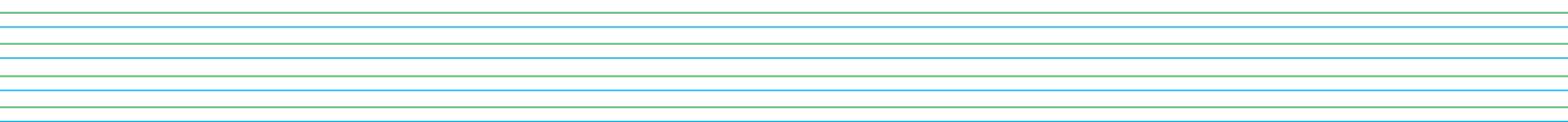


# PROSPERITY ECONOMICS

## Building an Economy for All



Jacob S. Hacker and Nate Loewentheil





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## About the authors

**Jacob S. Hacker, Ph.D.**, is the Director of the Institution for Social and Policy Studies (ISPS), the Stanley B. Resor Professor of Political Science, and Senior Research Fellow in International and Area Studies at the MacMillan Center at Yale University.

An expert on the politics of U.S. health and social policy, he is author of *Winner-Take-All Politics: How Washington Made the Rich Richer—And Turned Its Back on the Middle Class*, with Paul Pierson (September 2010, paperback March 2011); *The Great Risk Shift: The New Economic Insecurity and the Decline of the American Dream* (2006, paperback 2008); *The Divided Welfare State: The Battle Over Public and Private Social Benefits in the United States* (2002); and *The Road to Nowhere: The Genesis of President Clinton's Plan for Health Security* (1997), co-winner of the Brownlow Book Award of the National Academy of Public Administration. He is also co-author, with Paul Pierson, of *Off Center: The Republican Revolution and the Erosion of American Democracy* (2005), and has edited volumes, most recently, *Shared Responsibility, Shared Risk: Government, Markets and Social Policy in the Twenty-First Century*, with Ann O'Leary (2012).

Professor Hacker is the author of a 2001 proposal for universal health care (re-issued in 2007 as “Health Care for America”) that shaped several presidential aspirants’ plans, as well as of three briefs on how and why to encourage private health insurance to compete with a new public health plan for the nonelderly, the so-called public option.

He received his B.A. from Harvard in 1994 and Ph.D. from Yale in 2000. From 1999 through 2002, he was a Junior Fellow of the Harvard Society of Fellows.

**Nate Loewentheil** is entering his third year at Yale Law School where he is focusing his studies on environmental law and politics. In early 2005, while in his sophomore year in college, he helped found the Roosevelt Campus Network and later served from 2007 to 2009 as executive director. Following this, he spent a year working in Cochabamba, Bolivia, on water provision in rural areas. More recently, he spent a summer working at the White House Domestic Policy Council.

Mr. Loewentheil sits on the Board of Directors of the New Leaders Council and on the Founders Board of PolicyMic.com. He blogs regularly for *The Huffington Post* and writes for *citizenthink.net*. He is also the editor of a 2008 book, *Thinking Big: Progressive Ideas for a New Era*. He graduated *cum laude* from Yale University in 2007 with distinction in the Program in Ethics, Politics, and Economics.

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# Executive Summary

The United States faces two pressing economic problems. The first is immediate: Almost five years after the financial collapse, joblessness remains rampant and the economy is recovering far too slowly. The second problem is deeper: the breaking of the historical connection between *growing economic output*, on the one hand, and *middle-class wages and income*, on the other. Over the last generation, the productivity of American workers—output per hour of work—grew substantially. Yet, in a sharp break with the past, wages for most workers stopped rising in tandem with productivity. The gains of economic growth instead accrued disproportionately to affluent Americans. Along with these increased economic gains, wealthy Americans, large corporations, and Wall Street also gained greater political clout relative to the American middle class.

Confronted with these challenges, the leading theory in Washington, which we call “austerity economics,” maintains that the answer is getting government out of the way and giving business free rein. It is the same set of prescriptions that has dominated policy making for decades: cut taxes for the wealthy; scale back rules that protect the environment, the financial system, and the workforce; and slash the sources of economic security on which Americans rely—Medicare, Medicaid, Social Security.

This report lays out an alternative to austerity economics, one based on our history, the successful experiences of other nations, and recent currents of research and theory in economics and allied fields. We call this model “prosperity economics.” Its central conclusion is that there is no inevitable trade-off between creating a strong, dynamic economy and fostering a society marked by greater health, broader security, increased equality of opportunity, and more broadly distributed growth. To the contrary, societies that cultivate a wider distribution of the returns from increasing social wealth are the ones that flourish economically.

When all members of a society share in the rewards of advancement—from better health to greater political freedom, from basic economic security to greater upward mobility—society is more likely to prosper in a sustained way. And when the government plays an active role in the economy through investments in education and scientific research, economies are more dynamic and innovative.

In Part One of the report, we discuss some of the key myths of austerity economics used to justify its painful prescriptions for the middle class, including the myth that spending and deficits are the greatest threat to the economy and that gains at the top drive gains for everyone else. We highlight in particular that, contrary to popular impression, the last generation of tax cuts for the rich has not pushed more Americans to create businesses or become self-employed. Quite the opposite: measures of entrepreneurship have fallen substantially, and our small business sector and rates of self-employment are low compared with other rich nations. What these tax cuts have mostly done is add to the economic gains at the top. At the same time, they have undermined key public investments and our ability to help the middle class and those aspiring to join it.

These regrettable results should not be so surprising. Austerity economics has prosperity backward. Prosperity doesn’t just “trickle down” from the top. It depends on the common investments and sources of security we agree on as members of a democracy, on institutions—especially unions—that ensure that gains are broadly shared, and on a healthy democracy that can sustain sound economic policies and check today’s economic winners from undermining the openness and dynamism of the economy. This is what prosperity economics shows, as we lay out in Part Two of this report.

Shared prosperity, according to prosperity economics, is built on three pillars: growth, security, and democracy. These three pillars support a strong, secure

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middle class and reinforce one another. Any agenda for economic reform therefore must focus on:

- dynamic, innovation-led **growth**—first from immediate action to jumpstart our sagging economy, and then, over the coming decades, through investment in people and productivity that leads to good jobs and rising wages;
- **security** for workers and their families, for the environment, and for our public finances;
- a **democracy** that works—one based on accountability and democratic values in the private sector as well as in public life; and on a system of government that is not overwhelmed by money or hamstrung by political procedures that allow the wealthiest and most partisan to dictate policies.

These were the pillars that supported the rapidly growing economy of the mid-20th century. They have also characterized the most successful economic models we see in other rich democracies. And when they are actively cultivated, we see a “virtuous cycle” of shared growth—an increasingly educated, secure, and prosperous middle class reflecting and strengthening a vibrant democracy.

To rebuild the three pillars of shared prosperity, we call for bold, immediate action. This makes up Part Three—our key recommendations for strengthening the American economy now and for the future. To restart economic growth, we recommend major investments in infrastructure. To accelerate growth

for the future, we call for a college system that guarantees all qualified students the chance to attend and graduate with a diploma. Economic growth will do little for most Americans, however, unless wages rise with productivity and economic security is strengthened. To this end, we call for empowering workers to engage in collective bargaining. We also show how we can reinforce Social Security and continue to improve health coverage and tackle medical costs, supporting American families and putting families, businesses, and government on firmer fiscal footing. We call too for stricter lobbying rules and public financing of our elections to limit the power of special interests and shape a government more responsive to the middle class. Each of these policies, and the others we suggest, are strongly rooted in American traditions and in solid economic theory and research. Together, they will help build a stronger, more inclusive, and more sustainable economy.

We *can* afford to rebuild America’s productive capacity, reconnect earnings and economic security to overall productivity, increase social mobility, and reform our political institutions. Indeed, we cannot afford to ignore these challenges. Increased global competition, growing social diversity, and other changes in our society do not stand in the way of this vision. They make it all the more imperative that we act today to create a virtuous cycle of shared growth, broad economic and fiscal security, and a vibrant participatory democracy. These are the qualities that have historically made America’s economic model one to envy—and they must guide us again today.

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# Introduction

In an era of economic uncertainty, how can we achieve a better future? How can we ensure that today's young workers—and the generations after them—inherit a stronger economy? How can we overcome our current jobs crisis and achieve prosperity for all?

The leading theory in Washington today says that the answer is to get government out of the way and give business free rein. Cut taxes for the wealthy and cut government investments benefiting everyone else. Slash rules that protect the environment, the financial system, and the workforce, and slash the sources of economic security on which Americans rely—Medicare, Medicaid, Social Security.

If this argument sounds familiar, it's because it has shaped government policy for more than 30 years. The results speak for themselves: growing insecurity and inequality; stagnant wages and contracting social mobility; and an acute jobs crisis that threatens to become chronic, with more than 23 million Americans unemployed, underemployed, or completely outside the job market. And yet, in the face of these challenges, we hear calls to double down on the old formula: cut programs providing security, divert more to the wealthiest, and let the market work everything out.

This theory about how to run our nation, which we call “austerity economics,” has it exactly backward. Prosperity does not just flow “downward” from current economic winners. It is generated by *everyone* who works to gain skills and climb the economic ladder. It is generated by workers as well as employers, by entrepreneurs just starting out as well as established corporate giants, through unions and collective bargaining as well as through innovative companies and visionary managers. The market does not and simply cannot

work out everything on its own. Prosperity depends on the common investments and sources of security we agree on as members of a democracy—on things like roads, schools, and basic worker protections. And it depends on democratic institutions that both provide broader gains for all and ensure that today's economic winners do not undermine the openness and dynamism of the economy.

Austerity economics is based on a set of assumptions that are each demonstrably false. In place of them, we present an evidence-based approach that draws on the lessons of history and builds on recent theory and research in economics and allied fields. We call this approach “prosperity economics.” Its central message is that our long-term prosperity rests on three pillars:

- dynamic, innovation-led **growth**—first from immediate action to jumpstart our sagging economy, and then, over the coming decades, through investment in people and productivity that leads to good jobs and rising wages;
- **security** for workers and their families, for the environment, and for our public finances;
- a **democracy** that works—one based on accountability and democratic values in the private sector as well as in public life; and on a system of government that is not overwhelmed by money or hamstrung by political procedures that allow the wealthiest and most partisan to dictate policies.

To rebuild these pillars, we call for major investments in infrastructure and public education. We call for robust new commitments to promoting scientific

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research and providing pathways into and through college. We call for our leaders to provide jobs, reset the trade deficit, and reinvigorate American manufacturing. We call for measures to rein in health costs while strengthening Medicare and Social Security. We call for increased emphasis on the economic security of working-age Americans and families with children. And we call for rolling back the excess influence of large corporations and the superrich, creating space for more small-scale entrepreneurship and greater democratic participation in both public life and in the workplace. No modern political democracy has been created and sustained without a strong middle class fostering economic equality, advancement, and security, or without strong rights for workers to join and bargain together.

This is an agenda wholly consistent with a vibrant, innovative capitalism; indeed, it is essential for it. As economists from Adam Smith onward have recognized, market competition requires public investments and public goods, ground rules for commerce and finance, protections against market concentration, and a well-functioning, responsive democracy—above all, a democracy that is independent of the power of powerful business interests.<sup>1</sup> Contrary to popular impression, the last generation of tax cuts for the rich and rising inequality have not unleashed a boom in entrepreneurship. Far from it: measures of entrepreneurship—from new business startups to self-employment—have fallen, and our small business sector is smaller and rate of self-employment is lower than most other rich nations.<sup>2</sup> Whether the cause is exorbitant health costs or the difficulty of finding financing due to middle-class economic strains and short-term-oriented financial markets, the reality is that the economic model advocated by austerity economics is failing to deliver on its central promise of dynamic market competition, precisely because it fails to identify the true sources of long-term prosperity.

We face substantial challenges today. But as John F. Kennedy once wrote: “No problem of human destiny is beyond human beings.” It is a lesson we must remember. Outdated policies, failures in our market, and the weakening of checks and balances in our democracy

and in our economy require bold reforms. These actions have to be simple and clear, and create positive political momentum in favor of further reforms. And they must be guided by evidence from our history, from the experience of other nations, and from recent social science research about what works and what doesn’t.

No single document can shift public debate, but we hope that the ideas included here will add to a growing movement for change that rejects the false logic and false promises of austerity economics and starts rebuilding the American dream. This movement will have to build power sufficient to push for a new generation of economic policies and for the political reform necessary to achieve them. But it is possible. We have seen powerful, effective movements before in American history—from the New Deal to the civil rights movement—and we will see them again.

Our small contribution is to provide a body of evidence to support the proposition that shared prosperity is the only economically viable route to a strong future, and to suggest what policies can move us toward this vision. To that end, we will first sketch out the dueling economic theories—austerity economics (Part One) and prosperity economics (Part Two)—before laying out a broad economic agenda (Part Three). This agenda is not designed to be comprehensive. Instead, each set of policies highlights a few major areas that are in need of action, that are capable of generating broad public support, and that can help create shared prosperity.

Our central message is this: We *can* afford to rebuild America’s productive capacity, reconnect wages and productivity, improve equality of opportunity, and reform our political institutions. Indeed, we cannot afford to ignore these challenges. Increased global competition, growing social diversity, and other changes in our society do not stand in the way of this vision. Quite the opposite: They make it all the more imperative that we create a virtuous cycle of shared growth, broad economic and fiscal security, and a vibrant participatory democracy. These are the qualities that have historically made America’s economic model one to envy—and they must guide us again today.

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## PART ONE ■■■

# Austerity Economics and Its Discontents

The United States faces two pressing economic problems. The first is immediate: Almost five years after the financial collapse, joblessness remains rampant amid a historically weak economic recovery. Millions of workers are unemployed or underemployed, and some communities, especially communities of color, are experiencing Depression-era levels of joblessness. High levels of consumer debt drag down confidence and spending, while the effects of the collapse of the housing market continue to be felt through foreclosures, underwater mortgages, and abandoned homes. The economy may be roaring back to life for those at the top, but for the rest of us, its heart is barely beating.<sup>3</sup>

It doesn't have to be this way. Nothing fundamental has changed in the quality of the American workforce since 2007 that would prevent us from returning to full employment. Joblessness today is overwhelmingly cyclical (due to a weak economy) rather than structural (workers with skills unsuited to today's jobs). That is, persistent high unemployment is driven by the aftermath of the financial crisis rather than any sudden mismatch between jobs and skills—as is shown by the ubiquity and similarity of job losses across sectors of our economy, and the continuing high ratio of job seekers to job openings.<sup>4</sup>

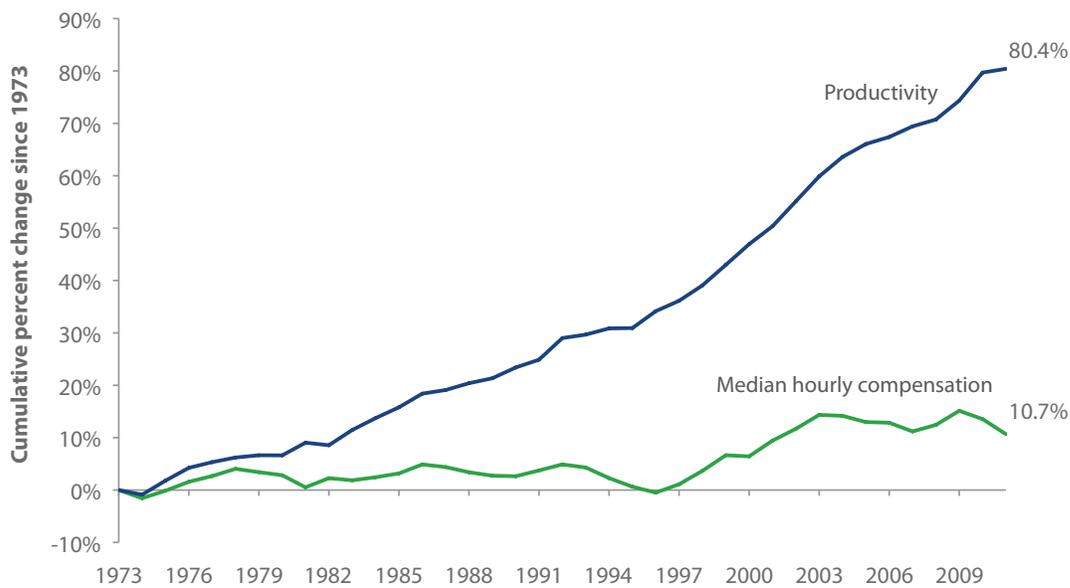
But we do face a deeper long-term problem, one that has become ever clearer over the last generation: the breaking of the historical connection between *growing economic output* on the one hand and *middle-class wages and income* on the other. In the decades leading up to the financial crisis, the productivity of American workers—output per hour of work—grew substantially. Yet, in a sharp break from the past, wages stopped

rising in tandem with productivity (**Figure A** shows the trend since 1973). Nor were these relative declines offset by increased benefits; in fact, job-based benefits like health insurance and pensions are less common than they were a generation ago and shift more risk and costs onto workers.<sup>5</sup>

To make up for this wage slowdown, middle-class households worked more hours, sent more of their members into the labor market, and borrowed more. Yet despite working harder and longer, most Americans saw their after-tax incomes grow extremely slowly, especially in comparison with the meteoric gains experienced by the highest-income households (**Figure B**) In the run-up to the downturn, the share of pre-tax national income received by the richest 1% of Americans more than doubled. The share received by the richest 0.1% (average pretax income in 2007 of \$7 million) more than *quadrupled*, rising from less than 3% of total income in 1970 to more than 12% in 2007—the highest proportion since the creation of the income tax in 1913.<sup>6</sup>

The rise of a strong middle class in the United States was not an accident, and its decline was not an accident either. Working Americans built the middle class by shaping the political process to produce shared prosperity and economic security, by building unions and bargaining collectively with their employers, by pressing for better wages, better working conditions, and better benefits. And when the clout of the middle class and labor unions declined starting in earnest in the late 1970s—as business mobilized on a scale never before seen and money became more and more important in politics—the middle class' share of national income declined as well.

**FIGURE A: Change in hourly productivity and median compensation, 1973-2011**



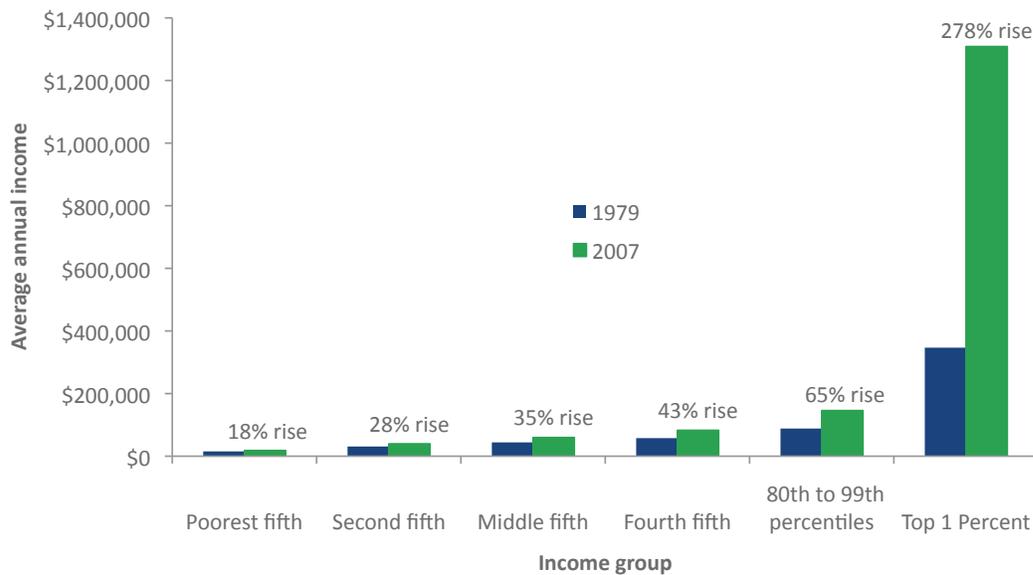
Note: Compensation for production/nonsupervisory workers in the private sector and productivity for the total economy.  
Source: Economic Policy Institute analysis of unpublished total economy data from Bureau of Labor Statistics Labor Productivity and Costs program; data from the Bureau of Economic Analysis National Income and Product Accounts; and Current Population Survey Outgoing Rotation Group microdata.

In other words, before the current crisis began the U.S. economy—for most of us, and for more of us every year—was like a slowing bus. The crisis threw the bus into reverse. Now we need not just to get it moving forward, but to accelerate it. This document is a manual for how to do so, a plan for developing broadly shared prosperity.

Because we face both short-term and long-term challenges, our prosperity agenda combines immediate solutions—like major investments in infrastructure to create jobs and debt relief for underwater homeowners—with efforts to address long-term structural issues, such as the decline in U.S. manufacturing and more general shortage of quality, middle-class jobs; low rates of social mobility; declining job and economic security; unequal labor market outcomes for minorities; and the loss of democratic voice and power for most citizens in a political system increasingly dominated by corporate lobbying and deep-pocketed donors.

The first and central challenge is **growth**. Over the last generation, our economy has produced shallow, top-heavy growth—growth based on housing and stock market bubbles, escalating consumer debt, disinvestment in public infrastructure and R&D, and an unsustainable upward trend in family work hours. Most disappointing is that the growth we experienced did not provide robust across-the-board income gains, though it was adequate to do so; instead the gains were concentrated among the best off. Economic, environmental, and fiscal **security** have been sacrificed on the altar of tax cuts for the rich and solicitousness toward corporate lobbies. These shifts in turn reflect and reinforce a major weakening of our **democracy**—from our national government down to our communities and workplaces. The current immobilization in the face of broad distress is the latest alarming evidence of a political system out of touch with the concerns of ordinary workers and their families.

**FIGURE B: Average household after-tax income including public and private benefits, 1979 and 2007**



Source: Calculations from Congressional Budget Office, "Trends in the Distribution of Household Income Between 1979 and 2007," Washington, D.C.: CBO, October 2011.

We are not living up to our promise as a nation. **Figure C** is a report card rating the United States' performance relative to other rich democracies on key measures of social health, such as health and longevity, upward social mobility, poverty, inequality, and environmental conservation. The United States is at or near the bottom of the rankings on nearly all measures. Despite spending roughly twice as much on health care per person, for example, we have the highest infant mortality rate, the highest percentage of people without health insurance, and the shortest life expectancy. We may be the richest economy in the world, but we are plagued by levels of poverty, intergenerational social immobility, and inequality that are worse, often much worse, than in all or virtually all other wealthy nations.

As is too often the case, these social ills are magnified in marginalized communities. While the recession has caused significant harm to Americans of all races, it has been particularly hard on people of color. In the

first half of this year, the national unemployment rate was 8.2%. For blacks, it was 13.8%. Latinos, meanwhile, suffer from unemployment rates that are about 1.6 times the white rate.<sup>7</sup>

These disparate effects reflect decades of overt discrimination and continuing barriers to equal opportunity. Even when employed, for example, there is a substantial wage gap between white and black workers. In 2008, black men earned only 71% of what white men earned. Blacks remain greatly overrepresented in lower-wage occupations and underrepresented in higher-wage occupations.<sup>8</sup> With these long-term conditions have come high rates of poverty and sharply limited ability to accumulate assets and save for retirement.

Women too have historically suffered from a range of obstacles in the labor market: lower wages, occupational segregation,<sup>9</sup> limited opportunities for advancement, and all of the challenges that come with working while serving as the principal caretaker for children and aged and infirm family members. Women who work

FIGURE C

UNITED STATES 'SOCIAL HEALTH' REPORT CARD	
<b>COUNTRIES IN THE RANKINGS:</b>	
<b>North America:</b> Canada, United States / <b>Europe</b> (except Scandinavia): Austria, Belgium, France, Germany, Greece, Ireland, Italy, Netherlands, Spain, Switzerland, United Kingdom / <b>Scandinavia:</b> Denmark, Finland, Norway, Sweden / <b>Asia:</b> Japan / <b>Oceania:</b> Australia, New Zealand	
Measure	U.S. rank
1. Income inequality (Gini coefficient, 2005)	Highest of 20
2. Income share of top 1% (2005)	Highest of 17
3. Relative poverty (late-2000s)	Highest of 20
4. Total health expenditures per capita (2009)	Highest of 20
5. Infant mortality (per 1000 births, 2011)	Highest of 20
6. Health insurance coverage rate (2009)	Lowest of 20
7. Life expectancy at birth (2008)	Lowest of 20
8. Yale Environmental Performance Index (2012)	Lowest of 20
9. Union membership (2006-2007)	2nd lowest of 20
10. Intergenerational earnings mobility (1995-2002)	3rd lowest of 12

Source: See endnote 177.

full time year-round still earn only 77 cents for each dollar earned by men. African American women earn 62 cents and Latino women 54 cents for each dollar paid to white, non-Latino men.<sup>10</sup> Moreover, women account for almost two-thirds of minimum wage workers and two-thirds of tipped workers, for whom the minimum wage is only \$2.13 per hour.<sup>11</sup>

These inequalities are not simply unfair, they are economically destructive. The economy grows and we prosper as a society when all Americans can enter the workforce, when all our talents and capacities can be utilized, and when more and more workers and families can enter the middle class and use their buying power to contribute to a virtuous cycle of growth. In an era of increasing global competition abroad and growing diversity at home, we cannot afford to keep millions of individuals on the sidelines. Many of the policies in this agenda—efforts at creating jobs,

improving labor standards, empowering workers, improving education, providing job training—are aimed at helping to address these inequalities, equalizing the playing field for women and communities of color, and ultimately making the economy stronger for us all.

Public debate about our economy has lost track of an important fact: Societies that cultivate a broad distribution of the returns from increasing social wealth also flourish economically.<sup>12</sup> When all members of a society share in the rewards of advancement—from better health to greater political freedom, from basic economic security to greater upward mobility—society is more likely to prosper in a sustained way. We have always known that affluence is associated with democratization, broader opportunities, and economic, health, and social gains. What we have increasingly learned is that these valuable *results* of affluence are also a *precondition* for innovation and growth. That is,

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a broad distribution of opportunities and the gains of growth create the kind of society that ensures that these opportunities and gains continue into the future. We all do well when we are all doing well.

This virtuous cycle does not just happen by lucky coincidence. It is a result of basic public commitments to quality education, basic R&D, high-quality transportation and communications, investments in green energy and advanced manufacturing, and other crucial prerequisites of productivity and upward social mobility. It is a result of commitments to providing the security individuals need to plan for the future, face the risks of health care, take care of themselves and their families, and retire safely. It is a result of commitments to forms of production and spatial development that draw on natural resources in a way that allows our environment to continue to sustain our material needs, without crisis or collapse. And it is a result of commitments to a political system that works to ensure the voices of citizens are more powerful than the donations and lobbyists of powerful economic interests. When these preconditions break down, the economy becomes imbalanced and vulnerable. It is suggestive to say the least that the two greatest economic crises of the last century—the Great Depression and the recent financial crash—both followed closely on the heels of sharp rises in economic and political inequality.

Nor is the breakdown of our commitment to shared prosperity and long-term competitiveness an unfortunate accident. Both our economic challenges and our failure to address them reflect deliberate choices by influential economic and political leaders, guided by a broad theory about how the economy works. The central premises of this theory—which we call “austerity economics”—are all myths: that spending and deficits are the greatest threat to the economy, that gains at the top drive gains for everyone else, that upward mobility makes rising inequality a non-issue, that markets will naturally align private economic behavior with the long-term health of the economy, and that only those at the top create jobs and prosperity. Though cloaked in the pleasing rhetoric of free markets, these arguments often serve as a cynical cover

for the efforts of major economic interests to secure favorable government treatment and choke off real competition. Let us look at these claims in more detail.

## **Myth 1: Spending and deficits are our #1 problem**

Since the financial crisis began, we have been told that deficits are the gravest threat to our nation’s prosperity and that the United States faces near-collapse if they are not immediately reduced. We are told, moreover, that slashing spending to reduce the deficit will actually help the economy by increasing the confidence of private investors. Both of these arguments are directly contradicted by economic theory and historical experience.

First, contrary to austerity economics, the deterioration of the U.S. fiscal position over the last decade was not driven by increased public spending on social benefits. Prior to the economic crisis, our public sector had been remarkably stable as a share of gross domestic product for nearly three decades.<sup>13</sup> And even with the large and regressive Bush tax cuts of 2001 and 2003, the costly prescription drug benefit of 2003, and mammoth increases in defense spending after 2001, deficits in 2006 and 2007 (the last two years before the Great Recession) averaged less than 1.5% of total GDP—a level consistent with falling debt-to-GDP ratios.

Deficits ballooned after 2008, but this was overwhelmingly a *symptom* of the Great Recession, which caused a severe drop in tax revenues as well as increases in safety net spending. The policy responses to the recession—including both the 2009 and 2010 economic recovery packages—added only trivially to long-term deficit problems for the simple reason that they were *temporary*.<sup>14</sup>

Deficits since the Great Recession have been a crucial shock absorber for the economy, and they have provided needed purchasing power that has put downward pressure on the unemployment rate.<sup>15</sup> When the economy is operating below its productive capacity, expansionary fiscal policy can boost growth—this is economics 101, and evidence for it continues to

accumulate.<sup>16</sup> We are underproducing relative to what we could, at a huge cost to the nation. Worse, we are squandering the nation's most valuable asset, its human capital. High unemployment does not just cause short-term depression of wages and incomes. The evidence is overwhelming that new high school or college graduates entering their work lives during periods of high unemployment will see lower earnings over their lifetimes.<sup>17</sup> Deficits are justified when they fund investments with large payoffs, like getting Americans back to work. This is precisely the case today.

Historical experience reinforces this message. In 1937, a premature turn toward fiscal austerity worsened the Great Depression. Conversely, after World War II the United States had a huge national debt, yet instead of paying it down immediately the nation made large investments in infrastructure, education, and economic security, which paid off in long-term growth that gradually brought the debt down. In recent years, countries like the U.K. that have embarked on austerity programs by choice have experienced unimpressive growth or fallen back into recession, with unemployment remaining high or actually rising, particularly among younger workers.<sup>18</sup>

Fiscal responsibility should be an important priority of government, and this blueprint lays out steps to bring our budget into long-term balance and stabilize our debt as a share of our economy. The most crucial steps are restraining the rise of America's exorbitant health costs and gradually restoring a tax base that has been decimated by round after round of tax cuts disproportionately benefiting the richest. In contrast, efforts to achieve short-term fiscal balance by radically scaling back crucial and popular social programs and public investments would be doubly defeating. First, scaling back spending would worsen the jobs picture and prevent the robust recovery necessary to tackle the deficit over the long term. Second, as argued throughout this report, our future competitiveness and success as an economy depend on active efforts to create and secure a strong middle class.

## Myth 2: Cutting taxes on the richest is an effective way to spur prosperity

Austerity economics contends that the affluent and big corporations are the main agents of economic prosperity. Incentives for them, in the form of reduced tax rates, will inevitably benefit the rest of Americans—whether through private investments that increase productivity or the creation of jobs.

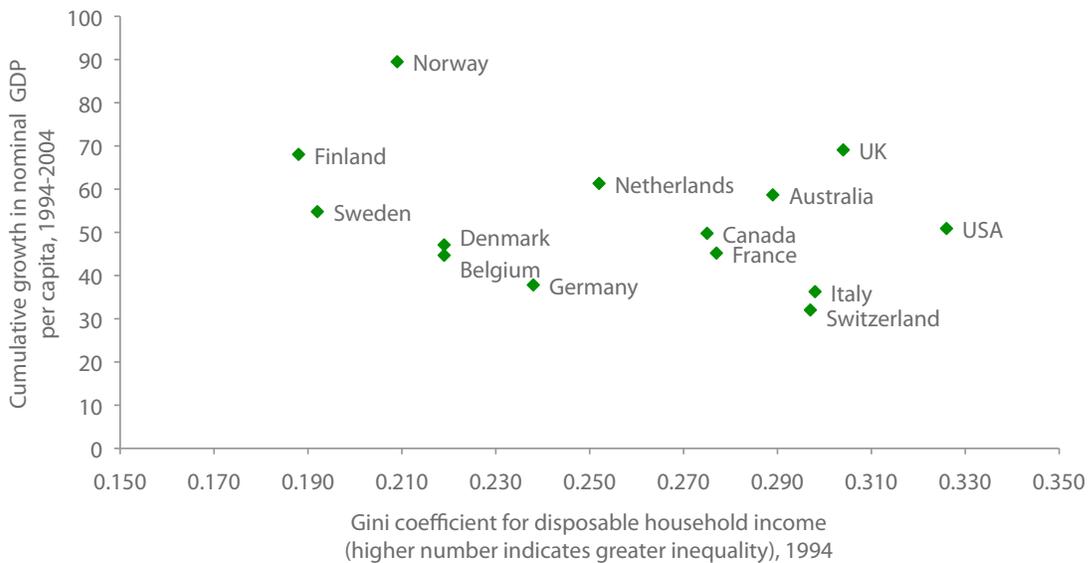
This theory was given a fair hearing over the last few years—and found badly wanting. The Bush-era tax cuts were followed by an anemic economic recovery in which family income failed to rise, and then by a calamitous recession. To be sure, there was some growth in the 2000s—at the top. During the expansion of the 2000s, more than *half* of all household income gains after taxes accrued to the richest 1%.<sup>19</sup> Executive pay and financial salaries climbed to stratospheric levels: Today, six in 10 of the richest 0.1% of Americans are corporate and financial executives, managers, and professionals.<sup>20</sup> Meanwhile, the typical household ended the decade with a lower income than it enjoyed at the start.

This pattern stands in stark contrast to the several decades after World War II, when growth was actually slightly faster in the middle and at the bottom than it was at the top (and, yes, tax rates on top earners were much higher). During this period, a rising tide did in fact lift all boats. Since the 1970s, it has mostly lifted yachts.

Of course, the defenders of austerity economics will argue that the slow or no growth experienced by most Americans would have been *even slower* if the gains at the top had been less. We cannot easily use our historical experience to address this point. But we can look at other rich democracies, and what we find is that economic growth is not consistently faster in nations like the U.S. where inequality is greater (see **Figure D**).<sup>21</sup> Nor is economic growth over the last generation faster in countries with bigger cuts in top marginal tax rates (see **Figure E**). Taxes on high earners have been dramatically slashed in the United States since the 1970s, yet overall economic growth has not

**FIGURE D: Economic growth and inequality, 1994-2004**

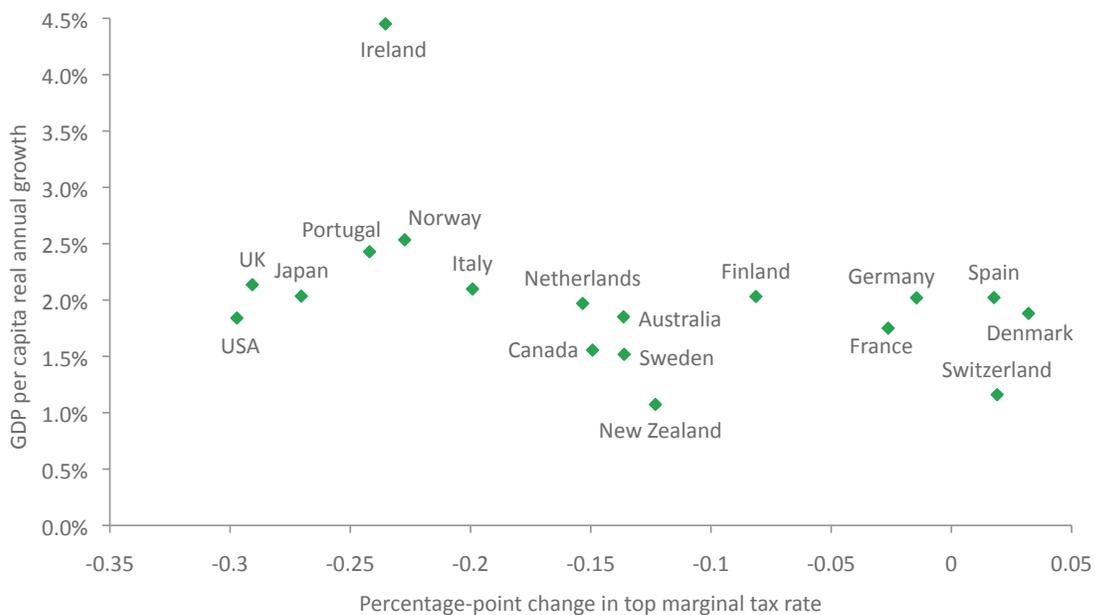
Economic growth has not been faster in nations where inequality is greater



Source: Based on Jonas Pontusson, "Inequality and Economic Growth in Comparative Perspective," David Grusky and Tamar Kricheli-Katz, eds., *The New Gilded Age: The Critical Inequality Debates of Our Time* (Stanford: Stanford University Press, 2012), 96. GDP per capita in U.S. dollars, current prices (i.e., not adjusted for inflation) and adjusted for purchasing power parity, Organization for Economic Cooperation and Development, OECD Factbook 2010: *Economic, Environmental and Social Statistics* (Paris: OECD, 2010).

**FIGURE E: Growth and change in top marginal tax rate, 1975–2006**

Economic growth has not been faster in countries with bigger cuts in top marginal tax rates



Source: Economic Policy Institute analysis of Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva, "Optimal Taxation of Top Labor Income: A Tale of Three Elasticities," Working Paper No. 17616, Cambridge, Mass.: National Bureau of Economic Research, 2011. <http://www.nber.org/papers/w17616>

been higher, on average, than in peer nations. (On the other hand, there is a strong association across nations between marginal rate cuts and rich people's share of national income.)<sup>22</sup>

When it comes to the growth of the overall economy, the essential ingredient is expansion of a nation's productivity, which rests heavily on public investments in education, research and development, infrastructure, and the like. These investments are vital for creating the next generation of entrepreneurs and innovators. And, of course, these investments require tax revenues, so cutting taxes at the top does not simply violate notions of fairness but potentially hurts economic growth.

The main effect of lower tax rates for the rich is that the rich get richer. To restore shared prosperity, there is no substitute for the hard work of building up the productive capacity of all workers and providing broad opportunities for advancement.

### **Myth 3: Inequality is not a problem because social mobility is high**

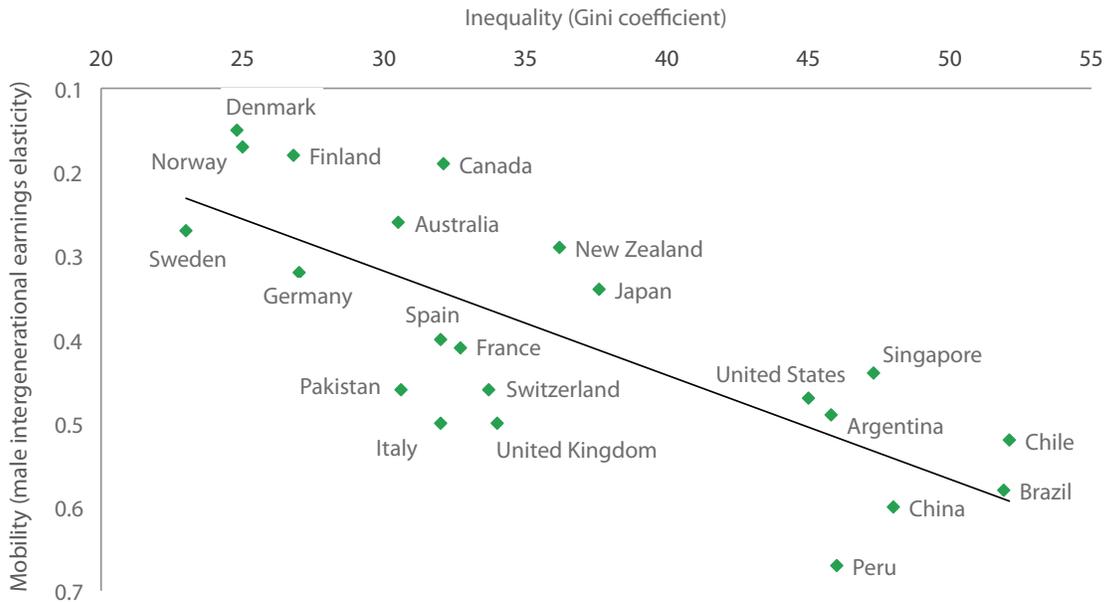
Whenever the inconvenient facts just outlined are mentioned, proponents of austerity economics shift to a second line of defense: There are no real class lines in the United States because anybody can rise to a higher position on the economic ladder.<sup>23</sup> The fact is, however, that upward mobility has stagnated even as inequality has risen. The chance that children will rise to a higher station than they are born into is greater in most other affluent nations than it is in the United States. Across nations, there is a strong relationship between economic inequality and economic mobility—more inequality, less mobility. **Figure F** illustrates this relationship: Countries with higher inequality (shown in the figure using a statistical measure called the Gini coefficient), also appear to be countries in which sons grow up to have similar earnings to what their father earned (an indication of low mobility). The United States has both higher inequality and lower mobility than other rich nations, and on our current path our already-low rates of mobility threaten to fall in the future.<sup>24</sup>

America's low rates of mobility—seven in 10 Americans raised in the bottom fifth end up in the bottom two fifths—are particularly glaring among African Americans.<sup>25</sup> Over half of blacks raised in the bottom of the income distribution will remain stuck in the bottom, compared with one third of whites, and half of all blacks raised in the middle fifth of the income distribution will actually fall to the bottom two quintiles.

Proponents of austerity economics lionize mobility. Yet at the same time, they call for shifting more and more of the costs of economic advancement onto families, which will hurt equality of opportunity, not foster it. While prices for basic consumer goods like food have fallen over the last generation, the cost of “enabling” goods, such as education and child care, have skyrocketed. The path to success starts earlier and earlier (even before kindergarten) and lasts longer and longer (well through college, today the equivalent of having a high school degree a generation ago). But our government has not stepped up to ensure that all kids have access to affordable pre-kindergarten options or that college is within the reach of every family. As a result, we are losing the promise of equality of opportunity that has defined the American dream since our founding.

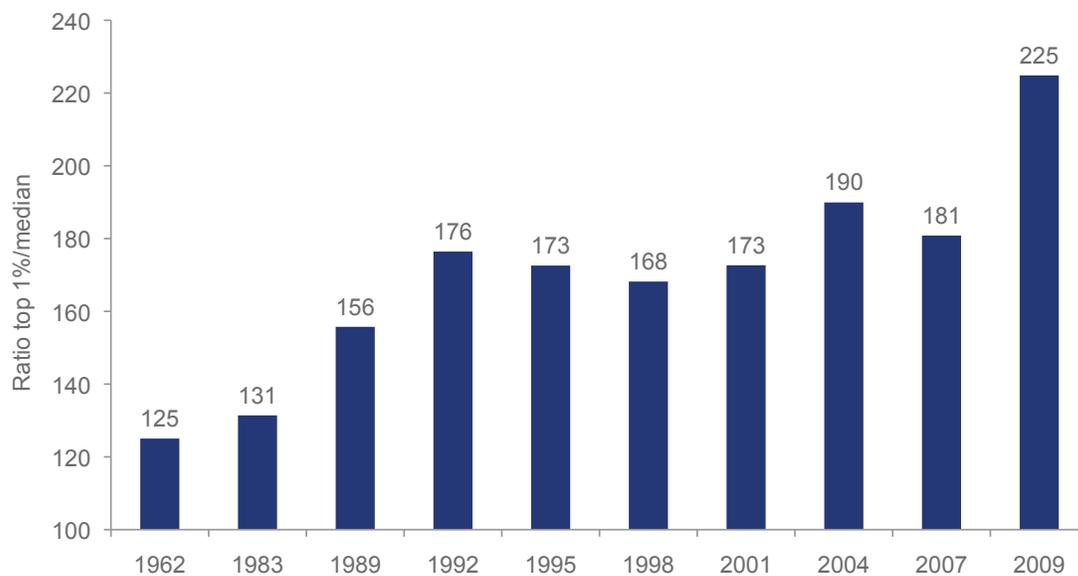
With public goods under strain, private assets have become more crucial. Yet they have grown more unequal, too. In 1983, the average wealth of the top 1% of wealth holders was 131 times the wealth of a typical household; by 2009, it was 225 times as large (**Figure G**). The richest 5% of wealth holders claim over 60% of the nation's wealth; the bottom 80%, only 13%. The gaps are particularly striking between white and minority households. In 2009, the median wealth of white households was more than 44 times that of black households. That year, the median net worth of black households, *including* housing, was \$2,200.<sup>26</sup> Without basic family assets, families are not just insecure in the present; they are constrained from making investments in their future—investments that are a critical well-spring of social mobility.

**FIGURE F: Inequality and immobility: relationship between income inequality and economic mobility across generations**



Source: Based on Miles Corak, "Inequality From Generation to Generation: The United States in Comparison," in Robert Rycroft (editor), *The Economics of Inequality, Poverty, and discrimination in the 21st Century*, ABC-CLIO, forthcoming 2012. Intergenerational earnings elasticity is a measure of the degree of correlation between the incomes of father and son, with higher numbers indicating less mobility. Gini coefficients obtained from *The World Factbook 2009*. Washington, D.C.: Central Intelligence Agency, 2009. <https://www.cia.gov/library/publications/the-world-factbook/index.html>. Every coefficient comes from 2005-2012, except for New Zealand, for which the only year available is 1997.

**FIGURE G: The ratio of the wealthiest 1% to median wealth in the United States, 1962–2009**



Source: Edward Wolff, unpublished analysis of the U.S. Federal Reserve Board, Survey of Consumer Finances and Federal Reserve Flow of Funds, prepared for the Economic Policy Institute, 2010.

## Myth 4: Markets are smart, governments are dumb

A companion to the claim that gains at the top drive gains for the rest is the claim that markets with little regulation or oversight always align private economic behavior with the long-term health of the economy. This claim is directly contradicted by generations of economic theory, research, and history. Markets have enormous virtues. They coordinate activity among decentralized buyers and sellers. They reveal and aggregate huge amounts of private information into the single clear signal of prices. And when open and dynamic rather than captured, they are powerful engines of innovation and growth.

But as economists have argued for decades, markets also have predictable vices. The most important is their failure to provide public goods, a vice long recognized and long addressed. Public goods are simply goods whose benefits are spread so broadly that individual market actors don't have an incentive to invest in them. For example, private employers—and the economy overall—benefit incalculably from an educated workforce. No other factor of production matters more. But employers have little incentive to invest in educating workers, since these benefits flow to all employers, not just them. The United States' success has therefore hinged on its early commitment to universal public education and, after World War II, its enormous investment in higher education. These investments made the United States the world leader in college completion for several decades. Yet today, as college costs have risen and financing has shifted from grants to loans, the United States is falling well behind other rich democracies in encouraging young adults to finish college; we currently rank 16<sup>th</sup> in the world in college completion.<sup>27</sup>

Similarly, investments in basic science, nation-spanning communications and transportation networks, energy grids and sources, and other forms of infrastructure have been vital to our economic development in the past and are essential to our future growth. Our society rightly celebrates entrepreneurs who innovate and produce. Yet we should not forget

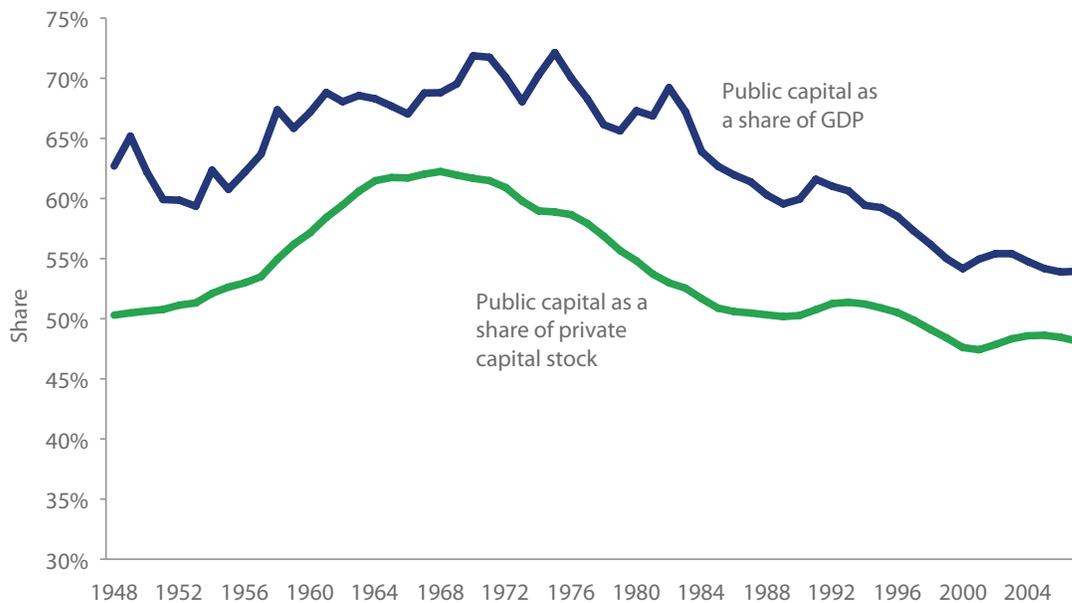
that their success is possible because American society has historically invested in the broad preconditions that enable their work. Today, however, the economy is running on the fumes of the investments we made in public goods decades ago (**Figure H**).<sup>28</sup> With our infrastructure crumbling and our basic science investments dwindling, we need to refill the tank—or risk stalling on the side of the global economic highway.

Markets will not produce public goods because no one has a strong incentive to provide them. For much the same reason, markets will spew out “negative externalities,” such as pollution, because no one has a strong incentive to reduce them. Negative externalities are costs borne by society that are not borne by the market actors creating the costs. Without effective regulations, for example, carbon emissions aren't priced into the cost of the goods we buy. In effect, failing to regulate carbon emissions represents a huge subsidy for producers who endanger our environment. We all bear the cost, but especially those of us most affected by the negative externalities that unregulated markets produce—in this case, the next generation, who will inherit a planet in peril.

Climate change is perhaps the most extreme version of the threat of externalities. But in our economy, there is another almost equally great externality, namely, the risk that comes from unbridled financial speculation. This is what economists call “systemic risk.” Our recent, devastating financial crisis occurred in large part because Wall Street was free to engage in highly risky activities without having to pay for the risks inherent in them. Those risks were instead borne by all of us—through our government, which had to bail out the financial sector, and through the huge negative effects of the financial crash on American workers and their families.

The financial crisis points to a final—and substantial—category of reasons why markets without effective rules and protections can undermine shared prosperity: behavioral failures. Economists and other social scientists have made enormous progress in identifying situations in which individuals, acting rationally but often myopically or with systemic biases in

**FIGURE H: . Public capital as a share of GDP and as a share of private capital stock, 1948-2007**



Notes: Public capital measure excludes national defense capital stock. Private capital stock excludes residential capital stock.  
Source: Bureau of Economic Analysis, 2011.

their thinking, produce collectively terrible outcomes.<sup>29</sup> Bubbles and bank runs are classic examples. What makes sense for the individual in each case—throwing more money into inflated assets, liquidating one’s deposits—creates a crisis for the financial economy. Recognition of these risks is why comprehensive financial regulations were put in place after the great crash of 1929. For more than five decades, our financial economy was remarkably stable—until the post-1970s wave of deregulation that helped precipitate the current financial crisis.

Franklin Roosevelt once said, “Economic laws are not made by nature. They are made by human beings.”<sup>30</sup> Absent thoughtful regulation and public investments, markets will not align private and social returns or produce optimal outcomes. Austerity economics ignores this reality. Markets bereft of sensible ground rules and public investments are markets distorted

by the underprovision of public goods, marked by destructive bubbles and busts, and weakened by the ability of market actors to impose costs on the rest of society.

### **Myth 5: Those at the top are the ones who create wealth and are alone responsible for their good fortune**

Warren Buffet, one of the richest men in the world, has said that “society is responsible for a very significant percentage of what I’ve earned.” He is correct, and not just in the obvious sense that society helped educate him, provided him police protection, and so on. We are individually and collectively more productive in the present than Americans were in the past—and more productive than people in poorer societies are today—not because we work harder or have greater

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raw talent. We are more productive because we have greater common knowledge and technology, and, no less important, because we enjoy the kinds of economic and political institutions that allow these shared sources of wealth to contribute to our productivity. Even the most brilliant of American investors, like Buffet, owe much of their success to the good fortune of living in a particular society at a particular time. We all do.

Economic historians estimate that a huge share of our national wealth is due to this “free lunch” of past advances, all of them highly dependent on public investments and our society’s basic economic and political institutions. In light of this finding, we must ask the question, as Gar Alperovitz and Lew Daly do in their book, *Unjust Deserts*, why “should this gift of our collective history not more generously and broadly benefit all members of society?”<sup>31</sup> The huge imbalances in wealth in our country, especially financial wealth, are even less defensible when the vast bulk of wealth at the top reflects the hard labor of past generations, enabled by our society’s investments and institutions.

Once we recognize that much wealth is socially generated, the argument turns from claims about moral desert to questions about incentives. Defenders of austerity economics suggest we need to have vast inequality to promote growth.<sup>32</sup> But the evidence for this view is feeble to say the least. Growth was both strong and widely shared in the immediate decades after World War II. Economists, psychologists, and business experts have found suggestive evidence that high levels of inequality in the boardroom result in poorer corporate performance, and that high levels of

inequality in the workplace undermine the incentives of workers to do their best.<sup>33</sup> Looking across developed countries, experts have yet to find convincing evidence that inequality helps growth.<sup>34</sup> And over the last generation, as discussed above, there has been no association between cuts in tax rates at the top and levels of economic growth across rich democracies.

Moreover, the crucial question is, “growth for whom?” The United States has done relatively well in terms of aggregate growth in the last generation, but growth for the middle class and the less-well-off has been more anemic than in almost any other rich nation.<sup>35</sup> This is in great measure a result of austerity economics—of the policies propagated around and through these five myths.

To tackle our immediate and long-term economic challenges, we must reject austerity economics and embrace a reality-based economic agenda. The plan we propose here embodies that approach, an approach we call “prosperity economics.” Prosperity economics recognizes that we must make investments in productivity to build our economy, that individually and collectively we need basic securities to move confidently into the future, and that a strong democracy undergirds a strong economy.

We turn first to the intellectual underpinnings of prosperity economics and its three pillars: growth, security, and democracy. We then turn to describing the key policies that will be needed to strengthen these pillars and put us on a path toward greater global competitiveness and shared prosperity.

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## PART TWO ■■■

# Prosperity Economics and the Way Forward

Our history as well as a growing body of economic theory and research point to a very different model for economic success than that pushed by austerity economics. Our alternative, “prosperity economics” is a set of established findings based on recent currents of scholarship and real-world experience. Prosperity economics has a distinctive goal: shared prosperity. It also has a distinctive prescription: policies and institutions that broadly distribute opportunities for economic success, create the preconditions for productivity among all workers, and provide the broadest possible space for people to shape their own economic lives through voice in the workplace and through democratic politics. Shared prosperity, in other words, is a means as well as an end. As we all share in the production of prosperity, we all share in its rewards.

The central idea of prosperity economics is this: Our prosperity is generated by *everyone*. It does not just drip down from current economic winners, but flows from all of us who work hard to gain skills and climb the economic ladder. It is generated by the common investments and sources of security we agree on as members of a democracy, by the stock of technology and knowledge fostered by these investments—a socially generated stock of productive capacity that is far and away the greatest source of our wealth—and by democratic political institutions that ensure that today’s economic winners do not lock in their position and thereby undermine the openness and dynamism of the economy overall.

More and more, economic researchers are finding that the differences across societies in both productivity and quality of life reflect the basic institutions that channel and support economic and political activity: ef-

fective regulations of the market, investment in public goods, checks and balances in the private sector that prevent undue concentration of economic power, and, above all, democratic political institutions that allow all citizens to shape what government does to promote prosperity and social health. As Daron Acemoglu and James A. Robinson argue in a recent compelling contribution to this literature, “Countries which have created egalitarian, economically dynamic societies have done so because they have forged inclusive political institutions which then led to inclusive economic institutions.”<sup>36</sup>

In the United States, the broadening of the franchise and the civil rights revolutions of the 20th century lifted to a new level of inclusivity the world’s most successful middle-class society. Neither gaps in opportunity nor economic injustices were fully erased, of course. But opportunities were broadly available, basic economic security was guaranteed through public and private benefits, and the rewards of growth were widely shared. America’s civil society was vibrant as well: voter participation was high, partisan polarization much lower than in the past (or since), and a wide range of political organizations, including unions and voluntary civic groups, provided ordinary citizens with leverage and information. All this was self-reinforcing—an increasingly educated, secure, and prosperous middle class reflected and strengthened a vibrant democracy.

Unfortunately, this virtuous cycle has come undone, and we are at risk of a prolonged *vicious* cycle, in which broadly distributed opportunities and growth wane along with the responsiveness of our political institutions and the ability of private watchdogs, like

unions and civic organizations, to check the abuse of economic power—which in turn encourages a greater divorce between gains at the top and the health of our society (see **Figure I**). Tragically, this is happening precisely when we need to pull together, a moment of rising global economic competition and increased social diversity, when economic innovation is more collaborative than ever and public investment more vital to our long-term prosperity and the sustainability of our environment.<sup>37</sup>

This vicious cycle is compounded by the weakness of organizations representing the broad middle class. The decline of labor unions in the private sector, even as business groups such as the Chamber of Commerce have become more politically organized, has reduced the power of workers in the labor market and contributed to rising inequality and a divorce between productivity and wages. But the decline of workers' ability to collectively bargain has also weakened the sway of the middle class in American politics. On bread-and-butter economic issues, groups that stand up for the concerns of working Americans and their families are increasingly outgunned by the lobbying and campaign clout of Wall Street and other corporate interests. Middle-class Americans have lost both clout in politics and standing in the economy.

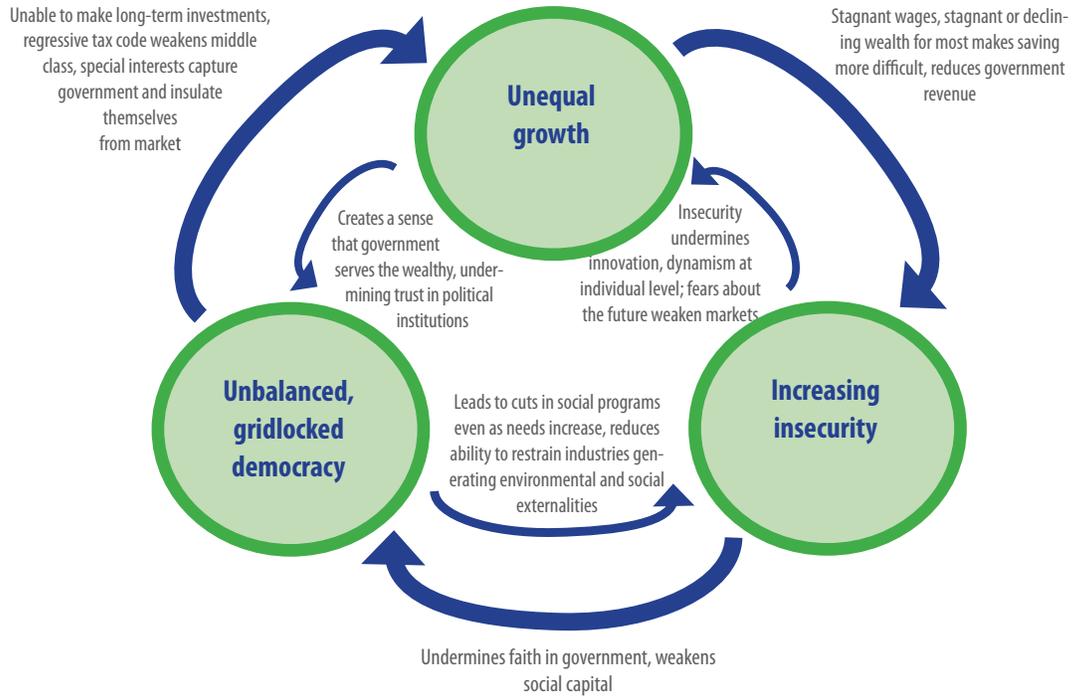
If the prescriptions of austerity economics continue to reign, this imbalance in our market and our politics will only grow worse. Indeed, austerity economics is itself a symptom of the vicious cycle that threatens to take deeper hold. For what is most remarkable about the transformation of the last generation is that the rise in economic inequality and decline of economic security have coincided with increased calls for *further* assisting current economic insiders while cutting back efforts to provide broader opportunity and security.<sup>38</sup> The only way to reverse this vicious cycle and to respond to the challenges we face is to restore the place of a strong, secure middle class with real political clout at the heart of our economy. That is the message of prosperity economics, and that is what we must do.

According to prosperity economics, shared prosperity rests on three vital pillars:

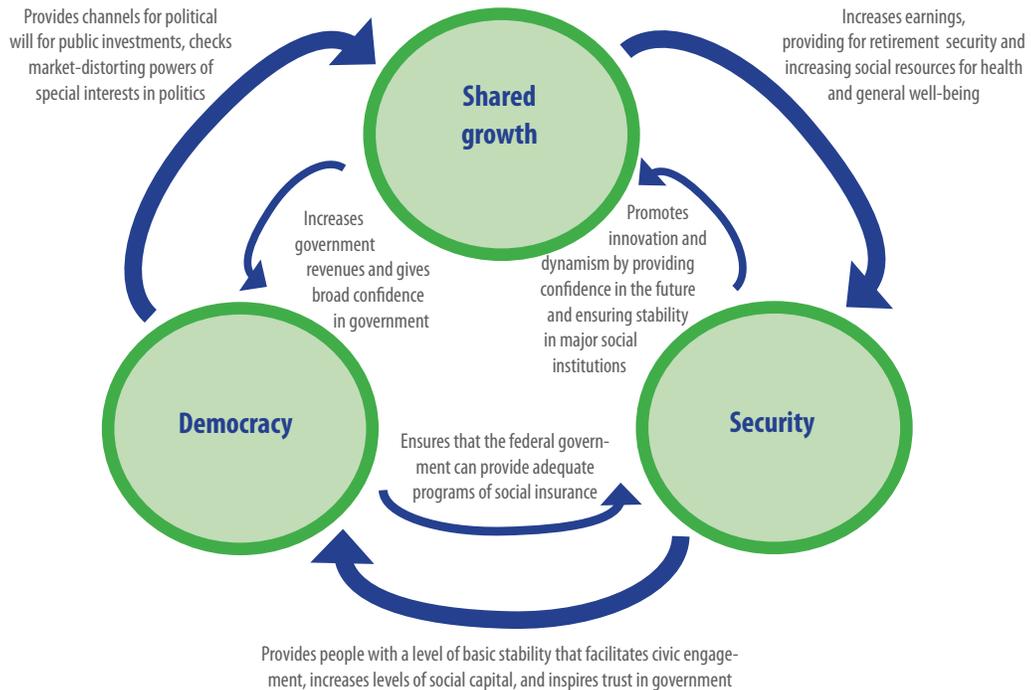
- 1. Innovation-led growth, grounded in job creation, public investment, and broad opportunity.** We create wealth together as a society. A large share of America's prosperity rests on our accumulated stock of intellectual and physical capital, capital that has accumulated over time through the work of millions of Americans. This stock is a form of shared wealth, wealth that is a precondition for economic growth and individual advancement but which no individual alone creates. Such stock—in areas like scientific knowledge, technology, and physical infrastructure—depends in significant part on public investment, and public investment in these areas will help keep us competitive. Public policy must drive investments not just in physical and intellectual capital but in human capital, through increased funding for education and job training. We need to utilize the talents and abilities of all members of society. Especially in the context of increased competition abroad and growing diversity at home, we cannot afford to let *any* human capital lie fallow. Today's unemployment, which stands at over 8%, is thus not only a sign of a failed economic theory but is itself a major barrier to future growth. Only an economy that puts all willing Americans to work and includes all members of society can be strong enough to keep our country competitive and generate shared prosperity.
- 2. Security for workers and their families, the environment, and government finances.** The successful, long-term operation of the economy requires that we be able to plan for the future at the individual and social level, which in turn requires that we guarantee the stability of the basic institutions on which our economy and our society rest. For individuals and families, security means having the confidence to invest in skills and take entrepreneurial risks while at the same time caring for a family and planning for job, retirement, and health contingencies. The market cannot provide this security on its own. By using programs of

FIGURE I

VICIOUS CYCLE



VIRTUOUS CYCLE



social insurance and other measures that put individuals and families on solid footing, we reinforce the foundations of a dynamic, competitive market. Likewise, we must protect our resources and natural infrastructure, elements of our environment on which the operations of our economy depend. As with worker and family security, the market fails to adequately protect environmental security and must be buttressed with strong policies. Lastly, we need to lay the foundations for shared prosperity by putting the government on sound fiscal footing. This does not mean cutting public investment and programs of security, but rather creating a framework for efficiently raising the resources necessary to fund these vital aims and for more effectively using public dollars, especially in health care. Such resources are best raised through a progressive tax structure that supports the middle class. Together, these three forms of security constitute the second pillar on which shared prosperity is built.

### 3. **Democratic voice, inclusivity, and accountability—in Washington and in the workplace.**

The last pillar of shared prosperity is a system of checks and balances both in our government and in the private sector that empowers citizens, guarantees more inclusive decision making, and creates strong mechanisms of accountability. As money has become more important in politics and corporate interests more organized, business groups and the affluent have gained enormous power relative to the middle class. This allows today's economic winners to create and reinforce their gains by shaping government policy, rather than by innovating in the market. These activities make the rest of Americans poorer and our political system weaker. Yet strengthening democracy means more than just empowering citizens within government; it means empowering them in the market as well. Unions and other private watchdogs push for better representation of workers' and communities' interests in corporate decision making, and they police managerial excesses, such

as runaway executive pay. Restoring such private checks and balances by giving workers increased voice to collectively bargain and encouraging broad civic engagement is a vital way of ensuring a more inclusive economy—one that does not require direct redistribution of market rewards but rather a broadening of the distribution of influence so that the market itself is not distorted by concentrated economic power.

These three pillars—growth, security, democracy—support a strong middle class and reinforce one another. They are intertwined both politically and economically. When people feel that their voice matters and that democratic participation fosters prosperity, civic engagement and trust rise, thereby encouraging better policies and a better politics down the road. Economically, a strong middle class creates stabilizing and growth effects. Growth is broadest and the financial economy most stable in societies in which those at the bottom are not too far from the middle, those at the top not too divorced from the rest, and upward mobility is substantial.<sup>39</sup> All of these conditions of stable and shared growth are currently slipping away.

In Part Three, we show how the three pillars of shared prosperity can be rebuilt with key suggestions for policy and political reform. First, however, we articulate the case for growth based on public investment in our citizens' and nation's productive capacity; economic and environmental security as a foundation for a dynamic, innovative economy; and the central role of a well-functioning democracy in fostering shared prosperity. In each of these areas, we also highlight a few concrete steps that can be taken to rebuild the pillars of shared prosperity, steps we elaborate and situate within our other recommendations in Part Three.

### **Innovation-led growth, grounded in job creation, public investment, and broad opportunity**

The United States faces dramatic economic challenges that require us to rethink our current policies and respond with force and creativity. In the short term,

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we face persistently high levels of unemployment and underemployment, which are aggravating the long-term challenges we face in an increasingly integrated and technologically sophisticated global economy. Our workforce sits idle while we face an enormous trade deficit. Our manufacturing base has been in steady decline for decades: From its peak in 1979 to its low in 2009, the U.S. lost 41% of its manufacturing jobs.<sup>40</sup> And the 2000s were the worst decade yet; a greater share of manufacturing jobs were lost in the first decade of the 21st century than during the economic cataclysm of the Great Depression.<sup>41</sup> Competition from developing countries, particularly China and India, threatens not only established industries but our emerging high-technology sectors as well.<sup>42</sup>

Challenges of globalization were and are inevitable. But the policies we have adopted over the past few decades—above all, declining investment in education, R&D, infrastructure, and other public goods and a hands-off approach to trade deficits, financial markets, and corporate governance—have limited our capacity to respond. Worse yet, some of our own policies actively exacerbate the problem, by, for example, encouraging outsourcing, weakening the position of the American worker, and decreasing the revenue base for public investment. As evidence that policies matter, we can look at places like Germany and Japan, where strong manufacturing sectors still thrive. We must rise to the challenge of combining global competitiveness with shared prosperity, not retreat from it.

As a first step, we need to recognize that innovation and increasing productivity are grounded in the nation's communal stock of physical capital and especially its human capital. America's greatest wealth is in its people, and only an inclusive economy that continually creates room for each successive wave of innovators—small businesses, the self-employed, fledgling competitors, entrepreneurial immigrants—will successfully exploit its own strengths. Openness to the cycle of risk, growth, and reward is a basic principle of prosperity economics. It focuses on tapping the full potential of every worker immediately and in the long term by **creating jobs**, using public investment to fos-

**ter innovation**, and by **expanding opportunity** for all Americans, including those facing hardship or who are excluded today.

Our growth agenda aims to rebuild and sustain an educated, confident middle class with the income and wealth to maintain a vibrant consumer economy and stabilize our financial economy. The economic storms endured since the start of the Great Recession have battered Americans already reeling from decades of growing inequality and government disinvestment. Since the 1970s, wages for most Americans have risen only modestly even as economy-wide productivity has increased. The result has been rising inequality and a burgeoning class of workers stranded in low-paying jobs with little prospect for advancement. Restoring the middle class means reversing the disconnect between wages and productivity, which means giving workers power to negotiate for better terms of employment and a larger share of the rewards of growth. Together, these policies will help to foster broad, innovation-led growth, the first of the three pillars of shared prosperity.

## CREATING JOBS

Our economic agenda starts with jobs. America's greatest resource is its workers, and we are squandering their talents. Over 12 million Americans are actively searching for work and unable to find it. Millions more are trapped in part-time jobs or have simply given up. Joblessness means not only physical deprivation but family strife, depression, and neighborhood and community decline.<sup>43</sup> This is not just a social catastrophe. High unemployment is like a tax we all pay, the most vulnerable more than others, in the form of untapped productive potential. According to the Congressional Budget Office, we are collectively \$750 billion poorer in 2012 alone because of this shortfall. Since the recession began, our lost productivity totals a stunning \$3.6 trillion.<sup>44</sup>

This is not a situation we can, need, or should accept. There is a simple and effective way to create jobs right now that would be good immediately and good over the long term: put people to work rebuild-

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ing the nation's crumbling infrastructure. We face a five-year deficit of \$2.2 trillion in investment, only half of which will be covered under current local, state, and federal policies.<sup>45</sup> That is, we are investing less than half of what we need just to keep our infrastructure from further deterioration. *An investment of \$250 billion per year for the next six years* would immediately address our jobs crisis while meeting the current shortfall and beginning to upgrade and build for the future.

In the meantime, *restoring federal help to the states* to prevent layoffs and allow critical workers like teachers and first responders to be rehired is an immediate step we can take to put America's greatest resource, our human capital, back to work.

Immediate action to restore jobs is vital, but there are deeper problems with the economy that will not be addressed simply through public hiring and investment in infrastructure. In addition to putting Americans back to work, we need to reverse certain policies that have led to slow job growth and rising inequality, devastated our manufacturing base, and driven up the trade deficit. The first is the persistent overvaluation of the U.S. dollar, fueled in part by the attempts of some of our key trading partners to artificially hold down the value of their currencies. A strong dollar may be good for retail companies that depend on cheap Chinese imports or investment banks that buy Chinese assets with our overvalued currency, but it is a job killer in American export industries that create good jobs at home. Joseph Gagnon, a former Federal Reserve official now at the Peterson Institute for International Economics, has recently estimated that literally "millions more Americans and Europeans would be employed if other countries did not manipulate their currencies and instead achieved sustainable growth through higher domestic demand."<sup>46</sup> The U.S. Treasury has tools at its disposal to combat the pressures that push the dollar higher, including penalizing the dollar holdings of countries that buy dollar assets to prop up their own currencies.<sup>47</sup> It is well past time to use those tools. Such efforts would help jumpstart key sectors of the American economy, like manufacturing, that will be central to restoring balanced trade.

It is also well past time to *press the Federal Reserve to do more on the economy*. As a start, the Fed should use the monetary rescue measures as its disposal—measures that Fed Chair Ben Bernanke himself advocated when he was a professor.<sup>48</sup> This would mean first and foremost targeting a moderately higher inflation rate until the economy fully recovers. To guarantee the Fed is quicker to take such actions in the future, we must reduce the harmful bias of the Federal Reserve toward protecting the banking industry over workers. This bias leads the Fed to pursue low inflation even when such inflation means unnecessarily high unemployment. The bias arises in part from the influence that banks have with the Fed—an influence perpetuated by banks' automatic seats on the Federal Open Market Committee and control over the choice of regional Fed presidents. Before "full employment" is defined down to mean something only slightly better than the intolerable situation of today, monetary policy should be reset on a shared-growth path.

## FOSTERING INNOVATION

The investments in infrastructure just outlined are investments in our common capital stock—the mix of physical and intellectual capital that we share in common as a nation and that is centrally responsible for advances in science and technology, growth in productivity, and breakthroughs in the market. Even the greatest of entrepreneurs build on the ideas, technologies, and products of leaders from the past. America has a history of innovation, each generation building on the last—from the telegraph to the telephone to the personal computer to the World Wide Web, from the Model T to the Boeing 747. The United States has been a source for dynamism and entrepreneurship, creating new industries and modes of production that have reshaped the world and how we move and communicate across it.

While innovation builds on past successes, it takes shape in the present. Benefiting from public investments in years gone by, it relies on ongoing investments and supportive public policies.<sup>49</sup> For our scientific and commercial creativity to advance, the economy requires that three interrelated sectors of

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society work in tandem: public education, our universities and laboratories, and the industrial sector.

A populace educated in public schools and trained in government-supported universities provides the human capital for scientific research and a technically sophisticated workforce. Universities and laboratories, drawing on the talent that has made its way through our educational institutions and supported with government dollars, advance the boundaries of scientific knowledge. The industrial sector, in turn, when supported by the right legal environment, tax policies, and government procurement and programs, sponsors research and development and applies scientific breakthroughs to the commercial sphere.<sup>50</sup> Our major growth areas over the last few decades—computing, the Internet, the life sciences, and energy technologies—have followed this path from government laboratory and government-sponsored research to commercial application.<sup>51</sup> This is why we propose that *every student who is eligible to attend college should be able to do so with the help of federal and state support, and that annual government investments in R&D be increased over current levels by 50%.*

Austerity economics describes public investment as inherently wasteful and private investment as inherently profitable. But a huge and growing body of economic research has found that public investment in basic physical infrastructure (roads, bridges, rail lines, airports, and so on) has average rates of return far higher than private investment. And public investment's returns are distributed far more broadly than the returns of private investment.<sup>52</sup> Public investment does not always pay off, but neither does private investment: only a tiny share of venture-capital investments ever make a dollar. What's more, extraordinarily low interest rates on Treasury bonds signal that, not only can the federal government finance long-term investments cheaply, bond markets are practically begging it to do so. Government investments in public goods have the added benefit of being able to drive forward national strategic priorities, which is why we suggest *an increase of \$15 billion per year in research and development for clean energy technology.*

Likewise, increases in R&D help drive forward another critical national priority: the revitalization of our manufacturing base. Manufacturing is essential for innovation, accounting for 68% of our private sector investments in research and development. It creates good blue-collar jobs and is critical to restoring balanced trade.<sup>53</sup> Moreover, without our manufacturing base, our country's capacity to defend itself is weakened.<sup>54</sup>

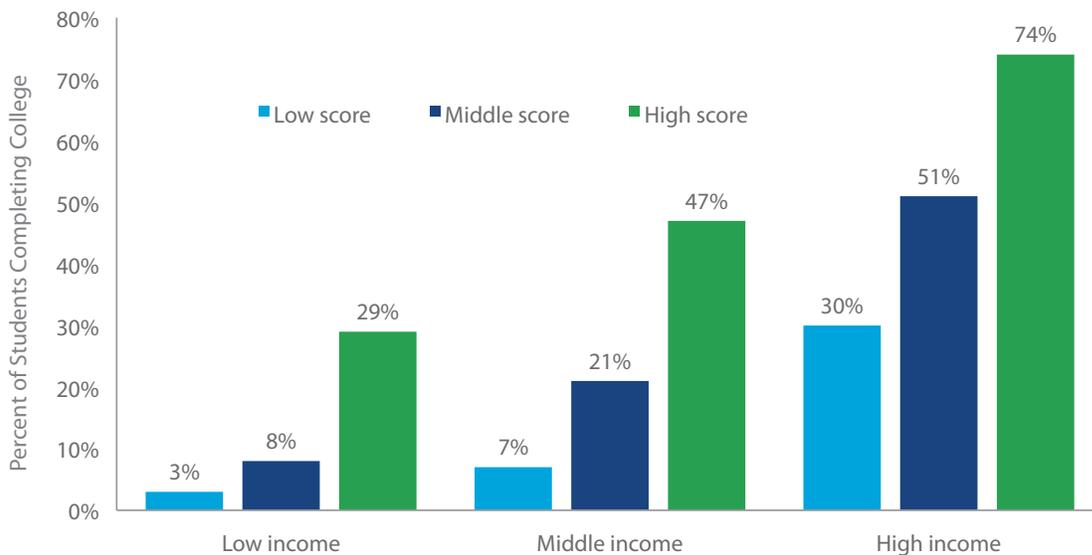
This is the right time to rebuild American manufacturing. A number of global economic trends suggest that industry may be headed back toward developed countries. Labor costs are rising in China, just as they did in South Korea and Taiwan before it.<sup>55</sup> New technologies are changing the way that goods are made, increasing the need for high-skill workers, high-technology clusters, and legal protections, areas in which the U.S. has historically been strong. We can restore the American manufacturing sector by leading in areas like biotechnology, computing, communications, and robotics—areas that will keep us on the global manufacturing high road.

## EXPANDING OPPORTUNITY

Investments in human and physical capital do more than grow the economy overall. They also expand opportunities for individual workers. Few promises resound as deeply as the promise of opportunity, that all individuals can overcome conditions of their birth and provide their children with a brighter future. Yet opportunity is under grave threat today, with the greatest challenges facing low-income communities and communities of color.<sup>56</sup> Today, according to the Department of Education, a low-income student with high 8th-grade test scores has about the same (small) chance of obtaining a college degree as a high-income student with *low* 8th-grade test scores (**Figure J**)—a striking indicator of unequal opportunity and another reason for pursuing true universal access to college education.

Given the importance of opportunity to our nation's self-conception, the stagnation of social mobility in the face of rising inequality is of significant

**FIGURE J: College completion by income status and 8th-grade test scores**



Source: Economic Policy Institute analysis of Mary Ann Fox, B.A. Connolly, and T.D. Snyder, "Youth Indicators, 2005: Trends in the Well-Being of American Youth." Washington, D.C.: U.S. Department of Education, 2005.

moral concern.<sup>57</sup> Yet it also a threat to our economic prosperity. Expanding opportunity is an indispensable component of an economy of broadly shared prosperity. Opportunity contributes to shared prosperity by increasing social mobility and encouraging movement into the middle class; it also helps ensure that the economy utilizes all human talent. In an increasingly globalized and competitive economy, we cannot afford to leave human resources unused.

History shows that the entrance of women and individuals from communities of color into the workplace has generated economic growth beyond the simple addition of numbers to the workforce, as firms are able to utilize greater reserves of talent. Indeed, the U.S. economy is perhaps a fifth larger today than it would have been otherwise because of the opening up of professional opportunities to women and communities of color after 1960.<sup>58</sup> But millions remain on the sidelines. According to the McKinsey Consulting Group, the gaps in access to education by

income in the United States impose “the economic equivalent of a permanent national recession.”<sup>59</sup> This is one reason why we need to dramatically *expand job training programs* at all levels of government and in both the public and private sectors and put in place *comprehensive, place-based strategies for revitalizing disadvantaged communities*.

Similar commitments must be made to another group of marginalized members of our society—undocumented immigrants. Our current immigration system is dysfunctional, damaging the smooth operation of our economy and contributing to an untenable social and political situation. There are between 11 million and 12 million immigrants in this country without legal status.<sup>60</sup> They live in the shadows without basic legal protections, without health care, and without long-term economic security. Worse yet, many suffer from unfair labor practices and are denied both minimum wages and workplace protections. A democracy cannot permit millions of people to live within

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its borders as second-class citizens. Nor does it make sense for our economy. Undocumented immigrants make important direct contributions to economic production through the workforce, but because employers feel they can employ them at below minimum-wage levels, the current situation depresses wages for less-skilled workers and contributes to broader problems of inequality. A report from the Center for American Progress suggests that comprehensive immigration reform might yield up to \$1.5 trillion in cumulative U.S. gross domestic product over 10 years.<sup>61</sup> The promise of opportunity must be expanded through immigration reform—and in particular by creating a pathway to citizenship for all undocumented immigrants, coupled with tough sanctions on employers that use unauthorized labor and new immigration procedures that place greater emphasis on reunifying families and meeting real labor market needs.

Guaranteeing opportunity is a three-fold proposition. First, opportunity requires that all members of society, regardless of race or economic standing, have access to the social infrastructure—education, training, health care—necessary to enter the job market. Second, opportunity means that jobs must pay wages that permit working people to provide for themselves and their families. And third, opportunity demands that individuals be able to advance within their fields and enter the middle class.

Unions will be critical in pursuing these three goals. Collective bargaining rights and strong basic labor standards are essential in ensuring that jobs are of a quality that can support families and provide opportunities for training and advancement in fields like manufacturing and child care. Among workers who have never graduated high school or hold only a high school degree, employees with the protection of collective bargaining agreements earn 30% more than employees without them.<sup>62</sup> Unionization also helps ensure that worker productivity gains are more widely shared. After the start of the previous recovery in 2002 productivity rose 16.1% but the inflation-adjusted hourly compensation (wages and benefits) of both high school and college graduates actually fell.<sup>63</sup>

Reconnecting wages to productivity and restoring the middle class are goals that would be greatly furthered by broader unionization. Meanwhile, higher labor standards, such as *setting the minimum wage at half what a typical worker earns*, would also better link gains for low-wage workers to productivity growth.

## **Security for workers and their families, the environment, and government finances**

Investments and risk-taking are at the heart of innovation and entrepreneurship, and they are at the heart of the kind of dynamic economy we need to build shared prosperity. We have long recognized, however, that there are some things on which market participants don't like to bet—on whether contracts will be enforced, for example, or physical security protected. These are the kinds of securities, the kinds of certainties, that the government guarantees, creating space for other, more productive kinds of risks and investments. Our markets are most dynamic when they operate within a stable institutional structure—where there is a court system to uphold signed deals, a police force to guard the streets, and laws in place to provide for transparency. Increasingly we understand that the market depends on similar kinds of stability in other spheres, like the family, the environment, and public institutions.

When individuals and families have basic security and therefore feel confident investing in themselves and their families, markets have more input, more players, more resources, and more dynamism. We think of this as **economic security**. When we have adequate resources of clean air and clean water, and a stable natural environment in which to lead our lives and conduct our business, markets have a bounty of resources on which to draw. We call this **environmental security**. And when our government has a broad, secure tax base and long-term sustainable budget outlook, markets will not be squeezed for capital, and they can rely on government to fulfill its public investment obligations. We call this **fiscal security**. Security for ourselves individually and our society as a whole reinforces

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the foundations of our economy. Facing an uncertain future, we are far more likely to be bold when we have reason to be hopeful and forward-looking. This is what security is all about: confidence in the future.

## ECONOMIC SECURITY

Security starts when Americans have enough confidence in their economic futures so that they can plan and invest to build strong families and careers, or even businesses of their own. Providing Americans with economic security is about more than providing peace of mind or limiting economic hardship, vital as these aims are: It is essential to our economic growth and innovation. Just as limited liability for corporations and bankruptcy protection for investors encourage entrepreneurial risk-taking, basic assurances of security provide Americans with the confidence to invest in their skills, their families, and their futures.

Safeguarding economic security is, in short, a necessary counterpart to fostering open competitive markets marked by innovation and adaptation—the “creative destruction” of which Joseph Schumpeter wrote.<sup>64</sup> Insecure workers underinvest in specialized training and exhibit lower job commitment.<sup>65</sup> Insecure families are less likely to make investments in education and other keys to their own or society’s advancement.<sup>66</sup> And when benefits are tied too closely to a particular job, workers are reluctant to seek better opportunities, and risk losing everything if they are laid off.<sup>67</sup> Ensuring that workers have benefits that move from job to job, that parents can raise children while working, that health costs do not ruin family finances, that workers have some protection when jobs are lost or demand for their skills shifts, that retirement is possible even for those who work in multiple jobs, or take time off to care for children, or labor for low wages—all these forms of security are vital to encouraging workers to invest in their productive capacities and participate fully in a dynamic, inherently uncertain economy.

Security is in this sense the flip-side of innovation—far from standing in opposition, the two concepts support one another. Meanwhile, by supporting incomes during times of economic distress or absence

from the labor market, programs of security also provide a broader boost to the economy when a boost is most needed.

In practice, such safeguarding requires the establishment of systems of social insurance that pool risks widely, meaning that participation must be broad and that contributions by employers, workers, and the government generally must be required. In the past, some argued that private health insurance and pensions would make public efforts unnecessary. Yet these private benefits have never reached all workers, and while a vital supplement to public programs, they are losing ground.<sup>68</sup> In fact, it is precisely the decline of America’s distinctive system of private workplace benefits that makes our public programs of economic security so essential. Defined-benefit pensions that protect workers against key retirement risks are rapidly being eclipsed by 401(k)s and other defined-contribution plans, which shift these risks onto workers, concentrate their benefits on the well off, and are inadequate for most who have them. (In 2008, the typical amount in a 401(k) account was under \$13,000.)<sup>69</sup> Despite constant reminders to prepare for retirement, the share of working-age households that are at risk of being financially unprepared for retirement has increased substantially, with younger Americans far more likely to be at risk than older Americans and low-income Americans the most at risk, even accounting for Social Security.<sup>70</sup>

The continuing erosion of private retirement security makes it essential that we *strengthen and expand Social Security* to ensure it remains a solid foundation for retirement planning. The only crisis Social Security faces is the effort of critics to gut it. Social Security is projected to grow modestly as a share of our economy over the next generation, but it is prohibited by law from adding to the deficit—it must be self-supporting. The share of preretirement income it replaces for beneficiaries is already slated to decline, in part because of rising Medicare premiums and in part because of changes to the program made in the early 1980s. Yet while its benefits are hardly lavish, they are the major source of retirement income for most retirees. With modest changes to its financing, Social Security can pay all promised benefits, and we can

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increase benefits for vulnerable groups, such as widows, older beneficiaries, and college-attending children receiving survivors' benefits.<sup>71</sup>

As guaranteed private pensions have disappeared, employment-based health insurance has also become increasingly scarce. In just the last decade, we have seen a 10 percentage-point drop in the share of nonelderly Americans with workplace coverage—from more than 69% in 2000 to less than 59% in 2010.<sup>72</sup> Even where private coverage remains in the labor market, it is shifting more costs and risks onto workers. And over the past few years, we have all learned how vulnerable workers are to losing health coverage when they lose their jobs. This is why we must *build on and expand the Affordable Care Act with a public option* to continue increasing coverage and better restrain costs.

Public programs of economic security are not only broader and more risk-protecting than private benefits; they are also—contrary to what austerity economics would have us believe—far more efficient. The administrative costs of Social Security, Medicare, and Medicaid are but a small fraction of those of private pensions and health insurance, and public health insurance has much greater bargaining clout to contain costs. Programs of economic security are thus not in tension with long-term fiscal balance. Quite the opposite: Because budget pressures are driven overwhelmingly by rising health costs, effective restraint of these costs by Medicare and other public programs is the only realistic route to balancing the budget without undoing the American social contract. We thus need to *strengthen Medicare* and its capacity to hold down cost increases by pushing forward existing reforms that will control costs without reducing benefits and new reforms that will cement and extend these advances. Among these new reforms should be creating an enforceable budget for Medicare spending and using the concentrated purchasing power of Medicare to restrain price increases and obtain greater drug discounts.

But while we should not be undoing that contract, we should be revising it to respond to changing realities, like the decline of private workplace benefits and the rise of new and intensified risks to family finances.

Most vital is to recognize that economic security is as important to working-age Americans and parents trying to raise children while building careers as it is to those who have retired after a lifetime of labor. For younger Americans, economic security is about easing the financial strains of balancing work and family by *providing families with paid family and sick leave*, along with ensuring affordable child care and flexibility in work schedules. It is also about helping Americans build up the assets they need to protect themselves against economic risks by encouraging less affluent Americans to save and, for those who need the help, *restructuring underwater mortgages*.

By providing Americans with economic security, we give individuals confidence for the future. But security is about more than feeling confident in one's own future. We focus on two of the most critical foundations of this broader sense of confidence: environmental security and fiscal security.

## ENVIRONMENTAL SECURITY

Environmental security is first and foremost about guaranteeing the long-term health of our economy by protecting our natural infrastructure and resources. America has always depended on nature's bounty for its economic growth. European settlers arrived on the promise of open lands and fertile soil. Early industrialists built mills by fast-running streams and shipped their goods down wide rivers. Later generations took advantage of vast deposits of iron and coal, building America into the powerful economy it remains today. And we continue to depend on the wealth of America's lands. Today 85% of the domestic food supply is produced here at home; overall, we produce roughly 30% of the world's total grains.<sup>73</sup> Approximately 80% of our timber is cut on American lands,<sup>74</sup> and nearly all of our coal is mined out of American soils.<sup>75</sup> These are critical inputs into the economy.

Today, however, our economy is threatening the environmental infrastructure and environmental goods on which it depends. We are draining rivers that should flow to the oceans and mining aquifers filled over thousands of years. We are rapidly losing arable soil

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and open land. We are contributing to global declines in ocean fisheries and rainforests. Policies that once protected the quality of our air and water can no longer guarantee their future quality amid growing population demands and usage. And, most important, we are undermining the stability of our global atmosphere, in the process disrupting natural systems so large that we take them completely for granted. Our environment is in a very real sense the foundation on which our economy and society is built. Climate change threatens this foundation, disrupting our cities and towns—not only raising temperatures but affecting the weather patterns and water flows that define geographic regions. We are already seeing the dangerous side effects; this summer's fierce fires, searing heat waves, and lost crops may be a harbinger of things to come.<sup>76</sup>

Such signs suggest that we can no longer afford to take our resources and environment for granted.<sup>77</sup> Environmental damage comes at significant costs to the economy, both direct and indirect. Beyond the direct impacts on human health and property, at some point environmental degradation will begin to engender fear about the future, creating uncertainty inimical to confident investment and growth. We need to enact wide-ranging public policies today that secure tomorrow's resources and a stable environment for the future in which people can live, work, and invest with hope.

The first step is to tackle the output of carbon, which means *putting a price on carbon emissions*. Action on climate change does not begin until we internalize the external costs of carbon emissions. Dealing with climate change will require more than a price on carbon, however; it will also require both *new clean energy technologies* and *cleaner forms of old technologies*, and we need to make significant federal investments in pursuit of both. Such investments will help position the U.S. as a global leader in these critical industries of the future.

But as we have suggested, climate change is only the first of many resource issues we will face in the coming decades; the federal government needs to get out ahead of broader resource challenges. Domestically, this means everything from *shifting housing,*

*transportation, and development patterns* to *investing in more sustainable forms of manufacturing*. Internationally, this will require taking a leadership role in *promoting sustainable technologies*.

Resource policy is ultimately economic policy. Our economy depends on our natural resources: on domestic flows of water and sources of timber, on international trade in oil and minerals and foodstuffs, and, most critically, on those resources about which we never think—a stable environment and regular seasons and weather patterns. Preserving America's natural resources and contributing to global stability in both climate and environment will ensure future access to goods we need and provide the basic security on which our economy and society depend.

### **FISCAL SECURITY**

Like our environment, we tend to overlook the role of our government in providing security and prosperity. But government must actively protect individuals, families, and the environment. At the same time, the government plays a critical role in making the investments that drive long-term, shared growth. This is why fiscal security is such a central part of prosperity economics: Our economy rests in crucial ways on our government and our government in turn rests on fiscal balance. Taxes, in this sense, are part of ensuring the basic well-being of our country. As Adam Smith—often cited as the father of free-market economics—once put it, “Every tax...is to the person who pays it a badge...of liberty,” the entry fee for a democratic society that can achieve shared prosperity.

Too often, however, fiscal balance is understood to be just about cutting current spending to match current revenues. This is going about it backwards. Our system needs to be designed with the long-term goal of shared prosperity, which means a government that can raise the revenues to provide security and make investments. A clear strategy for economic growth should drive the tax system, and not vice-versa. Moreover, with the retirement of the baby boom generation and continuing increases in medical costs, it is both unrealistic and unwise to insist that America's public

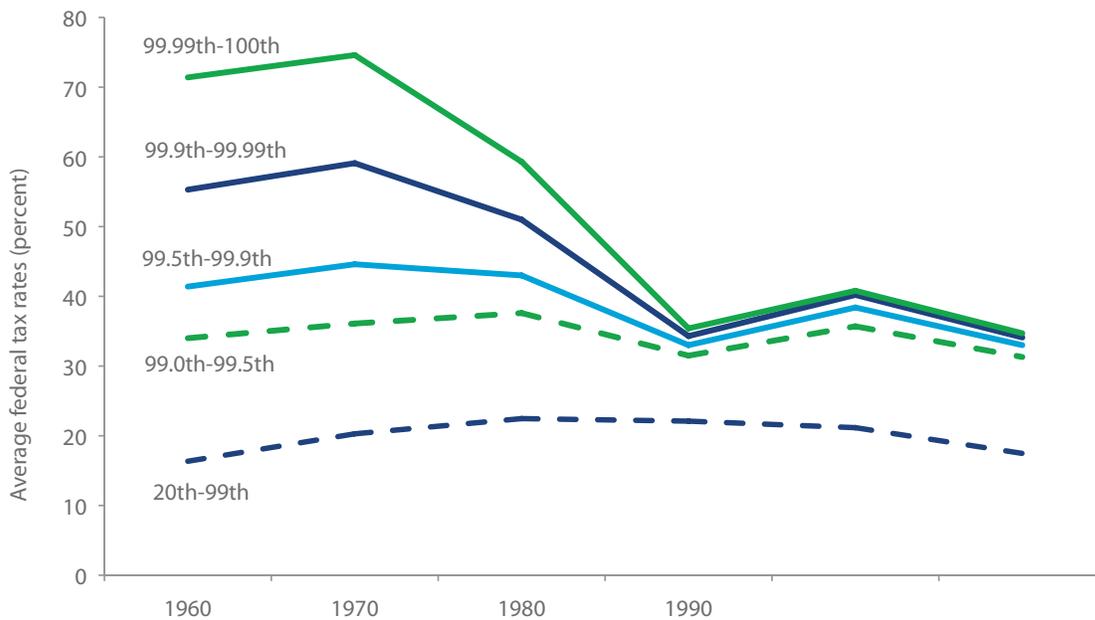
sector contract to levels of a generation ago. This is especially true if contracting government simply means shifting more and more health costs onto families and businesses—the main change sought by austerity advocates. Shifting health costs from the public sector to the private sector does nothing to deal with the underlying problem; it merely fosters greater insecurity. Only by effectively controlling health care costs system-wide can we tackle our long-term deficits.

Ensuring fiscal security also requires reforming our tax code. As economists have long recognized, the most effective way to raise revenues is through broad progressive taxation. To quote Adam Smith again, “The rich should contribute to the public expense not only in proportion to their revenue, but something more than in that proportion.”<sup>78</sup> A progressive tax structure places greater tax burden on those in a better position to bear it—the wealthy. By funding critical investments, it also helps strengthen the middle class,

reinforcing a key foundation of long-term economic growth.

Unfortunately, as our society has grown more unequal, our tax code has become less progressive. This is especially true at the very top of the income ladder, where gains have been sharpest.<sup>79</sup> As **Figure K** shows, the effective average federal tax rate—what taxpayers actually pay after taking into account all federal taxes and all deductions and credits—has declined dramatically for the top 1% and especially the top slices of the top 1%. Today, many of the very richest pay a lower tax rate than those below them on the economic ladder.<sup>80</sup> Thus, a major goal of tax reform has to be a code that is not just more efficient and better capable of funding critical public investments and economic security but also more progressive. This reform begins by *ending the Bush tax cuts for the highest earners and by taxing capital and labor income at the same rates.*

**FIGURE K: Average federal tax rates by income group, 1960 - 2004**



Source: Economic Policy Institute analysis of Thomas Piketty and Emmanuel Saez, "How Progressive Is the U.S. Federal Tax System? A Historical and International Perspective," *Journal of Economic Perspectives* 21(1):3-4, 2007. <http://elsa.berkeley.edu/~saez/piketty-saezJEP07taxprog.pdf>

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## Democratic voice, inclusivity, and accountability —in Washington and in the workplace

A strong, open, participatory democracy is the foundation of a strong, open, and dynamic economy. Policies to ensure growth and security depend on democratically responsive political institutions both for their implementation and their long-term viability. It is responsive government—government of, by, and for the people—that creates and sustains an economy of shared prosperity.

Such government has always been our nation’s ideal, a beacon for the broadening of the franchise and the strengthening of civil rights and economic protections over the course of our history. But today, even more than in recent memory, the ideal is far from reality. We have neither an economy of shared prosperity nor a responsive government. Our political institutions are instead beholden to special interests, institutionally dysfunctional, and insulated from public priorities. These pathologies are echoed in the market, where basic checks and balances on corporate power—above all, by working people exercising their rights to collective bargaining through unions—have all but disappeared.

Reform will require that we first **free government from narrow corporate interests** so we can use politics to regulate industry instead of letting industry regulate politics. Yet reducing the pull of narrow corporate interests is only the first step. Markets must be externally regulated, but they also need internal checks and balances. To create **accountability in and through the private sector**, we need organizations—notably unions, corporate watchdogs (such as pension funds and other groups of active shareholders), and private civic organizations—that can work within markets to help ensure that gains are widely shared and that corporate leaders and financial executives are restrained. These organizations will be hard-pressed to win major victories over the long term, however, unless our government itself is first reformed to make it more responsive. To **strengthen our democracy**, we need to engage in direct reform of political institutions, like the Senate filibuster. We also need to limit the role of

money in politics and ensure broad voter access.

By restoring the pillar of democracy alongside the pillars of growth and security, we will create the conditions for an economy of broadly shared prosperity that will keep America competitive in the 21st century.

### FREE GOVERNMENT FROM NARROW CORPORATE INTERESTS

Those with concentrated economic power are always tempted to use government to their narrow ends. Adam Smith noted that “the interested sophistry of merchants and manufacturers confounded the common sense of mankind. Their interest is, in this respect, directly opposite to that of the great body of the people.” When it comes to government regulation, Smith continued, their advice:

...ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.<sup>81</sup>

A century and a half later, Theodore Roosevelt made the same point in the language of a modern financial and industrial economy:

The true friend of property, the true conservative, is he who insists that property shall be the servant and not the master of the commonwealth; who insists that the creature of man’s making shall be the servant and not the master of the man who made it. The citizens of the United States must effectively control the mighty commercial forces which they have themselves called into being...The absence of effective state, and, especially, national restraint upon unfair money getting has tended to create a small

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class of enormously wealthy and economically powerful men, whose chief object is to hold and increase their power.<sup>82</sup>

Today, we face the same challenge. Increasingly, our political system is a two-way channel in which money flows in one direction and favorable policy flows back. Large corporations give donations, hire expensive lobbyists (often, former public officials and their staffs), and run costly faux-grassroots campaigns in pursuit of their favored policies. The revolving door in Washington swings faster and faster—between worlds that are increasingly far apart in pay and privilege. Members of Congress and their staffs and high-level executive branch officials are offered huge sums to ply their influence within the halls of power. Official expenditures on federal lobbying—which surely understate the true numbers—have risen from \$460 million to over \$3 billion.<sup>83</sup> If business and the rich invest in the private sector for a return, they invest in politics for a return, too—only this return comes at the expense of our broader economy, taxpayers, and our democracy.<sup>84</sup>

Take the financial sector. In the run-up to the financial crisis, wave after wave of deregulation allowed the industry to make enormous profits, in part through predatory lending and the offloading of systemic risks. Economic research suggests that the huge earnings in the financial industry are directly linked to this deregulatory wave.<sup>85</sup> This deregulation, in turn, responded directly to the political clout of the finance, insurance, and real estate industries, which poured money into campaigns and lobbyists into Washington.<sup>86</sup> The rest of the story is well known: a massive financial crisis, followed by attempts to re-regulate the financial industry in the face of fierce political resistance—and record political spending—from Wall Street.

The banking crisis is not an isolated example. We see the effects across industries—in pharmaceuticals, in carbon-intensive energy production, in agriculture, in telecommunications, and in many others. Corporations undermine critical areas of regulation, putting individuals, families, the environment, and the broader economy at risk. They capture large subsidies, wasting

taxpayer dollars and creating distortions in the market. And their influence makes any real reform more difficult. To achieve broadly shared prosperity, we must first reduce the sway of corporate lobbies. This can be done directly through stronger and more effective oversight. In financial markets, that means regulation that provides stability, encourages a productive allocation of capital, and protects consumers against unscrupulous lenders, making it easier for individuals to make wise financial choices. Of all necessary regulations, the most critical is *reinstating the firewalls between investment and banking*, ensuring that basic banking functions are not caught up in high-rolling speculative gambles and limiting the risk of future bailouts.

But pressures for industry capture can also be reduced indirectly—by limiting the power of money in politics, closing the revolving door, and increasing the sway of ordinary voters in the making of policy. Indeed, the two go together: effective regulation to align the private and social benefits of market activity is only possible when government is responsive to the broad public and has the power to act in the face of industry resistance. That is why we must also *reform lobbying* through stricter rules and greater disclosure.

## ACCOUNTABILITY IN AND THROUGH THE PRIVATE SECTOR

The reforms we have discussed throughout this document will not be easily achieved. They will require substantial political mobilization outside government—from organizations operating in our broader civil society and within the market. The institutions of civil society, from social movements to broad-based civic organizations to consumer and environmental watchdogs, will be crucial not only to passage of this new generation of policies but also to their maintenance over time. The strengthening of our civil society is therefore itself an important goal, one that can be achieved in part by *ensuring a strong independent media, increasing the transparency and online engagement of the federal government, and empowering nonprofit organizations* that serve the disadvantaged to engage with the political system.

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A strong civil society will, among other things, help to reinforce and maintain the checks and balances that are central to democracy. But it is not only our democracy that needs organizational balance. So too does the market. Austerity economics argues that individuals pursuing their self-interest will always and automatically generate the best possible outcomes for society. But that is false. As both history and theory show, markets are prone to failure: they generate massive negative externalities, develop bubbles, and otherwise fail to create the conditions for shared prosperity. Moreover, those in positions of power within markets—CEOs, top financial executives, corporate boards—have their own interests, and these interests are not always aligned with the health of the economy or, at times, even the interests of companies themselves. This is why prosperity economics suggests that, like our politics, our markets also need better checks and balances. We need institutions that can work within markets to help ensure that gains are widely shared and that corporate leaders consider the interests of other key stakeholders.

Two sets of checks and balances within the market are particularly important: improved corporate governance and unions. Corporations play an enormous role in our society. They drive innovation and provide employment and generally constitute the basic units of our markets. But corporations are institutions like any other—capable of good but also prone to self-dealing. Powerful incentives drive corporations to stretch the limits of the law and sometimes to break it outright. The results are the kinds of corporate malfeasance—in accounting, finance, and elsewhere—that have rocked our markets in recent years. We need to reform both the institutional and individual incentives that drive corporations. Part of this can happen through politics. But we also need checks internal to the market. As we outline in Part Three, a crucial step is to *empower shareholders*—especially investor collectives, such as pension funds—through greater *corporate disclosure* and transparency, and by providing for greater *input in the setting of executive pay*.

Historically, the most critical check within the market has been organized labor, and organized labor must be revitalized. Unions have been central in

securing many of the most basic worker protections we today enjoy—from the weekend to overtime pay. Unions and collective bargaining help ensure that the benefits of growth are shared between employers and employees. Crucially, these benefits of organized labor do not just accrue to union members. Much research has shown that union density provides benefits that spill over to nonunion workers in heavily unionized industries and geographic areas, as unions institutionalize and enforce norms of wage equity, as well as provide a check against excessive executive pay. In all of these ways, collective bargaining and its expression through unions are critical supports of the middle class, which in turn is central to maintaining broadly shared prosperity.

Unions are also a critical part of our democratic infrastructure. Unions give workers a voice in the workplace, empowering them as active agents in the economy. Unions have played a critical role in the formation and maintenance of democratic societies, from Britain in the 19th century to Poland in the 1980s to Tunisia and Egypt today. In the United States, unions have been the single most important voice fighting for the bread-and-butter economic concerns of ordinary workers. Unions helped build the framework of security that protects American workers and families, and helped lead government toward civil rights reforms and the kinds of public investments that drove forward our economy for much of the 20th century. Unions also increase voter turnout, both through direct voter drives and through the greater engagement they create around policy issues within and beyond union households.<sup>87</sup>

Both our history and the recent histories of countries as diverse as Germany, Brazil, South Africa, and South Korea tell us that, when workers can come together in unions to bargain collectively and make their voices heard in public life, policies that make for shared prosperity can become a reality. Around the world, union density is positively correlated with key measures of social well-being, such as adult literacy, life expectancy and infant mortality, rates of incarceration, income and wealth equality, mental health and reported life satisfaction, and environmental protections.<sup>88</sup>

The decline in union coverage over the last 40 years—from about one in four workers in 1973 to about one in eight today (**Figure L**)—has thus contributed in myriad ways to rising inequality and the increasing power of corporate economic interests. Empowering unions and other forms of collective bargaining is therefore a top priority. A revival of unions would give workers voice, resulting in higher wages and more opportunities for economic advancement. It would undo at least part of the rampant rise in inequality. And it would create an institutional check on corporate power at the national level. To that end, we must implement a *quick, fair process for workers to choose union representation and have the power to bargain collectively and stronger penalties for violation of labor laws.*

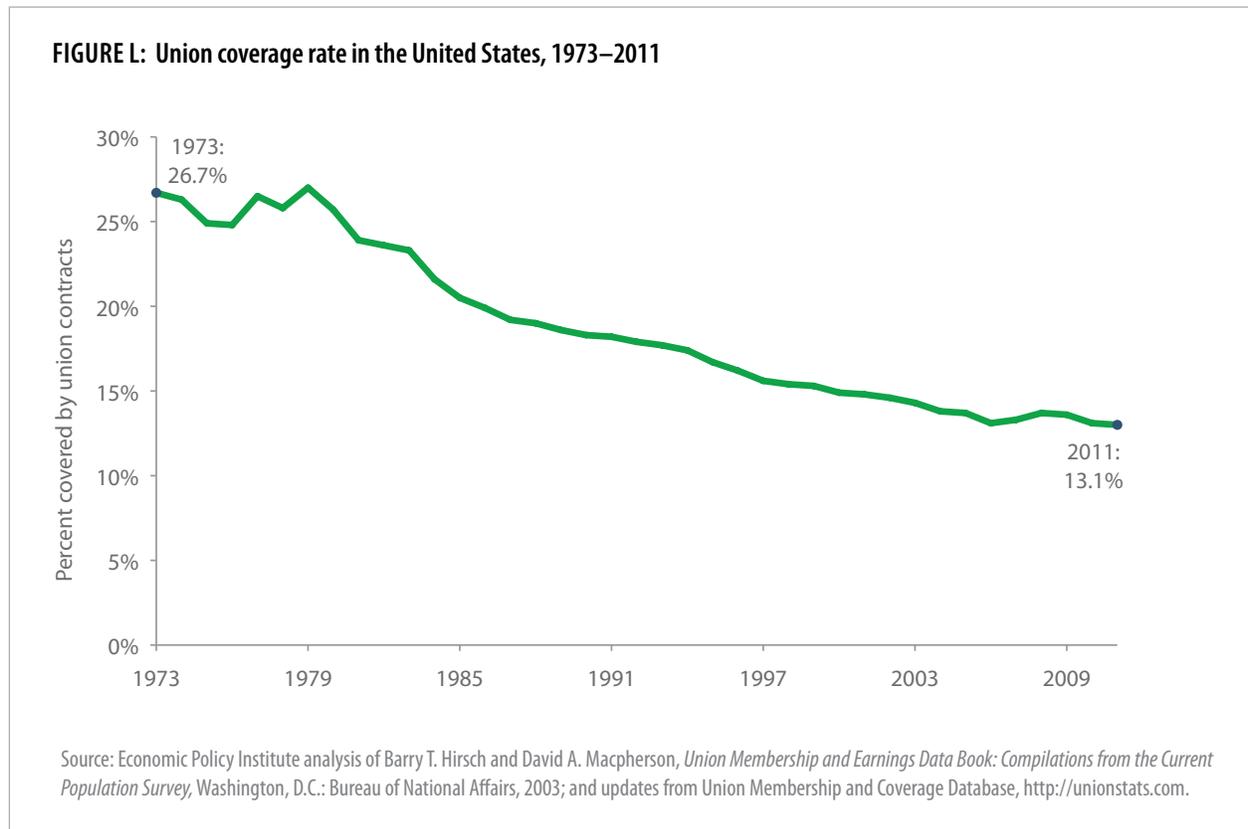
### STRENGTHENING OUR DEMOCRACY

A strong, responsive democracy is a necessary precondition for many of the other reforms we have discussed throughout this report. To implement and

enforce sound programs that support public goods and build a more inclusive economy, we need a well-functioning democracy in which ordinary voters, not powerful economic interests, call the shots. A vibrant and healthy democracy is not just good in itself; it is a prerequisite to long-term economic success.

Rebuilding our democracy begins with three areas of change. First, we have to reform the policy process itself, including the hurdles to sensible lawmaking, such as the filibuster, and the infirmities in the budgeting process, such as the redundant but destructive requirement to authorize increases in the federal debt ceiling for previously legislated spending.<sup>89</sup> Too often, the current process permits small minorities on the legislative fringes—especially the fringe dedicated to austerity economics—to dominate debate and escape accountability.

The Senate filibuster illustrates the problem well. Over the last generation, it has gone from a rare expression of minority dissent to a routine tool of



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minority obstruction (**Figure M**). Today, all major legislation except the budget requires not a simple majority of 51 Senate votes but a supermajority of 60. The filibuster is a rule of the Senate, not a constitutional provision, and it is certainly not what the Founders had in mind when they wrote of checks and balances.<sup>90</sup> Coupled with increased partisan polarization, the filibuster breeds stalemate and pulls policy toward the extremes.<sup>91</sup> In an era of rapid economic change, this means government cannot play a constructive role in promoting shared prosperity or responding to new risks or opportunities. As a cautionary tale, we can look to California, where political dysfunction has created impasses in the budgeting and legislative processes that undermine the very stability of the state. Such an outcome is not impossible at the national level, particularly if polarization and procedural hand-tying continues unchecked. Improving the processes by which we make decisions—and in particular *reforming the Senate filibuster*—will help avoid dangerous political brinkmanship and stalemates.

Second, we need to limit the flow of money into politics. We have already discussed the pernicious effects of corporate lobbying, by far the largest area of political spending by corporations. But especially in the wake of the Supreme Court's *Citizens United* decision, our campaign finance system is also broken, with the floodgates opening wider to special-interest spending and the sway of multibillionaires in campaigns. A telling indicator: David and Charles Koch, heads of the energy and consumer products conglomerate Koch Industries, will spend more this year than John McCain's entire presidential campaign raised in 2008.<sup>92</sup> Political and economic reform will falter unless we can reduce the influence of large corporations and wealthy individuals that comes from their campaign and lobbying expenditures and from the revolving door between public service and K Street lobbying firms—unless, in short, we make money matter less in American politics. To this end, we propose a *national public financing law* that works within current constitutional constraints.<sup>93</sup>

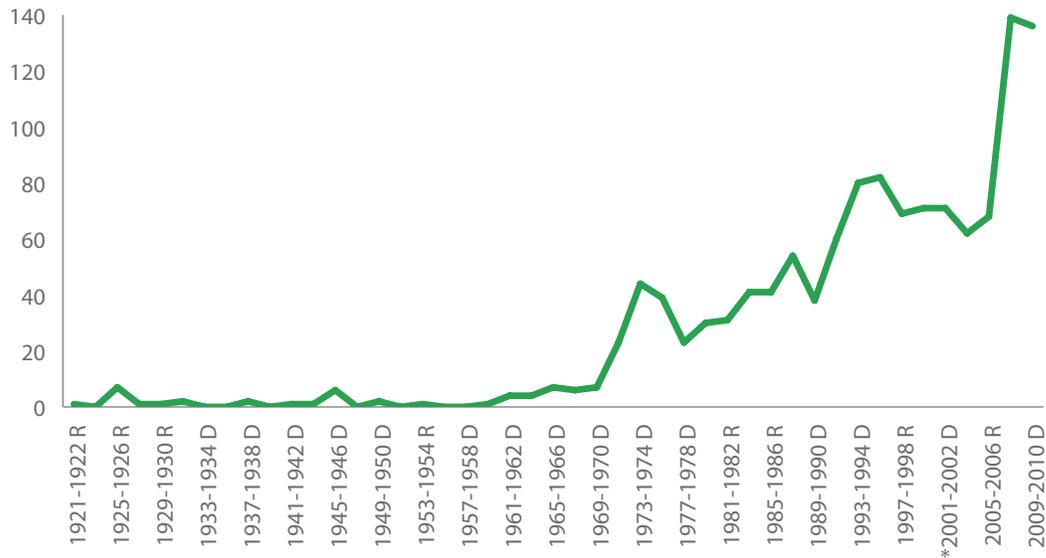
We also need to make votes count. Voting is the most equally distributed political resource. But while

money—the least equally distributed resource—has increased in might, the less affluent have also seen their electoral strength wane. Thus, third, we need to empower individuals to participate directly in politics through political organizing and through the critical channel of voting. The course of American history has seen a gradual expansion of the franchise and a shift away from requirements based on property, gender, and race. With the expansion of the franchise has come increasing social and economic integration; citizenship fosters a sense of ownership not only over politics but over the economy as well. Over time, we have built a nation of economic and political stakeholders, to our great benefit.

The recrudescence of efforts to disenfranchise citizens and impose barriers to voting are therefore of significant concern—both because a strong democracy rests on voting and because voting is a way that citizens develop a sense of agency that extends beyond politics. Nothing is more integral to our standing as a democratic society than the universal franchise. It should be an unquestioned goal of our political system to permit and encourage as many citizens as possible to vote. But in fact many states are moving in the opposite direction. States must be pushed to put in place same-day voter registration and to reform laws that constrain voter access, from the denial of voting rights to felons who have served their time to burdensome voter identification requirements. We therefore demand *putting an end to disenfranchisement*. At the same time, we need to actively encourage citizens to engage with our democratic process through, for example, a national election-day holiday. Particularly at a time of increasing frustration with government, we should be striving to make more salient the timing and importance of elections and the vital role of elections in ensuring shared prosperity.

These are the pillars of shared prosperity—growth, security, democracy. Below, we lay out key policies to begin building these pillars. These are written in such a way that they describe the key contours and driving ideas and values of each policy area, without

**FIGURE M: Cloture filings to end Senate filibusters, 1921-2010**



Note: "D" or "R" indicates party controlling Senate in that session; \* power switched during session.

Source: U.S. Senate, "Senate Actions on Cloture Motions: Motions Filed," [http://www.senate.gov/pagelayout/reference/cloture\\_motions/clotureCounts.htm](http://www.senate.gov/pagelayout/reference/cloture_motions/clotureCounts.htm)

delving into too much detail. This is not and is not intended to be a budget document. There are plenty of such blueprints out there, and we have consulted them in ensuring the public investments and the reinforcements to economic security we advocate are consistent with tackling our long-term fiscal situation—though we should stress again that, in the short term, substantial investments in infrastructure should be deficit-financed to maximize their positive effect. In matching our ambitions with the need for long-term fiscal balance, we have emphasized two essential steps: reducing the growth of health care costs, the largest driver of our long-term deficits; and restoring a revenue base devastated by round after round of unfunded tax cuts focused on the wealthy. Along with the greater efficiencies in defense and elimination of direct subsidies for industries with large external costs to our economy and society—such as the fossil-fuel industry—these changes would be more than sufficient to ensure that we stabilize and then bring down our debt.<sup>94</sup> More important, they would do so without jeopardizing the

growth that is essential for long-term fiscal health or the programs of economic security on which Americans—and a dynamic capitalist economy—depend. Perhaps most important, they would create the fiscal breathing room for the high-return public investments our society has badly neglected for a generation. A preliminary analysis (see the **Appendix**) of the policies proposed here shows that they would lead to sustainable deficit levels within five years of the current 10-year budget window (FY2013-2022).

In part, we have avoided greater detail because we believe that no single blueprint can or should try to illuminate every aspect of the three pillars. They can only be developed by recreating a virtuous cycle in which shared growth coupled with economic security emerges from a democratic process that represents the aspirations and concerns of all Americans, not just the demands of those with substantial market power. It is to help start this process that we now turn to laying out the major prescriptions of an agenda of prosperity economics.



## PART THREE ■■■

# Policies for Broadly Shared Prosperity

## 1 The First Pillar: Growth

Unemployment in the United States remains persistently high. The present jobs crisis is aggravating long-term economic challenges occasioned by an increasingly integrated and technologically sophisticated global economy. America's trade deficit has increased dramatically over the last three decades while its manufacturing base has declined. Competition from developing countries threatens not only older industries but high-technology sectors as well.<sup>95</sup> We must therefore confront both current unemployment and lay the groundwork for future job growth.

Challenges of globalization are inevitable, but the policies adopted over the past several decades—above all, declining investment in education, R&D, infrastructure, and other public goods and a weak approach to trade—have limited our capacity to respond to them.

A growth agenda built on public investment, a strong export sector promoted by a more competitive dollar, and macroeconomic policy promoting full employment will create jobs, ensure long-term growth based on innovation, and foster social mobility.

### ■ BY CREATING JOBS

#### › Create jobs by investing in infrastructure and restoring communities

*Goal: Put Americans to work building a world-class infrastructure for transportation, communications, education, energy, and environmental protection, and providing vital public goods like education and police and fire protection.*

#### *Policy recommendations:*

**Invest \$250 billion per year in infrastructure over the next six years.** Over 12 million Americans are actively searching for work and unable to find it. But as many top economists have argued, there is a simple and effective way to create jobs right now that would be good now and good over the long term: rebuild the nation's deteriorating infrastructure. Estimates suggest that each billion in infrastructure spending generates between 4,000 and 18,000 jobs,<sup>96</sup> most of which are middle-class jobs.<sup>97</sup> Infrastructure is also a smart investment. Large private-sector productivity gains flow from public infrastructure investments; economists estimate the returns to range from 15% to 45%.<sup>98</sup> And with interest rates on Treasury bonds at historic lows, the federal government can finance long-term investments more cheaply than ever. A six-year commitment of \$250 billion per year would, when combined with existing federal, state, and local commitments, address the current infrastructure deficit.

The \$250 billion per year for the next six years would be focused on:

- Rebuilding and improving roads, bridges, ports, airports and public transit, with a focus on encouraging more environmentally friendly forms of land development, including investments in multi-modal transit systems;
- Developing a “smart” electrical grid to encourage sustainable electricity generation and higher consumer efficiency;<sup>99</sup>
- Reinforcing environmental and social infrastructure, including dams, levees, waste management facilities, broadband, and schools.;
- Retrofitting buildings to increase energy efficiency.

**Create an infrastructure bank.** To invest for the future, we recommend the creation of a National Infrastructure Bank, with a small portion of new federal infrastructure spending invested alongside private capital. Such a bank would help lawmakers identify critical projects and attract private capital to help meet the country's needs. In Europe, many infrastructure investments like toll roads and airports attract private capital. This does not mean simply selling off public assets, but rather finding ways in which public capital can spur private investment. Bank infrastructure projects should be guided by “Buy American” provisions; in this way, infrastructure spending will reinforce the U.S. industrial base.

**Provide help to states and localities to hire back teachers, first responders, and other public servants.** The painfully slow pace of our current recovery is driven not so much by anemic growth in private-sector jobs relative to past recoveries as by continuing declines in state and local jobs—most of them in education and police and fire protection. This “hidden” austerity program has led to an unprecedented loss of middle-class jobs at the state and local level and likely adds around one point to our unemployment rate today, through its direct effects (fewer jobs) and indirect effects (reduced income to be spent by teachers and first responders).<sup>100</sup> These continuing layoffs hurt not just our economy overall but also the vital public services provided by local governments. And they have been borne disproportionately by women, who have lost almost 400,000 jobs during the recovery as compared to about 230,000 jobs lost by men.<sup>101</sup> We recommend an expenditure of \$75 billion over two years.

**Spend \$8 billion per year to expand AmeriCorps and directly create jobs for out-of-work young Americans.** Unemployment among young Americans stands at 16.5%. For Latino youth, it is 20.5%, and for young African Americans 30.2%,—almost four times the national average.<sup>102</sup> Meanwhile, our country faces enormous deficits not only in infrastructure

but in many other critical areas: in maintaining public lands, increasing the energy efficiency of homes and businesses, and tackling issues of poverty and social injustice. The Edward M. Kennedy Serve America Act expanded AmeriCorps from 75,000 to 250,000 members. Over the next decade, we should double that number, bringing the total AmeriCorps membership up to 500,000 per year. The expansion should focus on the Clean Energy Corps and Opportunity Corps, with expanded programs for unemployed young workers in their late 20s and early 30s.<sup>103</sup>

### › Create jobs by ensuring U.S. global competitiveness

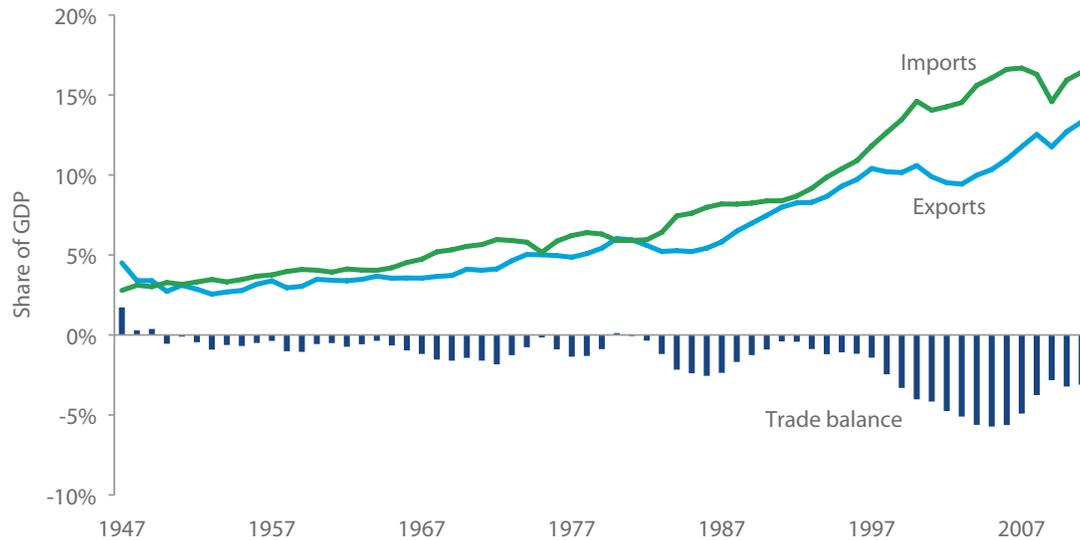
*Goal: Increase net exports (i.e., the difference between total imports and total exports) with aim of balanced trade.*

*Policy recommendations:*

**Commit to a long-term dollar strategy that prevents its value from undermining the trade competitiveness of American companies.** The trade deficit (see **Figure N**) and the jobs deficit are closely linked, and the best way to turn around the trade deficit—to make the United States a net exporter—is to lower the value of the dollar. In fact, no single policy intervention would create more American jobs. Lowering the value of the dollar makes foreign goods relatively more expensive at home and domestic goods relatively cheaper abroad. A lower dollar will therefore help American goods and traded services compete in overseas markets, driving increased demand for industries here at home. To lower the value of the dollar, China and other countries that maintain artificially low currencies must be encouraged—if necessary, by penalizing the dollar holdings of countries buying dollar assets to prop up their own currencies—to let their currencies rise so that international imbalances can move closer to sustainable levels.<sup>104</sup>

**Combat unfair mercantilist policies used against the U.S. by its trading partners.** Such policies include export subsidies, tariffs, trade-distorting taxes,

**FIGURE N: Imports, exports, and trade balance as a share of U.S. GDP, 1947–2011**



Source: Economic Policy Institute' analysis of Bureau of Economic Analysis National Income and Product Accounts.

technology-transfer requirements, and restrictions on foreign direct investment.<sup>105</sup> The United States can use a number of both sanctions and inducements, including the promise of normalized trade relations, to combat mercantilist trade policies.

#### **Eliminate tax benefits that encourage offshoring.**

Within the constraints of World Trade Organization provisions, we should be encouraging production at home by reforming relevant tax provisions; the tax code should be encouraging the creation of jobs here at home, not their shipment overseas.

#### **› Create jobs by enforcing full-employment monetary policy**

*Goal: Encourage stable and strong employment expansion to take advantage of U.S. economic potential and insure against risks to full employment.*

*Policy recommendations:*

**Clarify the Federal Reserve's mandate to priori-**

**tize full employment.** Full employment—jobs for all who want them, except the inevitable small percent of workers between jobs—is the most powerful means of increasing living standards and reducing inequality. Though the Fed has a dual mandate to promote full employment and price stability, the Fed's actual policy stance has been biased against full employment and rising real wages and in favor of the priorities of Wall Street and its bondholders.

#### **Formalize and expand the Fed's tools for guarding against asset bubbles and stabilizing the macroeconomy more broadly.**

The primary tool the Fed has chosen for managing asset bubbles and stimulating the economy is its control over short-term “policy interest rates.” When these interest rates reach their lower bound (zero), the Fed has implicitly declared it is out of ammunition. This represents a failure of policy imagination and will: the Fed has other powerful tools at its disposal, including more aggressive use of large-scale asset purchases (a.k.a., “quantitative easing”), setting targets for long-term interest rates, and

setting a higher target for inflation, and it should begin using them.

**Reduce the power of the banking industry within the Fed.** We should not forget that the Fed bears an important share of the responsibility for the financial crisis. Its leaders failed to foresee the crisis and indeed actively encouraged it through a hands-off policy toward finance, among other policy mistakes. The banking sector has a huge influence on the Fed in direct and indirect ways. We should work to reform the governance of the regional feds to ensure banks do not control who the regional Fed presidents are and to foster a more diverse set of actors in regional presidencies, and we should change the rules that provide regional presidents with an automatic position on the Federal Open Market Committee. Such reforms would provide true independence from powerful political actors—especially the financial sector—that the Fed does not enjoy today.

## **GROWTH BY FOSTERING INNOVATION**

### **› Foster innovation through education**

*Goal: Provide every child with the opportunity to achieve in a global economy.*

*Policy recommendations:*

**Provide universal pre-K child care for children ages 3-5.** The United States is one of only a handful of advanced countries that does not provide universal early childhood education.<sup>106</sup> Early childhood has a huge impact on shaping the lives of individuals, and substantial research shows that the quality of child care is central to childhood development and long-term social and economic outcomes.<sup>107</sup> Such investments can have a particularly strong impact on children from low-income families, who lack a variety of benefits available to children in middle- and upper-income families.<sup>108</sup> Evidence suggests that annual returns on investments in preschool programs for disadvantaged youth are around 16%,<sup>109</sup> though some studies suggest

even higher returns.<sup>110</sup> Despite these high returns, there are 4.5 million children ages 3-5 in the U.S. who are not attending preschool or kindergarten. Only the federal government, in partnership with the states, can ensure universal access to high-quality learning for our youngest children. Efforts to expand pre-K should build on the success of Head Start programs.

**Encourage innovation and teacher excellence in K-12 education.** K-12 education is central to creating opportunity and fostering competitiveness. Yet today, young adults in countries like Finland and Singapore achieve higher levels of education than their counterparts here in the U.S. Moreover, they do it with systems that properly train and support teachers, develop and resource curricula, and integrate students' classroom experience with broader social supports. Not only are we growing less competitive in comparison with peer countries, but we're also weakening our absolute economic strength. The OECD suggests that each additional year of schooling attained by a population translates into at least a two percentage-point increase in economic output.<sup>111</sup> Our K-12 education system needs broad improvements if we are to remain a leader in an increasingly dynamic global economy. Alongside other reforms, federal policies should be strengthened along two critical lines. First, we need to expand grant programs to encourage innovation in school organization, curricula, and technology. Second, we need to further the professionalization of teachers by improving teacher education, providing mentorship for young teachers, and expanding opportunities for ongoing education and development.<sup>112</sup> Finally, we must reverse recent trends and see that funding is available to provide basic services and to meet these additional goals.

**Ensure that every person has an opportunity to attend and graduate from college.** The higher education system needs to be organized around three basic principles. First, all students should be encouraged and empowered to apply to college. Second, all students who get into college should be able to afford to attend. Third, all students who start college should

be given the support they need to graduate, and only those schools capable of graduating students should be given public support. Putting these principles into practice will require reforms at all levels, from individual institutions to the federal government. For example, we need better college guidance and counseling at the high school level and programs geared toward supporting completion at the college level. The federal government, meanwhile, has a central role to play in increasing investments in community colleges, increasing federal student loan support (including support for loans whose repayment is proportional to post-college income), and helping control college costs through market reforms and support for the use of education technology. All of these efforts will be largely meaningless, however, if we don't start by reversing the steep declines in both state and federal support for public colleges and universities.

**Expand job training.** We need to combine high school and college education with both workplace oriented training and education and with lifelong workplace learning. Job training policy should expand along numerous fronts. As a start, the federal government should provide grants to companies that institute and maintain industry-based or internal training programs. Wherever possible, industries and unions should partner with educational institutions, especially high schools and community colleges.<sup>113</sup> Vocational training programs in these institutions, meanwhile, should directly engage with employers and with organized labor and help guide students toward specific careers.<sup>114</sup> In order to avoid abuses of the kind we have recently seen in for-profit colleges, any occupation that is an apprenticeship trade or craft must conform with the National Apprenticeship Act.

In addition to subsidizing training programs, Congress should create a “right to training” for workers. A right to training gives workers the right to request training from employers and be given an answer, in writing, if training is not to be made available. This would vastly expand opportunities for training across industries and sectors.

## › Foster innovation through technology and entrepreneurship

*Goal: Bolster America's position as the center for global innovation and the world leader in entrepreneurship, especially in high technology and manufacturing.*

*Policy recommendations:*

### **Increase federal investments in R&D by 50%.**

Global competitiveness depends on technological and scientific research and the progress in management, communications, design, and production that it generates.<sup>115</sup> And yet the market systematically underfunds such research because the benefits of research accrue widely; like any public good, individual firms won't invest in basic science because they won't be able to secure enough of the benefits of their investment. Global competition aggravates this market failure; firms feel pressured to cut budgets and rein in costs, with the consequence that fewer companies have the kind of long-time horizon that supports spending on research and development.<sup>116</sup>

The natural market failure and decreasing levels of corporate R&D create an important space for federal investments in basic science. Yet funding is being cut back. We are quickly losing our lead on our trading partners in terms of research<sup>117</sup> and applications of research (i.e., patents).<sup>118</sup> The gaps in investment in scientific research and development pose a threat to our long-term economic dynamism. In 1976, federal non-defense R&D spending constituted 0.6% of U.S. GDP; today, it stands at 0.4%.<sup>119</sup> An increase of 50% would move us back toward the historic levels of investment that engendered so many critical technological and commercial advances. All federal R&D funding must be accompanied by policies designed to maximize the job-creating deployment of the resulting technologies in the United States.

**Encourage a ‘startup’ economy by leveling the playing field with corporate giants.** More and more innovation occurs not in large firms acting on their own, but through partnerships between new enterpris-

es on the one hand and government and universities on the other.<sup>120</sup> Yet our startup rate has reached record lows: In the last three decades, the share of firms that are five years or younger has fallen from almost half to just over a third.<sup>121</sup> We need to enforce antitrust laws more aggressively, encourage government contracts for smaller firms, reduce the burden of health costs on small firms, and make sure startups and small businesses can get financing. This will require financial reform (discussed later). Too much of the investment community has focused on short-term returns through fast trading, complex derivatives, and high leverage rather than on providing the patient, often small-scale capital infusions that entrepreneurship requires.

### **Establish a National Innovation Foundation.**

Innovation policy gets short-shrift within relevant government agencies like the Department of Commerce (DOC) and the Small Business Administration. To help remedy the lack of attention, we suggest that federal research and development efforts, as well as efforts to improve the legal environment for innovation, be driven forward by a new National Innovation Foundation,<sup>122</sup> which could be established as an independent agency or housed at DOC.

### **› Foster innovation by growing the advanced manufacturing sector**

*Goal: Put America's manufacturing sector on the global high road toward competitiveness and growth.*

*Policy recommendations:*

**Use government procurement powers to drive manufacturing growth.** Government procurement has an important role to play in supporting nascent industries and encouraging growth in manufacturing at home. Federal procurement policies should incorporate “Buy American” provisions, and local and state governments should be encouraged to follow suit. One innovative idea in this area is the creation of comprehensive public procurement/public spending accountability programs designed in consultation with employ-

ers, workers, and local communities to ensure federal spending promotes the creation of good jobs.

**Expand the Manufacturing Extension Program (MEP) at the Department of Commerce.** MEP is the only program in the country that directly supports manufacturing establishments. In addition to providing more funding, Congress should instruct Commerce and the Small Business Administration to coordinate on providing targeted support for small manufacturers, especially those in high-technology areas seeking to scale up operations.

**Augment investments in clean energy.** Clean and renewable energy is of strategic and economic importance, representing a path to both tackle climate change and develop a new industry.<sup>123</sup> To help foster the manufacturing sector and to secure our long-term energy future, the U.S. should invest \$15 billion per year in clean energy technologies.<sup>124</sup> Likewise, we should be making investments in sustainable manufacturing; we expand on this in our discussion of the second pillar of shared prosperity, security.

## **GROWTH BY EXPANDING OPPORTUNITY AND PROMOTING INCLUSIVITY**

### **› Expanding opportunity through immigration policy**

*Goal: Ensure that our immigration system promotes integration, economic security and a voice in our democracy*

*Policy recommendations:*

**Create a path to citizenship for undocumented immigrants.** Keeping workers in the shadows of the economy leaves them vulnerable to exploitation and undercuts wages and living standards broadly. All Americans, including employers and immigrants, deserve a common-sense immigration process that provides a roadmap to citizenship for new immigrants in our country. Everyone agrees that the current patch-

work of policies and programs is mismanaged and broken, and it leaves workers vulnerable to exploitation, undermining the ability of all workers to exercise their rights. The Obama Administration's decision to temporarily stop deporting young people is a small step in the right direction, but congressional action is needed.

**Manage future immigration flows based on principles of family reunification and economic demands.** Families serve as the basic social unit in our society and are responsible for the vast majority of the investments in the human capital of our young people. Beyond family reunification, reforms to the immigration system should reflect real labor market needs.

**Hold employers accountable for labor and immigration law.** This means strictly enforcing current labor laws and then implementing an employment verification system as a way to enforce a new immigration code. Guest worker programs should not be used as an employer mechanism to undercut labor standards, exploit vulnerable workers, and shrink job opportunities for the workforce.

### › Expanding opportunity through enhanced social mobility

*Goal: Help low-income Americans enter the economic mainstream.*

*Policy recommendations:*

**Implement comprehensive place-based economic revitalization strategies.** Many neighborhoods in the U.S. have high levels of concentrated poverty, often overlapping with high levels of racial segregation. Concentrated poverty is correlated with high rates of unemployment, poor educational outcomes, and poor health. Solving these challenges requires combining education, health, and job training elements. Powerful examples from around the country—like the Harlem Children's Zone—demonstrate the impact that such strategies can have. Support for these programs should be expanded.

**Expand job training programs.** We need to supplement high school education with an ongoing program of job training. Job training policy should expand along two fronts. First, the federal government should provide subsidies through the tax code to companies that put in place internal training programs for low-wage workers. Second, the federal government should expand its own job training programs through partnerships with existing state agencies.

**Expand support for housing.** A report from the Department of Housing and Urban Development (HUD) found that more than 7 million low-income families who receive no housing assistance were paying more than half their monthly income on rent or living in severely inadequate housing in 2009, a 42% increase since 2001.<sup>125</sup> Many low-income workers cannot afford to live near work, and so they face long commutes that conflict with child care and family support.<sup>126</sup> Additional federal support for low-income housing would help increase the supply of affordable units, stabilize neighborhoods blighted by foreclosures, and help address the spatial divides between jobs and housing.

### › Expanding opportunity through rising wages and job quality

*Goal: Ensure that Americans who work are able to support themselves and their families.*

*Policy recommendations:*

**Raise the minimum wage and index it to production workers' wages.** In the 1960s, the minimum wage was half the nation's average wage for production and nonsupervisory workers;<sup>127</sup> restored to that level the minimum wage would be just over \$10 today. If maintained at 50% of the average production worker's wage, the minimum wage would once again serve as a genuinely protective labor market institution.<sup>128</sup> The minimum wage for tipped workers, which has stagnated at \$2.13 an hour, should be pegged to 70% of the regular minimum wage. Recent research demonstrates that normal upward adjustments to the minimum wage

have no harmful effects for unemployment. Indeed, within the U.S., many states have raised minimum wages with no negative effects.<sup>129</sup>

**End discrimination in employment, education, and job preparation.** Gender and racial discrimination remains rampant in the workplace, an injustice that weakens our economy by reducing incomes for working women and families. We need to strengthen the Equal Employment Opportunity Commission's enforcement of Title IX, ensure fair access to apprenticeships and other job training programs, and improve federal job training assistance to eliminate segregation by race and gender. All of these measures will help ensure fair pay across gender, racial, and ethnic lines.

**Create pathways out of low-wage work, especially in the human services sector.** Congress should move to require that jobs in the human services—health care, child care, and education—that are supported in whole or in part by federal funds pay a professional wage and be part of a career track, including opportunities for training.<sup>130</sup> By ensuring that service jobs have career potential, we can help to professionalize low-wage areas like health care and child care. Professionalization in turn leads to better jobs—with higher wages, greater job security, and clear tracks for promotion. To help states and localities meet these requirements, and to allow for the expansion of needed services in all of these areas, federal funding should be increased as necessary. Failure to couple funding with improved standards will likely lead to inadequate efforts to implement and enforce standards, cutbacks in other areas of public expenditures, or both. Outside of fields where government contracts can reach, we should offer incentives for employers to adopt policies to turn low-wage jobs into good jobs. Such policies are win-win: by providing the opportunity for workers to advance, employers can earn greater loyalty and higher productivity from their employees.<sup>131</sup> By empowering workers to collectively bargain, we can create an additional point of leverage to encourage employers to put in place these kinds of employment strategies.

Through collective bargaining, low-pay jobs can be turned into good jobs, as happened with semi-skilled manufacturing work in the last century. Given the increasing size of the human care sector, these reforms will have major impacts down the line.

## 2 The Second Pillar: Security

Markets work better when individuals and families feel a basic security for their futures and therefore feel comfortable investing in themselves and taking entrepreneurial risks. They also work better when basic resources like clean air and clean water are assured and environmental practices are sustainable. And markets work better when governments have the resources to operate smoothly far into the future.

To achieve prosperity that is broadly shared and sustainable requires security—economic, environmental, and fiscal.

### ECONOMIC SECURITY

#### › Secure health care

*Goal: Guarantee that every American has access to affordable, quality health care and protection against the financial risks of medical costs, while reducing the growth in health care costs system-wide to ease the burden on businesses, families, and public budgets.*

*Policy recommendations:*

**Build on the Affordable Care Act by adding a public option with the clout to push back against consolidated providers and insurers.** Rising health costs will be effectively checked only by a strong public insurance plan with the capacity to protect and improve the quality of care while restraining prices. In many regions, large physicians' groups and flagship hospital systems have gained increasing leverage to drive up prices, even when faced with dominant insurers. Private insurance plans also have near-monopoly

coverage in huge swaths of the country.<sup>132</sup> A public option, available within the state exchanges set up by the ACA, could pioneer new methods of payment and care coordination alongside Medicare, provide coverage on simple terms at an affordable price, force private plans to compete, and create pressure on providers to lower prices. In addition, exchanges should be encouraged to allow a wide range of insurance options (co-ops, multi-employer health plans, state-run health plans, and so on) to participate in the exchanges and to avoid giving excessive market power to consolidated private insurance companies.

Bold efforts will also be needed to ensure that everyone eligible for coverage receives it. All employers, not just larger employers, should be required to make some contribution to the cost of coverage if they do not provide it directly; uninsured workers should then be automatically enrolled in the exchanges, where they will have a choice of good plans and access to subsidies for low- and middle-income workers. Meanwhile, all public programs should assess eligibility for coverage within Medicaid or exchanges. And all those seeking care without insurance should be automatically enrolled as well.

**Strengthen Medicare by controlling its spending growth through new budget goals and payment reforms, not by shifting costs onto beneficiaries.**

Raising the age of eligibility for Medicare would save the federal government money only by shifting costs.<sup>133</sup> The same is true of a voucher system that covered less and less of health care costs. In any year, most Medicare spending goes to those in greatest need of care; for them, greater cost-sharing will have virtually no effect on costs, since they will exceed any reasonable out-of-pocket limit. More reliance on private plans is not the solution either. Not only do these plans cost more for the same benefits (according to the CBO, privatizing Medicare would lead costs to be 40% higher for a typical 65-year old by 2022),<sup>134</sup> but they break apart the Medicare program in ways that threaten beneficiaries with high costs and limit the program's ability to restrain spending through its concentrated purchasing power.

Instead, Medicare should adopt new strategies for controlling spending without shifting costs, thereby reducing the growth of costs for everyone. The ACA authorizes a series of such efforts to restrain price increases and improve care, with an explicit prohibition on cutting back Medicare's benefits (which are not generous compared with private employment-based plans). Thanks to these efforts and Medicare's historical advantage in cost control, the per capita cost of Medicare is projected to grow roughly a third slower than private premiums over the next decade.<sup>135</sup> These efforts should be expanded and linked to an annual budget for Medicare, enforced through reductions in payments—the method of cost control successfully used in most rich nations. The Independent Payment Advisory Board established by the ACA has an important role to play in this regard. Medicare should be allowed to directly bargain for lower prescription drug prices, and Medicare's payments should be shifted away from specialty care and toward primary and preventive care. If growth in Medicare spending were similar to the spending growth experienced in other rich democracies, our long-term budget picture would be much rosier.<sup>136</sup> Moreover, these efforts would be greatly aided by the public option for the nonelderly, which would work with Medicare to control costs system-wide. When it comes to cost control, Medicare is the solution, not the problem, but it cannot do the job alone—we need broader cost restraint.

**Move toward greater federal financing of Medicaid.** The ACA will dramatically expand Medicaid to low-income nonelderly adults (and their children), who increasingly have no access to coverage through employment. Under the recent Supreme Court ruling upholding the ACA, however, the expansion of Medicaid to cover all adults below 133% of the federal poverty level has become a state option. Every state should take up this option, which is almost entirely funded by the federal government. Medicaid remains under threat for other reasons as well. During times of distress, when the program is most needed, the pressures to cut it are greatest. At the federal level, politicians want to

reduce the federal contribution to Medicaid and turn it into a fixed grant, leaving the states to figure out how to deal with the rising cost of health care. Given that Medicaid payments to providers are already extremely low, the only way such savings could be achieved would be by throwing millions of Americans off the program.<sup>137</sup> Instead, federal financing of Medicaid should be increased and automatically adjusted upward when unemployment in a state is high. The latter measure would not only help to maintain the integrity of the Medicaid program, but also provide needed fiscal relief to states during periods typically marked by declining revenues from other sources. The federal Medicare program should also take a greater leadership role with regard to those eligible for both Medicare and Medicaid, improving the efficiency and quality of care for this vulnerable, high-cost population, rather than shifting responsibilities to state Medicaid programs.

### › Secure retirement

*Goal: Ensure that all Americans are able to retire with security after a lifetime of work.*

*Policy recommendations:*

**Strengthen Social Security by substantially raising or completely eliminating the cap on earnings subject to tax and by subjecting asset income to tax.** As incomes have grown more unequal, an increasing share of wages covered by Social Security has spilled over the “cap” on Social Security taxes (the cap in 2012 was \$111,000—no Social Security taxes are collected on annual earnings above that amount). This rise in inequality has eroded Social Security’s tax base and undermined the program’s finances. Eliminating the cap on taxable wages would essentially close the program’s long-term funding shortfall; raising it substantially would greatly reduce the shortfall, with the remainder left to be filled by other modest financing changes. At the same time, the payroll tax base could also be extended to asset income, such as capital gains. This would raise additional revenues in a progressive fashion that could be used to enhance the program for

vulnerable groups, such as widows, older beneficiaries, workers who have taken time out of the labor market to care for young children or frail family members, and college-attending children receiving benefits because of the death or disability of a parent.

**Replace 401(k)s with a simple, universal mandatory public-private plan.** This new approach would restore the best elements of defined-benefit pensions on a new, sustainable foundation of shared responsibility (rather than having employers bear key retirement risks alone). Employers and workers would be required to put aside a share of pay in earmarked accounts that are distinct from Social Security. These contributions would be pooled, professionally managed, and kept separate from other savings purposes; they would be available only at retirement except in the event of permanent disability. Payouts would be in the form of a guaranteed lifetime benefit. Though people would be able to keep existing 401(k) accounts and enjoy their continuing benefits, some portion of projected tax breaks for 401(k)s should be restructured to supplement contributions to these accounts for less-affluent workers, as well as to finance the universal IRAs described in the next recommendation. These changes would bring back something close to a guaranteed private pension, with pooled risk and shared financing. This new universal plan should, of course, be integrated with existing defined-benefit plans to encourage the continuation of plans that provide real retirement security to workers

**Create a new consolidated option for tax-favored private retirement savings that would provide real incentives to save for less-affluent workers.** Currently, 80% of the tax breaks for 401(k)s and IRAs go to the richest 20% of workers; only 7% go to the bottom 60% of the population.<sup>138</sup> To reduce this skew, we should create a new universal IRA available to all Americans. Workers would be automatically enrolled in these accounts, with a small amount placed in them each year, and contributions would be matched by the federal government for lower-income workers (em-

ployers would also be able to match contributions). Contributions would be tax-favored up to a reasonable limit, and rules for withdrawal would be similar to those for IRAs.

## › Household security

*Goal: Ensure that middle-class workers and their families have a foundation of economic security in the form of housing and other assets and support work/family balance.*

*Policy recommendations:*

### **Require banks to restructure loans where homes are worth significantly less than the amount owed.**

Any public funding for mortgage restructuring—such as financing a share of the cost of reducing mortgage principal for underwater homeowners—should be debt-financed to maximize its positive effect on the economy. Writing down mortgage debt would also force banks to own up to losses they continue to hide, making the financial system more transparent and ultimately more stable.

**Restore a well-functioning and simple mortgage financing system.**<sup>139</sup> We should either return to the public mortgage model that preceded Fannie Mae and Freddie Mac or create a system of federally chartered mortgage-bond insurers, backed by a federal reinsurance program to deal with catastrophic losses. In neither case should the publicly supported system be able to lobby Congress or support candidates, as Fannie and Freddie did. Whatever the model, there must be a heavy emphasis on straightforward mortgage offerings, strong consumer protections, and strict regulation of the private mortgage market, as well as built-in funding and rules to support affordable homeownership and affordable rental options.

**Mandate paid family and sick leave.** The United States is virtually the only nation in the advanced industrial world without paid family leave.<sup>140</sup> The Family and Medical Leave Act does not replace lost pay and applies to just over half the workforce. States that have

moved ahead with family-leave programs have found that they are both affordable and deliver substantial benefits in increased productivity and employee satisfaction.<sup>141</sup> Compared with women who do not take any leave, women who take paid leave after a child's birth report stronger labor force attachment, greater increases in wages, and less reliance on public assistance in the year following a child's birth (the last is true of fathers as well).<sup>142</sup>

### **Expand opportunities for affordable child care.**

Good child-care options are frequently beyond parents' financial reach. As part of the professionalization of service work discussed in the last section, substantial new funding should be available to the states to subsidize high-quality care options for lower-income families. The tax deduction for dependent care should also be converted into a refundable credit available even to those without federal income tax liability.

### **Consolidate tax breaks for nonretirement savings into a single, progressive Universal Savings Account.**

Most Americans receive little benefit from costly tax breaks for savings, which deliver most of their rewards to people who have substantial income and assets (and who are therefore most likely to simply shift their savings around to avoid taxes rather than to save more).<sup>143</sup> Replacing the current array of tax breaks for nonretirement savings with a single, progressive Universal Savings Account would go a long way toward restoring the balance.

### **Strengthen unemployment insurance and continuing federal unemployment benefits.**

The unemployment insurance (UI) system is in serious disrepair. For the first time in over 50 years,<sup>144</sup> some states have reduced the number of weeks of state benefits, undercutting the effect of the additional federal extended benefits Congress put in place during the recession. The current program of federal extended benefits will expire at the end of 2012, and under new rules many states are dropping out of the program before then. As with Medicaid, states cannot bear the burden of

unemployment insurance in deep recessions without federal help. The system needs reform to help states rebuild their trust funds, to provide greater federal assistance tied to the severity of unemployment, and to strengthen the reemployment services that are funded by the UI system.

## ■ ENVIRONMENTAL SECURITY

### › Secure climate

*Goal: The U.S. must ensure a stable and secure future by acting to mitigate climate change.*

*Policy recommendations:*

**Put a price on carbon and other greenhouse gases.** The scale of changes needed to reduce our carbon footprint to the levels suggested by climate scientists requires changes across every industry of the economy, changes that are most effectively driven by strong price signals. These price signals should be directly connected with the production of energy at the source—an upstream model of carbon pricing. Such a pricing system can be accomplished through a variety of mechanisms, of which the cap-and-trade system included in the American Clean Energy and Security Act of 2009 is only one example. Revenues should be used to both offset consumer price increases in electricity and to support energy-related infrastructure investments.

**Drive energy innovation and efficiency.** A price signal for carbon is only the start, however. We also need to drive innovation in the market through investments and support technological development. As already discussed, we need to make major investments—on the order of \$15 billion per year—in renewable energy and clean energy technologies. Today, China, Japan, and South Korea are leapfrogging the U.S. to lead the world in energy innovation in areas like solar power generation and carbon capture and sequestration; these are enormous growth industries for the future, and

we need to carve out a space for American firms.<sup>145</sup> To complement funding, Congress should create the Clean Energy Deployment Administration in the Department of Energy (DOE) to help bring clean energy technologies to market.<sup>146</sup> At the same time, we are going to be dependent on fossil fuels for at least the new few decades, as will the rest of the world. We should invest substantial resources in technologies that reduce the pollution, especially the carbon emissions, of all forms of energy production and use this technology to help reduce both domestic and global emissions.

**Shift transportation, housing, and development patterns.** Even with improved technologies, we need to deal with even deeper structural issues. In particular, we have to start shifting toward a more sustainable form of physical development. The greenest places in America are our densest cities. Density also benefits innovation and drives growth.<sup>147</sup> For the past 70 years, federal policy has encouraged sprawling growth. Those trends need to be reversed. Federal policy, especially transportation policy, should be focused on promoting denser, greener growth by subsidizing public transportation and supporting livable communities. Such efforts should help reshape urban landscapes with attention to current environmental injustice. To the extent possible, institutional structures should be created to drive more sustainable development patterns. The Partnership for Sustainable Communities,<sup>148</sup> a joint program of the Department of Transportation, HUD, and the EPA, is a good example of this kind of work.

### › Secure natural resources

*Goal: Husband natural resources to ensure stable flows of the goods on which the economy depends.*

*Policy recommendations:*

**Protect water and arable soil and encourage more intelligent and sustainable use.** Water is our most precious natural resource. In the decades to come, our water supplies will face increasing pressures from a combination of consumer and industrial demand and

shifts in climate.<sup>149</sup> Though water policy is generally local in nature, the federal government retains a central role through the Clean Water Act, through its investments in transportation and in water infrastructure, through the reach of the U.S. Army Corps of Engineers, and through USDA agricultural policies.<sup>150</sup> Our water policies—and closely related agricultural and urban policies—need to focus on a gradual transition toward a smarter allocation of water resources. At the same time, we need to expand enforcement of the Clean Water Act, which today is violated at will,<sup>151</sup> and apply its provisions more broadly.<sup>152</sup>

Like water, we take for granted soil and the agricultural productivity it provides. But our farmlands are losing soil at an unsustainable rate—nearly 10 times as fast as it can be replenished.<sup>153</sup> Where land is dry and bare, soil is easily eroded by winds; the infamous Dust Bowl of the 1930s was a result of over-farming followed by drought. Franklin Roosevelt’s response to such devastation, meanwhile, resulted in the planting of millions of trees and the environmental and ultimately economic revitalization of the region. The federal government can play a similar role today in pushing more sustainable farming practices. For example, tying USDA subsidies to more environmentally friendly practices would quickly shift the entire landscape.<sup>154</sup>

**Promote public awareness of and government sensitivity to the critical role of ecosystem services in maintaining human well-being.** Too often we think about natural resources in isolation. But the components of our natural infrastructure are integrated into a larger whole—into ecosystems. The services that areas like wetlands and forests provide us—water filtration and flood prevention, carbon sequestration, nutrient cycling, and pest control—depend on maintaining the integrity and health of our ecosystems. The federal government has a critical role to play in promoting education around and attention to ecosystem protection. One important step is to expand funding to states to protect their ecosystems, especially forests and coastal lands, building on successes like the National

Oceanic and Atmospheric Administration’s (NOAA) regional grant-making program.

### › Secure and sustainable global economics

*Goal: In an integrated global economy, the U.S. should lead the world toward a future of more sustainable forms of production and consumption.*

*Policy recommendations:*

**Invest in new forms of energy and material production, including \$5 billion for sustainable forms of manufacturing.** In the decades to come, resource scarcity will be an increasingly important factor shaping forms of production and consumption. We can position ourselves to lead in this era by investing resources in forms of sustainable manufacturing. Sustainable manufacturing can be defined in many ways, but it focuses in particular on industrial processes that use recycled materials and/or create products easily recycled back into industrial processes, as well as forms of production that decrease total energy, water, and material use. Building off programs like Commerce’s Sustainable Manufacturing Initiative and the DOE’s Advanced Manufacturing Office, the government should invest \$5 billion in “eco-innovation” and others areas that meld high-end manufacturing and sustainability.<sup>155</sup>

**Globalize U.S. sustainable technologies.** By embracing forms of sustainable energy production and manufacturing, we can encourage other nations to follow suit. To facilitate this process, the U.S. will need to develop partnerships with developing countries to disseminate innovative environmental technologies, especially clean energy technologies, in both the short and long term. In addition to helping developing countries grow in more sustainable fashions, such dissemination can also help secure future markets for American clean-tech goods and services. And it can help ensure that foreign firms don’t gain an advantage on American corporations by using cheaper pollution technologies.

## FISCAL SECURITY

### » Broad and secure tax base

*Goal: Make the tax code more efficient, progressive, and simple—and capable of raising the revenues needed to fund new public investments and safeguard economic security.*

*Policy recommendations:*

**End the Bush tax cuts for high-earners.** The Bush tax cuts are the largest single contributor to our current revenue shortfall. Their scheduled expiration on December 31, 2012, provides a rare opportunity to revisit fiscal priorities in a gridlocked political environment. President Obama's proposal to end the Bush tax cuts for the highest earners (households making \$250,000 or more) is the right start. The rest of the Bush tax cuts should be gradually phased out as the economy recovers. The exceptions are certain benefits for middle-class and low-income families, such as marriage-penalty relief for joint filers, alternative minimum tax (AMT) relief, the expanded child tax credit, and expanded education incentives. Finally, the AMT should be set at its current level and indexed to inflation.

**Create new tax brackets for the highest earners, restoring progressivity at the top of the tax code.** Representative Jan Schakowsky (D-Ill.) has proposed four new brackets: those with incomes of \$1-10 million would be taxed at 45%; \$10-20 million, 46%; \$20-100 million, 47%; \$100 million to \$1 billion, 48%; and \$1 billion and over, 49%. Adding more tax brackets creates little additional tax complexity; after all, the easiest part of doing taxes is looking up the tax due in the tax tables. A recent analysis by Peter Diamond and Emmanuel Saez suggests that even the highest of these rates would fall below the marginal income tax rate that would maximize government revenue (50-70%, taking into account that individuals face additional taxes from Medicare and state and local taxes).<sup>156</sup> And even the highest of these rates would be lower than the highest marginal rate during President Reagan's first term.

**Treat capital and labor income equally, eliminating the preferential treatment of capital gains and dividends and closing the “carried-interest” loophole.** The sharp decline in capital gains tax rates since 1986 has created enormous incentives for high-income workers to reclassify or divert their earnings to make them show up as capital gains. The most egregious case is the so-called carried interest provision, which allows private equity and hedge fund managers to treat their earnings from managing other people's money not as income, but as capital gains. Taxing capital and labor income at the same rates would close this loophole, and every other one that rests on such reclassification.

**Cap the value of itemized individual tax deductions and convert the deduction for dependent care into a refundable credit.** The value of all itemized deductions should be capped at the lowest income tax rate of 15% (i.e., the lowest rate after the Bush tax cuts expire). Taxpayers would receive a tax reduction equal to 15% of the value of the itemized deduction, even if their marginal tax rate were higher than 15%. In addition, the tax deduction for dependent care should be converted into a refundable credit.

**Maintain the 2009 expansions of the Earned Income Tax Credit (EITC), and expand the EITC to include childless adults.** The expansions of the EITC enacted in 2009, which have reduced poverty and increased the rewards of work, should be extended, and the EITC made more generous for childless workers, who are among the poorest of EITC recipients yet receive tiny benefits compared to workers with children. Both of these changes would have modest costs.

**Restore an estate tax with a reasonable exemption and a graduated rate structure.** Repeal of the estate tax would mostly benefit a few wealthy families who had little or no role in the creation of the vast fortunes from which they now benefit.<sup>157</sup> Virtually no small businesses or family farms face the estate tax. In

addition, it is important to recognize that heirs pay no income tax on their share of estates—none at all—and that virtually all estates (99% or more) will be tax free at any reasonable exemption level. An estate tax is justified not just as a means of encouraging equality of opportunity, but also a way of taxing the unrealized capital gains on estates, a major tax break for the wealthy.<sup>158</sup> Finally, because of the exemption and other features of the estate tax, the average effective rate that is actually paid on estates is dramatically lower than the statutory rate. We propose setting the exemption at \$2 million (\$4 million for married couples) and enacting a graduated rate structure that matches the graduated income tax on the highest-income groups.

**Bring the effective corporate tax rate in line with the effective rates of our main competitors and reduce incentives for tax avoidance and offshoring.**

While the stated corporate tax rate is higher than the statutory rates of our main competitors, the effective rate that is actually paid is lower than the international norm, as are U.S. corporate tax receipts as a share of GDP. Moreover, this average rate hides enormous variation across companies, which reflects a mess of tax breaks and opportunities for tax arbitrage as well as the sophisticated tax avoidance strategies and aggressive lobbying of large corporations.<sup>159</sup>

Reform of the corporate code should have three aims. It should, first, stabilize corporate tax revenues and, second, broaden the amount of income subject to taxation and eliminate special preferences, including deferral of taxes on offshore earnings—a revenue loss of roughly \$40 billion a year that provides large tax advantage for locating operations in low-tax nations.<sup>160</sup> Third, it should eliminate the perverse incentives in the code for piling debt onto corporate balance sheets, which reduces companies’ ability to weather financial downturns, encourages highly leveraged buyouts, and discriminates against innovative firms that plow profits back into R&D and technology.<sup>161</sup> The goal of corporate tax reform should not be revenue neutrality. Receipts are at historic lows and lower as a share of

income than in our peer nations, and so any corporate tax reform should stabilize revenues at a level above their current lows. The goal should be a simple code in which the statutory and effective rates are relatively similar and in line with those of our main trading partners.

› **Other revenue sources and savings**

*Goal: Broaden sources of tax revenue and ensure good value for public dollars.*

*Policy recommendations:*

**Create a “too big to fail” fee for the largest financial institutions to recoup taxpayer losses associated with TARP and to offset the cost of future bailouts.** The fee should only affect banks with substantial assets and be based on both size and leverage.

**Implement a financial transactions tax to discourage short-term speculation and reduce the chance of financial crises while funding job creation and public investment.** A small tax on financial transactions would discourage split-second, high-volume trading that has little value for the economy. The tax should be broad—applying to derivatives, stocks, options, etc.—so as to discourage financial institutions from making end-runs around it. The United States has had financial transaction taxes in the past, European leaders are considering one, and Great Britain has such a tax, during a period in which London has remained a vibrant financial center.

**Reduce defense spending at least to the levels of the eve of the wars in Iraq and Afghanistan, and require that foreseeable military actions be explicitly budgeted.** Military spending is the third-largest item in the federal budget, behind Social Security and health care. In 2010, we spent nearly 5% of our economy on defense—more than in any year since the start of the defense wind-down following the Cold War. The bipartisan Sustainable Defense Task Force has identified numerous targeted cuts in strategic

capabilities, conventional forces, operational expenses, and procurement strategies that could yield large savings without harming defense.<sup>162</sup> We should also move away from emergency supplemental appropriations for foreseeable military operations; these emergency supplementals weaken any budget constraints on the Department of Defense.

**Weed out cash and tax subsidies for established industries with large negative externalities—notably, oil and gas, agribusiness, and finance.** Deeply entrenched subsidies to existing economic winners, like oil companies and large agribusinesses, are simply handouts to corporate lobbies.<sup>163</sup> Worse yet, they distort important markets, make it difficult for new competitors to enter, and undermine public confidence in government by reinforcing the widespread belief that the government stands for corporations, not people.

### **3 The Third Pillar: Democracy**

A strong, open, participatory democracy is the bedrock of a strong, open, and dynamic economy. The many provisions discussed in this report—from infrastructure investment to early childhood education to climate change policies—depend on democratically responsive political institutions both for their implementation and for their long-term viability. Today, however, our democratic institutions are beholden to special interests, institutionally dysfunctional, and insulated from public priorities.

Reform will require three steps. First, we can start by using politics to regulate industry instead of letting industry regulate politics. But withdrawing government support for industry and putting in place regulation is only the first step. Markets must be externally regulated, but they also need internal checks and balances. We need institutions, notably unions, that can work within markets through collective bargaining and other means to help ensure that gains are widely shared and that corporate leaders and others are restrained. In this effort, civil society also has a central role to play. These

organizations will be hard-pressed to win major victories over the long term, however, unless the government itself is first reformed to make it more responsive. To this end, we need to limit the role of money in politics, ensure broad voter access, and reform dysfunctional political rules like the Senate filibuster.

## **FREE GOVERNMENT FROM NARROW CORPORATE INTERESTS**

### **› The banking industry**

*Goal: Create a stable banking system that encourages growth in the real economy.*

*Policy recommendations:*

**Reinstate firewalls between investment and banking.** Firewalls limit the exposure of the commercial banking sector to riskier financial investments and thereby reduce the exposure of the public treasury to bailouts. At the same time, the separation forces investment banks to forego risking the deposits of their commercial clients and requires them to prove the value of their proposed investments to external lenders. Likewise, the separation of the institutions provides needed stability to the economy: Investment bank failures would not bring down commercial banks at the same time; it would allow the Federal Deposit Insurance Corporation to provide a credible means of resolving bank failures; and it would diversify the economy—and, indeed, the political economy—of finance, fostering competition, rather than further consolidation.<sup>164</sup> In addition to separating investment and banking, we should require banks to disclose conflicts of interest when they bet against their clients.

**Strengthen community-banking institutions.** The movement of individual savings into local banks would in and of itself help to limit the size and power of major national banks, in the process limiting the exposure of the economy to these institutions. At the same time, local banks and lending institutions are more likely to

support local businesses and less likely to make risky investments.<sup>165</sup> Federal policy should be used to expand and strengthen the nation's network of community banks.

### › Consumer protection

*Goal: Ensure broad market access to credit on transparent, fair terms.*

*Policy recommendations:*

**Strengthen the Consumer Financial Protection Bureau and ensure its independence.** Since the moment of its inception, the CFPB has been met with fierce opposition from both the Republican Party and bank lobbyists. The CFPB is a critical institution in representing consumer interests in financial service regulation, and it must have political independence and adequate funding and staff in order to achieve its goals.

**Improve regulations around credit cards and predatory lending.** While American household debt has declined since its peak, families continue to increase their debt load while others, especially young people, get trapped in debt cycles for the first time. Credit cards and predatory lending are the most important areas in which to intervene to help break these cycles or stop them before they begin.

**Restructure bankruptcy proceedings.** Bankruptcy proceedings should support consumers with unmanageable mortgage and student loan debt. By restructuring bankruptcy proceedings for those who have taken out personal loans for new businesses or ventures, we can encourage more entrepreneurial risk-taking. Just as the corporate structure protects the personal assets of investors, firmer bankruptcy protections will give individuals confidence to invest in themselves and start new enterprises.

### › Lobbying reform

*Goal: Lengthen the path that leads from public service to influ-*

*ence peddling, and mandate full identification of lobbyists and disclosure of lobbying activities.*

*Policy recommendations:*

**Close the revolving door.** Public servants and their staffs should not be able to cash in on their inside connections (which is what lobbying firms prize above all).<sup>166</sup> As the revolving door has swung ever faster, with more and more money on the other side, the ability and incentive of public officials to act independently on behalf of voters has weakened. Members of Congress and congressional staff should have to refrain from lobbying for at least several election cycles, when their connections—often, their main asset for lobbying firms—will no longer be their prime selling point to K Street.<sup>167</sup> Negotiating for lobbying posts should be prohibited while in government.

**Expand the definition and disclosure of lobbying and enforcement of lobbying regulations.** Current laws narrowly define who lobbyists are and limit the amount of information available to the public about their contacts and activities; the laws are also weakly enforced. All people who engage in activities that constitute lobbying by any common-sense definition should be counted as lobbyists and fall under the limits of disclosure and other regulations, these laws should be strictly enforced, and all information should be made widely available and easily accessible.

## ACCOUNTABILITY IN AND THROUGH THE PRIVATE SECTOR

### › Civil society

*Goal: Encourage a more vibrant and active civil society capable of policing corporate behavior and holding government accountable.*

*Policy recommendations:*

**Empower new voices in media.** Today, control of media content is highly aggregated.<sup>168</sup> This tends to narrow political debate to those alternatives in vogue

and to entertainment-oriented news that fails to provide much informational content. This is not a way to encourage a vibrant democracy or broad debate over political alternatives. Federal policy should work to limit the extent and power of media monopolies by supporting funding for public media, encouraging media diversity from multiple sources, and limiting cable companies' ability to control the public's access to content.

**Increase government transparency and online presence.** The increasing use of communications technology, social media, and handheld devices creates opportunities for seismic shifts in the relationship between citizens and government. The federal government needs to engage in a sustained effort to make itself more open to citizens and to citizen watchdogs. This means creating more engaging online spaces for citizen feedback, organizing virtual citizen forums, making government data more widely available in easier-to-use formats, and broadcasting government activities in new media.

**Clarify IRS rules around nonprofit advocacy.** Nonprofits that help the poor, the mentally ill, children, and other vulnerable group are at the heart of America's public-private framework for providing health and human services.<sup>169</sup> Yet too often these critical voices on social issues are restrained by confusing IRS tax code regulations from engaging in the sort of public advocacy the law allows. As a result, the vulnerable people they serve have almost no voice in American politics—in stark contrast to the affluent and corporations, who have access to elite advocates and huge resources. IRS rules around nonprofits should be clarified so that 501(c)(3) organizations feel comfortable engaging with public officials around critical social issues. More broadly, nonprofit law should be reoriented toward encouraging broad membership organizations that engage with their members and their communities.<sup>170</sup>

## › Corporate governance

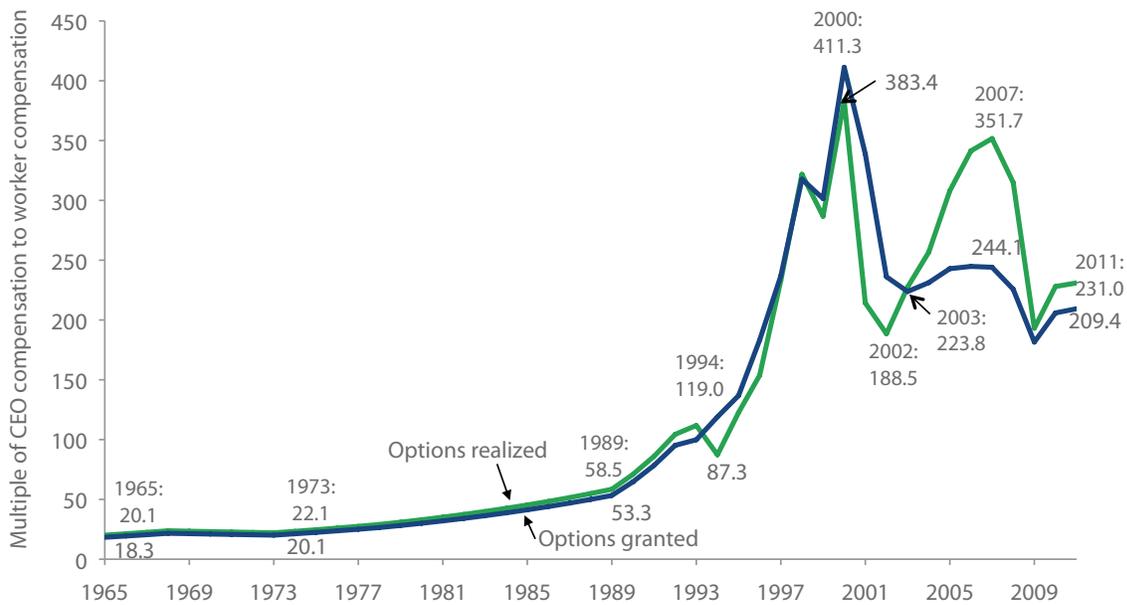
*Goal: Empower shareholders and investor collectives to hold accountable executives and the corporations they run.*

*Policy recommendations:*

**Check corporate executive pay and encourage pay-for-performance through increased transparency and disclosure requirements.** From 1978 to 2011, average CEO compensation increased more than 725%, a rise substantially greater than stock market growth and the painfully slow 5.7% growth in average worker compensation (see **Figure O**). One important way to check the rise in CEO pay is to mandate greater transparency and disclosure of executive pay and board compensation, including options, to encourage pay-for-performance and compensation that more closely aligns the incentives of CEOs with the long-term interests of the company. Performance-based CEO and managerial pay should actually reward exceptional performance relative to similarly situated firms, not volatility in stock prices or luck, and it should reflect long horizons to insure that managers do not have incentives to degrade the long-run prospects of the firm to increase current profits.

**Empower shareholders—especially investor collectives, such as pension funds—to play a more active role in corporate governance.** Increasing the power of this existing check on corporate activity is the easiest way to police corporate behavior and reduce the opportunities for illegal and unethical corporate action. Corporate governance reforms should be designed to encourage all the key players—notably, executives, boards and their directors, and shareholders (including institutional investors and pension funds)—to focus on long-term value creation, not short-term market fluctuations.<sup>171</sup> Directors of corporate boards should not only be made more independent of executives, especially in the setting and structuring of pay, but also made more responsive to shareholders—by, for example, providing shareholders with greater power to remove poorly performing directors.<sup>172</sup> With regard to executive pay, share-

**FIGURE 0: CEO-to-worker compensation ratio (options granted and options realized), 1965–2011**



Note: "Options granted" compensation series data include salaries, bonuses, restricted stock grants, options granted, and long-term incentive payouts for CEOs at the top 350 U.S. firms ranked by sales. "Options exercised" compensation series data include salaries, bonuses, restricted stock grants, options exercised, and long-term incentive payouts for CEOs at the top 350 firms ranked by sales.  
 Sources: Economic Policy Institute analysis of data from Compustat ExecuComp database, Bureau of Labor Statistics Current Employment Statistics, and Bureau of Economic Analysis National Income and Product Accounts.

holders should be provided a binding “say on pay,” and significant increases in managerial compensation should need to get the majority approval of all shareholders who actually cast a vote. Currently, stock proxies that are not returned are counted by corporations as votes in favor their proposals, thus making it extremely hard for even well-organized shareholder activists to block CEO pay packages they see as excessive.

➤ **Collective bargaining and worker voice**

*Goal: Guarantee every American a voice in the workplace.*

*Policy recommendations:*

**Adopt legislation guaranteeing a quick, fair process for workers to choose union representation and have the power to bargain collectively.** Over

the last few congressional sessions, the Employee Free Choice Act has been repeatedly introduced but never passed. Fundamental labor law reform legislation is needed to give employees a fair shot at obtaining workplace representation.

**Implement stronger penalties for violation of labor laws.** Employers all over the country flagrantly violate labor law knowing that the cases will likely never be heard, will be decided in their favor if heard, or might result in small backpay awards if decided against them. We need to create and enforce stronger penalties against employers to create space for workers to exercise their basic right to organize.

**Create a “right to training” for workers.** A right to training gives workers the right to request training from

employers and be given an answer, in writing, if training is not to be made available. More worker training generates positive externalities for the economy as a whole by improving the overall quality of the workforce.

**Develop a more comprehensive legal regime to support collective bargaining.** Important work around the country is under way to organize new types of workers in new forms of relationships—like domestic workers in New York—and we need a legal regime that matches new economic realities and gives all workers a meaningful right to choose to be represented by a union.

## STRENGTHENING OF OUR DEMOCRACY

### › Limit big money in elections

*Goal: Protect democratic elections from the corrosive impacts of money.*

*Policy recommendations:*

**Enact a national public financing law that works within current constitutional constraints.** Tackling money in politics will require major reforms. Citizens United pushed Supreme Court jurisprudence to protect all corporate spending as speech, severely limiting the capacity for congressional action without either a new Supreme Court ruling or a constitutional amendment. Congress should enact a national public financing law that provides candidates who raise a large number of small contributions to qualify for public funds.<sup>173</sup>

**Reverse *Citizens United*.** A tailored constitutional amendment to ensure that free speech protections do not preclude regulation of campaign finance would be most effective. But given the constraints imposed by the amendment process, efforts should first focus on public financing and encouraging the Supreme Court through the nomination process and legal challenges

to return to former precedents limiting the right of corporations to spend unlimited sums on campaigns.

**Require prompt public disclosure.** Democracy depends on open exchange and transparency; citizens should know who funds campaigns for public office and the expenditures surrounding campaigns. Corporate expenses for electioneering should be disclosed, all sizable organizations involved in elections should disclose their funding sources, elected officials and candidates should disclose who holds and attends fundraising events, and all independently funded ads should disclose their top donors.

### › Procedural reform

*Goal: Reform our political institutions to reduce gridlock and encourage democratic control.*

*Policy recommendations:*

**Reform the filibuster.** The Senate was designed to operate under majority rule, like the House, but today minorities can obstruct critical measures. The Senate should explore ways of reeliminating or reducing what has become a 60-vote barrier to the passage of legislation.

**Improve the budget process.** The budget process has developed in an ad hoc fashion, resulting in a byzantine system that resists public understanding and influence. Reforms should make it more efficient and ensure that spending and tax cuts are subject to the same constraints. The United States should follow international precedent and adopt a separate capital budget to encourage public investments with demonstrated payoffs. And the debt ceiling should be automatically raised in line with congressional budget decisions, rather than continue as a legislative hurdle that allows the full faith and credit of the federal government to be held hostage for political or policy gains.

## › Voter access

*Goal: Ensure every voter's voice is heard in the political process.*

*Policy recommendations:*

**Eliminate disenfranchisement efforts.** Nothing is more integral to our standing as a democratic society than the universal franchise. It should be an unquestioned goal of our political system to permit and encourage as many citizens as possible to vote. But many states are moving in the opposite direction, tightening voter eligibility to combat alleged—and virtually nonexistent—fraud. States should be pushed to repeal their disenfranchisement and voter identification laws and adopt same-day voter registration, provisional voting, and other measures to maximize voter access.

**Create a national voting day.** The traditional date of first Tuesday after the first Monday in November could be either moved to a Saturday or declared a holiday, National Vote Day.<sup>174</sup> Such a holiday could also be combined with voter education efforts and efforts to encourage voter deliberation.<sup>175</sup> A national voting holiday would help create time and space for citizens to think seriously about their votes and boost voter turnout, creating a more engaged citizen body and holding elected officials more accountable for their performances.



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# Conclusion

The choice before us is stark: austerity for most or prosperity for all. In the face of our current jobs crisis, after a generation of rising inequality and insecurity, austerity economics holds that we can do little more to solve current challenges than cut taxes on the rich and reduce regulation. There is no room for bold collective action to create jobs directly or to shore up the American economy—we must simply step further out of the way of the market and let things work themselves out. Rather than laying foundations for the future, austerity economics prescribes huge cuts in crucial sources of economic security like Medicare. It demands enormous reductions in already-insufficient public investments that are critical for our long-term growth. It tells Americans to tighten their belts and fend for themselves.

There is an alternative to these tired prescriptions: prosperity economics. Prosperity economics draws on recent research and theory in economics and allied fields. It also embodies the best elements of the economic model that propelled the United States into its preeminent role in the world economy and created the broad middle class that is under threat today. In prosperity economics, the goal is growth that is not just strong but widely distributed—growth that translates into rising living standards across the board and improvements in the health of our society and our environment. Such shared prosperity can only be accomplished through sustained investment in the skills, output, and security of American workers, whether through restoring our ailing infrastructure, improving education and job training, or giving workers the ability to join together in the workplace to collectively bargain. Together these measures will help to restore the

historical link between productivity and the earnings of all Americans while boosting the middle class.

That prosperity economics appears unfamiliar today is only a measure of how much the debate has been dominated by the claims of austerity economics. Its arguments—that spending and deficits are our greatest threat, that gains inevitably “trickle down,” that upward mobility is a robust antidote to rising inequality in the United States, that markets naturally align private economic behavior and our economy’s long-term health, and that only those at the top create prosperity—are all myths. But these myths drive a public debate that is increasingly divorced from the realities of the challenges we face or the real impact of the prescriptions offered. It might be comforting if a single magic bullet of greater tax cuts for the rich would solve our economic problems, but our history, economic theory, and common sense show otherwise. Cutting taxes on the rich helps the rich and drives up the deficit, but it doesn’t consistently produce jobs or growth. Closing unspecified “loopholes” in the tax code cannot realistically make up for the massive revenue losses of huge new tax cuts for the superrich, and cutting public investment will only worsen the situation by choking off future growth.<sup>176</sup> And turning Medicare into a voucher program might sound appealing until it becomes clear that cost savings by the government are simply cost increases for vulnerable older Americans.

Instead of these hollow promises, we have provided a set of arguments and recommendations that are built on history, economic theory and research, and an appreciation of the vital role of our political system in cultivating shared prosperity. The ideas we have laid out do not constitute a fully comprehensive agenda.

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But if put into place, they will set us on a virtuous cycle of public investment, rising productivity and wages, a stronger and more secure middle class, increased aggregate demand, and in turn sustained growth.

Major investments in infrastructure (\$250 billion per year for six years) will provide jobs now while laying the groundwork—literally—for future growth. Investments in science and technology will help revitalize our industrial and manufacturing base, particularly if these investments are partnered with a policy to lower the value of the dollar, a move that would shift our balance of trade and create jobs. Stronger representation in the workplace and greater opportunities for collective bargaining will ensure that the jobs we create share in the gains of rising productivity, and sharing the fruits of our labor and investments more broadly will bolster the middle class and put the economy on a sustainable path toward shared prosperity.

These policies aimed at growth will be enhanced by increased security at the individual and collective level. By broadening health coverage while tackling the inexorable rise of medical costs, we can provide greater protections to workers, families, the self-employed, and small and large businesses alike, thereby letting them invest in their futures with greater confidence while at the same time reducing long-term deficits. Addressing climate change by encouraging new technology and putting a price on carbon will open up new areas for private innovation and entrepreneurship and stabilize the environment in which all of our economic activity takes place.

Finally, a stronger democracy will help us enact and sustain the policies that can drive our economy into the 21st century. Reducing the sway of money and the influence of corporate lobbyists will create space for democratic voice, voice that will be more effective when citizens are absolutely guaranteed the franchise. We can no longer afford to let the winners of the last round of market competition control the next round

through their lobbying and donations. Instead, we must recreate the conditions for innovation and advancement that historically made the American economy the envy of the world—not by showering favors on current economic winners, but by ensuring that the political and economic playing field is level and the promise of social mobility is real.

In sum, our three pillars—growth, security, and democracy—are mutually reinforcing, working together to lay the foundations for an economy that generates sustainable, broadly shared prosperity over the long term. Though the list of policies is long, the logic of prosperity economic can be summed up briefly: the strongest economy is built by all, and benefits all.

We have to make choices, and inaction is itself a choice. If we do nothing, austerity economics will maintain its hold over our policy-making. That would be disastrous. Over the next year and next decade, we will make choices with profound consequences for the American economy in the 21st century. We need to take the initiative, push back against austerity economics and pursue an agenda based on prosperity economics. Doing so will require an engaged public—policy-makers, activists, and, most important, citizens—committed to building a prosperous, secure future for all Americans.

Our hope is that this agenda shines light on the current debate and illuminates the choices more clearly. But a document can do no more than provide evidence and guidance; change will require much more. It will require an upwelling of public support and clear demands for change: new ideas and voices, letters and petitions, political actions and organizations. It will require, in other words, a movement. To build an economy that works for all, we all have to do our part, not only as workers and entrepreneurs and business owners but as engaged participants in our democracy. This is our charge and our goal. This is the way forward to prosperity for all.

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# Appendix

## Preliminary Analysis of 10-Year Fiscal Impact of the *Prosperity Economics Policy Agenda*

The current moment calls for substantial deficit-funded outlays to spur economic recovery. Furthermore, our country reaches this moment after a critical seven-year period (2001-2007) in which our political leaders irresponsibly added to the deficit with unfunded tax cuts, unfunded military operations in Iraq and Afghanistan, and the unfunded expansion of Medicare Part D (which was more expensive than necessary because it failed to allow Medicare to bargain directly for lower drug prices). Since 2007, the drop in revenues that accompanied the Great Recession and the increase in income-security spending to soothe the effects of the downturn have added further to our deficits. These pre-recession policies and the Great Recession (and the accompanying interest due to higher debt) are the overwhelming cause of current deficits.

This recent fiscal history carries two messages. First, deficits that are targeted at restoring a robust recovery and thereby higher revenues are wholly justified and, indeed, essential. This is all the more true at a time when interest rates are essentially zero and projected to remain extremely low until the economy recovers. In this context, growth-enhancing spending and long-term public investments that are financed by deficits are simply an unbelievable bargain. Second, given the string of unfunded tax cuts and spending initiatives pursued in the last decade—whose revenue effects dwarf any new spending authorized by Congress since the Great Recession—and the fact that additional contributions to the deficit since 2007 were overwhelmingly driven by the downturn (and essential to reducing its negative impact), the notion that we should be eliminating deficits within the 10-year window used for budgeting is both fanciful and unwise. Instead, we should be gradually moving toward sustainable deficits that imply a long-term reduction in our debt. Far more important, we should be addressing the major driver of long-term deficits (beyond the typical 10-year window), namely, runaway health care costs.

What is a sustainable level of deficits is a matter of debate and uncertainty—since some deficit hawks unwisely insist on deficit reduction as an end in itself, and because it depends on the growth of our economy, interest rates, and other inherently uncertain factors. Nonetheless, the nonpartisan Congressional Research Service in its February 15, 2012, Report for Congress suggests

that average annual deficits of just under 3% of GDP would put the deficit on a path on which publicly held debt stabilizes as a share of our economy. Our analysis of the most fiscally significant policies within this blueprint indicates that if enacted, they would lead to such sustainable deficits within just a few years (by 2015). In the beginning of the budget window deficits are somewhat higher, because this budget makes room for the upfront investments needed to spur immediate job creation and long-term growth. By the end of the 10-year budget window, in 2022, deficits would drop down to 1.7% of GDP. To be clear, we would not advocate reducing the deficit as quickly as this estimate implies. Rather, we are leaving room for significant investments in the various priorities that we lay out in the document without specific funding levels—for instance, providing universal pre-K for young children, expanding job training, and establishing a national innovation foundation.

Even if coupled with significant additional public investments, our broad recommendations would result in a near-term fiscal situation substantially better than the so-called current policy baseline (more or less if we continued present policy—by, for example, extending all the Bush tax cuts). Additionally, these deficit levels imply significantly smaller primary deficit levels; that is, deficits excluding the net interest that mostly reflects the extra debt incurred by the 2001-2007 unfunded policies and the fiscal effects of the Great Recession (again, overwhelmingly due to lower taxes and higher income-security spending, rather than the 2009 recovery package or other legislated spending). Finally, and most crucial, these recommendations would improve our fiscal standing well beyond the next decade, because they would restore our revenue base and, even more important, put in place effective measures to restrain the runaway health costs that are the greatest financial threat to the private sector as well as the public sector.

To turn to specific numbers, over the 10-year window we calculate that the big-ticket items in this budget blueprint would result in just under \$2 trillion in spending on public investments, an effort that would support significant job creation. (To leave margin for additional investments and unforeseen factors, we do not take into account these growth effects in calculating these budget

impacts—which means our estimates may well be conservative.) This includes a \$250 billion per-year investment in infrastructure projects from 2013 to 2018, as well as an infrastructure bank, support for state hiring, an expansion of AmeriCorps, and investments in research and development and clean energy.

At the same time, the blueprint would achieve meaningful savings over the 10-year budget window by going above and beyond the policies enacted in the Affordable Care Act (ACA). Long-term debt reduction requires that we engage in health care cost containment. The ACA helped lock in a number of innovative health policy interventions whose positive effects will be felt in the longer term, beyond our 10-year budget window. We build on these steps by including a public option and strengthening Medicare, using the purchasing power of the federal government to restrain price increases and obtain greater drug discounts—the strategy for cost control successfully used in other nations. By doing so, this blueprint would achieve hundreds of billions more in savings over those already booked due to the passage of the ACA. In the longer term, these reforms would achieve even greater health savings relative to current law by putting in place an enforceable health budget (we assume this budget would be set at GDP +1/2%, though the exact rate within this ballpark has little effect within the 10-year window). Between the additional investments and the cost controls, our policies would require 10-year outlays of just over \$1.5 trillion.

Beyond health savings, this blueprint achieves defense savings designed to bring spending levels at least as low as seen just before the conflicts in Iraq and Afghanistan. The blueprint identifies savings outlined by the bipartisan Sustainable Defense Task Force, as other budget alternatives have done, as a guide for how to responsibly reform Department of Defense spending. These reforms, along with the significant investments the blueprint would engage in, would yield a total increase in 10-year outlays of just over \$600 billion.

Finally, this blueprint would make changes to the

tax code that would increase fairness, progressivity, and efficiency. Beyond reforming the Bush tax cuts so they would immediately end for high-earners and phase out for the tax filers in the middle two brackets, we would equalize the treatment of labor and capital income, put in place additional brackets for income over \$1 million for increased progressivity, keep and in some cases expand refundable tax credits, cap the value of itemized deductions at 15%, and enact a progressive estate tax (which would not only tax the largest estates at progressive rates, but also replace the so-called step-up basis for calculating capital gains, which allows heirs to avoid capital gains taxes on the appreciation of assets prior to transfer, a huge tax break for the wealthy that encourages individuals with large estates to hold onto assets, rather than reinvest them). Additionally, we put a price on carbon, reform the international tax system, limit the deductibility of corporate debt interest payments for financial firms, eliminate fossil fuel preferences in the tax code, and enact both a financial crisis responsibility fee and a financial transactions tax. On net, these revenue policies would raise around \$1.1 trillion relative to current law over 10 years.

Note on methodology: The preliminary impacts of these policies were modeled off of a current policy baseline that was used in the Economic Policy Institute's analysis of the Progressive Caucus' *Budget for All*. This baseline assumes the automatic enforcement spending cuts scheduled to take effect in FY2013 by the Budget Control Act (P.L. 112-25), i.e., the debt ceiling deal, do not occur, overseas contingency operations (OCO, or funding for overseas military operations) are gradually wound down, the scheduled reduction in Medicare physician payments is prevented (i.e., the "doc fix" is maintained), the 2001 and 2003 income tax cuts are continued, the American Recovery and Reinvestment Act (ARRA) expansion of refundable tax credits is maintained, the 2011–2012 estate and gift tax cuts are continued, the 2011 parameters of the alternative minimum tax are indexed for inflation, and the business tax extenders (routinely extended credits such as the research and experimentation credit) are continued.

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