) fail to rise over the next twenty years, as they have failed to rise over the past thirty? The difficulty with that question is that real earnings (as noted in chapter 5) are a function of eighteen different income sources, including wages, interest, dividends, and unemployment compensation. The complexity of forecasting all eighteen is self-evident. Our task can nevertheless be usefully narrowed by focusing on wages alone, which are the dominant source of income for most of those toward the bottom of the income distribution.

To predict wage trends in the future requires some understanding of why the pattern of wage distribution has become so unequal in the last three decades. Again, our objective helps to narrow the investigation. The explosion of wages at the top is of no interest. This is not an income cohort likely to lose faith in the American Dream. What we want to know are the answers to two questions concerning the wages of various groups in the bottom quartile. First, why, beginning in the 1970s, did the wages of these groups cease to grow rapidly, or even flatten out, or worse, decline?

Second, will the causal forces that were largely responsible for producing these wage trends change significantly in the foreseeable future? Economists will undoubtedly point out that our chances of success are negligible. This pessimistic expectation follows from their definition of "success." Both questions, they would insist, require an elaborate model of wage determination to establish the relative importance of the causes under investigation. Furthermore—their clinching argument—the persistence of unresolved disputes among the experts who build such models dooms our enterprise from the start.

One way to circumvent such difficulties is to redefine "success." For our purposes, we need to accomplish two things:

1. Compile a list of the main causal variables that, according to the experts, had at least some effect (whether "major" or "minor") on the wage trends of those at the bottom for the last thirty years.
2. For each causal variable on the list, investigate the likelihood of its exerting significantly less downward pressure on the wages of those at or near the bottom in the near future.

If none of the major causes under review are likely to improve significantly in the next decade, then we can reasonably conclude that wage trends during the coming decade will not be significantly different from wage trends of the last two decades. Notice what we do *not* have to do: establish the relative importance of every cause in question as a determinant of trends of the past. All we want to establish is the likely direction of wage trends in the foreseeable future: strongly up, or relatively unchanged. (The likelihood of significantly down we ignore, because that possibility merely strengthens our conclusions about the fading of the American Dream.)

THE ARGUMENTS

What follows is the list of factors cited by labor economists and others as having, at a minimum, some impact of consequence on wage trends since the mid-1970s. There are six.

Skill-Biased Technological Change

Beginning in the early 1980s, a revolution occurred in the design and use of computers and related technologies. The result was an ongoing and

dramatic transformation in how information could be acquired and transmitted. The breadth and speed of these changes have been mind-boggling and are often not easily understood by the lay reader. A few examples:[1]

- Processor speed (millions of operations per second) rose from sixteen in 1990 to 21,600 by 2006.
- Megabytes of portable memory storage in the same time period increased from 1.4 to more than 16,000 (where "mega" refers to either 10,002 bytes or 10,242 bytes).
- E-mail accounts, which were nonexistent in 1985, numbered 1.4 billion by 2006.
- Internet web sites, barely ten thousand in 1990, had increased to 110 million by 2006.

As the story is conventionally told, this technological revolution shifted the demand for workers who had the conceptual and organizational skills to use these technologies most effectively. Accordingly, their wages increased. Our concern, however, is with workers toward the low end of the wage distribution. Many doing routine, repetitive tasks were replaced by computers, which could do the same job faster, cheaper, and with fewer mistakes. Consider the answering service of large insurance companies. In the 1970s, your telephone call to request a complicated policy change would be handled by an operator who would route you to a second operator, who might well transfer you to a third to find the employee with the relevant expertise. The same call now will be filtered through a series of recorded messages giving numerical options that—if the system works perfectly—will not elicit a response from an actual employee until you have been routed to the relevant expert. Perhaps a more impressive example of the superiority of computers over unskilled labor is the change in inventory control at your local grocery store. In the 1970s, the supply of bath soap on hand was determined by somebody counting bars on a shelf. Now the bars you buy are scanned by a device that instantly transfers this sale information to a database that shows the store manager, at any time, the actual inventory on hand.

As computers replaced unskilled workers, the resulting increase in people seeking jobs depressed wages. This happened in a straightforward way in the above two examples. It happened in a less direct way as those with some skills were similarly displaced, and forced to seek employment in lower-paying, less skilled jobs. The ensuing cascading effect of an increase in job seekers in successively less skilled labor markets created a downward

pressure on wages throughout the entire lower tier of American labor markets.[2] The net effect of this skill-biased technology on wages was glumly summarized by a former vice chairman of the Federal Reserve Board: "In plain English, it means that the labor market has turned ferociously against the low skilled and the uneducated."[3]

Other economists disagree. The sluggish performance of wages at the bottom, they argue, was due primarily to other factors, with many emphasizing the prominent role of globalization.[4]

Globalization

As noted previously, globalization is a new word for an old phenomenon: at the international level, the integration of multiple markets that heretofore were either loosely linked or not linked at all. What is different in recent decades is the speed and breadth of that integration, spurred to a significant degree by the revolution in information technology. The use of Indian telephone operators to route calls for an American insurance company was simply not a cost-saving option in the 1970s. As the example illustrates, estimating the effects on American wages of globalization alone is difficult because so many of those effects are closely intertwined with changes made in skill-biased technology.

For our purposes, all that matters is to clarify the nature of the mechanisms at work (and not to estimate net effects). Assume that trade has just opened up between two nations (call them China and America), one with cheap labor, the other with more expensive labor. To describe all of the economic adjustment mechanisms that are triggered would require a course in international trade. The limited set of adjustment mechanisms that concern us are relatively simple, and all focus on developments in the labor markets of the nation with higher-priced workers. Three are of particular concern, because all have been evident in the United States in recent years as international competition has intensified with low-wage countries.

To simplify further, assume that toys can be produced by identical production techniques[5] in both America and China, the labor required is unskilled, and the wages of such workers are much lower in China. If the Chinese labor costs per toy are less than the cost of moving that toy from China to American markets, the results are easy to predict. More Chinese toys will be imported into the United States, demand for American-made toys will decline, production in the United States will fall, and workers will be laid off. The first adjustment mechanism therefore produces a negative pressure on U.S. wages. Notice that the pressure in question arises in

the first instance in a particular labor market (here, unskilled). The second adjustment is merely an extreme variant of the first. Instead of American toy producers laying off workers, they might simply shut down production in the United States and move their factories to China. Instead of some American toy workers being laid off, all are now out of a job and looking for work. Again, their search will have the effect of creating downward pressures on American wages.[6]

The third adjustment mechanism is quite different, but the bottom line is the same. American companies may exploit the availability of cheaper foreign workers by purchasing from China (staying with our two-country example) some of the goods and/or services required by them as inputs for production here and heretofore purchased in America. Insurance companies may shift their telephone operators from Cleveland to Canton. American airline companies with routes to China may shift the servicing of their aircraft from Seattle to Shanghai. Notice the marked difference in these two examples of "offshoring" or "offshore outsourcing." The first increases the supply of American unskilled workers out of work and looking for a job; the second, the supply of skilled mechanics facing similar problems.

If we shift from the oversimplified two-country example to the real world, two questions immediately spring to mind:

1. Which American labor markets have been affected by any or all of these three mechanisms?
2. How large has the resulting drop in American wages been?

The labor markets affected are not limited to the unskilled. A few examples:

- Boeing now uses technicians in India to write software to prevent airborne collisions.
- Textile and furniture factories in Virginia have recently shut down and moved to China, where unskilled and semi-skilled labor needed to produce such goods is significantly cheaper.
- Wall Street banks in the last five years have moved progressively more research jobs to India.
- To publicize the availability of lower-cost medical care outside the United States, a top executive of Blue Cross Blue Shield chose to have a colonoscopy at a highly regarded hospital in Thailand. (A heart bypass operation, which could cost $130,000 in the United

States, currently costs between $10,000 and $20,000 at some of the best private hospitals in Singapore, Thailand, and India.)

As these examples make clear, the negative pressures on American jobs and wages caused by globalization are not limited to the low-skill end of our labor market. Which workers, then, are likely to be threatened? "The crucial distinction," argues Princeton economist Alan Blinder, "is not . . . the required levels of skill and education." How "offshorable" jobs are, he points out, depends upon whether the service being rendered by the worker

- requires "personal delivery" (such as a taxi ride or mopping the office floor)
- is "seriously degraded when delivered electronically" (such as college teaching, or so Blinder hopes)
- does not require personal delivery and is not degraded if "offshored" (such as answering phones or analyzing data)[7]

The criteria in question apply to "services." As for "goods," any time a foreign product can arrive at American docks with a lower price tag than comparable goods produced here, the manufacturers of the latter will be under pressure to cut back output, lay off workers, or—in the extreme case—close the plant.

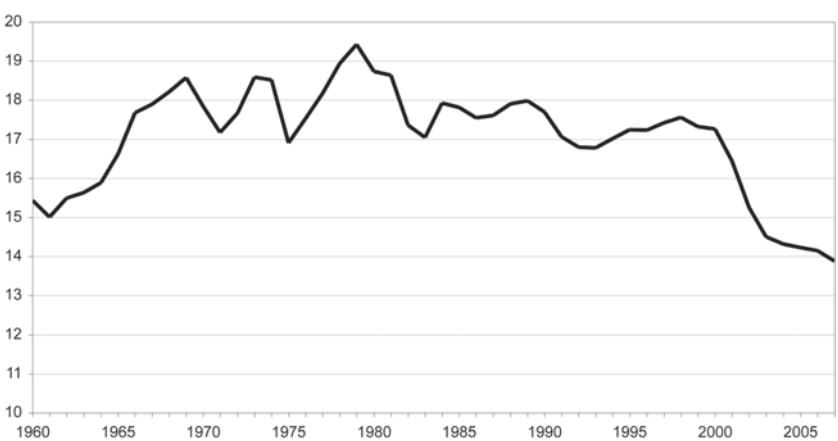
Economists tend to be somewhat divided on the merits of the above adjustment mechanisms in response to intensified international competition. Advocates of free trade point out that a fourth adjustment mechanism is certain to arise that so far has been ignored. Globalization will expand markets for goods and services that America produces more cheaply than other countries (or goods and services in which America has a comparative advantage). One example is information hardware and software requiring a relatively large input of highly skilled labor. American exports of such goods and services will accordingly increase, as will the demand for the kind of skilled labor needed as an input. The wages and employment of such workers should therefore rise. Furthermore, as globalization generates export-led growth and rising incomes in other countries, demand in these countries is likely to increase for the goods and services that American firms can supply most efficiently. In the long run, the argument concludes, the increase in the international trading of goods and services (the core of the globalization process) should benefit all nations as each specializes in producing those goods and services in which it has a comparative advantage.

In the short run, reply the skeptics, the costs of adjusting to shifting supply and demand in America's many labor markets may come high. The decline in this country's manufacturing sector is well known. What may surprise many is the rapidity of that decline since 2000. (See figure 7.1.) This has forced workers with skills specific to a given manufacturing process (say, rolling steel) to find employment in other sectors, often resulting in a significant cut in pay. Those with low skills or no skills are almost certain to face the prospect of lower wages and higher unemployment whenever their employers confront competition from third world countries with cheaper labor (plus, in many cases, lower taxes and weaker labor regulations).[8]

Free trade advocates concede that adjustment problems of this sort invariably arise. The solution they emphasize is for American workers to move from sectors in which America does not have a comparative advantage to those sectors where it does.

But how? How does an unemployed steel worker acquire the skills needed to be employed by a producer of computer software?[9] More generally, what are the characteristics that all workers in this country must strive to acquire if they are to flourish in a world in which international markets are becoming progressively more integrated? Here are two suggestions. The *Economist* notes that "globalization underscores the need for a flexible, dynamic labor market and a well-educated, adaptable workforce."[10] A former member of the Federal Reserve Board outlines the kind of adaptability that will be needed. This country must develop "a creative workforce that will

Figure 7.1. Manufacturing employment (in millions), 1960–2007



Source: U.S. Department of Labor, Bureau of Labor Statistics, "Current Employment Statistics Table B-1, Employees on nonfarm payrolls by industry sector and selected industry detail (in thousands)," www.bls.gov/webapps/legacy/cesbtab1.htm>.

keep America incubating and developing new processes, new products, and entirely new industries. Offshoring is . . . mainly about following and copying. America needs to lead and innovate."[11]

Compare the requirements noted with the education and skills (or absence of both) typically found among those at the bottom of our present labor market. This pool of workers is not likely to shrink rapidly in future years, given the large number of poorly educated students emerging annually from America's public school system, as outlined in chapter 6. Which brings us to the nub of the issue. Globalization is creating constant negative pressures on the wages paid to workers in the lowest tiers of this country's labor markets. The chances seem somewhere between slight and infinitesimal that those with no skills or low skills can be transformed into the kind of workers likely to prosper in a world of growing international competition. To the extent that this inauspicious expectation proves correct, the wages of such workers will be under constant pressure to converge with the wages of unskilled workers abroad. Such expectations are hardly consistent with the hopes embedded in the American Dream.

Immigration

The theoretical argument is perfectly straightforward. If large numbers of foreign unskilled workers migrate to America, the wages of unskilled workers already here will decline. The difficulty in moving from theory to the facts is uncertainty about how many immigrant workers are arriving each year and with what skills. The main problem, of course, is illegal immigration, variously estimated to be at least "significant" and possibly "huge." What can be inferred from available information on legal immigrants plus illegal immigrants subsequently caught is that, collectively, this group includes a large percentage of the unskilled with limited education. Their net effect on the bottom tier of American wages therefore is sure to be negative, at least in the short run. How negative is difficult to say because the number of illegal immigrants is difficult to estimate. In the long run, their impact on the American wage structure will depend crucially upon the willingness and the ability of new arrivals to raise their education level and skills as well as those of their children.

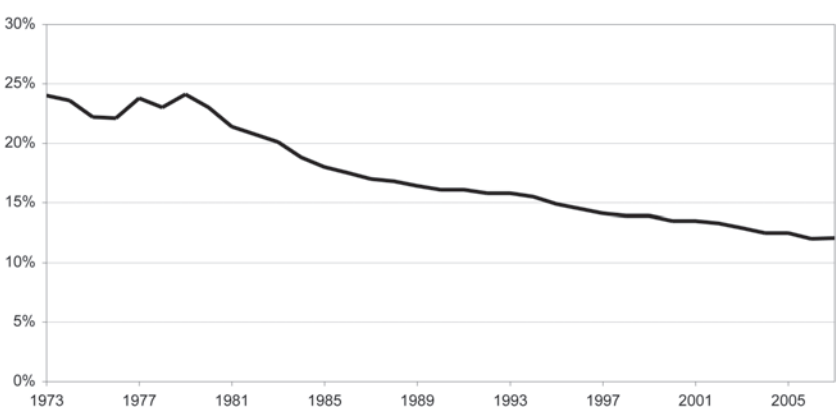
Decline in Labor Union Membership

The history of American labor unions since the early 1980s can be summarized in one word: decline. As illustrated in figure 7.2, union mem-

bership as a share of the workforce has fallen by roughly half from the late 1970s until now, and at present barely exceeds 10 percent. At bottom, what has been lost is power at the bargaining table. The wages of union members have generally been significantly higher than wages of workers doing comparable work who are not unionized. This slow but continuing decline in union membership has had two effects, one obvious and the other difficult to gauge. The obvious effect is a reduction in the pay of workers who previously were members of a union and now are not. What remains a subject of debate is the effect of the decline in unions on the rest of the labor market. The core difficulty here is identifying the extent to which the bargaining of employers with nonunion members is "conditioned" or "influenced" by the wage rates established by union bargaining in employment activities that are, in some sense, comparable. The fewer the unions and the smaller their membership, the argument runs, the less such nonunion wage setting will be influenced by the results of collective bargaining. How much less is hard to say.

But why have unions in America been in decline for more than a quarter-century? Among the causes cited are three that appear on almost every list. One is globalization. If collective bargaining is to raise wages, the key requirement is limited employer access to alternative labor sources. As pointed out in the section on globalization, the more international markets for goods and services become integrated, the greater is the downward pressure exerted on American wages from competition with cheap, unskilled

Figure 7.2. Labor union membership,[a] 1973–2007



[a]This graph shows the percent of employed wage and salary workers who are union members.
Source: Barry T. Hirsch and David A. Macpherson, "Union Membership and Coverage Database from the Current Population Survey: Note," *Industrial and Labor Relations Review* 56 (January 2003), Table 1, and Barry T. Hirsch and David A. Macpherson, "U.S. Historical Tables: Union Membership, Coverage, Density and Employment, 1973–2007, All Wage & Salary Workers," unionstats.gsu.edu.

labor in third world countries (as well as second world countries, if that is what China and India have become). A second and related reason for the decline of unions in this country is the shift in the share of the labor force out of manufacturing—formerly a bastion of powerful labor unions—to other sectors such as services that include many occupations more difficult to unionize. Finally—and more vaguely still—are shifts since the 1970s in "economic institutions and popular norms," which are the subject of the next section. The question to be kept in mind in assessing the past is the possibility in the years ahead of any of the causes of declining union membership changing for the better from the vantage point of labor in general and low-skilled workers in particular.

Changes in Economic Institutions and Popular Norms

The words used in this section's title are unavoidably vague. Their meaning can perhaps best be explored through examples. Those that follow are often cited as a partial explanation of changing pressures on American wages in a variety of labor markets.

The "norms" of particular interest are those popular with the public concerning, on the one hand, the value of unions, and, on the other, the merits of minimizing the restraints on "the natural mechanisms" of a free market system. To oversimplify a complicated historical transformation, in the immediate postwar era the general public and the politicians in power tended to be "union friendly." By the early twenty-first century, they were not. In 1946, for example, the president of the United States Chamber of Commerce—in present-day America hardly a hotbed of pro-labor sentiment—at a national conference reiterated a sentiment prevalent at that time.

> Labor unions are woven into our economic pattern of American life, and collective bargaining is a part of the democratic process. I say recognize this fact not only with our lips but with our hearts.[12]

One popular rationale for deeming the results of collective bargaining "democratic" was the perception that such bargaining made for a more level playing field. Big business, the argument ran, invariably has a lot of power at the bargaining table. Allowing labor to be represented at the same table by big unions created a "countervailing power." Even workers not represented by unions were assumed to benefit from union bargaining because of a ripple effect that collective bargaining results had throughout related labor markets.[13]

As for economic institutions, one of the most influential overseeing labor market activities has been the National Labor Relations Board, or NLRB. Created in 1935 by the Roosevelt administration, the NLRB is responsible for interpreting labor legislation and adjudicating labor disputes. (The enabling legislation in 1935 gave labor the right to organize and required that management recognize their collective bargaining units.[14]) As originally conceived, and as initially operated, the NLRB was an impartial oversight body.[15] This would change. By the 1980s, the Board began to be viewed as a vehicle for implementing the policies of the politicians who controlled appointments to the Board. This practice actually began under Dwight Eisenhower, but with little apparent effect on the Board's decisions. Overt effects began to surface when Ronald Reagan appointed as chairman of the NLRB a management consultant who had specialized in defeating unions.[16] By the beginning of the second Bush's presidency, what had begun as a slight shift in the Board's neutrality had culminated in a blatantly pro-management organization, at least as characterized by prominent analysts on the Left. Robert Kuttner, for one, has been scathing in his condemnation.

> Some 40 National Labor Relations Board decisions under Bush appointees have made it easier for employers to harass or intimidate pro-union workers and harder to win union certification. In a flagrant double standard, the NLRB allows employers to get decertification of unions based on signed cards, but makes it almost impossible for unions to use signed cards to win union recognition.[17]

The point is not whether Kuttner's claims are an exaggeration of the facts. The point is that such accusations would have been unthinkable in the quarter-century following World War II.

Such a shift in the composition and decision making of a public economic institution such as the NLRB would seem unlikely unless it was, in some sense, consistent with a similar shift in popular norms. This latter shift, arguably of seismic proportions, is complex, multifaceted, and informed by a wide variety of beliefs and values typically found among our heterogeneous population. A compact characterization is therefore out of the question. But one central strand more popular at the beginning of the twenty-first century than, say, four decades ago is the belief that fewer market restrictions are, in principle, preferable unless, in a given case, compelling evidence can be offered to the contrary. Such sentiments reflect, in part, a desire to enhance competition and improve efficiency, but also to

give what is perceived to be greater freedom to market participants. One indication that this attitudinal transformation was well under way by the end of the Reagan era was the growing support for, and implementation of, deregulation in a variety of industries, including trucking and the airlines. Another was the public support for Reagan during his battle with the air traffic controllers union, which ultimately culminated in the union's decertification. A third was the willingness of Washington politicians to allow inflation to reduce the purchasing power of the minimum wage, a topic considered in the following section.

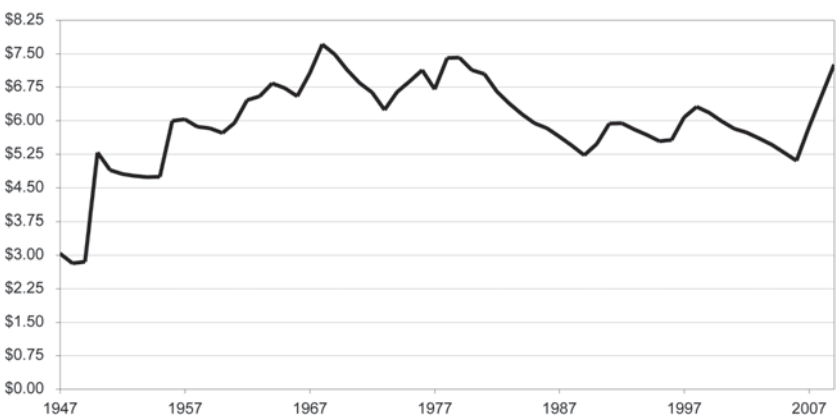
Decline in the Real Value of the Minimum Wage

A central tenet of economic theory is that, with rare exceptions, when a price goes up, demand goes down. In the case of the labor market, the price is the wage and the demand is generated by employers seeking employees. By this line of reasoning, if the minimum wage is raised, the demand for workers should decline. But decline by how much? And for which kind of workers? The answers to these questions have long been topics of debate among economists. Some argue that (1) the resulting rise in unemployment is likely to be minimal, and (2) other wages for those with the least skills will also tend to rise. The reasoning behind the second point is that the minimum wage acts as a floor for a variety of wages in a variety of labor markets at the lower end of the wage spectrum. When the minimum wage is raised, the argument runs, a "ripple effect" will "bump up the pay of a large portion of the working poor" because employers will tend "to raise wages for workers who make above the new minimum, even though they have no legal obligation to do so."[18] The question not addressed in this observation is how employers perceive resulting market pressures. If some believe that, for the sake of worker retention and morale, they must raise the wage of their least skilled employees whose present pay exceeds the new minimum, others will feel pressured to follow for the same reasons: worker retention and morale. Retention saves the costs of searching for replacements, and worker productivity in many instances is closely linked to worker morale. To ratchet up the minimum wage, the argument concludes, is thus to ratchet up a whole tier of wages earned by the least skilled and lowest paid members of the workforce. Now run this argument in reverse. If the minimum wage remains unchanged while inflation causes the value of all fixed wages to decline, employers will lack this "push" to raise the wages of the lowest paid among their employees. The entire tier

of wages at the bottom is therefore likely to rise less, or, in some instances, not rise at all.

Whatever the theoretical disputes about causal mechanisms at work, the facts make abundantly clear that since the 1970s, the long-run trend of the minimum wage, corrected for inflation, has been down. (See figure 7.3.) The upward short-term surges in the graph signal a legislated increase in the minimum allowed by law, whose real value was soon eroded by subsequent inflation. For decades this has been a game of catch-up, in which changes authorized by the federal government are invariably outpaced by changes in the general price level. A willingness to play the game with these results reflects the priorities of a majority of members of Congress and, ultimately, of the Americans who elected them. Admittedly the plea to halt the erosion in the real value of the minimum wage has long been a part of the nation's political discourse. But beginning in the Reagan years if not earlier, it has never been a banner that, once waved, prompted vast numbers to rally to the cause. At least until recently. In 2007, Congress passed a bill raising the federal minimum wage from $5.15 to $7.25 an hour in three phases over two years. Barack Obama has promised to further increase the federal minimum wage to $9.50 an hour by 2011, and then to index the resulting wage to offset subsequent inflation. The latter provision,

Figure 7.3. Real federal minimum wage, 1947–2009[a]



[a]On May 24, 2007, Congress passed a bill raising the federal minimum wage from $5.15 to $7.25 in three phases over two years. The final rise from $6.55 to $7.25 was effective July 24, 2009.

Source: Guillame Rocheteau and Murat Tasci, "Positive and Normative Effects of a Minimum Wage," Working Paper 08-01 (Cleveland, Ohio: Federal Reserve Bank of Cleveland, 2008), 2, www.clevelandfed.org/research/workpaper/2008/wp0801.pdf, and data supplied by Murat Tasci.

if implemented, would eradicate any future downward trend of the sort portrayed in figure 7.3.

THE INFERENCE

With these arguments in hand, we must now direct the same question to each of these six causal factors affecting wages in America over the past 30 years. To review, they are:

(a) Skill-biased technological change
(b) Globalization
(c) Immigration
(d) Decline in labor union membership
(e) Changes in economic institutions and popular norms
(f) Decline in the real value of the minimum wage

For each cause noted, the question is this: In the foreseeable future, what is the likelihood that the negative pressures on wages generated by the cause under scrutiny will (1) slacken significantly, (2) become inconsequential, or (3) reverse and thereby create upward pressures on market wages? Downward pressures created by the minimum wage failing to keep pace with inflation, as noted, will disappear if the Obama administration achieves its stated goal of indexing this federally mandated floor for the price of labor. That leaves five other variables to forecast. Readers with sharply different ideologies will have sharply different ideas about the merits of massive government intervention designed to change significantly the negative impact of one or more of these five. But most will agree that, minus such intervention, the likelihood of a sharp reversal in any of the five is minimal. The inference is that, barring stunning and multiple changes in federal government policies, for the lower end of the wage distribution, the trends of the past are likely to persist for the foreseeable future.

8

FISCAL CONSTRAINTS

What is to be done? To tackle most of the major problems considered above in a major way will require money—a lot of money, the bulk of which will have to come from the federal government. And therein lies the final problem.

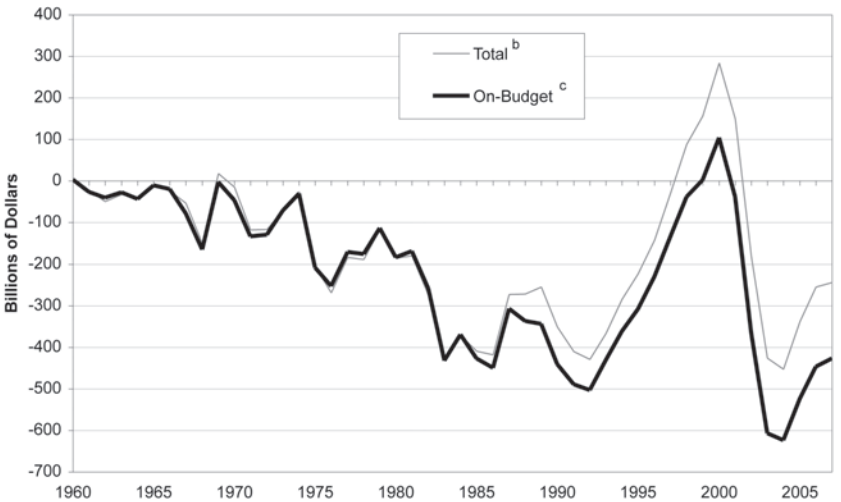
The evidence presented in figure 8.1 suggests that America has become a profligate nation, at least in the management of the country's budget at the national level. (On the vertical axis, "0" indicates a balanced budget, and the "On-budget" line more accurately reflects what the actual balance is, either positive [a surplus] or negative [a deficit].) Since 1961, the federal government has run deficits in all but five years. The minor and momentary surpluses in the late 1990s had little to do with deliberate planning and much to do with luck, including a sharp cut in defense spending with the end of the Cold War and a surge in tax revenues from an economic boom of unexpected strength and duration.[1]

The dominance of deficits, some would argue, is not surprising. The problem is as old as the capacity of elected officials to issue promissory notes upon the future. So are the dangers. Centuries before the recent and rapid escalation of our national debt, the philosopher David Hume warned that

> it is very tempting to a minister to employ such an expedient, as enables him to make a great figure during his administration, without overburdening the people with taxes, or exciting any immediate clamours against himself. The practice, therefore, of contracting debt will almost infallibly be abused in every government.[2]

What is perhaps remarkable is the absence of such behavior on the part of Congress in the immediate postwar years. As figure 8.1 demonstrates,

Figure 8.1. Real federal government surplus or deficit,[a] 1960–2007



[a]Constant 2007 dollars, CPI-U annual average adjusted.
[b]The Total surplus or deficit includes borrowing from the Social Security Trust Fund.
[c]The On-Budget surplus or deficit excludes borrowing from the Social Security Trust Fund.
Source: Author's analysis of The Council of Economic Advisors, *2008 Economic Report of the President* (Washington, D.C.: U.S. Government Printing Office, 2008), Table B-78, www.gpoaccess.gov/eop/index.html.

the downward plunge in annual deficits in real dollar terms began in the 1970s and—except for the brief respite already noted—has become more pronounced with the passage of time.

Reversing this trend *and* adding major federal programs to combat the withering of the American Dream promises to be a Herculean task. At present, some expansion in related programs is almost certain to be included in the new administration's efforts to combat the current economic downturn with the traditional Keynesian remedy of a fiscal stimulus. But if federal deficits are not to persist indefinitely—if the rise in the national debt is to be slowed and ultimately reversed—there are only three options: raise taxes, cut federal spending on other programs, or some combination of the two. The first is never easy, particularly if the tax increases are perceived as "large" and characterized by opponents as "unfair," "stifling private enterprise," or "indicative of class warfare." Making significant cuts in other federal spending programs is complicated by the fact that those which make up the majority of expenditures in any given year tend to be viewed as fixed, or at the very least, "untouchable." This includes Social Security, Medicare, Medicaid, and interest on federal debt outstanding. Defense expenditures, while not untouchable, seem unlikely to decline significantly in the immediate future.

The big problem—beside which all of the above pale—is a fiscal train wreck that every knowledgeable politician concedes is imminent and no one is prepared to address seriously. (Whether Barack Obama will prove to be the exception to that rule remains to be seen.) The cost of entitlement spending on Social Security, Medicare, and Medicaid is expected to rise dramatically in both the near and distant future. At present, these three programs alone account for almost a quarter of the federal budget.

Most analysts agree that the Social Security problem is not that serious. Prospective deficits in this trust fund can be solved by a modest reduction in benefits, a modest increase in withholding taxes, or (more likely) some combination of the two. Should the economy in decades to come grow faster than currently anticipated, the necessary changes to achieve a balance between revenues flowing in and payments flowing out would be even less.

What are unsustainable in their present form are Medicare and Medicaid, because spending required by these two programs is growing significantly faster than the economy or the revenues to finance them. Over the last forty years, average annual growth in health care costs has outpaced average GDP growth by 2.5 percent. Forecasting health care expenditures is a formidable assignment, largely because advances in medical technology and related costs are difficult to predict.[3] That said, here are a few. According to a recent Congressional Budget Office forecast, spending for these two entitlement programs, Medicare and Medicaid, will double in a decade, at which time the pair will account for more than 30 percent of the federal budget.[4] Spending on all entitlement programs plus interest payments on the national debt are projected by The Concord Coalition to consume *all* federal revenues in less than twenty years.[5] This obviously cannot, and will not, be allowed to happen. The longer addressing the problem is put off, however, the more drastic the requisite policy changes will have to be. Asked in 2007 when Congress should address "the looming deficits" in all three entitlement programs, Federal Reserve Board Chairman Ben Bernanke replied: "I think the right time to start is about 10 years ago."[6]

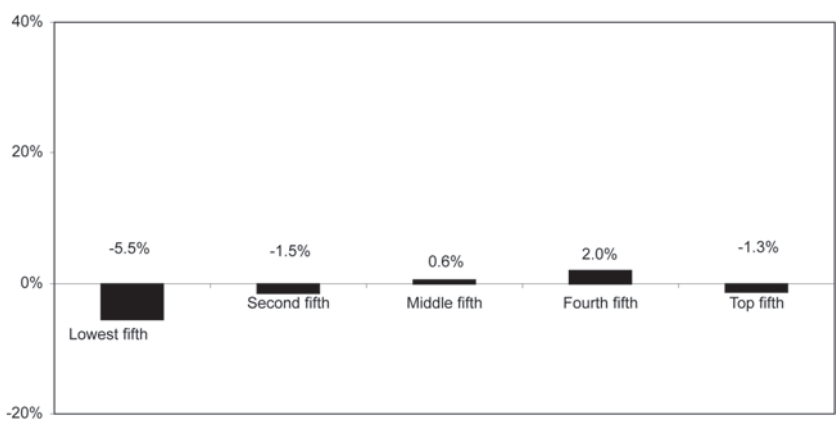
We began with a question: What is to be done to combat the withering of the American Dream for growing numbers in this country? The main conclusion of this chapter is that, given present and prospective fiscal strains at the federal level, *nothing* of great consequence is likely to be done unless the American people and their elected representatives become convinced that combating this withering is a national priority of the first importance.

9

CONCLUSION

The current economic and credit market problems are well calculated to shift attention from long-run developments. The medium-term developments that bear upon the central thesis of this book are portrayed in figure 9.1. The last recession ended in 2001. What happened in the subsequent recovery (i.e., until recently) was extraordinary compared with the historical record. Real family income for the lowest two quintiles actually fell. Incomes of "typical American households" for the first time on record failed to reach "the peak of the previous [business] cycle."[1] In short, the recent record is consistent with the secular record discussed in previous chapters. What became known as "the jobless recovery" has been aptly

Figure 9.1. Real family income growth by quintile, 2000–2007[a]



[a]2007 CPI-U-RS adjusted dollars.
Source: U.S. Census Bureau, "Current Population Survey Historical Income Tables—Families, (Table) F-3 Mean Income Received by Each Fifth and Top 5 Percent of Families, All Races: 1966 to 2007," www.census.gov/hhes/www/income/histinc/f03AR.html.

named. Not since unemployment statistics began to be tracked systematically in 1939 did it take so long to regain the jobs lost during the previous downturn.[2]

At this juncture, the discussion would normally turn to policy proposals designed to remedy or at least improve some of the troubling trends that have developed over the last three decades. In this instance, such a discussion would constitute a counterproductive distraction. The purpose of this book is to sound an alarm by enumerating an interconnected set of historical data. To discuss possible remedies would divert attention from those data and possibly provide useful targets for counterattacks against the fundamental findings of this work. Even without such targets, criticism remains inevitable. A few of the more likely are considered in the next section.

REBUTTALS TO POSSIBLE CRITIQUES

The evidence presented in previous chapters is sure to be assailed by two kinds of critics. The first will challenge the facts. The second (by and large) will accept the facts but claim that the inferences drawn from them are far too pessimistic—that other facts, here overlooked, imply a far more sanguine view of America's recent past and future prospects.

Gregory Mankiw, former economic advisor to George W. Bush, provides an example of those who are likely to challenge the facts.[3] The claim that "some 47 million Americans do not have health insurance," he argues, is "misleading." It includes "about 10 million residents who are not American citizens," including (he speculates) "many [who] are illegal immigrants," and "even if we had national health insurance, they would *probably* not be covered" (emphasis added). Further, that forty-seven million total includes "many who could buy insurance but haven't," plus "millions of the poor who are eligible for Medicaid but have not yet applied."

Our response to this and other numerical critiques is to emphasize two points. First, the data we have used were those used by experts in the various related fields. Put another way, we relied upon the numbers chosen by those who seemed most knowledgeable about the subject under review, whether it was health insurance, economic mobility, or income volatility. Second, and more important, the question is not whether any given data set is a dead accurate count of the reality it purports to represent. Macroeconomic data seldom are, including most of the numbers published by the U.S. Census Bureau. Rather, the question is whether the likely error

is of such a magnitude that it undermines the inferences drawn from the data concerning the withering of the American Dream. Given the care with which the numbers used were chosen, we doubt that any reasonable amendment of the data will challenge that inference.

A different kind of criticism can be expected from those who are inclined to be bullish on America—or at least bullish once the current downturn in the business cycle is behind us. They will note, correctly, that gloomy long-run forecasts are a staple of this country's literature, and always the country has weathered whatever storms were prophesied and continued to progress, where "progress" refers to moving in a direction different from that predicted by the pessimists. They have a point. The jeremiad has long been a tradition in America, dating back to colonial days. While these have differed in troubles singled out to bemoan, they shared the common theme that the country was going to hell in a handbasket. Each time, in retrospect, such jeremiads generally seem overdrawn. Present-day commentators who, at bottom, are upbeat about America will be inclined to discount or dismiss the analysis of previous chapters as too negative and one-sided. Symptomatic of this propensity to accentuate the positive are the following.

(a) To escape from poverty in this country, conservatives often argue, is comparatively easy. If you (1) graduate from high school, (2) have no child out of wedlock, and (3) have no child before you are twenty, then you are "unlikely . . . [to] fall into [long-term] poverty."[4] While statistically correct, this argument misses the point. The American Dream is not about clearing a low hurdle that the government defines as a "poverty level" of income. It is about achieving a rising standard of living, financial security, and upward economic and social mobility. Those whose income exceeds the official poverty level but whose earnings remain virtually stagnant near the bottom of the income distribution for their entire working life can hardly be characterized as living the American Dream.

(b) Consumption is a better measure of economic welfare than personal or family income, and consumption data reveal a pattern of spending that is far less unequal than the pattern revealed by the income data. Here, too, the statistical claim is correct. If we compare the incomes of the top and bottom fifth, the resulting ratio is fifteen to one. If we turn to consumption, the gap declines to four to one.[5] The argument, however, is both misleading and, for our purposes, irrelevant. Of course the poor

spend a higher percentage of their income on consumption than do the rich. The difference between income received and expenditures made is personal saving. Those savings can be used to acquire assets that can (1) improve financial security, (2) provide a future source of income, and (3) help to finance a college education. The poor—precisely because they are poor—have a much smaller chance of realizing these asset-related possibilities. To dismiss saving when measuring changes in economic welfare therefore seems singularly wrongheaded. The appropriate measure by far is the trend in income distribution. That trend, however, is not relevant for this book. Our concern, as repeatedly emphasized, is the trend in the standard of living, financial security, and upward mobility of those toward the bottom of the income distribution.

(c) A variety of data can and have been cited to suggest that the American economy has been doing rather well. Such assertions seem to fly in the face of recent problems with recession and the credit markets. The optimists might reply, correctly, that present difficulties reflect a short-run cyclical downturn, whereas the issue being raised concerns long-run or secular growth. This prospect, they argue, is rightly viewed in sanguine terms for reasons such as the following:

(1) "We're in the middle of one of the greatest economic eras ever. Global poverty has declined at astonishing rates. Globalization boosts each American household's income by about $10,000 a year. . . . Thanks to all the [associated economic] growth, tax revenues are at 18.8 percent of GDP, higher than the historical average."[6] Even if the $10,000 estimate is correct, this represents a boost in average family income. If the question is whether this globalization benefit has been sufficient to reverse family income trends of the bottom two quintiles, the answer (decisively in the negative) can be found in figure 9.1.

(2) "The evidence seems to show that . . . we are the most flexible economy around and may be best poised to take advantage of the coming changes on a global scale precisely because we are so good at adjusting." Or, in the words of the economist whose joint research prompted this speculation, "If the world has become one in which everyone is trying to hit a moving target, it certainly helps to be the best at changing one's aim."[7] The issue for us is not the flexibility of the American economy

but the adaptability of the workforce. As the nation continues to shift resources toward those economic activities in which it has a comparative advantage and away from those in which it does not, the impact on the workers at the bottom with few skills is likely to remain what it has been, which is hardly favorable.

(3) A recent report by the Rand Corporation points out that "America is still the world's science and technology powerhouse." It accounts for 40 percent of total world spending on research and development, is home to thirty of the world's leading forty universities, and has an annual growth rate in patents well above that of both Europe and Japan.[8] In every forecast of economic growth, prospective technological change is both crucial and yet impossible to predict with any precision. Despite that uncertainty, the dominant tendency among economists is to assume that it will at least equal, if not exceed, the rate of technological progress in the past (usually the recent past). But will it, combined with other causal factors favoring growth, be powerful enough to overcome the kind of negative pressures on GDP growth outlined in chapter 6? No one knows the answer. Even if significant aggregate growth does occur, as noted in chapter 7, the record of the past raised doubts concerning whether the associated gains in national income will improve the lot of those toward the bottom of the income distribution for whom the American Dream has been a fading possibility for decades.

OVERVIEW

So, then, to every man his chance—
to every man, regardless of his birth,
his shining, golden opportunity—
to every man the right to live,
to work, to be himself,
and to become
whatever thing his manhood and his vision
can combine to make him—
this, seeker,
is the promise of America.

—Thomas Wolfe[9]

For contemporary readers, the words of Wolfe need to be recrafted to encompass feminine as well as masculine possibilities. They nevertheless serve as a useful reminder of the majestic sweep of the Dream that has inspired successive generations almost from the beginning of the republic. Our concerns have been somewhat pedestrian, focused as they have been on the economic aspects of this more august and more amorphous concept. As previously argued, however, those aspects are part of the very core of the Dream. Were they to be imperiled by the many developments described above, the fate of the Dream would necessarily become problematic.

Three dangers lie ahead.

First, a preoccupation with current short-run cyclical difficulties—notably a slowdown in the economy and a faltering financial system—may divert attention from looming long-run problems, including those associated with the withering of the American Dream.

Second, in discussions about the current income distribution, a focus on the middle may deflect attention from the bottom. An example of such thinking is provided by economist and former Harvard president Larry Summers. "I think the defining issue of our time," he told a *New York Times* reporter, "is: Does the economic, social and political system work for the middle class? Because the system's viability, its staying power and its health depend on how well it works for the middle class."[10] What is missing from this statement is an awareness that the economic woes now threatening the lower segments of the middle class have been spreading upward from the bottom for the past three decades.

Third, the American Dream has always been part myth. For two centuries, however, the reality of economic and social developments has constantly provided instances for an ever-larger portion of the citizenry to suggest they too may get their feet upon the ladder. And once upon that ladder, most have believed that upward movement is crucially dependent upon personal effort and talent as well as upon luck. If the Dream is now shattered for large segments of society, one can surely expect unrest among the ruins. That prospect has long been recognized by members of this nation's elite. Often quoted in this context is John Kennedy's observation "If a free society cannot help the many who are poor, it cannot save the few who are rich."[11] In the depths of the Great Depression, one of Chicago's more successful bankers resorted to the conventional imagery of a social ladder to make the conventional point in language not that different from Kennedy's: "I have come to the conclusion that unless we make certain that people in the lower scale of income have their feet upon the ladder there is no security for us who are at the top."[12] The prospect of unrest, however,

is ultimately a secondary concern. What matters more is how the withering of the American Dream for an ever-larger share of the population—both in perceptions and in fact—will force a reshaping of what America is in the minds of both its citizens and those in other lands. That prospect is the core concern of this work. The defining issue of our time is the extent to which the concept of America will have to be redefined.

NOTES

CHAPTER 1: PROBLEMS OF DEFINITION

1. Everett C. Ladd and Karlyn H. Bowman, *What's Wrong: A Survey of American Satisfaction and Complaint* (Washington, D.C.: AEI Press, 1998), 72. See also National League of Cities, *The American Dream in 2004: A Survey of the American People*, Research Report, September 2004. This list can be lengthened by adding categories to the polling process that respondents may be reluctant to exclude from what, for them, is already an ill-defined concept. See, for example, the twenty-one headings under "Describing the American Dream" used by Sarah Roberts, "New American Dream: A Public Opinion Poll" (Takoma Park, Md.: Center for a New American Dream, 2004), 7 (www.progressiveroundtable.org/files/Roberts-poll.pdf), which include "peace," "happiness," and "U.S. is recognized as the world leader." The Roberts survey was sponsored by the Center for a New American Dream, an organization whose purpose is to redefine and broaden the concept in question beyond what are now its conventional boundaries.

2. Ladd and Bowman, *What's Wrong*, 72.

3. Cathy Schoen et al., "How Many Are Underinsured? Trends among U.S. Adults, 2003 and 2007," Health Affairs Web Exclusive, 10 June 2008, 303.

4. Ladd and Bowman, *What's Wrong*, 72.

5. For a more detailed exposition of these points, see Peter McClelland, *The American Search for Economic Justice* (Cambridge, Mass.: Basil Blackwell, 1990), chapters 2, 6–8.

6. Ladd and Bowman, *What's Wrong*, 53, 70.

7. National League of Cities, "American Dream in 2004," 30. The percentages were 67 and 70, respectively.

8. Roberts, "New American Dream," 14.

9. Douglas E. Schoen, "What Do Americans Really Want in '06?" (Queenstown, Md.: Aspen Institute, 2006), 33.

10. National League of Cities, "American Dream in 2004," 4, 15–18. The percentages were 67, 62, and 65, respectively.

11. Schoen, "What Do Americans Really Want," 34.

CHAPTER 2: STANDARD OF LIVING

1. More rigorously, national income is roughly equal to *net* domestic product. The reason why that rough equivalence is with net domestic product (NDP) and not with gross domestic product (GDP) is irrelevant for this study.

2. The obvious missing item is income received from assets owned, in general a factor of increasing importance the higher up the income scale the recipient of income is.

3. This seemingly simple procedure is complicated by the variety of consumer price indexes available. In each figure of this work for which the underlying data have been corrected for inflation, the consumer price index used is the same as the CPI used by the original source.

4. In fact, two population groups are used: all urban consumers, and urban wage earners and clerical workers.

5. For a more detailed discussion of the procedures actually used, see U.S. Department of Labor, Bureau of Labor Statistics, "Consumer Price Indexes" (www.bls.gov/cpi/cpifaq.htm), or from the same source, *BLS Handbook of Methods* (www.bls.gov/opub/hom), chapters 16 and 17.

6. This correction consisted of using a CPI for which the base year was 2005. All of the numbers are therefore expressed in 2005 dollars.

7. Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2005* (Ithaca, N.Y.: Cornell University Press, 2005), 4. For other examples, see Jacob S. Hacker, *The Great Risk Shift* (New York: Oxford University Press, 2006), 88–89; and Stephen Rose, Adam Solomon, and Anne Kim, "Talking Past the Middle," *Challenge* 50 (January–February 2007): 42–43.

8. Again, all values are expressed in 2005 dollars.

9. Aside from wages, other factors influencing family income include nonlabor income, the duration of employment, and the number of income generators in any given family unit. For an estimate of the relative importance of each to the general trend in family income, see Chulhee Lee, "Rising Family Income Inequality in the United States, 1968–2000: Impacts of Changing Labor Supply, Wages, and Family Structure," National Bureau of Economics Research Working Paper No. 11836, May 2005.

10. A preferable figure to "wages" would be "total compensation," which includes health and pension benefits. A lack of data for the forty-one-year period examined here explains why the less perfect earnings measure of "wages" was used.

11. In 1975, the median was $40,617; in 2000, $43,072.

CHAPTER 3: FINANCIAL SECURITY

1. This joint federal-state program provides coverage for children whose family income is too high to qualify for Medicaid, but too low to pay for private coverage. Specifying how "low" is "low enough" varies across states, as does the associated coverage for parents. An estimated two million children are eligible for S-chip, but remain unenrolled.

2. The first and final dollar figures for single coverage are $27 and $52; for family coverage, $129 and $248.

3. Michelle Conlin, "Held Hostage by Health Care," *Business Week*, 29 January 2007, 82.

4. Robert J. Samuelson, "Let's Not Hide Health Care Costs," *Newsweek*, 5 February 2007, 52.

5. For a review of the literature exploring this linkage, see Tom Buchmueller and Rob Valletta, "Health Insurance Costs and Declining Coverage," *Federal Reserve Bank of San Francisco Economic Letter*, 29 September 2006. As one might expect, the number with insufficient insurance has also been rising, although defining "underinsured" is a complicated task. For one recent attempt that claims the number of underinsured between 2003 and 2007 rose by 60 percent to a total of twenty-five million, see Cathy Schoen et al., "How Many Are Underinsured? Trends among U.S. Adults, 2003 and 2007," Health Affairs Web Exclusive, 10 June 2008, 298–309.

6. Alex Berenson, "Boom Times for U.S. Dentists, but Not for America's Teeth," *New York Times*, 11 October 2007, A1.

7. Conlin, "Held Hostage by Health Care," 82.

8. Reed Abelson, "Millions with Chronic Disease Get Little or No Treatment," *New York Times*, 5 August 2008, C5.

9. Milt Freudenheim, "New Urgency in Debating Health Care," *New York Times*, 6 April 2007, C4.

10. "Desperate Measures," *Economist*, 28 January 2006, 25.

11. "Health Care and the States: The Federalist Prescription," *Economist*, 13 January 2007, 28.

12. The rapid rise in the cost of this fringe benefit has also had a depressing effect on wages. See, for example, Anne Kim et al., "The New Rules Economy: A Policy Framework for the 21st Century," Third Way Middle Class Project, February 2007.

13. "Another Perk Joins the Endangered Species List," *Fortune*, 26 June 2006, 92.

14. Those who wish to study in detail the various pension schemes currently available, including these two, are in for some hard slogging because of a multitude of complexities, including relevant tax issues. One of the more comprehensive and recent surveys is William G. Gale, John B. Shoven, and Mark J. Warshawsky, eds.,

The Evolving Pension System: Trends, Effects, and Proposals for Reform (Washington, D.C.: Brookings Institution, 2005).

15. Employees typically do contribute to direct-contribution plans, but in the private sector, often do not contribute to direct-benefit plans. Both types of plans are explained below.

16. "For example, a plan might offer a benefit that is equal to 1.5 percent of average salary for the last three years of employment times the number of years of service with the employer. Thus, an employee with 30 years of service who retires at the plan's normal retirement age would receive a benefit that is 45 percent of that employee's final three-year average salary." Jeffrey R. Brown, "Guaranteed Trouble: The Economic Effects of the Pension Guarantee Corporation," *Journal of Economic Perspectives* 22 (Winter 2008): 180.

17. For an explanation of this and other plans, such as 403(b) annuity, 457 plan, and Keogh Plan, see Gale, Shoven, and Warshawsky, *The Evolving Pension System*, 212–13.

18. All such funds are tax-deferred until the money is withdrawn. Funds withdrawn before age fifty-nine are subject to a 10 percent penalty.

19. Pew Research Center survey, September 2006, cited in Kim et al., "The New Rules Economy," 26.

20. Defined-benefit plans have the added advantage that, should the employer become bankrupt, a large fraction of employee pension benefits are guaranteed by a government agency, the Pension Benefit Guarantee Corporation. For a comprehensive discussion of the many variations of each plan and the basic differences between the two, see Gale, Shoven, and Warshawsky, *The Evolving Pension System*, including the compact summary on page 54.

21. New Labor Department regulations have been devised to combat this problem, making enrollment of employees automatic, with an option of opting out. Several studies have shown that requiring employees to "opt out" rather than "opt in" increases participation rates. For a recent summary of research indicating that decisions by individuals concerning saving and investing in general or managing 401(k)s in particular are often not in their own best interest, see Mary Daly, "Retirement Savings and Decision Errors: Lessons from Behavioral Economics," *Federal Reserve Bank of San Francisco Economic Letter*, 6 June 2008, 1–3.

22. What counts as a "reasonable level of replacement income" is, predictably, an ongoing subject of debate. A summary of that debate can be found in Congressional Budget Office, "Baby Boomers' Retirement Prospects: An Overview," CBO Study, November 2003. See also Alicia H. Munnell et al., "Health Care Costs Drive Up the National Retirement Risk Index," Center for Retirement Research at Boston College, Working Paper No. 8-3, February 2008. One point commonly agreed upon is the dim retirement prospects for the vast majority of those at the bottom of the income distribution.

23. Congressional Budget Office, "Baby Boomers' Retirement Prospects," 2.

24. Kim et al., "The New Rules Economy," 26.

25. Theodore R. Groom and John B. Shoven, "Deregulating the Private Pension System," in *The Evolving Pension System*, ed. William G. Gale, John B. Shoven, and Mark J. Warshawsky (Washington, D.C.: Brookings Institution, 2005), 132.

26. Jeff Madrick, "The Specter Haunting Old Age," *New York Review of Books* 55 (20 March 2008): 43.

27. J. Alex Tarquinio, "In Search of Savers: 401(k) Rules Are Changing," *New York Times*, 11 November 2007, BU5. Brodie is referring particularly to those who will be automatically enrolled under the new regulations of the U.S. Labor Department, whereby eligible employees must "opt out" instead of being required (as previously) to "opt in."

28. Congressional Budget Office, "Baby Boomers' Retirement Prospects," 2.

29. More rigorously, "on average, the five recessions from 1959 to 1983 were forty-seven months apart, lingered twelve months and were associated with a 2.17 peak-to-trough decline in real gross domestic product. By contrast, the 1990 downturn came after ninety-two months of expansion, lasted eight months, and involved a 1.26 percent decline in GDP. The 2001 slump ended a record 120 months of uninterrupted growth, lasted eight months, and entailed a GDP decline of only 0.35 percent. More generally, quarterly growth in both real GDP and jobs became markedly less volatile after 1983." Evan F. Koenig and Nicole Ball, "The 'Great Moderation' in Output and Employment Volatility: An Update," *Federal Reserve Bank of Dallas Economic Letter*, September 2007, 1–2.

30. See, for example, Janet L. Yellen, "Economic Inequality in the United States," *Federal Reserve Bank of San Francisco Economic Letter*, 1 December 2006; and Gerald Carlino, "The Great Moderation in Economic Volatility: A View from the States," *Federal Reserve Bank of Philadelphia Business Review,* First Quarter 2007, 11–20. As is true of many major shifts in the American economy in the last three decades, the causes of the "Great Moderation" remain a subject of dispute among economists. For brief reviews of the literature and the main points of contention, see Carlino, "The Great Moderation"; Koenig and Ball, "The 'Great Moderation'"; Charles Notzon and Dan Wilson, "Recent Trends in Economic Volatility: Conference Summary," *Federal Reserve Bank of San Francisco Economic Letter*, 15 February 2008; and Andrea Pescatori, "The Great Moderation: Good Luck, Good Policy, or Less Oil Dependence?" *Federal Reserve Bank of Cleveland Economic Commentary*, March 2008.

31. As noted previously, at the national level, total output (as measured by NDP) roughly equals national income. If fluctuations in the first have declined, then fluctuations in the second must necessarily decline.

32. The conclusion quoted is from Karen E. Dynan, Douglas W. Elmendorf, and Daniel E. Sichel, "The Evolution of Household Income Volatility," Federal Reserve Working Paper 2007-61 (Washington, D.C.: Federal Reserve Board, 2007), 17, 30–31. This work also includes a useful summary of the methods and the results of a number of recent studies (Dynan et al., "Evolution of Household Income Volatility," 38–40).

33. Peter R. Orszag, *Trends in Earnings Variability over the Past 20 Years* (Washington, D.C.: Congressional Budget Office, 2007), 6.

34. Dynan et al., "The Evolution of Household Income Volatility," 33.

35. "Getting It Right on the Money," *Economist*, 15 April 2008, 74.

36. Brian Grow and Keith Epstein, "The Poverty Business," *Business Week*, 21 May 2007, 58.

37. "Shelter or Burden?" *Economist*, 18 April 2009, 76. For most Americans, acquiring a house represents far more than an addition to their asset portfolio. (See, for example, Carolina K. Reid, "Achieving the American Dream? A Longitudinal Analysis of the Homeownership Experiences of Low-Income Households," Center for the Study of Demography and Ecology Working Paper 04-4, University of Wisconsin, April 2004, 34.) Our focus here, however, is confined to its contribution to financial security.

38. "Research shows that people save more if they do so automatically, rather than choosing to set an amount aside each month." ("Shelter or Burden?" 77.)

39. Jan Kregel, "Changes in the U.S. Financial System and the Subprime Crisis," Levy Economics Institute Working Paper No. 530, April 2008, 14. For a concise summary of the multiple possible terms of a subprime mortgage, see Janet L. Yellen, "The Financial Markets, Housing, and the Economy," *Federal Reserve Bank of San Francisco Economic Letter*, 18 April 2008; and Federal Reserve Bank of Cleveland, "Breaking the Housing Cycle," *Annual Report*, 2008, 8–9.

40. Purchasers were encouraged, in part, by the (inappropriately) high ratings such debt packages received from rating agencies.

41. For those interested in exploring this topic, two useful starting points are Robert M. Solow, "How to Understand the Disaster," *New York Review of Books*, 14 May 2009; and Gary Gorton, "The Subprime Mess: Tracing the Origins of the Panic of 2007," *Milken Institute Review* 11 (First Quarter 2009): 36–47.

42. "The experience of large quantities of subprime mortgages only dates from 2003, as does the expansion in the issue of subprime mortgage–backed securities." (Kregel, "Changes in the U.S. Financial System," 16.) See also Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2008* (Cambridge, Mass.: Harvard University, 2008), 2–4.

43. These "adjustable-rate mortgages" were commonly marketed as 2/30s or 3/30s, meaning that only in the first two or three years would a thirty-year mortgage have low interest payments. See Kregel, "Changes in the U.S. Financial System," 14; and Gorton, "The Subprime Mess," 39.

44. In some instances, the monthly payment required did not even cover the interest due. This "negative amortization" thus increased the debt of the borrower even more. "Shelter or Burden?" 77.

45. "Shelter or Burden?" 77. For a brief description of the frenzy and fraud that came to typify the subprime mortgage market in its later stages, see Mara Der Hovanesian, "Sex, Lies and Mortgage Deals," *Business Week*, 24 November 2008.

46. "These loans were originated based on the assumption that housing appreciation would continue indefinitely and that when borrowers ran into trouble, they would refinance or sell." (First report of the State Foreclosure Prevention Working Group, quoted in Kregel, "Changes in the U.S. Financial System," 13.) See also Gorton, "The Subprime Mess," 39; and Brian Grow, Keith Epstein, and Robert Berner, "The Home Foreclosure Fiasco," *Business Week*, 23 February 2009, 34–40.

47. Whether or not it is in the best interest of homeowners under water "to walk away" from their mortgage (i.e., to force foreclosure) is still a subject of dispute. See "Can't Pay or Won't Pay," *Economist*, 21 February 2009, 32.

48. Reid, "Achieving the American Dream?" 20. Using data from the Panel Study of Income Dynamics (PSID), Reid tracked the experience of low-income households "who bought homes between 1977 and 1989 and remained active respondents in the PSID until 1993" (Reid, "Achieving the American Dream?" 19).

49. Reid, "Achieving the American Dream?" 26.

50. For a case study detailing these propensities of borrowers and lenders, see Reid, "Achieving the American Dream?"

51. Credit Suisse, "Foreclosure Update: Over 8 Million Foreclosures Expected," *Fixed Income Research*, 4 December 2008, 1.

52. This more general hypothesis has been argued by others. See especially Jacob S. Hacker, *The Great Risk Shift* (New York: Oxford University Press, 2006); and Peter Gosselin, *High Wire: The Precarious Financial Lives of American Families* (New York: Basic, 2008).

CHAPTER 4: MOBILITY

1. Edward Everett, *Orations and Speeches*, vol. 2 (Boston: Little Brown, 1878), 294.

2. Karl Marx and Friedrich Engels, *Selected Works* (New York: International Publishers, 1974), 104.

3. Roy Basler, *The Collected Works of Abraham Lincoln*, vol. 3 (New Brunswick, N.J.: Rutgers University Press, 1953), 462.

4. Basler, *The Collected Works of Abraham Lincoln*, 7:512.

5. What counts as egregious can change over time, as the history of attitudes toward women, blacks, and Native Americans in this country illustrates.

6. Barack Obama, *The Audacity of Hope: Thoughts on Reclaiming the American Dream* (New York: Crown, 2006), 54.

7. Obama, *Audacity of Hope*, 54. In fairness to Obama, one should note he also adds "self-reliance and self-improvement and risk-taking," as well as "thrift and personal responsibility." For a more extended discussion of the linkage between these assumptions and the American Dream, see Peter D. McClelland, *The*

American Search for Economic Justice (Cambridge, Mass.: Basil Blackwell, 1990), chapters 1 and 8.

8. Obama, *Audacity of Hope,* 55. For the relationship between freedom ("liberty") and equality of opportunity, see McClelland, *The American Search for Economic Justice*, chapter 8.

9. Information is gathered under three broad headings: economic, health, and social behavior. "Adults have been followed as they have grown older, and children have been observed as they advance through childhood and into adulthood, forming family units of their own." More complete information on the nature of the sample may be found at psidonline.isr.umich.edu/Guide/Overview.html.

10. Those who argue for a slight decline (especially in the 1990s) include Katherine Bradbury and Jane Katz, "Are Lifetime Incomes Growing More Unequal? Looking at New Evidence on Family Income Mobility," *Federal Reserve Bank of Boston Regional Review* (Fourth Quarter 2002); and Daniel Aaronson and Bhashkar Mazumder, *Intergenerational Economic Mobility in the U.S., 1940 to 2000* (Chicago: Federal Reserve Bank of Chicago, February 2007). Those arguing that mobility has changed little in recent decades include Chul-Il Lee and Gary Solon, "Trends in Intergenerational Income Mobility," National Bureau of Economic Research Working Paper No. 12007, January 2006; and Tom Hertz, "Trends in the Intergenerational Elasticity of Family Income in the United States," *Industrial Relations: A Journal of Economy and Society* 46 (January 2007). For a summary of the findings of major recent studies, see Miles Corak, "Do Poor Children Become Poor Adults? Lessons from a Cross-Country Comparison of Generational Earnings Mobility," Institute for the Study of Labor, Discussion Paper Series (March 2006): 52. International comparisons of mobility tend to be suspect because the accuracy and comparability of data across countries tend to be highly suspect. For an example of such a study, see Marcus Jäntti et al., "American Exceptionalism in a New Light: A Comparison of Intergenerational Earnings Mobility in the Nordic Countries, the United Kingdom, and the United States," Institute for the Study of Labor (IZA) Discussion Paper No. 1938, January 2006.

CHAPTER 5: EDUCATION AND MOBILITY

1. Bob Herbert, "Stepping on the Dream," *New York Times*, 22 March 2007, A25.

2. Real or inflation-adjusted earnings, as distinct from real family income, are earnings for "a one-person household." "Earnings" consist of money income from eighteen different sources, including wages, salaries, unemployment compensation, interest, dividends, and pension or retirement income. In short, it measures the total annual money income for a given individual. For further details, see U.S. Census Bureau, Current Population Survey: Definitions and Explanations, 2008: "Income Measurement," www.census.gov/population/www/cps/cpsdef.html.

3. See for example Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2002/2003* (Ithaca, N.Y.: Cornell University Press, 2003): 148–54.

4. For those with a high school diploma, real earnings were $28,471 in 1975 and $29,448 in 2005. The comparable numbers for those failing to finish high school were $22,499 and $19,915.

5. William J. Clinton and U.S. Department of Education, *President Clinton's Call to Action for American Education in the 21st Century* (Washington, D.C.: U.S. Department of Education, 1997), 1.

6. For private four-year colleges, the average annual cost rose from $14,127 in 1976 to $30,367 in 2006, or by 115 percent. For public four-year colleges, in the same time period average costs rose from $6,877 to $12,796, or by 86 percent.

7. The sharp dip in the late 1970s and early 1980s mainly reflects not a cut in grants but a spike in inflation at that time.

8. Using an intricate formula, the Department of Education administers these grants. In 2005, that formula was changed, reducing the number of students eligible and the amounts that those eligible would receive. See Greg Winter, "College Aid Rules Change, and Families Pay More," *New York Times*, 6 June 2005, A1.

9. Provosts of Eleven Public Universities, "Educational Excellence, without Ivy," *Business Week*, 14 January 2008, 75.

10. Jonathan D. Glater, "Fewer Options Open for Paying Costs of College," *New York Times*, 12 April 2008, A16.

11. "Study Now—and Pay and Pay and Pay Later," *Business Week*, 21 May 2007, 66.

12. "Study Now," 66. The recent "financial crisis" seems to have made loans from private sources less available and more expensive. See, for example, M. P. Dunleavey, "In Choosing a College, It's Prestige vs. Debt," *New York Times*, 19 April 2008, C1.

13. While figure 5.7 is based on data for "Americans age 25 or over," the same ratio of 70 percent without college degrees also applies to the workforce. See Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *State of Working America 2006/2007* (Ithaca, N.Y.: Cornell University Press, 2007): 153–54; see also Mary Daly, Osborne Jackson, and Robert G. Valletta, "Educational Attainment, Unemployment, and Wage Inflation," *Federal Reserve Bank of San Francisco Economic Review*, 2007.

14. For a summary of the competition and a list of the main competitors, see David Leonhardt, "Education Life," *New York Times*, 4 April 2008, 26–28.

15. Leonhardt, "Education Life," 26.

16. Leonhardt, "Education Life," 26.

17. Anthony Bianco, "The Dangerous Wealth of the Ivy League," *Business Week*, 10 December 2007, 40.

18. Bianco, "Dangerous Wealth," 40.

19. Age twenty-five and over; see figure 5.7.

CHAPTER 6: THE FUTURE: AGGREGATE GROWTH

1. Annual growth in the decade noted averaged slightly less than 1.9 percent.

2. While output increases, leisure time decreases, so the gain in total welfare is overstated by the exclusive focus (here and elsewhere) on changes in real output or real income.

3. The labor force participation rate is the percentage of the population age sixteen and over that is either employed or actively seeking employment. The Social Security Administration prefers the measure charted in figure 6.1, largely because of the difficulties of gathering data on young adults voluntarily not working (for example, because they are still in school) and older people who are still working part-time or full-time.

4. The literature on the likely trends in America's labor force participation rate is voluminous, some analysts emphasizing developments that could make the actual drop less pronounced, and others, developments that could make it even more pronounced. For recent and compact reviews of the literature, including measurement debates, see Mary Daly and Tali Regev, "Labor Force Participation and the Prospects for U.S. Growth," *Federal Reserve Bank of San Francisco Economic Letter*, 2 November 2007; and Ricardo Di Cecio et al., "Changing Trends in the Labor Force: A Survey," *Federal Reserve Bank of St. Louis Review* (January–February 2008): 47–61. All agree that a pronounced decline is in the offing. The only question is how steep.

5. Bob Herbert, "Clueless in America," *New York Times*, 22 April 2008, A27.

6. Herbert, "Clueless," A27.

7. Subsequent analysis will ignore performance gaps among races, a subject of the first importance but omitted here for the sake of brevity.

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9. National Opinion Research Center, University of Chicago, "General Social Survey, March 10–August 7, 2006," 1 (accessed June 26, 2008, from the iPOLL Databank, Roper Center for Public Opinion Research, University of Connecticut).

10. Survey by National Assessment of Educational Progress, reported in Sam Dillon, "U.S. Students Achieve Mixed Results on Writing Test," *New York Times*, 4 April 2008, A18.

11. National Commission on Writing, *Writing: A Ticket to Work . . . or a Ticket Out*. (Washington, D.C.: College Board, 2004), 13.

12. Christopher Clausen, "The New Ivory Tower," *Wilson Quarterly* (Autumn 2006): 32.

13. Frederic L. Pryor and David L. Shaffer, *Who's Not Working and Why: Employment, Cognitive Skills, Wages, and the Changing U.S. Labor Market* (Cambridge: Cambridge University Press, 1999), 23.

14. Herbert, "Clueless in America," A27.

15. Jay Mathews, "Bad Rap on the Schools," *Wilson Quarterly* (Spring 2008): 18–19. The data in question are from Trends in International Mathematics and

Science Study (TIMMS). For a detailed analysis relying on these data, see National Science Board, *Science and Engineering Indicators* (Washington, D.C.: National Science Board, 2004).

16. Paul Krugman, "Self-Inflicted Confusion," *New York Times*, 25 April 2008, A27.

17. National Center on Education and the Economy, *Tough Choices or Tough Times* (San Francisco: Jossey-Bass, 2008), xxv.

18. Quoted in National Academy of Sciences, *Rising above the Gathering Storm: Energizing and Employing America for a Brighter Economic Future* (Washington, D.C.: National Academies Press, 2007), 17.

19. Donald W. Moffat, *Economics Dictionary* (New York: Elsevier, 1976), 150.

20. American Society of Civil Engineers, *Report Card for America's Infrastructure*, 2005. www.asce.org/reportcard/2005/index.cfm.

21. Cited in Bruce Seely, "The Secret Is the System," *Wilson Quarterly* (Spring 2008): 54.

22. Cited in Rebecca J. Rosen, "Whose Road Is It, Anyway?" *Wilson Quarterly* (Spring 2008): 50.

23. American Society of Civil Engineers, *Report Card*, 2.

24. American Society of Civil Engineers, *Report Card*, 2–3.

25. David Brooks, "The Coming Activist Age," *New York Times*, 18 July 2008, A19.

26. "Building BRICs of Growth," *Economist*, 7 June 2008, 88.

27. "Building BRICs," 88.

28. Seely, "Secret Is the System," 54.

29. Norman Mineta, "Priority on Infrastructure," *New York Times*, 7 November 2008, A34.

30. For a summary of the kind of improvements proposed, see Peter Baker and John M. Broder, "Obama Vows Public Works on Vast Scale: Biggest Program since Interstate Highways," *New York Times,* 7 December 2008, A1.

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1. Richard Alm and Michael Cox, "Gaining Knowledge on a Global Scale," *Federal Reserve Bank of Dallas Annual Report*, 2006, 5.

2. For a detailed analysis of this process, see Frederic L. Pryor and David L. Schaffer, *Who's Not Working and Why: Employment, Cognitive Skills, Wages, and the Changing U.S. Labor Market* (Cambridge: Cambridge University Press, 1999).

3. Alan S. Blinder, "Outsourcing: Bigger Than You Thought," *American Prospect*, November 2006, 44.

4. For a review of the associated technical disputes, see Zvi Eckstein and Eva Nagypál, "The Evolution of U.S. Earnings Inequality, 1961–2002," *Federal Reserve Bank of Minneapolis Quarterly Review* 28, December 2004; Pryor and Schaffer, *Who's Not Working and Why*.

5. Production techniques need not be identical, as long as the costs paid for factors of production other than labor in China are the same as, or less than, comparable American costs.

6. "Other things being equal," economists like to add, precluding other developments that could offset any wage decline, such as a very high tariff on Chinese goods.

7. Blinder, "Outsourcing," 44–45.

8. "In the absence of enforceable global labor standards, liberalized trade with low-wage, low-worker rights nations tends to produce a downward convergence of wages." Robert Kuttner, "Good Jobs in a Global Economy," *American Prospect*, January–February 2008, 24.

9. The federal government has no large-scale program to meet these retraining needs. It does have a modest program—Trade Adjustment Assistance (or TAA)—to assist those "deemed to have lost their jobs to global competition." The benefits include "up to two years of unemployment benefits while retraining, temporary subsidies to help pay medical insurance and, for those over 50 . . . [a stipend that] pays half the difference between the old and new wages [assuming a job shift results in a pay cut] for two years, up to a maximum of $10,000." ("In the Shadow of Prosperity," *Economist*, 20 January 2007, 32, 34). Efforts have recently been made in Congress to expand both the coverage and the benefits of this program.

10. "In the Shadow of Prosperity," 34.

11. Blinder, "Outsourcing," 46.

12. Eric Johnston at the 1946 President's National Labor-Management Conference, quoted in Frank Levy and Peter Temin, "Inequality and Institutions in 20th Century America," National Bureau of Economic Research Working Paper No. 13106, May 2007, 21.

13. Levy and Temin, "Inequality and Institutions," 25–26.

14. One indicator of how successfully 1935 legislation promoted the interests of labor was the passage in 1947 of the Taft-Hartley Act, which sought to redress a perceived imbalance between union and management powers, reining in the first and expanding the second.

15. Levy and Temin, "Inequality and Institutions," 25, 36.

16. Levy and Temin, "Inequality and Institutions," 25.

17. Kuttner, "Good Jobs," 24.

18. Peter Coy, "The Minimum Wage: More Ammo for a Higher Minimum," *Business Week*, 27 November 2006, 38.

CHAPTER 8: FISCAL CONSTRAINTS

1. For a caustic commentary on these developments and current budget problems, see Robert J. Samuelson, "The $3 Trillion Cop-Out," *Newsweek*, 18 February 2008, 47.

2. David Hume, *Essays: Moral, Political, and Literary* (Oxford: Oxford University Press, 1963), 357. (Originally published in 1742.)

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4. Robert Pear, "About Those Health Care Plans by the Democrats . . . ," *New York Times*, 3 March 2008, A16.

5. The Concord Coalition, "An Open Letter to the President and Congress," *New York Times*, 7 January 2007, WK16.

6. Steven R. Weisman, "Fed Chief Warns That Entitlement Growth Could Harm Economy," *New York Times*, 19 January 2007, C1.

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2. Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2005* (Ithaca, N.Y.: Cornell University Press, 2005), 1.

3. N. Gregory Mankiw, "Beyond Those Health Care Numbers," *New York Times*, 4 November 2007, BU4.

4. George F. Will, *With a Happy Eye but . . . America and the World, 1997–2002* (New York: Free Press, 2002), 198. *New York Times* columnist David Brooks has compiled a similar list. He includes Will's (a) and (b), but Brooks's third requirement is to work full time "at whatever job," with the end result that "it is almost certain that you will not remain poor." David Brooks, "More than Money," *New York Times*, 2 March 2004, A23.

5. W. Michael Cox and Richard Alm, "You Are What You Spend," *New York Times*, 10 February 2008, WK14.

6. David Brooks, "A Reality-Based Economy," *New York Times*, 24 July 2007, A23.

7. Austan Goolsbee, "How the U.S. Has Kept the Productivity Playing Field Tilted to Its Advantage," *New York Times*, 21 June 2007, C3.

8. "Innovation: What Crisis?" *Economist*, 14 July 2008, 40.

9. Thomas Wolfe, *You Can't Go Home Again* (New York: Harper and Brothers, 1940), 508.

10. David Leonhardt, "Education Life," *New York Times*, 4 April 2008, 26.

11. John F. Kennedy, "Inaugural Address, January 20, 1961," in *The Inaugural Addresses of the American Presidents*, ed. David Newton Lott (New York: Holt, Rinehart, and Winston, 1961), 270.

12. Quoted in U.S. Congress, Senate, *Full Employment Act of 1945, Remarks in Senate on Bill (S.380) to Enact*, 79th Cong., 1st sess., September 27, 1945, *Congressional Record*, 9054.

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