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In the Wake of the Great Recession, Don't Lose Sight of the Big Picture

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Last week's strong employment report brought welcome news to many who have been worried about the nation's uneven economic recovery. The pace of job creation picked up substantially in recent months, and the labor market finally appears on track for a relatively robust recovery. Just hours after the Bureau of Labor Statistics released its latest raft of encouraging jobs numbers, however, private forecasters lowered their first-quarter growth estimates based on the latest less-than-stellar U.S. trade data.[1] The recovery is still fragile, to be sure.

While there is little question about the necessity of restoring economic growth, the American economy faces a set of broader challenges that may prove even more difficult to address. Many of today's problems reflect accelerations of troublesome longer-term trends. The country is burdened by high levels of economic inequality and insecurity that the Great Recession amplified, rather than caused. Upward mobility, particularly for those at the bottom of the income distribution, continues to fall short as compared to other Western nations. A simple return to the pre-recession status quo is not likely to solve these challenges. The next administration faces the dual task of nurturing a fragile economic recovery and developing a strategy that restores economic prosperity for all Americans. As the campaigns rev up and the nation's attention focuses on their competing visions, voters ought to be assessing candidates' diagnoses of and proposed solutions for both sets of issues.

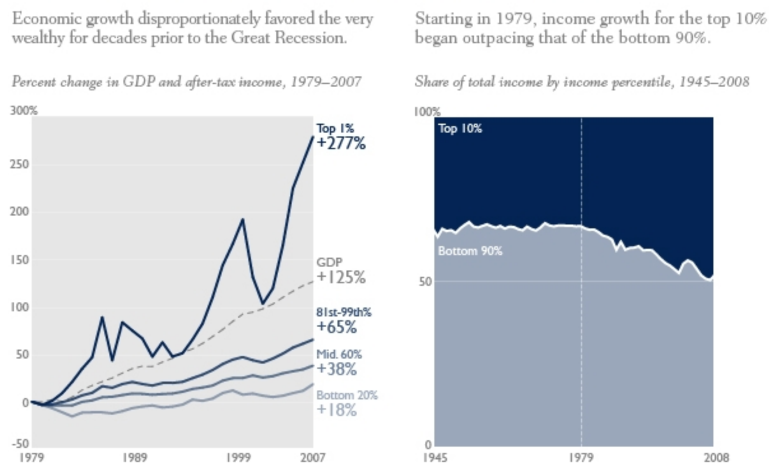
As Brookings economist Martin Baily and others have noted, the near-term problem facing the labor market remains weak consumer demand.2 The ratio of job seekers to job openings remains nearly 4 to 1, more than twice its level in the first month of the Great Recession.3 In simple terms, there are still far more unemployed workers than there are available jobs in today's economy. Recent strong employment reports show encouraging signs of a labor market recovery – payrolls added 227,000 new jobs in February and an average of 245,000 new jobs over the last three months. Yet, even at a strong pace for strong creation, it will take until 2020 to close the gap between pre-recession employment levels and the status quo.4 Job losses during the Great Recession were so deep that a historically high pace of job growth is necessary to return the labor market to its pre-recession levels of employment.

Just as importantly, however, all was not well in the pre-recession economy. Consider the following trouble spots:

Economic Inequality

The period between the end of World War II and the early 1970s was one of broad prosperity, where rapid economic growth translated into broadly shared prosperity. Up and down the income ladder, Americans' incomes roughly doubled between the late 1940s and the early 1970s. In contrast, the period from the 1970s through the present is characterized by slower economic growth and wildly disparate levels of growth across the income distribution. Income growth for households on the middle and lower rungs of the ladder slowed sharply, while incomes at the top continued to soar upward. In particular, the concentration of income at the very top of the distribution skyrocketed, growing 275 percent over this period.[5] Today, the income share of the top one percent of households remains historically large, at levels comparable to those of the Roaring Twenties.

Rising Economic Tides Don't Necessarily Lift All Boats



Sources: GDP data from the Bureau of Economic Analysis/Haver Analytics. After-tax income growth data from the Congressional Budget Office. Total income (including capital gains and excluding government taxes and transfers) data from Thomas Piketty and Emmanuel Saez.

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The slow growth of the average American family's income is a central piece of the decades-long story of rising economic inequality. Women's increased labor force participation explains nearly all of the growth in married couples' family income since the 1970s. Median household income actually fell in the 2000s. Men's earnings have stagnated (or, according to one widely-cited analysis, declined), while male employment rates have dropped sharply.[6] The result is a highly polarized economy, and a shrinking middle class. In 1970, just over half of all households fell within fifty percent of the national median income. Last year, just 42 percent of all households fell in that middle band.[7]

The Great Recession did little to change these basic facts.[8] During the 2002-2007 expansion, income growth for the top one percent dramatically outpaced that of the bottom ninety percent. The average income of the bottom ninety percent fell 7 percent in the first year of the recession, the largest one-year drop since 1938. These losses more than wiped out this group's expansion-era gains leaving the average income for the bottom 90 percent of households at its lowest level since 1996. While losses for the top one percent during the first year of the recession were more than twice that of the bottom ninety percent, the recovery period has only translated into income gains for those at the top. While incomes for the bottom ninety percent continued to fall between 2002 and 2008, incomes for the one percent grew by 30 percent.

The pernicious impacts of a polarized distribution of income are potentially myriad. Persistent inequality may hinder a return to economic growth, as stagnant wages for the majority will mean that the bulk of Americans are simply unable to consume at the level that the economy depends on for growth. Inequality may have been a driving force behind the financial crisis that precipitated the Great Recession.[9] High levels of economic inequality have the potential to unravel the fabric of democracy by depressing voter turnout and civic engagement and eroding trust in government.[10] And inequality may make upward mobility – the essence of the American Dream – unattainable for many.[11]

Economic Mobility

America is built on the idea that anyone – regardless of family background – can work hard and succeed beyond one's parents' wildest dreams. Yet research surveying economic mobility over the last several decades suggests that there are reasons to question whether there are serious cracks in the American Dream.

Some studies of intergenerational economic mobility compare the absolute incomes of children and parents, taking into account changes in the cost of living. This research consistently finds that each generation consistently does better than the one that came before – for instance, one recent study finds that two-thirds of American 40-year-olds are in households with larger absolute incomes than their parents had at the same age.[12] However, as noted earlier, much of the growth in family income over the last several decades occurred because of the impressive shifts in women's labor force participation, thus comparing absolute incomes across generations may not be the most useful measure of mobility.

Other studies of intergenerational mobility ask whether those whose parents were at the top (or bottom) of the income distribution relative to America as a whole remain in the same place in adulthood. These studies consistently find that the United States is far more class-bound than our national story allows. In a perfectly mobile America, a child born into a household in the bottom fifth of the income distribution would be no more likely to end up as an adult in the bottom fifth of the income distribution than would be a child born into the top fifth of the income distribution. In reality, however, about 40 percent of children raised in the bottom of the distribution are unable to escape the bottom.[13] The same holds for a variety of other measures of mobility, including family wealth.[14]

Another way of thinking about the implications of this research: Assuming the last generation's patterns continue, a child born into a family in the bottom fifth of the income distribution has about a 17 percent chance of making it into the top two-fifths of the income distribution (i.e. roughly $90,000 in total annual household income). In contrast, a child born into the top two-fifths of the income distribution has about a 60 percent chance of remaining there as an adult.[15] America today is not an "equal opportunity" society. Indeed, Denmark, Finland, Sweden, and the United Kingdom all perform better in terms of relative intergenerational mobility than does the United States.[16]

Further complicating the mobility picture is the impact of the widening chasm of income inequalities on prospects for upward mobility. Provocative evidence suggests an inverse relationship between a country's level of economic inequality and that country's level of relative economic mobility – more inequality strongly correlates with less mobility.[17] A wide variety of explanations between the phenomena are plausible. Two are particularly worth noting. First, high levels of inequality may simply make the space between the rungs on the income ladder so great that climbing becomes virtually impossible. Second, inequality may result in a severe underinvestment in public goods that benefit those lower down the income distribution. For instance, wealthy Americans may be unwilling to pay taxes to fund public early childhood programs that predominantly benefit the less-fortunate, for instance, and this under-funding of early childhood education will exaggerate early disadvantages so as to make upward mobility all the more difficult for the poor.[18]

The Great Recession's true impact on upward economic mobility remains to be seen. Mobility studies typically compare children's socio-economic status in adulthood to their parents' status at that same point in their lives, and the children of the most recent recession are obviously still just that, i.e. kids. Recent research examining the effects of a parent's job loss on children's life outcomes provides good reason to be concerned; children whose father's experienced job loss had earnings 9 percent lower than similar children whose fathers remained employed, for instance, and were more likely to receive social welfare benefits.[19] Pervasive economic loss – due to earnings lost through unemployment and wealth lost through both assets liquidated in order to weather unemployment spells and plummeting housing values – may mean that today's working-age adults are downwardly mobile as compared to their parents. Regardless of the costs of the recent downturn, however, the trouble with economic mobility in America pre-dates the Great Recession, and raises a set of thorny economic issues deserving the attention of the next administration.

Economic Insecurity

To be sure, the Great Recession has created enormous amounts of economic insecurity for today's families. Prolonged levels of high unemployment mean that joblessness and concerns regarding future joblessness are no longer confined to the few. In the spring of 2009, over three-quarters of all Americans were quite worried about at least one risk to their economic security.[20] Record-high rates of long-term unemployment have fundamentally changed the lives of millions of families; nearly 43 percent of the unemployed (5.5 million workers) have been out of work for six months or more, and many more have dropped out of the labor force entirely.[21] In the 18 months between March 2008 and September 2009, fully 93 percent of American households experienced at least one substantial decline in their wealth or earnings, or a substantial increase in non-discretional spending (e.g. medical needs or assistance to family members).[22] Amongst Americans losing more than a quarter of their incomes and lacking an adequate financial safety net, the typical drop in income reached 46 percent.[23] In no uncertain terms, the Great Recession rattled America badly.

Yet economic insecurity in the United States has been slowly rising over time for decades. A growing body of research tracking the fortunes of Americans over time – relying on repeated looks at the same set of families, rather than simply point-in-time snapshots – suggests that the risk of a substantial short-term loss of income has been on the rise since the 1970s.[24] Much of this rise occurred in the period between the 1970s and the 1990s. The risk of a sharp drop in income over a short time period is most dramatic for low-income families; about 20 percent of individuals in families with children in the lowest income quintile lose at least half their income at some point during the course of a year.[25] Recessions increase the risk of short-term losses, to be sure. But the research suggests an underlying structural change as well, as each successive recession has driven the likelihood of severe income losses ever higher.[26] The most recent recession has simply escalated a pre-existing trend.

Challenges Ahead

The resonance of the Occupy Wall Street protest movement's message of "We Are the 99 Percent" suggests that the issues outlined above resonate with the American public. President Obama's widely cited Osawatomie, Kansas speech spoke directly to these issues of economic inequality, insecurity, and opportunity, as did his State of the Union Address's repeated use of the "fairness" meme. Republican presidential candidate Rick Santorum routinely cites data on the problems with upward mobility in America, and Republican frontrunner Mitt Romney has grappled with how to campaign as a "regular guy" despite having grown up wealthy and making millions in his own right. Issues of economic justice that reach well beyond the question of how to restore economic growth have already defined the 2012 campaign. The pressing question is how to restore economic growth that benefits all Americans while promoting economic security and economic opportunity. Whichever candidate prevails in November would do well to face these challenges head-on.

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