

The Ingredients for Getting the Middle Class Back on Track

Steps to make up for decades of subpar gains include boosting productivity and putting more people to work.

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My job as chairman of the Council of Economic Advisers is to prepare the annual Economic Report of the President. The 2015 report, I'm pleased to say, has much good news. The economy has expanded at an annual rate of 2.7% over the past two years, up from the 2.1% pace in the first 31/2 years of the recovery. In the past year the economy added jobs at the fastest rate since the 1990s, extending the longest streak of U.S. job growth on record. Inflation-adjusted wages grew at a 1.3% annual rate in the past three years, more than twice the pace of the last recovery but still not enough to make up for decades of subpar gains for middle-class families.

President Obama's "middle-class economics" stands on the premise that the economy can and should do better for the middle class. As Congressional Budget Office data (with a minor extrapolation) show, median U.S. incomes are up 17% since 1973. But from 1948-73, median incomes rose 110%, according to broadly comparable Census estimates, a far greater increase in a shorter period. From 1973-2013, productivity increases should have allowed a worker to purchase 82% more per hour of work, well above the 17% increase actually obtained. Middle-class economics is about remedying this decades-long challenge and doing better going forward.

The solution starts with the diagnosis of the problem. The Economic Report of the President identifies three key factors underlying the multi-decade trend of lackluster income growth. The first and largest is the slowdown in productivity growth. From 1948-73, productivity grew at a 2.8% annual rate, but since 1973 it has slowed to a 1.8% annual rate.

This slowdown is partly due to temporary factors, as the boost from the commercialization of World War II innovations in the 1950s and '60s gave way to the dislocations of the oil shocks and the breakup of the Bretton Woods monetary system. But the slowdown is also the result of policy choices. For example, the U.S. government made significant investments in the Interstate Highway System in the 1950s and '60s, but in subsequent decades infrastructure investment as a share of GDP decreased substantially.

The second-largest factor in the household-income slowdown has been the increase in inequality. In 1973 the bottom 90% of households received 68% of the nation's income, a figure that has fallen to 53% today. It is hard to see sustained, sufficient income growth, especially in a world of slower productivity growth, when your share of the pie keeps shrinking.

The increase in inequality partially reflects factors largely beyond our control, like changes in the nature of technology and the rewards it confers on skills. But it is also a function of poor policy choices—including the failure to adequately fund, staff and expand the education system, along with the dramatic decline in unionization and the real value of the minimum wage.

The third factor is the decline in labor-force participation. Although the post-2007 decline has garnered the most attention, prime-age (25-54) male labor-force participation has been falling since the 1950s and prime-age female labor-force participation has been falling since the late 1990s. This suggests that policy choices regarding worker-training programs, workplace flexibility and tax laws need to change.

The Economic Report of the President estimates that if the U.S. had continued at a high rate of productivity growth, maintained the share of income going to the bottom 90%, and continued to raise female labor-force participation, median household incomes today would be twice as high—or an extra \$50,000 annually. Although this estimate is not intended to suggest that each of these assumptions are necessarily possible, it does underscore the large opportunity for the middle class if we make different policy choices.

We cannot change the past 50 years, but we can build on the policies put in place in recent years including investments in infrastructure, tax cuts for working families, steps to slow the growth of health costs, investments in manufacturing, and improvements to worker-training systems.

The president has proposed a range of measures to boost productivity growth over time, including investing in infrastructure, expanding overseas markets for our exports, reforming our business-tax system, encouraging investments in technology, expanding education and reforming immigration, all while reducing the medium- and long-term deficit.

While higher productivity is necessary for sustained increases in middle-class incomes, it is not sufficient—which is why the president is also calling for steps to expand opportunity, such as an increased minimum wage, expanded tax credits for low-income workers and the middle class, and a fairer tax system overall.

Finally, enabling more people to participate in the workforce is critical, a goal that will be furthered by more accessible child care, more flexible workplaces (including paid leave and paid sick days), a tax system that supports secondary earners, and better training and job matching.

The facts about the middle class are clear: A strengthening economy is helping to boost jobs and incomes, but not enough to make up for the decades-long trend of slower income growth for the middle class. There is more to do.

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