Resolution Foundation

The shape of things to come?

America's cautionary tale

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Contents

3.2 How American Politics is Undermining the American Dream – and What it Means for the UK

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What does it mean to be middle class? Economic experts talk about levels of income: between two and four times the poverty level, for example, or the middle three quintiles of the income distribution.

When you ask Americans, though, you get a very different answer. First, most Americans believe they *are* middle class; only a small share say they are poor or rich. Second, what defines the middle class for them—according to decades of polling, focus groups, and public discourse—is much broader than income: a job with reasonable pay and benefits, the ability to raise a family without undue hardship, basic economic security grounded in the ownership of homes and other assets, and the opportunity to rise up the economic ladder through education and hard work.

All these core aspects of the middle class are under siege in the United States and, increasingly, the UK as well. The most unmistakable sign of trouble, as Larry Mishel and Heidi Sherholz show in their essay, is the stagnation of median wages that has occurred over the last generation as income gains have accrued overwhelmingly to the richest.

But the income squeeze associated with rising inequality is only the most visible tip of a much larger iceberg of middle-class strain. As wages have stagnated, families have gained economic ground mostly by relying on both parents working more—which has created a "care squeeze" as they juggle paid work and caring for young children or aging parents. As job-based benefits like health insurance and traditional defined-benefit pensions have eroded or disappeared, middle-class families have borne greater economic risk despite little in the way of greater economic rewards. And the private safety net of savings and wealth on which these families depend has become much more threadbare, especially after the market crisis of 2007.

In short, the ideal and reality of the middle class are increasingly distant. Yet political leaders have been slow to respond to this growing gap and, in crucial areas, have actually made it worse. In this essay, I examine why, focusing on the United States and its lessons for the United Kingdom.

The middle class and its discontents

The last generation has witnessed a remarkable turnaround in American economic outcomes. In the generation after World War II, the economy and the earnings of all income classes grew roughly in tandem. Since the 1970s, the economy has slowed modestly, but the big change has been where the rewards of growth have gone. In a word, they have gone to the top. Over the last generation, the share of pre-tax national income received by the richest 1 percent of Americans has more than doubled. The share received by the richest 0.1 percent has more than *quadrupled*, rising from less than 3 percent in 1970 to more than 12 percent in 2007—the highest proportion since the creation of the income tax in 1913.[1]

This is not a story of stagnant productivity or general economic malaise. It is a story of the decoupling of aggregate productivity and most workers' wages. Even a college-educated entry-level male worker earns barely more than such a worker did a generation ago.[2] While the 1990s economic boom temporarily reduced the pay-productivity gap, the gap returned with a vengeance in the 2000s. Indeed, the 2000s expansion was the first on record in which a typical family's income was lower at the end than at the close of the prior business cycle.[3]

As job security has eroded and gains have shifted toward the top, other pillars of security and opportunity have also come under strain:

- **Education and Social Mobility**. Class lines have hardened. American inequality is sky high; American social mobility is below the advanced industrial norm.[4] The United States has gone from the world leader in college completion to a middling performer. More and more of rapidly rising college costs are financed through loans, burdening students and their parents—except for children of the rich, who gain a huge head-start.[5]

- **Pensions and Social Insurance.** The United States's job-based framework of economic security has gone from basic to broken. Defined, secure pensions that promise a guaranteed benefit in retirement—once the hallmark of a good job—are vanishing. 401(k)s and other tax-deferred savings accounts aren't filling the gap. As medical costs continue to outstrip inflation, employment-based health insurance benefits are becoming rarer and less protective.[6]

- **Housing and Economic Assets.** Besides their homes, most middle-class families have strikingly little in the way of private assets to cushion economic shocks or build their futures. And, of course, those homes look far less secure than they once did. The traditional strategy of gradually accumulating wealth through housing has taken a perhaps-fatal hit, with implications for the economic security not just of the middle aged but also of the young aspiring middle class.

- **Balancing Work and Family**. With families increasingly needing two earners to maintain a middle-class standard of living, their economic calculus has changed in ways that accentuate many of the risks they face. What happens when a parent leaves the workforce to care for children, when a child is chronically ill, when one spouse loses his or her job, or when an elderly parent needs assistance? Precisely because it takes more work and more income to maintain a middle-class

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[1] Hacker, J., and P. Pierson. 2011. *Winner-Take-All Politics: How Washington Made the Rich Richer—And Turned Its Back on the Middle Class*, ch. 1 (New York: Simon & Schuster).
[2] Ibid., p. 36.
[3] Greenstein, R., S. Parrott, and A. Sherman. 2008. "Poverty and Share of Americans without Health Insurance were Higher in 2007—And Median Income for Working Age Households Was Lower." (Wash., DC: Center on Budget and Policy Priorities). www.cbpp.org/cms/?fa=view&id=621.
[4] *A Family Affair: Intergenerational Social Mobility across OECD Countries*. 2010. (Paris: OECD). www.oecd.org/dataoecd/2/7/45002641.pdf.
[5] "Trends in Student Aid." 2010. College Board Advocacy and Policy Center. http://trends.collegeboard.org/downloads/Student_Aid_2010.pdf.
[6] Hacker, J., and P. Pierson. 2008. *The Great Risk Shift: The New Economic Insecurity and the Decline of the American Dream* (New York: Oxford University Press).

standard of living, events that require the care and time of family members produce special strains. This "care squeeze" creates new risks alongside traditional job concerns.

The political roots of middle class strains

Who killed the old middle-class social contract? Most explanations focus almost exclusively on the unstoppable forces of technology and globalization. Computers and automation have reduced the rewards for routine skills and encouraged outsourcing and off-shoring. The entry of hundreds of millions of literate low-wage workers into the global workforce has undermined the earning power of middle-class Americans, especially those without a college degree. Compared with these vast tides, the conventional wisdom suggests, American politics and policy have played only a bit role—and can do only a limited amount to reclaim the American Dream.

Technological change and globalization matter immensely, of course. But their effect in the United States (and other nations) has been heavily shaped by whether and how governments have responded to them. After all, these shifts have affected all rich nations—most more so than the United States—and yet few have seen anything like America's sharp upward shift of economic rewards, erosion of economic security, or breakdown of social benefits.

Moreover, in many nations where inequality and insecurity have risen, policymakers have pushed back through active labour market policies, taxes, and public spending. Not so in the United States. Despite the Earned Income Tax Credit for the working poor and expansion of Medicaid health insurance coverage for low-income families and children, low-wage workers have continued to fall behind. According to the Congressional Budget Office, even after all public and private benefits and federal taxes are taken into account, almost 40 percent of all household income gains between 1979 and 2007 accrued to the richest 1 percent of Americans—more than received by the bottom 90 percent combined.[7]

Another clue that politics and policy have been crucial is that America's newly unequal and insecure economy developed hand in hand with a new politics. As Paul Pierson and I have argued in our book *Winner-Take-All Politics*, corporate America organized on an unprecedented scale in the late 1970s to influence government policy, not just through campaign giving but also vast lobbying efforts. At the same time, with campaign costs shooting up, money became a far more important resource for politicians—and, as we have seen, a far more unequally distributed resource in American society.

The rising role of money and the increasing imbalance between business and other organized interests fundamentally changed Washington. For the contemporary Republican Party, these changes were welcome and encouraged the party to shift ever rightward on economic issues. Democrats, by contrast, found themselves increasingly torn between their historical commitment to the "little guy" and the pull of money from the big guys, including, for much of the 1990s and early 2000s, the ascendant titans of Wall Street. The result was an ever more polarized economic debate in which a significant faction of one party, the Democrats, repeatedly proved willing to cut bargains that undermined the middle class's standing.

[7] Congressional Budget Office (2010) *Average Federal Taxes by Income Group*. http://cbo.gov/publications/collections/collections.cfm?collect=13

The recent string of large tax cuts for the richest of Americans have highlighted the long-term role of our tax system in abetting inequality. Far more important and less recognized have been ways in which public policies have remade markets to advantage the top. Failure to enforce federal laws that empower workers to form unions undermined organized labour as a force for good pay and benefits. Corporate governance rules all but asked top executives to drive up their own earnings. Financial deregulation brought great riches for some while pushing many ordinary families into unaffordable loans, and ultimately crashing the economy.

Perhaps the least visible policy changes were passive-aggressive in nature—deliberate failures to address changing economic and social conditions, such as the need for families to balance work and family. Entire categories of support that have become essential to middle-class life, such as good childcare, are simply not a public responsibility in the United States. Meanwhile, responsibilities that corporations once shouldered are shifting back onto families. Uniquely among industrial nations, the United States came to rely on employers as mini-welfare states, providing health insurance, pensions, and other benefits that elsewhere enjoyed state sponsorship. But as employers have pulled back, government has not filled the gap, leaving families more vulnerable.

Perhaps it is not surprising then that so many middle-class Americans feel abandoned. Asked in mid-2010 whom government had helped "a great deal" during the downturn, 53 percent of Americans said banks and financial institutions; 44 percent fingered large corporations. Just two percent thought economic policies had helped the middle class a great deal.[8]

Lessons for the UK

To what extent has the UK experienced similar trends? In one respect, the parallels are striking. The share of income accruing to the richest in the United Kingdom has risen almost as sharply as it has in the United States. In 2005, the last year for which data are available for both nations, the proportion of pre-tax income going to the top 1 percent (excluding capital gains, which cannot be easily compared across the two countries) was 14.25 percent in the United Kingdom, compared with 17.42 percent in the United States.[9]

In the UK, however, this upward shift of income has not occurred alongside stagnation at the middle as it has in the US — at least not until recently. The main explanation appears to be public policy: direct government transfers to the middle and the bottom of the economic ladder. In a careful comparative analysis, the sociologist Lane Kenworthy has found that the income gains of low-income citizens in the last three decades has depended heavily on changes in public taxes and transfers. "The New Labour governments under Tony Blair and Gordon Brown," he notes, "increased benefits and/or reduced taxes for low earners, single parents, and pensioners…[T]hese were big policy shifts,

[8] Pew Research Center (2010) *Government Economic Policies Seen as Boon for Banks and Big Business, Not Middle Class or Poor*. http://pewresearch.org/pubs/1670/large-majorities-say-govt-stimulus-policies-mostly-helped-banks-financial-institutins-not-middle-class-or-poor

[9] Paris School of Economics (2011) *Top Incomes: A Global Perspective* http://g-mond.parisschoolofeconomics.eu/topincomes/

even if not always high-profile ones. They produced a significant rise in the real disposable incomes of poor households."[10]

In addition, the continued strong role of the National Health Service in providing universal—and comparatively affordable—services stands in stark contrast to the American experience of runaway health costs and declining private coverage. These policy differences may in turn reflect the stronger role of labour unions and the greater commitment to the welfare state evidenced by the Labour Party as compared with the Democratic Party. Whatever the cause, the substantial decline in economic security and painfully slow income growth seen in the United States does not appear to be the UK story.

Nonetheless, the US experience is looking more and more relevant. In the last decade, the British middle class has begun to experience the same wage and income stagnation that the American middle class has confronted for years. What's more, the economic crisis and subsequent austerity policies have simultaneously increased economic hardship and encouraged an American-style stagnation in policies, as public and employment-based benefits are cut or held steady in the face of rising needs and initiatives to deal with new risks such as the care needs of an aging population are pushed off the agenda. For all these reasons, the American experience offers increasingly salient lessons for the UK — three in particular.

Lesson 1: Pay Attention to "Predistribution." When we think of government's effects on inequality, we think of "redistribution"—government taxes and transfers that take from some and give to others. And redistribution is certainly a major part of what government does to reduce inequality and insecurity. As noted, the UK has done more to offset the growth in inequality in the market through taxes and transfers than the United States has.

Yet there is good reason to look beyond redistribution in thinking about how to tackle inequality and insecurity. In the US, many of the most important changes have been in what might be called "predistribution"—the way in which the market distribute its rewards in the first place. Policies governing financial markets, the rights of unions, and the pay of top executives have all shifted in favour of those at the top, especially the financial and nonfinancial executives who make up about six in ten of the richest 0.1 percent of Americans.[11]

The moral is that reformers need to focus on market reforms that encourage a more equal distribution of economic power and rewards even before government collects taxes or pays out benefits. This is not just because predistribution is crucial. It is also because excessive reliance on redistribution fosters backlash, making taxes more salient and feeding into the conservative critique that government simply meddles with "natural" market rewards. And, lastly, it is because societies in which market inequality is high are, ironically, ones where creating common support for government action is often most difficult. Regulation of markets to limit extremes and give the middle class more voice is hardly easy—witness the fight over financial reform in the United States. But it is both more popular and more effective than after-the-fact mopping up.

[10] Kenworthy, L. 2010 *Has Rising Inequality Been Bad for the Poor?* http://lanekenworthy.net/2010/12/14/has-rising-inequality-been-bad-for-the-poor/, and *Has the Rise in Income Inequality Been Rawlsian?* www.u.arizona.edu/~lkenwor/hastheriseinincomeinequalitybeenrawlsian.pdf

[11] Hacker, J., and P. Pierson, ibid. p.46

A predistribution agenda should have several elements. First and most obvious, it must involve a commitment to high levels of employment—a necessary but hardly sufficient condition for broadly shared growth. To tackle hyperconcentration of income at the top and protect against financial instability, effective regulation of financial markets and corporate governance are essential—starting with greater transparency and accountability in executive pay-setting. At the high end of the income scale, policies should be designed to encourage countervailing pressures against self-dealing and pay-without-performance from watchdog organizations and shareholder collectives (such as large institutional shareholders). In the middle range, policies should be focused on facilitating the organization of workers and the creation of opportunities for voice in the workplace, including not just more aggressive protection of those seeking union representation but also institutional reform, such as "right to request" laws, that give workers protected institutional channels through which to seek better employment arrangements.

Because growing top-heavy inequality creates threats to equality of opportunity as well, special emphasis should be placed on ensuring that small-scale enterprises and start-up entrepreneurs have the access to capital and legal protection necessary to enter into markets and expand. Similarly, ensuring that educational opportunities are broadly distributed—with a special emphasis on early childhood education and adequate support for college completion for less advantaged students—is also a pressing priority, even if not a panacea for addressing the deep inequality that so threatens basic equality of opportunity today.

Lesson 2: "Drift" is Dangerous. Over the last generation, across a wide range of areas, American public officials have deliberately failed to update policy in the face of changing economic circumstances, allowing outcomes to "drift" away from a more equal equilibrium.[12] Although particularly pronounced in the United States, drift seems characteristic of many rich democracies today as they confront a rapidly changing economy and society and grapple with persistent fiscal constraints. If this is so, preserving existing policies is not the only challenge. The welfare state traditionally understood remains deeply rooted. But the broader environment of the welfare state—a mixed economy characterized by a healthy civil society—is much more vulnerable. It has become abundantly clear that well-functioning markets are not natural or inherently self-correcting; they require continuing public policy updates in a highly dynamic economic world.

To be sure, British policymakers face nothing like the institutional hurdles that their American counterparts – who are coping with the fragmentation of US governing authority – do. Still, it is worth remembering that many of the most severe causes of drift in the United States are extra-constitutional, and thus potentially relevant to British developments. Partisan polarization—which in the United States at least has involved the conservative pole of the debate moving steadily further to the right—presents inherent barriers to policy updating, reducing the chance of agreement even when there is broad public support for it. Fiscal constraints are another cause of drift, and the tightness of these constraints depends very much on the policy choices of the past. Large shifts in the fiscal constitution of the state, such as major changes in the visibility or source of tax revenues, can powerfully influence the tendency of the political system toward drift.

[12] Hacker, J. (2004) 'Privatizing Risk without Privatizing the Welfare State.' *American Political Science Review*, vol. 98, no. 2.

To protect and restore a well-functioning market democracy, therefore, those worried about inequality and insecurity must preserve an effective capacity for robust governance. They should resist institutional reforms that abet gridlock and ensure that policies put in place retain the capacity for over-time adjustment, whether automatically (as in benefits indexed to wages or prices) or structurally (through the preservation of basic regulatory, tax, and spending powers that are too often sacrificed on the conservative altar of privatization and delegation).

Lesson 3: Increase the Organizational Might of the Middle. As documented at length in *Winner-Take-All Politics*, the transformation of America's political economy over the last generation has far less to do with the shifting demands of voters than with the changing organizational balance between concentrated economic interests and the broad public. Indeed, the sharp shift of policy toward the affluent and business occurred despite remarkable stability in public views on many economic issues—including views on government redistribution, progressive tax policy, and the importance of key programmes of economic security. The agenda disconnect that we see today, as politicians ignore Americans' concerns about the lack of jobs in favor of cutting programs that the public likes and preserving tax reductions for the rich that it doesn't, is not new. It has characterized the politics of the last generation.

The root of the problem, once again, is organizational. As Theda Skocpol has argued, middle-class democracy rested on organizations, such as unions and cross-class civic organizations that gave middle-class voters knowledge about what was at stake in policy debates and political leverage to influence these debates.[13] Without this organizational grounding, voters simply have a very hard time drawing connections between what politicians do and the strains they face in their lives, much less formulating a broad idea of how those strains could be effectively addressed.

A revival of middle-class organizations will necessarily require moving beyond the traditional base of such movements, namely, organized labour and old-line fraternal organizations, to encompass new social movements and the harnessing of new technologies. Where such initiative will come from is inherently difficult to foresee, but three trends give at least some cause for optimism. The first is that the start-up costs of organizational development have dramatically fallen over the last generation. The second is the widespread dissatisfaction with existing policy and political alignments seen in the United States and other wealthy nations. The third—and most up for grabs—is the typical pattern of new leaders emerging out of crisis moments to galvanize citizens around shared concerns.

Ironically, since the economic crisis, these trends have mostly benefited conservative movements. In the United States, the most effective organizing has taken place not on the left but on the right, with the rise of the loose organization of conservative voters, right-wing media figures, and corporate-funded ideological activists that travels under the "Tea Party" banner. But there is good reason to believe that many of the forces that impelled these developments also have the potential to galvanize progressive movements in the coming years, especially as the Tea Party agenda moves from gauzy ideals to concrete (and deeply unpopular) policies.

[13] Skocpol, T. 2004. *Diminished Democracy: From Membership to Management in American Civic Life*. (Norman, OK: University of Oklahoma).

Indeed, the Tea Party's success should be instructive for all organizational reformers. It rests on the combination of champions inside government and organizers working at the grassroots. It has a clear agenda (scale back government) and enemy (President Obama). And it has effectively utilized both old-style organizing through local chapters and new communications technologies (and, yes, has also benefited from lavish financing from deep-pocketed donors, including many from corporate quarters). While the Tea Party cannot and should not be simply emulated by those seeking to reconstruct middle-class democracy, its three key features—grassroots organizing linked to national reform leaders, a forward-looking vision that is directed against a perceived contemporary threat, and the use of flexible participatory modes enabled by new media—are contemporary preconditions for effective organizing.

This diagnosis is both encouraging and challenging. It is encouraging because there is nothing natural about the harsh divisions that have arisen in the United States. They are rooted in politics and policy, not the inexorable forces of globalization or technological change. In many cases, moreover, they require not major programs of redistribution—never easy to enact—but measures to reshape the market so that it distributes its rewards more broadly in the first place.

The challenge, however, is that reforms to tackle middle-class strains will require using a broken political system to fix a broken political system: The main obstacle to change and the main vehicle for change are one and the same. This Catch-22 affords no easy resolution. But it does suggest where reformers' energies should be directed, and it points to opportunities that are too often missed by those narrowly focused on rhetorical messages and strategic moves.

Perhaps the most important implication is that those seeking to achieve a new governing economic philosophy will have to rebuild the organizational foundations of democratic capitalism. An inspiring economic vision will be grounded in an institutional blueprint for using active democratic government to meet the challenges facing American society—challenges that are increasingly facing the United States' great ally across the Atlantic.

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