CHAPTER 1: GROWTH AND MOBILITY IN 21ST CENTURY AMERICA

This year's Economic Report of the President places emphasis on "inclusive growth" for the middle class, bolstered by policies aimed at promoting productivity, participation, and "equality of outcomes." However, equality of outcomes is a potentially dangerous misnomer for the resolution of "excessive" economic inequality, as it misplaces focus from the true problem of insufficient economic opportunities as detrimental to economic mobility and potential for growth. Moreover, any discussion of economic inequality must necessarily include economic mobility. While the analysis highlights the importance of removing barriers to employment and entrepreneurship that arise from unequal opportunities, its promotion of unionization and minimum wage increases beget a word of caution as these policies also present potential barriers to entry for the most vulnerable workers. Among the longer-term challenges listed above, high and rising publicly held Federal debt is unfortunately not among them.

In the final year of this Administration, the *2016 Economic Report of the President and the Annual Report of the Council of Economic Advisers* (CEA) (ERP, or *Report*), though quick to point out how far the economy has come from the recent recession, strikes a more moderate tone on economic growth going forward than offered in previous reports. Echoed in the *Report*, the President argued in his January 2016 State of the Union address: "The United States of America, right now, has the strongest, most durable economy in the world."[1] Strength and durability are not synonymous. The economy has endured, but growth is not strong. Now nearly seven years into the recovery from the December 2007-June 2009 recession, economic growth can at best be characterized as moderate.[2]

Over the course of this recovery, the country has learned hard lessons on how excessive spending, overzealous regulation, and overwhelmingly accommodative monetary policy can cause more harm than good to society. Unfortunately, the resulting low business investment, labor force participation, and productivity growth promise to continue for the foreseeable future. Forecasters now anticipate an era of slower growth than previous decades, and subdued expectations about economic, population, and labor force growth have placed additional pressures on Federal budget constraints. In turn, Federal policies will have a lasting effect on the labor force and the country's potential for growth. As the Congressional Budget Office (CBO) noted in its recent update to the *Budget and Economic Outlook,* the potential labor force is expected to decline in part due to Federal policies, including the *Affordable Care Act* (ACA) and real tax bracket creep.[3]

The first of a "Growth and Prosperity" Series produced by Joint Economic Committee (JEC) Republican staff in October 1999 entitled, "Economic Growth and the Future Prospects of the U.S. Economy," provided prescient caution about Federal policies in light of anticipated demographic changes:

> *The United States is at an important crossroads. If we control government spending during the next decade, the economy will grow more rapidly and thereby reduce the burden accompanying the retirement of the "baby boom" generation. In contrast, if the federal government undertakes new spending initiatives and does nothing to reform existing health care and retirement programs, the U.S. will become a big-government, European-style economy when the baby boomers retire. This will lead to slower growth and less prosperity... If we are not sensitive to this situation, the combination of new spending commitments and current obligations to future retirees will cause the U.S. to become a stagnating "big government" economy sometime after 2010.*[4]

At that time, baby boomers were in their peak earning years, providing a positive impact on the Federal budget and the economy which provided the growth that precipitated the budget surpluses of the late 1990s. In addition, publicly held Federal debt as a share of gross domestic product (GDP) stood at a comfortable 38.2 percent and Federal outlays at 17.9 percent.

The failure to take the necessary steps to address these challenges has resulted in outcomes that are as unfortunate as they were foreseeable. Health care and retirement programs are expected to comprise approximately half of Federal spending in fiscal year 2016 as baby boomers begin to retire, up from just over a third in 1999. Federal spending is expected to rise to 21.2 percent of GDP this fiscal year, and publicly held Federal debt is expected to rise to 75.6 percent, nearly double the 1999 level and the long-term historical average of 38 percent of GDP.[5]

The trajectory for Federal spending obligations, deficits, and debt are only expected to grow worse over time. In just ten years, 99 percent of revenue will go to mandatory and net interest spending, crowding out funds for other important priorities like national defense and medical research.[6] Deficits are projected to double as a share of GDP over the next decade while Federal spending rises to 23.1 percent of GDP in 2026. Publicly held Federal debt is projected to rise to 86.1 percent by the end of the next decade, and to 155 percent within three decades—the highest percentage ever recorded in the United States.[7]

In his State of the Union address this year, President Obama stated that he wanted "to focus on the next five years, the next 10 years, and beyond."[8] However, he failed to note one of the most important issues that America faces in the coming years: the financial obligations that will come due over those periods. Debt was not mentioned once in his address, and how to achieve fiscal sustainability was not among the four questions the President argued that "we as a country have to answer."[9]

Perhaps ironically, in last year's *Report*, it was growth in labor force participation that the President and his advisers were counting on to tackle deficits and debt posed by "the pig in the python" baby boomer retirement.[10] Analysis from CBO, the Bureau of Labor Statistics (BLS), and other institutions, however, paint a very different picture about the ability of the labor force to stabilize debt. CBO estimates that if lawmakers were to aim for maintaining debt at 74 percent of GDP by 2040, revenues would need to increase six percent annually or spending would need to fall 5.5 percent annually.[11] BLS notes that "stabilization is likely to come at a cost... the need to fund mandatory programs (such as Social Security and Medicare) while constraining deficits poses an increasingly large problem for the economy."[12]

In mid-2015, the Wells Fargo Economics Group also noted the dire consequences associated with the current policy trajectory:

> *Waiting until 2021 to enact tax policy changes to stabilize the debt-to-GDP ratio at the current 74 percent of GDP would translate into an additional $570 in taxes per year for a household in the middle income quintile (making around $66,400 per year)... In the case that Congress and the administration wait until 2021 and decide to enact across-the-board spending cuts, the impact on Social Security benefits for the average individual would be rather dramatic as well. For example, to just stabilize the national debt, across the board cuts to all non-interest spending would reduce the average annual Social Security benefits for a median income earner for someone born in 1955 by approximately $1,393 per year.*[13]

The Wells Fargo analysis noted that, on net, the long-run fiscal and economic benefits of addressing the unsustainable fiscal policy outlook outweigh the short-term costs.

Rather than address these imposing challenges, this year's *Report* instead focuses on narrower inequality measures. The *Report* claims that it "examines the economics and policies that can strengthen productivity without exacerbating inequality, promoting robust and inclusive growth that can be shared by a broad group of households." It further identifies inequality as a "defining challenge of the 21st century economy" that affects both the United States and abroad, suggesting that "unequal outcomes" arise from "unequal opportunities." While unequal opportunities are indeed concerning and a precursor for economic immobility, they are not solely to blame for unequal outcomes. The pursuit of policies that aim for "equality of outcomes" not only fails to account for the myriad underlying reasons why one American would pursue one "outcome" over another, but it also implies that all Americans share the same "American Dream." Given the incredibly diverse and vibrant population that makes up modern America, nothing could be so blatantly further from the truth. The American Dream has nothing to do with equality of outcomes and everything to do with equality of opportunity.

ECONOMIC INEQUALITY AND MOBILITY

Metrics

As in last year's *Report*, the 2016 *Report* fails to define the "middle class." And as the *2015 Joint Economic Report (Response)* made clear, metrics still matter. Specifically, to set achievable goals and measure progress, it is necessary to agree on the metrics:

> *The* [2015] Report *itself doesn't seem clear on that metric; its reference to the bottom 90 percent of households and the median household weave throughout the first chapter, suggesting that the "lens" is not quite clear. As it stands, there is no unified, broad definition of income, let alone a clear cut definition of "middle class." Income, even when clearly defined, is only one measure of many in determining the welfare and success of an individual. The "typical" or median household may make sense when referencing a moment in time, but is less useful when comparing the median household over time.*[14]

For example, recent research over the last year suggested that the middle class has narrowed compared to the growing lower- and upper-income classes. Pew Research Center (Pew) recently released an in-depth study on changes in lower-, middle-, and upper-income households over the past several decades. Researchers found that the middle class has shrunk compared to the growing lower- and upper-income classes, down to 50 percent in 2015 from a 61 percent majority in 1971.[15]

However, it is important to keep several considerations in mind when discussing the changes that have occurred in the distribution of income over time. Income commonly refers to more than just wages earned, and is one metric among others such as net worth and consumption patterns, in determining the financial well-being of Americans. Moreover, such metrics can be measured by person, household, or even family.[16] In the Pew study, income was measured by household using the Census definition of money income,[17] which excludes certain money receipts, tax payments, dues and deductions, and benefits like foods stamps, health insurance, subsidized housing and energy assistance.

Although the recent findings from the Pew study appear to confirm the *Report's* concern that the middle class is shrinking, several caveats are worth exploring in any discussion relating to the middle class. The income metric used to determine who falls into the middle class matters to the entire framing of the discussion. Different definitions, such as using only the middle-fifth of income or excluding the top and bottom quintiles, will yield different results than the Pew-defined size-adjusted households that fall between two-thirds to double the median U.S. households income. In fact, middle-income household advancement has been stronger in the past several decades[18] than the oft-cited statistics indicate because the data tends to overstate increases in the disparities between the income groups.[19] Many Americans still identify themselves as middle class, though less so since the recession.[20] Given the cost of living variations across America,[21] what it means to be middle class varies by state and even metropolitan area.[22] In addition, the Pew-defined threshold for middle income has not only broadened over time, but risen in real terms, suggesting a rising standard of living.[23]

Also noteworthy is that the upper-income group grew at a faster pace than the lower income group. As Pew reported: "From 1971 to 2015, the number of adults in upper-income households increased from 18.4 million to 51 million, a gain of 177%. During the same period, the number of adults in lower-income households increased from 33.2 million to 70.3 million, a gain of 112%."[24] By comparison, middle-income households grew by 51 percent from 80 million to 120.8 million. The fact that the upper-income group broadened—meaning that a relatively larger share of households frequent the upper-income group today than had in the past—is a positive trend and should ameliorate some of the concern regarding the "concentration" of income in the upper-income group. Such concern is misplaced if income mobility keeps to its historical pace or strengthens.[25]

Mobility still matters. The makeup of income groups is anything but static, with people frequently moving among the lower-, middle-, and upper-income groups. The distribution of households in each income group at any given moment is a snapshot of a dynamic flow (i.e. mobility) of households between income groups over time. Mobility is most commonly measured in both absolute terms, whereby a child is better off than his or her parents regardless of origin in the distribution, and also in relative terms, whereby a child moves up or down depending on where in the distribution they originated (i.e. a child in the bottom group could still be better off than his or her parents in the bottom group, suggesting upward mobility in the absolute sense, but immobility in the relative sense).

Many would likely be surprised to learn that, contrary to recently developed conventional wisdom, economic mobility in America has not lagged that of its international peers.[26] Relatively new research delves into a mobility-related measure known as intergenerational elasticity, which measures the relationship between a person's income and that of their parents. The findings suggest that roughly half of parental income advantages are passed down to children.[27] The *Report* points out that intergenerational earnings elasticity of fathers and sons in the United States is lower compared to most major developed economies, noting: "the higher the elasticity, the less mobile the society. Such a mobility can be understood as a measure of the inequality of opportunity."[28] This particular issue for young men in the United States is in fact an important one that must be addressed. An Organization for Economic Cooperation and Development (OECD) study also notes that this is true of France, Italy, and the United Kingdom as well.[29] However, similar research demonstrates that the United States is out of sync with other countries on intergenerational earnings mobility only for sons who had fathers in the bottom fifth of earnings—not exactly a middle-class issue, but rather one of low-income families looking to move into the middle class. In fact, the United States falls in the middle of the pack for other father and child correlations.[30]

Young Adults and Mobility in the 21st Century

As noted in last year's *Response*, alternative metrics continue to indicate a shift in the relationship that young individuals have with the labor market. While previous generations may have faced tough labor markets as they entered the workforce, as baby boomers did in the 1981-82 recession, the labor market recovery for millennials has been "much less robust" following the 2007-09

recession.[31] A Georgetown University Center on Education and the Workforce study notes that, like those in school in their late teens and early twenties, the share of people in their late twenties (26-30 years of age) participating in the labor force has also declined, down from 88 percent in 2000 to 80 percent in 2012. This is the lowest rate in the 60 years that data has been collected. The share of adults in their late twenties working full-time, year-round jobs has fallen by 15 percentage points for men to 65 percent from 2000 to 2012. Women have also seen a six percentage-point decrease over the same time period. The study further suggests that entering the labor market in a bad economy can have negative long-term effects on earnings and employment that can last for 10 to 15 years.[32] The data further suggest that millennials, collectively the youngest and largest generation in the workforce today, are also switching jobs at a slower pace than previous generations.[33]

Longer-term trends, however, suggest that the issue was building even prior to the recession. Between 1992 and 2000, each successive graduate class of college and post-college degree holders saw an increase in the likelihood of entering jobs that require "brains" instead of "brawn" at the start and in the middle of their careers. However, this pattern began to reverse after 2000, contributing to the declining job and income prospects young work entrants currently face. Wages of recent graduates haven't been keeping up with previous generations' starting wages relative to the median wage. The drag of graduating college during a recession can have a permanent effect on lifetime income. This seems to be true of certain college degrees over others. Graduates with scientific and business degrees see an increase in earnings graduating into a recession, while arts and social sciences see a decrease.[34] Nonetheless, a 2013 Urban Institute study found that the average wealth of millennials between 20 and 30 years of age in 2010 was 7 percent lower than the average wealth of baby boomers within that age group in 1983.[35]

According to Census Bureau data, 15.1 percent of 25- to 34-year-olds live with their parents, increasing for the fourth consecutive year. Compared to just 12 years ago when the rate was just above 10 percent, the trend remains historically elevated and continues to inch higher.[36] A household is formed when an adult leaves the home of another adult and finds his or her own place of residence, whether owned or rented. However, as the *Report* also highlights, two-thirds of the new households created over the year ending in June were created by Americans between 65 and 74 years old.[37]

As mentioned in the 2015 *Report*, this year's *Report* notes that millennials' delayed purchase of homes will continue to affect household formation in the near term, but finds that this will be remedied in the coming years as graduates pay off their student loans. Unfortunately, millennials and the generations that follow them face a number of unprecedented problems that could affect their mobility going forward, including a record amount of average student loan debt, elevated underemployment, lower starting wages than previous generations, and long-term fiscal challenges originating from entitlement and public pension programs.[38] Recent research from the Federal Reserve Bank of St. Louis finds that the average per-capita lifetime net benefit from Federal benefits received minus taxes paid turns from significantly positive to significantly negative

beginning with Generation X, and only worsens for millennials and post-millennial generations.[39] The longer reform is delayed, the greater the intergenerational imbalance will grow, and the more painful and drastic the necessary fiscal policy changes will become.

In addition, with the oldest baby boomers only recently becoming eligible for full Social Security benefits,[40] their retirement is only just beginning and will span at least the next two decades. In fact, baby boomers most commonly comprise the upper-income group because many are still in their highest earning years.[41] Though baby boomers are retiring at a slower rate than previous generations, as the labor force participation rate for Americans age 55 and older is rising[42] while younger age cohorts' participation is falling, their retirement will not only leave a lasting impact on the labor force,[43] but it also means more Americans will be living on relatively lower retiree incomes than they made in their working years.

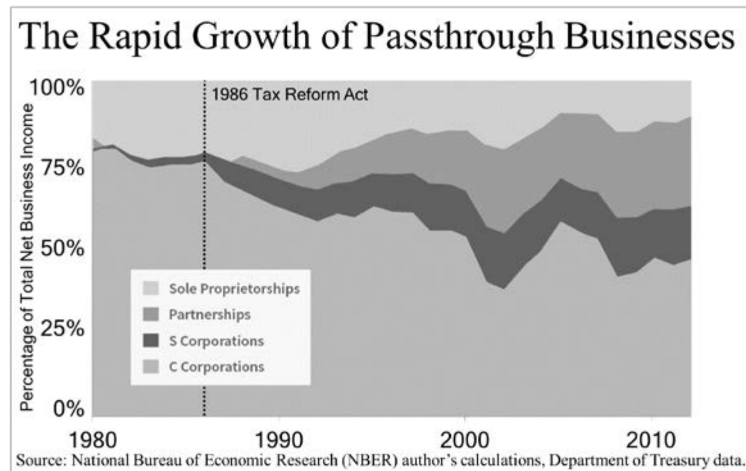
Economic Inequality, Mobility and Growth

The *Report* makes the following point that omits a significant reason for the divergent trends in top 1 percent income shares between the United States and other G-7 countries:

> *Until the 1980s, the United States experience was similar to other countries; as recently as 1975, the top 1 percent garnered a similar share of the income in the United States as in other G-7 countries, as shown in Figure 1-1. But since 1987 the share of income going to the top 1 percent in the United States has exceeded every other G-7 country in each year that data are available.*[44]

The reason, known perfectly well by the Administration, is largely due to the *Tax Reform Act of 1986* which, among other changes, lowered the top individual tax rate from 50 percent to 28 percent. This created an incentive for small businesses to file under the individual tax code since the top marginal corporate income tax rate was much higher. In fact, the data show a growing share of U.S. business income has been taxed on a passthrough basis (Figure 1-1),[45] meaning that a firm's business income is attributed to the owner(s) and taxed as individual income, which has further complicated the process of teasing out income inequality from existing data.[46]

Figure 1-1



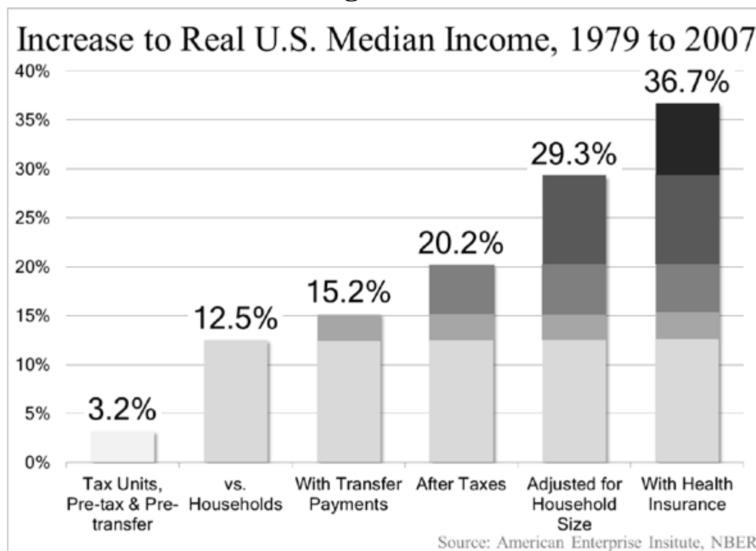
The *Report* also notes that technological change has played a role in increasing wage inequality and job polarization in both the United States and abroad. Information technology has changed relative demand for workers with different skill levels, known as skill-biased technological change (SBTC). Over the last nearly four decades, SBTC altered demand for different types of labor as the cost of acquiring and utilizing information technology assets fell rapidly and U.S. businesses substituted computers and computerized machinery for workers performing routine tasks. As discussed at length in last year's *Response*, previous JEC research found that SBTC explained a majority of the increase in income inequality among U.S. households over the past several decades, and that SBTC is also driving the increase in income inequality abroad.[47]

As supporting evidence of the growing global attention to inequality, the *Report* goes on to highlight Thomas Piketty's seminal 2014 book, *Capital in the Twenty-First Century*. However, data issues plague the work of scholars like Piketty and Emmanuel Saez. Specifically, the use of tax return data (particularly of pre-tax income) instead of after-tax household income fails to account for government benefits and employer-provided health insurance. As Manhattan Institute scholar Scott Winship states, "they do not account for the main ways in which we mitigate income concentration via public policy."[48] This begets the question: why does it make sense to measure inequality in a manner that does not account for the effect of the very policies meant to mitigate it? The answer is simple: It makes no sense whatsoever. Such a question underscores the importance of clearly defining the metrics and understanding their underpinnings before predicating policy changes upon them.

As pointed out in a previous JEC staff analysis, the increase to real U.S. median income over the past several decades has been far greater than reported using only pre-tax and pre-transfer income. Economist Richard Burkhauser noted that, after accounting for size of households, government transfer payments, taxes, and employer-provided health insurance, the real U.S. median income has actually increased 36.7 percent from 1979 to 2007 (pre-dating the recent recession), as compared to the unadjusted, pre-tax median income tax unit increase of 3.2 percent (Figure 1-2).

Burkhauser's numbers compare similarly with CBO, which found that for the 60 percent of the population in the middle of the income scale, real after-tax household income growth was just under 40 percent from 1979 to 2007.[49]

Figure 1-2



Despite the issues associated with measuring income inequality, the *Report* makes a brief attempt to point out that wealth inequality is even more unequally distributed, though making the caveat that wealth inequality is "particularly difficult to measure accurately because we do not track wealth in the way we do income and trends in wealth inequality are concentrated among a small number of households."[50] Not only is wealth inequality inherently more difficult to track, but it is unclear if it is a larger issue than income inequality. For wealth measurements, age is an even more important factor (in many cases, young adults have negative net worth as they pay off student loans, car payments, and mortgages, while the recently retired may have substantive wealth built over a lifetime to live off of in retirement), in addition to household formation (for example, if a married couple divorces and creates two households with lower wealth than they previously held combined, is this a policy concern when it comes to how it changes wealth inequality?), along with a number of other factors associated with the valuation of wealth as well.

The *Report* also highlights the 21 percent wage disparity between the typical woman and typical man working full-time as another area of inequality of opportunity. However, there is nothing typical or accurate about comparing the two averages. Recent research that uses *median* hourly earnings and makes adjustments for education, experience, and job type among workers age 25 to 34 found that all but 7 percent of the wage disparity disappears.[51] Furthermore, a study completed in 2010 using median, full-time income data at the metropolitan level found that among young adults age 22 to 30 never-married with no children, women were out-earning men by 8 percent on average among the metropolitan areas studied and by as much as 21 percent more. Interestingly, while women's earnings appear to benefit from the expansion of the knowledge-based economy, Silicon Valley was noted among the "holdout" areas where young men's earnings still surpass

women's.[52] Adjusting for these factors makes for a better apples-to-apples comparison by controlling for the choices individual Americans make which may influence their income disparities and may have very little to do with their earnings. Once again, the metrics are extremely important to policymakers' understanding of the problems that they wish to address.

The *Report* further states that inequality is correlated with lower mobility, trotting out the "Great Gatsby" curve first introduced in 2011. However, evidence of changes in income inequality and mobility in the United States reveal no such relationship.[53] Despite periods of high and rising inequality, including in the 1990s when income was increasingly concentrated within the top one percent and incomes were rising across the board, recent research from economist Raj Chetty finds that mobility did not fall. In fact, the research concluded "measures of social mobility have remained remarkably stable over the second half of the twentieth century in the United States."[54]

Ultimately, it is economic mobility that matters more than income inequality—the fact is that people in the lower-, middle-, and upper-income groups are always changing over time. Improving economic mobility, not income inequality, remains a challenge to the 21st-century economy. However, as aforementioned, economic mobility in America is not laggard compared to international peers, and mobility in America has remained largely unchanged over the last 20 years. Despite this, income immobility, the ability to "move to opportunity," and the relationship between child and parent earnings will continue to play prominent roles in the changes to distribution in income over time, and it remains more important than ever to remove barriers to opportunity and continue to every effort to improve economic mobility.

RENT-SEEKING AND THE ROLE OF GOVERNMENT

The *Report* states: "Rents arise when markets are not perfectly competitive, such as when uncompetitive markets yield monopoly profits or preferential regulation protects entities from competition."[55] No market, however, is perfectly competitive. The *Report* continues: "Classic examples of such rents include monopoly profits and the unearned benefits of preferential government regulation."[56] In fact, there are few better examples of preferential government regulation that promote rent-seeking behavior than the politically-designed energy policies pursued by this Administration, which are discussed in more detail in Chapter 6.

This is also true of increasing market concentration. Consolidation has become ubiquitous precisely because of increased regulation brought by this Administration. The sectors in which the *Report* cites massive consolidation are air travel, telecoms, banking, food-processing—a veritable "who's who" of overregulation. It is also of particular note that, largely as a result of the changes in the healthcare landscape brought on by the ACA, the healthcare sector—especially insurance—has recently undergone consolidation. In all its zeal, the Administration issued a record number of 82,036 pages of regulation to the Federal Register in 2015, amounting to more than 3,378 final rules and regulations and adding to the near-$2 trillion in lost economic productivity and higher prices due to cumulative regulatory burdens.[57]

The *Report* claims that evidence suggests in many cases that rent-seeking behavior "exacerbates inequality and can actually impair growth."[58] Rent-seeking is just political entrepreneurship by another name, as explained by economist Wayne Brough:

> *The entrepreneurial calculus may change in response to institutional changes brought by an expanding regulatory state. Some entrepreneurs will focus more on redistributing existing rents through the political process rather than innovating for the benefit of consumers... As political entrepreneurs crowd out economic entrepreneurs, society shifts from the positive-sum game of wealth creation to the zero-sum game of wealth transfers*.[59]

The *Report* wraps up discussion of problems associated with rent-seeking behavior by suggesting political reforms to reduce the influence of regulatory lobbying: "Finally, to the degree that rent-seeking warps regulations, policymakers should reduce the ability of people or corporations to seek rents successfully through political reforms and other steps to reduce the influence of regulatory lobbying."[60] The implication that the rent-seeking and regulations relationship is causal in only one direction is puzzling, as it is equally likely that regulation could incite or re-channel rent-seeking behavior. As pointed out in economist Bruce Yandle's classic "Bootleggers and Baptists" theory of rent-seeking behavior, the bootleggers—standing to profit handsomely from new regulation—support, or rent-seek, "tee-totaling" Baptist politicians to maintain prohibition of the sale of alcohol on Sundays. Such a relationship exists between interest groups, politicians and regulators:

> *In a democratic society, economic forces will always play through the political mechanism in ways determined by the voting mechanism employed. Politicians need resources in order to get elected. Selected members of the public can gain resources through the political process, and highly organized groups can do that quite handily. The most successful ventures of this sort occur where there is an overarching public concern to be addressed (like the problem of alcohol) whose "solution" allows resources to be distributed from the public purse to particular groups or from one group to another (as from bartenders to bootleggers).*[61]

In fact, Nobel laureate economist Milton Friedman described this relationship as more of an "iron triangle," an insurmountable connection between interest groups, bureaucracies, and politicians that makes reform particularly difficult, and virtually always fails the consumer.[62] As noted by economist Mancur Olson in his study of special-interest privileges, nations that allow entrenched interest groups to grow in power and influence over time engender the relative decline of those nations.[63]

Moreover, political reforms that ultimately reduce unproductive rent-seeking require that government, and the (redistributive) power of the purse associated with it, necessarily demand that the target of rent-seeking—government itself, in all of its current largess—become less tantalizing to seek in the first place. Less rent-seeking for political favor due to smaller government allows

for a greater ability to address the current unsustainable spending problem. As discussed in a previous JEC staff study, if fiscal consolidation and pro-growth reforms are to be successful in the long term, policymakers must credibly commit to addressing the multifaceted growth of government, including the size of government, the roles of government and how revenues are spent.[64]

PRO-GROWTH POLICY OPPORTUNITIES

Barriers to Entry: Unionization, Occupational Licensing and Minimum Wage

The *Report* extensively discusses the issues associated with barriers to entry into jobs and markets, and offers several policy solutions including greater support for collective bargaining, minimum wage, reducing occupational licensing barriers, and removing restrictive land use regulations. However, for all of the points that are made about occupational licensing and other regulations, the *Report* stops short of connecting these barriers to entry with the equally significant ones that unionization and minimum wage present:

> *First, the employment barriers created by licensing raise wages for those who are successful in gaining entry to a licensed occupation by restricting employment in the licensed profession and lowering wages for excluded workers. Estimates find that unlicensed workers earn 10- to 15-percent lower wages than licensed workers with similar levels of education, training, and experience (Kleiner and Krueger 2010). Second, research finds that more restrictive licensing laws lead to higher prices for goods and services, in many cases for lower-income households, while the quality, health and safety benefits do not always materialize (Kleiner 2015). Finally, some state-specific licensing requirements create unnecessary barriers to entry for out-of-state licensed practitioners, reducing mobility across state lines (Johnson and Kleiner 2014).*[65]

The employment barriers detailed in the *Report* resulting from occupational licensing also extend to union membership by: (1) increasing wages for licensed (union) workers compared to non-licensed (non-union) workers, and (2) increasing the price of goods and services, particularly burdensome on lower-income households.[66] In addition, the third and final point with regard to state-specific requirements is the same concept behind frequent criticism that the ACA restricts choice by disallowing shopping for insurance out-of-state.[67]

The *Report* notes that union membership declined consistently since the 1970s.[68] However, over the same time frame, occupational licensing was consistently rising. In fact, economist Morris Kleiner, the very same mentioned by the *Report* in the quote above, makes this link in a paper with fellow economist and former economic adviser to the President, Alan Krueger: as the prevalence of union membership fell into decline, from nearly one-third of workers in the 1950s to just above one-in-ten in 2008, so occupational licensing rose from roughly 5 percent in the 1950s to nearly 29 percent in 2008. The study additionally notes: “Indeed, the wage premium associated with

licensing is strikingly similar to that found in studies of the effect of unions on wages."[69] Though Kleiner and Krueger find that unions reduce inequality (by way of compressing the wage distribution),[70] their research does not suggest that the "balance of bargaining power leans toward the firm"[71] in absence of greater unionization.

As the *Report* acknowledges, occupational licensing can too often be a clumsy solution to ensure customer health and safety. Consumer health and safety can be prioritized in other ways, such as voluntary certification, without hurting entrepreneurship and job creation. The justification for licensing should include why certification is not enough. States should re-examine their occupational licensing laws to ensure that they are not serving the interests of incumbent groups in place of the consumers they are meant to protect.[72]

President Obama again included raising the minimum wage among his list of proposals for the year ahead in his State of the Union address. In step, the *Report* misleadingly argues that the minimum wage is "geared toward workers with the very least bargaining power."[73] However, evidence shows that the minimum wage is far from a useful tool to help the poor.[74] The main effect of minimum wage increases is a reduction in the number of low-skill and entry-level jobs.[75] In fact, CBO projected that a proposed Federal minimum wage to $10.10 per hour could amount to an employment reduction of as many as one million workers.[76] These are the very jobs that the most vulnerable workers in the labor force—those just starting out and looking to get a foothold into their job paths—rely upon the most. This flies in the face of the President's narrative for one simple reason: an unemployed worker is not an empowered worker.

Over time, the minimum wage gives employers added incentive to automate, which reduces job opportunities for those with limited skills. Yet one cannot easily distinguish the advances in technology that are motivated by artificially increased wage cost from those that occur independently. Consequently, the detrimental effect of the minimum wage on employment likely is greater than what can be definitively attributed to it.[77]

In an effort to alleviate the struggle in which many young workers find themselves in seeking to obtain their first job, President Obama has proposed a $5.5 billion dollar collective of grants, skill investment and direct wage payments. As noted by Mercatus Center scholar Adam Millsap, the fact that the minimum wage has a negative effect on teenage and young adult employment is a "glaring omission" from the President's proposal, especially given the glut of evidence demonstrating that minimum wages harm the most vulnerable and least skilled workers.[78] Other arguments against raising the minimum wage include that fact that an increase creates both winners and losers: those who keep their jobs at the new higher wage, and those who see a reduction in hours, job loss, or fail to obtain a job at all.[79]

Policy Goals and Full Employment

Despite assertions of being near "full employment," broader indicators continue to show significant slack in the labor market.[80] The unemployment rate has historically been used to

determine progress towards full employment. However, as detailed above and in greater detail in the subsequent chapter, labor force dropouts, discouraged workers, and long-term unemployment have not fully recovered from the recession, even adjusting for population changes.

Furthermore, the *Report* states that the same macroeconomic policies used to return the economy to full employment can be used to reduce income inequality introduced by cyclical unemployment:

> *Indeed, unemployment or sub-optimal employment is a form of inequality in itself, resulting in zero or insufficient labor earnings for a subset of workers. The same macroeconomic policies usually employed to boost growth and return the economy to full employment can unambiguously reduce this cyclical form of income inequality.*[81]

While Federal law establishes full employment as an official policy goal as detailed in Chapter 7, blind commitment to full employment at all costs can be wildly counterproductive. There are significant tradeoffs associated with using fiscal and monetary policies to bring the economy back to full employment. Federal borrowing to meet that goal comes with long-term economic costs and exacerbates intergenerational inequities.

In fact, the reasons for workers to find themselves jobless or leave the labor force may suggest a different remedy today than the ill-conceived stimulative measures initially pursued through fiscal and monetary policies during and in the immediate aftermath of the recent recession. Many economists and policymakers believe that, at least in theory, using these macroeconomic stabilization tools as "counter-cyclical" policy can boost economic growth in times of distress and rein in growth when the economy is perceived to be overheating (i.e. when growth is occurring at an unsustainable rate and demand outpaces production, leading to higher prices). However, the reality is that the appropriate policies may not be chosen in a timely manner or at all. The stakes are high: the wrong move may very well yield a worse outcome for the economy than would have occurred had no action been taken at all.

Although the *Report* places the discussion of income inequality in the specific context of cyclical unemployment (which results from insufficient aggregate demand), F.A. Hayek argued that not all unemployment above the natural rate is indicative of insufficient aggregate demand, and pursuit of full employment through spending meant to increase aggregate demand risks not only chronic inflation, but imposes a pervasive mismatch between the type of labor supplied and the type of labor demanded by employers. Hayek goes on to note the true problem is to achieve a distribution of labor with a sustainable level of high employment without artificial stimulus. However, Hayek cautions that we are incapable of knowing what that distribution of labor is beforehand.[82]

Federal policymakers have an important role in fostering a free-market economy in which Americans enjoy ample opportunities for employment, but government should not and cannot be the paramount facilitator of the labor market. The private sector is the true driver of labor market dynamism.

It is quite possible that the recession, paired with longer-term structural trends in technology and demographics, as well as policy changes that affect the reward of work, have altered incentives to participate in the workforce, work more hours, and start and grow businesses. Many policies that the Administration has pursued in the aftermath of the recession are estimated to negatively affect employment. Examples include the President's proposed minimum wage increase, the ACA's 30-hour full-time work threshold,[83] and the pending increase in the Department of Labor's income threshold for overtime pay eligibility.[84] As aforementioned, CBO projected that a proposed Federal minimum wage to $10.10 per hour could amount to an employment reduction of as many as one million workers.[85] In addition, CBO also estimates the implementation of the ACA will cause a labor force reduction of roughly two million full-time equivalent workers by 2025.[86] Full implementation of the increase in the Department of Labor's income threshold of overtime pay could reduce full-time equivalent jobs by as much as half a million jobs or more.[87] These and other regulations effectively reduce economic productivity and thwart job growth for the most vulnerable workers.

Rather than the Administration's policies, Congress should look to pro-growth, structural policy measures and reforms, including changes in spending and tax provisions, and deregulatory measures that aim to increase the incentives for potential workers to find jobs, and for businesses and entrepreneurs to hire and train workers.[88] Above all, in this uncharacteristically slow-growth environment, it remains more important than ever that the Administration, Congress and the Federal Reserve avoid taking hasty action that risks destabilizing an already fickle economy.

Improving Workforce Potential

Overall wage growth was middling for most of 2015, picking up in the final month of the year. By one measure, the 12-month change of average hourly earnings, nominal wage growth rose 2.5 percent in December 2015, suggesting long-awaited momentum for stronger growth had finally arrived, though the average annualized change for 2015 stood at 2.2 percent.[89] However, nominal wages are still increasing more slowly than the 3.5 percent rate which the Federal Reserve considers "healthy."[90] Furthermore, that momentum has a long way yet to translate into higher household incomes. Real median household income for 2014 (the latest data available) was slightly lower at $53,657 than in 2013 ($54,462).[91]

As aforementioned, wage gains for millennials have been much slower. In fact, other costs typical to a young person—such as rent and student loan debt— are actually outpacing wage gains. In addition, the starting wages of recent college graduates since the beginning of the recent recession have changed very little, and a gap has grown between recent graduates and overall median weekly earnings, an occurrence that predates the recent recession by several years.[92] In fact, the aforementioned Pew research on the middle class found that young adults age 18 to 29 were among the biggest "losers with a significant rise in their share in the lower-income tiers."[93] Economist Tyler Cowen argues that does not bode well for our economic future.[94] This is particularly concerning if the economy is giving way to a "Great Reset" that, in a low-productivity growth

environment,[95] will offer far less favorable long-run wage prospects and slower growth in living standards, borne out most clearly by the young entering into the workforce. Ultimately, it remains to be seen whether young adults will surmount the challenges they face today.[96]

In his State of the Union address, President Obama brought his proposal for two years of free community college back to the fore, stating that he will "keep fighting to get that started this year."[97] However, the Administration's focus in the realm of education remains misplaced and the solution offered does little to remedy the education deficits with which so many students across the nation are saddled. As mentioned in the *Response* last year:

> *Making community college free does not ensure that students who graduate from said programs will actually have the skills they need to obtain a good paying job. Today, many of the classes offered at community colleges are remedial, compensating for deficits in education received at the high school level. Financially, community college is not perceived as a chokepoint for many students, as most low-income individuals are already able to receive a community college education for free if they are eligible for Pell Grants. Furthermore, of the nearly 40 percent that are able to graduate, their incomes remain scant above that of workers with only a high school diploma if they do not go on to complete a college degree.*[98]

Recent research from the Federal Reserve Bank of New York indicates that nearly half of recent college graduates were underemployed between 2009 and 2013, working in jobs that do not require a college degree, though these recent graduates are making more than other young workers of a similar age without a degree. Only approximately one-fifth of underemployed recent graduates were in low-skilled jobs, including baristas, bartenders and cashiers.[99]

In testimony before the JEC, American Enterprise Institute scholar Andrew Kelly argued that evidence increasingly suggests that not only does an affordability crisis exist in American higher education, but that a value crisis exists as well. This is especially true in the case of recent college graduates, given that the wages of recent college graduates have declined over the past decade. The result is that students are paying more for a lower return to education.[100] In the same hearing, former Indiana governor and current Purdue University President Mitchell E. Daniels noted that accessibility and affordability of higher education and career readiness are imperative to economic growth and argued that universities should have more "skin in the game" to hold them accountable for student outcomes.[101]

CONCLUSION

Nearly seven years into the recovery, Americans are still waiting for a sign of stronger income growth and resulting economic mobility. As the JEC marks its 70th anniversary this year, as discussed in more depth in Chapter 7, it is remarkable that our nation finds itself continuing to

address many of the same challenges raised in previous years. For instance, in its *Response* on the 50th anniversary of the JEC, the Committee noted that though President Clinton and his CEA were painting a picture of economic robustness, members were concerned that things like a booming stock market belied economic fundamentals:

> *The President wants anxious workers to know that he 'feels their pain' while at the same time boasting…that this is the best economy in decades. Economic statistics paint a contradictory picture. The so-called "misery index" (inflation plus unemployment) is admittedly quite low (thank you [Fed Chairman] Alan Greenspan), but this economic expansion has been unambiguously poor.…The facts are clear. No matter how you slice it, Bill Clinton's economic expansion record—anemic growth of 2.3%—is dismal.*[102]

Not only did these words make it clear that Members believed tough times lay ahead (confirmed when the dot-com bubble burst), they have also proved timeless. One could easily read the exact same paragraph in today's paper with a couple of names changed to reflect different Administrations, and have no idea that it had been written 20 years ago.

It is only fair to note that although the JEC has a good track record, the Committee's *Response* has admittedly not always been spot on. For instance, the then-Majority's 2010 *Response* set out a three-point agenda that they claimed would kick start the post-financial crisis economy:

> *An effective, targeted stimulus would include a portfolio of policies. First, extending unemployment insurance would have ripple effects across the entire economy, triggering broad-based economic growth…Second, federal investment in small businesses would help jumpstart job creation.…Finally, federal funds for innovation and basic research play a key role in economy recovery.*[103]

After six years of irresponsible spending on programs like these, the United States remains mired in economic growth barely topping two percent.[104] Deficits and debt are on the rise and one in ten people age 16 and older is underemployed or unemployed.[105] Furthermore, the likelihood of the United States slipping into recession has risen to 25 percent according to Bank of America.[106] Perhaps the Administration should have heeded the conclusion of the Minority Views at that time:

> *Despite the daunting challenges facing our nation and recent steps by the majority in the wrong direction, we remain confident that the entrepreneurial spirit and drive of America will survive and prosper. It will emerge—not with the interference of an expansive government, but with the hard work, thrift, and determination of its people. Harnessing that work, thrift and determination requires that government help provide a transparent and fair playing field, but also requires that government let its working families and productive enterprises flourish by allowing them to reap the benefits of their activities. Higher taxes and expanded government serves to diminish rewards to entrepreneurial efforts.*[107]

As discussed in last year's *Response*, the Administration should broadly support policies that promote economic mobility for all Americans in addition to focusing on individuals who experience little to no economic mobility, such as those who lack the necessary skills to compete in today's workforce.

Furthermore, as longer-term technological trends continue, labor market polarization[108] will continue to affect the types of jobs demanded in the economy as middle-skill jobs are automated. Policies that negatively alter work incentives will reduce work opportunities, flexibility, and hours. Regulatory barriers to entrepreneurship, specifically the cumulative burdensome requirements imposed at the Federal level and occupational licensing laws at the state level, will continue to impede the creation and development of businesses and the jobs that come with it.[109] Altogether, these shifts in technology and policy will ultimately be reflected in the income earned, the number of earners, and the hours worked by individuals in these households, regardless of distribution.

As discussed in the *Report*, much concern remains over the considerable slowdown in productivity over the past decade, and labor productivity in the nonfarm business sector remained fairly subdued over the course of 2015.[110] Strong growth in productivity is a key component to output, profit, and wage and income growth. Yet nonfarm business sector productivity growth has achieved a mere 0.6 percent average annual rate since the first quarter of 2010, and fell at an annual rate of 3.0 percent in the last quarter of 2015. Thus far, it would appear that the Administration's hopes of higher productivity have been dashed, undermining the Administration's budget and expected lower future deficits.

In addition, while demographic trends continue to affect the overall labor force participation rate, the participation rate of prime-age workers (age 25 to 54) remains 1.8 percentage points below the recovery start after decelerating during the recession and reflecting a longer-term declining trend. As mentioned in the *Response* last year, though it is hoped that these trends will improve, productivity and labor force participation growth alone cannot address the Federal spending problems that have been years in the making. Furthermore, if the projected long-term trends in demographics and participation in the labor force serve to frame the future labor market, then countries such as the United States would be wise to ensure their fiscal sustainability to avoid potentially slower future economic growth.

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