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WE'RE NOT BROKE NOR WILL WE BE

Policy choices will determine whether rising national income leads to a prosperous middle class

BY LAWRENCE MISHEL

Many policymakers and pundits claim “we’re broke”¹ and “can’t afford”² public investments and policies that support workers. These claims are meant to justify efforts to scale back government programs and public-sector workers’ wages and benefits. The “we’re broke” theme also implies that America’s working families should be satisfied with the status quo in terms of wages that have been stagnant for 30 years.

Despite the rhetoric, it is clear that “we” as a nation are *not broke*. While the recession has led to job loss and shrinking incomes in recent years, the economy has produced substantial gains in *average* incomes and wealth over the last three decades, and economists agree that we can expect comparable growth over the next three decades as well. Between 1980 and 2010, income per capita grew 66.4%, and wealth per capita grew 73.2%. Over the next 30 years, per capita income is projected to grow by a comparable 60.6%. In other words, “we” are much richer as a nation than we used to be and can expect those riches to rise substantially in the future.

So who is the we in the “we’re broke” mantra? The recession has certainly been a rough patch of road for many families, but the output produced by corporations in the private sector has already recovered to pre-recession levels, and these firms’ profits were 21.7% higher overall, driven largely by the 60% jump in pre-tax profits enjoyed by firms in the financial sector.

TABLE OF CONTENTS

Income and wealth have risen substantially and will do so in the future.....	3
Corporate-sector profits are up and have recovered from the recession.....	7
We can afford faster wage growth for typical workers.....	8
We can afford greater domestic spending.....	9
State revenues decline.....	11
Conclusion.....	12

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Obviously, some of those included in this definition of “we” are doing very well, indeed, making it disingenuous to generalize about what we can and can’t afford to do in the future.

To fully understand the growth trends in income and wealth in recent decades, one must recognize that the growth has been very unequal: households at the top of the scale have seen much faster growth in their incomes and wealth accumulation than have those in the middle or bottom of the distribution. For instance, the top 10% of the income distribution has claimed almost two-thirds of the gains in income since 1979, with the top 1% alone claiming 38.7% of those overall gains.³ Moreover, the wealth of the *median* (or ‘typical’) household was lower in 2009 than in 1983, in spite of the 40.3% growth in the average household’s wealth.⁴ When the *median* is substantially lower than the *average*, it indicates very lopsided growth, which has been the case for the past 30 years: there was no growth in wealth for the bottom 80% of households, while those in the top fifth enjoyed a 50% increase.

So if the private sector has grown for the past 30 years (albeit very lopsidedly), and the projections for the next 30 years indicate comparable total income growth for the economy, then what is the story for the public sector?

It is true that all levels of government are facing budget difficulties as a result of falling revenues during the recession. Higher unemployment and depressed economic activity have certainly depressed tax revenues, and past tax cuts at all levels of government have seriously eroded revenues as well. But some policymakers and pundits want to have it both ways: choke off the revenue stream to governments while slashing budget expenditures. For instance, the current domestic spending cuts proposed by the House of Representatives for this year were smaller than the revenues lost from extending the upper-income Bush tax cuts and the inheritance tax cut legislated last December.⁵

The findings in this briefing paper have some simple implications. Given that incomes and wealth have actually grown substantially, the degree to which governments are “broke” depends upon policy choices that have been made and the revenue temporarily drained by the current recession, and not by some underlying economic force beyond our control. Because incomes will grow substantially in the coming decades, the decisions about what governments can afford to do hinge on the national policy choices that shape what portion of *increased* incomes will be taxed and spent.

TABLE 1

Growth of per capita income and per capita wealth, 1980–2040

	Growth in per capita income	Growth in per capita wealth
Actual		
1980–90	24.5%	24.8%
1990–2000	24.4	45.0
2000–10	7.4	-4.3
1980–2010	66.4%	73.2%
Projected		
2010–20	22.7%	n.a.
2020–30	12.3	n.a.
2030–40	16.5	n.a.
2010–40	60.6%	n.a.

SOURCE: Per capita income is measured as GDP per person. GDP data are from the Bureau of Economic Analysis, and projections are from the Congressional Budget Office “Budget and Economic Outlook: Fiscal Years 2011 to 2021.” Per capita wealth is from Federal Reserve Board. 2010. Flow of Funds Accounts of the United States, Table B.100: Balance Sheet of Households and Nonprofit Organizations; Line 42, Net Worth. Population levels and projections are from the Census Bureau. All figures are adjusted for inflation.

Correspondingly, the degree to which typical workers have benefitted from past income and wealth growth has depended on the economic policies that have structured the economy, especially those policies that have failed to produce and sustain good jobs and growing wages. Whether future growth results in *shared* prosperity and a prosperous middle class will depend on the same kinds of policy decisions yet to be made, including whether to maintain an economic regime that allows most growth to accrue to the already very well-off.

Income and wealth have risen substantially and will do so in the future

Incomes and wealth, on average, have grown substantially over the last three decades, both in absolute terms and per person. This means that as a nation the United States is in a better position to afford a variety of expenditures. It should be noted that averages can be misleading: When a billionaire walks into a room, everyone there becomes a millionaire “on average.” However, average income is a good measure of total resources available to a country to meet national priorities since it reflects the total resources available.

The economic pie has grown much larger over the last three decades. The trends in income per person and wealth per person over the last three decades and the expected growth of income per person over the next three decades are presented in **Table 1** and **Figure A**. Since 1980, income and wealth grew substantially, with average per capita income up 66.4% and per capita wealth up 73.2%.

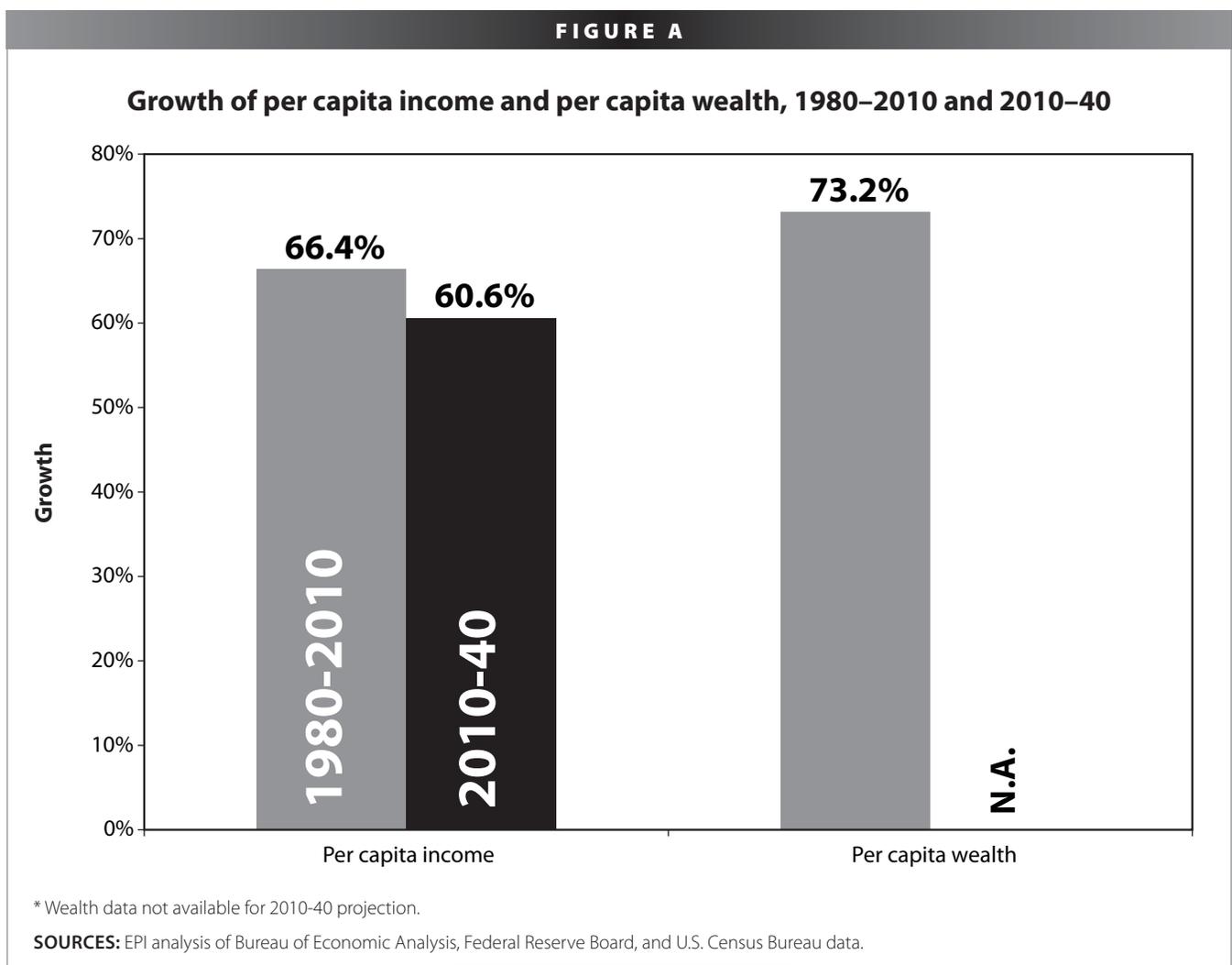
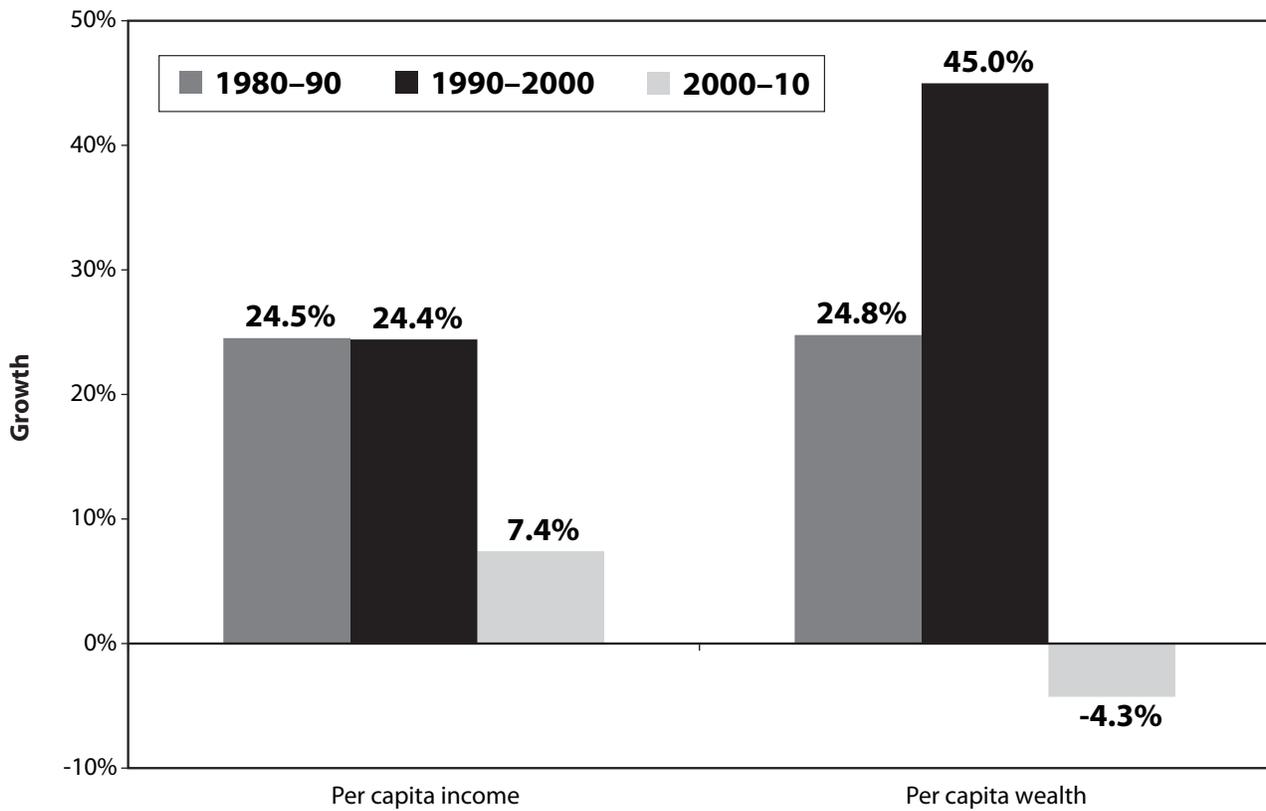


FIGURE B

Growth of per capita income and wealth by decade, 1980–2010

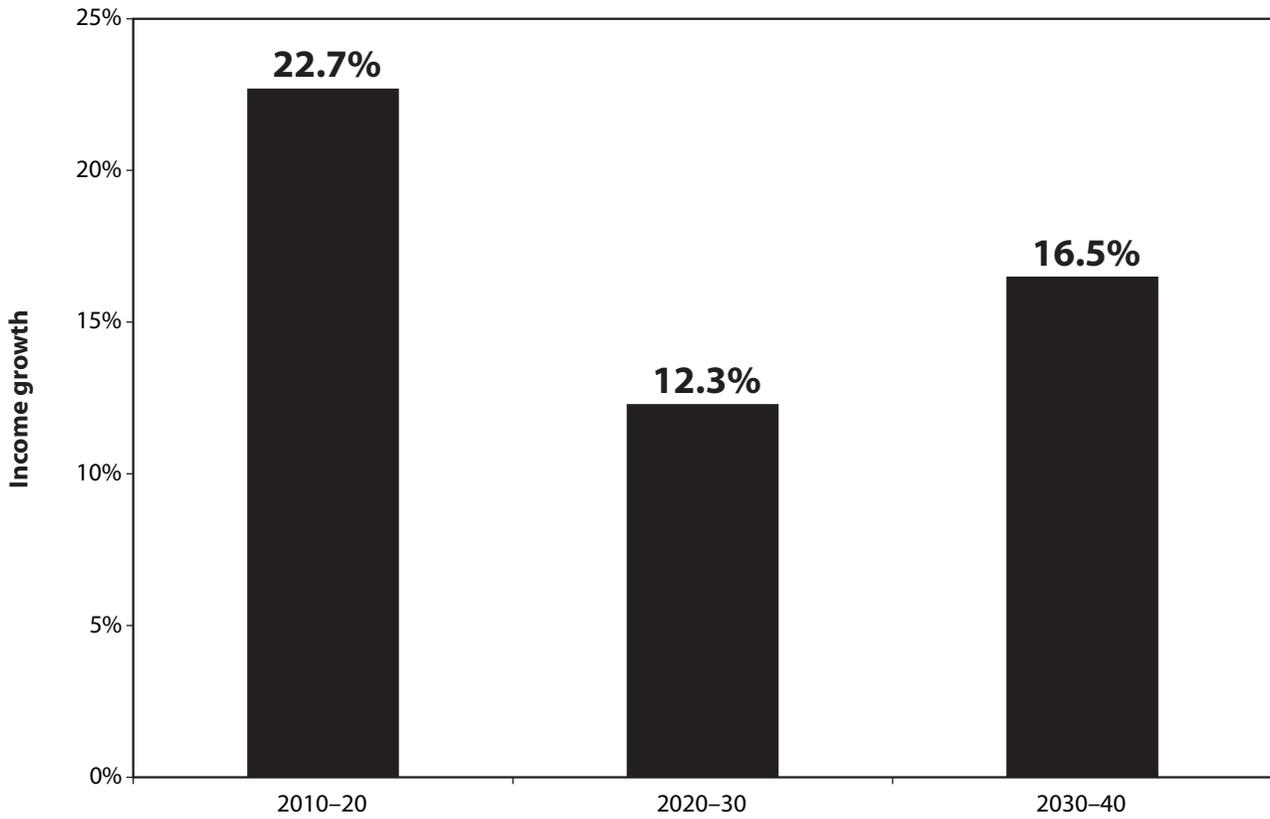


SOURCES: EPI analysis of Bureau of Economic Analysis, Federal Reserve Board, and U.S. Census Bureau data.

Wealth per person grew in the 1980s and then accelerated substantially in the 1990s. In the 2000s, economic gains were much weaker as a result of a sluggish recovery from the 2001 recession, the onset of the Great Recession in late 2007, the bursting of the housing bubble, and the financial crisis of 2008 (**Figure B**). Wealth per person, despite the recent decline, remains substantially higher than it was in 1980 or 1990.

FIGURE C

Growth of per capita income by decade, 2010–40

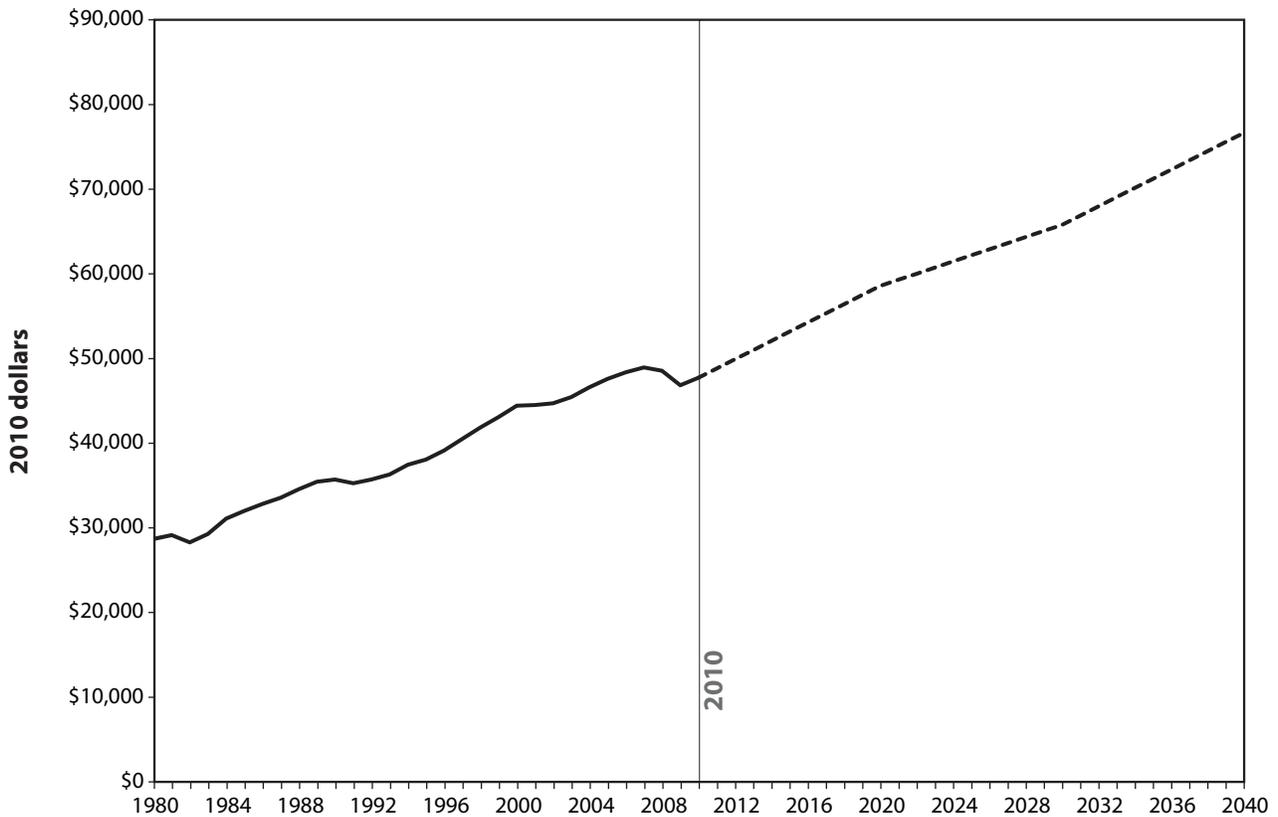


SOURCES: EPI analysis of Bureau of Economic Analysis and U.S. Census Bureau data.

Over the next 30 years, Congressional Budget Office (CBO) projections show that income per person is expected to grow 60.6%, roughly as much as in the prior 30 years (Table 1). (Unfortunately, there are no standard projections of future wealth.) As shown in **Figure C**, the fastest projected growth is in the first decade as incomes recover from the recession. Strong income growth is also expected in the following two decades.

FIGURE D

Per capita income and projected per capita income, 1980–2040

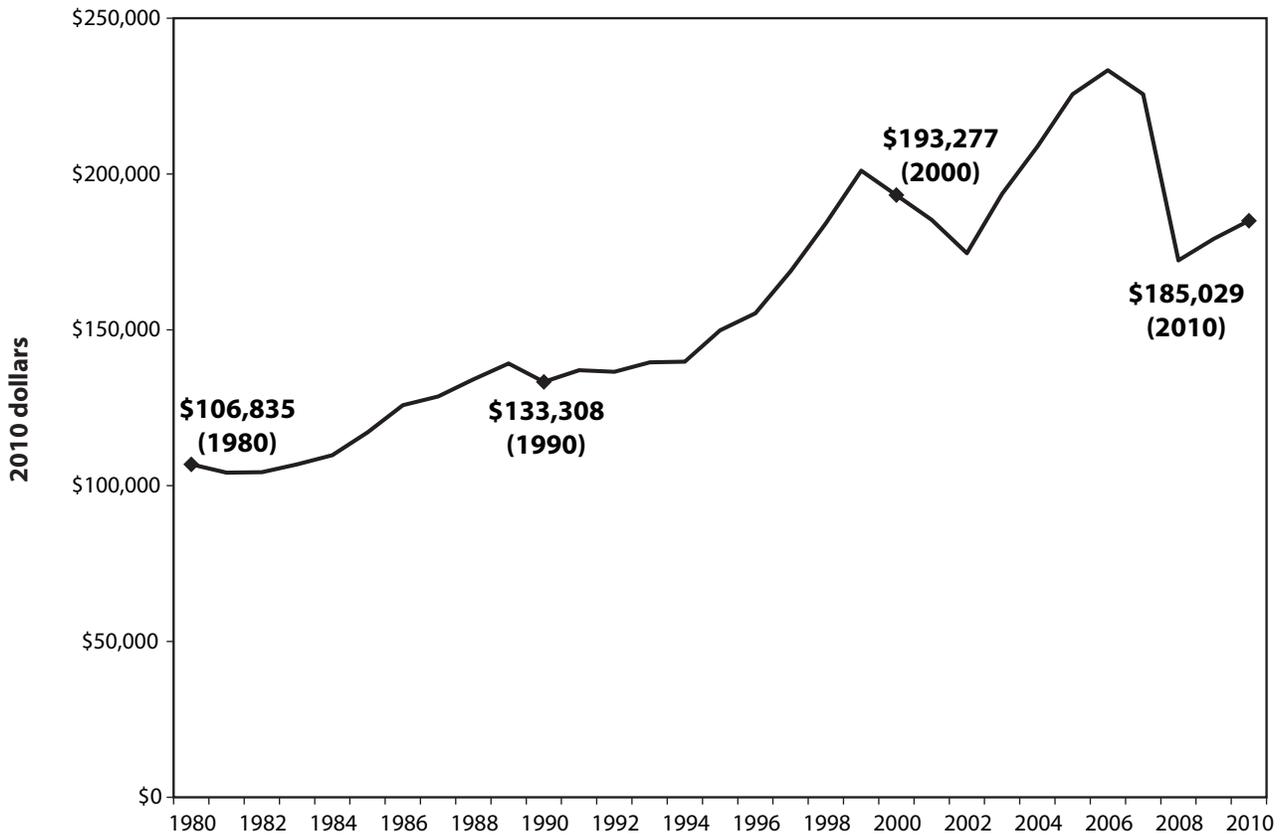


SOURCES: EPI analysis of Bureau of Economic Analysis and U.S. Census Bureau data.

There was substantially more income and wealth available per person in 2010 than in most earlier years, and there will be much more income available for each person in the future. **Figures D** and **E** show the annual levels of per capita income and wealth over the last three decades and the projected levels of per capita income over the next three decades. Adjusting for inflation, per capita income was \$28,684 in 1980 and increased to \$47,737 in 2010. Per capita income is projected to rise to just over \$75,000 by 2040. Average wealth (Figure E) was \$106,835 in 1980 and increased to \$185,029 in 2010. Given the projected increases in incomes, wealth can be expected to rise substantially over the next 30 years as well.

FIGURE E

Per capita wealth, 1980–2010



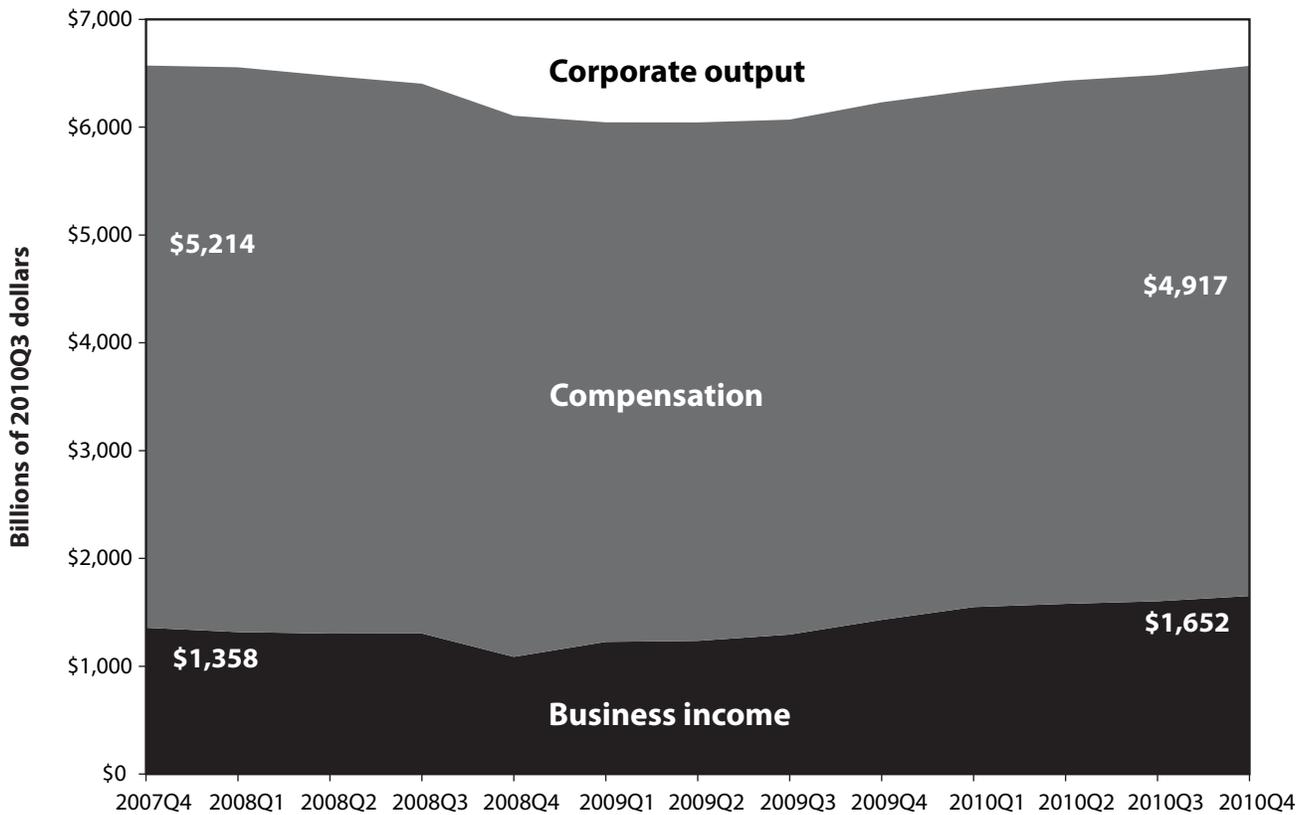
SOURCES: EPI analysis of Federal Reserve Board and U.S. Census Bureau data.

Corporate-sector profits are up and have recovered from the recession

The rapid growth in productivity and profitability in the corporate sector during the recession has allowed businesses to re-establish the level of business income (profit and other returns to capital, such as interest) reached before the recession, even though overall unemployment is roughly still 9%. Output in the corporate sector at the end of 2010 (fourth quarter) had returned to its pre-recession fourth-quarter 2007 level. However, business income is now 21.7% above the level reached before the recession. Yet, the total compensation paid to workers in the corporate sector remains 5.7% below pre-recession levels, reflecting the reduced employment levels and hours worked in the sector.

FIGURE F

Corporate output, employee compensation, and business income, 2007Q4–2010Q4



SOURCES: EPI analysis of Bureau of Economic Analysis data.

In sum, those receiving business income and profits have more than amply recovered from the downturn even though unemployment remains high and total worker compensation has fallen. **Figure F** charts changes in the total corporate output since the start of the recession and the incomes generated in the forms of compensation to workers and the business income received by owners. From the beginning of the recession (fourth quarter 2007) to the fourth quarter of 2010, employee compensation fell from \$5.21 trillion to \$4.92 trillion, while business income rose from \$1.36 trillion to \$1.65 trillion.

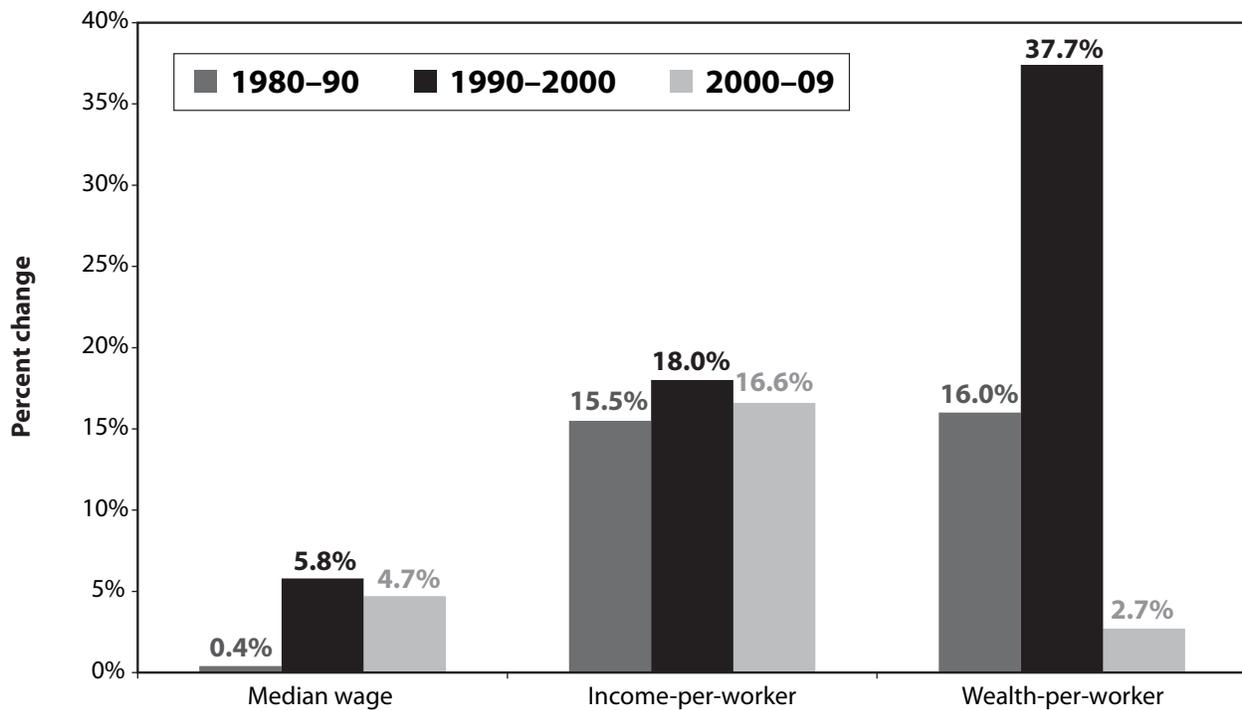
The Bureau of Labor Statistics productivity data sheds some light on this phenomenon, though the data are only through the third quarter of 2010. Between the fourth quarter of 2007 and the third quarter of 2010 the nonfinancial sector’s output had fallen 2.7% and productivity grew 6.7%, leaving total employee hours 8.8% lower. Profits per unit of output grew 16.5% in this period.⁶

We can afford faster wage growth for typical workers

Over the last 30 years, economic output per worker has outpaced typical wage growth, and in fact there has been only very modest wage growth for the typical worker. The economy has become much more productive, and as a result average income and wealth per worker has grown tremendously: From 1980 to 2009 income per *worker* grew 59.0% and wealth per *worker* grew 63.7%.⁷ However, the typical or median worker saw modest growth of just 11.2%

FIGURE G

Growth of median wage, income per worker, and wealth per worker, 1980–2009



SOURCES: EPI analysis of U.S. Census Bureau, Bureau of Labor Statistics and Federal Reserve Board data.

in wages over these decades.⁸ Those with higher incomes saw much faster than average growth over this period. This modest wage growth for most workers was not the result of a broken economy. Rather, it arose from specific economic policy choices.⁹ Were income growth more balanced, typical workers would have seen far better wage growth, on par with the growth of productivity.

Figure G, measuring the growth of the median hourly wage, income per *worker*, and wealth per *worker* in each of the last three decades, shows the ongoing disparity between what a typical worker gained from the economy versus what the economy was capable of providing. The small growth in average wealth per worker in 2000–09 reflects the collapse of wealth in the recent financial crisis, which still left wealth greater than it was at the end of the 1990s (per worker).

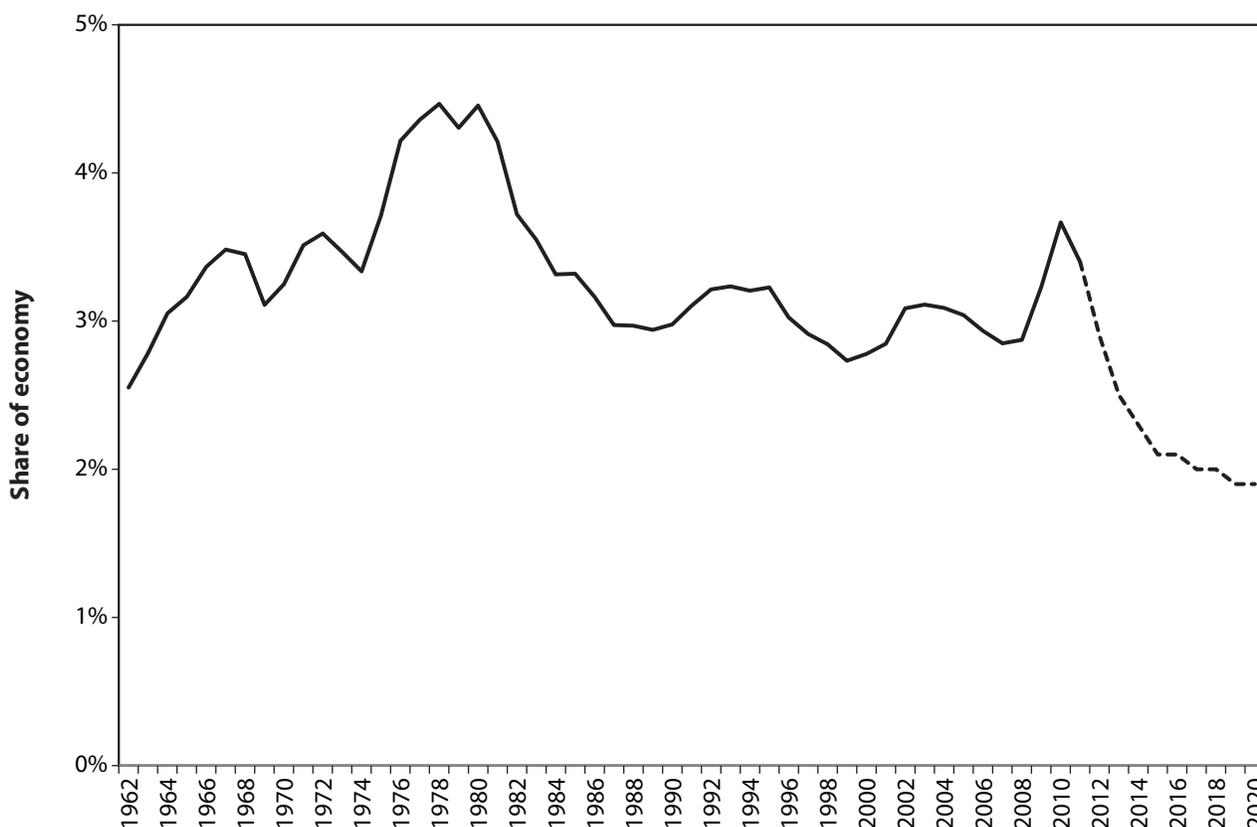
We can afford greater domestic spending

Despite the fact that average incomes have increased substantially over the past 30 years, the federal government is currently running a projected deficit of 9.8% of gross domestic product. As noted above, many use the deficit to support the “we’re broke” theme. But how can that be the case? How can the country have much more income, collectively, on which to draw, yet all levels of government are “broke” and unable to afford anything?

The answer is that revenue has declined substantially due to the recession and due to the Bush-era tax cuts. The Congressional Budget Office projects federal revenues will be just 14.8% of GDP in the fiscal year ending September 30, 2011—by far the lowest revenue intake relative to GDP since 1951. In contrast, federal revenues totaled over 18% of GDP at the end of the last recovery (fiscal year 2007) and were roughly 20% at the end of the 1990s recovery. A large

FIGURE H

Non-security domestic spending as share of U.S. economy, 1962–2020



SOURCES: OMB Historical Tables 5.4, 10.1, OMB FY 2012 budget.

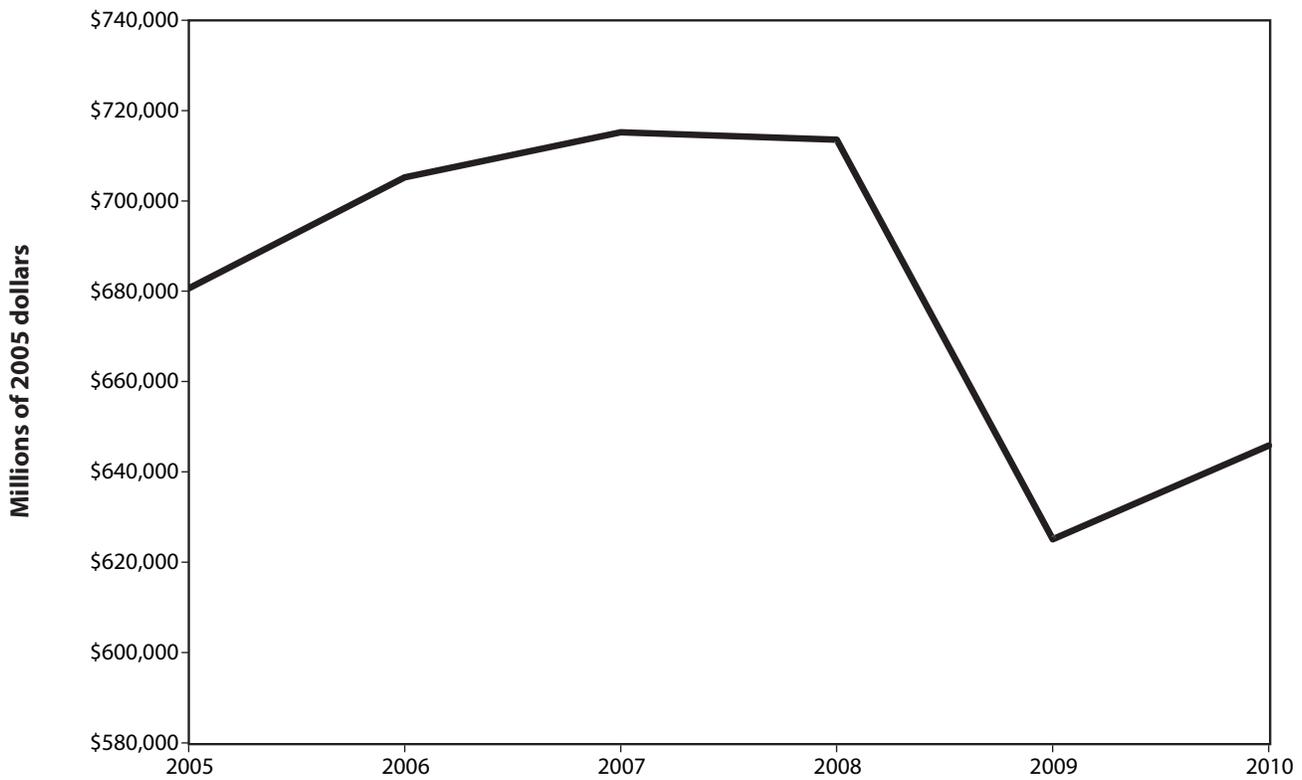
part of the revenue shortfall can be attributed to legislated changes in taxes under George W. Bush, which lowered the revenue share by 2.1%.¹⁰

As the economy recovers, the deficit will fall as unemployment declines, as incomes and associated revenues increase, and as recession-sensitive expenditures automatically decline (expenditures for food stamps, unemployment benefits, Medicaid and other programs rise with the economic distress in a recession and fade as unemployment declines). This expected decrease in the deficit is reflected in CBO projections showing the deficit declining from 9.8% of GDP in 2011 to just 3.0% in fiscal year 2015. Some of this decline can be attributed to the assumed expiration of the Bush tax cuts extended in 2010 and the inheritance tax change in 2010 (plus the R&D, ethanol, and first-year depreciation tax breaks), which would total 2.9 percentage points of GDP that year. Even so, that still leaves the deficit falling by 4.0 percentage points due to the recovery.¹¹

Quite remarkably, the category of spending that has received the most attention (and been targeted for cuts) has been non-security, appropriated domestic funding—frequently called domestic discretionary spending. These programs include all federal spending on transportation, education, health research, the environment, parks, energy, and other domestic matters. Can we afford this spending? In 2010 the spending on domestic discretionary (annually appropriated) programs was \$1,521 per person. **Figure H** shows the history of this spending as a share of the economy since the late 1950s as well as projections over the next 10 years under the Obama administration fiscal year 2012 budget proposal. As

FIGURE I

State revenues, 2005–10



NOTES: Calendar years.

SOURCES: Census Bureau data deflated with GDP price index.

the figure shows, the current spending in these areas is historically low. Although it is a bit higher than it was at the end of the last two recoveries (in 2005–07 or 1998–2000), it is equivalent to the spending at the end of the 1980s recovery and substantially less than in 1980, when the spending was 4.5% of GDP. Between 1980 and 2010, the per-person spending on domestic discretionary programs actually fell by \$195, reflecting the \$522 decline in the 1980s and the increases thereafter. *This is not an area of spending that has been breaking the budget.* Between 1990 and 2010, per capita income grew by \$12,019 and spending on domestic discretionary programs grew by \$327, meaning that we devoted 2.7% of our income growth to greater spending on domestic programs. Note that under the 2112 Obama budget presented earlier this year, this domestic spending would shrink to just 1.8% of GDP in 2021, lower than at any point in the last half century, and down from 3.4% of GDP now. In a recent speech President Obama indicated his revised budget proposal will make further cuts in this area than those included in the original budget proposal.

State revenues decline

The revenue declines at the federal level are mirrored at the state level. State government revenues severely declined due to the Great Recession. Since most states have balanced budget requirements, they have compensated by reducing spending levels and/or increasing tax rates. The stimulus plan assistance that helped offset some of this decline over the last two years has ended, aggravating the problems confronting state governments. It is important to note that, similar

to national trends, total resources available to states have increased over the last 30 years and are expected to further increase over the next 30.

Figure I tracks inflation-adjusted changes in state revenues since 2005. State revenues in 2008 were essentially even with those of 2007 as the economy stalled in the early stage of the recession. In 2009, revenues fell sharply, by 12.4%. After the economy started growing in mid-2009, state revenues began to rebound in 2010, growing by 3.3%. Nevertheless, state revenues in 2010 remained 9.7% below their 2007 levels.

Conclusion

There is an old joke about the Lone Ranger, who turned to Tonto and said, “We’re surrounded by Indians,” and Tonto responds, “What do you mean by ‘we,’ kimosabe?” That same logic applies to policymakers who claim that “we’re broke.” It matters who is included in “we.” We, collectively, have been gaining income and wealth and will continue to do so. “We,” the broad middle class, have not been gaining wealth and have not received much of the income gains of the past 30 years. Whether the broad middle class prospers in the next 30 years does not hinge on whether there will be substantial income growth; there most definitely will be. The future prosperity of the broad middle class hinges on the economic policies and structures that determine how that income is generated and shared.

Are our federal and state governments “broke”? They certainly face deficits. Whether those governments provide the services we need will totally depend upon the political decisions made regarding taxing and spending. Taxation and revenues have diminished, both due to policy choices and the impact of the Great Recession.

So, are we broke? Only if we choose to be.

Endnotes

1. As articulated, for example, by House Speaker John Boehner (R-Ohio): “If some of those jobs are lost, so be it. We’re broke.” as reported by *The Wall Street Journal* Feb. 15, 2011 (<http://blogs.wsj.com/washwire/2011/02/15/boehner-so-be-it-if-us-workers-are-laid-off/>); and “We’re broke; Broke going on bankrupt,” as reported by Bloomberg Feb. 28, 2011 (<http://www.businessweek.com/news/2011-03-07/bonds-show-why-boehner-saying-we-re-broke-is-figure-of-speech.html>). See also, Wisconsin Gov. Scott Walker: “We’re broke in this state because, time and time again, politicians of both political parties ran away from the tough decisions and punted them down the road for another day,” February 22, 2011 (<http://tpmdc.talkingpointsmemo.com/2011/02/scott-walker-to-democrats-come-home-or-the-employed-get-it.php>).
2. As articulated, for example, by Sen. Jim DeMint (R-S.C.) on funding National Public Radio: “It’s about two simple facts: We can’t afford it, and they don’t need it.” as reported by McClatchy Newspapers March 9, 2011 (<http://www.miamiherald.com/2011/03/09/2106742/demint-demands-end-to-npr-funding.html#ixzz1ICclbAt8>).
3. See Economic Policy Institute, “State of Working America: Inequality” at <http://www.stateofworkingamerica.org/articles/view/7> and Sylvia A. Allegretto, “The State of Working America’s Wealth, 2011,” Economic Policy Institute, March 2011; http://www.epi.org/publications/entry/the_state_of_working_americas_wealth_2011
4. See Allegretto, “The State of Working America’s Wealth, 2011”; http://www.epi.org/publications/entry/the_state_of_working_americas_wealth_2011
5. The House-passed 2011 continuing resolution would reduce spending by \$61.5 billion over the prior year’s level. The one-year cost of the extension of Bush-era tax cuts for those joint filers making over \$250,000 was estimated \$69.5 billion. See Andrew Fieldhouse, “Giving to the rich and taking from the poor,” Economic Policy Institute, March 29, 2011; http://www.epi.org/economic_snapshots/entry/giving_to_the_rich_and_taking_from_the_poor/
6. Calculated from the March 3, 2011 Bureau of Labor Statistics’ productivity and cost release: <http://www.bls.gov/news.release/pdf/prod2.pdf>
7. These data are the same GDP and household wealth data used above but calculated per full-time equivalent worker rather than per person.
8. The median hourly wage is available at www.stateofworkingamerica.org and is based on EPI computations of the CPS ORG data. See Appendix B in Mishel, Bernstein, and Shierholz for a description of the data.
9. Josh Bivens, *Failure by Design: The Story Behind America’s Broken Economy*, an Economic Policy Institute book, Ithaca, N.Y.: Cornell Press, 2011.
10. John Irons, Kathryn Edwards, and Anna Turner, “The 2009 Budget Deficit: How did we get here?” Issue Brief #262, Economic Policy Institute, 2009; http://epi.3cdn.net/0974dad8645a9d3216_5tm6bnxqd.pdf
11. Some additional factors may be responsible for parts of this but there are also higher health costs and other factors that will lift the deficit in 2015 but are not present now.