

Inclusive Growth: The Role of Productivity, Inequality, and Participation

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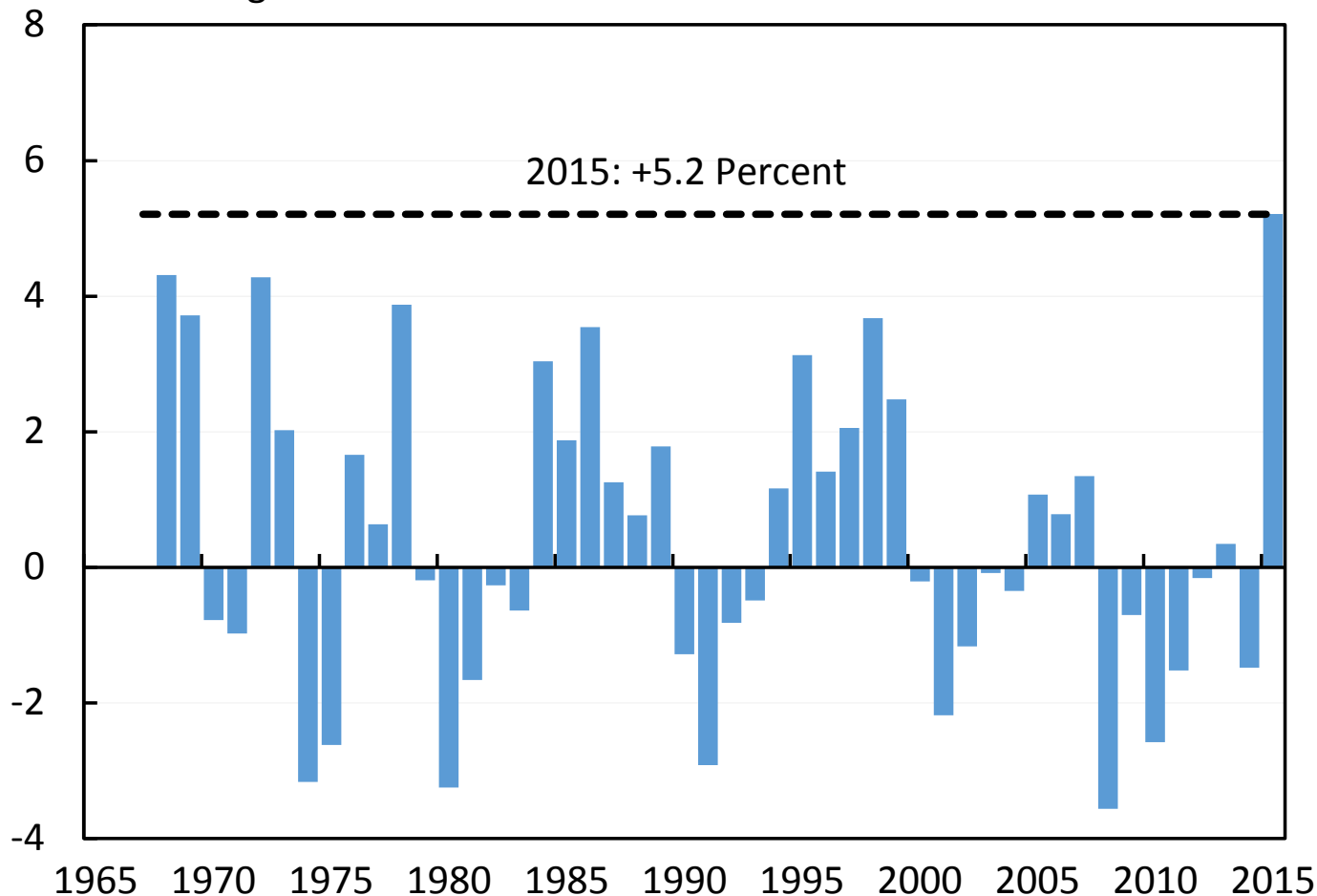
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From 2014 to 2015, Real Median Household Income Increased by \$2,800 (or 5.2 Percent), Fastest Annual Growth on Record

Change in Real Median Household Income, 1968-2015

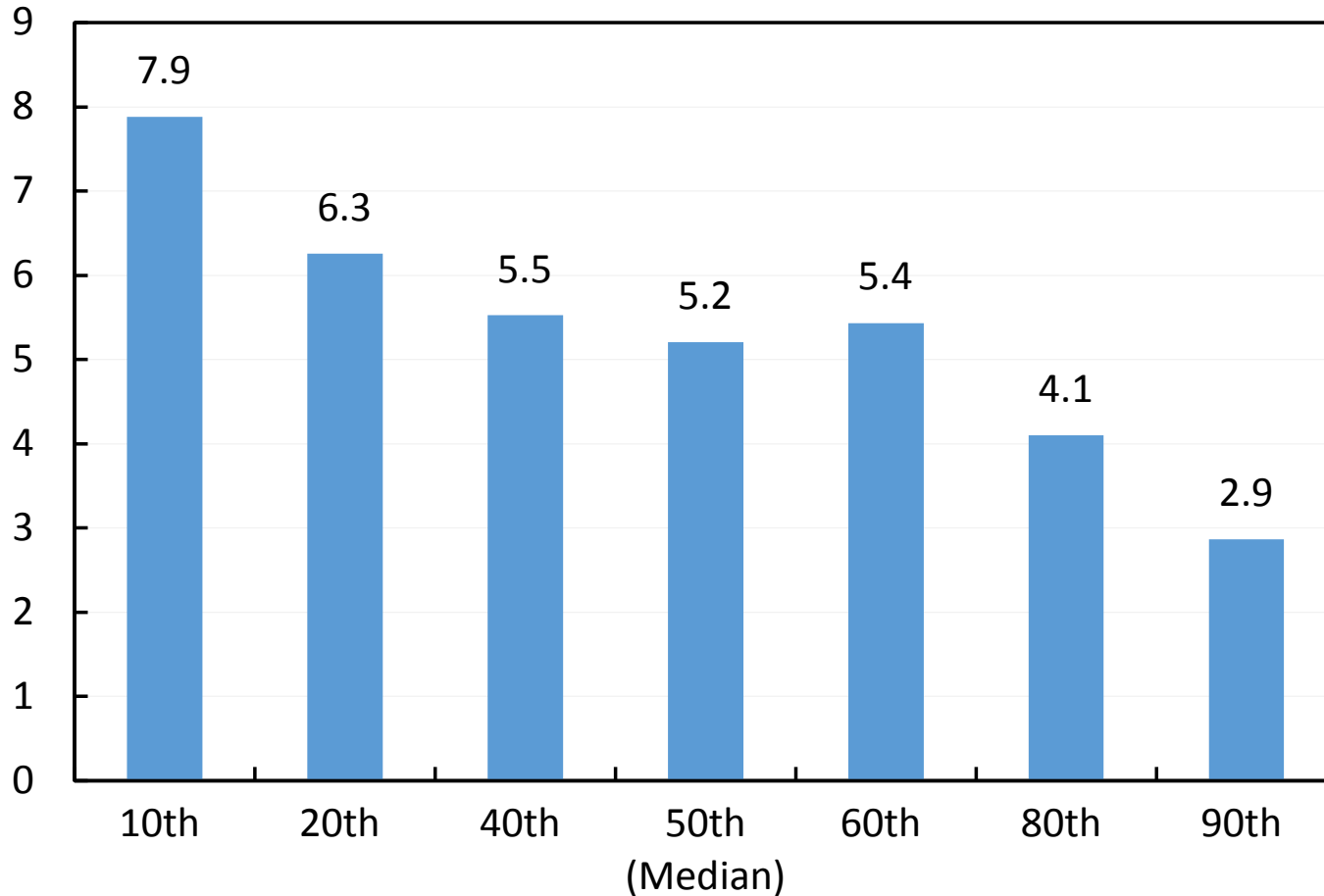
Percent Change from Prior Year



Income Increased for Households Across Distribution, With Largest Gains at Bottom and Middle

Growth in Real Household Income by Percentile, 2014-2015

Percent



Middle-Class Income Growth Has Slowed in Recent Decades

Annual Real Middle-Class Income Growth

	1948-1973	1973-2015
Median Family Income <i>(Census Bureau)</i>	3.0%	0.4%
Median Household Income with Benefits <i>(CBO, adj. for household size)</i>	N/A	0.5%
Median Household Income with Gov't Transfers/Taxes <i>(CBO, adj. for household size)</i>	N/A	1.0%

Note: Income levels from the Census Bureau are deflated with the CPI-U-RS price index, and income levels from the Congressional Budget Office (CBO) are deflated with the personal consumption expenditures price index. CBO median income is extended before 1979 and after 2013 with the growth rate of Census median household income.

Source: World Wealth and Income Database; Census Bureau; Congressional Budget Office; CEA calculations.

Drivers of Income Growth: Productivity, Inequality, and Participation

Determinants of Middle-Class Income Growth

	1948-1973	1973-2015
Labor Productivity Growth (Annual Average)	2.8%	1.8%
Income Shares		
Top 1 Percent	11% → 8%	8% → 18%
Bottom 90 Percent	66% → 68%	68% → 52%
Labor Force Participation Rate		
Men, 16 and Older	87% → 79%	79% → 69%
Women, 16 and Older	33% → 45%	45% → 57%

Some Thought Experiments

Counterfactual Scenarios for Productivity, Equality, and Participation

Thought Experiment	Factor	Base Period	Percentage Impact on 2015 Average Income	Income Gain to 2015 Typical Household
Productivity	Total Factor Productivity Growth	1948-1973	65%	\$37,000
Inequality	Share of Income Earned by Middle 20%	1973	19%	\$10,000
Participation	Female Labor Force Participation Rate	1948-1995	6%	\$4,000
Combined Impact	All of the Above		108%	\$61,000

Note: These thought experiments are intended to demonstrate the importance of these three factors for middle-class incomes. They do not consider second-order effects or interactive effects. The first thought experiment assumes that an increase in productivity is associated with an equal increase in the Census Bureau's mean household income. The second thought experiment uses the Census Bureau's mean income of the middle quintile as a proxy for median income. The third thought experiment assumes that newly-participating women will have the same average earnings as today's working women. The first and third thought experiments assume that income gains are distributed proportionally such that mean and median incomes grow at the same rate. Dollar gains are calculated off a base of the Census Bureau's median household income in 2013. The fourth thought experiment compounds the effects of the first three.

Source: World Top Incomes Database; Census Bureau; Congressional Budget Office; Bureau of Labor Statistics, Current Population Survey; Bureau of Economic Analysis; CEA calculations.

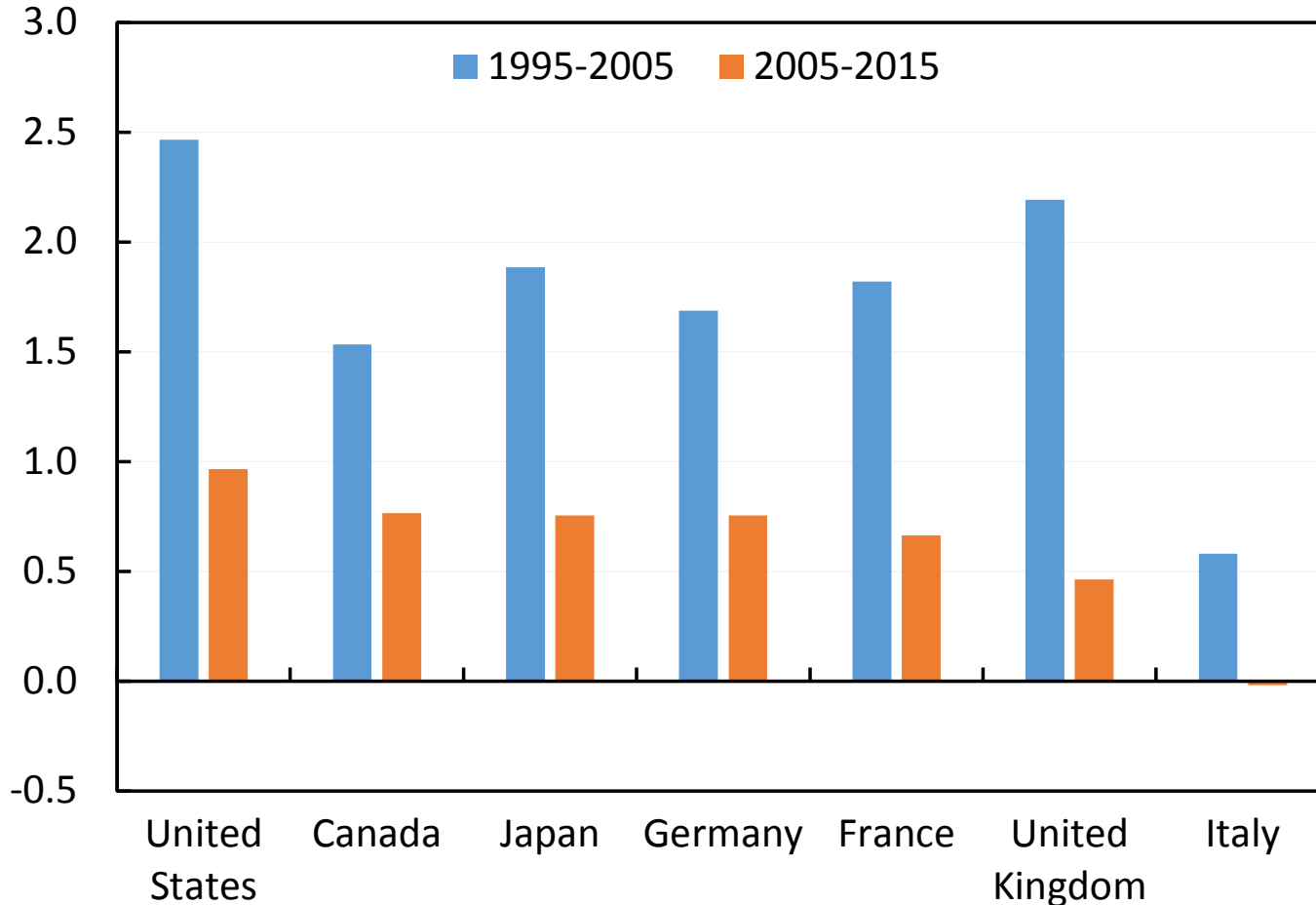
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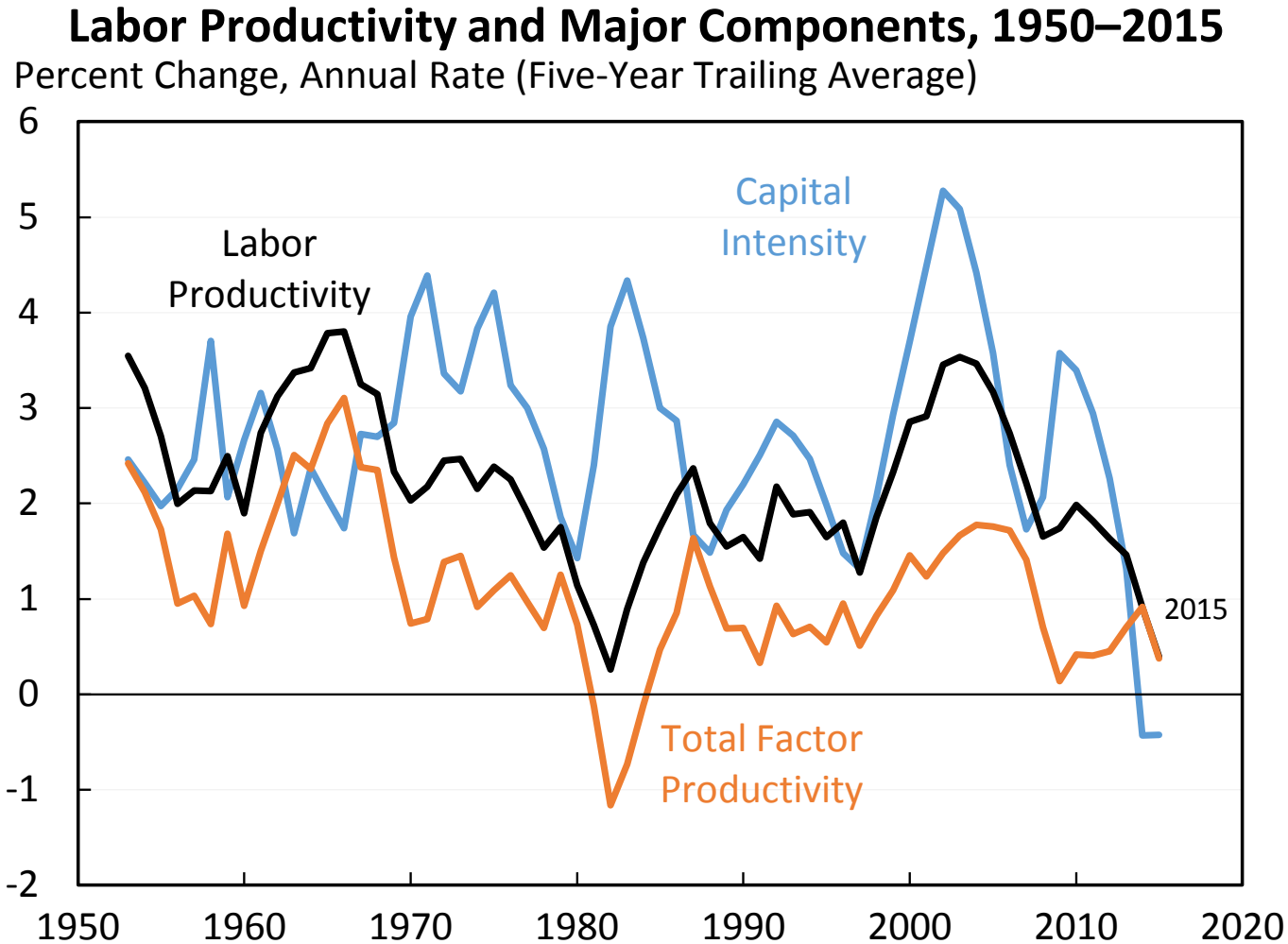
Average Annual Productivity Growth Has Slowed in All of the G-7 Economies

Labor Productivity Growth, G-7 Countries

Percent, Annual Rate

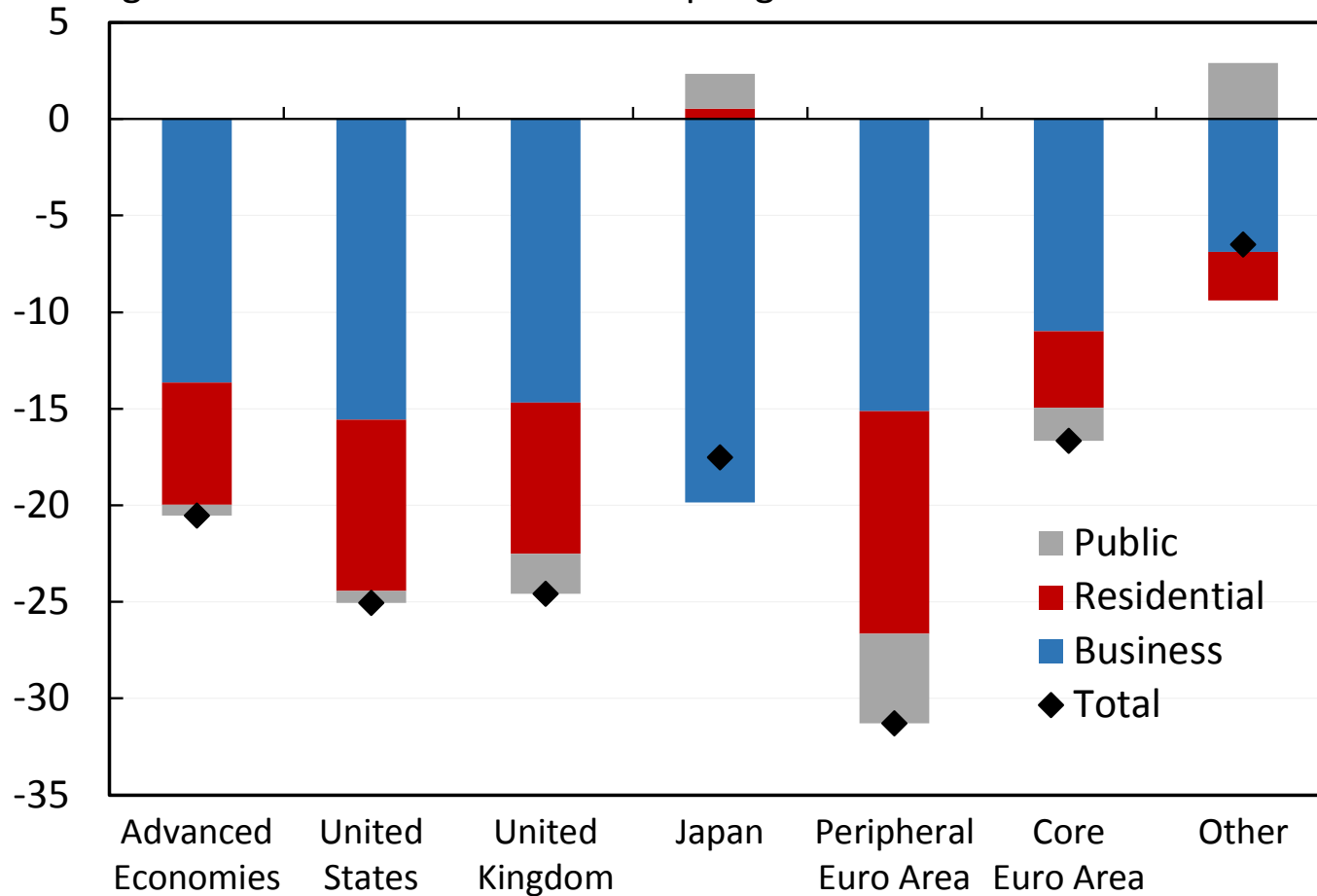


Largest Contributor to Recent Low Productivity Growth: Declining Capital Intensity per Worker



Inadequate Demand Has Contributed to a Shortfall in Investment

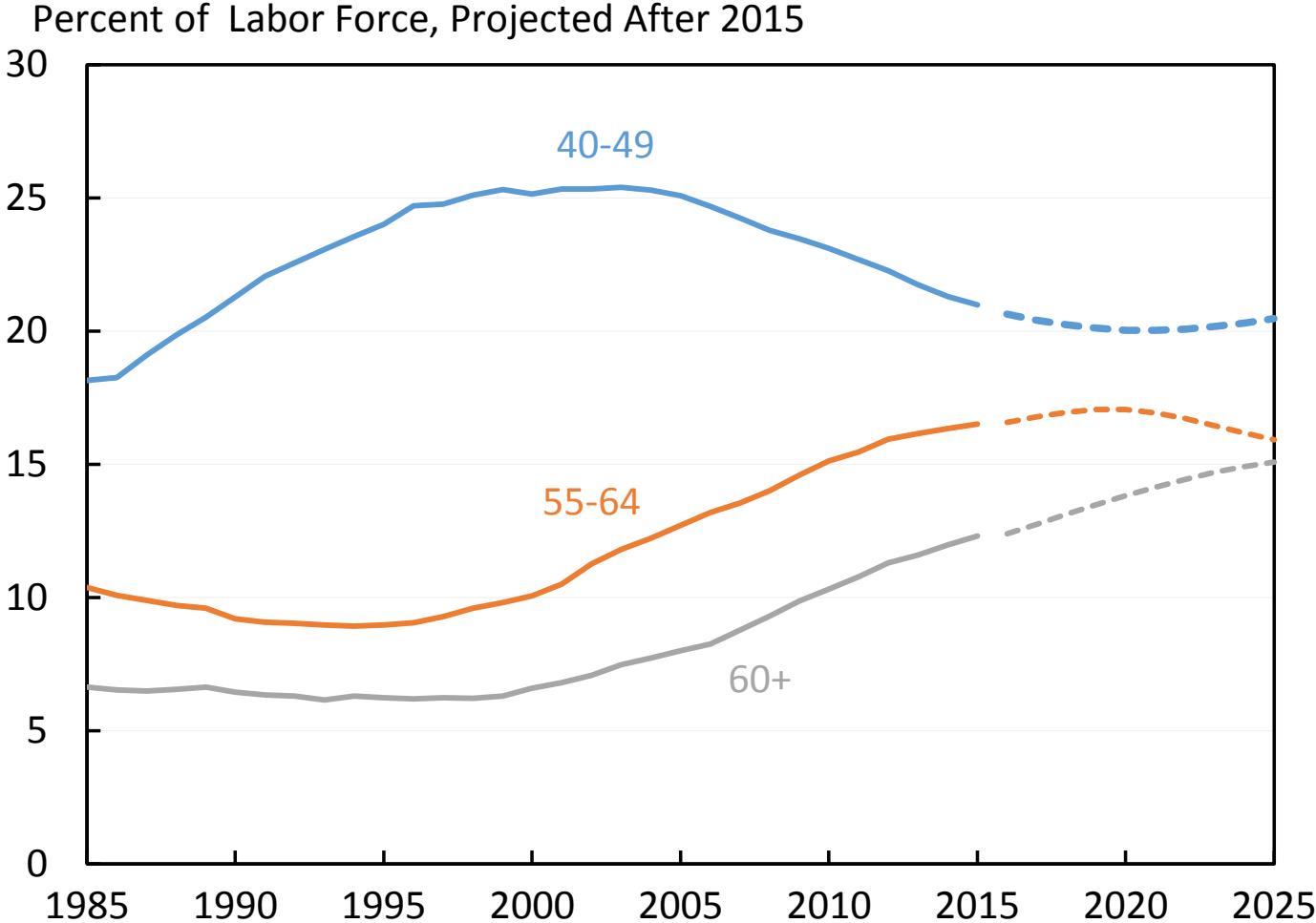
Decomposition of the Investment Slowdown, 2008-2014
Average Percent Deviation from IMF Spring 2007 Forecasts



Note: The figure shows the deviation of investment between 2008 and 2014 from forecasts made in the spring of 2007. Black diamonds indicate the average percent deviation of total investment. Colored segments show the contribution of the components of investment—business, residential, and public—to the deviation. Public-sector contributions to residential and nonresidential investment are excluded from these categories when data for these contributions are available. Peripheral Euro Area category includes Greece, Ireland, Italy, Portugal, and Spain. Core Euro Area category includes Austria, Estonia, Finland, France, Germany, Latvia, Luxembourg, Malta, the Netherlands, Slovakia, and Slovenia.
Source: International Monetary Fund, Fiscal Monitor Database; Consensus Economics; national sources via Haver Analytics.

Demography Boosted Productivity Growth from 1985 to 2005 and Has Been a Headwind Since, But Should Level Out in Coming Decades

Actual and Projected Labor Force by Age



Source: Bureau of Labor Statistics, Current Population Survey; International Labor Organization; CEA calculations.

Over the Last 35+ Years, Firm Exit Has Remained Relatively Steady But the Firm Entry Rate Has Decreased Substantially

Firm Dynamism, 1977-2013

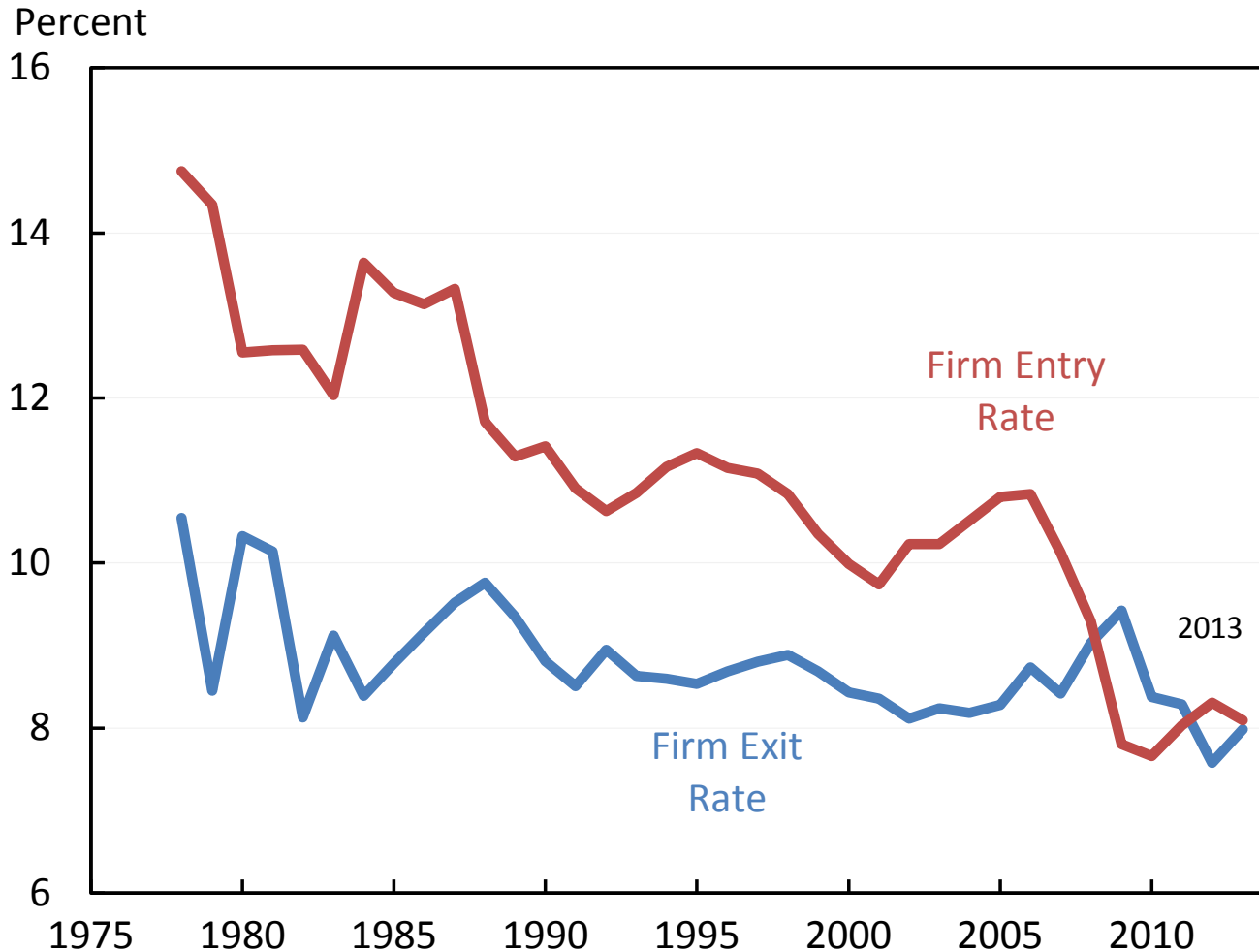
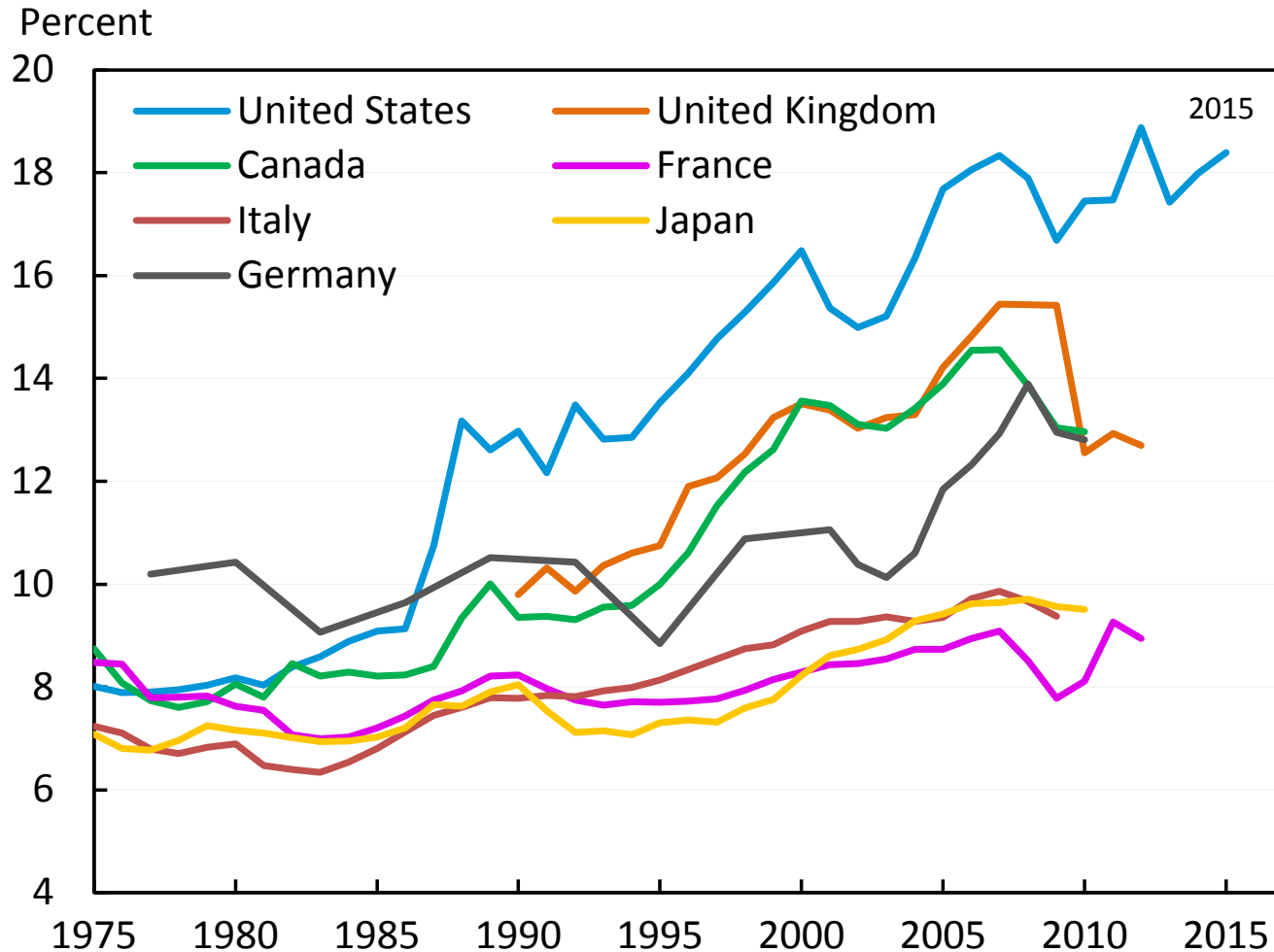


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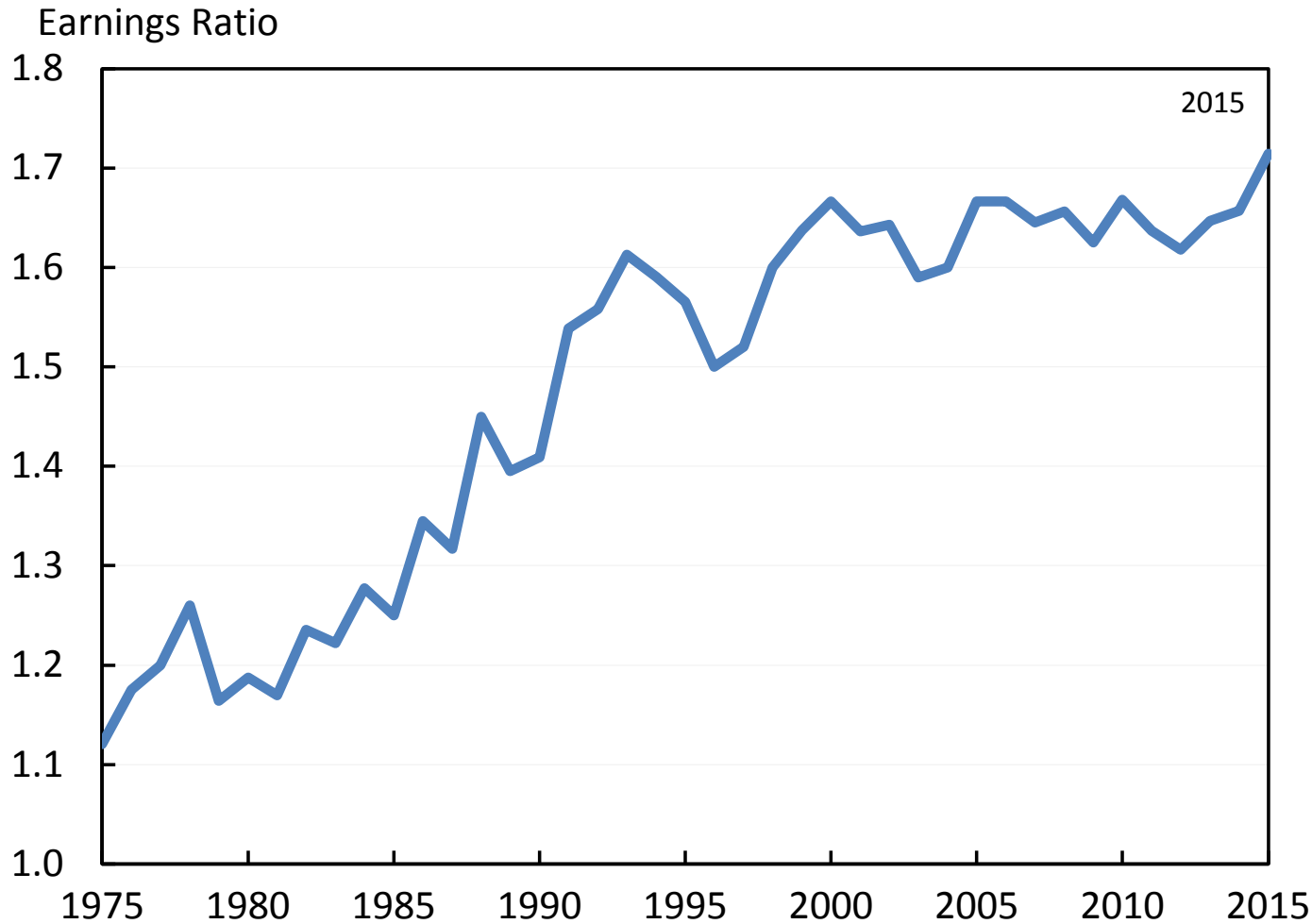
The United States Has Seen Faster Growth and Higher Levels of Income Inequality Than Other Major Advanced Economies

Share of Income Earned by Top 1 Percent, 1975-2015



Competitive Explanation: Increased Demand for Skills

College Earnings Premium, 1975-2015

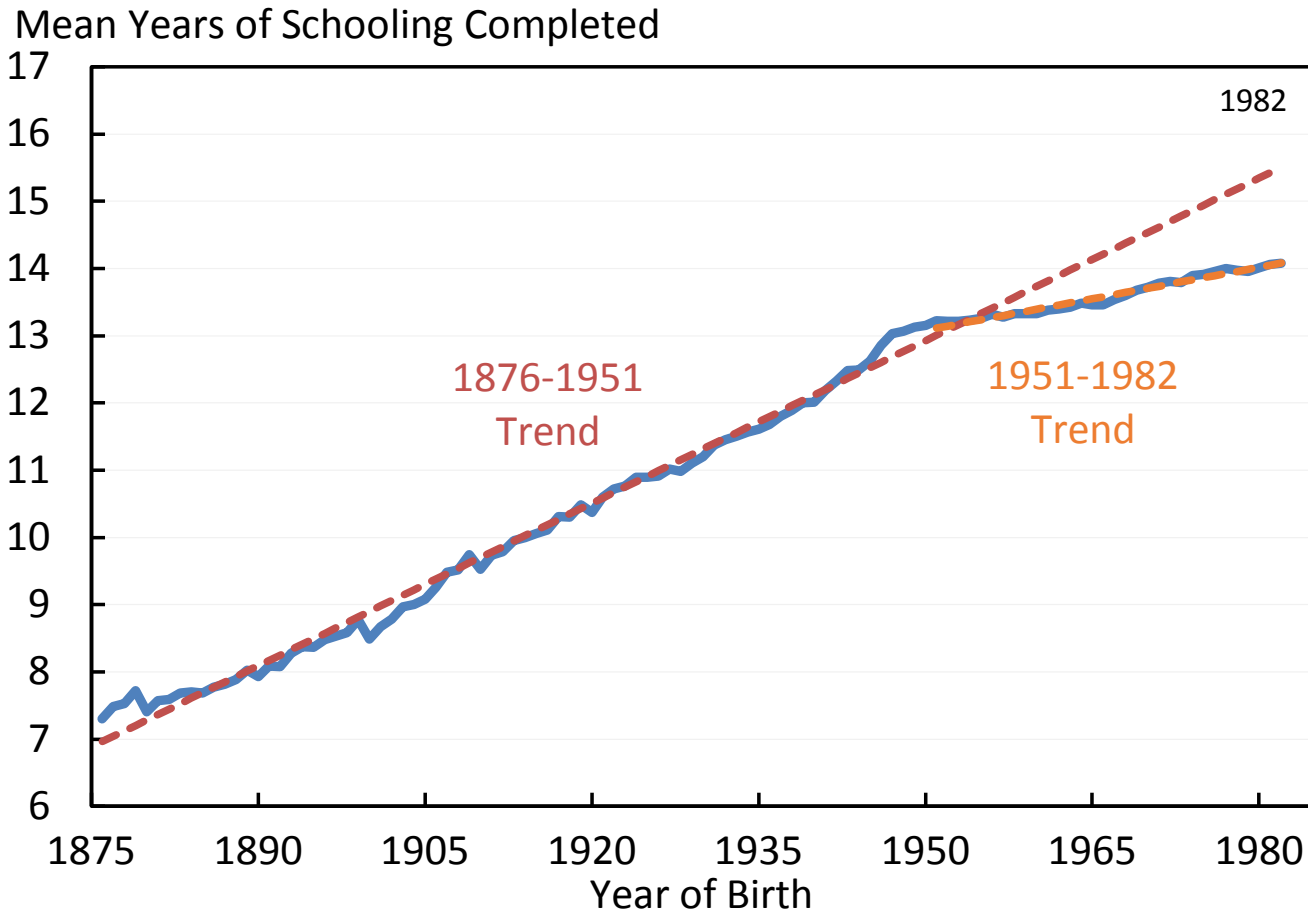


Note: Ratio of median annual earnings of full-time, full-year workers over age 25 with a bachelor's degree only to median annual earnings of full-time, full-year workers over age 25 with a high school degree only. Prior to 1992, bachelor's degree is defined as four years of college.

Source: Bureau of Labor Statistics, Current Population Survey (Annual Social and Economic Supplement); CEA calculations.

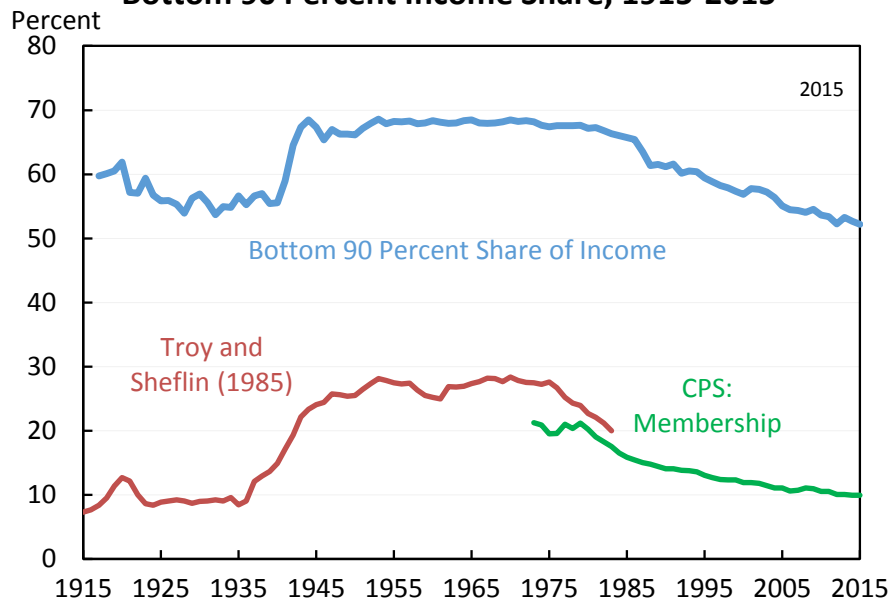
Competitive Explanation: Slowdown in the Growth of the Supply of Skills

Mean Years of Schooling at Age 30, U.S. Native-Born, by Year of Birth, 1876-1982

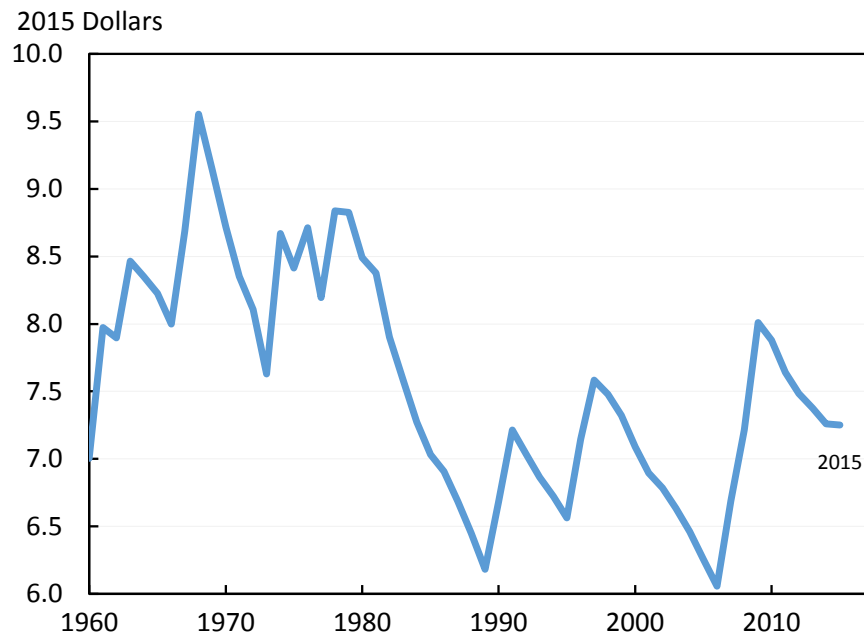


Noncompetitive Explanation: Worker Bargaining Power Has Been Reduced

Union Membership as a Share of Total Employment and Bottom 90 Percent Income Share, 1915-2015



Real Value of the Federal Minimum Wage, 1960-2015

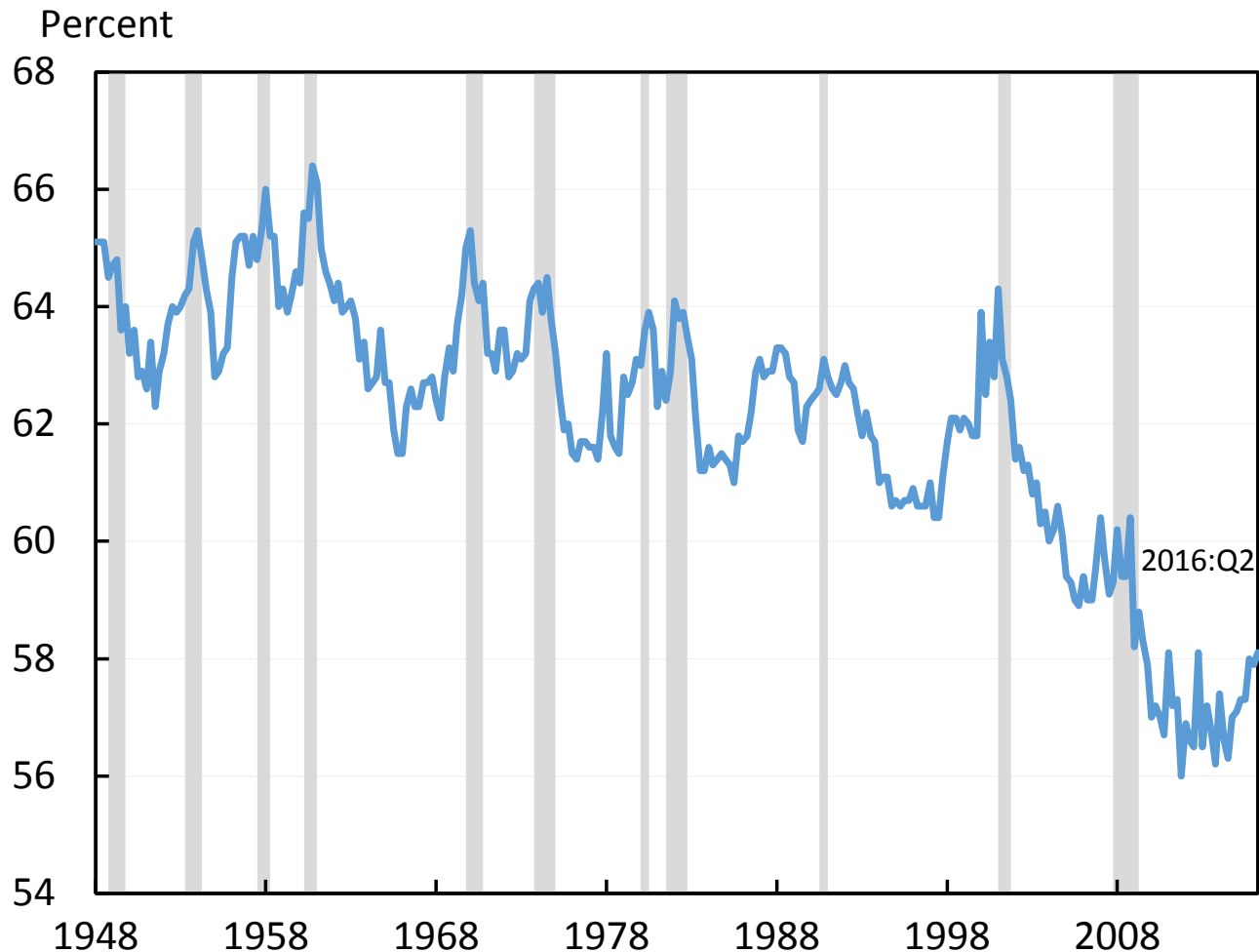


Note: Total employment from 1901 to 1947 is derived from estimates in Weir (1992). For 1948 to 2015, employment data are annual averages from the monthly Current Population Survey. Minimum wage adjusted for inflation using the CPI-U-RS.

Source: Troy and Sheflin (1985); Bureau of Labor Statistics, Current Population Survey; Weir (1992); World Wealth and Income Database; Department of Labor; Bureau of Labor Statistics, Consumer Prices; CEA calculations.

Noncompetitive Explanation: Labor Share of Income Has Fallen Since Around 2000

Labor Share of Income, Nonfarm Business Sector, 1948-2016

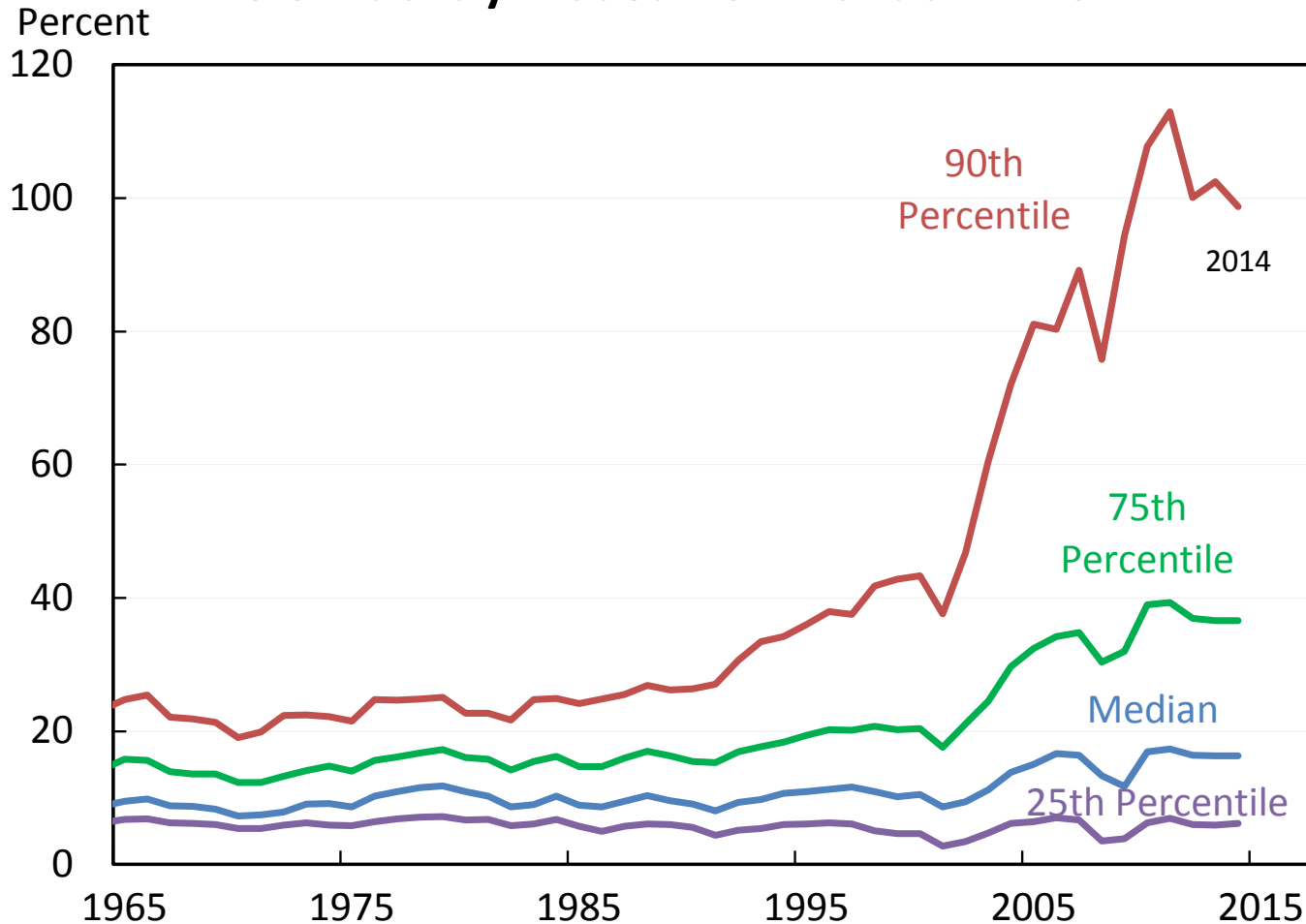


Notes: Shading denotes recession.

Source: Bureau of Labor Statistics, Productivity and Costs.

Noncompetitive Explanation: Increasing Dispersion in Returns to Invested Capital Across Firms

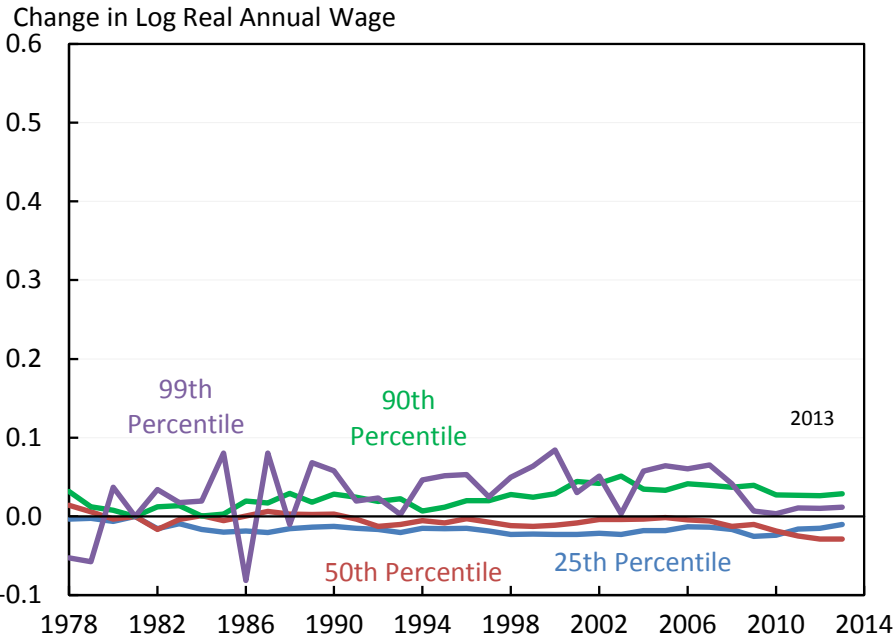
Return on Invested Capital Excluding Goodwill, U.S. Publicly-Traded Nonfinancial Firms



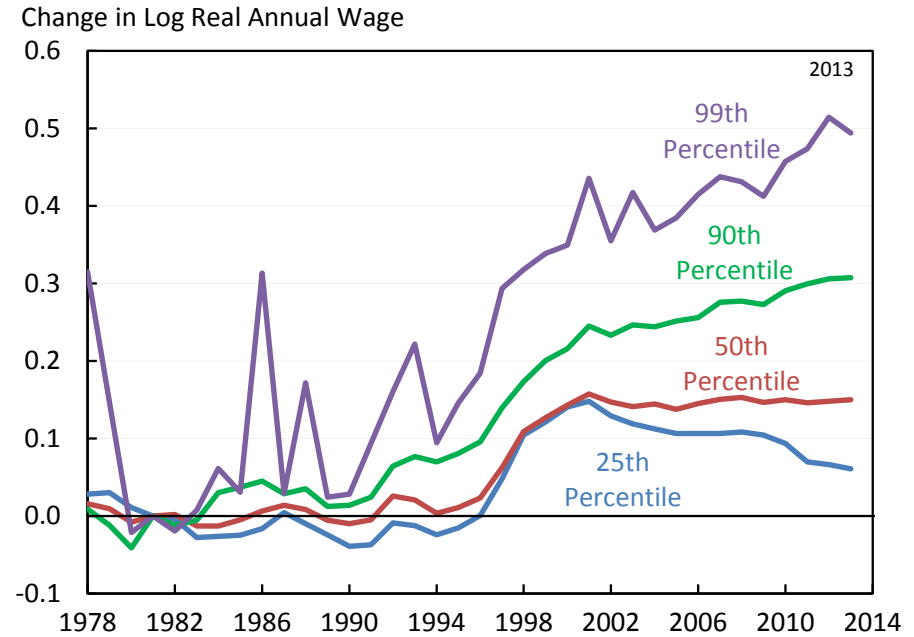
Note: The return on invested capital definition is based on Koller, Goedhart, and Wessels (2015), and the data presented here are updated and augmented versions of the figures presented in Chapter 6 of that volume. The McKinsey data includes McKinsey analysis of Standard & Poor's data and exclude financial firms from the analysis because of the practical complexities of computing returns on invested capital for such firms.
Source: Koller, Goedhart, and Wessels (2015); McKinsey & Company; Furman and Orszag (2015).

Noncompetitive Explanation: Increasing Wage Inequality Across, But Not Within, Firms

Within Firms: Change in Wage Structure Since 1981



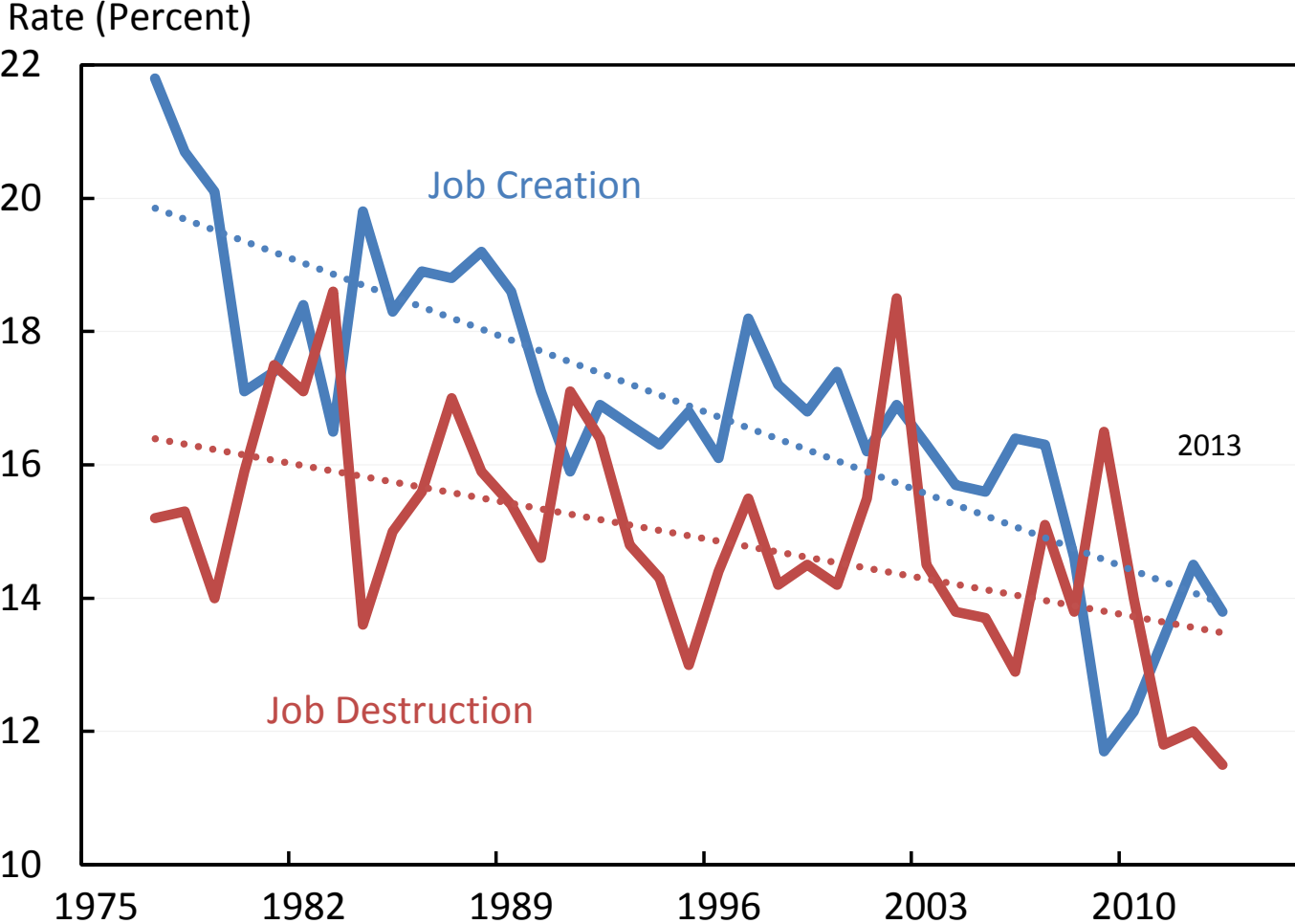
Between Firms: Change in Wage Structure Since 1981



Note: Only firms and individuals in firms with at least 20 employees are included. Only full-time individuals aged 20 to 60 are included in all statistics, where full-time is defined as earning the equivalent of minimum wage for 40 hours per week in 13 weeks. Individuals and firms in public administration or educational services are not included. Firm statistics are based on the average of mean log earnings at the firms for individuals in that percentile of earnings in each year. Data on individuals/their firms are based on individual log earnings minus firm mean log earnings for individuals in that percentile of earnings in each year. All values are adjusted for inflation using the PCE price index.
Source: Song et al. (2016).

Labor Market Dynamism Has Been Declining for Decades

Labor Market Dynamism, 1977-2013



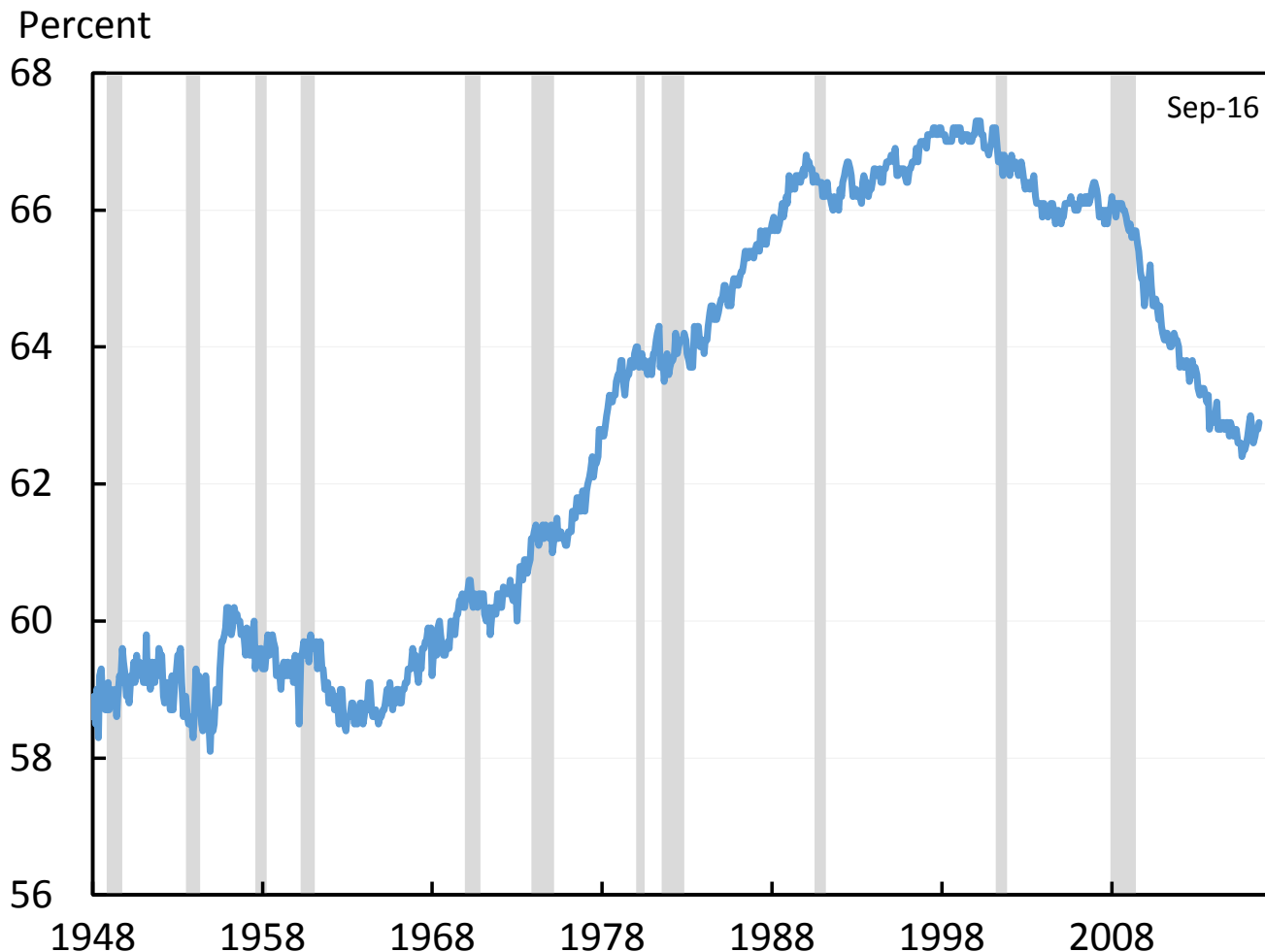
Source: Longitudinal Business Database, 1977-2013.

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The Labor Force Participation Rate Peaked in 2000 and Has Declined Since (Though Has Been Stable Since 2013:Q4)

Labor Force Participation Rate, 1948-2016

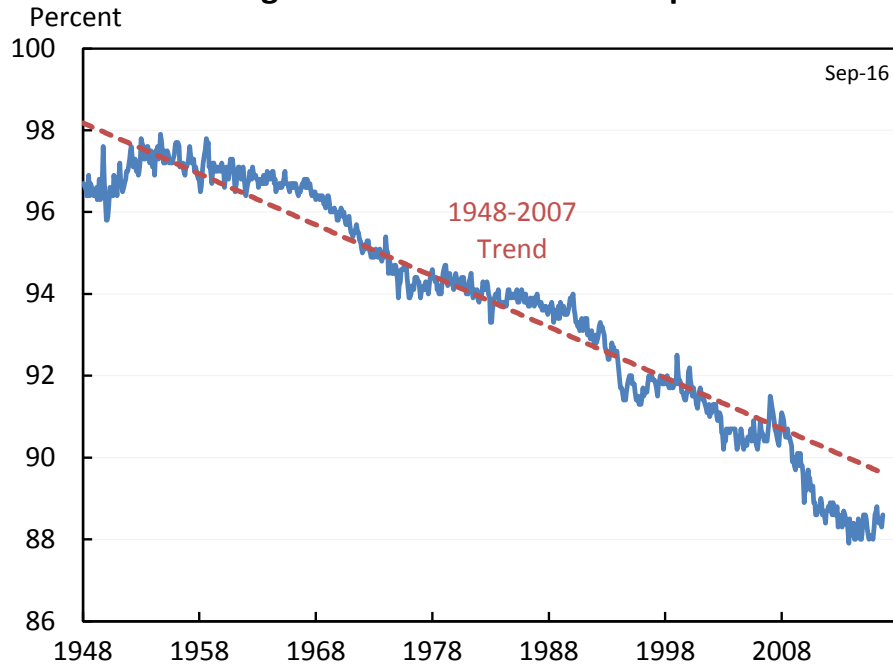


Note: Shading denotes recession.

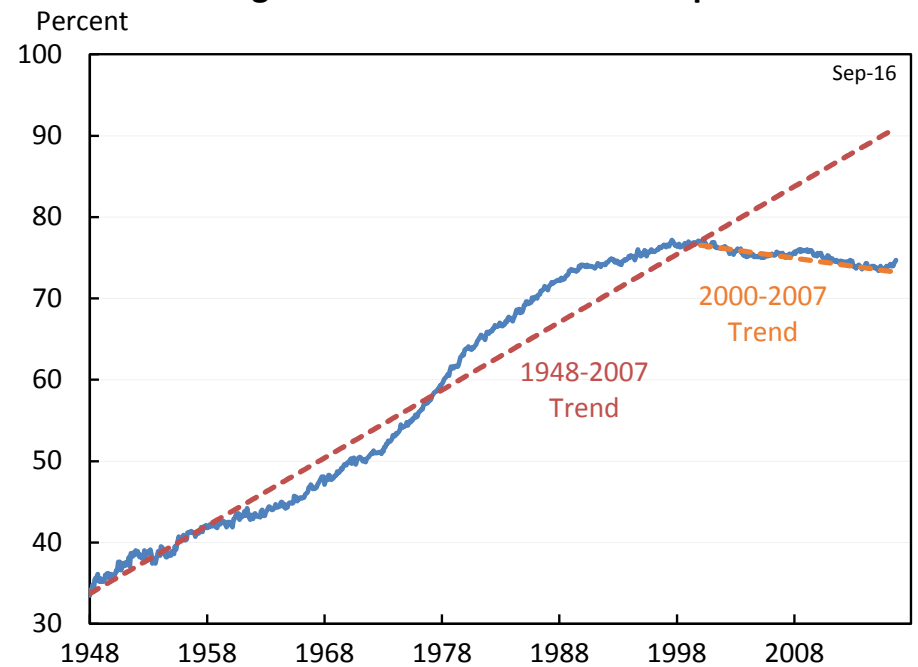
Source: Bureau of Labor Statistics, Current Population Survey.

A Troubling Trend: Declining Prime-Age Labor Force Participation

Prime-Age Male Labor Force Participation Rate

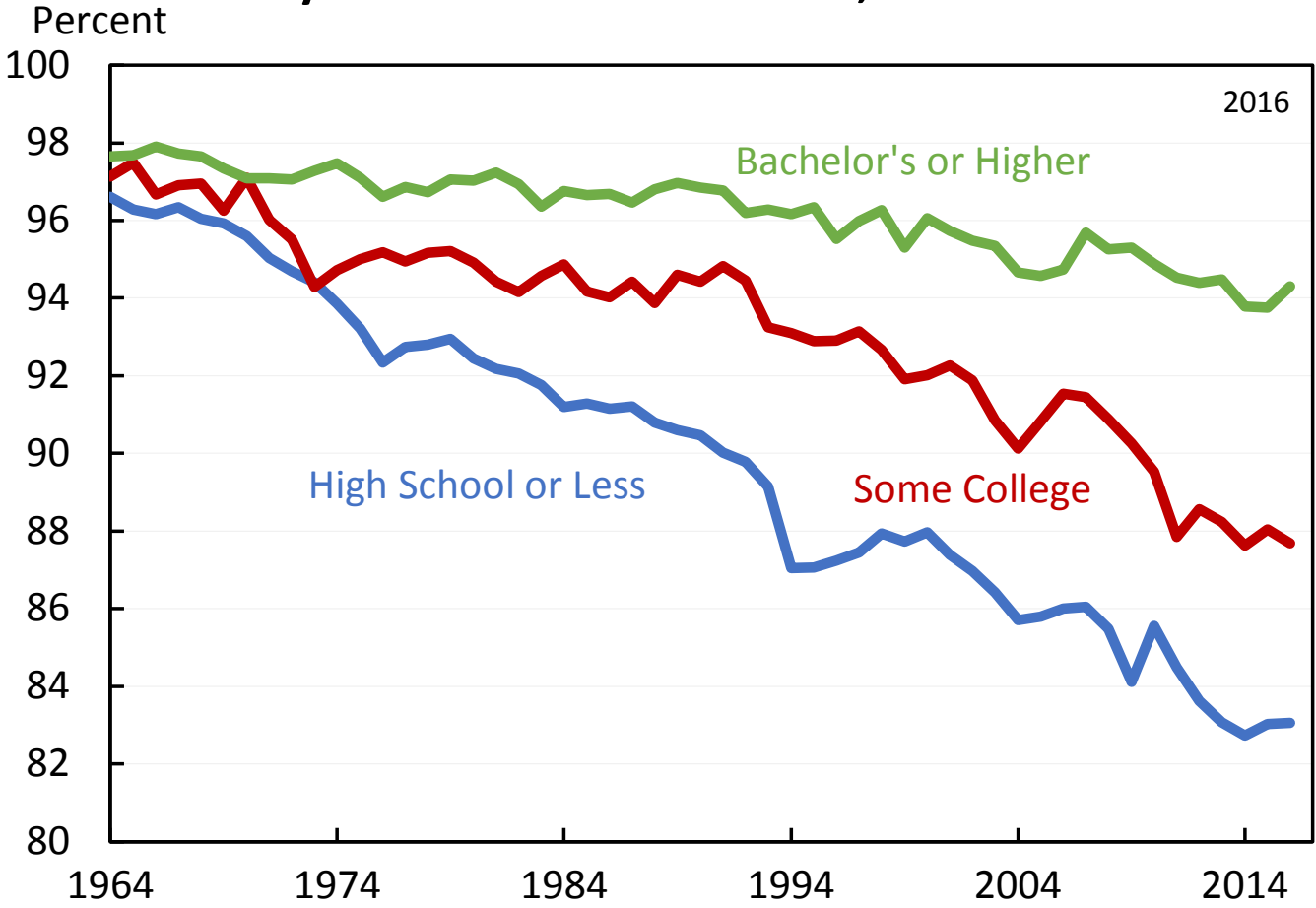


Prime-Age Female Labor Force Participation Rate



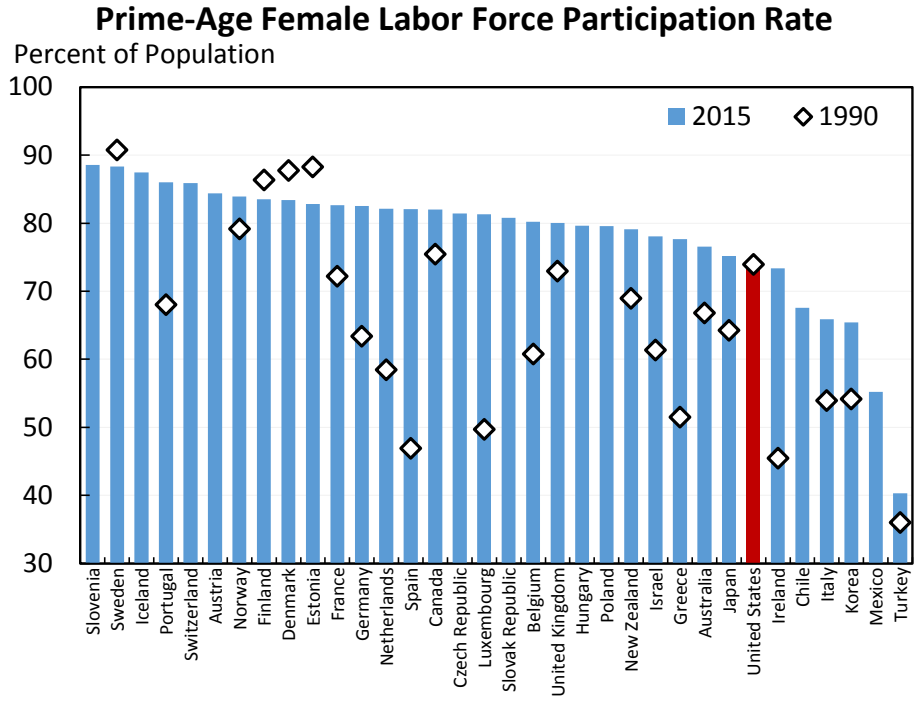
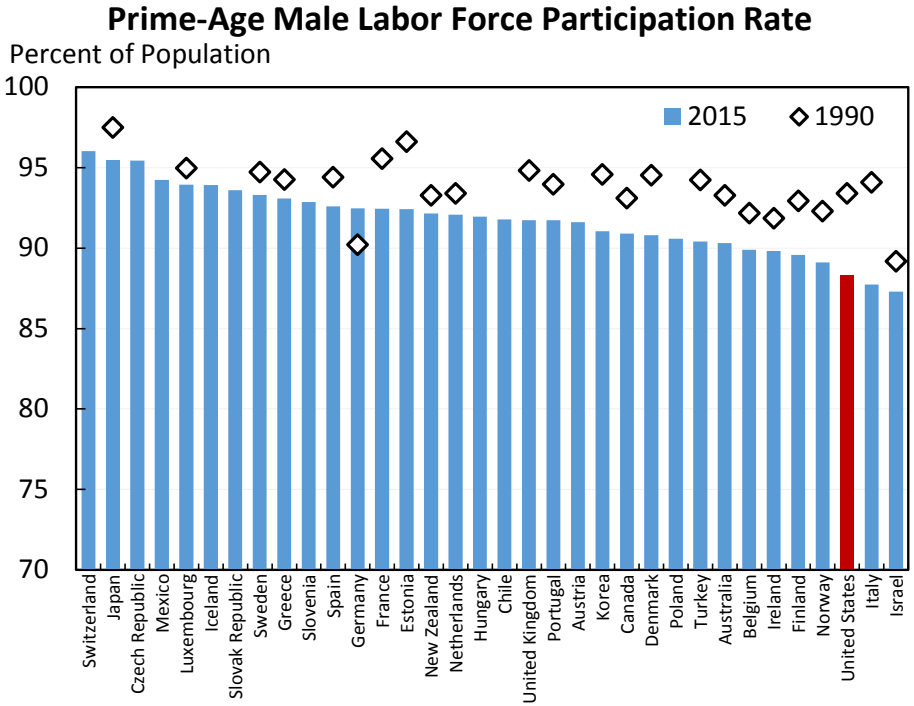
Declining Prime-Age Male Participation Has Been Concentrated Among Men with Less Educational Attainment

Prime-Age Male Labor Force Participation Rate by Educational Attainment, 1964-2016



Source: Bureau of Labor Statistics, Current Population Survey (Annual Social and Economic Supplement); CEA calculations.

Despite Flexible Labor Markets, the United States Ranks Towards the Bottom of the OECD in the Share of Prime-Age Men and Women in the Labor Force



Source: Organisation for Economic Co-operation and Development.

U.S. Labor Market Has High Flexibility But Low Supportiveness According to OECD's *Going for Growth* Indicators

OECD *Going for Growth* Indicators

	Percentile Rank (100 = Most Flexible/Most Supportive)
<i>Measures of Labor Market Flexibility</i>	
Overall Labor Market Regulation (2014)	100
Employment Protection for Regular Employment (2013)	100
Minimum Cost of Labor (2014)	96
Coverage of Collective Bargaining Agreements (2013)	94
<i>Measures of Institutional Labor Market Support</i>	
Expenditure on Active Labor Market Policies per Unemployed (2013)	6
Net Childcare Costs, Couples (2012)	10
Implicit Tax on Returning to Work, Second Earner (2012)	10

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Selected Policies for Faster Productivity Growth

- **Investing in infrastructure and research**
- **Promoting innovation via trade**
 - Passing the Trans-Pacific Partnership (TPP)
- **Reforming the business tax code to reduce distortions**
- **Promoting high-skilled immigration**

Some Policies to Address Inequality

- **Promoting equality of opportunity**
 - Investing in high-quality early learning and preschool programs
 - Investing in higher education, job training, and apprenticeship programs
 - Income support for low-income households
- **Reducing concentration of market power and rent-seeking behavior**
 - Raising the minimum wage
 - Supporting collective bargaining and other forms of worker voice
 - Carefully administering existing regulations that fight rent-seeking
 - Reforming patent rules
 - Making wireless spectrum more broadly available
 - Reforming occupational licensing and land-use restrictions

Some Policies to Increase Labor Force Participation

- **Expanding aggregate demand**
- **Investing in education**
- **Reforming occupational licensing**
- **Deepening “connective tissue” in labor markets**
 - Job-search assistance as part of unemployment insurance system
 - Wage insurance
- **Greater access to child care and paid leave for working families**
- **Criminal justice reform**
- **Comprehensive immigration reform**

Some Policies to Increase Resilience and Sustainability

- **Continuing to implement Wall Street Reform**
- **Improving automatic stabilizers and making more active use of fiscal policy**
- **Reducing the long-run deficit with a combination of reforms to entitlements and increased revenue**
- **Addressing climate change**

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