Economic Security for Working Families

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Mr. Chairman, members of the Committee, I am honored to testify before your Committee today on the subject of the Economic Security for Working Families.

By all measures, America's economy is in superb shape. From 3rd quarter 2005 to 3rd quarter 2006, real GDP grew at 3.0 percent, and the 4th quarter numbers released this morning are expected to show a similar trend. Real after-tax personal incomes are 3.2 percent higher than a year ago. Inflation is low, at 2.5 percent. The average annual growth rate of productivity since the business cycle peak in March 2001 (3.1 percent) has been one of the best rates in over 30 years. Retail sales in December rose a solid 0.9 percent, and were 5.4 percent higher than a year ago. Excluding the volatile auto sector, retail sales rose 1 percent, and were 5.8 percent higher than a year ago.

Our trade and budget deficits are narrowing. The trade deficit in November narrowed by 1 percent to $58.2 billion. Our exports of $124.8 billion were at a record high, and were 13.4 percent higher than a year ago. Last week the Congressional Budget Office announced that the budget deficit in 2006 dropped for a second consecutive year to $248 billion - $70 billion below its 2005 level and $165 billion below its peak in 2004. During the past three years, the budget deficit has fallen from 3.6 percent of GDP in 2004 to 2.6 percent in 2005 and 1.9 percent in 2006.

The prognosis is good for the future, too. New orders for manufactured durable goods rose 3.1 percent in December, and new orders of core capital goods rose 2.4 percent.

American labor markets are strong and are the envy of the world. Last December, the payroll survey recorded an increase of 167,000 jobs. Over the past year the economy has created 1.8 million jobs, of which 1.6 million are in the private sector. From August 2003 to December 2006, nonfarm payroll employment has increased by over 6.4 million jobs, 40 months of gains. This Friday more job gains will be announced, and the Bureau of Labor Statistics will announce that an extra 810,000 jobs, previously omitted, will be added to the count of payroll jobs for the period April 2005 to March 2006.

The Bureau of Labor Statistics' other survey, the household survey, shows that more Americans are working than ever before. The household survey showed a gain of 303,000 workers last December, and a gain of 8.4 million employed workers since August 2003. The unemployment rate is only 4.5 percent, down from 4.9 percent a year ago, and lower than all industrial countries except Japan. The number of unemployed was 6.8 million last month, compared with 7.3 million a year earlier in December 2005.

Many people say that the jobs have been created are just "hamburger-flipper jobs," but this is not borne out by the data. Employment in industries that pay above-average wages, such as professional and business services and education and health services, have expanded rapidly. Key industries that gained jobs in December include professional and business services (+50,000), education and health services (+43,000), leisure and hospitality (+31,000), government (+17,000), transportation and warehousing (+15,200), and information (+12,000). Leisure and hospitality pay below average wages, but the other industries pay above average wages.

According to David Malpass, Chief Economist at Bear Stearns, "In the last three weeks, data has shown strength in jobs, wages, exports, consumer confidence, housing, and orders. It is increasingly clear that the consumer is more responsive to jobs (our view) than to house prices, mortgage equity withdrawals, interest rate hikes, higher gasoline prices, or the misleading "personal savings rate" (the bearish views). We think there is still an underestimate of U.S. and global growth prospects. The consensus outlook is rising, but probably has further to go in coming weeks. We disagree with the still-frequent view that the U.S. unemployment rate will rise substantially in coming months, the housing market nosedive, and the consumer flag."

Why, with this strong economic picture, is there talk of economic insecurity and dissatisfaction? This economic insecurity cannot be proved with data. According to Karlyn Bowman, the nation's leading analyst of poll results, people are feeling secure about all aspects of the economy, with the exception of health care.

One reason for media angst is the perception that the gains are not distributed equally, that some people are falling behind. For instance, according to Eduardo Porter in the New York Times of Sunday, November 19, 2006, "The growing share of income devoted to those at the top is leaving less and less to share among the rest of us."

But the latest Consumer Expenditure Survey from the Bureau of Labor Statistics, covering the year 2005, shows that differences in per-person spending by the lowest and highest fifths, or quintiles, of income-earners are not dramatically different. Our measures show more income inequality than spending inequality. Spending is vital because it determines our current standard of living and our confidence in the future. It shows how much money Americans have. The usual pretax measures of income on which most inequality studies are based do not show how much money Americans have and fail to provide an accurate measure of inequality.

The top 50% of earners pay 97% of income taxes, so all their income is not available for spending. Lower-income Americans receive transfers such as Food Stamps, housing vouchers, Medicaid, and Medicare, so they consume more than their stated income. Middle-income Americans have assets in pension and individual retirement accounts that are not included in income. Therefore, spending is a far better guide to well-being than pretax income.

Last year Americans in the lowest income quintile spent an average of $11,247 per person, according to the Bureau of Labor Statistics, compared with $15,843 for middle income quintiles, and $28,272 for the top quintile. The top group is spending only 2.5 times as much as the bottom group, and 1.8 times as much as the middle classes. This is not major inequality.

The differences between per person spending are even smaller for food and housing. Those in the top 20% of income earners spend $3,141 on food per person and those at the bottom 20% spend $1,792, i.e. the top group spends less than twice as much. Middle quintiles are somewhat in between. For housing, the lowest spends about half as much as the highest.

With health care spending, an area where conventional wisdom holds that the poor are falling behind, the top group spends about 1.5 times the lowest group. For clothing, the top group spends just over twice the amount as the bottom group.

Some in households with low income levels are not poor. Many are retired and are living off Social Security, pensions, and accumulated savings. The average age of the lowest income group is 52, higher than any other. A full 30% own their homes free of mortgage, compared with only 17% of those in the upper income group.

To be sure, spending done by choice rather than by necessity shows somewhat larger differences. The top group spends almost three times as much on entertainment as does the lowest group, and just over twice as much as middle-income groups. And the top group spends three times as much on transportation as the lowest group, but only 1.6 times as much as the middle groups.

Spending on personal insurance and pensions shows the most inequality. Spending by the top group is more than 15 times the lowest group, and three times as much as the middle groups. This type of spending includes individual retirement accounts, 401(k) plans, and life insurance. It is not that the top group is spending substantially more, but it is saving more.

But these patterns do not show, as Senator James Webb said in response President Bush's State of the Union Address on January 23, 2007, that "When one looks at the health of our economy, it's almost as if we are living in two different countries. Some say that things have never been better. The stock market is at an all-time high, and so are corporate profits. But these benefits are not being fairly shared." Rather, data show that spending is not diverging considerably between groups.

Aside from tax payments and transfer receipts, why is spending inequality per person less than many popular measures of income inequality?

The average number of people for a household in the lowest quintile is 1.7. It increases to 2.5 people for the middle quintile and reaches 3.2 people for the highest quintile. If a larger amount of income is divided among more people, the spending per person falls. Look at it this way — if there was complete equality, and all quintiles had the same income, the ones with the larger families would be worse off. Furthermore, the top group has more earners. The top quintile averages 2.1 earners, compared with 1.4 earners for the middle quintile, and half an earner for the lowest quintile.

Yet a glance at per-person spending over the past 20 years shows that all groups are spending more in real terms. Everyone has grown richer over the past 20 years. The lowest quintile is spending 14% more in 2005 than it was in 1985, the second quintile 16%, the third quintile 11%, the fourth 13%, and the top quintile is spending an additional 16%. There is no striking inequality there, especially since people do not just stay in one quintile. Many have moved up to other quintiles in the 20-year time period as they get older and more experienced and marry other earners.

The Bureau of Labor Statistics data also provide a window on changes in our society. The bottom quintile is spending 120% more on audio and visual equipment and services, compared with the category of TVs and radios from 1985. The top quintile is spending only 31% more. All quintiles are spending less on reading, ranging from 44% less for the top quintile to 52% less for the middle quintile. But all are spending more on education — from 117% for the top quintile, to 29% for the second-lowest, with the rest in between. The self-taught man of letters is not of the 21st century — books are out, formal education is in.

Predictably, the top quintile has the highest proportion of respondents, 81%, who attended college, a proportion that falls as income declines. Only 40% of the lowest quintile graduated from college. It is no surprise that households with two college-educated earners have more income than those with half an earner without a college education.

Reforming education, as the late Milton Friedman advocated, remains the most effective way of increasing incomes. Lower-skilled workers earn less and are more likely to be unemployed than higher skilled ones. Hence, it is vital to take a serious look at education. There is little point in debating how workers have fared on average. What is important is to help individuals make faster progress, and education is the key.

The New Commission on the Skills of the American Workforce has just released a report on education entitled "Tough Choices or Tough Times." It was written by a prestigious bipartisan group and chaired by Charles Knapp, president emeritus of the University of Georgia. Members included New York City Chancellor Joel Klein and John Engler, former governor of Michigan, now president of the National Association of Manufacturers. The report tries to fix our education system - the major reason why some Americans are not doing as well as others.

A quick look at unemployment data shows how lack of education affects workers. Last month the unemployment rate for adults without a high-school diploma was 6.6 percent; it was only 4 percent for those with a high school diploma and 2 percent for those with a bachelor's degree.

It is widely reported in the press that we are falling behind other countries. The report says, "American students and young adults place anywhere from the middle to the bottom of the pack in all three continuing comparative studies of achievement in mathematics, science and general literacy in the advanced industrial nations."

The commission proposes a set of core examinations to be taken in 10th grade. Based on the results, students would either continue in high school to prepare for another set of exams leading them to college, or go straight to a vocational program at a community college - from which they could either go right into the job market or to a state university. In order to raise the quality of teaching, teachers would be recruited and licensed from the top third of the class by states rather than by school districts. Pay levels would be increased to the $45,000 to $110,000 range, comparable to private-sector jobs.

Instead of school boards, schools would be operated by independent corporations, with some run by teachers. The school district would contract with the schools to ensure that they meet new performance standards. Those that do not do so would not have their contracts renewed.

The commission proposes extending schooling to 3- and 4-year-olds and adults. Children would have the benefit of starting earlier, a particular advantage for some children and some parents. Adults would be entitled to free education to get them to the same standard as 16-year-olds - and then continue with classes as needed - so that they could advance in the workforce.

Can we afford this plan? The commission sees savings from reorganizing high schools, closing remedial programs rendered unnecessary by the changes and providing teachers with 401(k) retirement plans. The added costs would be $7 billion.

Parents may well welcome these proposals, while objections are likely to come from those teachers who fail to meet the new standards and school administrators, who are likely to lose power, influence and jobs.

In a global economy, education and innovation are the keys to high standards of living and job security. The New Commission on the Skills of the American Workforce has laid out one route to higher standards which deserves serious discussion. These recommendations have the potential to increase economic security by increasing skills.

A number of proposed solutions would be counterproductive to increasing economic security. Raising the minimum wage from $5.15 to $7.25 would affect about 10 million jobs and cost employers about $14 billion. Employers would not simply absorb the cost. If workers cannot produce goods and services worth $7.25 an hour employers will not hire them.

So for many workers the choice is not between a job at $5.15 an hour and the same job at $7.25 an hour. It is between a job at $5.15 an hour and no job at all, because an increase in the minimum wage may cause that job to disappear, as has happened in Europe and has been documented by Harvard Professor Alberto Alesina in a recent book, “The Future of Europe.” Legislating workers out of a job, as has done Europe, is no path to economic security, and has a great social cost.

Low wage jobs today are a stepping-stone to higher wage jobs tomorrow. About 1.8 million Americans earn the minimum wage, the majority of whom are under 25 and work part time in the hotel and restaurant industry. After a year on the job, most are promoted.

Those leading the charge for a higher federal minimum wage come from states that already have higher minimum wage laws and whose residents would not lose jobs due to the new law. California, home to the Chairman Miller, and Massachusetts, home to Senator Kennedy, Chairman of the Senate Committee on Health, Education, Pensions, and Labor, have state minimum wages of $7.50. It is residents of states with no extra minimum wage that would be most adversely affected. These include Oklahoma, Alabama, Montana, and Nebraska, where the incomes and costs of living are lower and where employers are less able to pass on higher wages to customers.

Other required benefits also will not buy economic security. If Congress wanted workers to have paid sick leave, it could require that firms provide six days paid sick leave to each employee. But the approximately 144 million workers who have jobs paying above minimum wage would see fewer raises and new job opportunities. The mix of cash and fringe benefits might change, but workers' total compensation would likely remain the same.

How can we help people gain security in the workforce? The answer is not to price them out of a job, but to improve opportunities and upward mobility through better education.

Thank you for giving me the opportunity to testify today.