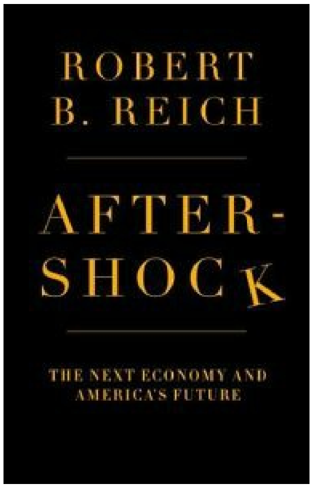

Book Aftershock

The Next Economy and America's Future

Robert B. Reich
Knopf, 2010

Recommendation

Politicians and pundits like to blame Americans' excessive debt for plunging the economy into recession in 2008. But middle-class earners had a good reason for borrowing: Their incomes have dropped since 1980, during a period when the US economy's gains increasingly went to the wealthy. According to former US Secretary of Labor Robert B. Reich, the only way out of the doldrums now is to redress that imbalance and help the middle class resume its role powering the economy. In this book, Reich explores the dire consequences of failing to get workers back to work. Without seeming particularly worried about stirring controversy, he offers his suggestions for restoring the "basic bargain" of shared prosperity: People work and the government supports good jobs backed by a "safety net" of public services. *BooksInShort* recommends Reich's sobering review to those studying ideas about what's broken and how to fix it.

Take-Aways

- America's working middle class powered the "Great Prosperity," 1947 to the late-1970s.
- But economic gains since 1980 largely accrued to the wealthy, while the middle class struggled to stay abreast.
- Globalization and high-tech advances meant lost jobs, less saving and more borrowing.
- To "cope" with their reduced purchasing power, middle-class people worked more hours and more women went to work.
- Free market policies loosened safety nets like unions and unemployment insurance.
- Wealth does not trickle down enough to keep the American economy productive.
- "Full employment" fuels the consumption that the US economy needs to recover.
- Focusing on the "financial economy" led politicians to ignore the "real economy," which was harmed by job loss and the ensuing drop in consumer demand.
- Government must restore the "basic bargain" that keeps the middle class productive by "giving workers a proportionate share of the fruits of economic growth."
- Failure to do so may result in more political upheaval and extremism.

Summary

The Rich Got Richer...

Excessive consumer borrowing in the US gets the lion's share of the blame for the crash and subsequent recession in 2008. True, massive mortgage lending at low rates did contribute to the speculative bubble in real estate, but "high debt is a symptom rather than the cause" of the recession. The growing income disparity between the rich and the middle class is really at fault. Middle-income wages failed to keep up with a growing economy; in fact, "a larger and larger portion of the economy's winnings had gone to the people at the top." Borrowing became the only way for most Americans to maintain their living standards.

> "The problem was not that Americans spent beyond their means but that their means had not kept up with what the larger economy could and should have been able to provide them."

Income levels historically have swung from concentrations of prosperity among the richest to more even distributions among the working and the wealthy. At the beginning of "modern American capitalism" from 1870 to 1929, wealth consolidated at the top. After the Great Depression and, later, after World War II, prosperity spread around to lift almost everyone. But by the late 1970s, incomes began to coalesce again at the peaks, leaving the poor and middle classes with a smaller share.

At that point, "the double whammy" of globalization and technological advancement began to cut into US jobs. Rather than secure the working person's "safety nets" of education and unions, politicians removed such safety nets based on their belief in deregulation and in the power of the "free market" to redress the loss of jobs and wages. This increasing income disparity explains the slow recovery following the 2008 recession and presents a "social and political predicament" that augurs "upheaval and reactionary politics" if not addressed.

The "Basic Bargain"

The US economy needs the purchases generated by a working middle class. The basic bargain is clear: A virtuous financial circle of decently paying jobs leads to demand for goods and services, generating employment and consumerism. When economic problems break that circle, government support should temporarily fund the economy to reinstate jobs and create demand. This would stimulate recovery and maintain the core fact that the US must keep its middle class productive by "giving workers a proportionate share of the fruits of economic growth."

> "The fundamental economic challenge ahead is to lift the means of middle-class Americans and reconstitute the basic bargain linking wages to overall improvements."

As Mark Twain once quipped, "History does not repeat itself, but it sometimes rhymes." Bear that in mind as you reflect on how policy makers' understanding of the Great Depression enabled them to prevent 2008's "Great Recession" from worsening into a depression. But they ignored the underlying cause of both crises – increased concentrations of wealth in the hands of a few.

> "None of us can thrive in a nation divided between a small number of people receiving an ever larger share of the nation's income and wealth, and everyone else receiving a declining share."

Middle-class incomes have stagnated since the 1970s and started dropping in 2000, yet the US economy has grown immensely since 1980. If every American had shared in that growth equally, each person would be "60% better off." Soaking up this excess, the ascendant rich invested in a relatively "limited range of assets," sending stocks and real estate soaring. Simultaneously, to maintain their shrinking living standards, the middle class saved less. Savings rates of 9% to 10% in the 1950s fell to 2.6% by 2008 – and people borrowed more. "Household debt (including mortgages)" increased from 55% in the 1960s to 138% in 2007. If the growing economy's financial returns had gone more to the poor and middle classes, and less to the rich, borrowing would not have reached "unsustainable" levels, and the stock and real estate bubbles would not have materialized.

> "At what point does an economy imperil itself politically, as large numbers conclude that the game is rigged against them?"

Wealth does not trickle down sufficiently to keep the US economy running smoothly. Despite conspicuous consumption on lavish mansions, fine art collections and yachts, the rich don't spend nearly enough of their money to create the "multiplier effect" of generating enough jobs for the lower classes. What the rich don't spend, they invest in speculation, which leads to the boom-bust cycles so prevalent in recent decades. While politicians focused on the "financial economy" by cheering a climbing stock market, relying on Wall Street to lead the economy and bailing out banks, they ignored the problems of the "real economy" – the failing middle class and the drop in consumer demand – which have more far-reaching effects on the US's economic stability.

"The Great Prosperity"

For 30 years after World War II, Americans' wages grew steadily; yearly household incomes went from $25,000 to $55,000, with the middle class enjoying proportionately more of that increase. Productivity kept the US economy humming, and government supported jobs and workers by legislating overtime pay, unemployment insurance, Social Security, Medicare and Medicaid. With that safety net, Americans had the "peace of mind and security" to enjoy their earnings. Subsidized mortgages and tax deductions on mortgage interest made owning a home a reality. The government-funded national highway system connected those homes to job sites while cutting transportation costs. Improved access to higher education through public colleges and the GI Bill for returning veterans helped more people advance. Everything from transistors and lasers to computers and the Internet – all developed under government aegis – contributed to affluence and innovation. High marginal tax rates didn't hinder investment and growth in the 1950s.

> "An economy functioning well below its capacity is a terrible waste of all our resources, especially of our people; a society riven by resentment is potentially unstable."

But by the late 1970s, while productivity continued to surge, jobs and wages fell behind in the wake of globalization and "automation." In fact, "America has lost at least as many jobs to automated technology as it has to trade." Outsourcing to cheaper labor markets took repetitive work from the US, and left behind jobs that paid less than the old ones. But rather than step up to maintain its side of the bargain, government began diminishing the safety net. By 2007 unemployment insurance took care of only 40% of those without jobs. Tax cuts for the wealthiest and tax havens for corporate earnings cut government funding of infrastructure and social services. Firms began to lay off people, and to shift risk and expenses onto workers through increasing health care costs and diminishing pensions. Even more ominously, "Washington deregulated Wall Street while insuring it against major losses." The federal government "turned finance – which until then had been the servant of American industry – into its master."

"Three Coping Mechanisms"

Most Americans not only accepted the situation but also supported the free market ethos against government interference. A "loss of generational memory" meant that modern Americans have little or no experience with great poverty or great prosperity. The middle class is facing its financial travails by using three coping mechanisms:

1. **"Women move into paid work"** – Education and new social mores enabled women to climb the career ladder just as women had to go to work to shore up the family income.
2. **"Everyone works longer hours"** – When their wages proved inadequate, people worked more. Americans averaged 2,200 hours annually at their jobs, more than Europeans and the Japanese. A US household now works "a full 12 weeks more than...in 1979."

3. **Americans "draw down savings and borrow to the hilt"** – By 2007, Americans "owed as much as their entire after-tax income." The savings rates dropped to 2.6% in 2008. And credit was available everywhere: Credit cards, student loans and mortgages on spiraling home values kept economic reality at bay, at least until the 2008 crash.

> "America cannot succeed if the basic bargain at the heart of our economy remains broken."

These coping mechanisms no longer work: Child care costs are becoming greater than the incremental pay a two-income household enjoys, you can work only so many hours in a day, and easy credit is long gone. The jobs filtering back into the economy pay less; for instance, Ford recently added 1,200 new employees at one plant at half the pay of existing workers. So people are "deleveraging" by paying off or abandoning their debts, and baby boomers will need to postpone, if not renounce, retirement, adding another strain to an already stretched job market.

"No Return to Normal"

Economic tensions naturally manifest in political and social unrest, and these tensions could threaten American democracy. Politicians and pundits exhort people to make do with less, but a "lower standard of living" could undermine the consumer economy, even though some alternative voices speak of the value of living more simply. Cutting back is painful, however, and rising expectations of a better future for yourself and your children die hard. Research shows a 1.3% increase in suicides "for every 1% rise in a state's unemployment rate." Furthering the anxiety are obvious comparisons to the improving lot of the rich: Wall Street banks have returned to profitability and again are paying extraordinary bonuses. As the middle class retrenches, the have-nots cede quality education, health care and public services to the haves.

> "The central challenge is...to rebalance the American economy so that its benefits are shared more widely in America, as they were decades ago."

While Americans' traditional aspirations to join the upper classes so far have kept them from rising up against the establishment, mounting evidence of a "rigged game" by the rich could translate into revolt. The growing perception that Wall Street's bailout benefited only Wall Street and that shadowy Washington lobbyists wield sinister influence to push corporate interests raises mistrust. Populist anger grows as increases in sales and property taxes, which fall unfairly on the middle class, make up for income tax cuts for the rich. Suspicion and rage gain political footing in the rise of more conservative movements, and "prolonged economic stress could open the door to demagogues who prey on public anxieties in order to gain power."

"A New Deal for the Middle Class"

Addressing the income imbalance means reinstating the basic jobs bargain. Some policy changes that could accomplish that goal include:

- **Instituting "a reverse income tax"** – To begin to remedy income equality, pay "wage supplements" on a sliding scale to those earning less than $50,000 annually. The Earned Income Tax Credit provides such a boost for low-wage earners. Have those making more than $50,000 but less than $160,000 pay a tax rate of 10% or 20% on all income.
- **Levying "a carbon tax"** – Taxing carbon dioxide output would give firms reasons to reduce greenhouse gas emissions, develop alternative energy sources and increase "aggregate demand." The taxes would partially offset costs of the reverse income tax.
- **Setting "higher marginal tax rates on the wealthy"** – Those earning more than $160,000 annually would pay 40% taxes on all income, increasing to a top rate of 55% for those with incomes of more than $410,000. The new tax structure would earn more than the existing tax system, combining with carbon tax revenues to pay down the national deficit. And history shows that higher taxes on the rich don't deter growth.
- **Establishing "a reemployment system rather than an unemployment system"** – A temporary "wage insurance" would ease job seekers into taking work that pays less than their old jobs, partially and temporarily making up the difference. A "severance tax" on companies that lay off workers would cover this and the costs of retraining employees.
- **Creating "school vouchers based on family income"** – Giving families education credits in inverse proportion to their income would force competition among schools and improve educational choice for lower-income families, ensuring job access for future generations. The program would include early-childhood education.
- **Granting "college loans linked to subsequent earnings"** – Students could choose between free public colleges and loans for attending private colleges. Graduates would reimburse 10% of their earnings for 10 years to support public education and student loans, especially for those in lower-paying but essential fields like teaching or nursing.
- **Providing "Medicare for all" –** Offering everyone subsidized health care would save from $58 billion to $400 billion annually because of Medicare's lower administrative expenses and extensive bargaining power with drug companies and health care providers. Extending coverage to every citizen is not that big a stretch. Almost 50% of Americans now enjoy some public health care via Medicare, Medicaid, the Veterans' Health Administration or the federal health care program for government employees.
- **Extending "public goods" –** Free access to "public transportation, public parks...public museums and libraries" cuts pollution, creates jobs and adds to "quality of life."
- **Getting "money out of politics" –** To counteract large firms' influence on political decision making, political donations should go into "blind trusts" so officials won't know who financed them and for how much. "The quid would be severed from the quo."

About the Author

Robert B. Reich, a professor of public policy at the University of California, Berkeley, served in three presidential administrations, most recently as Secretary of Labor under Bill Clinton.