THE GROWING INCOME GAP IN THE AMERICAN MIDDLE CLASS

HEARING

BEFORE THE

SUBCOMMITTEE ON WORKFORCE PROTECTIONS

COMMITTEE ON

EDUCATION AND LABOR

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THE GROWING INCOME GAP IN THE AMERICAN MIDDLE CLASS

Thursday, July 31, 2008
U.S. House of Representatives
Subcommittee on Workforce Protections
Committee on Education and Labor
Washington, DC

The subcommittee met, pursuant to call, at 10:08 a.m., in Room 2175, Rayburn House Office Building, Hon. Lynn Woolsey [chairwoman of the subcommittee] presiding.

Present: Representatives Woolsey, Bishop, Shea-Porter, Hare, and Wilson.

Staff present: Aaron Albright, Press Secretary; Tylease Alli, Hearing Clerk; Jordan Barab, Senior Labor Policy Advisor; Lynn Dondis, Senior Policy Advisor, Subcommittee on Workforce Protections; David Hartzler, Systems Administrator; Sara Lonardo, Junior Legislative Associate, Labor; Joe Novotny, Chief Clerk; Michele Varnhagen, Labor Policy Director; Robert Borden, Minority General Counsel; Cameron Coursen, Minority Assistant Communications Director; Rob Gregg, Minority Senior Legislative Assistant; Jim Paretti, Minority Workforce Policy Counsel; Molly McLaughlin Salmi, Minority Deputy Director of Workforce Policy; Linda Stevens, Minority Chief Clerk/Assistant to the General Counsel; and Loren Sweatt, Minority Professional Staff Member.

Ms. WOOLSEY [presiding]. A quorum is present. The hearing of the Subcommittee on Workforce Protections will come to order.

I will now give my opening statement. Following will be our ranking member.

So I want to welcome all of you to this hearing on "The Growing Income Gap in the American Middle Class." But before I proceed with my opening remarks, I think we should all say happy birthday to Ranking Member Wilson. "Happy Birthday."

Mr. WILSON. Thank you very much.

Ms. WOOLSEY. And, you know, Joe, our staff person's birthday is today too. See, it is a nice day.

Income inequality between the top income earners and those in the middle class has been growing rapidly over the last three decades. For a frame of reference, the top one percent of the population, those making $450,000 or more in the year 2006, consisted of 1.4 million tax filers. The gap has grown so wide that some compare the era we live in to the Gilded Age, a period between 1870 and 1900 that was distinguished by the excesses of the rich.

In the 1960s and 1970s, the top one percent of earners took in 10 percent of the total income of this country—now, that is going from the 1960s and 1970s—to 2006, the top one percent of earners took in over 20 percent of the total income pie. The last time the top had this much of total income was in 1928. In addition, the average tax rate for these top earners has fallen to its lowest levels in 18 years.

CEOs are making record salaries, irrespective of performance, and these outrageous amounts affect the growing gap directly. In 2006, the average Fortune 250 CEO was paid over 600 times the average worker. Six hundred times is a staggering figure.

And this past Monday, the Washington Post published its annual survey of executive compensation at large public companies and found that in 2007 the average annual pay of the top 100 highest paid executives was $6.6 million. While those at the top of the income scale are prospering, since the 1990s, income has actually declined for workers at the bottom rung and has actually increased only slightly for middle class workers.

We know that Americans are very tolerant of differences in pay and, in general, choose to focus on opportunity instead. I feel like they think—everybody thinks that they are eventually going to be one of the top one percent. This opportunity, and the attitudes toward it, are vastly different in the United States than the attitudes of European workers who actually see fairness in equal outcome, not in the potential for equal outcomes.

But opportunity is slipping away for those in the middle classes in our country, as wages remain stagnant, and consumer goods, such as food, health care, and gas, have skyrocketed, health care. Many are losing their homes, and, as I said, health care is becoming more expensive and less available.

This, in turn, affects the ability of hardworking Americans, and it affects their ability to save for retirement, and it affects their ability to put their kids through college.

How important is the middle class, anyway? Why do we care? Well, the middle class is the glue that holds this country together. Otherwise, we are just scraping by.

This hearing will examine the causes and extent of the gap and how this inequality affects American workers.

Nell Minow of the Corporate Library is here to fill us in on the issue of excessive pay. This ever-widening pay disparity is bad for workers; it is bad for their health; and it is bad for their families. And there is even evidence that the rich in this country have a shorter life span than wealthy people who live in countries where the income gap is not as great as ours. This ever-widening gap has broad implications for society as a whole, and if not dealt with, will threaten our democracy.

I look forward to hearing from our witnesses and yield the floor to Ranking Member Wilson for his opening statement.

[The statement of Ms. Woolsey follows:]

Prepared Statement of Hon. Lynn C. Woolsey, Chairwoman, Subcommittee on Workforce Protections

I want to welcome you all to this hearing on "The Growing Income Gap in the American Middle Class." But before I proceed with my opening statement, I want to wish Ranking Member Wilson a very happy birthday.

Income inequality between the top income earners and those in the middle class has been growing rapidly over the last 3 decades. For frame of reference, the top 1% includes those making $450,000 or more; in 2006 that consisted of about 1.4 million tax filers.

The gap has grown so wide that some compare the era we live in to the Gilded Age, a period between 1870 and 1900 that was distinguished by the excesses of the rich.

In the 1960s and 1970s the top 1 percent of earners took in 10 percent of the total income in this Country.

By 2006 the top 1 percent of earners took in over 20 percent of the total income pie. The last time the top had this much of total income was in 1928.

In addition, the average tax rate for these top earners has fallen to its lowest levels in 18 years. CEOs are making record salaries, irrespective of performance, and these outrageous amounts affect the growing gap directly.

In 2006, the average Fortune 250 CEO was paid over 600 times the average worker. That is a staggering number.

And this past Monday, the Washington Post published its annual survey of executive compensation at large public companies and found that in 2007, the average annual pay of the top 100 highest-paid executives was $6.6 million.

While those at the top of the income scale are prospering, since the 1990s, income has actually declined for workers at the bottom rung, and increased only slightly for middle class workers.

We know that Americans are very tolerant of differences in pay, and in general, choose to focus on opportunity instead.

This is vastly different than the attitudes of European workers who see fairness in equal outcomes, not in the potential for equal outcomes.

But opportunity is slipping away for those in the middle class as wages remain stagnant and consumer goods, such as food and gas, have skyrocketed.

Many are losing their homes and their health care.

This in turn affects the ability of hard-working Americans to save for retirement and put their kids through college.

How important is the middle class anyway?

They are the glue that holds this country together; otherwise we are just scraping by.

This hearing will examine the causes and extent of the gap and how this inequality affects American workers.

Nell Minow of the Corporate Library is also here to fill us in on the issue of "excessive executive pay."

This ever widening pay disparity is bad for workers; it is bad for their health; and it is bad for their families.

And there is even evidence that the rich in this Country have shorter life spans than wealthy people who live in countries where the income gap is not as great as ours.

This ever-widening gap also has broad implications for society as a whole, and if not dealt with, will threaten our democracy.

I look forward to hearing from our witnesses and yield the floor to Ranking Member Wilson for his opening statement.

Mr. WILSON. Thank you, Madam Chairwoman, and thank you for the birthday greetings. And good morning.

I will be brief in my opening remarks. I want to get to our witnesses as quickly as possibly.

I, too, would like to welcome each of our witnesses. We look forward to hearing your testimony and appreciate you taking time out of your busy schedules to educate us here today.

As you have noted, Madam Chair, we are here today to look at improving the incomes of the American middle class. I believe 90 percent of the constituents I represent are of the middle class. I want everyone, as you indicated, to be in the top one percent. I suspect that we will hear about many factors in today's economic environment that contribute to income differences among families.

On its face, some of the data indicates large differences in the economic well being of families. Other data shows that Americans

of all income levels are better off today than they were a generation ago. We all know that there is usually more than one way to interpret data, so I think it is important that we use caution in extrapolating too far.

Out of the many factors that contribute to income differences, and I believe a very significant one, is education. The difference in earnings between individuals with a high school education and those with advanced degrees or high-skilled training is significant. Arguably, one of the best ways to find a meaningful solution for boosting pay is to bolster our education and training systems. Education and ongoing training is essential for future job growth and economic security in today's global economy.

As we examine the difficulties faced by those at the lower end of the economic spectrum, we should—we would be remiss if we did not acknowledge the burden of rising energy costs. Lower-wage workers have been shown to suffer disproportionately when fuel costs rise. Gas is likely to consume a greater share of their likely earnings even when fuel costs are low, exacerbating the burden of today's nearly $4 per gallon fuel cost. Moreover, lower-income Americans are more likely to own older, less efficient vehicles.

I hope somewhere in the context of the continuing debate on the current state of the middle class of workers that Congress can do something about addressing increasing fuel costs.

This hearing will provide us with a clearer picture of the level of income differences among families and a better understanding of the factors that contribute to those differences.

Thank you, Madam Chairwoman, and I yield back the balance of my time.

Prepared Statement of Hon. Joe Wilson, Ranking Minority Member, Subcommittee on Workforce Protections

Thank you, Madam Chairwoman, and good morning. I will be brief in my opening remarks. I know we want to get to our witnesses as quickly as possible.

I too, would like to welcome each of our witnesses. We look forward to hearing your testimony and appreciate you taking time out of your busy schedules to educate us today.

As you have noted, Madam Chair, we are here today to look at improving incomes of the American middle class. I suspect that we will hear about many factors in today's economic environment that contribute to income differences among families.

On its face, some of the data indicates large differences in the economic well-being of families. Other data shows that Americans of all income levels are better off today than they were a generation ago. We all know that there is usually more than one way to interpret data, so I think it's important that we use caution in extrapolating too far.

Out of the many factors that contribute to income differences, and I believe a significant one, is education. The difference in earnings between individuals with a high school education and those with advanced degrees or high-skilled training is significant. Arguably, one of the best ways to find a meaningful solution for boosting pay is to bolster our education and training systems. Education and ongoing training is essential for future job growth and economic security in today's global economy.

As we examine the difficulties faced by those at the lower end of the economic spectrum, we would be remiss if we did not acknowledge the burden of rising energy costs. Lower-wage workers have been shown to suffer disproportionately when fuel costs rise. Gas is likely to consume a greater share of their earnings even when fuel costs are low, exacerbating the burden of today's nearly $4.00 per gallon fuel costs. Moreover, lower-income Americans are more likely to own older, less efficient vehicles. I hope somewhere in the context of the continuing debate on the current state of middle class workers, that Congress can do something about addressing increasing fuel costs.

This hearing will provide us with a clearer picture of the level of income differences among families and a better understanding of the factors that contribute to those differences.

Thank you, Madam Chairwoman, and I yield back the balance of my time.

Ms. WOOLSEY. Thank you, Mr. Wilson.

Without objection, all members will have 14 days to submit additional materials for the hearing record.

I now have the privilege to introduce our very distinguished panel of witnesses here with us this morning, and I welcome our witnesses.

Thank you for being here.

Before I introduce you, I think I should remind everybody how the lighting system works. Some of you have not been here before; most of you have, though. What you will know is that you are limited to five minutes. When you start speaking, the light will go on in front of you. It will be green. When you are down to one minute, it will be yellow, and when it is red, that means your time is up. So when you see the yellow light, start tying it up and coming to conclusion. We won't—your chair doesn't fall through the floor when it turns red, but we would like you to start ending it there, and if you have more to say, we will make sure that you get to during the question and answer.

So, here we go. We are going to start with Robert Greenstein. Robert is the founder and executive director of the Center on Budget and Policy Priorities. In 1996, he was awarded a MacArthur Fellowship, in part, for making the center a model for nonpartisan research and policy organization. In 1994, he was appointed by President Clinton to serve on the Bipartisan Commission on Entitlement and Tax Reform. Prior to founding the center, Mr. Greenstein was administrator of the Food and Nutrition Service at the U.S. Department of Agriculture. He graduated from Harvard College and has received numerous honorary degrees.

Nell Minow is editor and co-founder of the Corporate Library. Prior to founding the Corporate Library, she was a principal at Lens, an investment firm that uses shareholder activism to increase the value of underperforming companies. She previously served as an attorney at the U.S. Environmental Protection Agency, the Office of Management and Budget and the Department of Justice. She is a graduate of Sarah Lawrence College and the University of Chicago Law School.

Diana Furchtgott-Roth is a senior fellow at the Hudson Institute and director of the Center for Employment Policy. She has been a chief economist at the U.S. Department of Labor and previously served as chief of staff for the president's Council of Economic Advisors. She received her B.A. from Swarthmore College and her master's from Oxford University.

Jared Bernstein is director of the Living Standard Program at the Economic Policy Institute, EPI. He joined the EPI in 1992 and has written extensively on issues, such as income equality, mobility and trends in employment and earnings. His latest book is, "Crunch: Why Do I Feel So Squeezed and Other Unsolved Economic Mysteries." Mr. Bernstein earned his Ph.D. in social welfare from Columbia University.

We will now hear from our first witness, and don't forget to turn on your microphone.

STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Mr. GREENSTEIN. Thank you for the invitation to testify today on inequality. There is broad consensus among analysts and economists that inequality has been rising for about 30 years and is at levels that cause concern. As former Federal Reserve Chair Alan Greenspan said a couple of years ago, "There is a really serious problem here in the concentration of income that is rising."

Let me start with a brief overview of the data and a cautionary note. And the cautionary note is that in looking at inequality one cannot place much stock in data—in official census data and what is called the Gini coefficient that comes out of those data, because the official census data is not based on full income reporting at the top of the income scale.

Specifically, the census data does not count any earnings above $999,999 a year. If you earn $20 million a year, it is recorded in the census data as $999,999. If your income rises from $20 million to $30 million a year, census shows that it is staying flat at $999,999. And the census data do not include capital gains income, which is very big at the top of the income scale.

To address these problems in the data, fortunately, about 15 years ago, the Congressional Budget Office came to the rescue and developed a data series that blends census data and data from the IRS so that the CBO data count all income, and they also count as income, as one should for these purposes, things like food stamps, housing subsidies and the earned income credit for the people at the bottom of the income scale. The CBO data are widely recognized by analysts as the best data available on inequality, they cover after-tax as well as before-tax income, and they span the period from 1979 to 2005.

So let's take a look at what those CBO data tell us. They show a stark picture of rising inequality. After adjusting for inflation, after-tax income for the bottom fifth of the population, average after-tax income for the bottom fifth was only six percent higher in 2005 than it had been 26 years earlier in 1979. And for the middle, the middle fifth, income was 21 percent higher than in 1979. That is less than an average of one percent gain per year over the 26-year period. In contrast, income rose 80 percent among the top fifth, and it more than tripled, rising 228 percent, among the top one percent of the population.

In dollar terms, the CBO data show that the average income for the bottom fifth is all of $900 per household higher in 2005 than it was 1979. The gain was $8,700 per household for the middle fifth, and for the top one percent, the gain was $745,000 per household.

We also have a data source on the distribution of before-tax income that goes back to 1913. This is based on IRS data.

And it shows, as you noted, Madam Chair, in your opening, that the share of before-tax income going to the top one percent is now greater than at any time since 1928.

I would note that the rise in inequality in after-tax income—for before-tax and after-tax income, the main causes are in the private economy, but there is a question as to whether government policy ameliorates or exacerbates the trends. And the evidence is compelling that the tax cuts of this decade have exacerbated the trend in inequality in after-tax income.

The CBO data show that the percentage of income that the top fifth pays in federal taxes fell in 2005 to its lowest level on record in these data. Data from the Urban Institute-Brookings Tax Policy Center show that the 2001 and 2003 tax cuts increase after-tax income by a far larger percentage for those at the top of the income scale than for those in the middle or the bottom.

And in dollar terms, the Tax Policy Center data show that in 2010, when the tax cuts are fully in effect, the average tax cut per household for those with incomes over $1 million a year will be $158,000 tax cut per household. The average tax cut in the middle, the Tax Policy Center tells us, will be $810 per household.

This is why the noted economist, Alan Blinder, in talking about rising inequality, recently noted that recent federal policies were the equivalent, if I may use the sports—I am really just using Alan Blinder's sports analogy, he used a sports analogy—he said they were the equivalent of piling on, which in football would draw a 15-yard penalty for unnecessary roughness.

Let me conclude with just a few very quick comments about the implications for federal policy going forward. As you all know, we face tough challenges in a series of areas: An unsustainable long-term deficit, need for health care reform, need for tax reform, need to address climate change. In every one of those areas, how you address the problem can either exacerbate inequality or mitigate it, and I would submit that this ought to be one of, certainly not the only by no means, but one of the factors you look at as you evaluate potential responses in those areas.

In addition, of course, we need a strong economy and rising productivity as a necessary, but not sufficient condition to get more widespread prosperity, and that does mean sound investments in preschool education, education worker training, infrastructure and basic research.

There are a variety of things that Congress could start doing next year, and among them, I would argue, would be such things as looking at what are bipartisan proposals to make things like the higher education and savers tax credits refundable. We, right now, have tax benefits that subsidize the cost of higher education for people higher up the income scale who would go to school anyway. We shut out people at the bottom. I think more focus on poverty reduction goals would be helpful. We need to remove barriers to labor organizing.

There are an array of things we need to do, and the first step, of course, is simply focusing more attention on the inequality issue and the need to address it.

And I think this hearing is an important step in what we have to do first in order to put on the agenda that one of the lenses through which we should evaluate policy in a whole range of areas is, does it exacerbate the inequality already being driven by trends in the international and national economy or does it lean against

it and help mitigate it and help us have prosperity that is more broadly shared across our people?

Thank you.

[The statement of Mr. Greenstein follows:]

Testimony of Robert Greenstein
Executive Director, Center on Budget and Policy Priorities
Before the Subcommittee on Workforce Protections
Committee on Education and Labor
July 31, 2008

Thank you for the invitation to testify about widening income inequality in the United States. As former Federal Reserve chairman Alan Greenspan has said, "this is not the type of thing which a democratic society — a capitalist democratic society — can really accept without addressing," and I commend the subcommittee for holding this hearing.

My testimony falls into three parts.

- The first is an overview of the data on household income and its distribution, where I will discuss recent developments in the context of longer-term historical trends.
- The second is a discussion of the role of public policy in influencing the distribution of income. That discussion largely focuses on government tax and transfer policies — that is, on how government policies affect the distribution of after-tax income. But policy also can have some influence on the distribution of pre-tax income determined by market forces, through such things as trade policy, education policy, and labor-market policy.
- The third is a discussion of the implications for public policy generally and some specific policy recommendations for addressing the problem of widening income inequality.

Recent Developments and Longer-Term Trends in Income Inequality

I would like to start by placing the issue of income inequality into the context of recent economic developments and to review some of the salient data on longer-term trends in inequality.

Income inequality in the United States has risen to historically high levels. This is not because of the current slump in the economy — the economic downturn is too recent to be reflected in the data, which only go through 2005 or 2006. And it is not a new development. Inequality has been increasing for more than 30 years.

There is, however, something different about the increase in inequality since 2001 that I want to comment on before examining the longer-run trends. Usually, concerns about inequality move to the back burner, at least in the public discourse, during economic expansions when most people see their standard of living rise and feel good about their economic prospects. That happened, for example, during the second half of the long economic expansion of the 1990s. But those good feelings have been noticeably absent in recent years, even though economic statisticians would characterize the economy's performance from the end of 2001 through most of last year as a business-cycle recovery and expansion following the 2001 recession.

The disconnect in recent years between how the overall economy is doing statistically and how most people living in that economy are doing has puzzled some pundits and some elected officials and their advisors. But it really is not very complicated. First, the post-2001 period was the weakest of all economic expansions since World War II by almost every economic measure. Second, to an unprecedented degree, the gains from economic growth after 2001 accrued to a narrow slice of the population at the top of the income distribution.

When I said the recovery was weak by *almost* every measure, I was alluding to the fact that there is one important exception — corporate profits. While aggregate wages and salaries grew only *half* as fast after 2001 as they did in the average postwar economic expansion, corporate profits grew 40 percent faster. Both employment growth and wage and salary growth were weaker in the most recent expansion than in any prior expansion since the end of World War II; growth in corporate profits was stronger than in any other expansion.

What have been the consequences for income inequality of that weak and unbalanced economic recovery? First, the share of pre-tax income flowing to the top 1 percent of households is at its highest level since 1928. Second, the gap between the after-tax income of people at the top of the income distribution and the after-tax income of people in the middle or at the bottom has continued to widen. So now that the economy is stumbling, the labor market is weakening, and household budgets are being strained by higher food and energy prices, it should be no surprise that people are even more pessimistic about their prospects. It is not just in their heads.

Let me turn now to a discussion of the data on income inequality and what they show about longer-term trends. There are two primary sources of annual data on household income and its distribution. The first is Census Bureau data on poverty and income based on the Current Population Survey, and the second is income tax data from the IRS. Neither alone can give a complete picture of trends in income inequality. The tax data provide good coverage of people who pay income taxes, including people with very high incomes, but they omit people with low incomes who are not required to file an income tax return. The Census data have good coverage of that low-income population but for various reasons do not have good coverage of people with very high incomes.

To bridge the gap, the Congressional Budget Office has developed a method for combining the two data sources that provides the most complete picture available of the distribution of before- and after-tax income. Although the Census data are available in one form or another back to the end of World War II and IRS data are available in one form or another back to the beginning of the income tax in 1913, CBO's comprehensive data series goes back only to 1979, and the most recent published CBO estimate is for 2005. We do have a much longer consistent series on concentration at the very top of the income scale derived from IRS data thanks to the efforts of economists Thomas Piketty and Emanuel Saez. The Piketty-Saez data series covers the years from 1913 through 2006.

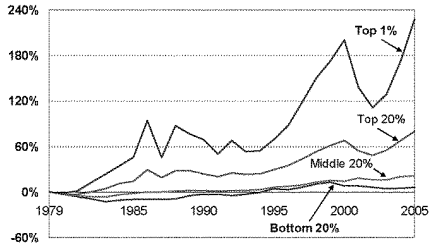
What do these data tell us about long-term trends in inequality? First, the CBO data in Figure 1, which shows the percentage increase in after-tax income at different points on the income scale since 1979, portray a widening gap between income at the top and income in the middle and at the bottom, with the largest income gains accruing at the very top. As Table 1 shows, after adjusting for inflation, income in the bottom fifth of the population was only 6 percent — or $900 — higher in 2005 than it was twenty-six years earlier in 1979, and income in the middle fifth of the population

was 21 percent — or $8,700 — higher. In contrast, income in the top fifth of the distribution rose 80 percent — or $76,500 per household — from 1979 to 2005, and income in the top 1 percent more than tripled, rising 228 percent — or $745,100 per household.

FIGURE 1

Highest Income Households Have Seen Far Greater Income Growth Than Others

Percent Change in After-Tax Income Since 1979



Source: CBPP calculations based on CBO data

TABLE 1: Change in After-Tax Income, 1976-2005, by Income Group

	Bottom 20 percent	Second 20 percent	Middle 20 percent	Fourth 20 percent	Top 20 percent	Top 1 percent
Increase in 2005 dollars	900	4,600	8,700	16,000	76,500	745,100
Percentage increase	6.3%	15.8%	21.0%	29.5%	79.9%	228.3%

While these CBO data show a strong upward trend in inequality over the past 25 years, it would be a mistake to think that rising inequality and increasing concentration of income at the very top of the income scale have been an inevitable feature of the American economy. As Figure 2 shows, the pattern of growth in household income over the past three decades is distinctly different from the pattern over the first three decades after the end of World War II. The data here are for pre-tax income, but the story for after-tax income (if it were available for this whole period) would likely not be noticeably different for the reasons discussed later in my testimony.

From 1946 to 1976, the increase in the average income of the bottom 90 percent of households closely matched the growth of per capita national income, while income at the very top grew more slowly. In other words, the gap between the average income of the very richest households and that of the bottom 90 percent of households narrowed over this period. Over the next three decades, in contrast, growth in the average income of the bottom 90 percent of households fell far short of growth in per-capita national income, while growth in the average income of the top 1 percent of households soared. If we had a figure like Figure 1 for this longer period, we would see the incomes

of the top, middle, and bottom fifths trending upward together at roughly the same rate from 1946 to sometime in the 1970s, followed by a sharp divergence in the years since 1976 like that depicted in Figure 1.

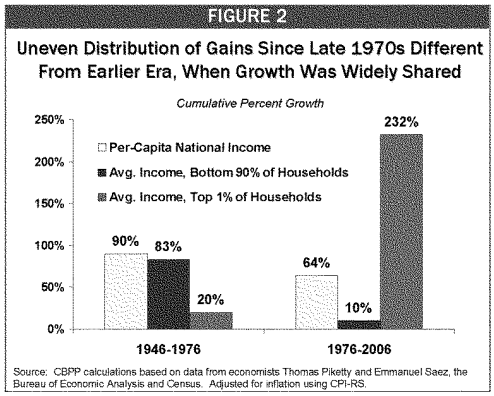
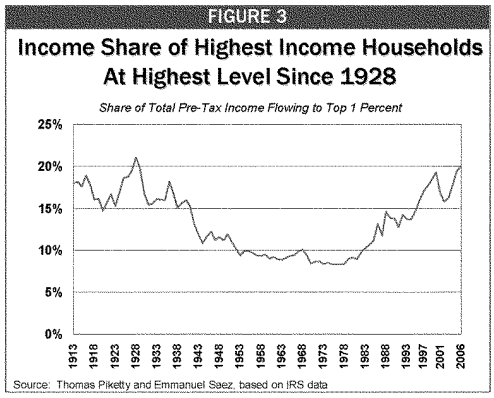


Figure 3, which is based on the the Piketty-Saez data, provides an even longer-term perspective on trends in the concentration of income at the very top. These data show that the relatively slow growth in income at the very top from 1946 to 1976 was part of a longer term trend beginning after 1928. The share of total pre-tax income in the nation that goes to the top 1 percent of households fell from 1928 to the 1970s, but as we have seen, since then the share of income going to the top 1 percent of households has soared. Although the upward surge was interrupted by a major speed bump in 2001 as a result of the dot.com collapse, by 2006 the share of income going to the top 1 percent was at its highest level since 1928.



These data also show that the trend toward greater inequality is once again rising sharply. From 2005 to 2006, the average before-tax income of the top 1 percent of households increased by almost $60,000 (or 5.8 percent), after adjusting for inflation, while the average income of the bottom 90 percent of households rose by less than $450 (or 1.4 percent). (Note: this bottom-90 percent figure is somewhat misleading because it is heavily influenced by the larger gains received by those in the upper ranges of this group. The typical, or median, gain for the bottom 90 percent was smaller than the average gain.)

How Do Government Policies Affect Inequality?

Government policies affect the distribution of income most directly through taxes and benefit programs, and federal taxes are, on balance, progressive. As a result, there is modestly less inequality in the after-tax distribution of income than in the before-tax distribution. But while this difference is real, it should not be exaggerated. Furthermore, the large tax cuts enacted in 2001 and 2003 favored higher income groups that were already benefiting from disproportionate gains in pre-tax income. As a result, federal taxes, while still progressive, are less progressive today than they were before the 2001-2003 tax cuts.

TABLE 2: Pre-Tax and After-Tax Income Shares and Effective Tax Rates by Income Group, 2001 and 2005

	Bottom 20 percent	Second 20 percent	Middle 20 percent	Fourth 20 percent	Top 20 percent	Top 1 percent
2001						
Share of pre-tax income	4.3	9.2	14.2	20.8	52.3	14.7
Share of after-tax income	5.1	10.3	15.2	21.5	48.8	12.6
Effective tax rate	5.1	11.5	15.3	18.9	26.7	32.8
2005						
Share of pre-tax income	4.0	8.5	13.3	19.8	55.1	18.1
Share of after-tax income	4.8	9.6	14.4	20.6	51.6	15.6
Effective Tax Rate	4.3	9.9	14.2	17.4	25.5	31.2
Percent change in income, 2001-2005						
Pre-Tax income	-3.0%	-1.6%	1.4%	2.4%	14.8%	34.8%
After-tax income	-1.9%	0.3%	2.7%	4.1%	16.6%	38.0%

The progressive structure of federal taxes, as well as its erosion in recent years, is illustrated by the CBO data in Table 2. In 2005, households in the bottom fifth of the income scale paid an average of 4.3 percent of their income in federal taxes, those in the middle paid 14.2 percent, those in the top fifth paid 25.5 percent, and those in the top 1 percent paid 31.2 percent. The bottom fifth of households received 4.0 percent of before-tax income and 4.8 percent of after-tax income. For the middle fifth, those percentages were 13.3 percent of before-tax income and 14.4 percent of after-tax

income. The top fifth of households, in contrast, received a larger share of before-tax income (55.1 percent) than of after-tax income (51.6 percent) as did the top 1 percent (18.1 percent of pre-tax income compared with 15.6 percent of after-tax income). Nevertheless, both before-tax and after-tax income distributions reveal a high degree of inequality. Moreover, the shares of after-tax income going to the top 20 percent and to the top 1 percent— like their shares of before-tax income — are now the highest on record in the CBO data, which go back to 1979.

I have already mentioned how high-income households benefited disproportionately from the economic growth that occurred after 2001. They also benefited disproportionately from the 2001-2003 tax cuts. As shown in the bottom section of Table 2, the before-tax income of the top fifth of households rose by 14.8 percent from 2001 to 2005. And because their effective tax rate (the percentage of income that they pay in federal taxes) fell to its lowest level on record in the CBO data, their after-tax income grew by an even greater proportion — 16.6 percent. For the top 1 percent of households, pre-tax income rose 34.8 percent from 2001 to 2005, and after-tax income rose by 38 percent. In contrast, low-income households experienced income *declines* over this period, and gains in the middle 60 percent of households were quite modest.

We hear from some quarters the argument that the tax system has become more progressive — and that this is proven by the fact that the affluent are now paying a higher share of total income tax revenues. This argument does not withstand scrutiny. A progressive tax cut, like a progressive tax system, is one that reduces inequality. The 2001-2003 tax cuts have done the opposite. When fully in effect, those tax cuts will boost after-tax income by more than 7 percent among households with incomes of more than $1 million, but just 2 percent among middle-income families, according to Urban Institute-Brookings Institution Tax Policy Center. That is an average tax cut of $158,000 in 2010 for households with incomes of over $1 million, but just $810 for middle-income families. Tax analysts know that effective tax rates and shares of after-tax income, *not* the share of taxes paid, are the proper indicators of progressivity.

The CBO data are clear about effective tax rates at the top: they are *lower* than they have been since at least 1979. These data show that the tax system has become less progressive. The share of taxes paid by high-income households has been going up, but this is because these are the households that have gotten most of the increase in before-tax income. Their income gains have been so large that they are paying more in taxes even though they have gotten substantial tax cuts and the percentage of their income that they pay in taxes has gone down. Between 2000 and 2005, the average income tax burden of the top fifth of the population fell by an amount equal to 4.8 percent of their income; in contrast, the middle and lowest fifths of the population saw their average income tax burdens reduced by amounts equal to less than 2 percent of their incomes.

The distinction between effective tax rates and share of taxes paid played out last week on the pages of the *Wall Street Journal* following the release of IRS data for 2006. On Monday, the editorial page midleadingly blared that "the data show that the 2003 Bush tax cuts caused what may be the biggest increase in tax payments by the rich in American history." The focus of the editorial was on the increase in the share of income taxes paid by the rich. Two days later, the news pages of the *Journal* got the story right, with the headline "Richest Americans See Their Income Share Grow." A nice graphic accompanying that story showed that the average tax rate of the richest 1 percent of Americans fell, so that even though their share of taxes rose, the rise was not fast enough to keep pace with their rising share of income — and their tax burdens decreased significantly.

So far I mainly have been documenting trends in inequality. But what has caused those trends? Princeton economist Alan Blinder expresses the view of many economists that market forces not government policies are primarily to blame:

> Let me be clear: The main culprit has not been the government but the marketplace. While there are a number of competing theoretical explanations, the fact is that, starting sometime in the late 1970s, the market turned ferociously against the less skilled and the less well educated.

Blinder criticizes government for not doing more to use the tax-and-transfer system and other policies to cushion the blow, and he condemns policies of enacting tax cuts for the wealthy while either permitting or causing large holes to emerge in the social safety net. These policies he labels "piling on," which in football would draw a penalty for unnecessary roughness. But just as football is a rough game to begin with, so too has been the labor market faced by workers without strong skills and sufficient education and training.

I will not endeavor here to disentangle the complex economic arguments about how much of the market's turning against the less-skilled and less-well-educated is due to international trade versus technological change or other factors, such as the weakening of the labor unions. I think the state of our knowledge is that there is a constellation of factors, and no single-bullet theory is sufficient. Instead I would like to make a couple of observations that I believe are relevant to this Committee on Education and Labor.

First, to state the obvious, if the market has turned fiercely against those with lower skills and less education and training, smart policies to close the skill gap should pay off over the longer term both in boosting productivity growth and in causing the benefits of that growth to be somewhat more widely shared.

Second, an interesting but underdeveloped strand of the economics literature has begun to focus on the role that changing institutions have played in producing greater inequality. In particular, I would note the work of MIT professors Frank Levy and Peter Temin. They argue that the quite different experiences with inequality I have described between the first three decades after the end of World War II and the most recent three decades were shaped by quite different sets of economic institutions. Levy and Temin argue that the early postwar years were dominated by unions, a negotiating framework that heavily influenced wage-setting, progressive taxes, and a high minimum wage. They describe this set of institutions as "parts of a general government effort to broadly distribute the gains from growth." They argue that the economic forces of technology and trade that most economists look to in explaining trends in earnings inequality "have been amplified by the collapse of the institutions of the post-war years." If they are correct, both government intervention and changes in the norms of private sector behavior will be necessary to avoid the widening gaps in income that seem to be a feature of market-determined incomes in today's global economy.

I don't think we should interpret the Levy-Temin analysis as an argument for trying to recreate the precise institutions that prevailed in the early postwar period. It is probably not even possible, given the structural changes in the economy that have taken place. But the Levy-Temin analysis is an argument for remembering the importance of institutions and social norms in determining how market forces play out and the ability of laws and the visions that policymakers express to shape those institutions and social norms. Reducing barriers to labor organizing, preserving the real value

of the minimum wage, and the other workforce security concerns of this committee would surely be a part of the kinds of institutions and social norms that would contribute to an economy with less glaring and sharply widening inequality.

Before moving to a discussion of the implications of trends in inequality for policy, I would like to note that I have been discussing trends in income inequality. As these data show, there is a great deal of inequality in the distribution of income in the United States. But that inequality pales in comparison to the inequality in the distribution of wealth. Our main source of data about wealth inequality comes from the Federal Reserve's Survey of Consumer Finances. Those data show that roughly a third of household wealth is held by the top 1 percent of households, another third is held by the next affluent 9 percent, and the remaining third of wealth is held by the remaining 90 percent of households. As extreme as the income inequality shown in Table 2 is, inequality in the distribution of wealth is considerably greater.

Implications for Policy

The United States faces a number of tough challenges ahead, including an unsustainable long-term deficit, the need for health care reform, fundamental tax reform, and the need to address climate change. The problem of widening income inequality is exceedingly unlikely to go away on its own. But how we address these other critical challenges also will have important implications for whether policymakers make inequality worse or better through their policy actions. In this section of the testimony, I will discuss some broad policy implications and offer some specific recommendations.

Addressing our long-term budget imbalance is important to achieving strong sustainable growth over the long term. But the distributional implications are vastly different if we address the challenge by slashing promised benefits in programs like Social Security, Medicare, and Medicaid to preserve the tax cuts we have enacted and add new regressive tax cuts on top, or if we instead pursue a more balanced approach that puts everything on the table. Similar distributional differences attach to alternative ways of approaching health care reform and fundamental tax reform.

Climate change legislation poses a similar challenge. Reducing greenhouse gas emissions, through either a cap-and-trade system or a carbon tax, works by raising the price of energy and energy-related products. Because low- and moderate-income households spend a disproportionate amount of their income on these products, they will experience the largest relative hits to their purchasing power from such legislation.

At the same time, however, either a cap-and-trade system in which most of the emissions allowances are auctioned off or a carbon tax has the potential to raise substantial revenues. If a portion of those revenues are used for well-designed climate rebates to offset the impacts of higher energy prices on low- and moderate-income households, we can achieve the benefits of reduced greenhouse gas emissions while protecting the purchasing power of vulnerable households and avoiding regressive effects. In contrast, if we give away a large percentage of the allowances to existing industrial emitters or we use the proceeds to cut income tax rates, we would provide tax relief benefits to high-income households that are larger than the increase in their energy costs while

leaving low- and moderate-income households worse off. Inequality would effectively be widened further.

I believe that if we are to take the problem of increasing inequality seriously, we need to keep these distributional considerations in mind as we address the big challenges that lie ahead. At the same time, strong economic growth and rising productivity are a necessary condition for achieving widespread prosperity. Sound investments in education, worker training, infrastructure, and basic research are necessary to complement private investment in generating that growth and productivity.

Having a strong economy is a necessary condition for achieving widespread prosperity. But as we have seen for more than 30 years, the outcomes determined by market forces alone seem to be aggravating inequality, especially during periods when the political environment is tilted toward skepticism about or outright hostility toward policies that provide an effective safety net for those struggling to keep their heads above water and policies aimed at ensuring that the gains from economic growth are shared more equally, as they were in the 1946-1976 period.

One important place we need to start to achieve that goal is a focused effort to reduce poverty. The poverty rate rose for four straight years from 2000 to 2004, peaking at 12.7 percent in 2004. In 2006, the rate was still stubbornly high at 12.3 percent, and over 36 million people were poor. Poverty is higher in the United States than in many other developed countries, and it is costly to the economy to have so many adults with limited skills and earnings and to perpetuate that situation through the damaging effects of persistent child poverty. We can do better. An effort that deserves attention here is the Half in Ten campaign, which is calling on policymakers to adopt the goal of cutting poverty in half over the next ten years.

Let me conclude with some concrete steps to address the problem of widening inequality. I'll start with the tax code, which includes provisions worth hundreds of billions of dollars a year to encourage a wide variety of activities from saving for retirement to acquiring more education. From the standpoint of equal treatment of people with different incomes, there is a fundamental flaw in most of these incentives: they are provided in the form of deductions, exemptions, and exclusions rather than in the form of refundable tax credits. That means that the size of the tax break is higher for taxpayers in higher income brackets For many of the activities that the tax incentive is meant to promote, there is no obvious reason why lower-income taxpayers or people who do not file income taxes should get smaller incentives (or no tax incentives at all).

But it is even worse that that: the central structure of these tax breaks also makes them economically inefficient. Because a large number of taxpayers will not have incomes high enough to benefit fully from current non-refundable incentives, society will get less of the activity it is trying to encourage; people with smaller income-tax liabilities will have a smaller incentive, and people with no income-tax liability will have no additional incentive to engage in the activity. Moreover, high-income taxpayers are likely to save for retirement and to invest in their children's education with or without the tax breaks; the tax breaks do not appear to have a large effect on their behavior. As a result, the current tax deduction structure used for these tax breaks is inefficient. Providing more modest tax breaks to high-income taxpayers and using the savings to provide refundable credits to lower-income taxpayers would increase the amount of desirable economic activity that the tax break is meant to encourage, at no additional cost.

In a 2006 Brookings Institution policy brief, three prominent tax policy analysts — Lily Batchelder, a professor of law and public policy at NYU, Fred Goldberg, who was IRS Commissioner and Assistant Secretary of the Treasury for Tax Policy under the first President Bush, and Peter Orszag, now the director of the Congressional Budget Office, recommended that the default for tax incentives designed to promote socially valued activities should be a refundable tax credit (i.e., a tax credit available to qualifying households even if they do not earn enough to owe income tax) rather than a deduction. The authors point out that such a credit would not only contribute to reducing inequality in after-tax income, but for the reasons discussed above, also would produce more powerful economic incentives.

If a system of refundable credits were in place, it also would have the virtue of providing a form of stabilization to the economy when the economic picture darkened, since people who lost their jobs or experienced a sharp drop in income during an economic downturn would continue to receive the full value of tax credits for which they qualified, rather than losing the value of the credits or seeing them reduced as is the case now. We could begin next year to take steps toward such a reform of the tax code by making the higher-education and savers' tax credits refundable and making improvements in the EITC. Moving to refundable tax credits for promoting socially worthwhile activities would be an important step toward enhancing progressivity in the tax code in a way that would improve economic efficiency and performance at the same time.

Other steps we could take that would contribute to reducing poverty and expanding educational opportunities include: increased investment in pre-school education and decent-quality child care for low- and moderate-income families. Such steps would both enable more low-income mothers to work (or enable those already working to work more) and increase the educational attainment and skills of the children.

In the area of health care, the lion's share of those without health insurance are low- or moderate-income. So legislation to achieve universal health insurance coverage *and* begin to put mechanisms in place to slow health care cost growth are important — both to improve the health and alleviate the squeeze on the uninsured *and* to ease the pressure on wages and salaries more broadly that rising health care costs impose.

I recognize that these suggestions are mostly outside the jurisdiction of the Education and Labor Committee. Nevertheless, this Committee has an important voice in the debate over what to do about inequality for at least two reasons. First, gaps in education and training have contributed to the inequality that has emerged over the past 30 years, and the Committee has the opportunity to be at the center of efforts to improve policies in that area. Second, if the Levy-Temin analysis is correct and trends in income inequality reflect an interaction between underlying market forces and institutions and social norms that can either moderate or aggravate the effects of those market forces, how this committee addresses issues concerning the rights of workers to organize and other laws that govern the workplace will also be important to how we address inequality.

Ms. WOOLSEY. Ms. Minow?

STATEMENT OF NELL MINOW, EDITOR AND CO–FOUNDER, THE CORPORATE LIBRARY

Ms. MINOW. Thank you very much, members of the committee. I am really honored to be here.

I am here just to make a couple of points about CEO compensation: First of all, that it is not determined by the market and, second, that it does matter.

I am a passionate capitalist. If I thought that these excessive CEO pay plans were beneficial to shareholders or to anybody else, I would stand up and cheer. If I thought that they resulted from the market or that they promoted market efficiency, I would be enthusiastic about them, but they do not.

As you pointed out, Madam Chair, disparity between the average worker and the CEO is increasing, and the velocity of the increase is also increasing, it is snowballing. And I appreciate especially your emphasis on equality of potential as our goal.

So I am here to talk about the tip of the iceberg, CEOs, because it is both a symptom and a contributing factor to market failure. It makes the days of the robber barons no longer the correct analogy. I think the analogy we should be working off of right now is Marie Antoinette.

The key points I want to make are, first of all, it is not the market that determines CEO pay. The CEO process exploits market inefficiencies. If you look at the people at the top of the pyramid on pay, everybody else is the ultimate pay-for-performance. Whether you are talking about athletes or musicians or movie stars, they are all pay-for-performance. But CEOs pick the people who set their pay and get rid of the ones who don't pay them enough. And for that reason, the pay just continues to go up.

I think that the most important point to consider in looking at CEO pay is that like any other allocation of assets by the board of directors, it has to be looked at in terms of its return on investment, and the return on investment, as documented by Professor Rakesh Khurana at Harvard University, is less than a piggybank. It is less than T-bill. It is not a productive use of the corporate assets.

I have a lot of examples in my testimony, and I encourage you to take a look at them. I noticed that after I filed my testimony this week there was a headline in the New York Times that said—about IndyMac. It said, "Bad Loans: The Cause of the Failure at IndyMac." Excuse me, it was bad CEO pay that was the cause of the failure at IndyMac, because in the subprime—this is a perfect example of what I am talking about—subprime, the executives were paid on the volume of business they created, not on the quality of business they created.

Now, we could never pay Congress what you are worth, because your worth is beyond price, but let's say we did decide to pay you based on the number of laws you passed. I think there would be more laws. That doesn't necessarily mean that they would be better laws, and that is pretty much what happened in the subprime circumstance.

Very, very few companies, very few—we have a list of them that we keep—have what are called clawbacks, meaning that after you find out that someone has been paid based on falsified accounting or inflated earnings, they have to actually give the money back. So, in other words, there is really no downside for them, and it creates all kinds of perverse incentives.

Bad pay misaligns the interests of the executives with shareholders and with employees, and, furthermore, our office has shown that the primary indicator of litigation, liability and investment risk is disparity between CEO pay and performance.

And I think I will reserve the rest of my time, because I want to have a free and frank exchange of ideas.

Thank you.

[The statement of Ms. Minow follows:]

Prepared Statement of Nell Minow, Editor, the Corporate Library

Madame Chairman and members of the committee, thank you very much for the opportunity to appear today. I am very pleased that this committee is looking into this vital area of concern.

I am a passionate capitalist. If our current system of executive compensation tied pay to performance, if it provided an effective incentive to create long-term shareholder value, if it met any possible market test, I would stand up and cheer. If I thought, as some have argued, that the amounts at issue are so small in proportion to the assets being managed that they do not have any material impact, I would not be here. On the contrary, the CEO compensation in America's public companies is a perversion of the market that imposes enormous and growing costs on America's working families—as shareholders, customers, employees, and members of the community. Executive compensation must be looked at as any other asset allocation. And the return on investment for the expenditures on CEO pay is by any measure inadequate. We are not getting what we pay for. These outrageous pay packages juxtaposed with losses in share value and jobs diminishes our credibility and increases our cost of capital. In today's global economy this is an expense we clearly can no longer afford.

The economist John Kenneth Galbraith said, "The salary of the chief executive of the large corporation is not a market award for achievement. It is frequently in the nature of a warm personal gesture by the individual to himself."

He said that in the 1950's. The primary change since then is the number of zeroes at the end of the figures.

My firm, The Corporate Library, maintains an extensive database on corporate governance in public companies, and that includes a great deal of information and analysis of executive compensation. The data show that the disparity between pay and performance is enormous and growing. We have done a series of studies showing that the largest percentage increases in total compensation for CEOs had very little connection to long-term value creation.

It's a very small group in the stratosphere of pay: rock stars, movie stars, athletes, investment bankers, and CEOs. Of that group, the first four are in the ultimate pay-for-performance category, with a tiny percentage at the very top making millions of dollars, and with deals that evaporate quickly if a movie, a CD, or a corporate acquisition tanks. Their pay is set through tough arms-length negotiations.

CEOs are the only ones who pick the people who set their pay, indeed they pay and provide information to the people who set their pay. And no matter what "independence" standard we try to impose, the board room culture of congeniality and consensus is so powerful that it makes it very hard to object, especially when the compensation consultant helpfully provides an avalanche of numbers designed to justify pay increases. In the wonderful world of CEOs, like the children in Lake Woebegon, everyone is above average. Even Warren Buffett acknowledges his own failings as a director, particularly in approving excessive compensation: "Too often, collegiality trumped independence." If Warren Buffett, always a significant shareholder in any company on whose board he serves, does not feel able to oppose excessive pay, something is wrong.

In the 1990s, the cult of the CEO was based on the idea that vision and the ability to inspire were what made the CEOs worth the hundreds of millions of dollars they were paid. But a book by Harvard Business School professor Rakesh Khurana, Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs, makes a compelling case that corporate boards err seriously when they pick chief executives based on "leadership" and "vision" or when they pay huge premium pay that is not sensitive to performance to attract a "superstar." Bringing in a CEO with a great record at another company may give the stock price a short-term boost. But high-profile transplants such as Al Dunlap at Sunbeam (which went into bankruptcy) and Gary Wendt at Conseco (which went into bankruptcy), CEOs should

have to make the same disclaimers that money managers do: "Past performance is no guarantee of future performance."

Some have argued that CEO pay is set by the market. But it is not, as a return on investment assessment shows. And the consequence can be disastrous.

For example: the very first report we ever issued at The Corporate Library, in January of 2000, we said that we thought there was a problem at what was then the fastest-rising stock in the history of the New York Stock Exchange. We said that the CEO's insistence on receiving 2 million stock options at $10 a share below the stock's trading price indicated that he expected the stock to decrease in value and did not want to pay the price for that decline that the shareholders did. It also indicated that the board of directors had no ability to provide any independent oversight and no ability to say "no."

That was Global Crossing which a year later became the fourth biggest bankruptcy in U.S. history.

At one financial services company there was a pay plan that had nine different measures of performance. But the plan gave the board discretion to award all of the bonuses for meeting any or all of those goals. They decided for fiscal 2006 to base the formula on the single metric of return on equity. The company was Bear Stearns. Another harbinger of and contributor to disaster. We also noted problems at a bank where the CEO's pay was as large as CEO salaries at firms exponentially larger and included $260,000 one-time initiation fee to a country club; reimbursement for payment of taxes ($12,650), financial planning ($15,000) and other perks. Is there any reason that the shareholders should be paying a CEO's taxes or financial planning? That bank is IndyMac, now the second-largest bank failure in history.

The subprime crisis was in part caused by pay plans that were based on volume of loans rather than quality of loans. That was a guarantee of disaster. Here are some of the mind-boggling numbers:

For 2006, Angelo Mozilo's total actual compensation was valued at over $102 million. His annual bonus for that year was based on a performance target of diluted earnings per share, or "EPS." For Fiscal 2006, Countrywide Financial's reported EPS was $4.30, which was an increase of 4.62% over Fiscal 2005 EPS of $4.11, resulting in a cash incentive award of $20.5 million to Mr. Mozilo. These inflated earnings forced the company's stock up by 26%.

But by the end of 2007, when Countrywide finally revealed the losses it had previously obscured, shareholders lost more than 78% of their investment value. Meanwhile, in early 2007 Mr. Mozilo sold over $127 million in exercised stock options before July 24, 2007, when he announced a $388 million write-down on profits. On August 16, Countrywide narrowly avoided bankruptcy by taking out an emergency loan of $11 billion from a group of banks. Mr. Mozilo continued to sell off shares, and by the end of 2007 he had sold an additional $30 million in exercised stock options. Mr. Mozilo received more than $102 million in compensation and $157 million in exercised stock options, while total shareholder return was negative 78% over the same period. He was entitled to receive another $58 million in non-qualified deferred compensation and supplemental pension benefits when he retires in connection with the Bank of America merger in 2008.

At Citigroup, Charles Prince received total compensation valued at over $25.9 million in 2006. His incentive awards for that year totaled more than $23 million and were based on multiple performance measurements. Specifically, the company stated that "revenues grew 7%, almost all of which was organic," "net income from continuing operations grew at about the same rate as total revenues (about 7% in each case)," "the 2006 return on equity was 18.8%," and "total return to stockholders was 19.6%." Then in 2007, the company announced its $24.1 billion write-down in connection with sub-prime lending. Soon after, Charles Prince announced his resignation and left the company with $40 million in severance. Shareholders lost 45% of their investment value by the end of the year.

At Merrill Lynch, former-CEO Stanley O'Neal received total compensation of more than $91 million for 2006. His incentive compensation was also based on multiple performance measurements. The company stated the following about the Mr. O'Neal's performance against objectives:

The Committee considered performance against the CEO objectives determined at the beginning of the year and noted that all financial targets were met or exceeded and all strategic and leadership objectives were met with distinction. This review included consideration of numerous objectives.

On October 24, 2007, Merrill Lynch reported an $8.4 billion subprime mortgage-related write-down. Just days later, Stanley O'Neal announced his retirement. He received more than $160 million in stock and retirement benefits in connection with his departure, while shareholder lost more than 41% of their investment value over

the year. On January 17, 2008, Merrill Lynch took an additional $14.1 billion write-down, bringing its subprime mortgage-related losses to nearly $23 billion.

During 2006, management at New Century Financial Corp issued false and misleading statements about the company's financials to boost earnings, which allowed New Century stock traded at artificially inflated prices. On March 2, 2007, the company announced that it was the subject of federal criminal probes related to securities trades and accounting fraud. On April 2, 2007, the company filed for Chapter 11 bankruptcy. Over the three year period prior to filing for bankruptcy, Robert K. Cole, Chairman and CEO of New Century Financial Corp, received over $22 million in total compensation, most of which he received from exercised stock options that he sold at artificially inflated stock prices.

In 2006, management at Novastar Financial Inc. reported a rise in earnings after the company originated a record $2.8 billion in loans, boosting the company's stock price to inflated levels. Then in February 2007, the Novastar's stock fell by 42% after announcing fourth quarter and year-end 2006 results, and warned that NovaStar was expecting to earn little or no taxable income in the next five years. In November 2007, Novastar stock plunged after the subprime mortgage lender posted a $598 million third-quarter loss and said that bankruptcy was possible. Over the three-year period leading to the enormous losses, Scott F. Hartman, Chairman and CEO of Novastar, received more than $13.6 million in total compensation.

In January 2007, American Home Mortgage earnings soared 288% after the subprime lender originated a record $15.5 billion in loans during the fourth quarter of 2006. Just eight months later, on August 6, 2007, American Home Mortgage Corp filed for bankruptcy. The stock was at 44 cents a share, down from an annual high of $36.40. Total compensation awarded to Michael Strauss, Chairman and CEO of American Home Mortgage, over the three-year period prior to the bankruptcy was over $8 million, largely based on bonuses tied to inflated earnings targets.

On June 15, 2008, American International Group (AIG) announced its plans to replace Chief Executive Officer Martin Sullivan with a director of the company who has been chairman since 2006, Robert Willumstad after the company posted losses for two consecutive quarters totaling $13 billion. Mr. Sullivan's contract entitled him to approximately $68 million.

There is an obvious disconnect between the performance of these CEOs and the compensation they received. They led the companies in a risky strategic direction that resulted in significant losses for investors across nations. Incentive compensation based on earnings and revenue increases is problematic in a situation like that of sub-prime mortgages. Principal officers, for themselves and in particular for those down the line who are similarly incentivized, can push "sales" without adequate concern for quality. There is a disconnect in that bonuses are "earned" as business is booked; only when it is clear that the business is defective—and that such defect should have been apparent at the outset—is the hit to earnings recognized. By that time, the CEO has been paid based on the inflated numbers. Fewer than 13 percent of public companies have clawback policies requiring executives to return bonuses based on inflated numbers. So why should they worry about manipulating the figures to get the money upfront?

There is no way to justify any of these pay plans by saying they meet a market test. Marie Antoinette would be ashamed to get paid like this while shareholders are losing money and employees are losing jobs. The last time Congress tried to fix this problem it made it worse by adopting the notorious 162m of the tax code. It poured gasoline on the fire by encouraging the award of stock options. Just thirty years ago, a CEO might get 30,000 options. Now million-option grants are not unusual and even stock option grants have only a tangential relationship to the creation of long-term, sustainable value. As long as CEOs pick the people who serve on their boards and shareholders have no ability to remove them, this will continue. In the 2006 proxy season, 25 director candidates failed to get the support of a majority of the shareholders. Yet 24 of them continue to serve on those boards. If shareholders cannot get rid of directors who agree to pay completely disconnected from performance, it will only get worse.

The pay-performance disparity is so outrageous, so atrocious that it undermines the credibility our system of capitalism. In a global environment, information and the ability to trade in any market at any time will provide our system with the toughest market test in the history of our country. As we compete for capital, we must be able to show those inside and outside our country that we deserve their trust and will provide them with a competitive return instead of shoveling more money into the pockets of the top executives.

I would like to acknowledge the assistance of Paul Hodgson, Alex Higgins, Marjorie Schwietering, Lauren Warmington, and other staff members at The Corporate

Library in preparing this testimony. Many thanks to the committee and its staff for the opportunity to appear, and I will be glad to answer any questions.

Ms. WOOLSEY. Well, thank you, and thank you for knowing how valuable we are.

Mr. WILSON. Particularly the chairwoman.

Ms. WOOLSEY. All right.

Ms. Furchtgott-Roth?

STATEMENT OF DIANA FURCHTGOTT–ROTH, DIRECTOR OF THE CENTER FOR EMPLOYMENT POLICY, HUDSON INSTITUTE

Ms. FURCHTGOTT-ROTH. Madam Chairwoman, thank you very much for inviting me to testify, and I would like to submit my written remarks for the record, if that is all right.

I chose to wear this ring today, because it was the one piece, the one thing that was sent over in 1976 when my father-in-law's family was in Czechoslovakia. They could only send one child to the United States in 1976, and they chose to send my father-in-law. He came with nothing except this ring, which was sent with him in case of emergency.

The ring symbolizes mobility. He came with nothing, yet he became chair of the psychology department in South Carolina. I, his daughter-in-law, am testifying before you today in Congress. His son became an FCC commissioner.

What is important is not equality but mobility and opportunity. We can all be equally poor, like Cuba and Haiti, but what we need to do is focus on workplace opportunities, not on workforce protections that result in reduced opportunities. It is because of opportunities that so many people want to come to the United States today.

There are many problems with traditional measures of inequality, one of the most important being that they don't take into account mobility. One problem is some measures use pre-tax, pre-transfer income, and that doesn't account for the income people actually have to spend.

In the latest data released by the IRS, 97 percent of taxes are paid by the top 50 percent, so people who earn a lot don't have all that income to spend. And people at the lower end receive Medicare, Medicaid, food stamps, housing vouchers. When after-tax and after-transfer incomes are measures, the Commerce Department's data show that inequality has not changed.

Another reason that income inequality looks like it has changed is the Tax Reform Act of 1986, and that changed the taxation of corporate and individual income taxes. Before that, corporate income taxes were lower, so a lot of small businesses were encouraged to file as corporations. After that, it became advantageous for small businesses to file as individuals. So it looked like people—normal people—were making a lot more money, but really it was just a change from corporate tax receipts into individual tax receipts.

Another problem with measures of inequality is demographic changes. Not all households are the same size, and households have shrunk over time, as there are more single parents, more divorces. There are 1.7 people per household in the lowest fifth and

about 3.1, on average, in the top fifth. The differences in household income are larger than differences in income per person.

Also, with the entry of greater numbers of women in the workforce over the past 25 years, something that all of us appreciate, a growing tendency toward dual-income couples polarizes income distribution without any change in individual income inequality. Two earners marrying, if they are two attorneys or two automotive mechanics, results in an immediate change in the distribution, because it takes two lower-income households and makes them into one upper-income household.

A police officer married to a nurse, each at the top of their profession, can earn about $200,000; whereas, if the police officer just had his own income, it would be closer to $100,000.

If more teenagers take after-school jobs, the number of low-income taxed households balloons and income inequality appears to increase.

The demographic characteristics at the bottom fifth of households shed light on consumption patterns. The bottom quintile has the highest average age, 52, while the top quintile has the second youngest age of 47. Believe or not, only 17 percent of households in the top fifth own their houses free of mortgage; whereas, 30 percent of people in the bottom quintile actually own their houses free of mortgage. So we have more assets in the bottom quintile even though they appear to be worse off.

Many people in the bottom quintile are not truly poor. They are older citizens living off accumulated assets and accumulated wealth that has been decried by some witnesses today.

America's workforce isn't in the middle of a surge of inequality—we should be wary of conclusions reached from dubious data, and we should keep in mind other ways of determining inequality, such as by adjusting for household size and consumption expenditures.

To the extent there is inequality in incomes, differences in education are an important factor. A better education gives everyone a better shot at the workplace. Yet putting in place more government benefits and mandated employer-provided benefits to combat alleged problems of inequality isn't going to help the people that we are trying to help, especially women. With the Paycheck Fairness Act on the floor today, we need to be especially careful of different kinds of employer mandates that hurt women, because the unemployment rate for women in the United States is far lower than in those countries that have those larger mandates.

Members should consider doing ways to help the economy grow, such as keeping taxes low, making use of America's oil and gas reserves through oil drilling and exploration so we have a reliable source of domestic energy and removing ethanol mandates that are driving up our food prices.

Thanks so much for giving me the opportunity to testify today.

[The statement of Ms. Furchtgott-Roth follows:]

Prepared Statement of Diana Furchtgott-Roth, Senior Fellow, Hudson Institute

Mr. Chairman, members of the Committee, I am honored to testify before your Committee today on the subject of the income gap in the American middle class.

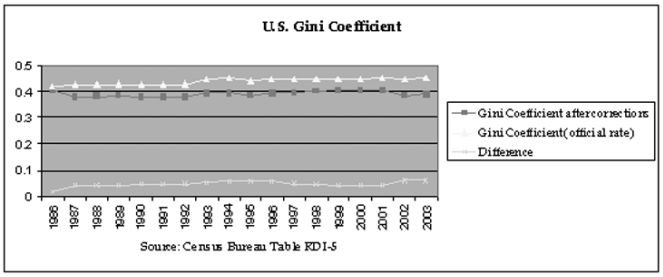
American workers are earning more today than they were a year ago. Real disposable personal income has increased steadily since 1996. Between January 1996 and

May 2008, real disposable personal income increased 54.5 percent. Over past year, from May 2007 to May 2008, real disposable income increased by 7.3 percent. In addition, the Census Bureau reported 0.7 percent increase in median household income from 2005 to 2006 (the 2007 numbers will come out next month).

With increases in income, what has happened to inequality? The popular perception of income inequality is dire. A quick search through the popular press will yield dozens of articles and speeches decrying the increasing excesses of the super-rich while the poor grow ever poorer. Robert Frank's best-selling book, Richistan, portrays the "new rich" who have multiple mansions and staffs of household helpers. David Shipler's The Working Poor: Invisible in America describes those in low-wage jobs, struggling to get by. Yet rather than relying on anecdotes, we should base our views of inequality on a firm understanding of the data.

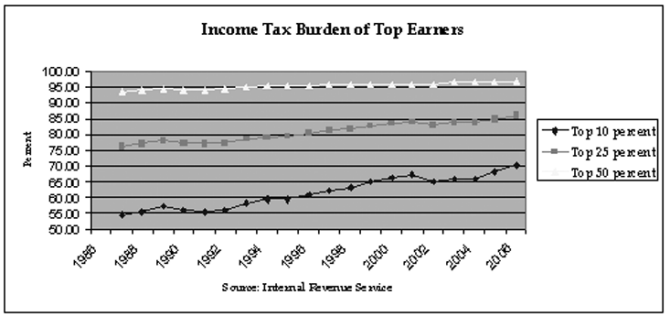
Economists use a variety of measures to determine how equally the income "pie" is divided. These measures include inequality indices and earning shares.

Common to all these measures, however, are certain challenges. All measures need a definition of income, and defining income is not as straightforward as it seems. Some researchers will use pre-tax income, while others will look post-tax income before transfer payments such as food stamps, Medicare, or Social Security. Others use post-tax, post-transfer income. What measure is used makes a significant difference.



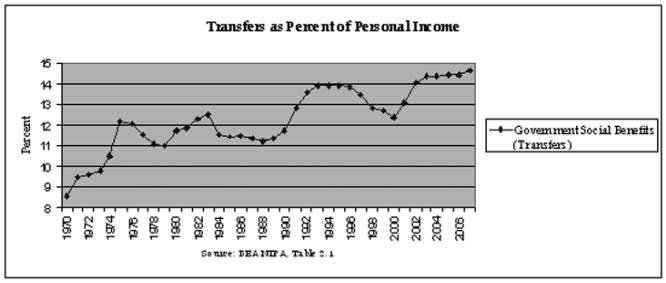
For example, consider the Gini coefficient, as calculated by the Census Bureau. The Gini coefficient is a statistical index inequality ranging from zero to one, calculated from the distribution of income throughout the population. Low values represent low levels of inequality, while values near one mean that income is concentrated among a few individuals. As can be seen from a Census Bureau table using alternate measures of income, the official Gini coefficient is consistently overestimated by about 5 percentage points,[1] after taxes and transfers are accounted for (see figure above).

A report from the Census Bureau concludes that "there have not been any statistically significant annual changes in the Gini index over the last 10 years."[2] A Congressional Budget Office report found that, between 1991 and 2005, the quintile of households with children with the lowest earnings experienced the second greatest percentage increase in income, after the top quintile. The lowest quintile experienced the largest percentage growth in earnings.[3]



The Internal Revenue Service reports that the top 50 percent of earners paid 97 percent of income taxes in 2006, a percentage which increased in almost every year since 1992[4] (see figure above). Meanwhile, personal current transfer receipts, as reported by the Bureau of Economic Analysis, have been steadily increasing (see fig-

ure below). These transfer payments go disproportionately to lower-income individuals. The net effect of taxes and transfer programs is to bring greater equality to the purchasing power of individuals.



Additionally, we need to consider the spending power of American dollars. Low-income households spend a greater portion of their income on goods that have become cheaper with international trade, such as food. High-income households, on the other hand, spend for "high-end services like private secondary schools, college tuition, high-end spas, message therapists, landscape gardeners, and other service providers whose relative prices rise steadily relative to the overall consumer price level."[5] Jerry Hausman and Ephraim Leibtag found in 2004 that a Wal-Mart in a new market decreases food prices by 15 to 25 percent.[6]

Demographic changes can create potentially spurious increases in income inequality. Most inequality measures are calculated from household or family income. So the increasing tendency of high-income men to marry high-income women will boost the inequality among household incomes without changing inequality among individual earners.

Furthermore, not all households are the same size, and household size has diminished over time due to later marriages, fewer children, and divorce. There are 1.7 people in the average household in the lowest fifth of households, and this number rises steadily to 3.1 persons in the top fifth of households. Differences in household income, then, are larger than differences in income per person. Similarly, there are differences in the number of earners per household, with the top fifth averaging 2.1 earners compared to the bottom fifth's half an earner per household.[7] Since more people are working in the higher income households, it is hardly surprising that the household as a whole is earning more.

Besides the questions of determining the "true" Gini coefficient highlighted above, there are concerns when using the Gini coefficient for comparison. It is important to realize that the Gini coefficient represents a snap-shot of inequality. As the working force population changes its average characteristics, the Gini coefficient likewise changes.

Consider an economy where workers have the same earnings experience over their lives. Younger workers earn less than older workers, and earnings rise throughout workers' careers. A snap-shot of this economy will show income inequality between workers even though lifetime income is more equal. In this case, the Gini coefficient indicates less an egregious lack of income equality than a need for good credit markets.

But even more than properly understanding the nuances of the numbers used to track income inequality, we need to understand the data that are used to generate them. A study by Thomas Piketty and Emmanuel Saez is the basis, directly or indirectly, for many of the commentators warning of rising income inequality. This study uses individual income tax returns from 1913 to 1998 (updated to 2001) to chart changes in the top earners' income shares over the past century.

To calculate these shares, Piketty and Saez aggregate the reported income of the top percentage groups of interest (specifically, the top 1 percent) and divide this number by the total personal income reported in the National Income and Product Accounts by the Bureau of Economic Analysis.[8]

Unfortunately, this simple measure is wholly dependent on the consistency of the underlying data. Individual income tax returns provide complicated data to work with, especially over time, because income tax returns provide data on tax units, not individuals. A married couple filing together represent one tax unit, as does their teenage son whose earned $3,350 at his part-time and summer jobs.[9] These three represent one household, but two tax units: one relatively rich, the other relatively poor.

With the entry of greater numbers of women into the workforce over the past 25 years, the growing tendency towards dual income couples polarizes the income distribution without any change in individual income inequality. Two earners marrying, whether they be attorneys or automotive mechanics, results in an immediate change in the income distribution. A police officer married to a nurse, each at the top of their profession, can earn almost $200,00. If more teenagers take after-school jobs, the number of low-income tax "households" balloons and income inequality appears to rise.

The Tax Reform Act of 1986 lowered the top income rate from 50 percent to 28 percent, and raised the capital gains tax to equal the ordinary income rate.[10] Prior to the passage of the Tax Reform Act, it was advantageous for many small-business owners to file under the comparatively lower corporate tax rate. After the Act, the individual tax rate was more favorable than the corporate rate, so small businesses switched to filing individual tax returns. This explains that large jump in the inequality series of Piketty and Saez between 1986 and 1988. A mass switch from corporate to individual filings by small-business owners fits this pattern perfectly.[11] After correcting for this change and the effect of transfer payments, Cato Institute economist Alan Reynolds finds that "the apparent increase of 1.7 percentage points in the top 1 percent's share from 1988 to 2003 in the unadjusted Piketty-Saez estimates becomes no increase."[12]

As well as analyzing income inequality directly, we can consider consumption inequality. This provides a better view of how much citizens actually spend, and therefore how well Americans live. Consumption spending generally has fewer fluctuations than income, so consumption data will be influenced less by transitory shocks. Data from the Consumer Expenditure Survey of the Bureau of Labor Statistics adjusted for the number of people per household gives us insight into spending equality among Americans.[13]

In 2006, the last year for which data are available, Americans in the lowest quintile of pre-tax income spent $12,006 per person, compared to $16, 572 per person in the middle fifth household, and $30, 371 per person in the top quintile. On a per person basis, the top quintile spends only 2.5 times what the bottom quintile does, and 1.8 times what the middle fifth does.

When spending is broken down into categories, results are similar. The bottom quintile spends $874 per person for health costs, about 1.5 times as much as the top quintile's $1318 per person. For food, the bottom fifth paid $1,878 while the top fifth paid $3,304. The top 20 percent spend only 1.8 times as much. In housing, the lowest quintile spent $4,781 to the top's $9,700—about two times as much. In all these categories, the middle quintiles are roughly in between.

The areas where the high-income quintile outspends the low-income quintile are personal insurance and pension, entertainment, and transportation. The top 20 percent spend 14.6 times more on personal insurance than the lowest fifth, but only three times more than the middle fifth. In both entertainment and transportation, the top quintile expends about three times as much as the bottom quintile. The top quintile outspends the middle quintile in entertainment and transportation by 2.2 times and 1.7 times, respectively. The pattern that emerges is not one of extreme inequality. The top income earners do not outspend the lowest earners by extreme amounts.

The demographic characteristics of the bottom fifth of households shed light on consumption patterns. The bottom income quintile has the highest average age, 52, while the top quintile has the second youngest age at 47 (the second-highest quintile has an average age of 46). Only 17 percent of the top twenty percent own homes mortgage-free, with 75 percent still paying off their mortgage; 30 percent of the bottom fifth own homes free of any mortgage, and only 13 percent have to spend for mortgages.[14]

These data support the conclusion that some households in the bottom income quintile are not truly poor. Instead, they are older citizens living off accumulated savings. Some of those in the top quintile are at the peak of their earning careers, and are saving up for their future.

Another important difference between income quintiles is in education. The percentage of reference people in each household with a college education rises to 83 percent in the top quintile, starting at 40 percent for the lowest 20 percent of households.[15]

Studies consistently find high returns to education. A study by economists Louis Jacobson, Robert LaLonde, and Daniel Sullivan on displaced workers in Washington State found that workers increased their incomes by 7 to 10 percent per year of community college, the same as students entering directly from high school.[16] Another study by economists Thomas Kane and Cecilia Rouse found that these returns,

about a 5 to 10 percent improvement in earnings per year of education, are remarkably similar across community colleges and four-year colleges.[17]

Perhaps more importantly, the subjects studied make a difference. A related study by Jacobson, LaLonde, and Sullivan find higher returns, 14 percent income improvement per year of education for men and 29 percent for women, when more technical or quantitative subjects are taken.[18]

Education gives Americans the skills they need to succeed in today's dynamic business world. Improvements to the education system focused on providing quality education in key areas will increase the human capital of America's citizens and help workers attain their potential in the workplace.

America's workforce is not in the midst of a surge of inequality as popularly portrayed. We should be wary of conclusions reached from dubious data, and keep in mind other ways of determining inequality, such as through consumption expenditures. To the extent that there is inequality in incomes, differences in education are an important factor. A better education system gives everyone a fairer shot in the workplace.

Putting in place more mandated employer-provided benefits to combat alleged problems of inequality would hurt those Americans that members of Congress are seeking to help. Many of the protections are aimed at women. Examples of such protections include paid maternity leave, government-provided child care, and "paycheck fairness"—mandating that women be paid the same as men not for equal work, as is the case now, but for jobs of equal worth.

Yet women in the United States have enjoyed a low unemployment rate, one comparable to men's, because low taxes and lack of employer mandates encourage women to work outside the home and be hired. This has remained true over the past year, as the economy has slowed. According to BLS data, the 2007 unemployment rate for American women was 4.5 percent and the rate for men was 4.7 percent. In June, 2008, the adult female unemployment rate in the United States was 4.7 percent, compared to the male rate of 5.1 percent. Of particular note is that the unemployment rate for American women moves closely to the rate for men.

In other countries, unemployment rates for women are higher than in the United States. In 2007, compared to the rate for American women of 4.5 percent, the rate for women in Canada was 4.8 percent; Australia, at 4.8 percent; France, at 9.1 percent; Italy, at 7.9 percent; Sweden, at 6.4 percent; and the UK, at 5 percent. In Italy, France, the Netherlands, and Sweden, women have a significantly higher unemployment rate than men.[19]

Not only do women in the United States have a lower unemployment rate, they also find jobs more quickly. According to the latest release from the OECD, only 9.2 percent of unemployed women in the United States had been unemployed for a year or more. This compares favorably to Australia, where 15.2 percent of unemployed women were unemployed for a year or more; France, where it was 43.3 percent; Germany, where it was 56.5 percent; Italy, where it was 54.8 percent; Japan, where it was 20.8 percent; the Netherlands, where it was 43.6 percent; Spain, where it was 32.2 percent; Sweden, where it was 12.2 percent; and the UK, where in 2006 14.9 percent of unemployed women had been unemployed for a year or more.[20]

The labor force participation rate for American women is also high. From 1980 to 1990, the participation rate rose 6 percentage points to 57.5 percent as large numbers of women entered the workforce. The rate peaked in 1999 at 60 percent, and in 2007 was only seven tenths of a percentage point lower, at 59.3 percent. In April 2008, 59.6 percent of women were in the labor market. The 2007 labor force participation rate for women was higher than in Australia at 59 percent; Japan, at 47.9 percent; France, at 51.3 percent; Italy, at 37.9 percent; the Netherlands, at 59 percent; and the UK, at 56.5 percent.

The way to reduce economic inequality is to provide more education and job opportunities for those in lower income groups. To that end, we need to focus not only on education, but also on how to spur economic growth and keep prices low. Members could consider keeping taxes low, making use of America's oil and gas reserves through oil drilling and exploration so that we have a reliable source of energy, and removal of the ethanol mandates that are driving up our food prices.

Thank you for giving me the opportunity to testify today. I would be glad to answer any questions.

ENDNOTES

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[4] Internal Revenue Service, SOI Tax Stats—Individual Income Tax Rates and Tax Shares, Table 1 "Number of Shares, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates." Available at *http://www.irs.gov/taxstats/indtaxstats/article/0,,id=129270,00.html*

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[6] Hausman, Jerry and Ephraim Leibtag. "CPI Bias From Supercenters: Does the BLS Know that Wal-Mart Exists?" NBER Working Paper No 10712 (August 2004).

[7] U.S. Department of Labor, Consumer Expenditure Survey, Table 55. Available at ftp://ftp.bls.gov/pub/special.requests/ce/aggregate/2006/quintile.txt

[8] Piketty, Thomas and Emmanuel Saez. "Income Inequality in the United States, 1913-1998." Quarterly Journal of Economics, Vol 118, Is 1 (Feb 2003) pp 1-39.

[9] Internal Revenue Service, "2007 Inst 1040 Instructions for Form 1040 and Schedules A, B, C, D, E, F, J, and SE." Chart B, pg 7, for dependent children who are not blind or over 65 years of age.

[10] Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085, as reported by Stacey Kean and David Brumbaugh, Congressional Research Service, CRS Report for Congress No. 87-231E, "Tax Reform Act of 1986 (P.L. 99-514): Comparison of New with Prior Tax Law.".

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[12] Ibid., at 11.

[13] All calculations on per-person spending are performed using U.S. Department of Labor's Consumer Expenditure Survey, table 1, available at *http://www.bls.gov/cex/home.htm.*

[14] Ibid.

[15] Ibid.

[16] Jacobson, Louis, Robert J LaLonde and Daniel Sullivan. "The Impact of Community College Retraining on Older Displaced Workers: Should We Teach Old Dogs New Tricks?" Industrial and Labor Relations Review, Vol 58, No 3 (April 2005) pp 398—415.

[17] Kane, Thomas J. and Cecilia Elena Rouse. "The Community College: Educating Students at the Margin Between College and Work," Journal of Economic Perspectives, 13, no. 1 (Winter 1999): 63-84.

[18] Jacobson, Louis, Robert J LaLonde and Daniel Sullivan. "Is Retraining Displaced Workers a Good Investment?" FRB of Chicago Economic Perspectives, Vol 29, Iss 2 (2nd Quarter 2005) pp 47-66.

[19] Bureau of Labor Statistics, "Comparative Civilian Labor Force Statistics, 10 Countries, 1960-2007," Washington, DC: Department of Labor, Updated April 18, 2008.

[20] OECD Employment Outlook 2007, Statistical Annex Table G, p 267.

Ms. WOOLSEY. Thank you.

Dr. Bernstein?

STATEMENT OF JARED BERNSTEIN, DIRECTOR OF LIVING STANDARDS PROGRAM, ECONOMIC POLICY INSTITUTE

Mr. BERNSTEIN. Chairman Woolsey, Ranking Member Wilson, I thank you for the opportunity to testify—happy birthday—and I commend the committee for examining what many economists and policymakers consider the most important economic challenge we face.

Of course, in the current economy challenges abound. The economy, while not officially in recession, is clearly weak in key sectors, most notably in the job market. As we meet today, even as the economy continues to expand, the paychecks of middle income families are—the paychecks of middle income persons are falling behind their families' economic needs, and living standards are sliding.

Though these problems are of recent vintage, they are also a microcosm of the topic we are here to discuss today: The inequality of economic outcomes.

Other witnesses have presented the statistics to make the case. I will only add a few examples and then discuss the causes of the problem and suggest some policy ideas.

The gap between the economy's growth and the income of the median family in the 2000s, in this business cycle, is one of the

clearest examples of the inequality phenomenon. While output per hour of productivity increased smartly in the 2000s, up 19 percent, the real income for the typical family fell—fell—by about one percent. Given the concentration of growth at the top of the income scale, middle income families responsible for creating that growth are failing to reap its benefits.

The increase in inequality is remarkably consistent across data sets, income definitions and other adjustments. The CBO data, as Bob Greenstein described, is the most complete source. It adjusts for taxes, it adjusts for transfers, it adjusts for family or household size, as was just raised. In large part, because of their addition of capital gains, critically important, these data show particularly large increases in inequality compared to, say, census, which admit those gains.

Consumption inequality trends reflect those of income inequality. Again, in the 2000s, spending data revealed that expenditures fell three percent real for households in the bottom two-fifths, relatively flat in the middle and up seven percent for households at the top of the scale.

Inequality is much more severe in the U.S. compared to that of most other advanced economies, and in reference to what Diana was just talking about regarding mobility, it is a particularly troubling aspect of such comparisons that income mobility is greater in these countries, except in the U.K.

Now, these differences are often raised to suggest that more extensive social protections in Europe and the Nordics hurt their macro economy, but the evidence belies this claim: Both Norway and the Netherlands, for example, have higher productivity than the U.S. and lower unemployment rates. Excluding the U.S., average OECD employment growth was greater in the 2000s than it was here, and poverty was considerably lower.

Now, turning to causes, increased inequality of labor earnings is usually attributed to technological change and the unmet demand of employers for skilled workers. Now, the idea here is that the production of the goods and services in the economies become more complex, and employers need more highly skilled workers. When the supply of such workers is low relative to employers' demand, the relative wage increases.

Now, this common sense explanation certainly makes sense and describes the relevant dimension of the problem, but it is too reductionist. It happens to be a very good idea for any economy to increase the skilled labor force—that is integral to a productive economy—but it can't be the sole reaction to rising inequality.

Now, first, we have to recognize that 70 percent of today's workforce has less than a college degree. Thus, unless we are willing to consign this majority to stagnant living standards, simply pressing for higher skills is too narrow an agenda.

Another important reason why the skills explanation is incomplete is that it refers largely to labor earnings, while non-labor, or capital income—profits, dividends, interest income, capital gains—has become increasingly important as a component of rising inequality.

Bob Greenstein mentioned the first "do no harm" principle of public policy regarding the contribution of tax changes since 2001

to increasing inequality, so I won't spend any time on that, but beyond tax policies there are other sins of omission that have contributed to higher inequality. We failed to strengthen workers' legal ability to organize, we have gutted investments in their skills and training, under-invested in their public—in our public infrastructure and stood by while the employer-based systems of health coverage and pensions slowly unraveled.

I can elaborate on those items as—in the Q and A, but I will stop there in the interest of time.

Thank you.

[The statement of Mr. Bernstein follows:]

Prepared Statement of Jared Bernstein, Senior Economist, Economic Policy Institute

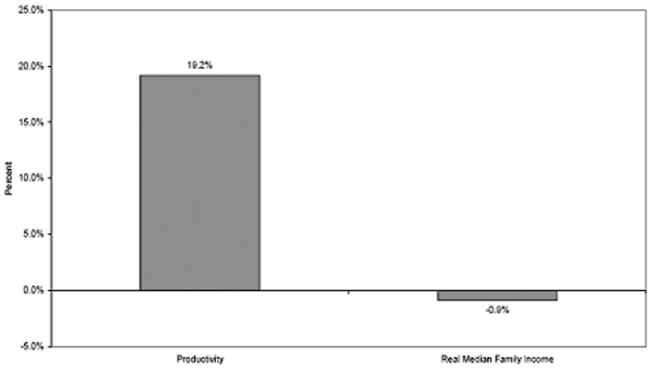
Chairwoman Woolsey, Ranking Member Wilson, I thank you for the opportunity to testify, and I commend the committee for targeting the critical challenge of economic inequality and the American middle class. In doing so, you are targeting what many economists and policy makers consider the most important economic challenge we face.

Of course, in the current American economy, challenges abound. We are faced with the aftermath of the bursting of a massive housing bubble, and the spillovers from that event are significantly constraining financial markets. The economy, while not officially in recession, is clearly weak in key sectors, most notably in the job market, where employment is down by about 440,000 jobs on net, and unemployment up about a point compared to one year ago to 5.5%. The underemployment rate, a more comprehensive measure of diminished job opportunities was 9.9% in June. These job market declines, in tandem with spiking prices driven by higher food and energy costs, are leading to real declines in compensation. Simply put, the paychecks of middle-income are falling behind these families' economic needs, and their living standards are sliding.

Though these problems are of recent vintage, and can to some extent be closely tied to the bursting of the housing bubble, they are also microcosm of the topic we are here to discuss today: the inequality of economic outcomes.

Figure 1 shows this relationship by plotting the productivity of the American workforce against the real income of the median family. While output per hour increase smartly in the 2000s, up 19%, real income for the typical family fell by about 1%. In fact, this split between productivity and median family income has been ongoing since the mid-1970s, and is regarding as one symptom of increasing inequality. When economic growth is concentrated at the top of the income scale, many families responsible for creating that growth will fail to reap its benefits.

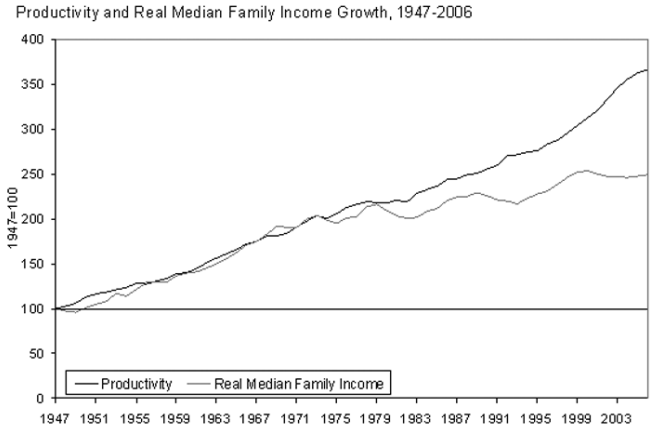
Growth of productivity and real median family income, 2000-07



Source: EPI's analysis of Census and BLS data. 2007 real family income is an EPI forecast (we forecast that real family income rose 0.8% in 2007)

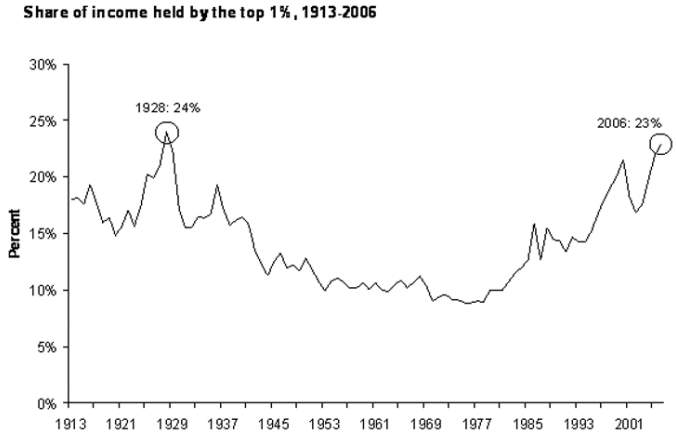
This period stands in stark contrast to the first few decades of the post-WWII era, when, as shown in the next figure, productivity and median family income grew in

lock-step, both doubling over these years. Clearly, the current era of rising inequality began in the mid-1970s, a fact that will be useful in diagnosing the problem later in this testimony.



Source: Author's analysis of U.S. Census Bureau and U.S. Bureau of Labor Statistics data.

Since committee staff has asked me to focus on causes and solutions, I will spend little time on the spate of statistics that document the increase in inequality. Those interested in such analysis should examine Chapter 1 of the book State of Working America, wherein myself and co-authors (Mishel, Shiersholz) present the evidence in great detail. Here, I will offer one very long term look at the issue, which tracks the share of national income held by the top 1%, including capital gains (an important component of income/wealth inequality), going back to 1913 (Figure 3). In 2006, most recent data point for this series, this share was 23% the second highest in the series. As the figure reveals, there was only one year with a higher share: 1928. Note also that the current share is twice that of the early 1970s.



Source: Piketty & Saez (2008).

Such evidence of historically high levels widely accepted. The causes, on the other hand, are hotly debated. And since appropriate solutions require accurate diagnoses, I will spend the rest of this testimony on causes and solutions.

Inequality: Causes and Solutions

Labor Earnings: Most commonly, increased inequality of labor earnings is attributed to technological change and the unmet demands of employers for skilled workers. Often, this explanation is discussed under the rubric of "skill biased technological change," or SBTC. Simply stated, the theory maintains that the production of the goods and services in the economy has become more complex, and employers

need more highly skilled workers to undertake the necessary tasks. When the supply of such workers is low relative to employers' demands for them, the relative wage—the pay of highly skilled workers compared to others—increases, i.e., wage inequality goes up.

In this sense, some economists view wage inequality as a race between technology and the supply of skilled workers. In periods when technological advances win that race, inequality rises, and visa-versa. Offsetting rising inequality in this framework requires an increase in the relative share of skilled workers, which, in the policy debate, usually translates into more college graduates with the skill sets that are complementary to the relevant technologies.

This common-sense explanation certainly makes sense and describes a relevant dimension of the problem, but it is too reductionist. By definition, if inequality is increasing in this model, skill deficits are to blame. Such analysis can only return one policy recommendation: more skilled workers, or, more precisely, raise the relative supply of college graduates. That is generally a good idea for any economy, since skilled labor is integral to a productive economy, but it cannot be the sole reaction to rising inequality.

First, we must recognize that 70% of today's workforce has less than a four-year college degree. Thus, unless we are willing to consign this majority to declining living standards, either relative or absolute (i.e., real income stagnation), simply pressing for higher skills is too narrow an agenda.

Second, in recent years, the college wage premium has actually been fairly flat, as shown in the table below. The values in the table are the wage advantage of college-education over high-school educated workers, controlling for the variety of factors noted above. The measure grew by about 14 percentage points over the 1980s, about half that much over the 1990s, and about zero in the 2000s. Thus, to the extent that wage inequality rose over the 1990s and especially the 2000s, it was increasingly a function of growing disparities within educational groups.

REGRESSION–ADJUSTED COLLEGE PREMIUM

Year	Percent
1979	23.4%
1989	37.8%
2000	45.3%
2006	45.4%

Source: State of Working America, 2006/07

Heuristically, this might be understood be considering a school teacher, a mid-level office manager or HR director, a lower-level computer programmer, compared to an investment banker. All of these workers could be college-educated, but many faced stagnant earnings in recent years (the real college wage rose 2.5%, 2000-07, compared to 15%, over the 1990s), while others—the banker in our example—experienced large gains. This is an example of "within-group" inequality growth, and it is less amenable to skill upgrading solutions.

Thus, while increasing the share of skilled workers is part of the solution, it is not the sole solution. It remains a critically important one, and I return to it below. But those interested in wielding policy to turn this inequality tide need also consider various mechanisms and institutions within our economy that have historically ensured that the benefits of growth are more broadly shared.

Capital Income:[1] Another important reason why the skills explanation is incomplete is that it refers largely to labor earnings, while non-labor, or capital income—profits, dividends, interest income, capital gains—has become an increasingly important component of rising inequality, particularly at the very top of the income scale.

Two trends have reinforced the increasing important role of capital income: 1) such income has become more concentrated among households at the top of the income scale, and 2) capital income accounts for a larger share of total income.

On the first point, the receipt of capital income has become much more concentrated over the last few decades, according to the data from the Congressional Budget Office. Whereas the top 1% received 34.2% of all capital income in 1979, their share rose to 58.6% by 2000 and rose further to 65.3% in 2005 (the latest year for these data). Thus, the top 1% roughly doubled its share of capital income between 1979 and 2005. Correspondingly, the share of capital income going to the bottom 90% declined from 36.7% in 1979 to just 15.1% in 2005.

[1] This section is adapted from the forthcoming State of Working America, 2008/09, by Mishel, Bernstein, and Shierholz.

Second, the economy, particularly the corporate sector (excluding government, non-profits, and proprietors) is now generating both higher returns to capital income (greater profits and interest), and this has expanded capital's share of total income. For instance, income such as capital gains, interest, and dividend income comprised 18.0% of personal market-based income in 1979 and 24.2% in 2007. This necessarily generates greater income inequality since, as the CBO reveal, most capital income is received by those who are well off.

Likewise, the share of income in the corporate sector going to capital income in the recent recovery was the highest in nearly 40 years: in the 2004-07 recovery capital income accounted for 22.3% of corporate income, a jump from its 19.2% share in the 1976-99 recovery. The share going to compensation was correspondingly at a low point. The resulting historically high returns to capital are associated with the average worker's compensation being 4.4% lower and the equivalent of transferring $206 billion dollars annually from labor compensation to capital incomes.

First, Do No Harm: All of the data and arguments presented this far are in regards to inequality from market outcomes, i.e., before taxes and transfers. And clearly, these market outcomes have become much more unequal in terms of distribution. It is thus important not to exacerbate the problems we have with policies that further amplify market-driven inequalities. For example, changes since 2001 to the Federal tax code have worsened the distributional outcomes, by disproportionately lowering the tax liabilities of the wealthiest families.

Such regressive tax policies hurt most families both directly and indirectly. Directly, they exacerbate the already excessive inequalities in market outcomes (i.e., the pretax distribution). Indirectly, they diminish revenues such that the Federal government is less able to perform needed functions (without borrowing), many of which, like safety net policies, disproportionately benefit the least well off. While the direct impact of the regressive tax cuts has been extensively measured and is well-appreciated, this indirect effect—the defunding of public services that boost economic security of the least advantaged—is also important and problematic.

Beyond tax policy, other policy "sins of omission" have contributed to higher inequality. We have failed to strengthen workers' legal ability to organize, gutted investments in their skills and training, under-invested in our public infrastructure, or stood by as the employer-based systems of health coverage and pensions slowly unravel.

The following section briefly suggests policies to proactively push back against the trends toward greater inequality.

Reconnection Growth and Living Standards of Middle and Lower Income Families[2]

These policies can be grouped into four categories, bargaining power, macro conditions, safety nets, and investments in human and physical capital.

Bargaining Power: The inability of most workers' to bargain for a greater share of the value they're adding to our economy is at the heart of the various gaps documented above. Historically, a broad set of policies and norms, including unions, minimum wages, defined-benefits pensions, and health care provisions, helped to lift workers' ability to bargain, and were thus associated with more broadly shared prosperity.

Many factors have eroded these institutions and norms. Global competition clearly has strong upsides, as the increased supply of goods and capital has lowered prices and interest rates. But this same increased supply has hurt the bargaining power of many workers in this country, particularly those with less than a college education. Indeed, recent trends in the offshoring of white collar work are reducing the bargaining power of more highly educated workers as well.

Unions play a key role in precisely this area. Research reviewed in Mishel et al (2007, table 3.37) shows that the decline in union density explains one-fifth to one-half the increase in male wage differentials over the past 25 years, and union wage premiums remain highly significant, even after controlling for human capital and observable characteristics.

The decline in unions is partly a mechanical function of the loss of jobs in unionized industries, like manufacturing, but the more important explanation is the very unbalanced playing field on which unions try to gain a foothold. In fact, Freeman (2007) argues that slightly more than half of the non-union workforce would like some type of union representation, a finding that is not particularly surprising given the divergence of incomes and productivity shown above.

[2] Some of this section originally appeared in earlier testimony (*http://www.epi.org/content.cfm/webfeatures—viewpoints—testimony—20080213*) though I have updated some of the analysis.

The problem here is that the legal and institutional forces that have historically tried to balance the power of anti-union employers and their proxies have significantly deteriorated in recent decades, as described by Shaiken (2007). One legislative solution is the Employee Free Choice Act (EFCA), a bill that helps to restore the right to organize in the workplace. A central component of EFCA is so-called majority sign-up or "card-check," which gives the members of a workplace the ability to certify a union once a majority sign authorizations in favor the union. The law also puts much needed teeth back into labor law by ratcheting up the penalties for those who violate the rights of workers trying to organize or negotiate a contract.

Macro-Economic Conditions: Full employment—a tight match between labor supply and labor demand—is another important criterion for reducing the gap between overall growth and living standards of working families. Historically, very low unemployment rates have also been a key contributor to workers' bargaining power, ensuring that employers needed to bid compensation up to get and keep the workers they needed in order to meet the demand for their goods and services.

We do not need to look back too far in time to corroborate such assertions, as the latter 1990s was a period of uniquely low unemployment in the context of the last few decades (unemployment was 4% on average in 2000). Overall poverty fell by 2.5 points, 1995-2000, but declines among minorities that were more than twice that magnitude. In the 2000s, though unemployment did fall to the mid-four percent range at its lowest, job markets were never as tight, job creation was much weaker, and poverty was higher at the end of the cycle than at the beginning.

Such trends are not at all unique to the 1990s cycle: longer term analysis confirms the result. For many of the years over the period 1949-73, the unemployment rate was actually below the so-called NAIRU: the lowest unemployment rate considered to be consistent with stable prices.[3] Recall from Figure 2, however, that this was the period when real median family income grew in step with the overall economy. Conversely, over the post-73 period, the labor market was often slack, as unemployment was higher than the rate associated with full employment. As has been shown, middle-incomes grew much more slowly over these years and inequality increased.

Of course, the conventional response would be that inflation must have grown more quickly over the earlier period, when job markets were especially tight but, in fact, the opposite is true. Even controlling for the steep inflation of the latter 1970s, inflation actually grew more slowly when the job market was "tight than recommended," at least based on the NAIRU criterion. We relearned this lesson in the latter 1990s, also a period of decelerating price growth, even while the unemployment rate was headed for 30-year lows.

In order to take a closer look at the benefits of full employment, and the costs of its absence, the next table examines these dynamics from the perspective of African-American median income. I take advantage of the Congressional Budget Office's series of the so-called "natural rate" of unemployment (the rate associated with stable price growth). By comparing this rate to the actual unemployment rate, we have a measure of whether the job market was above or below full employment (i.e., slack, meaning lots of job seekers and too few jobs, or taut, meaning the a tight match between the number of workers and the number of jobs).

The first column of the table accumulates the annual percentage-point differences over the two time periods. Thus, if CBO's natural rate was 5% and the actual jobless rate was 4.5%, this would show up as a -0.5 percentage point in the analysis. Between 1949-73, the unemployment rate was often below the "natural rate," cumulatively 19 percentage points. This happens to be about the same number of points that unemployment was above this rate in the latter period. In other words, in the first period, job markets were typically much tighter than in the second period.

When job markets were much tighter—when the unemployment rate average 4.8%—the incomes of black families grew at an average annual rate of 3.7%, compared to less than 1% in the latter period, when unemployment average 6.2%. Of course, many other factors were in play here. As shown above, every group's income grew more slowly in the latter period. The early progress of blacks grew off of a very low base, making it easier to post large percentage gains. Also, a larger share of black families was headed by single parents in the latter period, and this too contributed to the income slowdown. But less favorable job market conditions surely played an important role as well.

The last column in the table is offered to rebut the commonly heard caveat regarding tight job markets: they generate unacceptably high levels of inflation. This simple comparison shows that inflation was lower when job markets were much

[3] NAIRU is an acronym for non-accelerating rate of unemployment. These findings are described in Bernstein (2007a).

tighter, contradicting the simple story. Clearly, tight labor markets, persistently below the supposed natural rate, have been associated with much better income growth for African-American families.

FULL EMPLOYMENT, AFRICAN–AMERICAN FAMILY INCOME, UNEMPLOYMENT, AND INFLATION, 1949–2006

	Cumulative Points Below or Above Full Employment	Real Annual Growth, Median Income, Afr-Am Families	Average Unemployment	Inflation*
1949-73	−19.1%	3.7%	4.8%	2.4%
1973-2006	20.7%	0.8%	6.2%	3.7%

*Post-73 comparison leaves out 1979-82 to avoid upward bias. Including these years gives an average of 4.3%.

Sources: CBO NAIRU estimates; Census Bureau, median family income (RS deflator); BLS, unemployment; BLS, CPI-RS deflator.

In this regard, the 2000s were an important reminder of the impact on minorities of less then full employment. Interestingly, once the jobless recovery ended in the fall of 2003, the job market over this cycle was roundly praised by many commentators, mostly with reference to the low unemployment rate. But employment growth was weak over this recovery, and the low unemployment rate partially masked other problems (like declining employment rates) that depressed the bargaining power of minority workers.

The policy levers here, at least in normal times, i.e., outside of recessions, rest mainly with the Federal Reserve, but Congress can also play an important role which I discuss below under the rubric of investment policy.

Safety Nets: Historically, working families in our country have depended on employers to provide health care and pensions, but it is not an exaggeration to observe that this system of employer-based coverage is slowly unraveling. A slow but undeniable shift is occurring, as the economic risks associated with illness and aging out of the workforce are shifting from employers to workers. This shift is not simply affecting the least skilled workers, but, as Gould (2007) shows in the area of employer-based health coverage, it is reaching workers at all wage and skill levels. In the area of pensions, the shift from defined benefits (a guaranteed pension) to defined contribution has been at the heart of the process of shifting risks from firms to workers.

These shifts have motivated a vibrant debate regarding reform of our health care system. Such reform is especially urgent given the realization that the rate of increase in health spending in both the public and private sector is unsustainable. But this debate also has considerable bearing on the inequality debate, since the distribution of health care coverage and even outcomes have increasingly been skewed in a similar manner to other economic variables discussed thus far.[4] And in this regard, certain types of health care reform, such as "pay or play," or single payer models, could also involve considerable redistribution from the with above average care to those with less (or no) coverage. Similarly, the lack of savings preparedness among many persons approaching retirement (see Weller and Wolfe, 2005) and the shift from guaranteed pension underscores the need for pension reform as well.

It is beyond my scope here to review these plans. I refer interested parties to EPI's Agenda for Shared Propserity, an initiative by our institute to elaborate in some detail the best plans for meeting these challenges. I raise these issues in the context of this testimony because in this era of increasing inequality, health and pension coverage, especially through the job, are eroding, even as the economy expands. As ongoing technological change, globalization, and the lost bargaining power of many in the workforce have led to trends documented above, employers have been in the process of backing off their historical commitments to their workforce in many ways, including these types of coverage. And of course, the least advantaged workers rarely had such coverage to lose in the first place.

The inequality data along with information on profitability reveal that it is not for lack of resources that firms have been cutting back on health and pension coverage, although rising health costs can and should also be viewed as a competitiveness issue. Instead, it is yet another symptom of the unbalanced nature of growth in the current economy, as wealth flows upwards and risks flow down.

As these policy debates unfold, I urge the committee to view the issue of health care and pension reform as one that is intimately related to the findings regarding incomes, wages, and inequality in the first section of my testimony. By helping to

[4] *http://www.epi.org/content.cfm/webfeatures—snapshots—20080716.*

provide workers with access to health care and pensions, we take a huge step towards improving job quality and blocking the ongoing risk shift.

Finally, given the changes in the structure of work and the demography of the workforce, our nation's Unemployment Insurance system is also in need of reform and modernization. The Unemployment Insurance Modernization Act, already passed by this chamber, would make such changes, including providing benefits to both part-time workers and those who leave their jobs for compelling family reasons. The bill also accounts for shorter job tenures by considering a worker's most recent work history when determining eligibility for UI benefits.

Investments in Human and Physical Capital: The emphasis in this section thus far has been more towards creating good jobs than on improving the skills of workers. That "demand-side" emphasis is important, because, as noted earlier 70% of the workforce is non-college educated, and we must have a strategy for improving the quality of all jobs, not just those for workers with high levels of education. Similarly, regardless of skill levels, all workers will benefit from more effective and efficient safety nets.

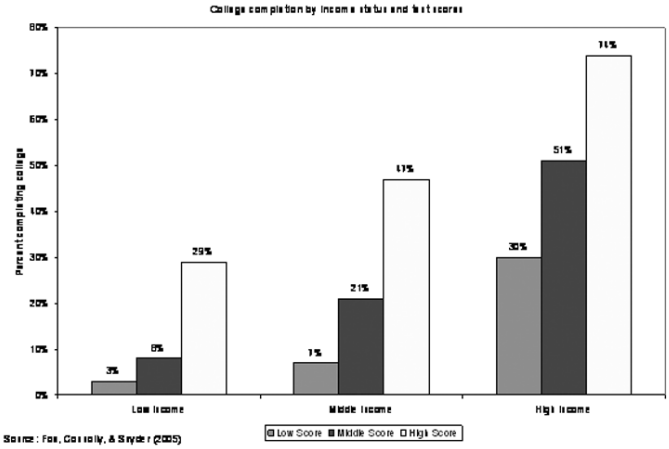
But it's also critical to invest in the skills of the workforce of both today and tomorrow. Unfortunately, our budgetary priorities have been moving in the opposite direction, as federal budgets over the past few decades have shortchanged training programs. Eisenbrey (2007), for example, shows that Federal investment in employment services and training is down about $1 billion in real terms since 1986 (from about $6 to $5 billion, 2006 dollars) even while the workforce has grown in size considerably over those years. The result is a decline in the budget for worker training and services from $63 to $35 per worker, in 2006 dollars.

According to the Coalition for Human Needs (2008) analysis of Congressional appropriations for a number of training programs, real declines have occurred in a number of job training programs between FY05 and FY08. Spending on both adult (-12%) and youth training (-14%) through the Workforce Investment Act are down, as are dislocated worker training (-9%) and adult basic education (-12%).

As Savner and Bernstein (2004) discuss, one reason this disinvestment is misguided is that recent initiatives in worker training have shown considerable promise relative to earlier, less effective approaches. Our analysis was partly motivated by the evident limitations of work-first policies, i.e., programs that placed workers in jobs with little attention to job quality or career opportunities. In reaction, there has been a growing emphasis on programs designed to help job seekers prepare for good jobs and advance to careers. As we wrote:

"This new generation of programs shares several key elements. First, they're grounded in extensive knowledge of the local labor market, focusing on occupations and industries that offer the best opportunities for advancement. Second, they help workers access education and training at community colleges, community-based training programs, and union-sponsored programs that work with employers to design curricula based on the skills that employers actually need. And third, they provide access to remedial services—often referred to as "bridge" programs—so that people who have weak basic skills can prepare for postsecondary-level programs."

Savner and I also recognized that even the best training programs will not work when the jobs aren't there. There will always be disadvantage localities beyond the reach of even the strongest macroeconomic booms, and neither full employment in the rest of the economy nor the most integrated training program will help. In these cases, we advocate the creation of public-service jobs to keep people gainfully employed, drawing on the successful experience of transitional jobs programs that have sprung up around the country using public funds to create work for people struggling to get a foothold in the labor market.



Source: Fox, Connolly, & Snyder (2005)

Of course, educational disadvantages begin well before most people reach the workforce. Income inequality itself is a factor, preventing children's whose abilities should lead to higher academic achievement, but whose income class blocks their opportunity. Figure 4 shows that even once we control for academic ability, it remains the case that higher income children are more likely to complete college. Each set of bars shows the probability of completing college for children based on income and their math test scores in eighth grade. For example, the first set of bars, for the students with the lowest test scores, shows that 3% of students with both low scores and low incomes completed college, while 30% of low-scoring children from high-income families managed to complete college.

The fact that each set of bars has an upward gradient is evidence against a meritocratic system. The pattern implies that at every level of test scores, higher income led to higher completion rates. The third set of bars, for example, shows that even among the highest scoring students in eighth grade, only 29% of those from low-income families finished college, compared with 74% of the from the most wealthy families. In fact, this 29% share is about identical to the completion rates of low-scoring, high-income students (30%), shown in the first set of bars. In other words, high-scoring, low-income children are no more likely to complete college than low-scoring, wealthy children.

Such barriers to higher education revealed in these last two figures are costly in terms of reduced mobility. Recent research by mobility analysts at the Brookings Institution revealed that among those who lived as children in the lowest income families, college completion was strongly associated with leaving the bottom fifth in adulthood: 16% of those with a college degree remained low-income as adults, compared to 45% without college. Similarly, 54% of high-income children who completed college were high-income adults. But less than half that share—23%—without a college degree managed to maintain their top-fifth status. That is, 77% of the children who grew up in top-fifth families but failed to complete college, fell to lower income classes as adults.

Though much recent educational policy has stressed accountability and standards, these results should serve to remind us that education policy designed to offset inequality also needs to be concerned with access to educational opportunity. Students with the cognitive strengths to achieve higher educational completion are too often blocked by income constraints, and the costs of such barriers in terms of diminished mobility are very high indeed.

Along with human capital, investments in public physical capital should also be considered. Though such ideas are not typically discussed in the context of inequality, I raise them as such here, because I believe they are an important complement to the macroeconomic discussion above. The reality of a recession-like contraction in the job market means that the bargaining power associated with tighter labor markets is conspicuously absent. As such, workers wages and compensation are falling in real terms, due to slower wage growth and fewer hours of work (faster price growth is also a major factor for real wage losses in the current context). In this regard, investment in public infrastructure can be considered one way to generated much needed labor demand and jobs for those falling behind.

Three facts motivate this contention. First, American households are highly leveraged, and may well be poised for a period of enhanced savings and diminished consumption. In this context, public investment should be viewed as an important source of macro-economic stimulus and labor demand—the creation of new, and often high quality jobs—which is clearly lacking from our current labor market.

Second, there are deep needs for productivity-enhancing investments in public goods that will not be not made by any private entities, who by definition cannot capture the returns on public investments in roads, bridges, waste systems, water systems, schools, libraries, parks, etc. Three, climate change heightens the urgency to make these investments with an eye towards the reduction of greenhouse gases and the conservation of energy resources.

One area of particularly significant job loss has been in construction. Jobs in residential building and contracting are down 480,000 over the past two years, and when we include other jobs related to housing, such as real estate, we find a decline of over 600,000 jobs since June 2006. In other words, there exists considerable labor market slack that will certainly deepen if the economy is in or near recession.

In this regard, infrastructure investment serves a dual role of deepening on investments in pubic capital while creating good jobs for workers that might otherwise by un- or underemployed. One common argument against such investment in the context of a stimulus package is that the water won't get to the fire in time, i.e., the implementation time lag is too long to quickly inject some growth into the ailing economy. However, research by EPI economists has carefully documented current infrastructure needs that could quickly be converted into productive, job-producing projects (Mishel et al, 2008).

Take, for example, the August 2007 bridge collapse in Minneapolis. The concrete for the replacement bridge began flowing last winter, and the bridge is now halfway done, with full completion expected by December. The American Association of State Highway and Transportation Officials claim that according to their surveys, "state transportation departments could award and begin more than 3,000 highway projects totaling approximately $18 billion within 30-90 days from enactment of federal economic stimulus legislation."[5]

The following are other relevant examples identified by these researchers:

- There are 772 communities in 33 states with a total of 9,471 identified combined sewer overflow problems, releasing approximately 850 billion gallons of raw or partially treated sewage annually. In addition, the Environmental Protection Agency (EPA) estimates that between 23,000 and 75,000 sanitary sewer overflows occur each year in the United States, releasing between three to 10 billion gallons of sewage per year.
- According to a survey by the National Association of Clean Water Agencies, communities throughout the nation have more than $4 billion of wastewater treatment projects that are ready to go to construction, if funding is made available. Funds can be distributed immediately through the Safe Drinking Water and Clean Water State Revolving Funds and designated for repair and construction projects that can begin within 90 days.
- The National Center for Education Statistics (NCES) put the average age of the main instructional public school building at 40 years. Estimates by EPI find that the United States should be spending approximately an [additional] $17 billion per year on public school facility maintenance and repair to catch up with and maintain its K-12 public education infrastructure repairs.
- According to a 1999 survey, 76% of all schools reported that they had deferred maintenance of their buildings and needed additional funding to bring them up to standard. The total deferred maintenance exceeded $100 billion, an estimate in line with earlier findings by the Government Accounting Office (GAO). In just New York City alone, officials have identified $1.7 billion of deferred maintenance projects on 800 city school buildings.
- The U.S. Department of Transportation has identified more than 6,000 high-priority, structurally deficient bridges in the National Highway System that need to be replaced, at a total cost of about $30 billion. A relatively small acceleration of existing plans to address this need—appropriating $5 billion to replace the worst of these dangerous bridges—could employ 70,000 construction workers, stimulate demand for steel and other materials, and boost local economies across the nation.
- The House Committee on Transportation and Infrastructure has identified more than $70 billion in construction projects that could begin soon after being funded. An effective short-term stimulus plan could include resources directed at projects for roads, rails, ports, and aviation; only projects that can begin within three months would be considered.

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[5] *http://www.transportation.org/news/96.aspx*

Finally, while I have discussed these infrastructure needs in the context of recession and stimulus, it is important to recognize that a) these are all necessary and productivity-enhancing investments that should be made regardless of the state of business cycle, and b) recent history suggest that it is a mistake to think that labor market slack will no longer be a problem when the recession officially ends.

This last point deserves a bit of elaboration. Much of the current recession/stimulus debate has stressed that recent recessions—the ones in 1990-91 and 2001—were both mild and short-lived, and perhaps the next recession will follow the same pattern. It is critical to recognize that these claims are based solely on real output growth, and not on job market conditions. The allegedly mild 2001 recession, wherein real GDP barely contracted, was followed by the longest "jobless recovery" on record. Though real GDP grew, payrolls shed another net 1.1 million jobs. The unemployment rate rose for another 19 months and for just under two years for African-Americans. The pattern was similar, though not quite as deep, after the early 1990s recession.

Part of the explanation for this disjuncture has to do with the way recessions are officially dated by the committee at the National Bureau of Economic Research, as they have apparently given less weight to the job market and greater weight to output growth. But policy makers are likely to give greater consideration to working families whose employment and income opportunities are significantly weakened as unemployment rises and job growth contracts. Thus, from a stimulus perspective, these investments will be still be relevant well after the recession is officially ended.

Conclusion

The existence of historically very high levels of income concentration in the American economy is well documented. While there is certainly debate about the causes of this trend, one factor widely agreed upon is education, in that skilled workers clearly have a large and growing wage and income advantage over less skilled workers. But other factors, including weakened distributional institutions, the absence of full employment, and deficient safety nets and investment are also problematic. At the same time, changes in tax policy have exacerbated inequalities that are already being driven up by imbalanced market outcomes.

I have elaborated ways to strengthen the mechanisms which historically have been called upon to ensure a fairer distribution of the fruits of growth. I recognize that many of these steps are ambitious, such as creating greater access to higher education by economically disadvantaged children. Others, such as tight labor markets or infrastructure investment, cut across many committees in Congress and even across government institutions, like the Federal Reserve.

Such an ambitious agenda is necessary, if we are to accomplish what must be a foremost goal of public policy: the reconnection of growth and living standards. The existence and expansion of this gap strikes at the heart of our core economic values, such as the belief that working families' living standards should reflect their contribution to the economy's growth. Every year that productivity rises, but middle incomes stagnate, poverty increases, and children are blocked from the opportunities to realize their potential, is another year in which the basic American economic contract is broken. I commend the committee for investigating this serious problem and look forward to working with in any way that would to helpful to fix it.

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Ms. WOOLSEY. Thank you very much.

And we will start right with you, Dr. Bernstein, because I would like you to elaborate on the importance of labor unions in building

a middle class for our nation. And I think you could just keep going with where you wanted to go on that one.

Mr. BERNSTEIN. Thank you. I am glad you gave me that opportunity.

The inability of workers to bargain for a greater share of the value that they are adding to our economy is at the heart of the gap that many of the panelists have described today.

Now, historically, there has been a broad set of policies and norms, and they have included unions but also minimum wages, defined benefit plans, as opposed to defined contributions, health care provisions. Many factors have eroded these institutions and norms. Global competition, which I agree with other panelists, has clear, strong upsides; it has also hurt the bargaining power of many workers in this country.

Unions play a key role in boosting bargaining power, and I stress the importance of legislation like the Employee Free Choice Act to level the playing field for workers hoping to organize.

Ms. WOOLSEY. Thank you.

Bob, I have a question, Bob Greenstein. In your testimony, you mention that reducing poverty is a major goal. The Progressive Caucus, of which I am co-chair with Barbara Lee, has endorsed the goal of cutting poverty in half over the next 10 years.

Do you see this as possible, and why is lifting Americans out of poverty so essential to our economic health?

Mr. GREENSTEIN. I think this is a very important goal. I also have endorsed that goal. I do think it will be a real challenge to get there, and it may be that if policymakers implement a striking array of policies to reduce poverty, the reduction may fall short of cutting it in half, but there is no question that one can make substantial progress on that front.

I think there are a number of kinds of implications. One of them is obviously economic. Children who are the low—low-income children today are a key part of the workforce of tomorrow. In order to have greater economic growth, we need a greater degree of growth in the productivity. We need a skilled and trained workforce. We have growing amounts of research evidence that poverty in childhood, especially early childhood, can have an inhibiting effect on the degree of skills that children ultimately develop, the level of education they ultimately get and so forth.

So this is an area where we can benefit the overall economy while reducing poverty at the same time.

Similarly, one of the reasons—if you look at the long-term fiscal picture, why do we have serious long-term fiscal problems, there are many factors. One of them—the biggest one is rising health care costs—but one of them is that economic growth is projected to slow in coming decades because of the slowdown in the growth of the size of the workforce as the population ages. Another way of saying this is every potential worker becomes more important.

We have a lot of people, a number of people who are poor adults who, with more education and with various kinds of supportive services to overcome various barriers to employment they now have, might be able to become productive workers as part of our workforce. We can no longer afford, going forward, to have people like that who are not part of the workforce.

Finally, I think it affects the whole social fabric of the country when we have significant numbers of people who are not sharing when the economy, as a whole, grows.

So there are a whole variety of reasons here. As you know, when he was prime minister, Tony Blair set a goal of cutting child poverty—I forget if it was in half or in whole, the percentage—in Great Britain, and while they didn't fully meet that goal during his tenure, they made major reductions in child poverty. I would like to see us do the same thing here.

Ms. WOOLSEY. Where there is a will there is a way.

Ms. Minow, I am changing the subject a little bit now. Do you have any examples for us on golden parachutes versus laying off the regular rank and file, and let us—is there anything you can tell us about how the two different groups are treated?

Ms. MINOW. Yes. I think probably the better analogy rather than golden parachutes would be other kinds of bonuses, because golden parachutes occur usually after a merger.

Yes, the problem is that, as I said, the pay plans, as structured, provide a lot of perverse incentives, and so the more money that they can save by—these executives can save by laying off employees or by clamping down on any increase in their benefits, the more it rebounds to them through bonuses. And I can give you some specific numbers on that if you will let me amend the record after the hearing.

Ms. WOOLSEY. I would appreciate that. Thank you.

Mr. Wilson?

Mr. WILSON. Thank you very much.

And, Ms. Furchtgott-Roth, I am happy to hear of your South Carolina connection.

As we face the issues discussing the middle class, the definition of middle class is something that I would like to know more about. And if you could explain how we measure what the middle class is, I have had the extraordinary opportunity to visit China, visit India. Both countries have phenomenal growth of what is called middle class, possibly exceeding the population of the entire United States in either country—over 300 million in India, possibly 300 million in China. And so, how in the world do you define middle class?

Ms. FURCHTGOTT-ROTH. Well, it is an excellent question, because it is a very difficult thing to do. You can take average household income, which is about $48,000 right now, but that hides the fact that a lot of people are moving through different life cycles.

So we have my interns back here, Steven and Jeff. They are right now working for free. I can't pay them less than minimum wage, but I am allowed to employ them as interns for free. But when they graduate from Swarthmore and Princeton, they are going to be able to make a good introductory salary, and then they are going to rise up, and if they marry other people, then they will have maybe two incomes and a family, a car, house. Their peak incomes will be around when they are about, you know, in their 50's or 60's, then they will retire, they won't have any income at all. They will look poor, they will drop into that bottom income quintile, but hopefully they will have saved enough assets to—so they will have a comfortable retirement.

So the middle class, at some point they will hit that maybe $48,000, but it will be moving through a life cycle, a life cycle of earnings, and most Americans work through a different life cycle of earnings depending on their skills and their education qualifications. That is why it is important to make sure we have as important skill base as possible. There are some states where there are only 70 percent of high school students that graduate, but that needs to be changed.

I would also like to add that in terms of what Mr. Bernstein was saying about unions, right now only seven percent of private-sector workers choose to belong to unions. The percent of workers choosing to belong—private-sector workers choosing to belong to unions has steadily declined over the past 25 years. At the same time, GDP in the United States has been steadily increasing, and our country has been getting wealthier.

The Employee Free Choice Act would take away the rights to a secret or a private ballot to vote for unions. It would have a card check phenomenon where someone could come up to you and say, "Hey, Mr. Wilson,"—come to you at your home, "Hey, Mr. Wilson, don't you want to join a union? Here is a card, you check it, and, by the way, I know where you live, I know your car, I can slash your tires if I want."

Mr. BERNSTEIN works for the Economic Policy Institute, which is funded by the AFL-CIO, so he has to take that position, but that is not an accurate representation of the problem in American living standards and inequality.

Mr. WILSON. Well, in fact, I appreciate—I live in a right-to-work state. We are very, very grateful for investments. I have got three Michelin plants in the district that I represent. They have had a phenomenal impact on increasing wage rates throughout the region. I am also grateful that we have BMW located in South Carolina. In fact, every X5, Z3, Z4 in the world is made in South Carolina, and they have just announced a three-quarter of a billion dollar expansion. And a key part of that has been a labor force which is truly emancipated, and it is doing very well. So that would back up what you said.

In your written testimony, you noted that a variety of measures are used to determine how equally the income pie is divided. All of the measures need a definition of income, and, as you noted, defining income is not as straightforward as it seems. Does that factor explain why researchers have reached vastly differently conclusions concerning the economic state of the middle class?

Another side issue is, when we try to figure out unemployment I was startled to find out that people who work at home, who sell on the Internet, aren't included in the employed. And I know many people in very wonderful businesses who work 24 hours a day on the Internet. They are not considered employed, so how do we address these different determinations?

Ms. FURCHTGOTT-ROTH. Right. Yes, yes. Well, it is very difficult to do depending on the measures of income you use, whether you use before-tax or after-tax. A lot of income grows out of taxes, and so depending on whether you use pre-tax or after-tax income, that affects the measure of inequality. Whether you include transfer payments in income, lower income—many lower income people re-

ceive Medicare, Medicaid, housing vouchers, food stamps. Whether those are included in income also affects measures.

And also if you look at different households, because the lowest fifth of households has a different size than the top fifth of households—1.7 people in it rather than 3.1 people. And so the fact that the bottom quintile has often lower incomes that is also a reflection of the number of earners and family size in that particular quintile.

Whether someone is employed is determined in a Labor Department survey. There is a survey called, "The Household Survey," 60,000 households every month. They call up and they say, "Are you employed, are you working?" So if someone says, "Well, no, I am not working," but they are really selling things on EBay, trading things on the Internet, then they would be counted as not working. So that also adds to the definition.

I think we need to look at what we have around us, I mean, cell phones, iPods. I mean, this BlackBerry here was amazing when Al Gore used it in 2000, and now a lot of people have BlackBerrys. So we have so much increase in technology. People go out to eat a lot more than they did before. People have houses that are routinely built with air conditioning and heating and multiple bathrooms. So I think we need to take a look at—around us and see what the real picture is.

Mr. WILSON. Thank you very much.

Ms. WOOLSEY. Mr. Bishop?

Mr. BISHOP. Thank you, Madam Chair, and thank you for holding this hearing.

And to the witnesses, thank you for your testimony.

I want to start with a question about the 2001 and the 2003 tax cuts. One of the challenges that the next president will have, and, certainly, the next Congress will have, will be what to do with those tax cuts.

Mr. Greenstein, you make the case that those tax cuts contribute to the income inequality that currently is the case. My own view is that only the most committed ideologue, given our recent experience, would be able to cling to the notion that tax cuts pay for themselves, that tax cuts generate an incredible amount of business activity and that a rising tide lifts all boats, that if we increase income distribution at the high ends, that people at the low ends will benefit.

So my question to you, Mr. Greenstein, and then to Ms. Furchtgott-Roth—I hope I am—I am sorry, I am mangling your name—but I am going to guess that your position on this is going to be different from Mr. Greenstein's, so if I could first hear from you, sir, on how we should go forward with the 2001 and the 2003 tax cuts and then from you.

Mr. GREENSTEIN. Well, I would start by saying that the biggest problem with those tax cuts, I think the inequality issue is part of it, but it isn't what I grade first. What I grade first is that making those tax cuts permanent without paying for them will cost several trillion dollars over the next 10 years. We are on a path toward long-term deficits that if not addressed, ultimately, will significantly reduce growth in the economy and cause a debt explosion. We simply can't afford tax cuts of that magnitude.

And most economists, if you look at the work of the Joint Tax Committee, the Congressional Budget Office, mainstream economists, the general consensus is that if one made those tax cuts permanent without paying for them, they would be more likely to reduce economic growth over the long-term than to increase it because of the negative effects on growth of the enlarged deficits and interest payments on the debt that would result.

I would also note that the Bush administration's own Treasury Department put out a report a year or so ago, and under its best case scenario, with its most optimistic assumptions, the tax cuts would produce enough growth, if fully paid for, that 10 percent of their costs would be offset by the higher growth, and 90 percent would remain.

Mr. BISHOP. If I may interrupt you, I just—I want to zero in on a particular point. The McCain tax plan, as I understand it, would call for the permanent—making permanent the 2001 and the 2003 tax cuts, the permanent elimination of the alternative minimum tax and making permanent the 2009 rates for the estate tax. Do I have it about right?

Mr. GREENSTEIN. Yes. I don't think he makes—yes, I think that is right.

Mr. BISHOP. Okay. So at any rate, in other words, we will do it all. We clearly can't do it all. I mean, that would be spectacularly irresponsible in terms of our debt. So of those three, which are, sort of, the big three, 2001, 2003 alternative minimum tax, and estate tax, which of those three do you think demands the most immediate action on the part of the Congress and the president?

Mr. GREENSTEIN. The most immediate action, I think, probably has to be the estate tax, because you need to deal with it in 2009, and I would—this wouldn't be my—but based on where we are today, I would just make the 2009 parameters permanent.

You, obviously, need to at least temporarily deal with the AMT, but all the other issues you clearly need to deal with no later than the end of 2010. And they are the fiscal issues involved but, obviously, also these big distributional issues. I mean, it is hard to imagine, given the long-term fiscal problems and the unmet needs of the country, do the people in the top one percent really need an average tax cut of $160,000—people with incomes over $1 million—need an average tax cut of $160,000 apiece? This really doesn't make sense.

Mr. BISHOP. Ms. Furchtgott-Roth, could you comment on that?

Ms. FURCHTGOTT-ROTH. Sure, sure. I am sure that I am one of these committed ideologues that you are talking about.

Mr. BISHOP. Perhaps so.

Ms. FURCHTGOTT-ROTH. My book, "Overcoming Barriers to Entrepreneurship in the United States," was just published by Lexington Books in March, and part of it addresses taxes and taxes on entrepreneurs. So the current tax rate on entrepreneurs who file under the individual tax system their top tax rate now is 35 percent. On January 1, 2011, it is scheduled to go up to almost 40 percent—39.5 percent. This has an effect on entrepreneurs and people who create jobs. They are not going to want to create jobs here. There are certain investments that they are not going to want to do. Of course, a lot of them will just keep growing and keep creating busi-

nesses, but some of them won't. Some of them are going to go other places.

And what is important is, how are we going to generate the most wealth in the United States, because that gives us tax revenue and enables you to do all these things that you want to pass, the housing bailout bill, foreign aid, different kinds of health benefits, Medicare and—that comes from tax revenue. We want to get as much tax revenue as we can.

And tax revenue from these top percent, the top income earners, has been going up since the tax cuts in 2001 to 2003. And so the federal government has been getting more of this revenue. It is more money to play with, more money to fund everything that we want to fund. That is why we need to keep these tax cuts low.

And in terms of, "Can we afford it, can we afford these tax cuts," it is not a—what we are talking about is making the current rate permanent. You are talking about, do we want to raise taxes on January 1, 2011, and I would say, no. It is going to drive businesses overseas; it is going to make it less productive for businesses to start here. It is going to make the United States a less welcoming place to do business. And in a global economy, entrepreneurs are going to go elsewhere. So I say we cannot afford not to leave the taxes as they are, and you can call me a committed ideologue if you like, but that is the way I see it.

Ms. WOOLSEY. Mr. Hare?

Mr. HARE. Thank you, Madam Chair.

Ms. Furchtgott-Roth, I know this isn't the subject of the hearing, but as long as you are here, I just wanted to take a minute to express the strong concern that I have with the DOL risk assessment regulation that is currently under OMB review that you have written about recently.

As you know, this regulation was not listed in the regulatory agenda, and almost no information was initially sent to OMB, and it is clear—in clear violation of the White House chief of staff's directive that all rules expected to be finalized by the end of this administration must be proposed by June the 1st, except in "ordinary circumstances."

It is hard for me to understand why OSHA, who has barely managed to get a single health regulation issued during this entire administration, would have actually protected workers. Suddenly, this high support, risk assessment is an extraordinary circumstance and a major Department of Labor policy. So I hope at some point we will be able to have you come back and maybe answer some questions about that.

Let me—with all due respect, you——

Ms. FURCHTGOTT-ROTH. I would be honored to do so.

I have not seen the rule, because the rule has not been yet published by the Department of Labor. There has been a rule—a version of a rule that was leaked to the Washington Post. It was put on the Washington Post Web site, but I don't know if it is the final rule or what rule this is.

Mr. HARE. Let me just take issue with a couple of things. You mentioned the organized labor only having seven percent, and it is a secret ballot.

Ms. FURCHTGOTT-ROTH. That is right.

Mr. HARE. We just had the Delta Air Lines people in here yesterday at a hearing, and they were going to go out of their way on the flight attendants to do everything that they possibly could to keep flight attendants from organizing. They had posters that they were sending out and talking to the employees, "Grip it and rip it," on their ballots.

But, look, this whole secret ballot process, to me, with all due respect, is the silliest thing I have ever heard of. If you can decertify a union with a petition of 50 percent plus one on signatures, it would seem to me the employees could be able to join a union for the very same way. So we can boot a union out by 50 percent plus one, but we can't bring a union in. And I have to tell you, quite candidly, that I believe that if we get this EFCA passed, you will see a tremendous boost in labor—in labor—be able to join labor unions.

Also—and I may be a bit naive—I don't believe these employers get up in the morning and say, "You know, I feel very benevolent today. I think I will work the 40-hour work week, pay overtime, do health care and all the things that the workers in this factory deserve, because I just feel like I am a good guy today." They got those benefits because ordinary people were willing to stand up and, in some instances, have to go out on strike. Some of them lost their lives, with all due respect.

So I think this whole secret ballot thing is the biggest charade I have ever seen on the other side, talking about—it is basically to prevent people from joining unions, because it is so titled as it is.

Let me just ask you, Mr. Bernstein, one of the greatest things about being American is the feeling that opportunity and upward mobility is out there, it is available to everybody. If we work hard enough and we are smart, we can attain wealth and success. And I was surprised to find out that the statistics you support don't support this belief.

Opportunity in the U.S. is often predetermined by one's parent's economic status and intergenerational mobility is no higher in the U.S. than in other developed nation. In fact, about 42 percent of children born to parents in the bottom fifth are still in the bottom fifth, and 39 percent born to parents at the top are still at the top.

Can you explain this?

Mr. BERNSTEIN. Yes, I can. The problem that we face is that inequality cannot be discussed separately—the inequality problem can't be discussed separately from the mobility problem. Inequality itself is now at such excessive levels that it is precluding opportunity and mobility and in that sense violating a basic economic or even a value-based norm in our country.

One of the figures I have in my testimony looks at college completion by children who are ranked both by their income and by their test scores when they were in eighth grade. And what it shows is that if you were poor but you had high cognitive skills, that is, you had high test scores—think about it as a high IQ poor child—your college completion rate is almost exactly the same as a low-testing rich kid. That is, controlling for academic ability, income barriers are keeping our children from realizing their educational and, of course, their economic potential.

Now, fascinatingly, we have far less economic mobility in this country than we do in European countries with some extent, excepting the U.K., and much more—and the disparities particularly start if we compare the U.S. to the Nordic countries.

Now, I want to respond to a couple of other things that have been said in ways my work has been evoked.

Would that be okay, Madam Chairman?

Ms. WOOLSEY. We are going to have a second round of questions, and I am going to ask all of you to be able to comment just on your own——

Mr. BERNSTEIN. Okay. Then let me just close out this comment to Mr. Hare. The point is that you can separate, as Diana does in her discussion, the notion of inequality and mobility, that you can—don't worry about inequality because mobility offsets it. Mobility does not offset the inequality problem, and, in fact, at this point, one can make a very strong and, I believe, compelling causal argument that the spillover from the inequality problem is precluding upward mobility.

Mr. HARE. I yield back.

Ms. WOOLSEY. Right.

Ms. Shea-Porter?

Ms. SHEA-PORTER. Thank you.

Ms. Furchtgott-Roth, I have a question. Do you think the minimum wage is high enough or too low?

Ms. FURCHTGOTT-ROTH. I think the minimum wage now is too high.

Ms. SHEA-PORTER. Okay. Do you think——

Ms. FURCHTGOTT-ROTH. It should be lower because a lot of teenagers are having problems finding jobs this summer. So it is something we have got to——

Ms. SHEA-PORTER. But, of course, we do know that a lot of single women with children earn that minimum wage.

Ms. FURCHTGOTT-ROTH. Well, actually, a very small——

Ms. SHEA-PORTER. That is okay. Let's go on, please, so we can get through all this.

So you think the minimum wage is too high. Do you think that everybody is going to be able to go to college and raise their income dramatically, that that is the answer for everybody? Just go to college, go to grad school and you will now earn a decent wage? Or you think that the decent wage is the minimum wage, right?

Ms. FURCHTGOTT-ROTH. Only about one million of our 154 million workforce earns minimum wage.

Ms. SHEA-PORTER. Let's just stick to what——

Ms. FURCHTGOTT-ROTH. And most of those are part-time workers and workers who——

Ms. SHEA-PORTER. Do you—yes, but we have to—I disagree with that, but let me follow the questioning, please.

Do you think that everybody in this country should go to college, grad school and raise their own income, that that is the key?

Ms. FURCHTGOTT-ROTH. No. No.

Ms. SHEA-PORTER. Okay.

Ms. FURCHTGOTT-ROTH. I definitely do not think everyone should go to college or grad school. There are many jobs in the skill trades that have—that are high paying, good paying jobs.

Ms. SHEA-PORTER. Okay. Now, let me ask you, you are talking about skilled trades. Do you think that there are certain people in this country that we accept are going to be poor, for example, housekeepers, because you think that it is okay to earn minimum wage? So are you basically accepting that people who work as housekeepers or people who work in restaurants or people who work as cashiers and serve us and make our daily lives possible, is that okay that they earn that minimum wage?

Because what I am asking you is, if we keep them at that minimum wage, aren't we guaranteeing that they are going to be part of a permanent underclass? If they are not going to college and they are not getting skilled jobs, and you know that we need that kind of work, are you basically sanctioning the fact that they are going to be underpaid or are they already overpaid?

Ms. FURCHTGOTT-ROTH. BLS data shows that about one million people are on minimum wage jobs, and those are usually stepping stones to other jobs. So——

Ms. SHEA-PORTER. Okay. Wait. Can I—I am not going to let you take me down that path, because you and I both know that that is just not so.

If you work——

Ms. FURCHTGOTT-ROTH. Well——

Ms. SHEA-PORTER. Have you ever worked as a housekeeper, for example, in a hotel, changing the sheets and scrubbing the sinks and that kind of work, because those people are working very hard? We can't do without them, and they are not making enough money, and they go to a second job to—maybe it is 7-11 or whatever. And don't tell me they don't exist, because I worked with them as I worked my way through college.

What about them? And you still haven't addressed that. You said they can get Medicaid——

Ms. FURCHTGOTT-ROTH. You haven't let me address it.

Ms. SHEA-PORTER. Yes, but you know what? The problem that I am having here is that you are just disregarding a certain percentage of the population like you have just written them off, "It is okay, we are not going to discuss them today," and I really want to talk about them.

Ms. FURCHTGOTT-ROTH. Well, that is—I have not written them off, but there are jobs in those skilled trades that you——

Ms. SHEA-PORTER. No, but then we talked about the skilled trade, because we still have to have people that change the sheets and scrub the sinks and peel the potatoes and do the kitchen work. What do we do about them? I am asking you to focus on them. Don't talk about the skilled jobs, because if everybody moved into a different sector, who would do that work?

Ms. FURCHTGOTT-ROTH. In a dynamic workforce, people change jobs all the time, and the people who are changing the sheets are not in those jobs, necessarily, permanently.

Ms. SHEA-PORTER. Well, I would have to disagree with you, but let me, again, get back to——

Ms. FURCHTGOTT-ROTH. I mean, you said that——

Ms. SHEA-PORTER [continuing]. Who will take care of them while they are in those jobs? What I am asking you is, are you acknowl-

edging that we have an underclass in this society, and you keep——

Ms. FURCHTGOTT-ROTH. No. No, I am not. I am not.

Ms. SHEA-PORTER. Okay. Well, that is—that is exactly what I thought you were doing. You are not acknowledging they were there. Well, I would like to tell you they are there, and, as you travel about and if you stop at a grocery store or you stop at your drycleaner, ask them how much they earn, ask them how long they have worked in those jobs, and ask them if they have a second job, because I think you could learn something, frankly, about that group of people that you think are overpaid.

So let me—and I appreciate your comments.

Okay. Now, I have a couple of minutes left, so Mr. Greenstein, would you please——

Ms. FURCHTGOTT-ROTH. I thought you were asking me a question, and you haven't let me respond.

Ms. SHEA-PORTER. What I asked you is you thought they were overpaid—if you thought the minimum wage was acceptable or if they were overpaid. And then I asked you if you thought we had created a permanent underclass, and you said, "No."

Ms. FURCHTGOTT-ROTH. Last year, we had about 59—in our workforce of 154 million, we had about 59 million new hires and about 57 million separations. People are changing jobs all the time. People who——

Ms. SHEA-PORTER. You know, the problem I have is that what I am hearing you do is hide behind numbers, which aren't even in front of us, okay? So you are talking about numbers, and I am trying to ask you about people, you know, the real people, what their lives are like. And what your answer is for those people—because our responsibility sitting here in Congress is to make sure that all boats do indeed rise with the tide, and you don't have any plan to help them come into the middle class.

And in order to keep this country's strengths, we have to have a robust middle class, and in order to have that, they have to have a livable wage. And you just told me that you think they are paid too much. So there is really no other place that we can go in this conversation, because we are divided by ideology.

So I just want you to know that I know they exist and that we know they exist, and we get letters from the constituents, and we are the ones who hear about their plight, and I didn't like the idea that we were hiding behind numbers instead of talking about what do we do with the people when they don't earn enough to get by.

Thank you.

Ms. FURCHTGOTT-ROTH. If you——

Ms. SHEA-PORTER. Sorry, my time is up. Thank you.

Ms. WOOLSEY. We are going to have a second round, and we are going to start right now.

I would like to ask Mr. Greenstein, Ms. Minow and Mr. Bernstein to respond to anything they have heard this morning.

Now, I only have five minutes, so do everything you can, please, to answer in a minute and a half.

And we are going to start down here with you, Dr. Bernstein.

Mr. BERNSTEIN. Yes. With due respect, Ranking Member Wilson, you said researchers reach vastly different conclusions regarding

economic inequality. That is absolutely wrong. Researchers reach vastly similar conclusions.

Mr. WILSON. [OFF MIKE]

Mr. BERNSTEIN. Right. The views that you heard from Diana are very distant outliers. The consensus among research, you heard Bob Greenstein quote Alan Greenspan. Now, Alan Greenspan is a purveyor of conventional wisdom in the economy. He doesn't make statements like that until he reviews research on all sides of the issue. Ben Bernanke has said the same thing, by the way, regarding the inequality discussion.

There is—you know, this notion of ideology has come up—we have thrown this word around. In my view, ideology is really described by those who are impenetrable to evidence. And I think the evidence is overwhelming on this point. Now, we can have great dissent about what we ought to do about it, and there are those, for example, Nobel laureate, Gary Becker, who writes, "Sure, inequality is happening, and it is absolutely the outcome of a meritocratic economy, and we shouldn't do anything about it," and that is fine. But to question the fact is not only off point but I think destructive to the progress we need to make.

One small point—I will be very quick here—that work that I have done for today comes out of our book, "The State of Working America." None of that work is funded by unions; it is funded by philanthropic organizations. And I will say, for the record, that my views that I espouse on policy are not influenced by any funder. I speak to what I believe are the causes and the solutions for these. I simply don't carry water for any institution.

Ms. WOOLSEY. Thank you.

Ms. Minow?

Ms. MINOW. I would like to respond to Mr. Bishop's line of questioning, if I may.

First, I want to say that I am a serial entrepreneur. I started—helped start three companies, including my current one, which employs 35 people, and I would much rather start a new company with a higher tax rate than start one with a higher deficit. And I am not going offshore.

The second point I want to make with regard to the tax issue is, as long as I am here to talk about CEOs, I have to say that one of the most loathsome aspects of CEO compensation is what is called a gross out, which is where they have the shareholders paying their taxes. It is the Leona Helmsley approach where you pay your taxes, I pay my taxes, but the CEOs don't want to pay their taxes. If Congress could eliminate that, that would be wonderful.

Ms. WOOLSEY. Mr. Greenstein?

Mr. GREENSTEIN. There is certainly disagreement about how much of a problem—how much we should be concerned about inequality and what we should do about it. There is not much disagreement among researchers across the political spectrum that inequality has been rising. It is true that the census data on inequality have issues because they don't take taxes into account—that is true—they don't take benefits at the bottom into account—that is true—the bottom quintile is made up disproportionately of elderly people,—that is true—but none of those criticisms apply to the CBO data, which adjusts for all of those things. And it is the CBO

data, after benefits, after taxes, after adjusting for family size that showed the increase since 1979 of six percent at the bottom and average income, 21 percent in the middle, and 228 percent at the very top.

The other comment I would make is about the issue of whether we will have a huge destruction of jobs if the tax rates at the top return to their levels prior to 2001. Those would have been the levels that prevailed in the 1990s when we created dramatically more jobs than during this decade. And those rates would still be far below the top rates in the 1950s, 1960s and 1970s, the first two decades of those three being big job creation periods.

Last quick comment has to do with business proprietors. You know, this small business thing really needs to be looked at carefully. The number of small business proprietors, mom-and-pop owners, who are—pay the top rate appears to be significantly smaller than the number who get the earned income credit. We have to distinguish extremely wealthy individuals who are passive investors in businesses from the real small business proprietors.

For the real small business proprietors, they benefit more from an expansion of the earned income credit than from cutting the top rate.

Ms. WOOLSEY. Thank you.

Mr. Wilson?

Mr. WILSON. Again, thank all of you for being here.

Ms. Furchtgott-Roth, I was happy to hear the discussion about housekeepers. I represent Hilton Head Island, which has possibly some of the highest income people in the world, but 40 miles into the state, in Allendale, South Carolina, we have some of the poorest people in North America—in the United States.

And the best employment, highest and best employment for many of the persons from Allendale has been to be a housekeeper, to work at the extraordinary resorts that exist at Hilton Head and different communities around, and it has been wonderful as an entry-level job—clean, positive work environment. Housekeepers, by becoming the lead housekeepers, can make up to $40,000 a year. And, indeed, this is a phenomenon across the South and particularly in my home state with Myrtle Beach. Again, you have very wealthy beach communities, but then you have communities in transition, from agriculture to tree farming now. It is just great employment.

And so in defense of the housekeeping profession, I can tell you from my experience, and from what I have seen with the ability of people who have good, clean employment, they are very proud of this. And then they are—it is just an extraordinary opportunity for people who wouldn't have opportunity before.

So with that background, there has been much discussion about the vanishing middle class in the media and many studies on the economic state of the middle class. If there is, in fact, a decline in the number of families that make up the middle class percentile, do you know—how many of those families have moved into different income brackets and to which brackets they have moved into?

Ms. FURCHTGOTT-ROTH. Well, it is very difficult to say exactly which income brackets they have moved into. We have different families in different places on the scale.

I would like to say, I do have the latest BLS release in front of me, and the unemployment rate last June for teenagers was 16 percent; this June it rose to 18 percent. Increasing the minimum wage is one of the consequences of that. And increasing the minimum wage even further would drive some of these hotel workers out of work. It is not as though they would get the same job at a higher pay. Many of them would lose their jobs.

The kinds of jobs that are possible from—without a graduate school or a college degree, nurses, for example, we have a great need for nurses, police officers. These are all—there are many kinds of skilled trade jobs—electricians, plumbers—that one can have without a college degree.

I would agree that it is not from the benevolence of the employer that people get benefits but because the employer doesn't want the worker to go anywhere else. The employer wakes up thinking, "How am I going to keep my workers," and one way to do that is to give them benefits. Otherwise, they are going to go to some other employer, not at all because the worker—the employer feels at all benevolent but because we have competition.

The secret ballot is something I think Americans are entitled to, a private ballot for voting and for other kinds of things. And I think that it is very important that people should have the privacy and a particular vote when it comes to joining unions.

Mr. WILSON. And thank you for hitting each one of those issues. In fact, related to that are mandates, and as we look at ways to increase income for certain wage earners, there are some who will say that employer mandates in the areas of pensions, health care and wages are necessary.

Could you elaborate on what increasing employer mandates would do for the least skilled and less educated employees? And you have touched on this before, but this is a very important matter.

Ms. FURCHTGOTT-ROTH. Well, increasing the benefits would have two potential effects. One is that the actual wages would go down. And we have seen that worker compensation has become more oriented toward benefits and less toward wage increases. So if benefits were mandated, then the worker would get less cash take-home pay. That is one point.

Another point is that the worker might not even have a job at all. That job might not be created yet. We hear a lot about outsourcing and off-shoring and a lot of those jobs might just go elsewhere.

Mr. WILSON. And it seems like that would encourage companies to consider movement overseas to Mexico or China or India.

Ms. FURCHTGOTT-ROTH. Right. Exactly, yes.

Mr. WILSON. And, finally, again, I just—some of the most heartwarming experiences I have had are to visit with my constituents who have—who are housekeepers, who live in rural communities where there are zero opportunities. But now they have fulfilling lives of where they work in areas 30, 40 miles away, and it is

meant so much to their families. It is just a—they are able to stay in their home community but yet have good, clean employment.

So thank you very much.

Ms. FURCHTGOTT-ROTH. Sure. Thank you.

Ms. WOOLSEY. Mr. Bishop?

Mr. BISHOP. Thank you Madam Chair. Let me say at the outset that I would become only slightly less agitated at the discussion of intimidation of workers who are being organized to join a union if the people who make that case would also, as a corollary, talk about intimidation of the workers on the part of management as they seek to organize. And I don't think there can be any reasonable discussion of intimidation in the workplace, irrespective of source, without including that.

Now, let me go back to the issue that I have talked about, which is tax cuts, the 2001 and 2003 tax cuts aggregate to about 10—pardon me, about $2 trillion in foregone revenue. It represents, perhaps, the only economic policy of this administration, and here is what we have to show for it after seven years: 2.5 million more people without jobs, five million more people living in poverty and seven million more people who don't have health insurance.

So tell me again why this is working so well. Tell me again why this ought to be the centerpiece of our economic policy, as we go forward. Does anyone want to comment on that?

Dr. Bernstein?

Mr. BERNSTEIN. Well, I don't think you even go far enough in describing the failure of this economic policy, which is typically under the rubric of supply side economics, over this business cycle, which I now believe has likely come to the end. Certainly, the labor market is in recession, if not the overall economy.

If you look at job creation over the 2000s, employment grew by four percent. Now, the average business cycle employment growth is 14 percent, so on the employment side—one of the arguments about the entrepreneurial story that Diana and others tell is that this will create more employment. Well, that is demonstrably untrue, didn't happen.

Secondly, the other part of the story is it will create more investment. These are macro economic indicators. This is evaluating the program on its own merits. Investments—outside of residential investment, this is factories investing based on this notion of firms and factories—investment has performed extremely poorly over this recovery. It has been one of the worst recoveries for investment.

GDP growth has been moderate at best. And, of course, wages, employment and poverty have performed poorly.

So if the notion is that trickle-down economics, or supply side economics, leads to faster growth and that growth then reaches down throughout the income scale, it is wrong on the growth part, and it is wrong on the distribution part. Other than that, it is fine.

Mr. GREENSTEIN. Could I add a quick note? If the tax cuts had these big, positive economic benefits, then in a whole array of areas, overall economic growth, job growth, investment growth, as Jared mentioned, wage and salary growth, this recovery that ended in 2007 should have had an average annual rate of growth greater than that in prior recoveries when we either didn't cut taxes or we

raised taxes at the beginning, as in the 1990s. And, in fact, as Jared just noted, in every one of those indicators, this recovery had lower rates of growth than the average recovery since the end of World War II.

So if the recoveries where we didn't cut taxes or even raised them at the start experienced better rates of growth than this one, it is a little hard to make the case that in the absence of these kinds of tax changes that the economy would have somehow been in the tank.

Ms. FURCHTGOTT-ROTH. The economy and the labor market are not doing nearly as bad as you are portraying. The last month we had was June, we are going to get more data tomorrow, but the payroll job survey shows that we have 5.17 million more jobs than we had in January 2001. According to the household survey, we had 8.1 million more workers working since January 2001. We have created millions of jobs. The unemployment rate for men is 5.1 percent, for women it is 4.7 percent.

Mr. BISHOP. Can I interrupt you for a second? My understanding is that average job growth over the last eight years has been about 57,000 jobs per month and that that number is less than half of the number necessary to keep pace with the growth in workforce. Is that or is that not correct, what I just said?

Ms. FURCHTGOTT-ROTH. I don't have the right number off the top of my head.

Mr. BISHOP. Mr. Greenstein?

Ms. FURCHTGOTT-ROTH. I have the total since January 2001.

Mr. BISHOP. I don't know if that number is right, but what I do know is in the 1990s, after taxes were increased in 1990 and 1993, there were over 20 million new jobs created. The five million that was just mentioned is a very poor performance for a full economic recovery.

I am sorry, I interrupted you.

Ms. WOOLSEY. Well——

Mr. BISHOP. I am out of time.

Ms. WOOLSEY [continuing]. You are out of time.

Mr. Hare?

Mr. HARE. Thank you, Madam Chair.

I am hearing a lot of numbers thrown out. I just find it—and maybe I am not the sharpest knife in the box up here, but when we have CEOs making more in four hours than their employees make in one year, I think the question has to be asked, how much is too much for some of these folks?

Listen, I am a card-carrying capitalist, I want to see people make money, but, for heaven sakes, I mean, how far are we going to go here?

I don't know how many more dollars Warren Buffet and other people at the top one percent in this country need. They have been having it their way for six years.

It would seem to me that you lead by example. I had the—I lost 1,600 jobs that my friend from South Carolina talks about—and maybe I should visit there, and I would invite him to visit Galesburg, Illinois where the CEO of Maytag, who put 1,600 people out of work, said to me, "I don't care about your houses, your educational benefits, the town, I am here to make money for my share-

holders." And after my state gave—and we are talking about money and figures—$9 million for this company, and the workers gave not one but two wage concessions, they bolt and go to Reynosa, Mexico.

And this guy, I don't know what he is making, but I have to tell you, after what he did to that town and to those people, if he is making 50 cents an hour, he is making too much from this congressman's perspective, because he turned on his back on people who really thought that this guy and this corporation was going to have corporate responsibility. And the sad part about it is we have laws in this country that actually pay for companies to be able to outsource their jobs.

Now, I would just like to ask maybe the panel, in general, how much is too much for these folks, and are they ever going to get to the day where we have some fairness here? Look, I don't mind them making a good dollar. They have every right. They have a tremendous amount of responsibility. But we have heard numbers today, you know, about, well, we are doing—the numbers I have seen, unless I am getting them fed incorrectly by the Department of Labor, show for the last six months we have had a steady loss every single month of jobs. So we are not growing this economy.

And one last comment, and then maybe just open this up as to the question of how much is too much or where do you think this Congress ought to go, but I just have to tell you, there are a lot of people that I know in my district that are on minimum wage. They work—they are single moms. Their husbands have left, they can't make it, they are doing the best that they possibly can. This whole attitude that the more you raise the minimum wage, the job losses—I am seeing it in my district. As a matter of fact, these are people, particularly with the fuel prices at $4 plus per gallon, are having a hard time even getting to work at their minimum wage job.

So my—with all due respect, I think the minimum wage, first of all, is too low, and it ought to be indexed for inflation. I don't think we ought to have to wait, as a Congress, 8 or 10 years to have to revisit whether or not people making $8 an hour, while a man comes before the—from the oil company comes before the Senate and says he is saddened—or I forget what it was—but he is only making $14 million a year. Get my Kleenex out.

My point here is that this is a responsibility, I think, that corporations have, and we don't have any corporate responsibility, it seems to me. The workers are the last to really be taken a look at here. And when this guy tells me from Maytag, to be honest, that all he cares about is making money for his shareholders and doesn't care about that community and the educational system, I say shame on him and shame on that corporation for having that guy as a CEO.

How much is too much for these people?

Ms. MINOW. I would like to respond to that. First of all, I would like to point out that Warren Buffet is one of the lowest paid CEOs in the country. He has got an exemplary pay package. His money is made by his investments. And I think—and I—we agree that we want them to be paid a lot of money because they earn a lot of money. We just don't want to create the risk incentives. The tragic

thing—I am from Illinois myself, by the way, and the tragic thing about the Galesburg situation is that those shareholders that he is making money for, who are they? They are the pension funds. They are the pension funds of the—you know, it is like we have—as—said, "We have met the enemy, and he is us."

If we had some kind of ability for the pension funds of the police and the firemen and the workers at Maytag themselves to send some kind of feedback to create a real market system, we wouldn't have this outrage. I track CEO pay data, and I will provide you with the data on——

Mr. HARE. I would love to have that.

Ms. MINOW [continuing]. The pay package at Maytag.

Mr. HARE. If you could send that to me, I would love to have that. Thank you.

Ms. MINOW. I will definitely do that.

But that answer is that we don't—Bill Gates created a tremendous company and we are happy that he made the money that he made. The problem is, the former CEO of Exxon made $400 million when he left, and that is——

Mr. HARE. Maybe he could buy us dinner.

Ms. MINOW. That is an outrage. That is just appalling. You know, he benefited because of the price of oil that had nothing to do with his performance. We have to tie that pay to performance.

Ms. FURCHTGOTT-ROTH. Well, I——

Ms. WOOLSEY. Well, I am sorry, we are through. His time is up. He knows that, he leaned back.

I was going to tell you, you had one minute to divide up among all of them, and then that was—so Mr. Wilson is going to give his closing remarks, and then I will, and then you will all be free.

Mr. WILSON. And thank you, Madam Chairwoman, and I was happy Mr. Hare referenced the district I represent. Indeed, I am really grateful that in many of the communities I represent 95 percent of the persons there are transplants from the Midwest and Northeast. And from the suburbs of Columbia to Hilton Head, Bluffton, Sun City, Hardeeville, 95 percent. We welcome transplants, and many years from now, when Mr. Hare contemplates retirement, we will still have a condo left, so please come on down.

And, indeed, Madam Chair, as I conclude, I would like to request unanimous consent to include in the hearing record a column by Diana Furchtgott-Roth in yesterday's New York Sun regarding, "The Battleground For Sound Science." This information follows up the question that we previously had. And at this time, again, make such a motion.

Ms. WOOLSEY. Without objection.

[The information follows:]

[From the New York Sun, July 30, 2008]

Battleground for Sound Science

By DIANA FURCHTGOTT-ROTH

Congress is in favor of protecting employees from dangerous working conditions, right? Yet a new draft rule to protect employees from hazardous substances by requiring more rigorous scientific analysis by the Labor Department is facing opposition from leaders of the two congressional committees with jurisdiction.

Senate Health, Education, Labor, and Pensions Chairman Edward Kennedy of Massachusetts and House Education and Labor Chairman George Miller of Cali-

fornia asked the Labor Department to withdraw a so-called "secret regulation" even before the two Democrats had seen its contents.

According to their July 23 letter to Labor Secretary Elaine Chao, "We are deeply disappointed that the Department of Labor is working to slip through a rule that may have a profound negative impact on the health and safety of American employees. It is equally disturbing, according to today's Washington Post, that the Department is moving this proposal over the objections of career staff in the relevant health and safety agencies. "

An examination of the alleged draft proposal published by the Washington Post shows that the letter from Mr. Kennedy and Mr. Miller was premature and incorrect. The draft rule would set higher standards for assessing dangers to employees of substances in the workplace, increasing their protection.

The Labor Department would get more public feedback and use peer reviewed studies; provide more information and calculations in reports; and make industry-specific calculations. This would be more precise than current Labor Department procedures.

For instance, the Labor Department is in the process of regulating two substances, beryllium and silica. If the new rule were in place, workers would have access to all the scientific studies on these compounds, different industries would have sent in information on worker exposure, and the public would be able to see detailed comments from unions and businesses.

Instead, in June 2007, the federal District Court for New Jersey had to order the Department's Occupational Safety and Health Administration to provide documents on toxic exposures of its own workplace inspectors, because it refused to do so. This followed a suit by University of Medicine and Dentistry of New Jersey Professor Adam Finkel, a former chief regulator and regional administrator at OSHA.

Although I served as chief economist of the Labor Department between 2003 and 2005, I did not work on this proposed rule. Between September 2007 and January 2008, however, the Hudson Institute, where I work now, was part of a team of outside economists under contract to the Labor Department to evaluate risk assessment procedures in federal agencies. So, I know a lot about the problem.

The new rule would follow the pattern of transparency in regulation adopted by Ms. Chao with union financial disclosure regulations. It would give the public and Congress more input into future decisions about how to regulate harmful substances.

Government officials would have to demonstrate, using peer-reviewed scientific studies, that substances were harmful. This helps employees by making sure that OSHA regulates real hazards and uses real science, not junk science and bogus risks.

When determining the consequences of exposure to potentially harmful substances, OSHA now estimates how long employees will be exposed. The proposed rule improves these estimates by requiring realistic estimates of time worked by employees who spend their entire lives in one industry. Now, the Labor Department assumes that employees work at the same job for 45 years, and work for 40 hours a week, 50 weeks a year.

This does not accord with reality. Employees tend to work fewer total years for one industry and have more vacation days. Yet, with overtime becoming increasingly common, they spend far more than 40 hours a week on the job. Workers may need more protection, because exposure to a carcinogen 55 hours a week for 10 years could potentially be more harmful than exposure for 40 hours a week for 45 years.

Critics complain that these requirements for sound science are too sweeping and may prevent OHSA from regulating hazardous substances.

In particular, some OSHA career staff have opposed the proposal, taking their case to the Washington Post as frequently happens in Washington. A rule based on sound science would diminish the power and discretion of government staffers, because the burden of proof would be on the scientific evidence rather than on their decisions.

Yet disclosure of competing interpretations and gaps in the data are elements of intellectual honesty.

The proposed rule would give the public—including unions and employers—an earlier voice in the regulatory process. An Advance Notice of Proposed Rulemaking would be required for every health rule, and scientific studies on the potential hazards would have to be posted by the Labor Department within seven days of a rulemaking announcement.

The congressional Democratic critics are probably unaware that the Labor Department is following the recommendations of a 1997 report by President Clinton's Commission on Risk Assessment and Risk Management.

The mystery is not why the Labor Department moves so fast, but why Congress wants it to move even more slowly.

Ms. Furchtgott-Roth, former chief economist at the U.S. Department of Labor, is a senior fellow at the Hudson Institute.

Mr. WILSON. And at this time, thank all of you for being here today.

And thank you, Madam Chairwoman, for a very interesting hearing.

Ms. WOOLSEY. Well, thank you all for attending this hearing, and, again, happy birthday, Mr. Wilson.

Mr. WILSON. Thank you. Thank you.

Ms. WOOLSEY. I want to thank our witnesses for being available to testify. This is a very exciting, interesting subject, and you were great, every one of you.

What we have heard today makes it clear that the current income gap is unsustainable. It threatens the stability of the middle class, it hurts the economy, it hurts our society, and excessive executive compensation is a major contributor to the problem, which must be addressed.

The problem of income inequality will not go away on its own. We need a national policy or a set of policies devoted to reducing the gap, to preventing a permanent underclass in the United States of America. This includes finding ways to protect our workers by passing the Employee Free Choice Act to strengthen unions and increase workers' bargaining powers. And this also includes a renewed commitment to training. We need to devote more resources to training, and we need to use these resources wisely on programs that work.

I have named only a few of the solutions that our witnesses have outlined today. I thank you for that. We need to use all the tools at our disposal to turn things around.

So, again, I thank you all for coming to today's hearing.

As previously ordered, members will have 14 days to submit additional materials for the hearing record. Any member who wishes to submit follow-up questions in writing to the witnesses should coordinate the majority—with the majority staff within 14 days.

Without objection, this hearing is adjourned.

[Additional submissions by Mr. Wilson follow:]

[From the New York Sun, August 6, 2008]

A Desirable Option

By DAVID FISCHER

School reform has been a top priority for the Bloomberg administration ever since the mayor took office. But it wasn't until this year that Mayor Bloomberg and Chancellor Klein took aim at one of the most overlooked and underfunded parts of the school system—vocational education, now known as career and technical education or CTE.

A task force convened by the mayor earlier this year just released its final report on July 30, calling on the city to transform CTE into "a desirable, respected, and accessible option" for city students.

In an era when "college for all" has become the universal goal and high-stakes standardized testing has taken hold as the measure of success or failure, CTE might not seem to have a place in the public high school of the 21st century.

But the numbers don't lie: a May 2008 report I authored for the Center for an Urban Future showed that 64% of New York City's CTE students in 2002—students who began high school that September—had graduated by October 2007, compared to 50% of the non-CTE high school students in the five boroughs who graduated.

Over the same period, the dropout rate among CTE students in the city was 5%; for non-CTE students it was 20%.

These vocational schools produce superior outcomes in spite of drawing disproportionately at-risk students, and groom young people for decent-paying jobs in occupations that are now in high demand, from automotive technicians to opticians.

The secret to CTE's success is that the courses engage students to a much greater extent than typical classroom fare. Research has shown that a large portion of those who drop out from high school do so because their classes seem boring and meaningless. At its best, CTE not only holds their interest, but also furnishes them with real world, in demand skills for which employers will pay well.

The city is home to a number of standout CTE schools, such as Aviation High School and Thomas Edison High School, both in Queens, and Manhattan's High School of Fashion Industries and Food and Finance High School. But the quality of New York's 21 CTE high schools is far from uniform, and CTE enrollment overall has dipped in recent years.

Programs have suffered from years of inattention and indifference on the part of city education officials, who have failed to provide schools with sufficient resources to pay for up-to-date equipment and training tools.

Commendably, the report released last week by the mayor's task force grapples with most of the major problems facing the city's CTE schools. In particular, it highlights lingering—and false—negative perceptions around "voc ed" as a lesser academic track for students who can't handle demanding schoolwork. The report also identifies the absence of integrated curricula to inculcate both core academic competencies and career-related skills, and the "disjointed" nature of engagement with the private sector—a vital partner in any successful CTE effort.

The report also is clear about how New York City and State must work together around defining new competencies, adjusting requirements for the amount of time spent in class, and other key areas of collaboration.

Unfortunately, the task force is more powerful in its diagnosis than in its prescriptions. Perhaps the biggest shortcoming is a lack of candor and detail about what it will cost to implement the suggested reforms. As just one example, the report urges the city's Department of Education to "[support] principals and teachers to redesign and create new courses and adapt new teaching methods * * * [and provide] appropriate, ongoing and embedded professional development * * * ." But none of that is free, and the Department has not shown great facility in delivering this support in the past. This is a goal, not a plan.

With few exceptions, such as the calls to develop "an inventory of existing partnerships linked to CTE schools * * * to provide a baseline from which to gauge the effectiveness of new efforts," and for "defin[ing] quantifiable targets for internship development across schools/programs," this absence of specifics characterizes the report. Moreover, there is little sense of how city officials and other stakeholders will know if reforms are working. In part, the problem is that this effort comes so late in the Bloomberg administration: the report calls for a five-year CTE Strategic Plan, but the last four of those years will unfold with a new mayor and, presumably, a new chancellor in charge.

Given the high profile of the effort—the task force was co-chaired by a former New York mayor, David Dinkins, and the chief executive officer of New York Life, Sy Sternberg—and commitments from business leaders, CUNY, the state Board of Regents, and other key players, the stars seem aligned for a needed overhaul of CTE. The risk is that with no strong follow-up plan and too little detail on what is to be done, a failed effort at reform will ensure many more years of underperforming programs.

Mr. Fischer, project director for workforce development at the Center for an Urban Future, is the author of the May 2008 study about New York's CTE programs, "Schools that Work."

[From the New York Sun, August 6, 2008]

Teenagers' Right to Work

By Diana Furchtgott-Roth

Teenagers, if you couldn't find a job this summer, call your senator or representative, because Congress wants to make it even harder next year. Tell Congress to stop pricing you out of a job.

Next July, New York's minimum wage will rise to $7.25 from its current level of $7.15 to match the new federal rate. This will be the third in a series of increases in the federal minimum wage, following increases to $6.55 last month and $5.85 in

July 2007. All this represents a significant increase from the $5.15 rate that had prevailed for a decade.

With the increase in teenage unemployment rates, Congress should rethink next year's minimum wage hike.

Last week's July employment data showed that teenagers are paying the price of Congress's generosity. The overall unemployment rate rose to 5.7% in July from 5.5% in June, but teen unemployment rate rose faster, to 20.3% from 18.1%.

It's even worse compared to last year. The overall unemployment rate has increased by one full percentage point, to 5.7% from 4.7%, yet teenage unemployment has risen five full percentage points, to 20.3% from 15.3%. This is an unprecedented historical increase for an economy that is still growing. Prior increases of this size have only occurred during recessions, and, press hype to the contrary, America is not in a recession.

Teenagers are particularly vulnerable to minimum wage increases due to their relatively low levels of experience and job-learned skills.

Congressional representatives, notably Democrats Carol Shea-Porter of New Hampshire and Phil Hare of Illinois, who assert that the minimum wage doesn't affect employment, as they did in last week's House Committee on Education and Labor hearing, aren't thinking about teenagers and low-skill workers. According to Ms. Shea-Porter, those who oppose a higher minimum wage favor "a permanent underclass."

New Hampshire and Illinois have minimum wage laws that exceed the federal one, so their residents aren't affected by the new law. So do California and Massachusetts, homes to House Speaker Nancy Pelosi, House Education and Labor Committee Chairman George Miller, and Senate Health, Education, Labor and Pensions Chairman Edward Kennedy, who led the charge for the higher federal minimum wage.

Yet the workforce in California, Massachusetts, and Illinois is declining, with residents migrating to fast-growing states without state minimum wage laws such as South Carolina and Alabama. Increasing the federal minimum wage is the latest in the blue state vs. red state battles, with the congressional leadership spreading the pain and reducing the growth of states with more sensible policies.

Minimum wage workers are overwhelmingly young, part-time, and work in the food service industries. Workers under the age of 25 make up roughly half of the 1.7 million minimum wage workers. Employed teenagers are almost five times more likely to be among the minimum wage earners than workers older than 25.

Members of Congress assume that if the minimum wage were raised, all workers would retain their jobs. But, according to my calculations, an increase to $7.25 an hour, plus the mandatory employer's share of social security, unemployment insurance, and workers' compensation taxes, brings the hourly employer cost close to $8, even without any benefits.

Teenagers already are feeling the unemployment pinch: next year, those whose productivity is worth less than $8.00 an hour to their employer won't be employed.

It sounds compassionate to alleviate poverty by mandating that employers give away their money. But employers won't necessarily cooperate. Instead, they will only employ workers who can produce $8.00 an hour of goods or services. That will be fewer people, especially teenagers, than they employ today. Employers can change technologies or hire more skilled workers to keep their firms in business.

Denying work opportunities to those whose skills and output don't add up to $8.00 per hour is not compassionate, it's manifestly unfair. The federal government essentially would be mandating that workers below a given level of skill have no right to work.

Much of Europe keeps a quarter of its youth unemployed, not with minimum wages, but with generous benefit packages (also proposed by Congress) that discourage work. The predictable effect is high unemployment rates with a substantial percentage out of work for more than a year, leading to deteriorating skills and a permanent underclass. This is not a good route for America.

Most American employers have to pay more than minimum wage just to attract and hold the workers they need. More than 140 million workers now earn above minimum wage, not because of federal or state law, but because that is the only way that firms can attract and keep employees with skills.

Rather than increasing the minimum wage in 2009 and taking away teenagers' right to work, Congress should focus on increasing their skills and growing our economy. Then, next summer, the unemployment rate might go down instead of up.

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[Whereupon, at 11:36 a.m., the subcommittee was adjourned.]

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