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Progressive redistribution without guilt

Using policy to shift economic power and make U.S. incomes grow fairer and faster

Report • By Josh Bivens • June 9, 2016

Summary: Since the late 1970s, American economic growth has been slow and unequal relative to the period after World War II. This suggests that there was very little payoff to overall growth from rising inequality, and that there will be no growth penalty from strong efforts to check or reverse inequality. In fact, far from being in direct conflict, faster overall growth and progressive redistribution are likely complementary. What is even clearer is that an agenda that explicitly confronts rising inequality will unambiguously raise living standards growth for the bottom 90 percent. Actually, such an agenda is necessary for securing decent living standards growth for these households.

What this report finds: Boosting income growth for the bottom 90 percent requires a policy agenda that explicitly aims to halt or reverse the rise in inequality in the United States in recent decades. The economic evidence shows no generalizable relationship between rising inequality and faster growth. This is important good news. It means that an agenda based on progressive redistribution can unambiguously raise living standards for the bottom 90 percent and even likely be better for overall growth than the agenda promoted by those who are opposed to strong efforts to check rising inequality and instead want to focus solely on spurring overall growth.

Why this matters: The lack of a general relationship between inequality and growth means that specifics matter in policy debates. And the specifics of the modern "growth only" agenda will fail. Policies such as cutting top tax rates, deregulating industries, and signing more trade agreements will both fail to appreciably boost growth rates and continue to send a disproportionate share of income gains to the top 10 and 1 percents. The "growth only" agenda has already been tried, and the results have been slower overall growth and sluggish income gains for the vast majority in recent decades.

How we can fix the problem: Income redistribution over the last few decades has been a zero-sum process, with gains at the top essentially coming straight out of the pockets of the bottom 90 percent of Americans. This zero-sum dynamic means that intelligent policies—including but going way beyond smarter and fairer taxing and spending—can convert these lost potential gains for the bottom and middle into actual income increases without harming overall economic growth. We should:

- Use the levers of macroeconomic policy (monetary, fiscal, and exchange-rate policy) to target genuine full employment.
- Make investments that markets are not making—in early childhood education, infrastructure, school construction, energy efficiency, and public health care.
- Strengthen antitrust regulations and look for other opportunities to introduce competition to private markets, such as public options for health insurance and retirement savings.

SECTIONS

- Reregulate many activities of the financial sector to squeeze out the activities that don't enhance productivity or create efficiency but simply enrich well-placed actors within finance. A financial transactions tax is the clearest example of a policy that can stop this income skimming.
- Enact climate-change mitigation measures—realizing that policies beyond simply increasing the market price of greenhouse gas emissions can play large and useful roles.
- Strengthen regulations and institutions that help shift bargaining leverage from capital-owners and corporate managers to low- and middle-income workers. Key examples include higher minimum wages and labor law reform that allows willing workers to join unions and bargain collectively.

Introduction and summary of findings

The decades-long rise in income inequality has finally become a front-burner political issue, dominating much of the debate in the 2016 presidential campaign. Predictably, those opposed to strong efforts to check (or even reverse) the rise in inequality have objected to this focus, and have argued instead that the simple *pace* of overall economic growth, and not how this growth is *distributed*, should be the prime concern of policymakers. Often this argument has a political edge; focusing on distribution is bad for candidates' electoral prospects. Maybe this political argument is right (we are no experts on that), but regardless of whether it is a good short-term *electoral* strategy, a sustained policy effort to either arrest or reverse the rise in inequality is a necessary *economic* strategy if the goal is maximizing income growth for low- and middle-income American households.

To put it simply, the rise in inequality in recent decades has largely been zero-sum (or even worse). Many economists, analysts, and policymakers resist this zero-sum thinking, as it does not seem nuanced or subtle enough to describe a system as complex as an $18 trillion American economy. Yet the evidence is clear that it really is about this simple: the gains at the very top of the income distribution in recent decades have come essentially straight out of potential gains at the bottom and middle. This zero-sum dynamic means that intelligent policy changes aimed at progressive redistribution to stop (or even reverse) the steady rise in inequality would likely not harm overall economic growth, and would *surely* boost living standards at the bottom and middle.

Such policy changes are clearly needed. There is every reason to expect that income growth in the near future will continue to be unbalanced, providing significantly greater gains to those at the top than those in the middle or at the bottom, unless there is a significant reorientation of economic policy. Too often a policy stance of ignoring this radically unequal growth is described as "growth oriented" rather than (more accurately) as "regressive redistribution." But the clear truth is that a progressive reorientation of policy is needed simply to ensure that growth going forward is not distributed as unequally as it has been.

This brief examines the trajectory of American living standards in recent decades and how they have been affected by rising inequality. It then assesses the likely effects of various policy recommendations on both income distribution and growth. Its key findings are:

- **Inequality has risen substantially in recent decades, regardless of how it is measured**. This is true even when examining income trends that account for government transfers (such as Social Security, Medicare, Medicaid, food stamps, and unemployment insurance) and noncash employer-provided benefits such as contributions towards health insurance premiums.

- **Due to this inequality, incomes of the vast majority have grown much more slowly than the economy's potential should have allowed.** By simple arithmetic, inequality has placed a growing wedge between overall average income growth and income growth for the bottom 90 percent of households. This wedge between bottom 90 percent income growth and average income growth—call it the "inequality tax"—reduced incomes of the bottom 90 percent of households by roughly 20 percent between 1979 and 2007 (the last year before the Great Recession) relative to what incomes could have been absent the rise in inequality. This inequality tax fell during and immediately after the Great Recession, as a plunging stock market disproportionately reduced top incomes. But the stock market recovery in recent years has almost surely pushed this inequality tax back up to near prerecession levels.

- **Incomes for the vast majority post-1979 have been harmed by both slow growth and rising inequality.** Compared with earlier economic eras, the period after 1979 has been characterized by *both* slower average economic growth and rising inequality. Both of these trends have hurt the income growth of the bottom 90 percent of American households. In short, the aggregate data show a clear association between *regressive* redistribution and slower growth.

- **Yet the rise in inequality—not the slowdown in overall economic growth—is the more important reason why living standards growth slowed so radically for the vast majority in recent decades.** Contrary to the arguments of those looking to prioritize efforts to boost overall growth rather than focus on progressive redistribution, the rise in inequality after 1979 has done more than the slowdown in average growth to impede living standards gains for the bottom 90 percent of American households relative to previous historical periods.

- **The rise in inequality is the predictable outcome of policy changes enacted in the post-1979 period**. Over the last few decades a large portfolio of policy changes has had the predictable effect of redistributing the benefits of economic growth to households at the top of the income distribution. These policy changes include the near-abandonment of full employment as a policy goal, cuts in top tax rates, the deregulation of finance, and a host of measures that eroded labor standards and institutions that buttressed bargaining power of low- and middle-wage workers.

- **Many of the policy decisions that increased inequality in recent decades also deeply damaged overall growth.** For example, the failure to aggressively target full

employment and the effort to deregulate the financial sector both clearly led to slower overall growth and redistributed income toward the highest-income households. In short, the aggregate data show a clear association between *regressive* redistribution and slower growth.

- **Many items on the modern progressive economic agenda would boost growth and halt the rise in inequality.** Despite much handwringing by those arguing against it, the broad distribution-focused agenda of progressives elevates many policy changes that would unambiguously boost overall growth rates as well as stop the rise of inequality. For example, investments in infrastructure and early childhood education would provide faster *average* growth and would distribute benefits more widely. In short, the modern progressive agenda is both pro-growth and explicitly aimed at progressive redistribution.
- **The modern "growth first" agenda that is commonly promoted would have trivial effects on overall growth but would regressively redistribute income.** Key items on the agenda of those claiming to focus on growth over redistribution, such as signing more trade agreements, cutting tax rates, and reversing federal regulations, would provide at best trivial overall growth payoffs. Worse, the regressive redistribution that would result from these policies would have a net negative effect on living standards for the vast majority of American households.
- **Some items on the modern progressive agenda would progressively redistribute income without harming overall growth and these items are crucial to do.** A substantial body of research indicates that many policy interventions that would lead to a progressive redistribution of income are essentially irrelevant to overall growth rates. *This is important good news*; it means that the zero-sum nature of income redistribution can be put to use to *increase*, not just suppress, growth for the bottom 90 percent.
- **Policies that are growth-neutral overall but strongly progressive in distribution generally work by increasing the economic leverage and bargaining power of low- and moderate-wage workers in the labor market**. This largely means either rebuilding labor standards that have eroded or adopting modern labor standards that America has largely ignored for too long. Examples include raising minimum wages, restoring rights to collective bargaining, ensuring overtime rights for a broad class of salaried workers (as just accomplished with a new rule from the U.S. Department of Labor), adopting more-generous unemployment insurance, and instituting new paid leave rights. All of these measures—which are part of EPI's Raising America's Pay (RAP) agenda, can help shift bargaining power in the labor market away from capital-owners and corporate managers and back to low- and moderate-wage workers. The research on this (from EPI's RAP research and other sources) shows that there is little to nothing to fear about the growth and efficiency consequences of such policies, but that they hold great promise in restoring the share of income claimed by the bottom 90 percent. There are even some reasons to believe that these efficiency-neutral progressive policies may help ameliorate a key growth problem: the chronically slow

growth of aggregate demand ("secular stagnation," in the jargon) that has plagued advanced economies in recent decades.

Background

The rise in inequality in recent decades has been essentially zero-sum, *at best*. The evidence strongly indicates that overall growth rates in recent decades were not buoyed by the large regressive redistribution of income that occurred during that time. Consequently, gains at the top were not financed by faster overall growth, instead they were achieved at the expense of decent living standards growth at the bottom and middle of the income distribution.

To put it simply, the rise in inequality has easily been the biggest factor driving underperformance of income growth for the bottom and middle. We define this *underperformance* in two ways in this paper. The first is essentially definitional—income growth for the bottom 90 percent of households that significantly lags economy-wide *average growth* (that is, slower growth than what the economy *could have delivered* to all households). That is, any increase in inequality should be seen as a potential economic policy failure. The second definition of underperformance is simply income growth for the bottom 90 percent that is significantly slower than what these households experienced in earlier economic eras.

In this paper we label the entire bottom 90 percent of American households the "vast majority" and examine trends in their living standards over time. We often compare their economic outcomes to *average* outcomes—outcomes buoyed by large gains in the top 10, 5, or 1 percent of the income distribution. We will also occasionally (and more depressingly) compare outcomes for the bottom 90 percent directly with outcomes achieved by the top 10, 5, or 1 percent.

The bottom 90 percent is obviously a heterogeneous group in a lot of ways: households in the bottom 10 percent of the income distribution are obviously poor in any reasonable sense of the term while households at the 90th percentile are awfully privileged relative to many others in this group. But we still think it's a useful group to examine. One point in favor of using this "vast majority" concept is data availability: it allows us to use a dataset from Thomas Piketty and Emmanuel Saez that does not differentiate between households in the bottom 90 percent to make comparisons over time. It is also worth pointing out that average income growth for the entire bottom 90 percent of American households has lagged lag far behind the economy-wide average in recent decades. And the difference between growth rates at the 20th percentile and 90th percentile is much smaller than the difference between growth rates at, say, the 90th percentile and the 99th percentile. In short, while this bottom 90 percent is a very expansive group, its members have experienced a pretty common trajectory in income growth in recent decades, so we think it makes sense to examine their experience as a group.

Since the rise of inequality has been the biggest cause of disappointing income growth for the vast majority, *reversing* (or at least stopping) this rise in inequality is obviously key to

accelerating future living standards' growth for this group. In short, an economic strategy that does *not* aim to explicitly confront inequality would severely shortchange the living standards of the vast majority. Given this, it is bizarre indeed to argue that policymakers should not make it a priority to reverse (or at least stop) recent decades' trends toward greater inequality.

Those arguing for ignoring distribution and focusing only on growth often claim (at least implicitly) that progressive redistribution and growth conflict, and that strategies aimed explicitly at progressively redistributing income will hamstring overall growth. In fact, recent economic history in the U.S. strongly indicates that it is *regressive* redistribution and growth that are in conflict; the package of policy changes that led to the rise in inequality did nothing to boost overall growth of the economy. Instead, as inequality rose, overall growth rates fell. In short, equity and efficiency are often *not* in conflict. And an ambitious agenda that restores economic power to the vast majority can make the economy grow both fairer *and* faster.

Inequality is sharply up in all high-quality datasets

Recent trends in income inequality and concentration are summed up in Table 1. In recent speeches, Senator Elizabeth Warren has cited a statistic indicating that between 1980 and 2014, the bottom 90 percent of American households (our "vast majority") have seen *no* income growth, while the top 1 percent have accounted for nearly two-thirds of the rise in average incomes. For an advanced economy, this is a stunningly poor performance in generating income growth for the vast majority, and is also a marked change relative to earlier periods that Warren highlights. For example, between 1935 and 1980, the bottom 90 percent accounted for roughly 70 percent of average income growth.

Senator Warren's numbers are based on the groundbreaking inequality research of Thomas Piketty and Emmanuel Saez. The Piketty-Saez data are based on analysis of *cash, market-based incomes* tracked by individual income tax returns—basically wages and salaries, interest, rental payments, dividends, business income, and capital gains.

While the Piketty-Saez dataset is universally considered high quality, some have criticized using it to infer trends in living standards on the grounds that it fails to account for government transfers (both cash and noncash) and noncash market-based income (mostly employer-provided health insurance premiums) that have boosted incomes for the vast majority over recent decades.

Is there anything to this critique? A little. It is clearly true that incomes for the bottom 90 percent are higher and rise faster post-1979 if one includes growth in government transfers and nonwage employment benefits. But it is also clearly true that the enormous rise in inequality in recent decades is entirely driven by the cash, market-based income tracked by the Piketty-Saez data, and that this rise in cash, market-based income inequality leads to a sharp rise in overall income inequality as well.

Table 1 displays some Piketty-Saez data as well as data on comprehensive income (including government transfers and employer-provided benefits) for various periods. These data on comprehensive income come from the Congressional Budget Office (CBO). The table calculates the average annual income growth rate as well as the share of average income growth accounted for by the income growth of top 1, top 5, top 10, and bottom 90 percent households over various periods.

Table 1

Average annual income growth and share of average income growth accounted for by various income groups

	Average annual income growth, by percent group					Share of average income growth accounted for by percent group				
	Average	Top 1%	Top 5%	Top 10%	Bottom 90%	Average	Top 1%	Top 5%	Top 10%	Bottom 90%
	CBO comprehensive incomes					CBO comprehensive incomes				
1979–2007	1.5%	4.5%	3.3%	2.8%	0.9%	100.0%	38.5%	54.3%	63.7%	36.3%
2007–2009	**-6.5%**	**-20.3%**	**-14.9%**	**-12.1%**	**-2.8%**	**100.0%**	**65.4%**	**80.1%**	**85.3%**	**14.7%**
2009–2011	0.7%	6.7%	4.7%	3.6%	-0.9%	100.0%	90.6%	105.1%	106.5%	-6.5%
	Piketty-Saez cash, market-based incomes					Piketty-Saez cash, market-based incomes				
1947–1979	2.1%	1.5%	1.8%	2.1%	2.1%	100.0%	7.8%	21.1%	34.1%	65.9%
1979–2007	1.1%	4.3%	3.0%	2.5%	0.2%	100.0%	59.8%	80.9%	91.4%	8.6%
2007–2009	**-9.1%**	**-20.2%**	**-14.7%**	**-12.1%**	**-6.3%**	**100.0%**	**49.0%**	**60.2%**	**65.1%**	**34.9%**
2009–2014	1.6%	4.9%	3.7%	3.1%	0.3%	100.0%	58.3%	81.4%	89.6%	10.4%
1979–2014	0.6%	2.8%	2.0%	1.7%	-0.2%	100.0%	70.5%	102.6%	118.1%	-18.1%
1935–1980	2.7%	1.5%	1.9%	2.1%	3.1%	100.0%	7.1%	19.2%	30.3%	69.7%
1980–2014	0.7%	2.9%	2.2%	1.8%	-0.1%	100.0%	63.3%	92.5%	106.9%	-6.9%
1997–2014	0.3%	1.2%	1.0%	0.9%	-0.3%	100.0%	92.4%	140.2%	164.7%	-64.7%

Note: 2007–2009 saw income losses across the board. So, the numbers reported here show the share of average income losses accounted for by each group.

Source: Author's analysis of data from Piketty and Saez (2003, updated) and the Congressional Budget Office

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While the Piketty-Saez data show a more extreme rise in inequality in the post-1979 era than do the CBO data, the top 1, 5, and 10 percent of households still account for extremely disproportionate shares of overall growth even in this comprehensive income data. For example, the bottom 90 percent account for just 8.6 percent of average income growth in the Piketty-Saez data between 1979 and 2007—the last year before the Great Recession hit. Over this same period the bottom 90 percent accounted for a bit over a third (36.3 percent) of average income growth in the comprehensive income data—but still less than the 38.5 percent accounted for by just the top 1 percent. It is odd to claim that comprehensive income data fundamentally disprove the idea that rising inequality has kept average income growth from fully reaching the bottom 90 percent; even using these data, the bottom 90 percent accounts for less income growth than the top 1 percent.

The Piketty-Saez data (which, unlike the CBO data, extend back before 1979) show that growth rates were much more equal between income groups in the pre-1979 era, and that average income growth was much more broadly based, with the bottom 90 percent accounting for almost two-thirds (65.9 percent) of average growth from 1947 to 1979.[1]

Two benchmarks to measure the underperformance of income growth for the vast majority

Much political rhetoric takes as given the disappointing economic trajectory of the bottom 90 percent of American households in recent years. We think that the economic facts support this political rhetoric, and suggest two benchmarks to assess income growth for the vast majority.

The first benchmark compares the income growth of the bottom 90 percent with average income growth. This average growth can be (and indeed has been) buoyed significantly by very fast growth rates at the top of the income distribution. Yet the fact that the top 1 percent of households saw cumulative comprehensive income growth of a staggering *245 percent* (4.5 percent annual growth compounded over 28 years) between 1979 and 2007 tells us very little about how the bottom 90 percent fared.

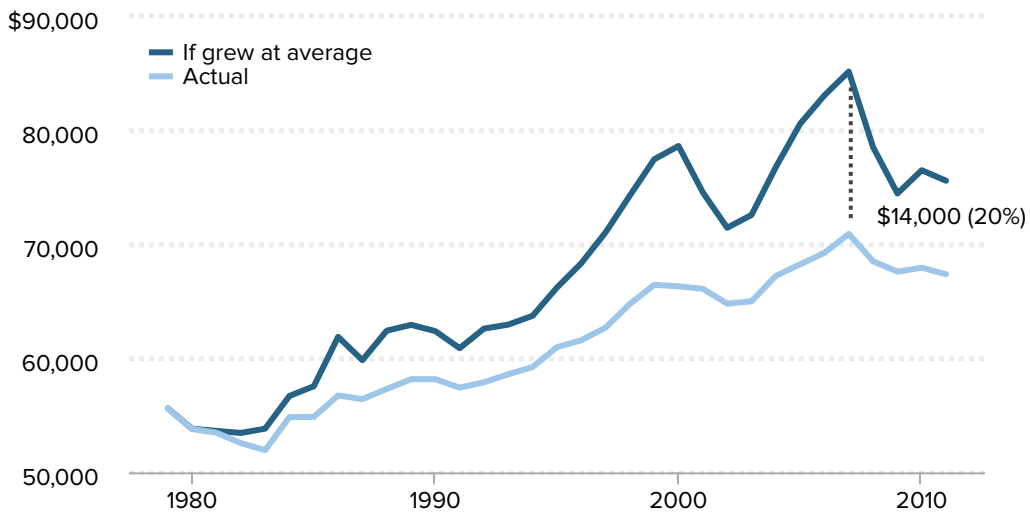
The second benchmark compares income growth for the vast majority between 1979 and 2007 with such growth in an earlier economic epoch, specifically growth between 1947 and 1979. This is a key comparison often made in the debate between those arguing that overall growth should be policymakers' key priority versus those arguing for progressive redistribution. Knowing the facts of the income slowdown for the vast majority that occurred in the second period will be useful in that regard.

Why do we highlight trends until 2007 even though data are available after that year? Because income trends for all groups post-2007 are dominated by the effects of the Great Recession. It is no puzzle why income growth was been weak since then—the degree and length of income weakness may be *surprising*, but it is easily *explainable*. In this paper we

Figure A

The inequality tax

Bottom 90 percent household income, actual average and average had it grown at the same rate as the overall average, 1979-2011



Source: Author's analysis of Congressional Budget Office data

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are more interested in longer-run changes in the policy environment that have steadily redistributed income upwards over the years. In years to come, the income weakness that can be attributed to the effects of the Great Recession will have (hopefully) faded, and these longer-run determinants will reassert themselves, but for now we think ending the data analysis in 2007 still provides a cleaner snapshot of their effects.

Benchmark one: vast majority versus overall average growth, or, the rising "inequality tax"

Figure A provides the clearest look at our first benchmark. Using the CBO comprehensive income measure, it shows the average income of the bottom 90 percent. It also shows what incomes of the bottom 90 percent of households *would have been* in each year since 1979 if they had grown at the same rate as average household income. In short, this tells us what income growth the vast majority *could have seen* had inequality not increased since 1979. We should be clear that the United States was an unequal country in 1979, with average incomes of the top 1 percent 11.8 times as large as average incomes of the bottom 90 percent. The benchmark being proposed here is not some platonic ideal of perfect equality. Instead, the benchmark is simply a *stable* level of already considerable inequality.

As the figure shows, had inequality not increased after 1979, the bottom 90 percent would have had incomes roughly 20 percent higher in 2007, the year before the Great Recession struck. This translates to more than $14,000 lost to inequality in that year alone. This can

be thought of as an "inequality tax"—an annual chunk of money that could be, but is not, boosting the living standards of the vast majority simply because of the rise in inequality. It is important to note that the incomes of the bottom 90 percent between 1979 and 2007 were buoyed by strong growth in government transfers. It is far from certain that the pace of growth in these social insurance and income support policies will be maintained going forward.

The most common objection to the claim that growing inequality imposed a tax on incomes of the vast majority is that this rise in inequality was somehow necessary to generate *any rise at all* in average income growth, and that efforts to progressively redistribute income going forward will cause a reduction in this average growth rate. That is, while efforts to brake or reverse the increase in inequality may allow the bottom 90 percent to take a larger *share* of the overall pie, these same efforts will shrink the overall size of the pie enough to make this group worse off in absolute terms. There is no serious evidence to support this claim, as we'll show in a later section. But for now, it is unambiguously true that as a matter of arithmetic, the economy in 2007 could have delivered 20 percent higher incomes to the bottom 90 percent of households *but for* the effect of rising inequality over the previous three decades.

Benchmark two: bottom 90 percent income growth in previous periods

Our second benchmark looks at the slowdown in income growth for the bottom 90 percent between 1979 and 2007 relative to the three decades before 1979 (as shown in the bottom portion of Table 1). This growth slowdown for the vast majority is driven by two factors: a sharp reduction in overall (average) income growth post-1979 and a rise in inequality that drove a large wedge between overall income growth and growth for the bottom 90 percent.

Participants in the debate over whether policymakers should focus on overall growth versus checking or reversing the rise in inequality often point to comparisons between these periods as a way of privileging the importance of growth. For example, in the latest Economic Report of the President (for the year 2015), the Council of Economic Advisers (CEA) wrote a chapter, "Middle-Class Economics," that seemed to say that the impact of declining overall growth dwarfed that of regressive redistribution on stunting middle-class income growth. This is not true. For household income, the role of redistribution is at least as important as the overall slowdown in growth in restraining income growth for the bottom 90 percent.

Our first cut at the issue looks at growth rates using the Piketty-Saez data, which let us calculate average annual growth rates of cash, market-based incomes of the bottom 90 percent since 1947. The results are striking: annual income growth slows from 2.1 percent in the 1947–1979 period to 0.2 percent in the 1979–2007 period.

But the objection noted above about the Piketty-Saez data remains: by not counting government transfers and employer-provided benefits the data understate the rise in

incomes for the vast majority. This is certainly true: the average growth rate of income of the bottom 90 percent is substantially higher after 1979 in the comprehensive income data—0.9 percent annually between 1979 and 2007. But this begs the question of how much transfers and employer-provided benefits contributed to growth in the earlier period. If the rate of growth of transfers and employer-provided benefits was similar in the two periods, then the *slowdown* in income growth for the vast majority identified in the Piketty-Saez data will be just as extreme.[2]

And in fact the overall growth of transfers and employer-provided benefits was significantly *more* rapid between 1947 and 1979 than thereafter. Hence, by our second benchmark, it is clear that income growth for the bottom 90 percent absolutely decelerated radically after 1979. As we detail in the next section, the role of inequality looms large in this slowdown in growth for the vast majority.

Have the bottom 90 percent been hurt more by rising inequality or slower growth?

The slowdown in income growth for the vast majority is well-recognized. A common diagnosis for why income growth for the bottom 90 percent has slowed so significantly is that *overall* economic growth has slowed in the U.S. beginning in the 1970s. There is a lot of truth to this: overall economic growth in the U.S. was indeed slower after 1979 relative to the decades before. For example, dividing total personal income as tracked by the National Income and Product Accounts (NIPA) by the total number of households in the U.S. produces an annual average rate of growth of 1.9 percent between 1947 and 1979, and 1.6 percent between 1979 and 2007. This overall growth slowdown was driven both by a slowdown in the growth of productivity (income produced in an average hour of work in the economy) as well as a slowdown in the growth of the labor force.

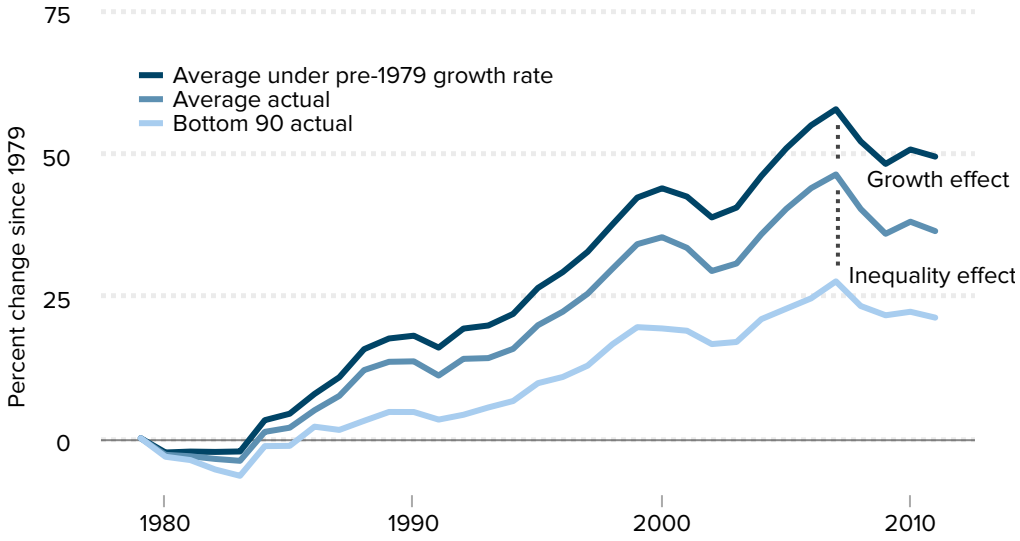
This slowdown in productivity growth starting in the 1970s looms very large indeed in the minds of economists; it is perhaps the most-studied event in American economic history. However, even relative to this average growth slowdown, the rise in inequality has played a huge role in the income slowdown for the vast majority. In fact, the rise in inequality is responsible for roughly two-thirds of the slowdown in income growth for the bottom 90 percent between 1979 and 2007.[3] That is, the rise of inequality has played an even bigger role in the slowdown of incomes for the bottom 90 percent than the *overall* slowdown in economic growth.

Figure B shows trends in comprehensive income growth for the bottom 90 percent of the household income distribution. The highest line in the figure shows how much bottom 90 percent income would have grown had overall income growth maintained its pre-1979 pace *and* inequality had not widened in the post-1979 period. This is calculated by taking the post-1979 pace of average growth (in the CBO data) that excludes capital gains (1.4 percent) and multiplying it by 1.2 to get 1.7 percent growth. This 1.2 is the ratio between

Figure B

Rising inequality has done more than a slowing economy to hurt income growth

Bottom 90 percent household income growth since 1979, compared with the overall average and growth assuming a pre-1979 growth rate



Source: Author's analysis of Congressional Budget Office data

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average growth rates of NIPA personal income divided by total households in the 1947–1979 and 1979–2007 periods referenced above. We think this ratio is a useful proxy for what growth in CBO-measured comprehensive income would have been in earlier periods. We exclude capital gains because they are not included in the NIPA data and so might have different trends. This exclusion of capital gains makes our inequality measure quite conservative, as capital gains are extraordinarily concentrated in the top 10 percent of the income distribution.

This top-line number represents a best-case scenario in which overall growth does not slow and inequality does not rise. The middle line shows what bottom 90 percent income growth would have been if it matched actual *average* income growth post-1979. The gap between the top two lines isolates the impact of the slowdown in overall growth. Finally, the bottom line shows cumulative income growth for the bottom 90 percent. The gap between the bottom and middle lines is simply the measure of the "inequality tax" we identified before, and it shows the contribution of rising inequality to keeping bottom 90 percent income growth below average growth.

The growth slowdown certainly matters. If growth had kept its pre-1979 pace, cumulative income growth for the bottom 90 percent would have been roughly 10 percentage points higher by 2007 *even had inequality followed the same path it took in those decades*. But rising inequality stunted income growth even more—cumulative income growth for the bottom 90 percent would have been nearly 20 percentage points higher had pre-1979 average growth not persisted but also had inequality not risen. This isolates the effect of

rising inequality on the income slowdown for the bottom 90 percent between 1979 and 2007. In short, rising inequality accounts for roughly two-thirds of the income growth slowdown for the bottom 90 percent between 1979 and 2007. This is an awfully large portion of the problem to ignore, which is implicitly what the "growth first" proponents are suggesting.

The previous section has demonstrated that ignoring questions of distribution will radically blunt what can be done to boost income growth for the vast majority, simply as a matter of arithmetic. Further, as we will show later, it is much easier and more certain to potentially affect distribution through policy levers than it is to use these levers to boost the economy-wide growth rate. Yet this has not stopped many pundits and policymakers from insisting (with very little evidence) that sidelining distributional concerns in favor of (usually unspecified) measures meant to promote growth should be the strategy of those concerned with the income growth of the bottom 90 percent.

The crucial and strange role of increased health spending—particularly transfers—on personal income

The large difference between the Piketty-Saez and CBO reports of income growth for the bottom 90 percent is attributable primarily to the CBO's inclusion of government transfers and nonwage employer benefits. Health care spending dominates both of these income flows, and the per capita cost of health care has risen extraordinarily rapidly in recent generations. Transfer payments and employer contributions to health insurance premiums would need to rise rapidly just to keep living standards constant.

There are a number of conceptual hurdles to properly accounting for the value of health care transfers in calculating changes in household income.

One hurdle is figuring out how to interpret large increases in nominal income dedicated to purchasing health care. Determining how much of that nominal increase translates into an increase in real (inflation-adjusted) household income depends on the deflator applied. Official health care price indices (such as those constructed by the Bureau of Labor Statistics and Bureau of Economic Analysis) indicate that there has been very little gain in real health care spending in recent decades. But this is hard to believe: given the technological improvements, few Americans believe that the health care available to them today is not better and more valuable than what was available to people in 1979.

Of course, there is a related question of whether American households in 2016 would be willing to trade their bundle of health care goods and services—including their costs—for what is available to French (or Canadian or British or Japanese) households in 2016. Given that health care prices in America are substantially higher than health care prices in other advanced countries, and

yet many measures of utilization and health care effectiveness are higher in our peer countries, this might well be a trade many would find worth doing.

Another hurdle, particularly in the case of transfers, is figuring out how to allocate the benefits of increased spending on health care goods and services. For example, poor households that do not receive Medicaid surely are able to consume less health care on average then poor households that do receive Medicaid, but is it true that the full benefits of the dollar value of average Medicaid spending flows only to recipients and not simply to higher incomes for medical providers? Take instances when uncompensated health care is provided to poor families in the absence of Medicaid. In those cases, the Medicaid benefits will (at least in part) serve to compensate providers for providing the care they would have provided anyway. A recent paper by Finkelstein, Hendren, and Lutter (2015) estimates that each dollar spent on Medicaid by federal and state governments boosts the consumption of health care by recipient families by only $.20 to $.40, with the remainder accruing to higher incomes for health care providers.

A final hurdle is the issue of how much non–health care consumption is made possible through a transfer of Medicaid benefits to low-income families. Say that a family has zero non-Medicaid income but then qualifies for Medicaid, which spends an average of $10,000 per year on beneficiaries. Does this Medicaid transfer really benefit this family's income by a full $10,000? For years the Congressional Budget Office only counted the "fungible value" of Medicaid and Medicare as additions to comprehensive income. The fungible value is the smaller of (1) the average value of Medicaid benefits and (2) the difference between a household's non–health care income and what it needs to spend on basic food and housing needs. The intuition behind this fungible measure of Medicaid's value is that only income boosts that provide purchasing power over and above the basic needs of food and housing should be counted as additions to household income. The difference between the fungible value of Medicaid and Medicare and the full-value approach currently used by the CBO can be substantial.

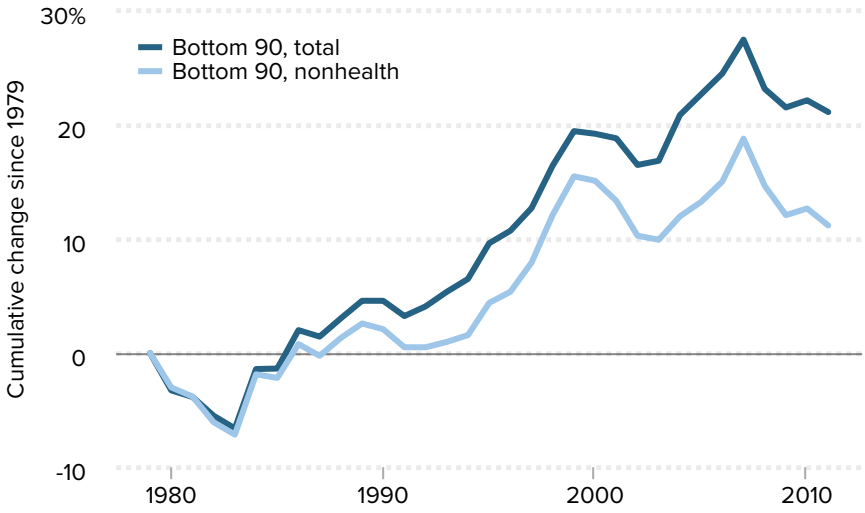
Given all of these conceptual hurdles to properly accounting for the value of health care transfers in calculating household income, an obvious solution is to simply stop trying to account for this value and instead report non–health care related incomes and health care related incomes separately. Non–health care related incomes can be deflated with the CPI-U-RS, as before, while health care income growth can be compared not just with official price indices, but with health outcomes to gauge the effectiveness of higher nominal spending in creating welfare. **Figure C** shows the trajectory of non–health care related incomes and health care incomes for the bottom 90 percent of households. Segregating health care related incomes significantly slows the growth of non-

health care related incomes, which rose a third slower (18.8 percent versus 27.5 percent) between 1979 and 2007, and about half as rapidly (11.2 percent versus 21.2 percent) between 1979 and 2011.

Figure C

Excluding health care significantly skews the income growth of the bottom 90 percent

Cumulative income growth of bottom 90 percent of households, including and excluding health care related incomes, 1979–2011



Notes: Income growth excluding healthcare related incomes subtracts out household income received in the form of employer-provided health insurance premiums and Medicare and Medicaid benefits.

Source: Author's analysis of Congressional Budget Office data

Economic Policy Institute

Does progressive redistribution necessarily hurt growth?

The diagnosis that the slowdown in *overall* growth is the chief problem confronting the vast majority of American households has led to prescriptions claiming to focus on boosting this overall growth. Those making these recommendations often claim (at least implicitly) that policies distributing growth more broadly are always and everywhere inimical to faster overall growth. That is, they claim that one must choose *either* faster overall growth *or* progressive redistribution, and that choosing to pursue one of these goals will mechanically make the other goal harder to achieve.

"Growth only" voices in the 'redistribution' versus growth debate

If you talk to leading progressives these days, you'll be sure to hear this message: The Democratic Party should embrace the economic populism of New York Mayor-elect Bill de Blasio and Massachusetts Sen. Elizabeth Warren. Such economic populism, they argue, should be the guiding star for Democrats heading into 2016. Nothing would be more disastrous for Democrats. … The political problems of liberal populism are bad enough. Worse are the actual policies proposed by left-wing populists. The movement relies on a potent "we can have it all" fantasy that goes something like this: If we force the wealthy to pay higher taxes (there are 300,000 tax filers who earn more than $1 million), close a few corporate tax loopholes, and break up some big banks then—presto!—we can pay for, and even expand, existing entitlements. Meanwhile, we can invest more deeply in K-12 education, infrastructure, health research, clean energy and more. (Cowan and Kessler 2013)

For many years, Democratic efforts to reduce inequality and lift middle-class wages were based on the theory that the key is to improve the skills of workers. … But a growing number of populist progressives have been arguing that inequality is not mainly about education levels. They argue that trying to lift wages by improving skills is an "evasion." It's "whistling past the graveyard." The real problem, some of them say, is concentrated political power. The oligarchs have rigged the game so that workers get squeezed. … Or it's about corporate power. Without stronger unions shareholders reap all the gains. … The implication? … Put redistribution first. … Unfortunately, this rising theory is wrong on substance and damaging in its effects. (Brooks 2015)

The economic debate is now sharply focused on the issue of income inequality. That may not be the debate Democrats want to have, however. It's negative and divisive. Democrats would be better off talking about growth—a hopeful and unifying agenda. (Schneider 2014).

A Better Campaign Theme Than Inequality: Income disparity doesn't much worry America. Advocating for growth holds more promise. (Galston 2015)

But there is nothing in the economic research that suggests a generalized tension between progressive redistribution and growth. Further, many measures that are often considered exercises in progressive redistribution actually have strong, positive impacts on overall growth. And many measures that are considered first and foremost as growth-promoting also have progressive distributional impacts. And other measures put forward as growth-promoting actually produce very little overall growth and instead serve primarily to redistribute income upward. Finally, many measures really do seem to *just* operate on distribution without affecting overall growth. This means that if implemented they can indeed boost incomes of the bottom 90 percent without slowing average growth. Again,

the zero-sum logic of past decades' regressive redistribution can be reversed to favor the bottom 90 percent.

Economic research on *general* relationships between growth and inequality

The links between growth and inequality are extraordinarily well-studied. But much too often policymakers and researchers set the bar for redistributive policies far too high by looking for unambiguously *positive* impacts on average growth rates. While some studies have indeed found a statistically significant positive relationship between increased equality and increased growth, this is not a robust generalized finding. Most common is research showing an insignificant relationship between growth and progressive redistribution.

However, for those concerned with boosting the income of the vast majority, the burden is *not* on those calling for progressive redistribution to prove that such measures will boost overall growth. Instead, the burden is on those seeking to block such redistribution to show that such measures unambiguously hurt overall growth (specifically, a statistically significant generalized *negative* relationship between increased equality and growth). And fewer studies have shown a negative relationship between progressive redistribution and growth than have shown a positive relationship.

The large majority of studies have found no conclusive, generalized relationship between inequality and overall growth. What this means is that efforts to progressively redistribute economic power and income have no predictable effect on growth rates. And if overall growth is unaffected by redistributing income downward to the vast majority, then progressive redistribution *unambiguously boosts incomes for those households*.

Redistribution and inequality in the United States have had the following broad historical pattern: a strong association between stable income shares (i.e., no increase in inequality) and rapid overall growth right after World War II followed by rising inequality and notably slower growth in the three decades before the Great Recession. That is, rising inequality is associated with slower growth. This broad association remains even when researchers undertake more systematic attempts to establish a link between rising inequality and aggregate economic performance, and it remains when researchers examine international or state-level data.

For example, Piketty, Saez, and Stantcheva (2011) examine the relationship between top marginal tax rates, top income shares, and aggregate economic performance, both in U.S time-series data as well as using data from an international panel of 18 Organization for Economic Cooperation and Development (OECD) countries. They find strong evidence that falling top marginal tax rates are associated with higher pretax top income shares (rising inequality). However, they do not find a strong association between either falling top marginal tax rates and rising economic growth or (for the U.S. data) rising top income shares and faster economic growth. They also find significant evidence that falling top marginal tax rates are associated with slower income growth for the bottom 99 percent of

households. They take this constellation of evidence as supporting a "bargaining model where gains at the top have come at the expense of the bottom."

Andrews, Jencks, and Leigh (2011) find slightly mixed evidence on the larger issue of top income shares and subsequent growth, with increases in the share of income accruing to the top 10 percent positively (and generally with statistical significance across regression specifications) related to subsequent overall growth in their preferred regression models. They note the modest economic impact implied by their results: "But at the very least, the 95 percent confidence intervals for our preferred estimates appear to rule out the claim that a rise in top income shares causes a large short-term increase or decrease in economic growth. The claim that inequality at the top of the distribution either benefits or harms everyone therefore depends on long-term effects that we cannot estimate very precisely even with these data." Most importantly for the question at hand, these results are driven by what is happening between the 90th and 99th percentiles. They note: "The top 1 percent's share is never both positively and significantly related to the growth rate."

Thompson and Leight (2012) have recently used a different sort of panel to examine the relationship between top income shares and growth—a panel looking at the top 1 percent within individual U.S. states. Their analysis finds that a rising share of income accounted for by the top 1 percent is associated with *falling* subsequent growth in incomes and earnings for households in the middle of the distribution, while having no significant effect on growth at the bottom of the distribution. Further, their finding on the statistical significance of the depressing effects of rising top shares on middle incomes is fairly robust and survives the inclusion of a range of covariates (though its economic impact is relatively modest).

We should end by repeating something important about where the burden of proof needs to lie in the debate over the effect of inequality on growth. If one is seeking to maximize the incomes of low- and moderate-income households, the burden of proof is clearly on the side claiming that increased inequality significantly *boosts* growth. If that side is wrong and inequality instead restricts growth, then clearly low- and moderate-income households will gain from a move toward a more equal distribution. Importantly, even if distribution is *completely* neutral with respect to growth, the incomes of low- and moderate-income households can be boosted by redistributing from the top. Our claim here is modest: the empirical research that has directly examined the effect of rising inequality on overall economic growth certainly does not suggest that inequality strongly boosts growth. And as long as the shift of income to the top of the distribution is not associated with *improved* overall growth, then the rest of the income distribution is harmed. Again, the zero-sum character of much of the regressive redistribution of income towards the top we have seen in past decades can be put to work in reverse to progressively redistribute toward the bottom 90 percent without harming overall growth rates. This makes reversing this upward redistribution a key policy priority, and one unlikely to come at the cost of slowing overall economic growth.

The importance of moving from general to specific when debating redistribution and growth

In one sense it is not surprising that there is no durable *generalized* relationship between progressive redistribution and overall growth rates. Progressive redistribution could occur in a number of ways. Some of these ways could indeed harm overall growth. The forcible expropriation of private-sector assets, for example, is unlikely to be growth-enhancing. Other measures aimed at progressive redistribution could have powerful growth-promoting effects: for example, providing income to families with children in the form of paying for high-quality universal prekindergarten education.

This means that the debate over distribution versus growth really needs to move quickly away from generalities and to specifics to be of any use. A number of items that have emerged on the progressive economic agenda in recent years would clearly have strongly positive effects on both growth and equity.

Policies that boost *both* overall growth and progressive redistribution

Today's progressive economic agenda essentially involves three major planks. First, use the tools of macroeconomic stabilization to ensure that the economy reaches genuine full employment so that it is not leaving money on the table in the form of unemployed workers and unused productive capacity. Second, boost investment where the market is not doing enough—both in "core infrastructure" projects as well as in "noncore" public investments with the potential to pay large returns, as identified by independent research. Third, use either legislation or regulatory tools to blunt the impact of market failures and to ensure competition.

All three of these planks require effective public structures and well-run government. But they are not just limited to a government that taxes and spends. To be clear: smarter and fairer taxing and spending needs to be a key part of the progressive agenda. But too often the fiscal tax-and-transfer system becomes the only policy response to rising inequality. We can do better than this through a range of policy changes that affect pre–tax-and-transfer distribution to make economic growth both fairer and faster.

Testing the true limits of full employment

A core plank of progressive economic strategy is to use the levers of macroeconomic policy (monetary, fiscal, and exchange-rate policy) to target genuine full employment One of these major levers—fiscal policy—has been redirected to actually *impede* recovery from the Great Recession in recent years through unnecessary austerity. This has led advocates for targeting full employment to more recently focus on trying to convince the Federal

Reserve to hold off on interest rate increases (or to at least adopt a very slow pace of increases) until unemployment is low enough to actually spur across-the-board wage growth.[4]

Using macroeconomic policy to boost demand and target genuine full employment would clearly be good for overall economic growth. An economy with 4 percent unemployment generates more income than one with 5 percent unemployment. Further, tight labor markets spur wage increases which can in turn spur firms to invest in labor-saving technologies that spur productivity growth. But this policy also has strongly progressive effects. The wage growth of low- and moderate-wage workers benefits *more* from lower rates of unemployment than wage growth of workers at the top of the wage distribution. More than their high-wage peers, these low- and moderate-wage workers need high pressure labor markets to give them bargaining power to demand wage increases .

Yes, there is a limit to how much growth can be wrung out of the system by supporting demand growth through more expansionary fiscal, monetary, and exchange-rate policy. But we are not at this limit yet, and it is clear that we should be absolutely sure the economy is at this limit before we stop using these tools.

Making investments that the private sector is not

Productivity growth has been decelerating for the last decade. This is driven in part by sluggish growth in business investment in plants and equipment. When businesses do not want to invest even during times of historically low interest rates, we do not have to throw up our hands in despair. We can instead mobilize capital and invest it productively through the public sector. A solid base of research indicates that there are plenty of high-return public investments out there to make.

Investing in early childhood education

Probably the most popular item on the progressive economic agenda is an expanded investment to make high-quality prekindergarten education available to all children. The economic benefits of high-quality early-childhood education are enormous and extraordinarily well-documented.[5] These benefits are so large that over the course of decades such an investment will be fully self-financing *even in narrow fiscal terms*.[6]

And these benefits come in part in the form of a higher quality labor force that will boost future growth. This investment is also strongly progressive. Currently, spending on children's enrichment is much higher for high-income families. Measures to make high-quality early-childhood education universally affordable will hence constitute large transfers directly to poor and moderate-income households (for more on the benefits of an ambitious investment in early child care and education, see Bivens et al. (2016).

Investing in infrastructure

Even before the Great Recession there were calls to restore public investment levels that had fallen dramatically in recent decades. In the early 1990s, a substantial body of

literature identified the slowdown in public investment as a key driver of the slowdown in productivity growth that began in the early 1970s. The productivity acceleration that began in the late 1990s—driven largely by investment in information and communication technology equipment—took the issue of slow productivity growth off of the policy radar for a number of years.

However, productivity growth began decelerating before the Great Recession and since 2007 (the last business cycle peak) productivity has grown as slowly as it did from 1973 to 1995. In short, sluggish productivity growth is clearly back on the policy radar. Aside from a short burst associated with the American Recovery and Reinvestment Act (ARRA) of 2009, public investment has also continued to decline as a share of the overall economy in recent years.[7]

Bivens (2012a) notes that a new wave of research on the productivity impacts of public investments strongly indicates large returns from greater public investment. In fact no other policy is as likely to reliably boost productivity growth in coming years as an expansion of the public capital stock.

Nontraditional public investments

The evidence surveyed in Bivens (2012a) applied mostly to "core" public investments: infrastructure, roads, highways, and sewer systems. However, Bivens (2012b) points to several noncore areas of public investment shown by independent research to be strongly productivity-enhancing. Early childhood education, "green investments," school construction, and public health care financing all provide large economic benefits.

Further, a growing body of research indicates that many programs considered first and foremost as income-support programs—such as the Supplemental Nutritional Assistance Program (SNAP, or food stamps) and Medicaid—have a strong *investment* component to them as well. This investment function is in the form of the improved prospects for a healthy and productive life that they provide their beneficiaries (particularly children).[8]

Policies to ensure that markets are competitive and efficient

For too many people pontificating about the need to make overall growth the top priority, regulation is a bogeyman. This shows a deep misunderstanding of basic economics. While regulations sometime seek to target non-economic goals or to redistribute economic gains, more often they aim to provide a correction to obvious market failures. These market failures can include a tendency for certain industries to become concentrated and noncompetitive, the existence of "externalities" (economic costs of a given activity that do not have to be paid by those undertaking the activity), or asymmetric information in key markets such as finance. The role of government in ensuring that markets remain competitive and efficient is one that not just makes the economy fairer, it also makes it more efficient.

Policies to ensure that markets remain competitive and to restrain monopoly power

Recently, many have argued that the progressive economic agenda should include measures to check monopoly power and ensure that markets remain competitive. For example, it is now widely recognized that a key driver in the rapid growth of American health care costs in recent decades has been the rapid growth in the prices of pharmaceuticals and medical devices—both industries are granted monopoly protection through patents. This monopoly power provides market power and shields these industries' profits from competition, and skews incentives in other ways. For example, the benefits of patenting a new drug lead to clear incentives to cut corners in the testing process.

The large increase in the share of overall national income claimed by capital-owners instead of employees suggests that growing market concentration across the entire economy may be happening, providing firms with excess profits and reducing households' living standards by raising prices above competitive levels.[9]

The effort to ensure that markets are competitive does not have to rely just on antitrust regulation, however. There are many opportunities to introduce competition to private markets by offering consumers a public option. The most famous public option was the proposal in early versions of the Affordable Care Act (ACA) to allow people to buy health care from a government-run insurance plan. This remains a good idea that should be a key focus of efforts to continue the valuable reform started by the ACA.

Further, the public option logic—simply offering a choice to consumers when private markets become concentrated or dysfunctional—applies to many other markets. For example, American housing finance should include a truly public option instead of the destructive public/private hybrid that the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac were before the 2008 crisis. That is, housing finance should be run by public employees who are paid well but not with the obscenely large salaries earned by the GSE directors before the crisis. And if private-sector financial institutions want to compete on price and service with the public GSEs, they should feel free.

A public option for retirement savings would also be an excellent idea. As recent regulations promulgated by the Department of Labor make clear, Americans are too often ill-served by the financial advice they get from private planners. They are frequently steered into high-turnover retirement plans that generate large fees, which eat into their net returns. Having a government savings plan that pooled savings and managed them with very low fees (by putting the money in mostly passive index funds) would provide a huge service to American savers. By checking monopoly power, all of these efforts would boost both economic efficiency and growth as well as direct a large share of economic growth to workers and households instead of just owners of capital.

Finally, the same logic that argues for expanding public options for health insurance and retirement savings argues for expanding the existing public options we already have in those areas: Social Security, Medicare, and Medicaid.

Squeezing out wasteful rents in the financial sector

Another item high on the agenda of progressive economic reformers is to reregulate many of the activities of the financial sector. Much of the argument surrounding this need for reregulating finance highlights the role that this sector played in amplifying the economic shocks that led to the Great Recession.

However, an even more compelling reason to consider financial regulation a crucial part of the progressive growth agenda is simply that much of what finance does—manage risk and allocate capital—*could be done for a lot less money*. Finance has grown from 2.8 percent of overall gross domestic product (GDP) in 1950 to 4.9 percent in 1980 to 8.3 percent in 2006, its pre–Great Recession peak (Greenwood and Scharfstein 2013). Despite this growth in total income claimed by finance, a large body of research notes that productivity growth in finance has been stagnant over long periods of time, and that much of what the sector has been paid to do in recent decades is to hide, rather than manage, risk.[10] Further, the fees and commissions that have played an outsized role in boosting the financial sector's share of overall income arguably have not played an efficiency-creating role for the economy at large, and have served instead to simply enrich well-placed actors within finance.

The simplest part of the financial reform agenda that could squeeze out this kind of wasteful rent-seeking from finance would be the provision of a broad-based financial transactions tax (FTT). [11] A primary rationale for an FTT is that it's an unambiguously progressive revenue-raiser.[12] But the evidence on the FTT shows that it reduces trading volumes (and hence traders' fees) nearly one-for-one with the size of the tax. Academic research suggests that for an already finance-rich economy such as the U.S. economy, this check on the growth of the financial sector could actually be beneficial for overall growth, as more resources would be directed to sectors with higher marginal returns.[13]

Mitigating global climate change, through any policy means necessary

Perhaps the highest-priority item on the progressive economic reform agenda is the mitigation of global climate change. While the aggregate damage from failing to mitigate climate change would be so large and catastrophic that it should make mitigation a top priority for anyone of any political stripe, this damage is likely to be steeply regressive as well. Internationally, this is almost a given; poorer countries are certain to suffer larger (proportionate) costs from climate change. But even in the United States, two of the most straightforward costs of climate change will be higher energy costs of air-conditioning and refrigeration and higher agricultural costs due to water scarcity. Energy and food costs are much larger items (proportionately) in the consumption basket of lower-income households. So, while the first, and sufficient, imperative for climate change mitigation is its aggregate costs, urgency for action is greatest for those at the bottom and middle of the distribution.

The most economically efficient mitigation measure would involve increasing the market price of greenhouse gas emissions, either through a tax or through tradeable permits that

auction off the right to emit greenhouse gases. But since this route of using market pricing for emissions requires legislation that Congress has not yet seen fit to pass, there are many other measures that could be taken to make serious progress on reducing emissions. For example, the Obama administration has passed regulations restricting emissions from electrical power generators and other regulations that boost the efficiency of automobiles.

Further, public investments in energy efficiency (tax credits for residential or commercial efficiency improvements, for example) could also be used to mitigate emissions. Investments in efficiency and/or renewable energy capacity could be undertaken for federal land and structures. More states could require that a portion of electricity generated come from low-emissions sources.

Far too often, efforts to mitigate climate change are framed as a trade-off between environmental health and economic growth. This is clearly wrong. Until the full social cost of greenhouse gases is priced into decisions, the economy is operating inefficiently, investing in too much greenhouse-gas-emitting capital and too little in greenhouse gas mitigation.[14] But contrary to too much emphasis in the climate change debate, we need not approach this issue as "put a market price on carbon or bust." Instead, until a correct market price on greenhouse gas emissions is achieved, efforts to reduce these over- and under-investments in emissions and mitigation through other policy tools like regulation will still be clearly growth-boosting relative to the *status quo*. In short, efforts to mitigate global climate change are efforts to boost economic efficiency and growth, period. This includes "second-best" measures such as regulatory changes and mandates.

Policies that are often sold as growth-promoting but just primarily spur regressive redistribution

Strangely, those arguing most strongly that promoting overall growth must take precedence over progressive redistribution generally do not mention most of the policies discussed above, even though these are some of the strongest growth-promoting policies we have. Instead, the policies most often put forward under the growth rubric include cutting income tax rates, cutting regulation, and signing trade agreements. Yet the evidence that such maneuvers boost overall growth rates is extremely thin. And the evidence that these policies simply redistribute income to people at the top is plentiful.

Cutting tax rates

Top marginal income tax rates were much higher during the higher-growth decades before 1979 than after. And since 1979, the fastest rates of economic growth and productivity growth came in years shortly following the 1993 tax increases. In contrast, by all measures economic growth was historically sluggish in the early 2000s recovery and expansion following the tax cuts of 2001 and 2003. Academic studies have confirmed that there is severely limited evidence that cutting tax rates has measurable effects on growth.

But because the income tax (both individual and corporate) remains notably progressive relative to most other federal and state taxes, this means that cutting income tax rates almost always disproportionately boosts the post-tax incomes of households at the top of the income distribution. Further, recent evidence indicates that cutting top marginal rates can even regressively redistribute *pretax* income. The theory proffered (and which is consistent with evidence) for this effect is what the authors call the "bargaining channel." Essentially, because some influential economic actors—corporate managers and finance-sector professionals in particular—operate in markets largely undisciplined by competition they have substantial influence over their own pay. They weigh the benefits of engineering large pay raises for themselves against a number of costs, including other employees' morale or the outrage of shareholders and/or the wider public should their pay raise gain attention. This trade-off becomes sharper when top marginal tax rates are high—the benefits of ignoring other constraints and claiming large shares of enterprise income are much lower when the top marginal tax rate is 70 percent versus when it is 35 percent. So as top marginal rates have been lowered in recent decades, this has boosted the incentive for well-placed economic actors to maximize their take-home pay, even in the face of other potential constraints.

Cutting federal regulation

The data on the macroeconomic benefits of slashing federal regulations are just as scarce as on any large benefits of tax cuts. Given that proponents of this strategy tend to be maddeningly nonspecific about which regulations they would like to roll back, it is hard to know how to test their claims.

But we do know that advocates of paring back federal regulation tend to offer deeply misleading research supporting their claims. For example, a long vein of research undertaken by Lafayette College economists Nicole and Mark Crain simply puts a subjective measure of "regulatory burden" in a cross-country regression relating levels of gross domestic product (GDP) to their possible determinants. Besides the numerous other problems that tend to plague such work, these subjective measures of regulatory burden tend often to simply consist of interviews with corporate managers.

For example, the 2014 Crain and Crain report undertaken for the National Association of Manufacturers (NAM) uses as its independent variable a simple average of three surveys of subjective opinions of business executives about (1) the burden of government regulation, (2) the efficiency of the legal framework in challenging a regulation, and (3) the regulation of securities exchanges. The surveys simply ask executives to rate, say, the burden of government regulation from 1 to 7, with 1 being "extremely burdensome" to 7 being "not burdensome at all." The benchmark against which U.S. performance is measured is simply the scores of the five highest-performing countries on each measure. These countries are generally some subset of the following: Norway, Finland, Sweden, the Netherlands, Luxembourg, Australia, and New Zealand. It is extremely unclear just what it could mean for regulatory policy to move the U.S. score on subjective regulatory burden from 3.4 to the five-country benchmark average of 4.4. For example, what possible specific policy tool or regulatory action could this map onto?

Further, it is worth noting that the three indices averaged together could well be telling very different stories. The first index is a measure of regulatory burden as assessed by business executives. This is straightforward enough (if incredibly difficult to interpret or operationalize). But the third index is "how *effective* is securities regulation in your country?" For some people, effective securities regulation would imply very tight limits on what financial intermediaries can do. For others, effective regulation would imply a light regulatory touch. Again, operationalizing any claim that the U.S. should simply "increase" its score on this index is impossible.

Additionally, it is worth noting two more things. First, the low score of the United States on these regulatory indices could in fact be driven by state and local regulations. Second, this low score could be driven simply by a more partisan or ideological business class in the United States relative to other countries. The clearest thing that the three indices used by these studies seem to be saying is that business executives in Scandinavia and Oceania are less bothered by government regulation than are U.S. executives. This could be because regulations really are more economically expensive in the United States, or because U.S. business executives are simply more partisan and ideological than their international peers.

Is there any *prima facie* case to doubt claims that growing regulatory burdens impose a large and growing drag on American growth? Well, yes. Were regulations burdening businesses specifically (a key claim of those pushing to pare regulations), they would be hurting profitability by boosting the cost of doing business. And yet profitability in the United States in recent years has certainly not suffered from anything outside the effect of the Great Recession. Profit margins in 2006 and 2007, right before the Great Recession, were high in historical perspective, and after falling sharply during the recession, in recent years they reached their highest levels in nearly five decades.[15]

Finally, as we noted above in our section on global climate change mitigation, many regulations are attempts to solve market failures, or to at least ameliorate their impacts. Clean air and water regulations, for example, are largely attempts to fix the fact that too much pollution can essentially be emitted for free, leading to inefficiently large amounts of it. In this sense, regulation clearly boosts efficiency and growth.

Trade agreements

A final item on the agenda of those arguing for growth over distribution is signing more trade agreements. Economic theory does suggest that reducing trade barriers in the U.S. economy should boost overall national income. This theory suggests equally as strongly, however, that this boost to overall income will be accompanied by substantial regressive redistribution of income, potentially leaving *most* American workers worse off than they were before trade barriers were cut.[16]

Crucially, trade *redistributes* significantly more income within the United States than it creates—on the order of five to six times more. In short, even trade agreements that simply cut barriers to trade would actually likely end up damaging the living standards of much of the bottom 90 percent.

And even the most optimistic estimates of the growth-spurring effects of more trade agreements are modest. Take for example estimates of the growth that would be spurred by signing the Trans-Pacific Partnership (TPP). By its proponents and the media, the TPP is often described in breathless terms as an "enormous" agreement because the countries involved in it constitute "40 percent of the global economy." Yet its growth effects in the U.S. will be on the scale of a small rounding error.

A paper by Petri and Plummer (2012) for the Peterson Institute for International Economics (PIIE) estimates that the proposed TPP would increase U.S. GDP by about 0.4 percent *cumulatively* over the next 12 years. And this estimate is actually a significant increase relative to an earlier estimate that the same authors and a colleague (Petri, Plummer, and Zhai 2011) justify by incorporating assumptions that are extremely favorable to showing a large trade impact.[17]

Finally, much of the theoretical discussion about what will happen when trade barriers are cut is moot. Actual existing and proposed trade agreements do not, in fact, simply pull down barriers to trade across the board. Instead, they pull down some barriers and erect others.

In the TPP, for example, protections for holders of patents in many countries would be strengthened, not reduced, by the treaty. This TPP-driven protectionism would severely blunt any growth-promoting effect of the treaty by forcing consumers of patent-protected goods (pharmaceuticals, most importantly) to pay higher prices. And virtually no economic models of the effect of the TPP take this into account; instead the treaty is nearly always modeled simply as a reduction to trade barriers. Finally, the trade barriers that trade agreements strengthen nearly always protect the incomes of those at the top of the income distribution, making the redistributive effect of these agreements even worse.

In short, even if real-world trade agreements simply reduced trade barriers (as modeled in economic textbooks), this would have much stronger effects on distribution than growth. The growth effects, in fact, would be essentially invisible in the data. And yet trade agreements do not simply reduce trade barriers; they reduce some and increase others. The strategy of signing more trade agreements has no relevance to good-faith debates over how to spur overall growth.[18]

Progressively redistributionist policies that do *not* drag on overall growth

The previous two sections have shown that many policies marketed as progressive redistribution actually have strong growth-promotion effects and many policies marketed as growth-oriented actually have minimal effects on growth but are strongly regressive.

But what about progressive policy changes whose first-order effects really are likely to be overwhelmingly redistributionist? The most obvious examples of such policies use the tax-and-transfer system to directly channel income to households (Social Security, food stamps, housing assistance, Medicare and Medicaid, for example). These transfers have

been the key to much of the meager income growth actually achieved by the bottom 90 percent over the past generation, so it is vital that they be at least preserved, if not expanded. And there is a growing recognition that direct fiscal redistribution—at least on the comparatively modest scale done in the United States—is not harmful to overall growth and may be helpful.

Besides direct fiscal transfers, however, there is much that policymakers can do to help the pre– tax-and-transfer incomes grow more equally over time. The key policies in this regard are regulations and institutions that help shift bargaining leverage from capital-owners and corporate managers to low- and middle-income workers. Policy initiatives to affect the pre– tax-and-transfer distribution of income through labor market regulations and institutions are often criticized on the grounds that they will introduce inefficiencies into otherwise well-functioning markets. Is there any reason to genuinely worry about such inefficiencies?

In the textbook models taught in introductory economics courses to undergraduates, many such policies would indeed reduce economic efficiency. But in the real world, evidence that labor markets in particular fit the caricature of perfectly competitive Econ 101 markets is obviously lacking.

Take the example of minimum wages. In the simplest textbook models, minimum wages lead to unemployment, as higher wages increase labor supply and reduce labor demand. Yet in the real world, ample evidence suggests that minimum-wage increases by U.S. states in recent decades (some of which were quite substantial—on the order of 20 percent in a single year) have had no measurable impact on employment, even while they significantly raised wages for affected workers.[19]

Or take the example of unionization. Again, the simplest textbook models would suggest that unions act as a cartel that drives the price of labor above market-clearing wage levels and simply leads to reduced employment. But evidence shows little to no impact of unionization on employment changes or the probability of firms going out of business.[20] However unions are associated with higher wages for members and for nonunion workers in heavily unionized industries, and are associated with lower levels of executive pay.[21]

Finally, take the recent results, noted earlier, by Piketty, Saez, and Stantcheva (2011) on the economic effect of cutting or raising top marginal tax rates. High marginal rates (as we noted above) do not seem to significantly reduce the labor supply of high-wage workers, but they do seem to reduce their pretax pay. Further, high tax rates on high-income workers seem to be associated with *higher pretax* incomes and wages for other workers, those who are not high income. According to Piketty, Saez, and Stantcheva (2011), these results show that tax rates change how hard high-income workers are willing to bargain for their share of a firm's surplus. When tax rates are high, the costs incurred (perhaps in the form of public backlash against exorbitant salaries or extremely low pay for rank-and-file workers) by bargaining for higher pretax pay may become prohibitive. When tax rates are low, high-income workers might become much more willing to ignore such "outrage constraints" when bargaining for their own pay, since they get to keep so much more of it.

In short, the effects of higher minimum wages, greater unionization, and higher top tax rates seem to be *strongly* redistributive, yet have little measurable effects on overall income levels or growth. This suggests that the simplest textbook labor-market models are inadequate for analyzing the impact of these policy changes. Luckily, numerous other labor-market models are available that seem much more consistent with the outcomes following minimum-wage changes and unionization.

Efficiency wage models, for example, predict that the level of wages determines not just the composition of a firm's potential workers but also the level of effort made by workers.[22] Higher wages induce more effort and higher productivity and can hence be (at least partially) self-financing. Search theory models predict that numerous frictions in labor markets can put a wedge between workers' wages and productivity and make it hard for firms to attract the right number and kind of workers. These frictions can include geographic mismatch between workers and firms, "thin" labor markets with fewer possible matches between workers with given skills and employers needing them, and informational failures. Monopsony models imply that offering higher wages can increase the available pool of workers to employers, thus higher mandated wages can actually *increase* employment levels.[23]

All of these imperfectly competitive labor-market models lead one back to an earlier insight made by Richard Lester: while supply and demand might put some bounds on the feasible range of wages, precise wage levels for any given worker can fall anywhere within these bounds. And these bounds might be quite wide, allowing for great variation in wages based on institutional factors. This in turn means that policies aimed at boosting wages of low- and moderate-wage workers by providing institutional support for their bargaining position vis-à-vis employers might have room to be quite effective before running into any efficiency trade-offs. Besides minimum wages and unionization, there are a range of regulatory and legislative changes to labor standards that could bolster these workers' bargaining position, including strengthening the protections provided by overtime regulations (as done by the recent federal rule raising the overtime pay threshold), outlawing forced arbitration that keeps workers from bringing lawsuits against employers, combatting wage theft, regularizing currently undocumented workers, and mandating paid leave, just as some examples. The insight that institutions and economic leverage and bargaining power strongly condition the distribution of income while not much affecting economic efficiency has been resuscitated in recent years by many economists, perhaps most explicitly by Robert Solow (2015) and Alan Manning (2015).

Of course, measures that do not affect *overall* growth but do channel more money to the broad middle class will, by definition, restrict the scale of rewards going to the very top. This will make enacting these measures *politically* hard to do: rich households in the U.S. have their economic interests well-policed by many policymakers. As a normative proposition, however, it is hard to be too worried if the very rich had to make do with somewhat slower income growth than they've gotten used to in recent decades.

Conclusion

Recommendations to focus only on measures to boost growth and to ignore measures that can progressively redistribute income are essentially recommendations to fight the battle for boosting incomes for the vast majority with our hands tied behind our backs. The primary impediment to rising incomes for the vast majority in recent decades has been the regressive redistribution of income that has occurred during that time. Ignoring that trend and making no attempt to stop or reverse it would be a prescription for failure in delivering rising living standards to America's vast majority.

Further, when it comes to boosting incomes for the vast majority, it is far harder to identify policy levers that would reliably and predictably boost overall growth than it is to identify levers that would progressively redistribute income. To put this another way: we're just not that sure why overall growth rates slowed so significantly after the 1970s. And we're certainly not sure what policy lever could reverse this slowdown. This is not to counsel despair. There are very plausible intelligent policies we could undertake to boost growth. Luckily, as this report shows, many of them would also progressively redistribute income. But if we want to ensure that the living standards of the vast majority rise in the next decade, we need to embrace policies explicitly aimed at progressively redistributing income.

Crucially, even the slower overall growth rates that have prevailed since 1979 could have fostered significant cumulative growth in living standards for the bottom 90 percent had they been distributed equitably. In short, the disappointing income growth for the vast majority is largely not an economic problem. The country has generated and will likely continue to generate steady and significant economic gains over time. Instead, the problems of the bottom 90 percent are largely political. The rules of the game governing the American economy have shifted bargaining power away from the bottom 90 percent and toward capital-owners and corporate managers at the top. It will be a heavy lift to solve this political problem—but it is still a better problem to have than genuine economic scarcity.

About the author

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Endnotes

1. As we show later, it is unquestionably true that a much higher share of average growth in *comprehensive* income (not just cash, market-based income) was captured in the pre-1979 period by the bottom 90 percent as well.

2. Of course, theoretically a faster increase in transfers in the pre-1979 period might not have benefited the bottom 90 percent if these transfers were more directed to the top 10 percent in that time. This seems highly unlikely, however. In the post-1979 period, transfers are very progressively distributed and there is no trend at all in their distribution. It seems very safe to assume this roughly characterizes their distribution and trend (or lack thereof) in the pre-1979 period as well.

3. If one uses size-adjusted households, or person-equivalent incomes, the influence of inequality relative to the overall growth slowdown moderates—but even in person-equivalent income terms, the influence of inequality is at least as large as the slowdown in overall growth rates.

4. See Baker and Bernstein (2013) for the benefits of genuine full employment and why they are attainable.

5. See Heckman et al. (2010) and Lynch (2007) on the measured benefits of early childhood education.

6. Lynch (2007) finds that even a universal high-quality pre-K program for 3- and 4-year-olds that costs $40 billion annually would become *fiscally self-financing* through growth effects within two decades.

7. See Bivens (2013) for trends in public investment.

8. See Almond, Hoynes, and Schanzenbach (2011) and Hoynes, Page, and Stevens (2011)for evidence on food stamps and future health and economic outcomes of children. See Rossin-Slater (2013) for evidence on the Supplemental Nutrition Program for Women, Infants and Children (WIC). See Brown et al. (2015) for the effect of access to Medicaid on future earnings and tax receipts.

9. The problem of policy-induced scarcity pushing up key prices for households is perhaps most pronounced in coastal housing markets in the United States. The return to housing ("rents" in the layperson's sense of the term) are rising as a share of national income as well, and much research has shown that this is driven by the rising price of land on the coasts around rich cities (such as New York, Boston, San Francisco, Seattle, and Los Angeles). A prime suspect in keeping expansions of housing supply from blunting the rise in land prices is the practice of passing land-use regulations that restrict housing supply (for example zoning ordinances allowing only single-family homes of a certain size be constructed in particular neighborhoods). These land-use regulations are universally imposed at the subfederal level, so one cannot really blame federal action for failing to address them. But it is true that while cutting regulations holds so little promise as a growth strategy at the federal level, it may well reap some fruit if it focuses on land-use restrictions at the state and local levels.

10. See Philipon (2012) on the declining productivity of finance, and Haldane, Brennan, and Madouros (2010) and Biais, Rochet, and Woolley (2010) for the role of risk-shifting in boosting the measured productivity and income of the financial sector.

11. Here we are defining economic "rents" as the income earned by a factor of production in excess of what is necessary to induce its supply. In essence, the economy could get the same level of financial services—the same employees, technology, and capital—at lower levels of sectoral remuneration.

12. See Burman et al. (2015) on the progressivity of an FTT.

13. See Cecchetti and Kharroubi (2015) for why financial sector growth can reduce growth in the rest of the economy.

14. See Rezai, Foley, and Taylor (2012) or Foley (2007) for the economics of global climate change and why economies are inefficient until the carbon externality is priced.

15. For trends in corporate profit shares (which are driven in the short run by profit rates), see the EPI nominal wage tracker page: http://www.epi.org/nominal-wage-tracker/

16. For more on the theory and evidence regarding this dynamic, see Bivens (2008).

17. For example, a footnote in their study says, "The modeling framework is based on recent developments in heterogeneous-firms trade theory, in contrast to the country-differentiated-goods approaches of past studies. This theoretical structure helps to correct the systematic underestimation of benefits that emerges in retrospective studies of the actual and projected effects of substantial free trade agreements."

18. For some ideas of what genuinely progressive and growth-promoting international trade agreements might look like, see Bivens 2015.

19. See Dube, Lester, and Reich (2010) for the clearest evidence of this.

20. See DiNardo and Lee (2004) for the non-effect of unionization on firm closures.

21. See DiNardo, Hallock, and Pischke (2000) on unions and managerial pay, and Rosenfeld (2015, forthcoming) on the spillover effect of unionization.

22. Bowles (1985) and Shapiro and Stiglitz (1984) are the canonical efficiency wage models.

23. Manning (2003) is the most comprehensive statement of the theory of labor market monopsony.

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