Closing Keynote Address
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Chairman, Joint Economic Committee

Good afternoon.

Growth Gap

Our economy suffers from a large and widening "Growth Gap" between the current recovery, which started in June 2009, and an average post-1960 recovery. These are the indisputable facts:

- Real GDP growth has averaged 2.4 percent in the current recovery compared with 4.1 percent in an average recovery. That produced a real GDP gap of $1.3 trillion in the fourth quarter of 2013, or $3.6 trillion cumulatively since the recession ended.

- Our economy has generated 7.3 million new private payroll jobs since the recession ended, but that still leaves a gap of 5.5 million jobs compared with an average recovery.

- The unemployment rate has fallen from a peak of 10.0 percent in October 2009 to 6.6 percent in January 2014. Much of this decline is a statistical mirage due to falling labor force participation. Had the labor force participation rate remained constant since President Obama took office in January 2009, the unemployment rate would be 10.5 percent today. The Administration excuses this drop in labor force participation due to the aging of our population. However, the nonpartisan Congressional Budget Office (CBO) found that changing demographic factors explains only half of this reduction.[1]

- Finally, one segment of our economy—Wall Street—is booming while families and small businesses on Main Streets across America are just muddling through. From the end of the recession in June 2009 through the end of 2013, the S&P 500 Total Return index, adjusted for inflation, grew by 105.5 percent. In contrast, real disposable income per capita inched up by merely 3.4 percent. If this recovery had been merely average, the average American would have enjoyed $3,850 more in real disposable income per capita just last year alone.

Overview

In the context of this anemic recovery, President Obama raised the issues of economic inequality and mobility. These are real issues. Indeed, the JEC Republican staff has conducted extensive research on economic inequality and mobility that is available on the JEC's website.[2]

We are not all blessed with equal desires and talents. Therefore, we should not expect equal outcomes. In America, however, everyone should have an equal chance to climb the ladder of success—driven upward by his or her initiative—and to achieve his or her American dream.

What role should Washington play in addressing economic inequality and mobility? President Abraham Lincoln—perhaps the greatest "equalizer" to inhabit the White House—provided the answer.

In his message to Congress on July 4, 1861, he made clear that the proper role of government in promoting economic opportunity is "to elevate the condition of men - to lift artificial weights from all shoulders - to clear the paths of laudable pursuit for all - to afford all, an unfettered start and a fair chance, in the race of life."

Economic Inequality

Before offering solutions, we must first understand economic inequality. Economists disagree on how to measure changes in the distribution of income over time. While measurement issues may sound trivial, different techniques produce conflicting results.

For example, Thomas Piketty and Emmanuel Saez found the top one percent received nearly 20 percent of income in 2010 by attributing pre-tax, pre-government benefits income to tax units.[3] In contrast, the Congressional Budget Office (CBO) found that top one percent received 13 percent of income in 2010 by attributing post-tax, post-benefits income to households.[4]

Using the definition and measurement unit of Piketty and Saez, income inequality has widened significantly since 1979. Piketty and Saez have generated a so-called "Golden Gate Bridge" chart showing that the share of income earned by the top 10 percent reached a new high, rivaling the previous high of the late 1920s.[5] Using an alternative definition and measurement unit, however, the CBO paints quite a different picture—a far smaller rise in income inequality since 1979.[6]

There are other measurement issues as well. Household demographics have changed; and accounting for these changes affects the results. Likewise, the choice of price deflators yields significantly different results.

Piketty and Saez claim that the growth of real median household income has stalled. For example, using pre-tax, pre-benefit income data for tax units, Piketty and Saez found that real median household income rose by only 3.2 percent from 1979 to 2007. However, this finding was driven by their choice of measurement techniques. After accounting for the changing size of households, taxes, government benefits, and employer-provided health insurance, Richard Burkhauser found the median real household income has actually risen a sizable 36.7 percent from 1979 to 2007.[7]

Moreover, income does not equal wealth. An elderly woman may have substantial wealth, but a modest income from Social Security, private pensions, and interest and dividend payments. Conversely, a couple of young engineers that have recently graduated from Rice University may have a high income, but a negative net worth because of student loans.

On balance, the empirical studies have found a modest increase in income inequality over the last several decades in the United States and other countries. The most important cause of this increase has been proliferation of and innovations in information technology. Computers and computer-driven machinery have vastly increased the marginal productivity of highly skilled workers in cognitive, creative jobs (such as engineers). Skill-biased technological change has increased the demand for workers with college, professional, and post-graduate degrees, boosting their "wage premium" over workers with only a high school education.

At the same time, many less-skilled workers with repetitive jobs (such as assembly-line workers or bookkeepers) are effectively competing with workers around the world. Some of these workers have lost their jobs while others have had their wages squeezed. Skill-biased technological change has indirectly increased the wages of workers with manual, creative jobs (such as chefs and landscapers) as growing income earned by highly skilled workers boosted the demand for certain labor-intensive services.

Skill-biased technological change is not limited to the United States; rather it is a global phenomenon. The Organization for Economic Cooperation and Development (OECD) found that skill-biased technological change and globalization are major contributors to increasing income inequality around the world.[8]

Politically, these two factors are driving the perceptions of a "middle-class squeeze" and rising income inequality in America.

Economic Mobility

Economic inequality is less troubling if economic mobility is strong. There are two concepts of economic mobility—absolute and relative.[9]

In absolute terms, this generation is better off than previous generations. From 1967 to 2009, the percentage of U.S. households with real annual income below $75,000 fell, while the percentage earning over $75,000 increased. Recessions may temporarily reverse this trend, but roughly one-in-three households currently earn more than $75,000 in real income—up from just one-in-seven in 1967.[10]

In contrast with absolute mobility, relative mobility encompasses the ability of individuals that are born into one income class to rise or fall into other classes over the course of their lives.

The interaction between absolute and relative mobility is complex. While a full 93 percent of those in the bottom fifth (quintile) achieve higher income than their parents, 57 percent have both higher income and have moved up a quintile. Similarly, though 70 percent of those in the top fifth have higher income than their parents, only 38 percent have stayed within the top fifth with higher income.[11]

More Americans are achieving at least the top 2 percent of income at some point in their working lives; recent research finds that 21 percent of working Americans achieve that threshold at some point before they turn 60 years old, a figure which has more than doubled since 1979.[12]

As Scott Winship observed in recent testimony before the JEC, relative mobility in the United States has not declined in recent years, but it has not increased either.[13]

Characteristics of Economically Mobile Individuals

Personal decisions greatly affect one's economic mobility. According to the Brookings Institution, individuals born into bottom fifth who (1) graduated from high school, (2) got a job, and (3) reached the age of 21 and married before having children, had a 2 percent chance of living in poverty and a better than 70 percent chance of upward mobility into the middle class—defined as $65,000 or more in household income. Those who did not meet any of the three criteria had a 77 percent chance of living in poverty and a 4 percent chance of mobility into the middle class.[14]

In a Pew Charitable Trusts analysis, 86 percent of college graduates, 84 percent of dual-earning families, and 64 percent of people who were continuously employed left the bottom fifth; by contrast, only 55 percent of non-college graduates, 49 percent of single-earning families, and 34 percent of people who experienced unemployment moved up from the bottom fifth.[15]

Public Policy

Skill-biased technological change and globalization have modestly increased income inequality over the last few decades. Economic mobility has remained relatively stable in the United States, but it is not as high as some other developed countries. Moreover, one's economic mobility depends, in large part, on personal decisions about education, employment, marriage, and children.

What role should government play in ameliorating economic inequality and enhancing economic mobility? There are four areas, in which a limited, constitutional government can be helpful.

Closing the Growth Gap

First, Washington must change its economic policies to close the Growth Gap by:

1. Reforming the federal tax system. We need to end the tax code's "war on work". We need to replace the current system with one that is built for growth. That means a simpler and flatter system with lower marginal tax rates on both labor and capital;

2. Replacing the Federal Reserve's current dual mandate with a predictable, rules-based monetary policy that focuses on preserving the purchasing power of the dollar;

3. Beginning the process of addressing our unfunded liabilities by reforming Social Security, Medicare, and Medicaid to make these programs permanently solvent;

4. Restoring balance and common sense to the regulatory process by mandating cost-benefit and risk analyses for all new federal regulations; and

5. Accelerating the opening of new markets for American exports by granting trade promotion authority to the President.

Providing Quality Education

Second, education and training are keys to one's success. During the 19th century and early 20th century, Americans were the most literate and numeric people on Earth. This skill advantage propelled the United States to become the world's largest economy and build a strong middle class.

Now our children are falling behind their future competitors worldwide in math and science. While we have some excellent public schools with outstanding teachers, too many children—especially those from minority families—are trapped in failing schools that do not provide them with the skills necessary to prosper in tomorrow's economy.

Yet, two teachers unions have pressed Democratic lawmakers in Washington and state capitols to block any education reform—merit pay, charter schools, or school choice plans—that would interject accountability and competition into primary and secondary education.

States and local governments, not Washington, have the primary responsibility for education. Across America, Republican governors and state legislators are working to improve public schools, create charter schools, and facilitate choice for poor and middle-class parents whose children are assigned to failing public schools. However, Congress can facilitate these promising policies, as Senators Lamar Alexander and Tim Scott have proposed, by removing all federal roadblocks to public school reform, charter schools, and school choice.

Congress has committed that every qualified young American, regardless of his or her financial circumstances, should be able to obtain a college degree or advanced vocational training. To fulfill this commitment, Congress has increased the real amount of federal student aid by 438 percent over past three decades.[16] While the explosive growth in aid may have broadened college access for some, it has reduced college affordability for many others.

A 2007 University of Oregon study found that colleges “tend to absorb most federal student aid by increasing their tuition revenue.” And the Center for College Affordability and Productivity found that a $1 increase in the average student loan was associated with a net increase in tuition of 93¢ at public schools and 55¢ at private schools.[17]

Such tuition inflation has saddled many recent graduates with mountains of student debt. As a result, they are delaying forming families, buying houses, or starting businesses. The student loan crisis is diminishing the potential of our economy to grow. Congress must rethink how we aid college students.

Minimizing Poverty Traps

Third, increasing economic mobility requires Congress to address the restrictions on opportunities for low-income individuals. The interaction between taxes and the phase-outs of social welfare benefits imposes an extremely high effective marginal tax rate on earning additional income. The Urban Institute found that the marginal effective tax rates for a head of household with two children can reach 80 percent or higher.[18]

This phenomenon, known as the poverty trap, discourages low-income individuals from entering the labor force, working extra hours, or seeking career advancement that would contribute to their economic mobility and well-being. Michael Tanner and Charles Hughes found that welfare can pay more than the minimum wage in 35 states, even after accounting for the Earned Income Tax Credit, and in 13 of those states, welfare can pay more than $15 per hour.[19]

Marriage, which promotes economic mobility, is penalized. If a couple earning similar income decides to get married next year, the tax code penalizes these dual earners when changing tax status from single to filing jointly or separately. The Brookings Institution found that among low-income families with a primary earner making $25,000 per year, a secondary earner’s take-home pay can be less than 30 percent once taxes, loss of Supplemental Nutrition Assistance Program (SNAP) benefits, and cost of child care are accounted for.[20]

In the context of comprehensive tax reform, Congress must work to minimize such “poverty traps.”

Ensuring that “First-Rung” Jobs are Available to Teenagers

Fourth, we must encourage the young, especially young males from dysfunctional families, to get their first job. In this regard, the proposed increase in the federal minimum wage to $10.10 per hour is troubling.

President Obama asserts that a full-time minimum-wage worker trying to support a family should not be in poverty. I agree. Indeed, such workers typically receive the Child Tax Credit, the Earned Income Tax Credit, and SNAP benefits. Including the value of these federal benefits, the net income of such workers usually exceeds the poverty level. For such workers, even assuming no job losses, the result of the proposed increase in the federal minimum wage would be lower federal benefits, offsetting much of the higher wages.

However, adults trying to support a family are only a small portion of minimum-wage workers. The majority are teenagers and young adults under age 25.[21] Teenagers have the least education, training, and work experience and are, therefore, the most likely to be laid off or not hired after a large increase in the federal minimum wage. A higher minimum would saw the first rung off the ladder of success for many teenagers.

Federal Economic Statistics

Before I conclude, let me voice my support for improving federal economic statistics.

First, I applaud the improvements in the National Income and Product Accounts implemented by the Bureau of Economic Analysis (BEA) last July. Treating expenditures for research and development and for original artistic creations as investment improves the accuracy of our measurement of GDP. I urge the BEA to work toward treating other business expenditures for intangible assets as investment.

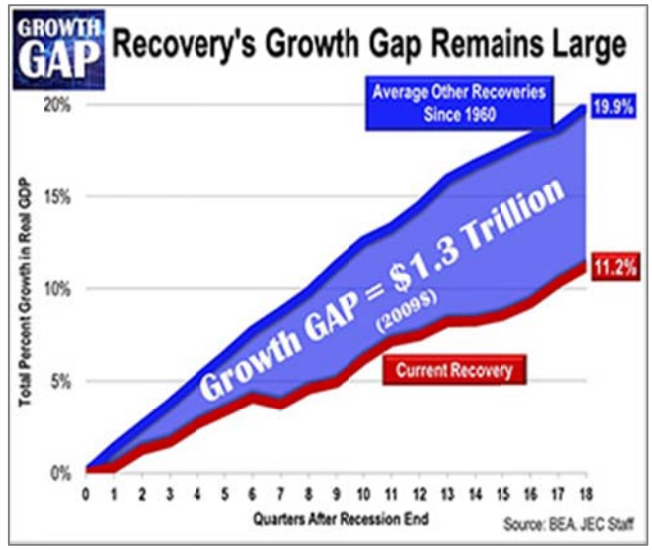
Second, I urge the BEA to develop a value-added approach toward measuring and assigning countries of origin to imports and exports. Cross-border production networks mean that traditional country of origin labeling may be quite deceiving.

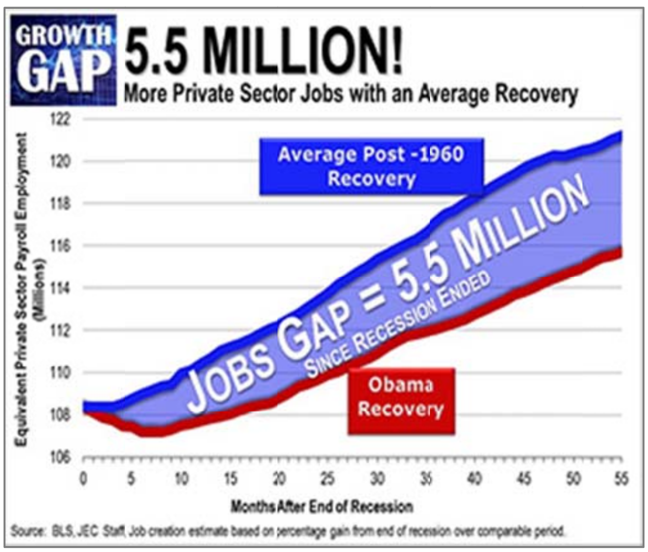
Third, I applaud the Bureau of Labor Statistics (BLS) for its recent modernization of the Producer Price Index (PPI). I urge the BLS to develop asset price indices, especially for residential, commercial, industrial, and agricultural real estate. An important lesson from the recent financial crisis is that stabilizing an index of goods and services prices, such as personal consumption expenditure (PCE) index, is a necessary, but not sufficient, condition for long-term price stability. Sometimes, an overly loose monetary policy can flow disproportionately into asset prices that the PCE index would not capture as inflation. Comprehensive asset price indices would have allowed the Federal Reserve to detect the housing price bubble more easily and to adjust monetary policy accordingly.

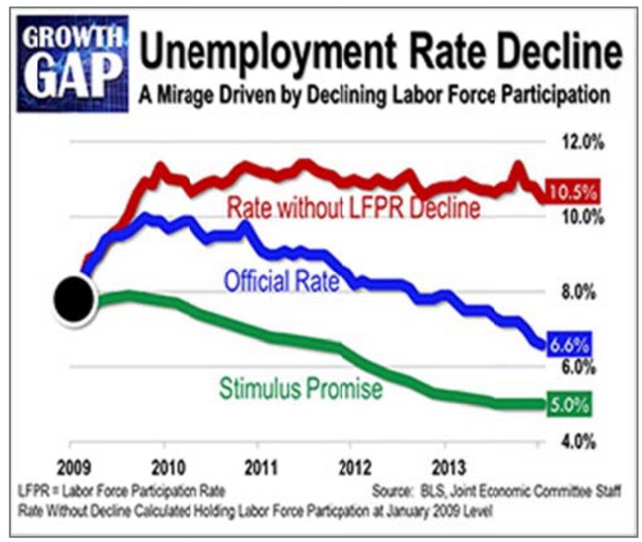
Conclusion

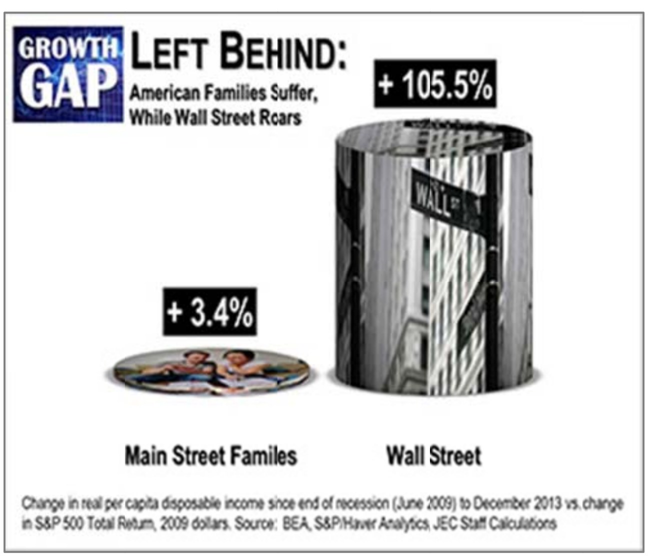
Thank you for your time. I look forward to your questions.

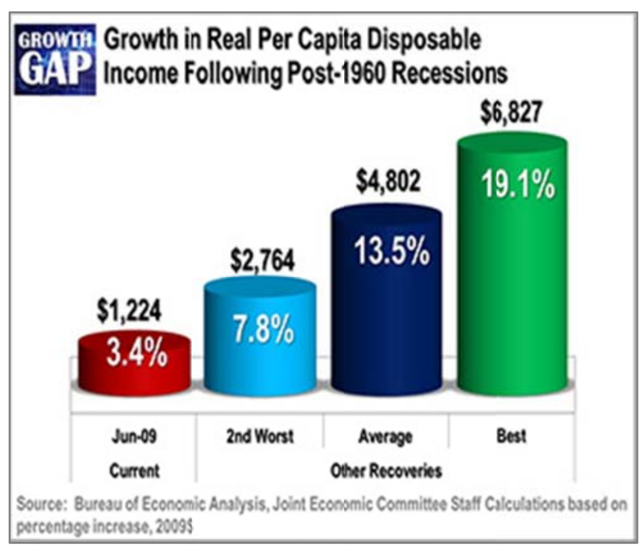

JOBS WAGES INCOME
GROWTH OPPORTUNITY
GAP


GROWTH GAP
Recovery's Growth Gap Remains Large
Average Other Recoveries Since 1960
19.9%
Growth GAP = $1.3 Trillion (2009$)
11.2%
Current Recovery
Total Percent Growth in Real GDP
Quarters After Recession End
Source: BEA, JEC Staff


GROWTH GAP
5.5 MILLION!
More Private Sector Jobs with an Average Recovery
Average Post -1960 Recovery
JOBS GAP = 5.5 MILLION
SINCE RECESSION ENDED
Obama Recovery
Equivalent Private Sector Payroll Employment (Millions)
Months After End of Recession
Source: BLS, JEC Staff, Job creation estimate based on percentage gain from end of recession over comparable period.


GROWTH GAP
Unemployment Rate Decline
A Mirage Driven by Declining Labor Force Participation
Rate without LFPR Decline
10.5%
Official Rate
6.6%
Stimulus Promise
5.0%
LFPR = Labor Force Participation Rate
Source: BLS, Joint Economic Committee Staff
Rate Without Decline Calculated Holding Labor Force Participation at January 2009 Level


GROWTH GAP
LEFT BEHIND:
American Families Suffer, While Wall Street Roars
+ 105.5%
+ 3.4%
Main Street Familes
Wall Street
Change in real per capita disposable income since end of recession (June 2009) to December 2013 vs. change in S&P 500 Total Return, 2009 dollars. Source: BEA, S&P/Haver Analytics, JEC Staff Calculations


GROWTH GAP
Growth in Real Per Capita Disposable Income Following Post-1960 Recessions
$1,224
3.4%
$2,764
7.8%
$4,802
13.5%
$6,827
19.1%
Jun-09 Current
2nd Worst
Average
Best
Other Recoveries
Source: Bureau of Economic Analysis, Joint Economic Committee Staff Calculations based on percentage increase, 2009$

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