Center for American Progress

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Progressive Ideas for a Strong, Just, and Free America

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Five Economic Challenges That Need More Policy Attention

As we head into *State of the Union* season this winter, it is abundantly clear that the U.S. economy is in need of critical policy attention. More than five years into the current economic recovery, there is still a marked disconnect between declining economic opportunities for America's middle class (and those aspiring to join those ranks) and the policy realm, which has either ignored this deteriorating situation or even exacerbated it.

Serious economic challenges exist at the *personal* level for middle class Americans and at the macroeconomic level in communities across the country. Personal economic anxieties played a significant role in the last fall's congressional elections. While many in the media or in the current administration seek to portray these feelings as mysterious or unfounded, a close look at recent economic data shows that the typical American faces real economic insecurity, shrinking job opportunities, declining upward mobility, and a growing inability to save and accumulate wealth. In addition, our nation's large and rising foreign debt—much of which grows out of an unsustainable federal budget deficit—exacerbates these insecurities and threatens future improvements in most Americans' standard of living.

It is time to take seriously the concerns of hard working families and then set our policy priorities straight. In particular, there are five immediate key economic challenges that deserve attention and cannot be ignored.

1. A Historically Weak Job Market that Erodes Opportunities for Everybody

- **Job growth is the weakest on record.** Job growth during the current business cycle, beginning in March 2001, has averaged an annualized 0.5 percent per month, the lowest of any business cycle since the Great Depression. In fact, this is less than a quarter of the average of all prior business cycles since World War II. Since the recession ended in November 2001, job growth has averaged an annualized 0.8 percent, or 85,000 jobs per month, instead of the 2.7 percent average growth rate during recoveries of at least equal length since World War II.

  The Bush administration commonly points to job growth since the point at which job losses stopped in August 2003—using this period to highlight labor market gains. Yet *even since August 2003*, the economy has still had slower job growth than during similar periods of prior business cycles. From August 2003 to December 2006, the economy gained 6.4 million jobs, an average of 160,000 jobs per month. During the same months in prior business cycles (months 21 to 61 months), the economy added 179,000 jobs each month in the mid-1960s, 222,000 in the 1980s recovery, and 246,000 in the 1990s recovery, which was a full 50 percent higher per month.[1]

- **Once unemployed, it takes workers longer than before to find a new job.** The average length of unemployment totaled 17.5 weeks between March 2001 and December 2006, higher than during any other business cycle since World War II. The share of workers looking for a job for more than 27 weeks averaged 18.8 percent during the current business cycle, which also reflects the highest level on record.[2]

- **Employment opportunities decline.** The employment rate, defined as the employed share of the adult population, grew by an annualized 0.14 percentage points each month in the 1990s. In the current business cycle, the employment rate *decreased* by 0.16 percentage points. This marks the first business cycle since the 1950s in which job opportunities dropped. For some demographic groups, this reversal in new job opportunities was especially stark. The employed share of the female population grew by 0.39 percentage points each month in the 1990s, but declined by 0.14 percentage points since March 2001. The difference is even larger for African Americans, who saw average increases of 0.39 percentage points each month in the 1990s and an average decline of 0.28 percentage points in the current business cycle.[3]

2. Sluggish Real Income Gains Amid Rising Income Volatility

- **After accounting for inflation, wage gains have been minimal.** Real wages have barely moved during the recovery or since the period when the economy stopped losing jobs in August 2003. Extremely weak wage growth over these periods is particularly striking when compared to productivity growth. For instance, between March 2001 and December 2006, real hourly wages grew at an average annualized rate of 0.5 percent, and real weekly wages grew at an average annualized rate of 0.4 percent.[4] Meanwhile, business sector productivity between March 2001 and September 2006 (the last month for which there is data) grew at an annualized 3.1 percent rate. Just focusing on the period between August 2003 and December 2006 we see a similar comparison: real hourly wages grew at a 0.2 percent annualized rate and real weekly wages grew at a 0.5 percent rate, while productivity grew at an annualized 2 percent rate between August 2003 and September 2006.[5]

- **The share of all wages and salaries relative to the economy fell to a record low.** In the third quarter of 2006, the share of wages and salaries out of national income fell to 51.5 percent, the smallest share since the government collected this information in 1947.[6]

- **Incomes for the typical household were still lower in 2005 than in 2000.** In 2005, median household income was about $1,300 less in inflation-adjusted terms than in 2000 and $240 less than in 2001. Indeed, inflation-adjusted median household income declined during every single year of the recovery from 2001 to 2004. In 2005, median household income grew slightly, but median earnings for full time workers fell again. For women who worked all year on a full time basis, inflation-adjusted annual earnings dropped by $427 from 2004. For men in the same situation, inflation-adjusted earnings fell by $774 during this period.[7]

- **Low wage and income gains were accompanied by greater income volatility.** Targeted studies of income volatility show that families' mounting anxieties are real. In one study by Princeton University economics professor Henry Farber, for instance, displaced workers were shown to have experienced an average 17.1 percent decline in earnings between 2001 and 2003, compared to an average 7.8 percent decline between 1997 and 1999.[8] Another study commissioned by the Center for American Progress showed that the share of families who saw their real incomes decline by $20,000 or more in a given year grew to 16.6 percent between 2003 and 2004 compared to 13 percent between 1990 and 1991.[9]

- **Corporate profits soar but new business investment is mediocre.** Pre-tax corporate profits relative to national income amounted to 14.1 percent in the third quarter of 2006, the largest share since 1950. After-tax profits as a share of national income totaled 9.9 percent, the highest share since 1947. Yet, business investment stayed relatively low. Business investment as a share of the economy averaged 10.3 percent between March 2001 and September 2006, the smallest of any business cycle since the early 1960s. More importantly, the current business cycle saw the smallest addition of *new* capital compared with every cycle since World War II. Net investment, the amount of investment beyond replacing obsolete capital, averaged only 1.8 percent of GDP between March 2001 and September 2006.

- **President Bush's policies have exacerbated lack of income growth.**

  - **A quickly eroding and ignored minimum wage.** The federal minimum wage has stayed at $5.15 since 1997. Throughout much of his presidency, Bush has advocated that states be able to opt out of future increases in the federal minimum wage.[10] Meanwhile, the real value of the last federal minimum wage increase in 1997 was quickly eroding so that the inflation adjusted value of the minimum wage today stands at a 50-year low.[11]

  - **Under President Bush, the right to bargain collectively has been weakened.** In 2006, the National Labor Relations Board ruled to broaden significantly the definition of a supervisor, thereby effectively eliminating the right of eight million workers to bargain collectively. The single largest affected group from the 2006 NLRB ruling is that of registered nurses.[12]

  - **Bush tax cuts disproportionately favor higher income taxpayers.** According to a recent report by the Congressional Budget Office, the Bush tax cuts lowered the effective federal tax rate (which includes both income taxes and payroll taxes) by 3.6 percentage points for the wealthiest 20 percent of Americans between 2000 and 2004 but only by 2.1 percentage points for tax payers in the middle 20 percent of income distribution.[13] In 2006, the combined effect of all the Bush tax cuts was an increase of 6.2 percent in after-tax income for the top 0.1 percent of tax payers, and an increase of 4.1 percent in after-tax income for the top fifth of taxpayers. This compares to a mere increase of 0.3 percent for the bottom fifth of tax payers. *In short: the relative benefit from all of the Bush tax cuts for the top 0.1 percent of taxpayers was 21 times larger than for the bottom 20 percent.*[14]

3. Accumulating Household Debt and Rising Financial Risk

- **Prices for costly necessities grew more than for other items.** From March 2001 through June 2006, prices for the five largest consumption items—medical care, housing, food, household operation, and cars—grew more than twice as fast as they did for the smallest five consumption items. At the same time, college costs continue to soar.[15]

- **Weak labor market and higher prices translate into record debt.** By the third quarter of 2006, the amount of household debt outstanding relative to disposable income totaled a record high of 130.9 percent.[16] The amount of debt payments, including interest and principal, relative to disposable income is also at the highest level since the Federal Reserve began recording in 1980, now standing at 14.5 percent compared to 13.0 percent in the first quarter of 2001.[17] To put this in perspective, debt payments grew 28.7 percent faster than families' expenditures for gasoline, fuel, and other energy costs between March 2001 and September 2006.[18]

- **Families' financial security erodes.** Record amounts of debt have made families financially vulnerable to various shocks. Specifically, according to a recent study released by the Center for American Progress, a smaller share of families in 2004 were prepared for a spell of unemployment, a medical emergency, or had three months of their income in financial wealth than in 2001. In 2004, 32.5 percent of all families had three months of their income in financial wealth, down from 38.8 percent in 2001. Also, only 48.6 percent of households had enough financial wealth to sustain a spell of unemployment, a smaller share than at any point since 1989. And the share of families who could sustain a medical emergency fell to 36.0 percent in 2004 from 43.8 percent in 2001, the lowest level since 1995.[19]

4. Declining Opportunities to Save and Build Wealth for Working Families

- **Families spent all of their disposable income and then some.** For the first time since the Great Depression, the personal saving rate became negative in 2005. In the third quarter of 2006, the saving rate was -1.2 percent, the sixth quarter in a row with a negative saving rate.[20]

- **Families see little wealth gains.** Wealth or the difference between assets and debt for the median family rose in inflation-adjusted terms to $93,100 in 2005 from $91,700 in 2001, an increase of only 1.5 percent over three years. In comparison, median wealth grew by 10.3 percent from 1998 to 2001, and by 17.4 percent from 1995 to 1998. Moreover, the median wealth for the bottom 40 percent of income earners in America declined from 2001 to 2004.[21]

- **Retirement wealth leaves many holes.** According to a study by the Congressional Budget Office, among those approaching retirement age in 2004, roughly one quarter were unprepared for retirement and another quarter were somewhat unprepared.[22] Underlying this inadequacy is a large share of families with no retirement savings. The share of households with any savings in tax-deferred retirement plans was just 49.7 percent as of 2004, the last year for which there was data, and the median balance for such households was a mere $35,200.[23] Retirement wealth is also highly unequal. Only 10.1 percent of families in the bottom fifth of income earners owned tax-deferred retirement accounts as of 2004, compared to 88.5 percent of those in the top tenth of income earners. The median balance for the bottom fifth was $5,000 compared to a balance of $182,700 for those in the top tenth bracket.[24] The lack of adequate retirement savings has been a persistent problem that may have gotten worse due to declining pension coverage. In 2000, 50.3 percent of all private sector workers were covered by an employer sponsored retirement plan—a traditionally defined benefit pension or a 401(k) style defined contribution saving plan. By 2005, this share had dropped to 45 percent.[25]

- **President Bush's policies have ignored or impeded middle class wealth creation.**

  – **The 2003 capital gains and dividend tax cuts barely accrued to middle- and lower- income families.** An estimated 90 percent of the tax cut accrued to the top fifth of income earners in 2006—and within that pool, 57 percent of the tax cut accrued to the top one percent and 40 percent accrued to millionaires alone. Meanwhile, among the bottom four-fifths of the population, the typical American got an extra $20.80 dollars in 2006 from the capital gains and dividend tax cut.[26]

  – **More tax giveaways in 2006 IRA provisions.** The 2006 Tax Reconciliation Act, which extended the capital gains and dividends tax cuts made in 2003, also contained a provision that made it easier for high-income families alone to save and accumulate wealth. The Act included a so-called "IRA rollover provision" that effectively eliminated income caps for contributing to Roth IRA accounts. This provision only helped those with incomes over $100,000.[27]

  – **Health Savings Accounts promoted as another vehicle for those with higher incomes.** Health Savings Accounts, or HSAs, were developed as part of the Bush administration's 2003 Medicare drug legislation. In 2006, an individual who paid at least a $1,050 deductible for his health plan was able to establish an HSA, into which could be deposited income-tax deductible contributions that maxed out at the total value of the deductible, or $2,700. Unlike all other savings vehicles with tax-deductible contributions, tax *withdrawals* from HSAs are also tax-free. HSAs are overwhelmingly used by higher income individuals with the average adjusted gross income of all tax filers reported HSA contributions at $133,000 in 2004, compared to $51,00 for tax filers as a whole. An amendment added onto the tax extenders package that passed in December 2006 made HSAs even more attractive tax-havens for upper income individuals—by allowing *all* HSA users to contribute as much as $2,700 per year.[28]

  – **Ignoring Our "Upside Down System" for Encouraging Savings.** As one of the authors has written, the United States today has an "upside down system for encouraging savings… which turns our progressive tax system on its head."[29] This is because our current system is based on tax deductibility, which means that the higher your tax bracket, the bigger your tax deduction for retirement savings—and the lower your tax bracket, the lower your deduction. Thus, incentives are directed most fully at those with the highest incomes, or those who already are in the best position to face retirement. In 2005, for instance, our government spent about $150 billion dollars in tax expenditures to encourage retirement savings. Studies have shown that of that amount, about three percent went to the bottom 40 percent of taxpayers, while 50 percent went to those tax payers in the top 10 percent.[30] Bold policies to turn around this system and provide strong incentives to save for lower and middle class families—as proposed by one of the authors of this paper—include a 30 percent flat tax incentive for savings, as well as a Universal 401(k).

5. U.S. Foreign Indebtedness Grows in Wake of Large Budget Deficits

- **Foreigners increasingly finance U.S. budget deficits.** Between March 2001 and September 2006, foreigners financed 78 percent of the U.S. federal budget deficit. Foreigners held 45.0 percent of all outstanding publicly held U.S. Treasuries in September 2006, up from 31.9 percent in March 2001.[31] In September 2006, foreigners held $2.1 trillion in U.S. Treasuries. Japan was the largest holder with $640 billion, followed by China with $392 billion. Oil exporting countries held $97 billion.[32]

- **Record current account deficits increase our nation's foreign indebtedness.** The current account deficit is defined as the sum of the trade balance and the difference between interest earnings on assets held abroad, minus interest payments on international debt. When any country runs a current account deficit, this means that it is borrowing money from overseas—by selling treasuries, stocks, corporate bonds, and real estate, among other assets. In the third quarter of 2006, the U.S. current account deficit reached a historic 6.8 percent of GDP, a level considered by many to be unsustainable.[33] Part of the growth in the current account deficit is due to the fact that the U.S. is now paying more interest on its international debt than it earns on its assets abroad. In the third quarter of 2005, interest payments to foreigners became larger than earnings on assets held abroad by U.S. residents for the first time since 1960. This has remained the case in subsequent quarters through the third quarter of 2006.[34]

- **Fiscal irresponsibility under President Bush has substantially contributed to U.S. foreign indebtedness.**

  – **Large swing from budget surpluses to deficits:** When President Bush took office in early 2001, the Congressional Budget Office anticipated that the government balance between 2002 and 2011 would be in the black to the tune of $5.6 trillion; for the fiscal year 2006, the CBO projected a surplus of $505 billion.[35] Today, the CBO projects deficits between 2002 and 2011 of $2.9 trillion; for fiscal year 2006,[36] the actual deficit amounted to $248 billion.[37] This constitutes a deterioration in the budget outlook for the period 2002 to 2011 of $8.5 trillion and a decline of $753 billion for fiscal year 2006—over the span of less than five years.

– **President Bush's tax cuts are the largest contributing factor to the deteriorating budget outlook.** In 2006, the estimated cost of the Bush tax cuts was $252 billion dollars.[38] *Even with additional spending for the rebuilding of the Gulf area after Hurricane Katrina and the costs of wars in Iraq and Afghanistan, the federal government would have had a balanced budget in 2006 had it not been for the passage of the Bush tax cuts without offsetting savings.* Between 2001 and 2006, the passage of the Bush tax cuts without the offsetting savings have cost $1.2 trillion in lost revenues, or more than 80 percent of the cumulative deficit during this period.[39] While tax relief for middle class families is an important priority, the Bush tax cuts were highly regressive, and were pushed through without any consideration of their impact on the deficit.

– **Deficits are unlikely to disappear in the future if we stay the course.** Between 2007 and 2016, the Congressional Budget Office predicts cumulative deficits of $1.8 trillion, excluding any reforms to the Alternative Minimum Tax and before factoring in President Bush's desire to make his tax cuts permanent. If ATM reform and permanent tax cuts for the wealthy are included, the total deficit for the next decade would come to $3.5 trillion—even if the costs for the war in Iraq and Afghanistan drop below current projections in a few years.[40]

Sara Aronchick, an economic policy research assistant at the Center for American Progress, contributed to this report.

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Endnotes

1 Calculations are based on BLS (2007a). Business cycle dates are from NBER (2007).

2 Calculations are based on BLS (2007b). Business cycle dates are from NBER (2007).

3 Calculations are based on BLS (2007b). Business cycle dates are from NBER (2007).

4 Inflation adjusted wage comparisons are based on BLS (2007b). Hourly wages in 2006 dollars are authors' calculations based on BLS (2007b) and BLS (2007c).

5 See Mishel et al, 2007

6 Calculations are based on BEA (2007a).

7 Calculations are based on Census (2006).

8 See Farber (2005) for details.

9 See Hertz (2006) for details.

10 See, for instance, Chasanov (2004).

11 See Furman and Parrott (2007)

12 See Eisenbrey and Mishel (2006) for more details.

13 Calculations are based on CBO (2006c).

14 Calculations are based on TPC (2006).

15 See Weller and Staub (2006) for more details.

16 Calculations are based on BOG (2006a).

17 Data from BOG (2006b).

18 Calculations are based on BEA (2007a).

19 See Weller and Staub (2006) for more details.

20 Data from BEA (2007a).

21 See Bucks et al. (2006) for more details.

22 See CBO (2004) for more details.

23 See Bucks et al. (2006) for more details.

24 See Bucks et al. (2006) for more details.

25 See Purcell (2006) for more details.

26 See TPC (2003) for more details.

27 See Aron-Dine and Greenstein (2006) for more details.

28 See Dicken (2006) for more details.

29 See Sperling (2005a)

30 Sperling, 2005a. Original source is Burman, Gale, Hall, and Orszag, 2006.

31 Calculations are based on BOG (2006a).

32 Data are from Treasury (2007).

33 Calculations are based on BEA (2007b).

34 Data are from BOG (2007b).

35 See CBO (2001) for details.

36 Calculations based on CBO (2006b, 2006c).

37 See CBO (2006d) for details.

38 See Kogan and Fiedler (2006) for more details.

39 Calculations are based on Kogan and Fiedler (2006) and CBO (2006c, 2006d).

40 Calculations are based on CBO (2006b).

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