Dēmos

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Hon. Jeff Merkley, Chair

Hon. Dean Heller, Ranking Member

"State of the American Dream – Economic Policy and the Future of the Middle Class"

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I. INTRODUCTION

Widely shared middle-class prosperity is a signature of American society. It has made America the most hopeful and dynamic country on earth and it is a foundation of strong democracy.

Yet today, America's middle class is in trouble—and those troubles long preceded the financial crash of 2008 and the downturn that followed. As a result of major economic and policy changes over the past three decades, the traditional routes into the middle class have become more difficult to travel and security has eroded for those already in the middle class. Many jobs do not pay enough to cover basic living expenses, much less allow workers to save money and build assets for the future. In fact, a quarter of full-time working-age adults are still not earning enough money to meet economic needs like housing, utilities, food, health care, and transportation for themselves or their families.[1]

A college education has become ever more critical to moving up the income ladder—even as it has also become less affordable and the earning power of a college degree has stagnated. Building significant wealth assets for retirement or to help the next generation remains an impossible dream for millions. Many households are instead mired in debt. In short, too many people who play by the rules and do everything right find that they cannot climb into the middle class—or stay there.

The hard economic times of the past few years have compounded the long accumulating challenges facing the middle class. Jobs are harder to come by amid extended high unemployment. Many jobs lost during the recession may never come back as a result of corporate policies that have eliminated jobs, moved them overseas, or replaced people with technology. The nation's new jobs disproportionately offer lower wages and fewer benefits than those they replaced.

The dream of homeownership has turned into a nightmare for millions of Americans who have lost their homes to foreclosure or now find themselves owing more on their mortgages than their homes are worth. Retirement savings accounts were hit hard by the stock market plunge of 2008-2009. Government investments in education and job training have declined amid draconian budget cuts and hundreds of thousands of once secure jobs in the public sector have been eliminated.

America's economy has been an awesome engine of wealth creation in the past thirty years, but the new prosperity has disproportionately gone to the wealthiest. Between 1979 and 2007, according to the Congressional Budget Office, American households in the highest-paid 1 percent of the income distribution saw after-tax income gains of 275 percent[2]—while the 60 percent of the households in the middle saw their incomes grow by just under 40 percent over this same period.[3] And, according to much research, social mobility – the very essence of the American idea – has stagnated or declined in the United States, with many young people struggling to replicate their parents' standard of living.[4] For example, young men are earning 10 cents per dollar less than their fathers did 30 years ago, according to research from Dēmos.[5] A persistent and growing racial wealth gap, with historic inequities and injustices exacerbated by the recent iniquity of predatory lending, restricts opportunity for people of color to join or remain part of the nation's middle class. Princeton economist Alan Krueger observes that the economic data "challenge the notion that the United States is an exceptionally mobile society. If the United States stands out in comparison with other countries, it is in having a more static distribution of income across generations with fewer opportunities for advancement."[6]

A host of public policy choices created this state of affairs – including tax cuts that disproportionately benefitted the wealthy, financial deregulation, state divestment in public higher education, and decisions to let the minimum wage stagnate, to name only a few – and things are likely to get worse without major policy corrections. The long-term trends that have moved America toward a postindustrial service economy are here to stay and, in fact, have accelerated during the economic downturn. Over the next two decades, the Department of Labor projects that the largest job growth will be in low-wage jobs offering little opportunity for advancement and that do not offer health insurance or pay enough to allow workers to put money toward home equity and retirement savings. Meanwhile, most of the good jobs that are created will require a post-secondary education that is likely to remain out of reach for millions as college tuition costs continue to rise.

Even as structural changes have imperiled the middle class, national action has been lacking. Over recent decades, many political leaders have failed to reckon with a basic fact of the new economic era – for millions of Americans, no amount of individual effort or self-improvement or thrift can guarantee a secure middle-class life. The American social contract – a promise of opportunity and security for those who act responsibly – is fundamentally broken.

Dramatic new public policy initiatives are needed to accomplish two broad interrelated goals: to ensure that all Americans have a chance to move into the middle class and, second, to ensure greater security for those in the middle class. Such initiatives must move far beyond incremental measures and be of sufficient scale to permanently address the economic insecurities of what is now a vast number of U.S. households.

II. THE VIEW FROM THE HOUSEHOLD LEVEL

A. Stagnating Incomes, Rising Costs

It used to be the case that a rising economic tide lifted all boats. In the years after World War II, as economic growth and productivity increased, the workers contributing to that prosperity saw commensurate gains in wages, across the income spectrum. However, that connection has broken down over the last thirty years: while productivity increased 80.4 percent in the three decades between 1979 and 2011, the inflation-adjusted wages of the median worker grew just 6 percent, and that growth occurred exclusively as a result of the strong economy of the late 1990s, according to analysis by the Economic Policy Institute.[7] Since 2000, the picture of earnings and income has become still more stark: despite a productivity increase of 22.8 percent between 2000 and 2011, median family income in the United States has ***declined*** 6 percent, from $66,259 to $62,301, over the same period.[8]

Part of the story is the increasing economic returns to education, which left workers without a college degree lagging further behind in income and employment. For example, as chronicled in Dēmos' State of Young America report, in 1980, a young man with a bachelor's degree earned roughly $9,100 more than a young man with a high school degree. Today, he earns $20,000 more, and the trends are similar among women.[9] However, a college degree has not entirely protected workers from declining wages in the years since 2000. Between 2000 and 2012, the wages of young college graduates fell 8.5 percent, translating into a decline of more than $3,000 for full-time, full-year workers.[10] This suggests that boosting college attainment, while critical, will not be sufficient by itself to restore middle-class wages or re-establish the link between economic growth and productivity and wage growth.

A bigger part of the story has to do with the rising share of the nation's gross domestic product flowing to corporate profits rather than wages and the larger share of overall income going to the highest 1 percent of income earners. Until 1975, wages generally accounted for the majority of the nation's GDP, but by 2012 wages had declined to a record low of 43.5 percent.[11] Research from Northeastern University finds that in the first seven quarters after the end of the Great Recession, American corporations received an astonishing 92 percent of the growth in real national income, while aggregate workers' wages and salaries actually declined by $22 billion and contributed nothing to national income growth.[12]

Personal income has become far more concentrated at the top, a trend that has also accelerated rapidly since the end of the Great Recession. Economist Emmanuel Saez finds that between 2009 and 2011, the incomes of the highest-paid 1 percent of Americans grew by 11.2 percent while the incomes of the rest of Americans declined by 0.4 percent. In effect, the top 1 percent captured 121 percent of the income gains in the first two years of the recovery.[13]

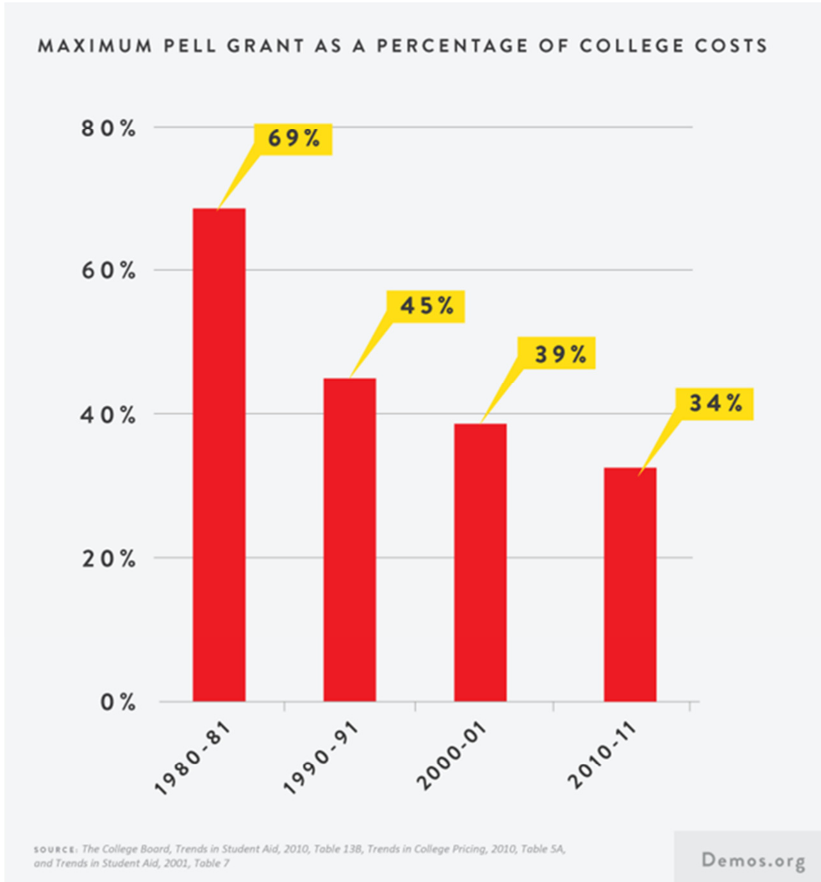
Finally, while the real wage data above is adjusted for inflation, this story does not fully account for the cost of middle-class fundamentals, such as health care, child care and higher education, which have seen their costs grow far more quickly than inflation as a whole. For example, the average annual employee contribution to health premiums has tripled since 1999, growing from $318 to $951 for singles and from $1,543 to $4,316 for family coverage.[14] The national average cost for center-based child care in 2011 was $8,900 for full-time care for an infant and $7,150 for full-time care for a preschooler.[15] Center-based child care fees for two children (an infant and a 4-year-old) exceeded annual median rent payments in all 50 states and the District of Columbia.[16] This is all the more troubling since according to the Center for Housing Policy, nearly one in four working households (renters and owners combined) also experienced a severe housing cost burden in 2011, spending more than 50 percent of household income on housing costs, including utilities.[17] Meanwhile, at public four-year universities, average tuition has risen 126% (in real terms) since 1990. The American middle class, and workers aspiring to a middle-class standard of living, are squeezed between stagnant and declining wages and higher costs for the fundamentals of a middle-class life. Aside from the major advances in health care coverage and affordability in the Affordable Care Act of 2009, policymakers have done little to address this new reality.

B. The New Price of Entry to the Middle Class, Now Priced Out: Higher Education

During the post-war industrial era, a post-secondary education was not required for a single breadwinner to support a family. For example, in 1970 male high school graduates earned a median income equivalent to $45,432 in today's dollars—32.5 percent more than they earn today.[18] However, just as automation, trade liberalization and globalized manufacturing began to put downward pressure on the wages and job opportunities of non-college educated Americans, state and federal policymakers allowed college to become less affordable to non-affluent families. Tuition at public 4-year schools has more than tripled in the past three decades, rising faster than either inflation or growth in family income.[19] The United States went from first in the world in degree-holders to eleventh in the course of one generation. [20] The enrollment gap between low-income families and high-income families is as high as it was three decades ago. Many hardworking students are priced out of pursuing and completing higher education—a fundamental component to upward mobility and opportunity in American society. And those who do enroll are leaving college with unprecedented levels of debt, often without a degree in hand.

A major factor in the rise of public college costs is declining state support for higher education. Dēmos' research report *The Great Cost Shift* finds that, despite appropriating $75.6 billion for higher education in 2010 (from $65.1 billion in 1990), states actually devoted less of their wealth to higher education than they did just 20 years ago. After controlling for inflation, states collectively invested $6.12 per $1,000 in personal income in 2010, down from $8.75 in 1990, despite the fact that personal income increased by 66.2 percent over that period. As a result, between the 1990 and 2009 academic years, the real funding per public full-time equivalent (FTE) student dropped by 26.1 percent, falling from $8,608 to $6,360. Funding levels failing to keep pace with population growth, as the largest generation since the Baby Boomers has come of college age against the backdrop of a nationwide trend away from taxes and public investment. If states had provided the same level of funding as in 1990, total appropriations in 2009 would have equaled approximately $102 billion, an amount 35.3 percent greater than the actual one.[21]

Although increasingly large numbers of high school graduates enroll in some type of college, college completion has stagnated: today more than half of students who begin college never complete their degrees. **Financial barriers are the primary reason why students do not finish college.**[22] The high cost of college is particularly prohibitive for students from lower-income families, and shifts away from need-based aid are only exacerbating the challenge. In 2010, just 36 percent of all federal student aid was



grant-based, down from 55 percent in 1980. Similarly, in 1980, the maximum Pell grant covered 69 percent of the costs of a 4-year public college, compared to just 34 percent in 2010.[23]

Rising tuition and limited financial aid has more students than ever financing their college education with debt and at ever-increasing amounts. In addition, students are struggling to meet rising college costs by enrolling part-time and working long hours. Two-thirds of community college students and 46 percent of four-year college students work more than 20 hours a week while attending school, greatly increasing their risk of dropping out.[24] Lack of preparation at the high school level is another factor contributing to high drop-out rates. Our K-12 system often fails to graduate students ready for college, forcing many into costly remedial classes at the outset of their college education.

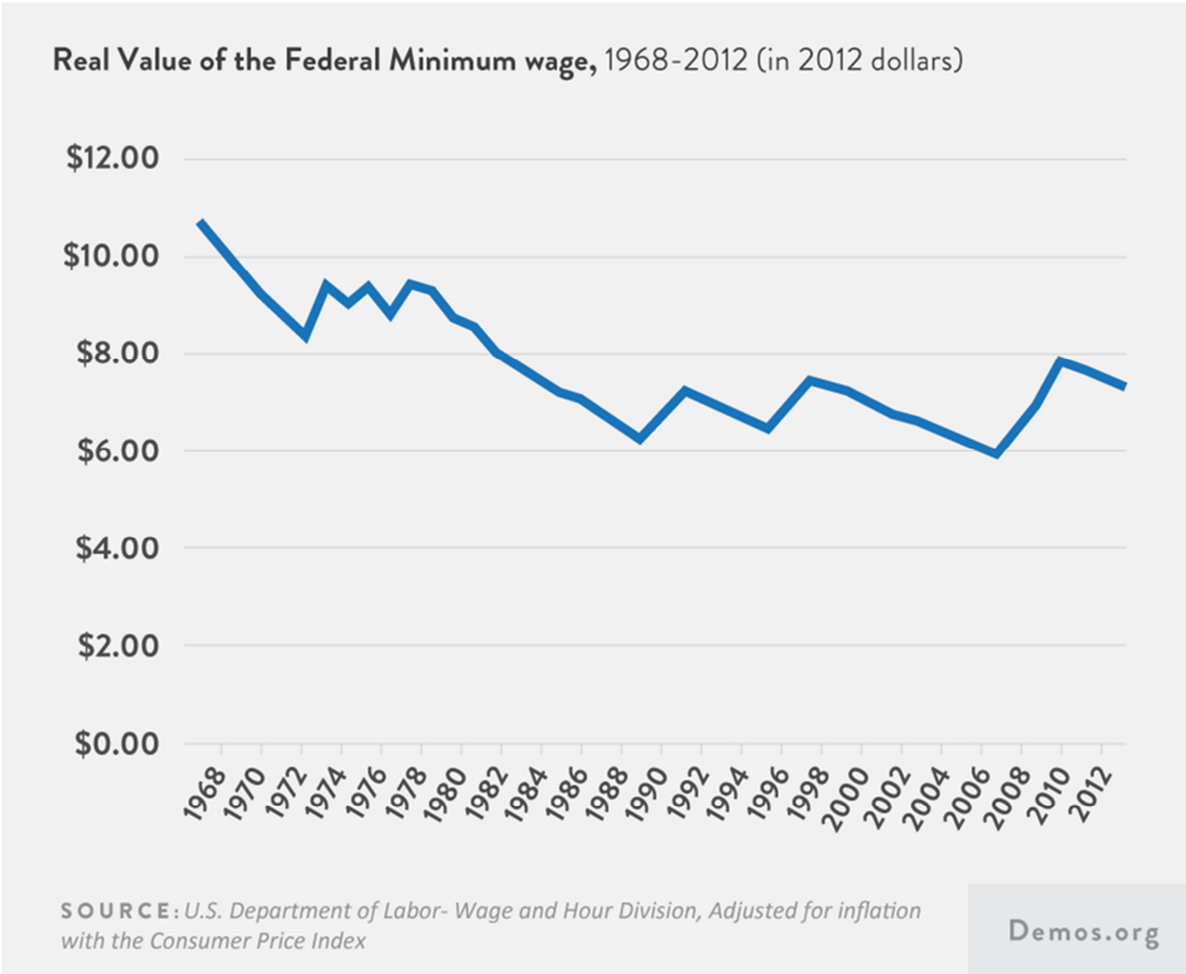
C. Weakened Employee Protections Make It Harder to Work Your Way Into the Middle Class

Americans believe that hard work should be rewarded—people who go to work every day should not then be forced to raise their families in poverty. Yet today nearly a quarter of working adults in the U.S. are laboring at jobs that do not pay enough to support a family at a minimally acceptable level. [25] Offering workforce development and training in order to ease mobility out of low-wage, no-benefit jobs is part of the solution, but fails to fully address the problem. Regardless of how many training opportunities are available to individuals, millions of jobs as home health aides, food service workers, retail salespeople and other currently low-wage occupations will still exist and, in fact, are projected to be among the nation's fastest growing positions in the future.[26]

It is important to acknowledge that the manufacturing jobs of the post-war era that helped build the nation's middle class required no more education than today's low-paid service jobs, and in fact, often less. However, those workers, mostly white and male, were able to bargain with employers to turn low-skilled factory jobs into family-supporting jobs with security and benefits, and the country prospered as a result. It remains to be seen whether today's low-paid workforce, which is disproportionately female, immigrant and people of color – those left out of the original post-war social contract – can likewise succeed in transforming their jobs into decent jobs. If they can, the country as a whole stands to benefit. According to calculations in Dēmos' 2012 report, *Retail's Hidden Potential*, lifting the wage floor at the largest U.S. retailers (those with over 1,000 employees) to a minimum of $12 per hour would lift 1.5 million Americans out of poverty or near-poverty, boost GDP and create a consumer stimulus generating 100,000 – 130,000 jobs over a year and, if costs were passed on, only affect prices by an average of 7 to 15 cents per shopping trip.[27] In addition, Dēmos has found that nearly 2 million of the country's lowest-paid jobs are underwritten by taxpayers through federal contracts, building leases, construction grants, health care spending and small business loans.[28]

The nation must act to ensure that these jobs can, at minimum, lift families above the poverty line and provide basic workplace protections, in order to strengthen the floor for employment in the United States. By lifting the bottom of the nation's labor market, we give working people a firm base from which they can work their way into the middle class. We also put a stronger backstop on the declining job quality of many formerly middle-class occupations.

The current minimum wage of $7.25 an hour is a rate at which it is impossible for working Americans to independently pay their rent, feed their families or get needed medical care—much less save for the types of investments that make it possible to lift oneself into the middle class, like an education, a first home, or the chance to start a business. Indeed, the value of the minimum wage today is nearly 30 percent below its peak in 1968.[29] The majority of minimum wage earners are adults living in low-income households and making significant contributions to their family's total income. Assuming a full-time work schedule, a minimum wage job at the current rate of $7.25 an hour brings in an annual income of $15,080—not enough to lift a family of three with a single working parent over the federal poverty threshold. The federal minimum wage for workers who are eligible to earn tips – such as food service workers, hotel bellhops, and nail service employees – has been stuck at $2.13 an hour for more than 20 years and is nearly 50 percent lower in real value.



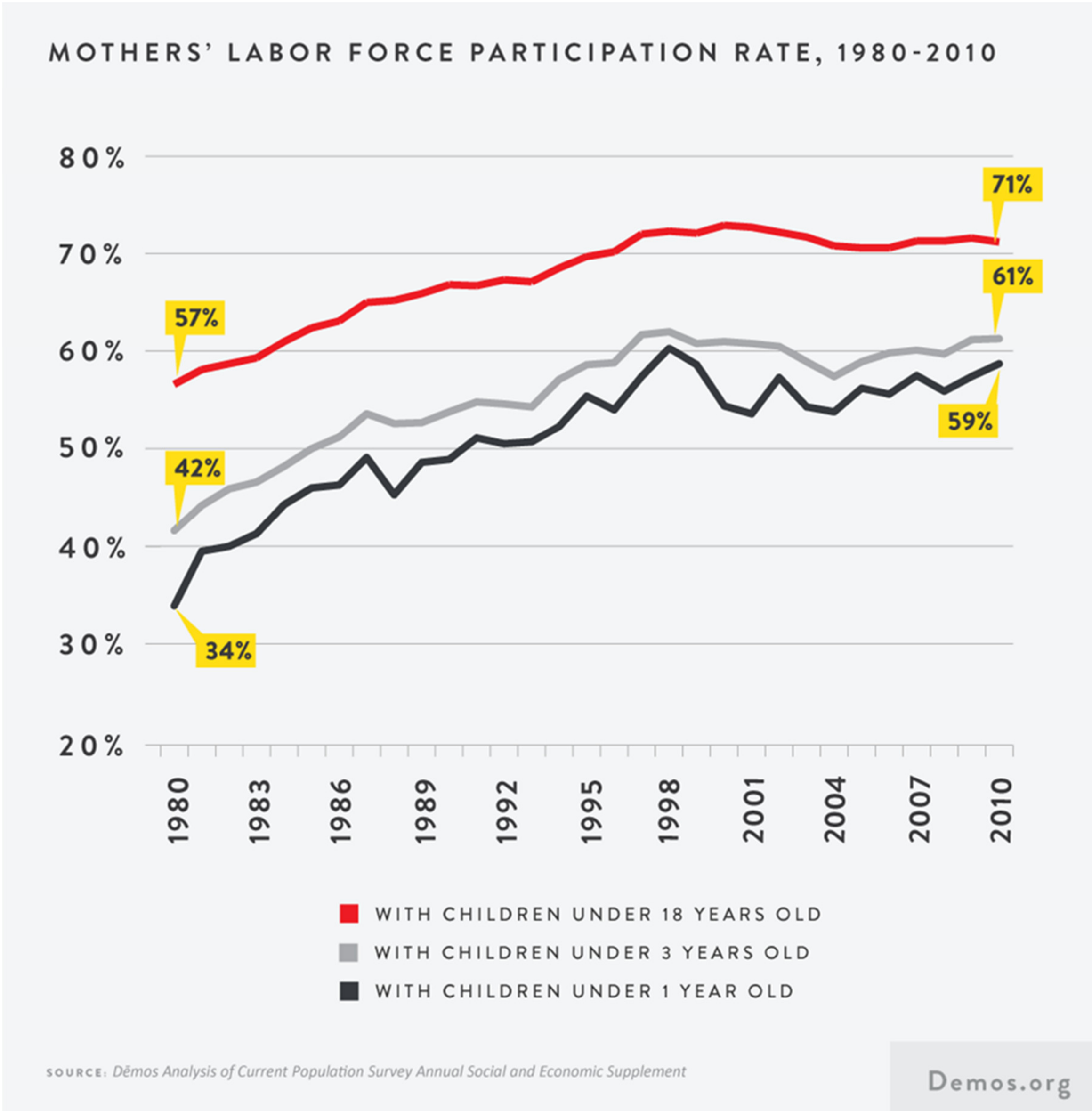
As inadequate as the minimum wage is, millions of American workers bring home even less. Wage theft – the practice of illegally underpaying workers – has become commonplace in the low-wage labor market. A study of employment conditions in America's largest cities found that one in four low-wage workers were paid less than the minimum wage in a given week.[30] Altogether, wage violations (including paying less than minimum wage, making employees work off the clock, pilfering tips, misclassifying employees as independent contractors, and a host of other violations) robbed low-income employees of $2,634 annually on average, out of total average earnings of just $17,616. In addition to harming the families of low-income workers, wage theft drains tax revenue, deprives neighborhood businesses of the income that low-income families would be spending, and puts law-abiding employers at a competitive disadvantage with those who break the law.

In addition, several categories of workers are currently left out of even the nation's most basic labor protections. Domestic workers – a category that includes nannies, housekeepers, and elderly caregivers – and farm workers are among the employees who have been deliberately excluded from the protections of federal and state labor laws, originally due to discrimination against a labor force made up predominantly of women and people of color. Both industries now have a predominantly immigrant workforce and are generally low paid: a survey of domestic workers in New York found 26 percent earn wages that put them below the poverty line.[31] Farm workers experience poverty rates more than double that of other wage and salary workers.[32]

D. Family Policy Lags Behind Changing Families

In today's economy, families increasingly depend on the incomes of all adults in the household, yet many working people also have responsibilities as parents and caregivers. Public policy has not kept up with the changing workforce: without access to paid leave, employees who need flexibility in their work lives to recover from illness or care for family members often face economic hardship.

While still the typical primary caregiver, the number of women in the American workforce has expanded dramatically in the past decades: today nearly two-thirds of American families with children – including both married couples and single parents—have all adults in the workforce.[33] Indeed, without the mass entry of mothers into the workforce, the income picture for the American middle class would be far more dire than it is today. At the same time, 27 percent of American adults reports having caregiving responsibilities for another adult, such as a disabled or elderly relative, and most of these caregivers are employed.[34] The proportion of the workforce with caring for elderly loved ones will continue to grow as the U.S. population ages.



Uncompensated caregiving responsibilities have very real economic consequences for working Americans. For example, an adult caring for his or her aging parent stands to lose as much as $303,880 cumulatively in lost wages, Social Security, and pension benefits due to leaving the labor force early and/or working reduced hours because of caregiving responsibilities, according to one recent estimate.[35] Yet it is the least-paid workers who are least likely to have access to any form of paid leave.[36] Low-wage workers often hold jobs with rigid or unpredictable schedules that further exacerbate conflicts between work and family responsibilities.[37] Faced with the need to cope with a family illness or the birth of child, many workers see no option other than to quit or take time off that they know will result in being fired from their job.[38]

Even short-term illnesses can become major economic setbacks for workers without paid sick days. Two out of three low-wage workers in the U.S. – the employees who can least afford to miss a paycheck – do not have a single paid sick day to recover from illness or take care of sick child or relative.[39] These workers must choose between losing a day's pay or coming to work sick, endangering their own health and the public. Many low-wage workers even risk losing their jobs and health coverage if they call in sick. According to one survey, one in six Americans says that they or a family member have been fired, suspended, punished, or threatened by an employer for missing work due to illness.[40]

The Family and Medical Leave Act, passed in 1993, was intended to provide some security to families facing a sudden illness, providing family care, or welcoming a new child. The law guarantees 12 weeks of unpaid leave to Americans working at businesses with 50 or more employees. Employers cannot replace workers on FMLA leave or retaliate against them in any way. Since its implementation, workers have used FMLA leave more than 100 million times.[41] But four in ten American workers are not eligible because they work for smaller companies or have not been on the job long enough, and millions of Americans cannot afford to take leave without pay.[42] Because only a small proportion of employees receive paid leave benefits directly from their employers, working Americans are still forced to risk their incomes and jobs to maintain their families.[43] Employees of smaller companies lack any federal protection whatsoever.

The U.S. policy of offering only a portion of its workers only unpaid leave to deal with major life events stands in sharp contrast to the rest of the world. For example, 169 countries guarantee some form of paid leave to new parents—the U.S. joins Liberia, Papua New Guinea, and Swaziland on the short list of nations that leave workers alone to cope with this life-changing event and fail to mandate that employers provide paid time off when a child is born.[44]

E. Households Borrowing to Make Ends Meet

Sacrificing today for a brighter future tomorrow has long been a key ingredient of middle-class success. Home equity and savings nest eggs provide a buffer against hard times, and increase household economic stability, helping to fuel middle-class optimism and self-improvement. Household assets have a particularly powerful effect on how well children will do in their own independent lives.[45]

Yet in recent decades, financial deregulation and the aggressive marketing of toxic loans preyed on Americans' aspirations to build assets, fueling an unsustainable housing bubble that began to deflate in 2006. The bubble and the economic crash that followed decimated the wealth of American families, causing more than 2.7 million homeowners to lose their single largest asset to foreclosure and tens of millions of others to see their homes' value drop dramatically.[46] The crash hit those who had carefully saved and invested in their homes as well as speculators who gambled on a rising real estate market. Overall, the nation lost more than $6.5 trillion in home equity since the housing market peaked in 2006.[47] At the same time, the value of retirement savings collapsed as the stock market plummeted, destabilizing hopes for a secure retirement. Not having enough money for retirement became Americans' biggest financial worry.[48] Even as middle-class Americans saw their assets diminished, the dramatic and long-lasting rise in unemployment and underemployment contributed to Americans' difficulty paying back their debts.

The prevalence of asset poverty in America is dramatic. In September 2011, one in three American adults said that if they lost their job they would only be able to pay their mortgage or rent payment for one month or less.[49] A quarter of Americans report having no emergency savings at all, and would have to borrow or turn to family and friends if faced with an emergency car repair, medical bill, or job loss.[50] Only 24 percent of Americans have six months or more emergency savings—the amount recommended by most financial planners. The status quo is equally grim when it comes to homeownership and retirement savings, the assets key to middle-class security. Nearly one in four homeowners owes more on their mortgage than their homes are currently worth.[51] Only half of households have any retirement savings whatsoever. And even those who do have very little saved.[52]

Instead of saving for the future, millions of working- and middle-class Americans are struggling just to service their debts. Dēmos has been chronicling the rapid rise in debt for nearly a decade: as wages stagnated and lagged behind the cost of living, Americans increasingly turned to borrowing – from credit card debt to loans against the value of their homes – to make ends meet and to try to get ahead.[53] The deregulation of consumer lending that began in the 1980s meant that many of these loans included deceptive and predatory terms that were highly profitable for lenders but led to record bankruptcies and debt-to-income ratios. Americans were aggressively marketed high-interest credit cards with hidden fees, abusive payday loans, misleadingly-marketed adjustable rate mortgages, and high-interest subprime loans (even for homebuyers who could have qualified for a better rate). While some of the worst practices unleashed by deregulation have been curbed by regulatory enforcement, the Credit CARD Act of 2009, and the Dodd-Frank Act of 2010, Americans remain vulnerable to unlimited loan interest rates and widespread servicer and debt collector abuse.[54]

Even today, as credit card debt has declined post-crash, 40 percent of among low- and middle-income households carrying credit card debt still rely on their cards to pay basic living expenses because they do not have enough money in their checking or savings accounts, according to Dēmos' own national household survey.[55] Credit cards are also widely used to pay medical bills and cope with spells of unemployment, in effect a high-interest way to make up for gaps in the public safety net.

Fortunately, smart regulation has recently made credit cards a better, fairer financial product for American consumers. The Credit CARD Act of 2009 has benefited millions of households in ways that directly affect their monthly budgets. Dēmos' 2012 "National Survey on Credit Card Debt of Low- and Middle-Income Households" found that the Credit CARD Act has empowered Americans to take control of their finances by increasing the transparency of credit card statements and dramatically reducing excessive fees and penalties.[56] For example, the Act set new standards for clarity and disclosure in monthly billing statements. Credit card statements must now include information on how long it will take to pay off the current balance if consumers pay only the minimum payment amount each month. Ninety percent of households in our survey report they have noticed the change and one-third say they are responding to the new information included on credit card statements by paying their balances down faster. The CARD Act also offers consumers a reprieve from the assorted charges and fees that accompanied many accounts. In 2012, just 28 percent of households reported paying late fees—a significant decline from the one half of indebted households that accrued these fees in 2008. Of those who experienced late fees, only 29 percent saw interest rates go up on that card as a result, down from 53 percent in 2008, and only 14 percent experienced interest rate increases on their other credit cards. Finally, the Credit CARD Act virtually eliminated over-the-limit fees, previously one of the credit card industry's most abusive and profitable practices. Instead of denying transactions that exceeded a consumer's credit limit, credit card companies used to process them and then charge consumers a fee—whether the consumers wanted to go above their credit limit or not. The Credit CARD Act requires consumer authorization for exceeding limits, virtually eliminating these fees.

F. Retirement System Working For Employers, Bankers – Not Retirees

As a result of the drastic shift in our retirement system from traditional defined benefit pensions to defined contribution plans, Americans' retirement security is now more at risk than any time since Social Security was created. **Only half of workers currently have any kind of retirement savings accumulated outside of Social Security.**[57] The vast majority of those who do are offered only the 401(k)-type plans that are an inadequate solution for retirement for multiple reasons. First, they are inordinately expensive. The fees charged by firms that manage 401(k) accounts can cost workers a quarter or more of their retirement savings. According to a widely-cited 2012 study by Dēmos, *The Retirement Savings Drain*, over a lifetime, these fees can add up to more than $155,000 in losses for the average household.[58] Fees are levied on employers' matching contributions as well. In addition, 401(k)s are a poor substitute for traditional pensions because they place the burden of investment risk exclusively on individual workers. After working throughout their lives, older Americans relying on individual retirement plans could lose their savings in a market crash, invest so conservatively that they ensure themselves weak returns, or outlive the funds they have been able to save. Pension-style plans, meanwhile, ensure security by spreading these risks among many plan participants over a long time horizon—no individual puts their entire retirement in danger. Yet in 2012, just 17% of private sector workers participated in a traditional pension as employers have opted for the low-cost 401(k) option instead.[59]

G. The Debt-for-Diploma System Burdens the Future Middle Class

Student loan debt is another area of growing economic concern. Due to rising college costs and diminishing grant aid, students are increasingly reliant on interest-accruing loans to pay for college, a dramatic shift in norms over the course of a single generation. In 2011, 66 percent of college seniors (at public or non-profit schools) graduated with debt, with borrowers carrying an average burden of $26,600 (up from only 33% of students in 1992).[60] Graduates of for-profit schools are even deeper in debt: 96 percent graduated with debt and their average was $33,050 as of 2008.[61] All told, borrowers now owe more than $1 trillion in student loan debt.[62] And there are increasing signs that student loan borrowers are becoming unable to repay this debt: $113 billion in student loans are more than 90 days delinquent on payments, and in serious risk of default; this represents an astonishing 31 percent of all student loan balances currently in repayment status.[63] Already student debt is causing young Americans to delay building the financial assets that are necessary to middle-class security, including purchasing homes and saving for retirement.[64] And the rising rate of defaults on student debt is impairing the credit of many Americans as well, making it more difficult to borrow or find employment among the nearly half of employers who now screen credit histories during hiring.[65]

The consequences of student loan debt can have a profound impact on the economy as a whole. According to a forthcoming Dēmos study, $53,000 in education debt (the average amount held by a dual-headed college educated household) leads to a net worth nearly $218,000 lower than if the household had not been forced to borrow to pay for their college education. Over time, the indebted household will end up with a net worth 17% lower than a similar non-indebted household. Over the economy as a whole, the $1 trillion in total outstanding student loan debt will lead to $4 trillion in lifetime lost assets for indebted households, not even accounting for the heavy impact of defaults.[66]

III. THE MACRO-ECONOMIC VIEW: FOUR MEGA-TRENDS INADEQUATELY ADDRESSED

A. Increasing U.S. Diversity Without a Commitment to Equity

A major societal trend with implications for economic policy has been the rapid demographic change over the past four decades. After the Immigration Act of 1965 removed race-restrictive entry quotas, the share of immigrants from non-European countries climbed.[67] The white population was 83 percent in 1970 and 76 percent in 1990; it now stands at 64 percent.[68] By 2042, whites will no longer be a majority in the US.[69] Already, 43 percent of Americans under the age of twenty-four are not white.[70]

Ironically, the country has only grown more diverse since the end of the Civil Rights Movement. American society has been experiencing rapid demographic change with only intermittent leadership attention to the challenges of coalescing a sense of common national purpose and identity out of a people with roots from every nation on the planet. While our discourse has recently embraced the idea that society can be color-blind, the facts belie the notion. In a 2011 *Associated Press* survey, 51 percent of all Americans expressed *explicit* anti-black attitudes, and 52 percent of non-Hispanic whites expressed anti-Hispanic attitudes.[71] The incidence of *unconscious* prejudice, which can affect decision-making in ways that are hard to detect by the actors themselves, much less those who would enforce anti-discrimination laws in the courts, are even higher. For example, Harvard University's Implicit

Association Test found that 88 percent of white people had a pro-white or anti-black implicit bias, and more than two-thirds of non-Arab, non-Muslim respondents displayed implicit biases against Arab Muslims.[72]

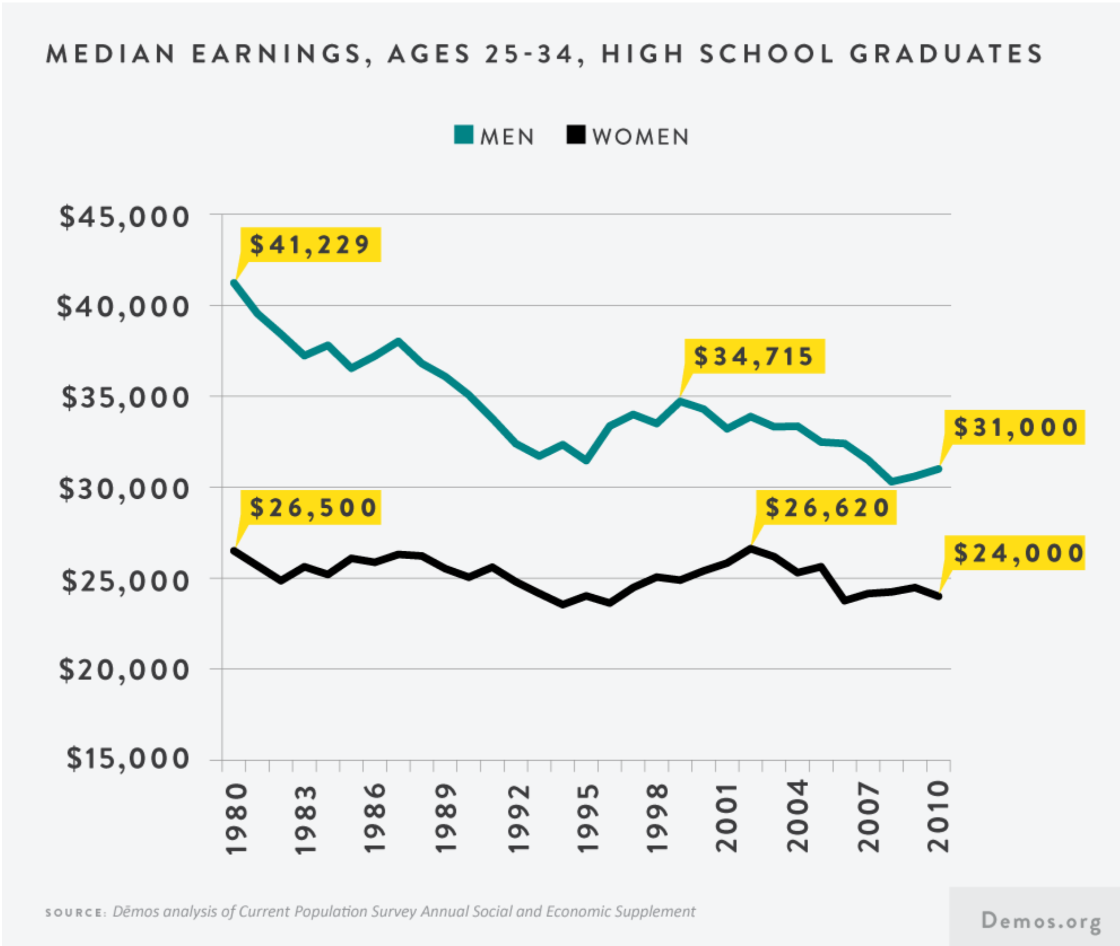
These implicit and explicit prejudices have real economic consequences for our diverse population. Approximately 3.7 million fair housing violations occur annually against African Americans, Latinos, Native Americans, and Asian Pacific Islanders as they seek to rent and purchase housing. Yet, HUD processed only 2,123 complaints in 2008.[73] In financial services, after decades of credit unavailability due to private and government redlining, the 1990s and 2000s saw communities of color experience a wealth-stripping phenomenon known as reverse redlining. Lenders and brokers targeted segregated neighborhoods with under-regulated financial products, particularly mortgages with features such as exploding adjustable rates, deceptive teaser rates, and balloon payments. Households of color were more than three times as likely as white households to end up with riskier loans.[74] Federal policymakers and regulators declined to protect these communities for years as foreclosures rose, even acting to pre-empt state anti-predatory lending efforts in the 2000s.[75] The resulting loss of wealth – 66 percent average loss for Latino households, 53 percent for African Americans compare to just 16 percent for white households[76] – stands as a grave and lasting blight on the future of our diverse middle class. For every dollar in assets that the typical white family owns, the typical Latino family has just twelve cents, and the typical African American family has only ten cents.[77] African Americans are twice as likely as whites to have zero or negative net worth.[78]

Finally, numerous studies have shown that job discrimination plays a role in the higher incidence of unemployment among non-whites (while the unemployment rate for whites is 6.7 percent, it is 13 percent for blacks and 9 percent for Hispanics.)[79] As just one striking example of this literature, a 2005 Princeton University study revealed that employers were more likely to offer a callback to white job applicants with criminal records than to well-qualified African American job-seekers with no criminal history.[80]

B. "Free Trade" Globalization Trades Away Middle-Class Jobs

The United States has lost millions of middle-class jobs as a result of the particularly labor-competitive form of globalized trade that policymakers have aggressively adopted in recent decades. Our trade policies have been written and enforced in ways that advantage multi-national firms seeking lower-cost labor, directly resulting in fewer and lower-paying jobs for the American middle class. Increasingly, white-collar jobs are also moving overseas as China, India, and other nations field more educated workers who can do the jobs now done by U.S. scientists, accountants, lawyers, and doctors. As a historic champion of a more open global economy, the United States has often failed to take a hard look at how this system puts U.S. living standards at risk and develop policies to balance the prerogatives of multi-national corporations and the American middle class. Worse, the U.S. has often done little as other countries, like China and Japan, have played by a different set of trading rules that put the U.S. at a disadvantage. And we have repeatedly been silent in the face of abuses of worker rights, even when these abuses are perpetrated by close trading partners who are bound by Free Trade Agreements to uphold basic labor standards.

Over the past few decades, Increased trade with low-wage countries has been responsible for fully a third of the depression in wages of non-bachelors degree holders relative to degree-holders since 1979; tracking just since 1995 (one year after the North American Free Trade Agreement came into force), low-wage country trade accounts for over 90 percent of the wage depression.[81]

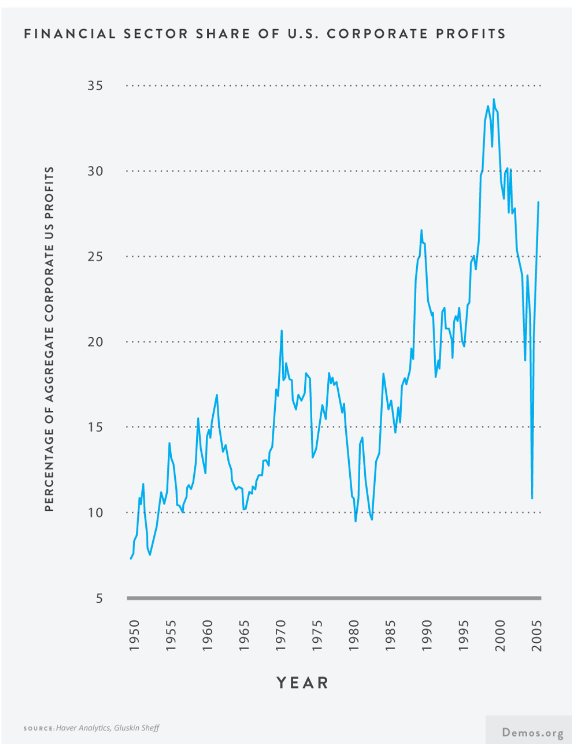


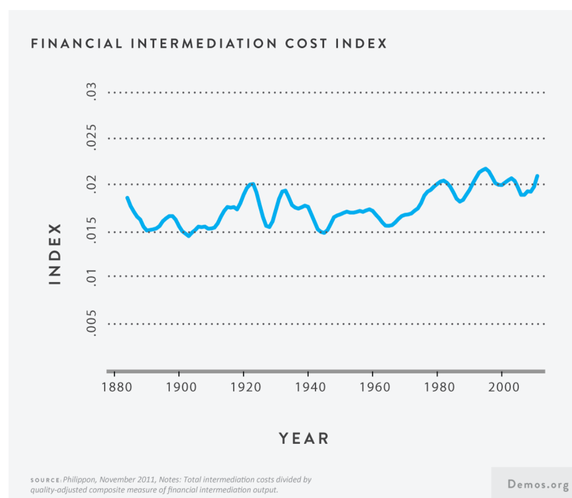
The downward pressure on wages affects not just workers who are directly competing with foreign production workers. When multi-national firms layoff American manufacturing workers in favor of less expensive employees in our trading partner countries, these laid-off workers compete for lower-paying jobs in non-offshorable sectors, such as landscaping or food service.[82] Thus the effect of our trade policy ripples throughout the working and middle class, beyond just those directly affected by plant closings.

The broader economic dynamic of high corporate profits amidst weak job growth and declining wages for most Americans is in large part a result of our global trade policies. The North American Free Trade Agreement turned a slight trade surplus with Mexico into the current almost $100 billion deficit, which has cost nearly 682,900 jobs.[83] The permanent normalization of trade relations with China has cost over 2 million American manufacturing jobs between 2001 and 2011.[84]

C. The Financialization of the Economy

The deregulatory movement that transformed consumer finance also revolutionized commercial and investment banking and trading in ways that have dramatically increased finance's share of the U.S. economy, from 3.8 percent to 8.2 percent of GDP.[85] This growth of the financial sector was not because of increased demand for financial services, which only grew by 4 percent in the last decade.[86] Financial sector profits have also increased as a share of total corporate profits, with the non-financial sector transferring increasing income to the financial sector. Research from New York University's Stern School of Business shows that the cost of financial intermediation – the critical function of transferring capital from investors to productive uses in the economy – has actually *increased* since deregulation. The reason appears to be an enormous increase in trading.



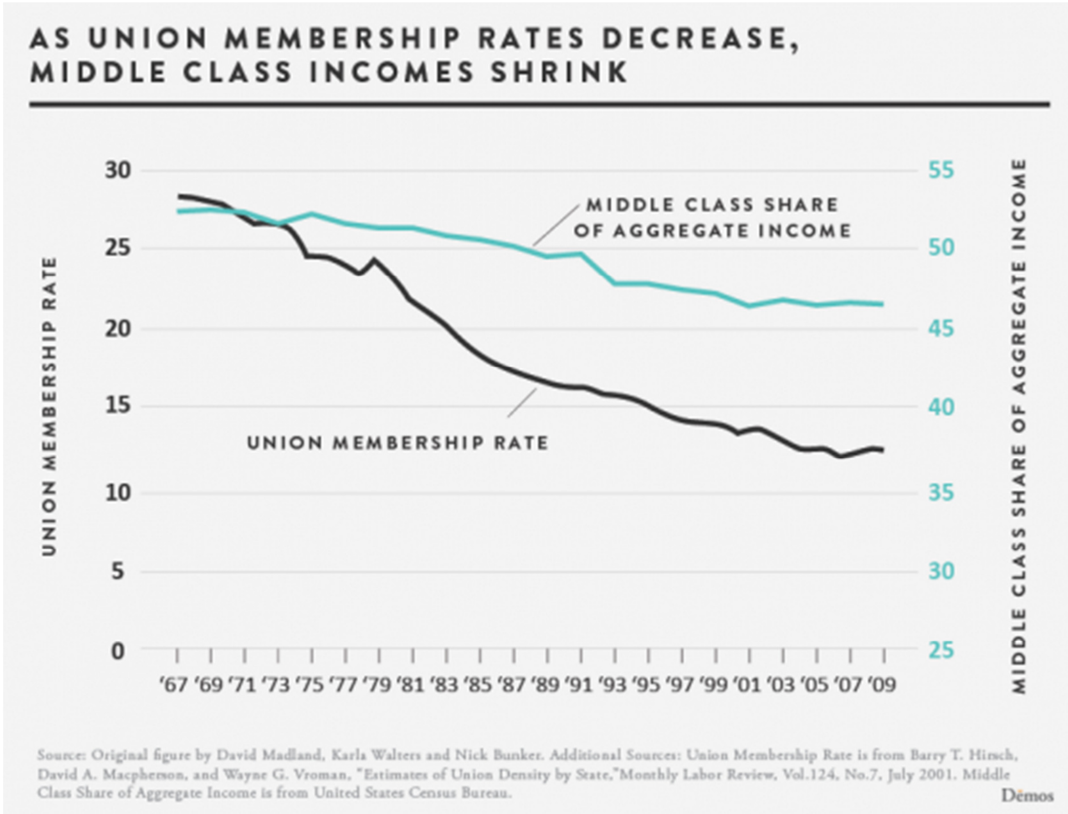


The relative growth of the financial sector is not necessarily a problem if the services provided by the sector provide commensurate value to the overall economy. With the cost of intermediation rising despite technological advances – and with economic performance worsening, particularly as measured by the employment recovery time post-recessions – it becoming apparent that value is being simply reallocated to the beneficial owners of financial firms. This drains resources that could be put to uses that would increase the productivity of the overall economy and create jobs and wealth. Dēmos Senior Fellow Wallace Turbeville has estimated that the excessive wealth transfer to the financial sector is in the range of $635 billion per year.[87]

In fact, the growing financialization of the U.S. economy and its impact on publicly traded corporations undermines the middle class in a range of ways. A focus on "shareholder value" has trumped all other goals for the modern corporation since the 1980s – a shift that Wall Street helped usher in through a relentless search for profits that included leveraged buy-outs, mergers and acquisitions, and private equity deals, as well as a more aggressive quest for short-term trading gains. This narrow focus on the bottom line has undermined American workers and the middle class by justifying any cost-cutting measures that can boost quarterly earnings, including layoffs, foreign outsourcing, eliminating benefits, and defeating union drives. Nearly all the forces typically blamed for rising inequality—globalization, new technologies, declining unionization – have had a more devastating impact on U.S. living standards thanks to Wall Street's imperative to put stock price above all else.

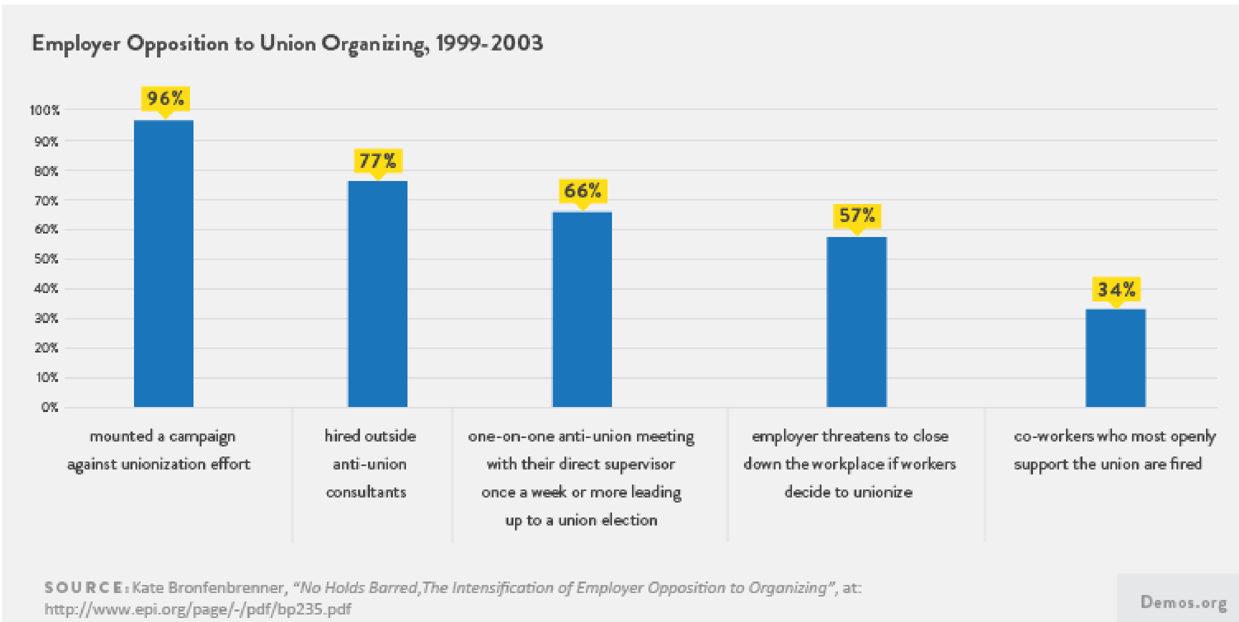
D. Increased Employer Resistance to Employee Collective Bargaining

Organized labor has traditionally played a critical role in ensuring that middle-class working people receive a larger share of the economy's gains. Unions bargain collectively for better wages and benefits for their members. But unions also raise compensation for workers they do not represent: a recent study by Bruce Western and Jake Rosenfeld finds that unions substantially boost compensation for non-union employees in addition to their own members by influencing non-union employers to raise wages in order to avoid unionization; by promoting norms of fair pay, and by lobbying for public policies that raise wages.[88] In short, high unionization boosts the share of economic growth going to working people rather than to corporate profits or the very highest earners.



However, the percentage of Americans belonging to unions has declined steadily, falling by 44 percent between 1983 and 2012, so that today, just 6.6 percent of private sector workers belong to unions. Western and Rosenfeld estimate that **the decline of unionization has contributed as much as third to the growth of income inequality among working men since 1973.**[89]

One reasons for union decline is growth of employer opposition to unionization and the weakening of laws intended to protect employees' right to organize. Today, the system meant to defend the rights of employees to form unions no longer functions. Weak and slow-moving enforcement of labor rights allows employers to routinely violate the law, threatening and harassing employees who attempt to organize. An analysis of union elections from 1999 to 2003 revealed that when workers attempted to organize a union, 96 percent of employers mounted a campaign against their effort.[90] Three quarters of employers hired outside anti-union consultants. So while workers might wish to join unions, they often fail to persist in the effort after an intimidating one-on-one anti-union meeting with their direct supervisor once a week or more leading up to a union election (a tactic employers used in 66 percent of organizing campaigns), after their boss threatens to close down the workplace if workers decide to unionize (57 percent of organizing campaigns), or after those co-workers who most openly support the union are fired (34 percent of organizing campaigns).



IV. THE DECLINE OF THE MIDDLE-CLASS DEMOCRACY

We have reviewed the data indicating that the middle class is struggling and that upward mobility is elusive for many Americans. Meanwhile, evidence abounds that the U.S. political system is increasingly dominated by wealthy interests, and strong, bi-partisan majorities of the public believe the deck is stacked against ordinary voters.[91] What is less understood, however, is the interplay between these two problems and how a growing chasm of income and wealth translates into diminished opportunities for Americans lower down the economic ladder.

As Dēmos outlines in our foundational report, *Stacked Deck: How the Dominance of Politics by the Affluent and Business Undermines Economic Mobility in America*, this tilting of political life toward those the well-connected and already-wealthy has served to undermine economic mobility as a whole. As private interests have come to wield more influence over public policy, with ever larger sums of money shaping elections and the policymaking process, our political system has become less responsive to those looking for a shot to improve their lives and move upward. This is in part because wealthy interests are keenly focused on concerns not shared by the rest of the American public and often oppose policies that would foster upward mobility among low-income citizens, such as raising the minimum wage.

A. Different Incomes, Different Priorities

Significant differences between the wealthy and the general public exist in such areas as tax and budget, trade and globalization, regulation of business, labor, the social safety net, and the overall role of government. the general public is more open than the wealthy to a variety of policies designed to reduce inequality and strengthen economic opportunity, including: raising the minimum wage, increasing the Earned Income Tax Credit, providing generous unemployment benefits, and directly creating jobs. For example, as the table below reports, only 40% of the wealthy think the minimum wage should be high enough to prevent full-time workers from being in poverty, while 78% of the general public holds this view. Affluent voters are also less supportive of labor unions and less likely to support laws that make it easier for workers to join unions—even as research shows that unions are crucial to enabling people to work their way into the middle class. Governors elected with strong support from affluent voters and business groups have prioritized tax cuts over funding for primary and secondary public education.[92]

Jobs & Income Policy Preferences of Affluent vs. General Public

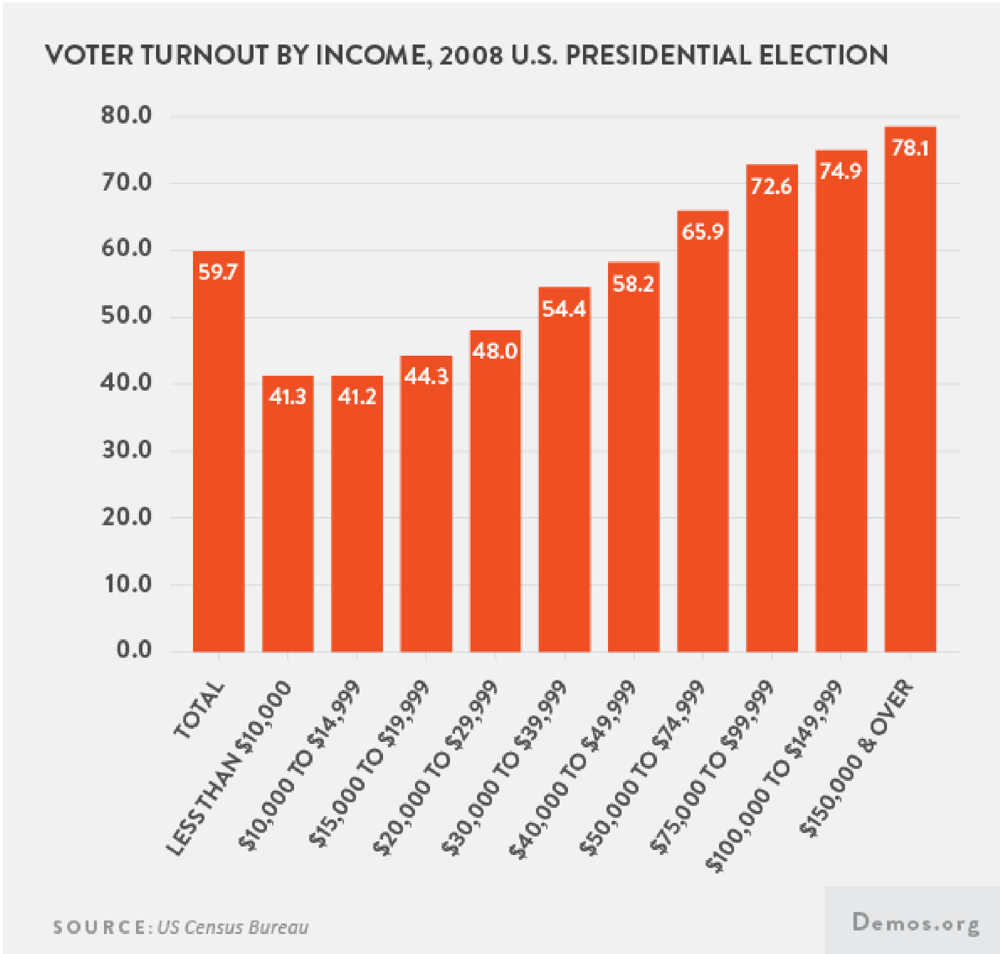
Policy	% Wealthy in Favor	% General Public in Favor
Government must see that no one is without food, clothing or shelter	43%	68%
Minimum wage high enough so that no family with a full-time worker falls below official poverty line	40%	78%
The government should provide a decent standard of living for the unemployed	23%	50%
The government in Washington ought to see to it that everyone who wants to work can find a job	19%	68%
The Earned Income Tax Credit (EITC) should be increased rather than decreased or kept the same	13%	49%
The federal government should provide jobs for everyone able and willing to work who cannot find a job in private employment	8%	53%

SOURCE: *Benjamin I. Page, Larry M. Bartels, and Jason Seawright, "Democracy and the Policy Preferences of Wealthy Americans," Perspectives on Politics, 11:1, pp. 51-73.*

Demos.org

B. Unequal Political Voice

These differences in policy preference by class create distortions in our policymaking precisely because the affluent are over-represented among both donors and voters (not to mention lobbyists, media influencers and other categories with outsized influence in our political system). Working and middle-class citizens are more susceptible to the disenfranchising effects of our needlessly bureaucratic system of voter registration, a system which leads to 51 million eligible Americans being unregistered to vote.



Non-wealthy Americans are even less likely to contribute to political campaigns. Just 0.07 percent of the U.S. population made campaign donations of $2,500 or more in 2012, yet this group had contributed a total of $1.4 billion to both presidential candidates.[93] In contrast, the total haul from a much larger pool of donors contributing between $200 and $2,500 was just $485.7 million.[94] The donor pool does not reflect the electorate's diversity, either: over 90 percent of donations in the 2012 election came from majority white neighborhoods while only four, three and less than one percent came from Latino, African-American and Asian neighborhoods respectively.[95] This unequal political voice distorts elected officials' representation of citizens' actual policy views, given how many non-affluent Americans favor policies to create new pathways to the middle class.

For example, despite the important role a strong minimum wage plays in economic mobility, Congress has allowed the wage to decline steadily in real terms over the past four decades. (Meanwhile, it has repeatedly lowered capital gains tax rates to benefit the wealthy, despite majority opposition to preferential treatment of wealth income over work income).[96] Even with the series of minimum wage increases, adjusting for inflation shows that the real value of the federal minimum wage fell roughly 30 percent since 1968**.** If the minimum wage increased at the same rate as inflation, it would be equal to $10.69 per hour, far above the current $7.25.[97]

This slide in the minimum wage should be no surprise when one takes a close look at the data on lobbying expenditures. The data suggests that low-wage workers, who constitute as much as a fifth of the U.S. labor force, have very few paid advocates in the corridors of Washington. Labor unions often speak up for these Americans, but otherwise, lobbying by groups that explicitly advocate for low-wage workers or non-elderly low-income people is so small that it doesn't even merit its own category in records compiled by the Center for Responsive Politics. This lobbying imbalance exacerbates the problem of elected officials being accountable to wealthy campaign contributors by ensuring that once in office, these officials are exposed to a constant flow of information supporting the donor class' views and positions.

The most important study in this area is by the political scientist Martin Gilens, *Affluence and Influence: Economic Inequality and Political Power in America*. By comparing the policy preferences of different income groups with actual policy outcomes, he was able to determine how much influence different groups have had over policy. Gilens writes of his findings: "*The American government does respond to the public's preferences, but that responsiveness is strongly tilted toward the most affluent citizens. Indeed, under most circumstances,* ***the preferences of the vast majority of Americans appear to have essentially no impact on which policies the government does or doesn't adopt.***" Gilens shows that, in many cases, public policy outcomes would have been quite different if Congress and the President had been equally responsive to all income groups.

V. Policy Recommendations

A. Strengthen Pathways to the Middle Class

Building a stronger middle class that fully reflects America's diversity will require policies that:

- I*nvest in human capital and education.* Investing in education and human development, ensuring that future generations are well cared for and well educated, and that working people have the time they need to be caregivers to the people they love is a key starting point for moving millions of Americans into the middle class. For example, employees who need flexibility in their work lives to care for a child or other family member often face economic hardship. A system of family leave insurance – like the successful model in California – would help insure that the birth of a child no longer leads to poverty. Investing in affordable, high-quality child care and early education would reduce educational gaps and set the groundwork for success long after school. Finally, the nation's financial aid system should be revamped to ensure that every college-qualified student has access to higher education without taking on ruinous debt.

- *Increase employees' power in the workplace.* Since the 1970s, a growing share of share of national income has gone to corporate profits while the proportion going to labor compensation has decreased. This shift has greatly accelerated in the last decade. To reverse the trend, employees need more power in the workplace. The bottom of the labor market should be bolstered by raising the minimum wage, guaranteeing paid sick days to working people, and ensuring that worker protections are effective and apply to everyone. At the same time, weakened labor laws should be reconstituted so that Americans can exercise their right to organize unions and negotiate for pay and benefits that will allow them to enter the middle class. Finally, the U.S.

should create a short-term public jobs program and long-term public investment plan to promote full employment.

- *Use tax policy to strengthen and expand the middle class.* Too often, the nation's tax policy bolsters the already wealthy rather than supporting Americans trying to work their way into the middle class. A more progressive tax system could increase economic mobility and reduce inequality. The Earned Income Tax Credit and the Child Tax Credit, which benefit low-income workers and their families, should be expanded. To ensure that the home mortgage tax credit helps middle-class families rather than subsidizing the super-wealthy, its value should be capped. Meanwhile, taxes on capital gains and dividends – income which disproportionately flows to the wealthiest Americans – should be increased, and corporate tax loopholes should be eliminated. To reduce the transfer of tremendous wealth from one generation to the next, estate taxes should be increased.

- *Enable Americans to build assets.* Owning assets – from a retirement account, to a home, to an emergency savings fund – is crucial to middle-class security. Yet American families have lost trillions of dollars in home equity as a result of the housing crash, and one in three say that if they lost their jobs, they could not make housing payments for more than a month. To help distressed homeowners, a new public agency should be established to acquire and refinance under-water mortgages. To increase retirement security, Social Security should be safeguarded and supplemented with a system of voluntary annuitized pensions that guarantee a minimum rate of return. And to ensure that the predatory lending that drains pocketbooks is halted, federal usury limits should be established for all forms of lending and bankruptcy laws should be rewritten to provide greater relief to student borrowers and homeowners.

B. Limit the Economic Policy-Distorting Influence of Money in Politics

To achieve and preserve these reforms, we must also limit the influence of money in politics. One critical way to reduce the disproportionate influence of the wealthy on public policy is to create a system for financing election campaigns that lives up to the idea of one-person, one-vote by leveling the playing field between rich and poor and giving every American a strong voice. Such a system requires several key reforms:

- *Amend the U.S. Constitution to restore the ability of the people to enact common-sense, content-neutral restrictions on political contributions and spending to promote political equality.* Congress should propose an amendment or package of amendments to the U.S. Constitution to clarify that the First Amendment was never intended as a tool for use by corporations and the wealthy to dominate the political arena.

- *Enact strict limits on the amount that wealthy individuals and interests can contribute and spend on U.S. politics.* Millionaires, billionaires, and large corporations have no inherent right to drown out the voices of the rest of the population. After amending the Constitution or educating the next generation of Justices, Congress and states should sharply limit contributions and spending to level the playing field for all Americans.

- *Match small contributions with public resources to empower small donors and help grassroots candidates run viable campaigns.* Low-dollar contributions from constituents should be matched with public funds, and candidates who demonstrate their ability to mobilize support in their districts should receive a public grant to kick start their campaigns. These measures would amplify the voices of non-wealthy citizens, encourage average Americans to participate in campaigns, change candidate incentives, and enable aspiring public servants without access to big-money networks to run viable campaigns for federal office.

- *Encourage small political contributions by providing vouchers or tax credits.* Encouraging millions of average-earning Americans to make small contributions can help counterbalance the influence of the wealthy few. Several states provide refunds or tax credits for small political contributions, and the federal tax code did the same between 1972 and 1986. Past experience suggests that a well designed program can motivate more small donors to participate. An ideal program would provide vouchers to citizens up front, eliminating disposable income as a factor in political giving.

- *Require greater transparency around political spending.* Congress should close existing loopholes in disclosure laws so that all money spent to influence U.S. elections (above a reasonable threshold) can be traced back to its original source. Allowing citizens to "follow the money" would help voters make informed choices and prevent wealthy interests from sponsoring nasty or misleading adds while insulated from public accountability.

- *Strengthen rules governing lobbying to reduce the influence of well-heeled special interests.* Congress should strengthen disclosure around lobbying and implement stronger revolving door limits that prevent former elected officials from approaching former colleagues for several years.

C. Address Class Gaps in Voting by Expanding the Freedom to Vote

A legitimate government "of the people, by the people, and for the people" must vigorously promote and protect the freedom to vote so that all eligible persons can participate in self-government. But today, too many bureaucratic barriers still block the ability of millions of eligible persons to register and vote, and too many politicians are actively seeking to shrink the electorate with unnecessary and discriminatory restrictions on political participation. Reversing this trend entails:

- *Removing Barriers to Registration and Voting:* Voter registration is a particularly important target for reform, given that almost one of four eligible Americans was not registered to vote in the period leading up to the 2012 elections. In particular, the following should be adopted:

  - *Same-Day Registration:* Implementing Same Day Voter Registration, which allows eligible individuals to register and vote at the same time, is a proven method to increase participation and turnout among eligible voters.[98] States with Same Day Registration record consistently higher voter turnout and participation than states without it.[99]

  - *Expanding Agency Registration and Automate the Registration Process:* States should modernize the voter registration system to remove administrative burdens and costs by taking the initiative to place eligible voters on the registration rolls rather than leaving the burden on individual citizens to navigate the voter registration process.

  - *Making Registration Permanent and Portable:* Almost 36.5 million US residents moved between 2011 and 2012.[100] Low-income individuals are twice as likely to move as those above the poverty line. Voter registration should become portable and permanent for persons who move within a state, by automatic updates to registration records as citizens change their address.

- *Protections Against Intimidation and Wrongful Challenges* States should put measures in place to protect voters from intimidation tactics, including clear rules and procedures to protect voters from improper removal from voting rolls, intimidating behavior at polls, and deceptive practices that discourage voting.

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