Testimony before
the U.S. Senate Committee on Health, Education, Labor, and Pensions
on “The Endangered Middle Class:
Is the American Dream Slipping out of Reach for American Families?”

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Thank you, Chairman Harkin and Ranking Member Enzi, for inviting me to talk to you about the importance of a broadly prosperous middle class to the future of our nation. My name is Heather Boushey and I’m a Senior Economist at the Center for American Progress Action Fund.

This hearing could not be timelier. Our country has experienced a widening income gap and a hollowing out of our middle class since the late 1970s and these trends threaten our nation's economic growth and stability.

Many academics, pundits, and politicians point to rising income inequality as a social concern or a concern for the viability of our democracy. Economists, on the other hand, tend to posit that such income gaps between the wealthy and the rest of the citizens in developed countries are not incompatible with economic growth and thus not a key economic concern. The economic argument goes like this: Focusing on income equality for equality’s sake, or because high inequality leaves too many in poverty, or because the wealthy are pulling so far out ahead of the middle class misses the point that, in fact, this may be good for the economy as those at the top of the income scale can make the economy grow if they invest their additional income.

Empirical reality, however, has come into direct conflict with this argument.

Beginning in the 1970s, with the decline in union membership across our nation and the arrival of products made by cheaper workers abroad, businesses began relentless efforts to cut labor costs in union and nonunion manufacturing operations across our country. Middle-class families struggled to cope, with women entering the labor market in droves to make up for lackluster single-wage earners’ income growth.

This lack of broad-based income growth for the American middle class was clearly exacerbated by the Great Recession. The factors that led to the recession were many of the same ones that led to higher income inequality in the previous decades. While the jury is still out on whether rising inequality was a causal factor in creating the conditions for the still-existing economic crisis for our middle class, there is no question that the wealthy took greater and greater shares of our nation's income in the 2000s and right up to today—and then failed to reinvest it in renewed economic growth.

With a hollowing out of America's middle class, the middle class could no longer be a solid source of economic demand without new extraordinary measures to bolster incomes. As middle-class incomes failed to keep pace with the cost of living, families increasingly had to live on credit just to maintain the lifestyle of their parents, send their kids to college, and take care of their aging parents. The lack of income growth for the broad middle class had devastating consequences for the U.S. economy when the housing market collapsed—almost taking our financial markets with it.

Unless we focus wholeheartedly on policies aimed at rebuilding our middle class, our economy will remain fragile and millions will continue to fall down the income ladder. In the remainder of my testimony, then, I will make two key points.

First, the evidence in front of us points to the conclusion that the middle class matters for economic growth and economic stability. Not having a solid and growing middle class weakens our economy and leads to slower, more fragile growth.

Second, undermining the economic vitality of the middle class is bad for families, especially as it has led to not only declining incomes but also to sharply rising hours of work and greater economic insecurity.

Policies that focus on building, supporting, and expanding opportunity for the middle class will not only be good for families but good for our businesses and our economy overall as well.

To understand how the middle class matters for our economy, we have to begin with the question: Where does economic growth come from?

Supply siders argue that economic growth comes from increasing the supply of goods and services, which means expanding the capacity to invest. Supply siders thus believe the key to growth is for government to reduce taxes and limit regulation to spur investment.

It is true that investment is the key to growth. But this argument starts in the middle, not the beginning of the story. The supply siders get the story fundamentally wrong because firms won't invest if they don't see a willing and able customer to buy their goods or services. Ask any business owner: Will you open a new factory, purchase inventory for a retail store, or add another employee if you don't see customers?

In fact, having a deep market with demand from a strong middle class is what tells businesses where there are profitable opportunities to invest.

This, by the way, is the problem our economy continues to face today. Small businesses report that their single-largest concern is poor sales. They say this is more of a problem than regulations, taxes, inflation, or the cost of labor.[1]

And herein lies the crux of the issue: Supply alone does not create growth; it must be balanced by demand. Supply-side policies have led us to where we are today: unbalanced growth and a crisis-prone economy.

It is demand for goods and services, backed up by an ability to pay for them, which drives economic growth. The hollowing out of our middle class limits our nation's capacity to grow unless firms can find new customers.

Today, many believe that to be competitive, employers must always focus on reducing costs. This is a supply-side argument: If employers keep more of the money, they will have more to invest. The false logic behind our "Wal-Mart" economy is that lowering wages is the key to growth.

In fact, lowering wages and a hollowed-out middle class means consumers can demand less and less each year. This puts a brake on economic growth unless another source of demand is found.

Of course, many U.S. firms do business in countries around the world and may not care one iota about whether U.S. consumers can afford to buy their wares. But we as a nation need to care.

Over the past few decades, the middle class found innovative ways to cope with the Wal-Mart economy. Over the 1980s and 1990s, as I noted earlier, families put more adults in the labor force, with the labor force participation rate of wives and mothers rising remarkably.[2]

In fact, it is only because of the earnings of wives that married couples have seen any income growth. From the late 1940s through the mid-1970s, married-couple families with and without a working wife saw their income rise at about the same pace, about 3 percent per year after inflation.[3] But since the mid-1970s, married couples with a stay-at-home wife experienced no increase in income, after inflation, while those with a working wife watched their income grow by less than 1 percent per year—not impressive, but not backsliding.

Working more means families have less time together and less time to care for one another. This is a net loss for the typical middle-class family, who works longer than their parents but has seen slower income gains than their parents' generation.

And while women have more economic opportunity than a generation or two ago, families now struggle enormously with how to care for the young, the aged, and the ill. Without a set of policies that addresses the need for workplace flexibility, including predictable hours that work for families, paid sick days for a worker's illness or to care for a sick family member, and paid family leave to provide care during longer illnesses or when a new child comes into the family, the middle class struggles with a lack of time to care.

This time famine is a direct result of the hollowing out of the middle class that made it necessary for middle-class families to have two breadwinners, not just one.

Families also began taking on increasing levels of debt. Up until the 1980s, family debt was about 60 percent of annual income.[4] But as middle-class incomes began falling, the share of debt rose enormously, so much so that debt was a whopping 130 percent of income by December 2007. With wage growth not keeping pace with inflation, and with falling asset values slamming middle-class families at the onset of the housing and financial crises at the end of the last decade, even as families try to pay off debt, debt continues to be at near-historic highs.

Over the 2000s, the median family saw their income fall from the economic peak in 2000 to the peak in 2007, a first in the post-World War II era. Since consumption is about 70 percent of the total U.S. economy, this lack of income growth would have reduced our economic growth if families had not borrowed to make ends meet.[5]

Indebtedness, however, especially in light of the lack of income growth, increased the fragility of the U.S. economy.

The idea that the middle class was important to our economy was one American business leaders used to understand. In 1914 Henry Ford announced that he'd begin paying his workers the then-princely sum of $5 a day.[6] He did this because at the time, the assembly line was not a good job and turnover was exceptionally high. By offering workers a better wage, Henry Ford was taking the "high road" to economic development.

It wasn't until later that Ford embraced the idea that paying workers a livable wage also meant that they could become his consumer base. But today, that's the notion we associate with Fordism: the win-win concept that if you create a solid consumer base—a large middle class—then you'll have deep markets for the goods and services produced.

Paying decent wages became so thoroughly embedded in the popular imagination as a driver of economic growth that President Franklin D. Roosevelt was able to say that "a sounder distribution of buying power" was a key reason to enact the Fair Labor Standards Act into law, which established the minimum wage.[7]

Decades of empirical research demonstrates that the middle class is good for growth. The middle class invests in human capital—they learn, work, and spend—which are key drivers of economic growth and contributors to higher labor productivity.

Today stagnant incomes not only limit our economy's capacity to grow; they limit families' ability to invest in education and improve our nation's stock of human capital, which reduces our nation's productivity.

Indeed, the hollowing out of the middle class actually reduces the incentives for young people to get a higher education. Among 25- to 34-year-old men, one in five (19.4 percent) who has a college degree actually earns less than the average male high school graduate—and yet is saddled with debt (as are his parents) from the cost of education. This is also the case for women, although less so, as one in seven women with a college degree (14.0 percent) earns less than the typical female high school graduate.[8]

Then there's the loss of the middle class as a platform for entrepreneurship and innovation. With the economic security of a middle-class family, individuals have the means and the security to take on risks. But greater economic inequality and insecurity limits the capacity of ordinary people to become entrepreneurs or follow up on an invention or innovative idea. With a hollowed-out middle class, families have less access to resources that could float an entrepreneur while her vision takes shape.

The decline of a broad middle class has real implications for the poorest among us as well. With fewer middle-class jobs, what hope do the poor have for working their way up into the middle class?[9]

Certainly, economic competitiveness requires that firms produce the highest-quality products for the lowest price. This is a key feature of a capitalist mode of production. In the Wal-Mart economy, however, when every employer focuses solely on reducing wages at the expense of all else, this has devastating consequences for the economy overall.

My generation lived through a great experiment in supply-side economics. The result? Our nation experienced more growth in income inequality than any other developed nation. For years we were told this was okay, that having more rich people wasn't taking away from the rest of us; it was a reward for the best and the brightest, who would then reinvest in our economy.

What we now know is that a strong middle class creates stable markets for businesses to invest. The decline of America's middle class entails real hardships for families and limits opportunity. But it also appears that the demise of our middle class is a part of what ails our economy overall.

Thank you for your attention to this matter. I encourage you to focus on policies that will rebuild our middle class, to strengthen our families and our economy.

Thank you.

[1] William C. Dunkelberg and Holly Wade, "NFIB Small Business Economic Trends" (Washington: National Federation of Independent Business, 2011), available at http://www.nfib.com/Portals/0/PDF/sbet/sbet201104.pdf.

[2] "Table A-1. Employment status of the civilian population by sex and age," available at http://bls.gov/webapps/legacy/cpsatab1.htm (last accessed May 2011).

[3] Bureau of the Census, *Income, Poverty, and Health Insurance Coverage in the United States: 2009* (Department of Commerce, 2010), table F-7, available at http://www.census.gov/hhes/www/income/data/historical/families/index.html.

[4] Christian Weller and Jessica Lynch, "Household Wealth in Freefall: Americans' Private Safety Net in Tatters" (Washington: Center for American Progress, 2009), available at http://www.americanprogress.org/issues/2009/04/pdf/wealth_declines.pdf.

[5] "National Income and Product Accounts Table 1.1.6. Real Gross Domestic Product, Chained Dollars," available at http://bea.gov/national/nipaweb/TableView.asp?SelectedTable=6&Freq=Qtr&FirstYear=2009&LastYear=2011 (last accessed May 2011).

[6] "Henry Ford's $5-a-Day Revolution," available at http://corporate.ford.com/about-ford/heritage/milestones/5dollaraday/677-5-dollar-a-day (last accessed May 2011).

[7] "I came to the conclusion that the present-day problem calls for action both by the government and by the people, that we suffer primarily from a failure of consumer demand because of lack of buying power. Therefore it is up to us to create an economic upturn. … I am again expressing my hope that the Congress will enact at this session a wage and hour bill putting a floor under industrial wages and a limit on working hours—to ensure a better distribution of our prosperity, a better distribution of available work, and ***a sounder distribution of buying power*** (emphasis added)." See: "Fireside Chat 12: On the Recession (April 14, 1938)," available at http://millercenter.org/scripps/archive/speeches/detail/3313.

[8] John Schmitt and Heather Boushey, "The College Conundrum: Why the Benefits of a College Education May Not Be So Clear, Especially to Men" (Washington: Center for American Progress, 2010).

[9] David H. Autor, "The Polarization of Job Opportunities in the U.S. Labor Market: Implications for Employment and Earnings" (Washington: MIT Department of Economics, National Bureau of Economic Research, 2010).