Statement of William E. Spriggs

"Wage Policies to Address Rising Economic Inequality and Why They are Needed"

Testimony prepared for

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Solutions to Rising Economic Inequality

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Thank you, Chair John Yarmuth and Ranking Member Steve Womack, for this invitation to give testimony before your committee today on the issue of rising economic inequality. I am happy to offer this testimony on behalf of the AFL-CIO, America's house of labor, representing the working people of the United States; and based on my expertise as a professor in Howard University's Department of Economics.

My testimony today will discuss the challenges of inequality for the Committee on Budget, and then talk about a major source of rising inequality, which is labor's falling share of national income, and rising wage inequality. Inequality is a problem for creating a budget for the United States because rising income concentration challenges a tax system to produce sufficient revenues for national priorities when the tax policy is designed with lowering tax rates where incomes are rising. And rising inequality slows economic growth, which will put further downward pressure on revenues. And, aiming government actions using the federal budget to ensure the United States has a viable economy with well trained workers is hard when rising shares of households are priced out of making the needed private investments in housing and education the economy needs. Given the large size of the gap in income faced by middle income Americans, the Committee on Budget needs to look at policies that can restore labor's share of income. The House of Representatives has passed the Raise the Wage Act and will face a vote on the Protect the Right to Organize (PRO) Act. These actions will reduce inequality and make creating a federal budget easier.

Last week, the U.S. Census Bureau released its latest report on income and income inequality in the United States. Fortunately, it showed that the major measures of income inequality and income dispersion that had shown rising inequality since 2015 were a little lower and flat, comparing 2017 to 2018. The gap between the top 10 percent of income earners and those at the bottom 10 percent and those at the median, fortunately fell. And broader measures of inequality, including the Gini coefficient, the Theil and Atkinson indices fell.[1] While this is good news, it does not mean the trend of rising inequality that began in the early 1980s has necessarily begun reversing itself.

In 1968, those in the middle three quintiles of the income distribution—the "middle income"—held 53.2 percent of all household income. But, in 1988, their share of income dipped below 50.0 percent. By 2004, over half all U.S. household income was held by the top 20 percent of earners. America truly transformed from being a middle-income nation, where market based economic activity was dominated by a middle class, to an unequal nation, where the majority of economic activity was determined by less than one-in-five households.[2]

This has real meaning for the Committee on Budget. A driving force of this inequality is the stagnation of American wages, resulting in a declining share of national income going to labor. Joint with the rising share of income going to those at the top, and the recent tax legislation has a clear problem. Recent tax legislation lowered tax rates on non-labor income, but that is the rising share of national income; and it lowered personal income tax rates, but the high-income bracket is the rising share of personal income. So, a clear challenge is devising a budget that can fit tax revenues that are increasingly dependent on falling shares of national income.

Another clear challenge is that the Committee on Budget will confront creating a budget for the United States where increasingly the market is not going to be able to generate enough income for households to buy homes or invest in their children's education. Those key investments are needed to fuel the economy through necessary private physical investment and human capital growth. An increasing share of households will require increasing assistance so as a nation we can house and educate our people for a 21st Century global economy.

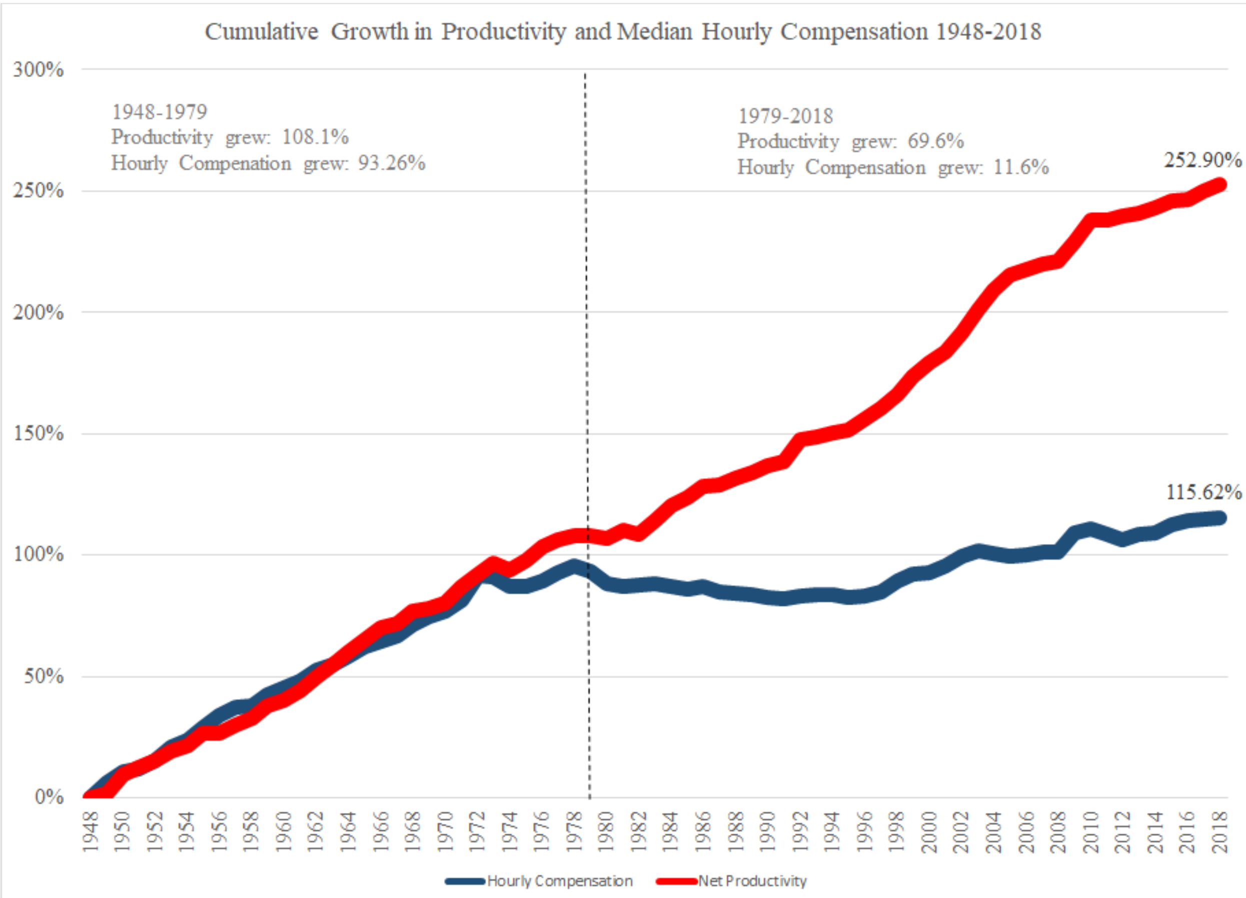
To return to a middle-income nation would require shifting 6% of household income, or about $694 billion, to those in the lower quintiles from those in the top quintile. Given the size

[1] U.S. Census Bureau, Income and Poverty in the United States: 2018, Current Population Reports P60-266 (September 2019), p.6

[2] Op.cit., Table A-4.

of the challenge, it is easier to devise strategies to restore labor's share of national income and return to a previous trend where labor's share was stable because wages and productivity rose together.

Figure 1.



Source: https://www.epi.org/productivity-pay-gap/

Figure 1 shows that from 1948 to about 1979, productivity and the total hourly compensation to the typical worker rose with productivity. Since 1979, productivity has continued to climb but the median, or typical worker, has not seen their wages, retirement and health benefits keep pace. Part of that gap is from rising wage inequality. Average hourly compensation has risen much faster than the median. But, as labor's share of national income has fallen, a gap has grown also between the growth in average compensation and productivity.[3]

Labor's falling share of national income is not unique to the United States. The Organization for Economic Cooperation and Development (OECD) has noted that among the 30 advanced economies where data is available, labor share has fallen in 26 of them.[4] A joint report drafted by the OECD and the International Labor Organization (ILO) done for the 2015 G-20 meetings, showed the decline in labor share was true whether using price indices for factor costs, as a company would weigh capital and labor costs, or using market prices, as a worker would weigh their wages against the price of purchases. They found that among the advanced economies in the G-20, the United States had the greatest decline of slightly over 10% from 1970 to 2014, exceeded only by Italy and the Republic of Korea.[5] In documenting this trend of the falling labor share, an International Monetary Fund study highlights how falling labor shares are highly correlated with rising income inequality.[6]

Growing inequality is key, because many major institutions have now reached consensus that growing inequality hurts growth. Research from the IMF shows that rising inequality leads to weaker growth (measured as Gross Domestic Product (GDP) per capita) over the medium term—meaning a five year horizon, and further reduces the chances that an expansion period will continue.[7] Similarly, the OECD independently concluded that growing inequality hurts economic growth. Looking at the growth in inequality that took place in the United States from 1985 to 2005, they conclude that rise in inequality lowered the cumulative growth of GDP per capita from 1990 to 2010 by about 20 per cent.[8] The World Bank, often concerned with helping

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[3] Josh Bivens, Elise Gould, Lawrence Mishel and Heidi Shierholz, "Raising America's Pay: Why It's Our Central Economic Policy Challenge," Economic Policy Institute Report (June 4, 2014) https://www.epi.org/publication/raising-americas-pay/

[4] Organization for Economic Co-operation and Development (OECD), *Employment Outlook 2012*. (Paris, 2012).

[5] International Labor Organization and OECD, *The Labour Share in G20 Economies*, Report prepared for the G20 Employment Working Group, Antalya, Turkey, (February 26-27, 2015) https://www.oecd.org/g20/topics/employment-and-social-policy/The-Labour-Share-in-G20-Economies.pdf

[6] Mai Chi Dao, Mitali Das, Zsoka Koczan and Weicheng Lian, "Why is Labor Receiving a Smaller Share of Global Income? Theory and Empirical Evidence," IMF Working Paper WP/17/169

[7] Jonathan D. Ostry, Andrew Berg, and Charalambos G. Tsangarides, "Redistribution, Inequality, and Growth," IMF Staff Discussion Note SDN/14/02 (February 2014). https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf

[8] Federico Cingano, "Trends in Income Inequality and its Impact on Economic Growth," OECD Social, Employment and Migration Working Papers, No. 163 (Paris 2014) http://www.oecd.org/els/soc/trends-in-income-inequality-and-its-impact-on-economic-growth-SEM-WP163.pdf

low income countries, has refined the relationship between growing inequality and growth. They note that for median and high-income countries, growing inequality slows economic growth. Their work goes further to remove the endogeneity between GDP per capita growth and inequality. So, their work adds greatly to the robustness of the conclusion that rising inequality hurts economic growth.[9]

In both the OECD and IMF research the focus is on "net inequality," that is, inequality after fiscal policy intervenes to address inequality. Both the OECD and IMF speculate that a mechanism for inequality to hurt growth is through lower levels of opportunity. Particularly in the work by the IMF, there is no direct effect of re-distribution on growth. So, addressing inequality through policies to increase opportunity that lowers net inequality help growth when the redistribution policies expand opportunity. This is consistent with research findings showing that the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC), for instance, have longer term payoffs such as: improved infant health, increased school performance, increased college enrollment and greater intergenerational mobility.[10]

Figure 2 shows, for the United States, how the gap between wages and productivity charted in Figure 1 correlates with the fall in union density. As unions and collective bargaining agreements cover fewer workers, the correlation between rising productivity and broad wage growth has weakened. An IMF staff working paper showed the strong relationship in advanced economies between the decline in union density and rising share of income to the top 10 percent. Declining union density and weakened minimum wage laws have characterized many advanced economies since 1980. But not all countries experienced the weakening of these labor market wage setting institutions to the same extent. Yet, all advanced economies have confronted technological advanced and increased global integration. Technology is a potential factor in both falling labor shares and rising income inequality, because technology can be biased toward different skill levels. The IMF paper shows that 40% of the increase in the share of income

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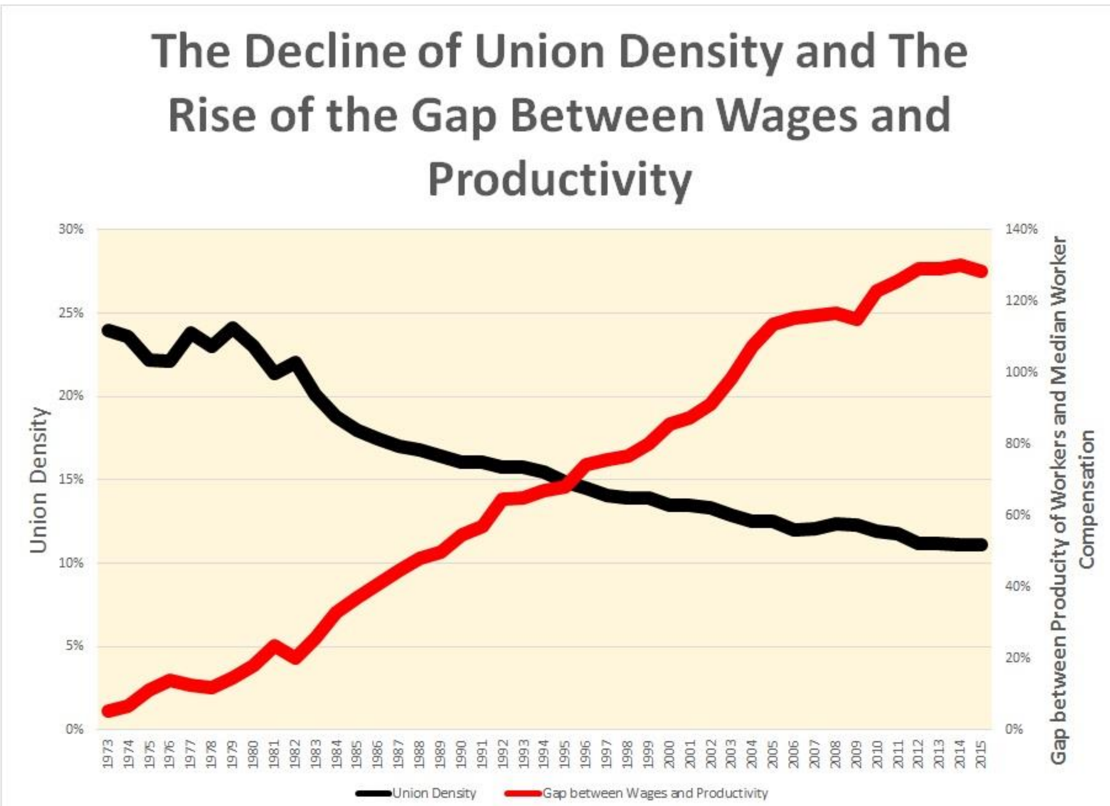
[9] Markus Brueckner and Daniel Lederman, "Inequality and Economic Growth: The Role of Initial Income,"Policy Research Working Paper 8467, World Bank Group, Middle East and North Africa Region, Office of the Chief Economist (June 2018) http://documents.worldbank.org/curated/en/574281528247194319/pdf/WPS8467.pdf

[10] Chuck Marr, Chye-Ching Huang, Arloc Sherman, and Brandon Debot, "EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds," Center on Budget and Policy Priorities (October 2015) https://www.cbpp.org/sites/default/files/atoms/files/6-26-12tax.pdf; and Austin Nichols and Jesse Rothstein, "The Earned Income Tax Credit (EITC)," National Bureau of Economic Research, NBER Working Paper No. 21211 (May 2015) https://www.nber.org/papers/w21211.pdf

going to the top 10 percent can be explained by the decline union density in advanced economies. While the paper shows little association between the minimum wage and the rising share of income to the top, it does show that the minimum wage reduces the broader measure of wage inequality.[11]

Figure 2



As new data become available, economists have found relying on skill-biased technical change to explain continued rises in inequality difficult. This has led to new research on unions and minimum wages in explaining the rise in inequality. One important component of the research is understanding the key importance unions played in raising the wages of men in low-skilled industries. A work by Farber, Herbst, Kuziemko and Naidu reconstructs individual level data to look at union effects on wages, controlling for skill from the late 1930s to 2017 and find changes in union density over that longer 80 year period can explain the fall in inequality as union density rose and the rise in inequality, including the rising share of income to the top 10

[11] Florence Jaumotte and Carolina Osorio Buitron, “Inequality and Labor Market Institutions,” IMF Staff Discussion Note SDN15/14 (July 2015).

percent, from the fall in union density since the late 1970s.[12] Understanding that the wages of union members can have spill-over effects to non-union workers, and that raises in the minimum wage can help workers earning above the minimum wage through spillover effects, researchers Fortin, Lemieux and Lloyd find that 37 percent of the growth in the wage gap for men in the top 10 percent and the median worker over the 1979 to 2017 period can be explained by the decline in union density in the U.S.. This is key, because a portion of the gap between the growth of productivity and median wages, is accounted for by the rising gap between the top 10 percent and median workers' wages. For women and men, they found the minimum wage was important in explaining the problems of inequality for the bottom 10 percent of earners falling behind other workers.[13]

The OECD has looked carefully across its member countries to analyze how well different collective bargaining systems function. The United States stands out because of its very low share of workers benefitting from collective bargaining and it's decentralized, firm-level bargaining. Comparing across different levels of bargaining structure, this is the worst performing type. Their report notes that higher levels of collective bargaining, particularly when the bargaining ends up with better coordination of wages at the sectoral level, yields several better labor market outcomes: lower wage inequality, lower unemployment rates, lower unemployment rates for workers who are often marginalized like women and young workers, and higher levels of job training.[14]

Before the House of Representatives now, is a bill introduced by Congressman Bobby Scott, The Protecting the Right to Organize Act (PRO Act) that will go a long way to restore American workers' rights to organize and bargain collectively with their employer. The PRO Act strengthens remedies and enhances punishment for violating the rights of workers and

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[12] Henry S. Farber, Daniel Herbst, Ilyana Kuziemko and Suresh Naidu, "Unions and Inequality over the Twentieth Century: New Evidence from Survey Data," National Bureau of Economic Research, Working Paper 24587 (May 2018).

[13] Nicole M. Fortin, Thomas Lemieux and Neil Lloyd, Labor Market Institutions and the Distribution of Wages: The Role of Spillover Effects, manuscript, Vancouver School of Economics, University of British Columbia (September 26, 2018) https://econ2017.sites.olt.ubc.ca/files/2018/12/pdf_paper_thomas-lemieux-spillovers.pdf

[14] Organization for Economic Cooperation and Development, Chapter 3 "The Role of Collective Bargaining Systems for Good Labour Market Performance," in *OECD Employment Outlook 2018* (Paris 2018) https://www.oecd-ilibrary.org/sites/empl_outlook-2018-7-en/index.html?itemId=/content/component/empl_outlook-2018-7-en

restores balance and fairness in a collective bargaining system that has become too slanted to achieve the economic necessary coordination of wage and productivity growth.

Congress has already taken an important step to fight inequality by passing the Raise the Wage Act. That Act will raise the minimum wage gradually to $15 an hour. As a rising share of the work force are women, the weight assigned to wage inequality faced by women increases in explaining overall wage inequality. Raising the minimum wage is one of the most potent tools for closing the gender pay gap; 58 percent of those who will get a raise are women. The best, most current comprehensive approach for assessing the effect of minimum wage increases on employment show no significant impact of raising the minimum wage on employment.[15]

Work looking at the increase to the minimum wage's highest level and its greatest expansion in coverage from the Fair Labor Standards Act of 1966, showed the increase did not have negative employment effects even in rural areas where the new minimum wage and its expansion in coverage doubled previously prevailing wages. That increase substantially lowered racial wage inequality between Black and White workers.[16] Similarly, the Raise the Wage Act will close racial wage gaps because it would erase the current de facto regional minimum wage laws now in effect. Because many states, cities and the District of Columbia have set in motion a raise to $15 an hour, there is a deepening racial disparity in labor standards as experienced especially by Black workers. Most Black workers are in states with a $7.25 minimum wage, while the majority of American workers live in states with a higher state or city minimum wage. A regional minimum wage approach would virtually, and surgically exclude Black workers, and women of color most specifically from the protection of higher wage standards. So, the regional minimum wage would be another prime example of how public policies have created the current racial wealth gap.

Passing the PRO Act and pushing forward on the Raise the Wage Act will go a long way to restoring the period in American growth where wages and productivity rose together. And, by lowering inequality it will also help increase economic growth and prolong economic recoveries.

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[15] Doruk Cengiz, Arindrajit Dube, Attila Lindner, and Ben Zipperer, "The Effect of Minimum Wages on Low-Wage Jobs: Evidence from the United States using a Bunching Estimator," National Bureau of Economic Research, NBER Working Paper Series, No. 25434 (January 2019) https://www.nber.org/papers/w25434.pdf

[16] Ellora Derenoncourt and Claire Montialoux, "Minimum Wages and Racial Inequality," manuscript, Harvard University (November 2018) https://scholar.harvard.edu/files/elloraderenoncourt/files/montialoux_jmp_2018.pdf

The current high level of inequality increases the share of Americans who struggle to buy homes and to educate their children. This is because those in higher income levels come to define the market for those goods, and so the prices in the markets increase with their incomes.

Figure 3

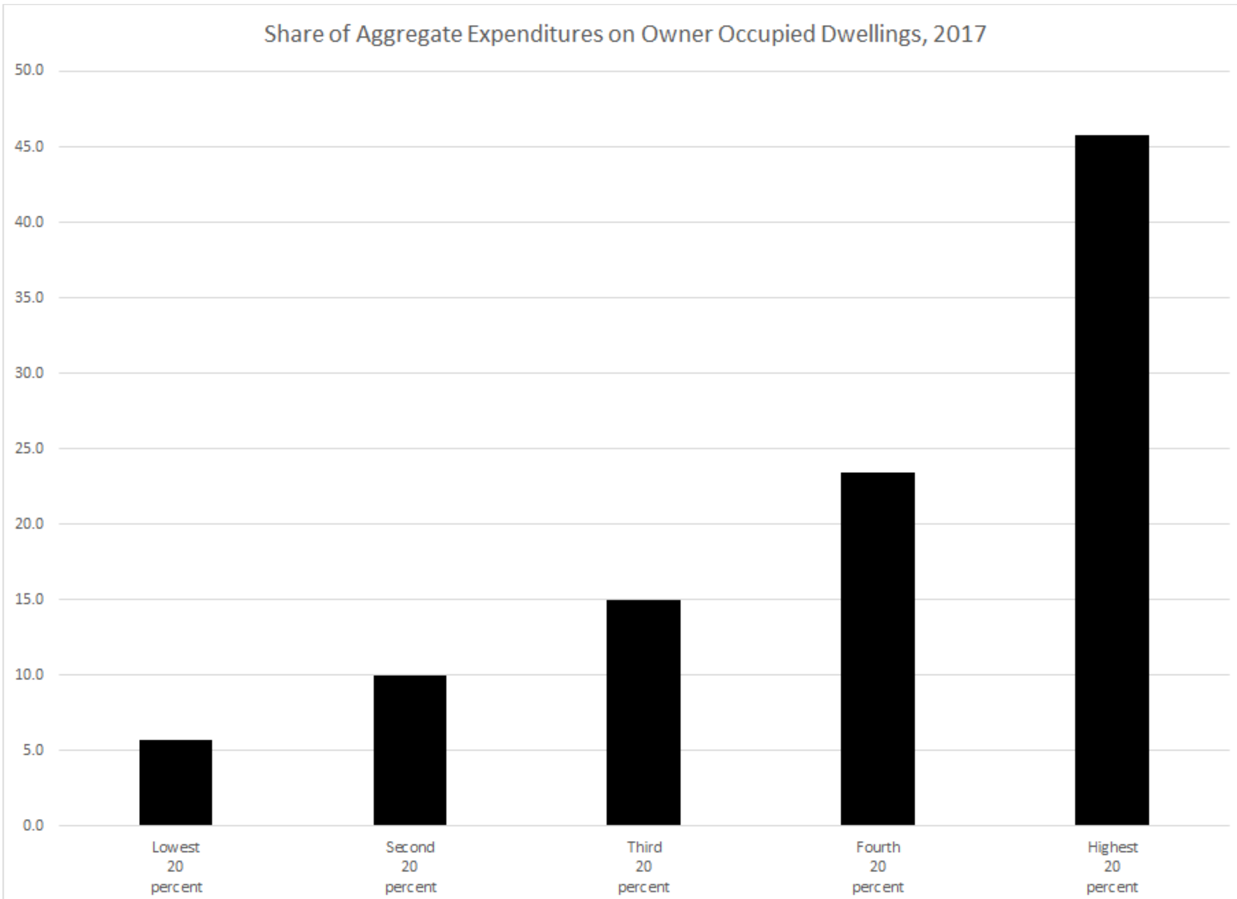
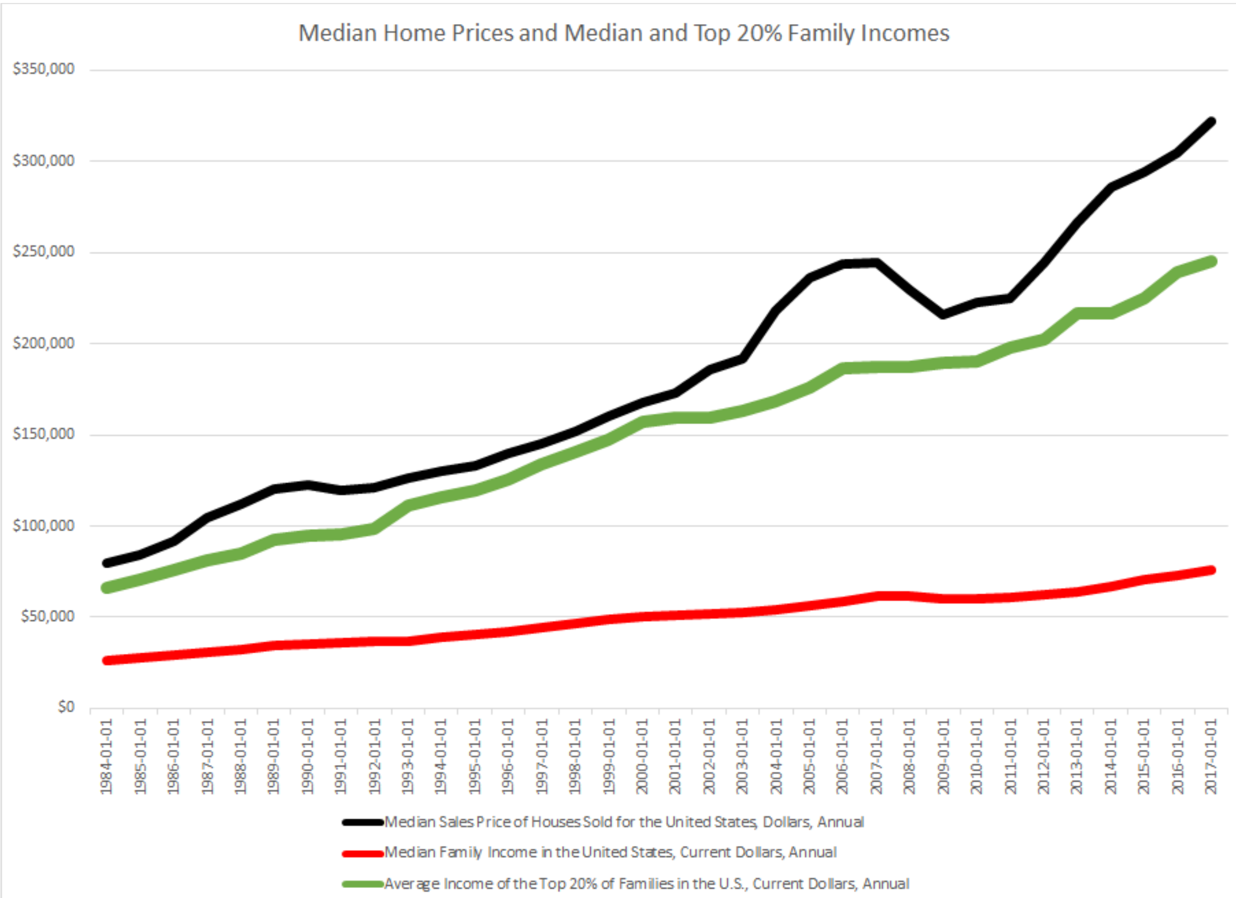


Figure 3 shows that over 45% of all private expenditure on owner occupied housing in the United States is accounted for by the top 20 percent of the income distribution. That is more than the bottom 60% of households combined. The result can be seen in Figure 4 that shows how the price of the median home in sold in the United States tracks the growth in income of those with higher incomes and leaves behind those with median earnings.

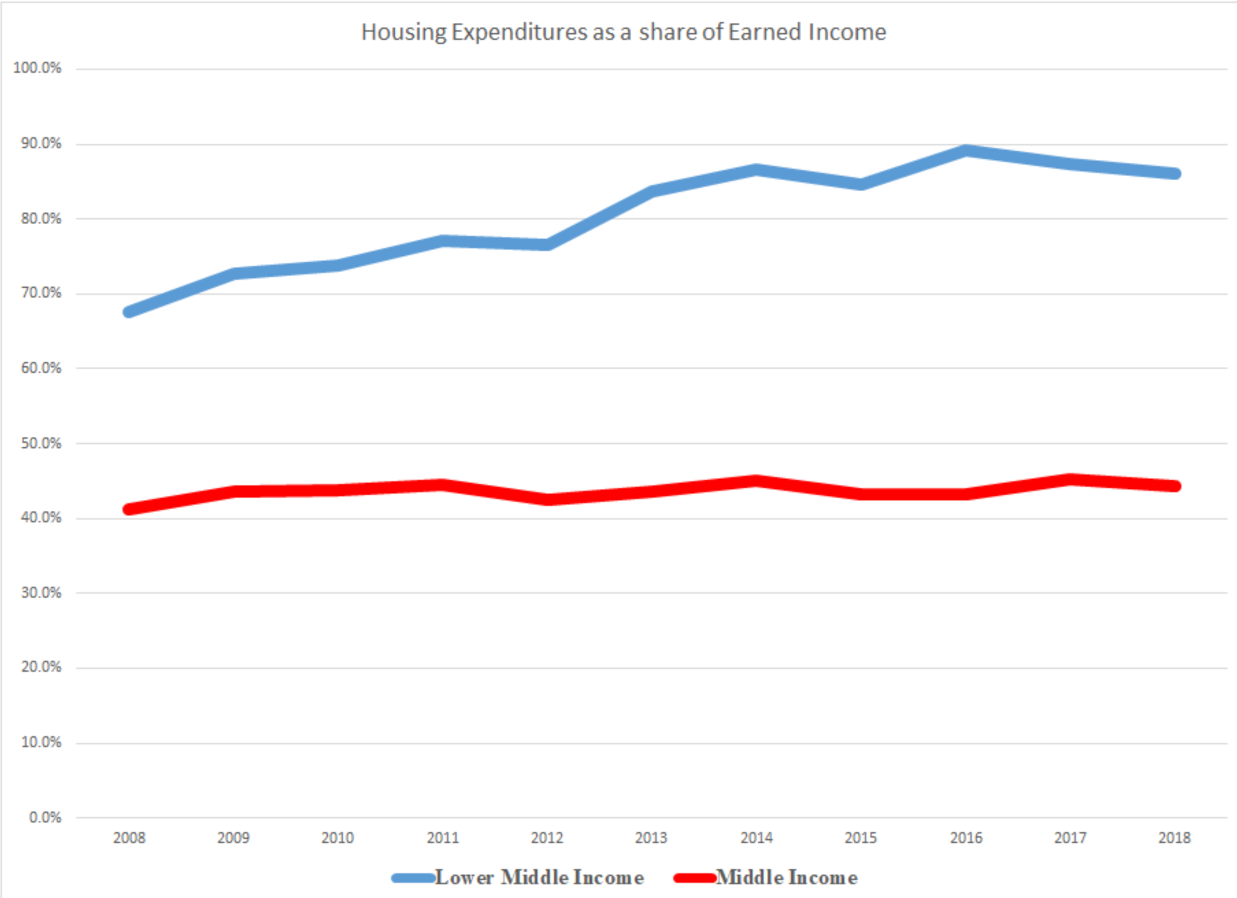
Figure 4 shows the median home price for homes sold in the United States, in nominal dollars, and the nominal average income of families in the top 20 percent of the income distribution and the nominal median income of families. The gap between median family income and home prices will slow the housing market. And, going forward, if the gap does not close, private residential investment will decline as a source of growth during economic expansions. It is one reason that expansions would be weaker and potentially last for shorter periods.

Figure 4



Earnings are slowly recovering to their pre-2008 levels. But with housing prices rising faster than incomes, the earnings gains of those in the lower-middle- and middle-income households, housing costs still eat up a rising share of earnings. Figure 5 shows data from the Bureau of Labor Statistics Consumer Expenditure Survey. It shows income by consumption units, which come closer to household than family income. For those in the lower-middle quintile of income, despite rising earnings, these households clearly are facing housing distress, and need help because of high housing costs. Even middle-income households are seeing little relief from rising housing costs, relative to what they earn.

Figure 5



The affordable housing crisis that this data shows as real, are going to be a challenge for budgeting. If a greater share of income was held by middle income families, they would represent a greater share of the market and make it easier to pursue market-based strategies to get the residential housing investment the economy needs for strong growth. And, higher earnings would reduce the need for government intervention into the market through tax expenditures or direct market intervention.

There is a similar challenge when it comes to higher education. The United States once stood as the nation with the highest share of workers who were college educated. Today, the United States is a distant mention. In large part, it is the result of these same forces, where the prices are rising with market, and those prices are rising faster than the incomes of most Americans.

Figure 6

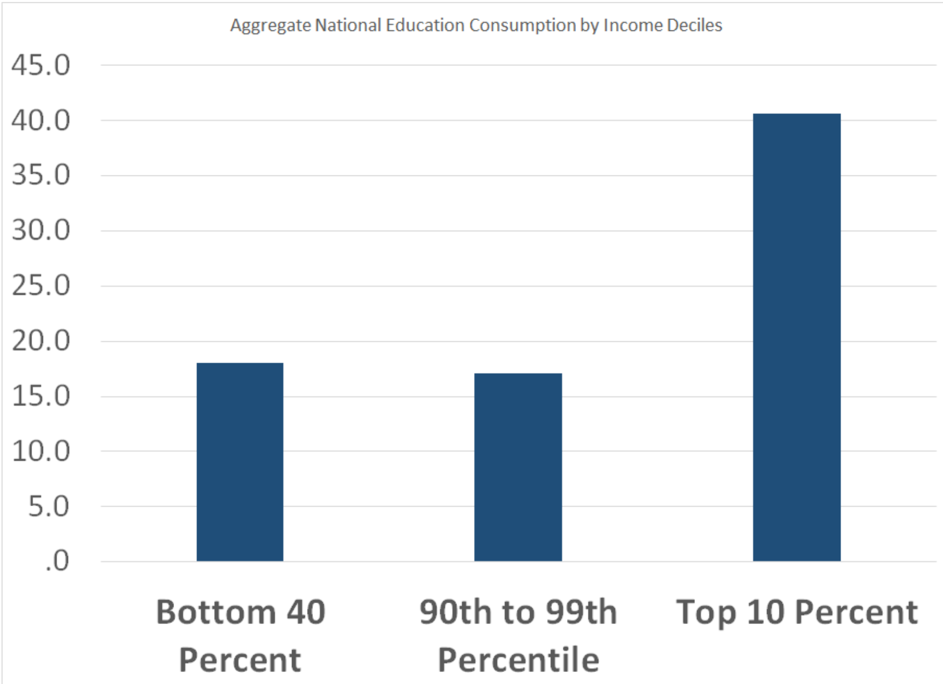
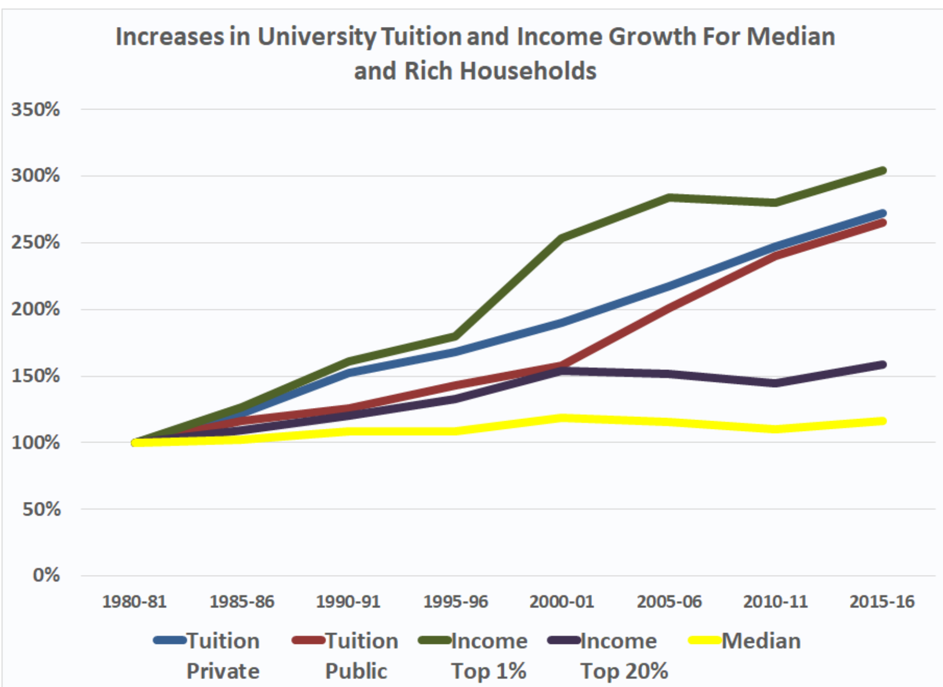


Figure 7



Figures 6 and 7 show that because of the dominance of high-income households in the market for education, the market result is that prices closely track their increases in incomes, leaving behind those with median incomes. The crisis is that since 2000, the increases in tuition have also outstripped growth in income for most in the top 20%, and better tracks the growth in income of the top 1%. In 1995, among OECD nations, the United States ranked first for the highest share of workers with college degrees. But, by 2012, the United States had fallen to a very distant 19th out of the 28 nations. In a market driven system of higher education then, it is little surprise there are several colleges that now have more students from the top 1% of family income than from the bottom 40%.[17]

To remain a competitive economy, the United States will need to move back toward its formal leadership in having the world's most educated work force. And, at this level of inequality, it will be a challenge relying only on existing market forces. A federal budget will need to re-invest in higher education to lower colleges' reliance on tuition revenue or make increasingly larger subsidies to colleges or students to insure we educate all our best and brightest, not just the few who can afford it. With the coming of artificial intelligence, workers will need to have higher levels of education so that artificial intelligence will complement their skills and augment their productivity.

Conclusion

Income inequality is a challenge for the Committee on Budget. It is already well established that the biggest challenge to Social Security's funding is the unprecedented rise in income inequality that started in the 1980s. Addressing the cap on Social Security taxes to correct for that is well known, and a simple fix to address that problem. But inequality diminishes too many Americans' opportunities. And, fixing clear regressive tax policy outcomes for low wage working families by passing the Working Families Tax Relief Act is another. To provide a strong and sustained economy, federal budgets will have to address the diminished investments that we currently rely on individuals to make. Without those investments, economic growth is slower, and recoveries are fragile. Two clear policies have played important roles in increasing inequality in the United States more than occurred globally. All nations face the pressures of technological advance and increased global integration. But not all nations have had

[17] Raj Chetty, John Friedman, Emmanuel Saez, Nicholas Turner, and Danny Yagan, "Mobility Report Cards: The Role of Colleges in Intergenerational Mobility," Manuscript, Stanford University (July 2017) http://www.equality-of-opportunity.org/papers/coll_mrc_paper.pdf

the same rise in inequality. The United States had a strong history of bounding competition by insuring adequate minimum wages and protecting the rights of Americans to bargain collectively with their employers. These standards help secure a strong relationship between productivity growth and wages. And that strong relationship helped maintain the purchasing power of the middle. Restoring those policies is a logical step to restoring a more vibrant economy. The passage of the Raise the Wage Act was a step forward, and passing the PRO Act will be another big step in that direction.