AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

S. HRG. 110–861

HOW MUCH MORE CAN AMERICAN FAMILIES BE SQUEEZED BY STAGNANT WAGES, SKYROCKETING HOUSEHOLD COSTS, AND FALLING HOME PRICES?

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

JULY 23, 2008

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

45–065 WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

CONTENTS

Opening Statement of Members

Hon. Charles E. Schumer, Chairman, a U.S. Senator from New York 1
Hon. Jim Saxton, Ranking Minority Member, a U.S. Representative from New Jersey 4
Hon. Carolyn B. Maloney, Vice Chair, a U.S. Representative from New York .. 5
Hon. Maurice D. Hinchey, a U.S. Representative from New York 7
Hon. Robert P. Casey, Jr., a U.S. Senator from Pennsylvania 8
Hon. Bernard Sanders, a U.S. Senator from Vermont 10
Hon. Amy Klobuchar, a U.S. Senator from Minnesota 11

Witnesses

Professor Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School, Cambridge, MA 14
Dr. Jared Bernstein, Senior Economist and Director, Living Standards Program, Economic Policy Institute, Washington, DC 16
Ms. Kristen Lewis, Co-Director, American Human Development Project, New York, NY 18
Dr. David Kreutzer, Senior Policy Analyst in Energy Economics and Climate Change, The Heritage Foundation, Washington, DC 20

Submissions for the Record

Prepared statement of Senator Charles E. Schumer, Chairman 38
Prepared statement of Representative Jim Saxton, Ranking Minority 40
Prepared statement of Representative Carolyn B. Maloney, Vice Chair 42
Chart entitled "Annual Change in Real Earnings" 44
Prepared statement of Professor Elizabeth Warren 45
Prepared statement of Dr. Jared Bernstein 67
Prepared statement of Ms. Kristen Lewis 87
Prepared statement of Dr. David Kreutzer 96
Essay entitled "How Rising Gas Prices Hurt American Households" 101

HOW MUCH MORE CAN AMERICAN FAMILIES BE SQUEEZED BY STAGNANT WAGES, SKYROCKETING HOUSEHOLD COSTS, AND FALLING HOME PRICES?

WEDNESDAY, JULY 23, 2008

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met at 10:00 a.m. in room 608 of the Dirksen Senate Office Building, The Honorable Charles E. Schumer, Chairman, presiding.

Senators present: The Honorable Amy Klobuchar and Robert P. Casey, Jr.

Representatives present: The Honorable Carolyn B. Maloney, Maurice D. Hinchey, Lloyd Doggett and Jim Saxton.

Staff present: Christina Baumgardner, Heather Boushey, Nate Brustein, Stephanie Dreyer, Tamara Fucile, Nan Gibson, Colleen Healy, Israel Klein, Ted Boll, Chris Frenze, Tyler Kurtz, Rachel Greszler and Jeff Wrase.

OPENING STATEMENT OF HON. CHARLES E. SCHUMER, CHAIRMAN, A U.S. SENATOR FROM NEW YORK

Chairman Schumer. The Committee will come to order. I apologize to the witnesses and my colleagues for being late.

Let's begin. Now, before I read my opening statement on this very important topic, the middle class squeeze, I've been asked to just say a few words, because the President lifted his veto threat on the Housing Bill.

That is good news. It comes at last. The bottom line is, the President had no choice, but it's better that he did it sooner, rather than later.

He had no choice, because his own Treasury Secretary proposed remedies for Fannie and Freddie, which are at the heart of the housing dilemma and the mortgage market, and to have vetoed that would have said, I don't give a hoot about the economy or even what my Treasury Secretary thinks about the economy, and he couldn't have done that.

But it is good that he came off the sort of ideological horse that you shouldn't spend any money on CDBG. On the merits, CDGB is needed.

We have large numbers of vacant homes in cities and suburbs throughout America, and for the CDBG funding to allow localities

to buy these homes will help put a floor on the housing market that would be much worse without it.

So, the CDBG component of this proposal is every bit as essential as any of the others, and simply an aversion to government programs, no matter what, shouldn't get in the way of us trying to recover from the housing crisis that we have.

So we welcome the President's dropping of his veto threat, and hopefully, finally, he will get off his ideological high horse and come work with us to solve this problem, because that's what we're trying to do.

Okay, I'll let Jimmy say a few words on the other side on this, or anyone who wants to, on this issue, as well.

Now, let's talk about the issue at hand, which is the fundamental issue plaguing our economy, and that is the middle class squeeze. We convene today's Joint Economic Committee hearing to examine this tightening middle class squeeze, the serious impact of rising household costs and stagnant wages and a slumping economy, and we're very fortunate to have a distinguished panel of experts to discuss the strangle-hold these tough times have on middle class households.

There's a silent cry going out as middle class families gather around the dinner table Friday night after dinner and talk about how they are ever going to pay their ballooning bills.

Middle class families are the engine of our economy, but their earning power and economic security has declined significantly in the last seven years. It declined during the times of prosperity, and now it's declining even further during times of recession.

What are most American families talking about around their dinner tables? They're talking about gas prices, which have more than doubled since 2001. They're talking about how much more their supermarket trip costs each week, or how they're paying so much more for college tuition or childcare or healthcare, and they're saying that their wages, their salaries, have not kept up with these increasing prices, in a way that they haven't seen and the American economy hasn't seen over the long term since World War II.

We have worked on many of these issues in the last year, and here at the Joint Economic Committee, we've been holding hearings on rising food prices, the energy crisis, unemployment, the economic costs of the Iraq War, and countless other kitchen table issues facing the American middle class.

And what we've learned is that all of these problems are serious, all affect real people every day. We had a baker from Long Island talk about rising wheat prices and dwindling profit margins for his small business.

We've heard from folks who have firsthand experience with the subprime mortgage mess, and have seen the rash of foreclosures in Slavic Village in Cleveland, and we've had Veterans testify to the serious economic and health consequences of the War in Iraq.

I can tell you one thing that Americans are not doing: Americans are not whining about the mental recession they're experiencing, as John McCain's top economic advisor, former Senator Phil Gramm, might have you believe.

This year's Republican Presidential campaign isn't the only place to find questionable economic commentary. Just last week, Presi-

dent Bush said, "I'm not an economist, but I do believe that we're growing. I can remember this press conference here, where people yelling recession this, recession that, as if you're economists."

"And I'm an optimist," the President said, "I believe there's positive things for our economy."

This is the same President who was caught by surprise when he was asked about predictions of $4 gas. He said, "That's interesting; I haven't heard about it."

And, you know, the comments of Phil Gramm about whining, remind me of the interchange my wife had with a very wealthy, very conservative friend of ours, who inherited a load of money. And he talked about freedom, how he wanted freedom to do whatever he wanted.

And my wife said to him, in front of his wife and children, said, sir—said his name, but I don't want to give it here—come back and talk to me about freedom after you live on $60,000 a year for two years and your kid is sick and you can't afford the health bills. Then you come back and talk to me about freedom.

And that says it all. The middle class, the solid middle class that has marched forward since World War II, is now having the most serious trouble that they have faced, and that's what our panel is going to explore.

And Americans hear President Bush, and, frankly, Senator McCain, address serious economic issues and it's like they're on a different planet. It's like they're that friend of ours, talking about freedom, when he's worth multi millions of dollars.

It's no wonder that American families today are feeling increasingly anxious about their jobs, their wages, and their economic security, because every day we learn bad news about the economy, and I have a whole bunch of statistics here, which I'm just going to ask to be added to the record, so we can move on.

Now, we're in danger for the first time, of seeing the economy—now, for the first time, we're seeing danger in the economy on both sides: Growth is too slow, and inflation is too high.

And who's squeezed in the middle? Once again, the middle class. So it isn't time for us to throw up our hands and say forget it; it isn't time to attach ourselves to some ideological nostrum like, oh, government is to blame, or freedom for all.

In fact, your testimonies, while shedding light on the difficult economic times at hand for most American families, suggests we can do better. Of course, we need freedom, but we need other things, as well, and that's what America's all about.

[The prepared statement of the Honorable Charles E. Schumer follows in Submissions for the Record on page 38.]

Chairman Schumer. I'm now happy to turn to the Ranking Republican, Jim Saxton, from New Jersey, for an opening statement, and he will be followed by Vice Chair Maloney, who just released a terrific JEC report on Women in the Recession, and I'm going to encourage—I will encourage all members to make brief opening statements here. Senator Sanders asked if he could sit in on this hearing, even though he's not a member of the Committee, and he'll have the opportunity to ask questions, as well.

Ranking Member Saxton.

OPENING STATEMENT OF HON. JIM SAXTON, RANKING MINORITY, A U.S. REPRESENTATIVE FROM NEW JERSEY

Representative Saxton. Mr. Chairman, thank you. It's a pleasure to join in welcoming the panel of witnesses before us today. Thank you all for being here. We are concerned about the increases in the cost of living to threaten to erode the American living standards.

I just returned from a weekend at home, and as I talked to my constituents in New Jersey, it won't surprise anyone here, that the number one thing on their mind, is the high cost of gasoline and other petroleum products.

This year, the oil price has risen 40 percent so far, with further price increases a distinct possibility.

These higher energy costs leave families with less money to cover their expenses, such as food. Of course, rising food prices also reflect higher costs for fertilizer, transportation, packaging, and the impact of our ethanol tariff, among other things.

As a first step, Congress might look at repealing the ethanol tariff. It would help all Americans, and also seek to produce more energy here in the United States.

With gasoline prices and food prices soaring, it's no wonder that income and wages, adjusted for the cost of living, are staggering. Unfortunately, Congress has done little, except to pass more farm subsidies, which actually increase the price of food, because farm subsidies pay farmers not to produce food.

As supplies remain stable and demand increases, food prices go up. Many American families are experiencing economic stress, due to high energy and food prices, but Congress is not acting to address their concerns, either.

On household income there are a number of different measures of household income and different ways to interpret them. The nonpartisan Congressional Budget Office, CBO, of course, publishes a comprehensive measure of household income trends, as well as taxes.

I recently asked the CBO to supplement these data, by providing a measure of real median after-tax household income. This is after tax. The most recent year available for CBO, is 2005, and this measure shows a gain of 5.3 percent since 2000, and 26 percent since 1980.

In 2005, the level of after-tax median household income, is $55,900, including various benefits, as well as the effects of tax changes. The moderate increase since 2000, does not mean that many families are not experiencing hardship, but it does put perspective into the other data.

It's also important to recall that there's quite a lot of income mobility in the economy. A recent Treasury study on income mobility, found that the median income of all taxpayers, increased by 24 percent between 1996 and 2005, after adjustment for inflation.

Other measures of income show less positive results. The reference period chosen, can be important.

For example, Census Bureau data can be used to suggest that median income began to stagnate between 2000 and 2006, however, the stagnation in this measure, actually started in the 1999–2000 period.

In other words, the trend started during the last year of the Clinton Administration, and not for the first year of the Bush Administration.

Neither Administration had much to do with causing it, but those unaware of the facts, might think the trend was triggered by the current Administration's economic policies, when actually they started during the last year of the Clinton Administration.

Another issue that often arises, is the increase in income inequality and suggestions that this worsened significantly in recent years. However, the CBO data show that inequality rose rapidly during the 1990s. For example, between 1992 and 2000, the income share of the top one percent surged from 12.3 percent to 17.8 percent, a startling increase of 5.5 percentage points.

Since 2000, this income share has edged up by only three tenths of one percent. In summary, the increase in inequality during the 1990s, was much, much greater than it has been since 2000.

The ongoing decline of housing prices, is something that many American families are very right to be concerned about. Government policies promoting home ownership may have been useful up to a point, but they contributed to a giant housing bubble that has now burst, causing widespread problems for many American families.

For example, the regulations finalized in 2000 by HUD, encouraged Fannie Mae and Freddie Mac to finance more subprime mortgages, and this is only one part of a much larger policy failure. Both institutions are too highly leveraged and have manipulated the political system to a point that an expensive taxpayer bailout may unfortunately be the only alternative ahead of us.

In closing, American families face a number of challenges. Unfortunately, Congress has failed to help address them.

The Congress has acted to support high food prices, and not acted to reduce high oil prices. Congress has coddled Fannie Mae and Freddie Mac institutions and contributed to creating a housing bubble that now threatens to cost taxpayers and families many billions of dollars to fix.

The economic problems now confronting the country have their origins in mistakes made by both public officials, as well as private parties, so there is plenty of blame to go around.

The truth is that the government policy has contributed to the challenges currently faced by American families, and ill-considered policies that are capable of doing even greater damage. Thank you, Mr. Chairman.

[The prepared statement of the Honorable Jim Saxton follows in Submissions for the Record on page 40.]

Chairman Schumer. Vice Chair Maloney.

OPENING STATEMENT OF HON. CAROLYN B. MALONEY, VICE CHAIR, A U.S. REPRESENTATIVE FROM NEW YORK

Vice Chair Maloney. Thank you, Senator Schumer, for arranging this important hearing, and all of the panelists. I'm particularly pleased to learn the President has decided that he will not veto the housing package, so that we can move forward to help American families and help the economy recover.

While my District, New York's 14th, is lucky enough to rank the highest on the American Human Development Project's Well Being Index, economic insecurity lurks on all corners of the nation during this downturn.

Families are being squeezed from all sides: Unemployment is rising and private employers have shed over half a million jobs so far in this year alone.

We learned from a report of the Joint Economic Committee, released yesterday, which I requested, that both men and women were hurt in the most recent recession in 2001, and that the weak recovery led women's employment rates to stop rising, a sharp departure from the trend over the latter half of the 20th century.

The report was interesting to me, because we have struggled so hard for equal pay for equal work, but what it showed is that women had achieved, regretfully, equal job loss, not equal pay for equal work, but equal job loss.

Wives and mothers may no longer be able to shelter their families from the economic storm that's hitting now. Over the past three decades, only families who have a working wife, have seen real increases in family income.

Higher job losses for women will be devastating for families. Rising job losses are occurring alongside rising prices and falling of real wages.

Families are spending more and more on the rising cost of basic necessities like gasoline and milk, leaving little left for much of anything else.

Annual wage growth has fallen for the past eight months. Adjusting for higher prices, wages are lower today than they were over a year and a half ago.

Too many families have lost ground on President Bush's watch. The weak recovery has left families heading into the current downturn with income that is about $1,000 lower than it was when President Bush took office.

Families coped with the lack of income gains by taking on more debt, but this is no longer an option. As Professor Warren will speak about today, over the economic recovery of the 2000s, families took on more debt of all kinds. Much of it was mortgage debt, but there were also sharp increases in consumer debt.

Now families are seeing lower home values, rising foreclosures, and tightening credit conditions. Millions have little to fall back on if the economy continues to deteriorate.

The Federal Reserve has now joined me in recognizing that greater consumer protections are needed so that the credit card house of cards does not come crashing down next.

Congress has already taken steps to help blunt the effects of the downturn on families by passing the first stimulus package and by extending unemployment benefits to the long-term unemployed.

We can see the boost from the recovery rebates in the upticks in personal income and retail sales last month, but the data show that we still must do much more to help American families.

The President should work with Congress to enact a second stimulus package of aid to the states and infrastructure investment, to get the economy back on track.

Over half of the states are projecting budget shortfalls for fiscal year 2009, and this will lead not only to cutbacks in necessary services, but likely higher unemployment, especially for women, who disproportionately work in social service agencies in states, and in education.

Mr. Chairman, I would like to take this opportunity to thank you once again for holding this important hearing, and I look forward to gaining insights from our witnesses today. Thank you.

[The prepared statement of the Honorable Carolyn B. Maloney follows in Submissions for the Record on page 42.]

Chairman Schumer. Congressman Hinchey.

Representative Hinchey. Well, thank you very much, Mr. Chairman. The first thing I would like to do, is express my deep gratitude and appreciation to you for the way in which you've handled this very important Joint Committee of both Houses.

And I think it is clear to anyone who is looking at this or interested in the economic circumstances that our country confronts, realizes that the job that you've done as Chairman, has been much, much more effective than this Committee has been over the course of the last many years, so I deeply appreciate that and I appreciate this opportunity to be here today with these very wonderful people, and to listen to them closely, and to learn more about the dire circumstances that the American people are confronting with regard to the economic conditions, nationally.

And those conditions are getting worse and worse. We now have a national debt, for example, which is $9.5 trillion and running up to $10 trillion.

That national debt is driven by a number of things that could have been prevented, like tax cuts, for example. A huge percentage of that national debt, is driven up these tax cuts, and those tax cuts have driven more and more income into the hands of a handful of people.

We now have a situation in the United States where nearly 60 percent of the wealth of America, is in the hands of five percent of Americans.

We haven't seen anything like that since a very significant year, 1929. We've also seen a very substantial decline in the median-income population of our country, and that decline has been driven a lot by a number of things, including the decline of the economy, increase in inflation, and a decline in the number of jobs, particularly manufacturing jobs, but now service jobs, as well are dropping at a dramatic rate.

We have lost more jobs over the course of the last six years, than at any time since the Great Depression, in that similar period of time.

So there's an awful lot of adverse circumstances that we're confronting now as a government, and it's interesting that this President has threatened to veto any piece of legislation passed by the Congress, which would engage in investment internally in our own country, at the same time that he's very comfortable spending more than $10 billion every month on this illicit military occupation of Iraq and on these tax cuts that he's been pushing and now would like to make permanent. Happily, that's not going to happen.

We've got a lot of issues to confront, unemployment among them. The official rate of unemployment is 5.5 percent now, but the fact of the matter is, if you look at the real number of people who are not really employed, who are working maybe a couple of days a week, at most, or who have run out of the unemployment insurance and they've dropped off the picture here, then you see the unemployment rate in this country, is almost double that 5.5 percent.

So, again, Mr. Chairman, these are issues that we have to deal with as a Congress and that we've got to force this Administration to try to address, before they leave office, so that people can stop the suffering that they have been experiencing over the course of the last six or seven years.

And the attention that you have focused on this issue, has been very, very productive, and I'm deeply grateful to you for the work that you've done. I thank you for joining us today.

[The chart entitled "Annual Change in Real Earnings" appears in the Submissions for the Record on page 44.]

Chairman Schumer. Thank you, Congressman Hinchey. Senator Casey.

Senator Casey. Mr. Chairman, thank you very much. I want to reiterate what the Congressman said about your leadership on this Committee and also the important issues that you're bringing before the American people today, by way of the panel, the members of the House and Senate who are here, but especially today, our witnesses, who can bring insight and wisdom and knowledge and data to the debates we're having here in Congress, as it pertains to the struggles of the American family in this difficult economy.

I think the best—and I'll refer to some data, but probably the best summation of what families are facing, came from, in my judgment—and I'm a little biased, because she's from Pennsylvania—came from a mother in Pleasant Gap, Pennsylvania, and a story in the Centre Daily Times newspaper, just about two weeks ago. I don't have the date in front of me, but—and I quoted her in front of Chairman Bernanke last week, just to focus his attention on these issues.

This is Tammy May, a single mother from Pleasant Gap, Pennsylvania, and she said, and I quote, "Pretty much, we have reprioritized . . ." for she and her two children, "the house payment is first, then daycare, then we worry about gas, then food."

She summarizes, I think, the struggles that a lot of families face. I think it's interesting and noteworthy, but also depressing in some ways, that she notes that food is number four, that she can only worry about food, after paying those other three costs in her life and the life of her family.

We know the data that undergirds that statement: 438,000 jobs lost, that's the low end. I've seen numbers as high more than 480,000 jobs, but let's just say it's 438, just in six months. Just today, the New York Times and others, are reporting that the average interest rate for a 30-year, fixed-rate mortgage, rose to 6.71 percent on Tuesday, from 6.44 percent on Friday.

That's good news about the President lifting his veto threat. We have to get housing legislation passed. It's the foundation of all of our trouble.

I think that the earnings chart that the staff prepared is significant. If you look from June 07 to June 08, in terms of hourly earnings and weekly earnings, it's going right in the wrong direction, right down.

And I think also, in the Committee, the Committee staff prepared a great report on earnings from a couple of different vantage points. One of them was earnings versus productivity.

In the first quarter of 08, output per hour in the non-farm business sector, grew at a 2.6 percent average annual rate. So you have output per hour going up, and at the same time, real hourly compensation, pay plus benefits, of workers producing that output, increasing by only 0.6 percent.

So, over and over again, this year, last year, for the last several years, you have output or productivity going up, and wages, at best, flattening out or maybe increasing just a little bit, at best, but mostly going down or not nearly increasing.

So there's that dichotomy of wages and output, so our workers are doing their jobs, and they're struggling, just to make ends meet, but our policymakers, in what we're doing in Congress, what the Administration is doing, is not compensating for or taking into consideration, that dichotomy.

I'll end with one note, rural America. I come from a state that is largely rural, outside of our major cities like Pittsburgh and Philadelphia, and all of these issues that we just talked about, wages, or the cost of—the impact of the housing crisis, childcare costs, gasoline costs, hit rural America at least as hard as urban America, and sometimes much harder.

The Oil Price Information Service, which is a fuel analysis—has done fuel analysis, talks about the impact of fuel prices in parts of Pennsylvania, and then their data was reviewed by a Penn State Professor, and they say, in part, that rural populations generally have lower incomes, drive longer distances to work, and have less access to public transportation than their urban counterparts.

Rural America is being hit hardest, in some ways, by the cost of gasoline, and, in Pennsylvania, this news article was pointing out that among the 67 counties in Pennsylvania, Forest County, a very small county in northwestern Pennsylvania, which has its name for a reason—it's a vast wilderness, in some ways, a very low population as compared to the rest of the state—the pain-at-the-pump rating, which others have come up with, is highest in that county than any other county in Pennsylvania.

So when you talk about these problems, this isn't just the problem of some big cities and some populations in urban areas of Pennsylvania or any other state; this is a problem, whether it's the cost of gasoline, the cost of childcare, the cost of healthcare, the cost of food, which hits rural America very hard.

So, Mr. Chairman, we're grateful for this opportunity today, and we look forward to the testimony of our witnesses and the questions. Thank you.

Chairman Schumer. Thank you once again, Senator Casey, for your passion and your erudition at the same time.

Senator Sanders is not a member of this Committee, but has shown a long-term interest in this area and has asked to come

here, and we welcome him, we're glad he did, and I'm going to ask him to make a brief opening statement.

I have to go make a quorum in the Finance Committee. I'm not upset with any of the witnesses or anything like that. I'll be back as quickly as I can. It's downstairs, but in the meantime, Vice Chair Maloney will introduce our witnesses. Thank you. Senator Sanders?

Senator Sanders. Senator Schumer, thank you very much for holding this hearing, and I want to thank our panelists for being with us, especially, perhaps, Professor Warren, who came to Vermont, Mr. Chairman, to do two hearings on the economy, which brought out many, many hundreds of people, and thank you, Elizabeth, for doing that.

I concur with much of what the members of Congress have said this morning, except for one thing: The title of this hearing is "The Squeeze of the Middle Class." I don't think it's a squeeze; I think it's a collapse, and I think this is one of the most under-reported issues in the last ten years.

The reality today, is that in many respects, the middle class of this country is collapsing. The vast majority of our people have seen a decline in their standard of living.

Another point that has not been made often enough, is, it's not everybody who is hurting. The people on top, are doing, in many ways, better than has been the case since the Great Depression, and what we are looking at is a gap between the very, very rich and everybody else, as Congressman Hinchey has pointed out, that we have not seen since just before the Great Depression.

This is the reality of life that we're seeing in America today. Since President Bush has been in office, some five million Americans have slipped into poverty. We don't talk about poverty very much, but that's the reality. Since Bush has been President.

I think I would have some disagreements with the information that Congressman Saxton put out there, but my understanding is that for working families, for working-age Americans, median household income has declined by nearly $2,500.

We don't talk about it within the context of this hearing, but we have to. Eight and a half million people in the last seven years, have lost their health insurance. Millions more are paying higher and higher rates for, in many cases, inferior coverage.

Senator Casey has mentioned the loss of manufacturing jobs, and three million, good-paying manufacturing jobs are gone; nearly four million American workers have lost their pensions; 35.5 million Americans struggled to put food on the table last year—hunger in America, the United States of America, and the number of the hungriest Americans keeps going up.

College students are graduating school very, very deeply in debt, and many of them cannot even go into the professions that they want, because they have to make money to repay those debts.

Home foreclosures, as we all know, are now the highest on record. And here's something that we have got to understand and not be proud of: The United States has the highest rate of childhood poverty in the industrialized world. Almost one out of five our kids is living in poverty.

We have the highest infant mortality rate in the industrialized world, the highest overall poverty rate, the largest gap between the rich and the poor, the largest incarceration rate, which, to my mind, has a lot to do with the highest childhood poverty rate, and we are the only country in the industrialized world not to have a national healthcare program.

That's what's going on, so when people tell you how great the economy is doing, I don't know who they are talking to; certainly not to working families.

Now, here's the story: In preparation for the town meetings that Professor Warren had with me in the State of Vermont, we sent out an e-mail to people in Vermont and said, tell me how is life going for you? What's going on in the middle class.

We expected to get a few dozen responses, but, in fact, we got 800 responses and we ended up publishing them and they are on our website. And the responses were so heartbreaking, were so powerful, it just blew me away, and it was difficult to read.

The reality is, the middle class is hurting, and we have got to address those problems and we've got to be bold and aggressive in addressing it, and we also have to understand that there is something wrong in this country, that while the middle class shrinks and poverty increases, the people on top, in many instances, are making out like bandits.

In 2006, the top one percent of Americans, received the largest share of national income since 1928; in 2005—and I would like people to hear this—the top one percent earn more income than the bottom 50 percent—one percent, 50 percent, and there are some people who think, by the way, that that gap is even larger.

That is a disgrace, to my mind, and a real threat to American democracy. The collective net worth of the wealthiest 400 Americans, increased by $290 billion last year, to $1.5 trillion. Let me repeat that: Wealthiest 400 Americans saw their wealth increase by $290 billion last year, so the point is not just collapse of the middle class and the increase in poverty; it is that the people on top are making out very, very well.

So if people ask me, have Bush's economic policies worked? Yeah, I think they have worked; they have worked and done exactly what they are supposed to do, is to make the richest people in this country, richer; they have worked fantastically.

Unfortunately, the question remains, whether we will have a middle class and whether, in fact, for the first time in American history, we will see our younger people have a lower standard of living than their parents, a reverse of the American dream. Madam Chairman, thank you very much.

Vice Chair Maloney [presiding]. Thank you, Senator, and we miss you in the House. I would now like to recognize Senator Klobuchar.

Senator Klobuchar. Thank you very much, Madam Chair, thank you for holding this hearing, and thank you to our witnesses. I have quoted Professor Warren so much in the last few months, about the great work that she's done on statistics, that I'm very pleased to see her and hope I've been quoting her correctly.

I will tell you that in my home state of Minnesota, I have just heard over and over again, how difficult it is for middle class people to get by.

You know, I remember going to a cafe a while back, and it was in an area where I didn't think a lot of people would show up for a Democratic Senator, and there were about a hundred people there, squeezed in. We had set up one table for eight chairs, so it doesn't look bad if people don't show up, and there were a hundred people that showed up in a rural part of our state, and I remember thinking to myself, you know what this is about, when you've got less disposable income, like so many of our citizens in rural areas, and the tuition at the University of Minnesota goes up 100 percent, like it has in just the last ten years, you feel it first in your pocketbook.

And when the healthcare premiums go up 100 percent as they have in our state, even though we have one of the highest coverage rates for people in the country, the healthcare premiums are up 100 percent, and you're in rural Minnesota and you've got less disposable income, you feel it first in your pocketbooks.

And when gas is up over four bucks a gallon and you've got a long way to drive and there is no—you know, you're not going to have a lot of bus service out there in Pipestone, Minnesota, you feel it first.

And when it's your kids going to war and your neighbor's kids and your cousins that are in the National Guard and thought they were going to come home in three months, and then they have left a job behind and left a family behind, you feel it first in your pocketbook and you feel it first in your heart.

And that's what's been going on, and, time and time again, families would talk to me, parents, and say, I feel like it's my fault. You know, my parents were able to afford to send me to college, and how come I can't afford to send my kid to college? Or howcome my kid, after they have a job, a pretty job, can't even afford to buy a house?

And that's what's been going on in this country. I know that Professor Warren and other witnesses have the statistics to back that up.

The New York Times did an article just this week, about a woman who had fallen farther and farther behind. I like the article—Senator Schumer, whose home is New York—because she wasn't the perfect citizen. She had, you know, done things she shouldn't have, she had run up credit card debt. She had done things she shouldn't have, she bought too much stuff, but at the same time, she was paying something like $20,000 a year in interest.

When I think of Professor Warren's study showing about how the average middle class family has lost about a thousand bucks at the same time their expenses have gone up something like 4,000 bucks, a lot of them have been putting it on the credit card in my state and across the country, so, in some ways, we're just seeing the tip of the iceberg with this crisis.

The most thing that I remember from that article, Senator Schumer, was this woman hid her telephone in the dishwasher, because

the bill collectors were calling all the time, so she couldn't hear that phone ring.

And we can no longer hide this problem in the dishwasher, and that's why I'm so grateful that we're doing this hearing today, and we start talking about some sensible solutions.

I mean, I have mine about rolling back some of these tax cuts on the wealthiest and putting the money into the middle class, an energy policy that looks to the future, and healthcare reform, which I hope will be one of the first things on a new President's agenda.

But I want to thank you for taking on this issue and I look forward to hearing the testimony.

Chairman Schumer. Congressman Doggett.

Representative Doggett. Thank you, Mr. Chairman, for convening this hearing. You identified a number of problems in your written testimony, that deserve our immediate attention. If we're unable to address them immediately this year, we clearly will address them next year.

And hopefully, you can identify in your oral testimony and in response to our questions, specific steps that you think we should or should not take.

As others have indicated, the crisis that we now face, is the natural product of the last seven and a half years of the Bush-Cheney Administration, and, as we begin to dig out of the disastrous policies and the effects of those policies, we need your guidance as to the specific steps we should take. Thank you.

Chairman Schumer. Thank you, Congressman Doggett. I want to thank every one of the members for excellent opening statements.

Now,let me introduce the four witnesses. Elizabeth Warren is currently the Leo Gottlieb Professor of Law at Harvard Law School, and has co-authored several books, including the recently-published, "All You're Worth," which is a bestseller.

Professor Warren is the Vice President of the American Law Institute and is on the Executive Committee of the National Bankruptcy Conference. Former Chief Justice Rehnquist appointed Professor Warren to the Judicial Education Committee of the Federal Judicial Center, from 1990 to 1999.

Dr. Jared Bernstein is the Director of the Living Standards Program at the Economic Policy Institute. Dr. Bernstein's areas of research include: Income inequality, poverty, and the analysis of federal and state economic policies.

He, too, is the author of several books. His latest is titled "Crunch: Why Do I Feel So Squeezed and Other Unsolved Economic Mysteries," which is apropos for this hearing.

Dr. Bernstein has been published extensively in the New York Times, Washington Post, American Prospect, and is a contributor to the Financial News Station, CNBC.

Kristen Lewis is the Co-Director of the American Human Development Project, a new, independent, nonprofit initiative which just released "The Measure of America: A First Ever Human Development Report for the United States," that introduces to our country, a well-honed international tool for measuring people's well being and opportunity.

Prior to the American Human Development Project, Ms. Lewis worked in international development for 15 years, and was a co-author of "The Water and Sanitation Report of the Jeffrey Sachs Millennium Project."

Finally, last, but certainly not least, Dr. David Kreutzer—did I pronounce that correctly, sir?

Dr. Kreutzer. Yes.

Chairman Schumer. Dr. Kreutzer is the Senior Policy Analyst in Energy, Economics, and Climate Change at the Heritage Foundation's Center for Data Analysis.

Before joining Heritage in February of 2008, Dr. Kreutzer was an economist at Berman & Company, a Washington-based public affairs firm, and from 1984 to 2007, he taught economics at James Madison University in Virginia, and also served as Director of the International Business Program.

To each of the witnesses, your entire statements will be read into the record, and please proceed. We all tried to limit our statements to five minutes. If you can sort of stick to that, that would be great.

Professor Warren, you may begin.

STATEMENT OF PROFESSOR ELIZABETH WARREN; LEO GOTTLIEB PROFESSOR OF LAW; HARVARD LAW SCHOOL; CAMBRIDGE, MA

Ms. Warren. Thank you very much, Senator Schumer, for the invitation to come here today, and to the Committee members. I'm here to do whatever I can to be helpful.

I've done some numbers to try to look at middle class America, the median American family, comparing that family in 2000 with that family in 2007. I've tried to be very conservative with the numbers and everything I will talk about today has been adjusted for inflation.

I'm not looking for anything fancy to try to shake and stir the data, but just what's happened to middle-income Americans. There are two key things we need to look at on the income side and the expense side:

On the income side, what's happened is that income is down. Adjusted for inflation, the median American family in the United States is making somewhere in the neighborhood of about $1200 less than they were making just back in 2000.

On the expense side, however, this family that's got to make up a gap on the income side, has been hit hard with basic expenses. The current story, obviously, is gasoline. I'm going to use numbers only up to May, because those are the ones that are clearest.

The average family is spending about $2200 more than they were spending on gasoline back in 2000, and, as you rightly point out, for rural families, this vastly understates what they're spending. They are out of options in rural America.

Increases in mortgage took another big bite, about $1700 annually. Now, with the falling housing market, many have mortgages they can neither refinance nor can they move. These are families headed for default, as surely as the next car in the train wreck.

Increases in health insurance, in food, in basic telephone, the land lines—this is the one I did the comparison on—and appliances, knocked about another $730 out of the family budget.

Altogether, just on these basic expenses, adjusted for inflation, American families are spending—are asked to spend about $4700 more. And I want to pause here. That's the average American family.

That's a family who doesn't have to spend a penny on their children. Now let's talk about a family with children. Childcare costs for a child under five, in this seven-year period, increased by $1,508. That's $125 a month.

Chairman Schumer. Excuse me, but there's a chart right here. I know my colleagues can't see it.

Ms. Warren. That's right. It's a chart that just puts these together, but I want to be clear. I don't think childcare is on there.

Chairman Schumer. Yes, it is.

Ms. Warren. Is it on there? Good.

And I want to draw a line under this again, $125 a month, not total expense; $125 a month more than they were spending to keep a child in daycare back in 2000.

For those with an older child, a school-age child, just one child, an additional $622 a year, and all parents have watched with alarm, as the Senator pointed out, as costs for college have spiraled upwards.

Taking the most conservative measure of costs in college, net of all scholarships and grants, we're talking again about an increase of about $1,050.

With a median household budget of about $48,200, these costs are tearing a hole in the family that they simply can't make up. And so I want to just say briefly, the next time you look at debt figures, the next time you look at home mortgages, keep in mind that some of that home mortgage debt was used to purchase houses, some of it was used to refinance houses in home equity lines of credit, where people have tried to pay off credit cards or to pay medical bills that they otherwise could not afford.

The next time you look at the mortgage debt numbers, the next time you look at credit card debt numbers, the next time you look at revolving debt numbers, the next time you look at consumer debt numbers, and see that they have all gone up, please pause to understand the income and expense side of this calculation.

Families are not laying down the credit cards because it's fun; they're laying down the credit cards because it's the only way to put food on the table.

Families are stressed, and what this is creating, that does not appear in the government statistics, is that families are creating an additional expense category. For the 44 percent or so of American families that are revolving their debt, that is, they cannot pay their credit card debts, we're talking about an average debt load of about $8,400.

They would have to take three months of their before-tax income and they would have to not eat, not pay rent, not pay interest on the debt, in order to be able to pay off the balances on their credit cards, and that's at the average for these families.

So, I will pause. I see I'm out of time, but I thank you so much for having this hearing today, and so much for talking about these families. They're in trouble.

[The prepared statement of Elizabeth Warren follows in Submissions for the Record on page 45.]

Chairman Schumer. Dr. Bernstein.

And thank you so much, Professor Warren. I think your numbers here have influence, because some of us have heard your discussions before. That's why I wanted you to be here. They have influenced so many people around here.

Dr. Bernstein.

STATEMENT OF DR. JARED BERNSTEIN; SENIOR ECONOMIST AND DIRECTOR, LIVING STANDARDS PROGRAM; ECONOMIC POLICY INSTITUTE; WASHINGTON, DC

Dr. Bernstein. Chairman Schumer, Ranking Member Saxton, I thank you for the opportunity to testify today, and I applaud your focus on the economic difficulties facing middle-income families.

My remarks this morning stress two points: First, middle-income families made considerable contributions to our economy's growth over the past business cycle, yet they have little to show for it.

As Senator Casey said, our workers are doing their job. The productivity of the American workforce grew a stellar 19 percent between 2000 and 2007, but the typical family's income, after inflation, fell about a percent over those years.

And since 2000, as this Committee well knows, the economy, in general, the job market, in particular, has weakened, further undermining the economic security of these families.

Second, I offer both short- and long-term policy solutions targeted at this historically unprecedented gap between overall economic growth and the living standards of middle-income families.

In the short term, a second stimulus package is necessary. While some of the package should again include direct payments to strapped households, more of the stimulus should be targeted to direct spending on relief to states and infrastructure investment.

Longer-term steps need to be taken to address the market bubbles that have caused the last two, and, arguably, three recessions. In this regard, I recommend a return to common-sense regulation in mortgage and financial markets.

Some of this involves enforcing rules already on the books but ignored, and some involves creating new rules designed to bring greater transparency and stability to these markets.

One key reason for the stagnant growth in incomes was the weak rate of job growth in the 2000s. Middle class families depend on their paychecks, not their stock portfolios, and their living standards thus depend on robust job and wage growth.

On net, the number of jobs expanded by six million in the 2000s cycle, compared to over 22 million in the 1990s. Annualized, jobs grew at a rate that was one-third that of the historical average.

More recently, the job market has, of course, begun shedding jobs, over 400,000 this year, and as job growth stalls and unemployment rises, wages for many workers have shifted from stagnation to decline. This June, real weekly earnings for most workers are 2.4 percent lower than last June; average hourly compensation for all workers, the broadest measure of wages and benefits, is down 2 percent in real terms over the past year.

In other words, while people, understandably, identify high prices, especially at the pump, as being at the heart of this squeeze, the wage side of this equation is also crucial. It's not just that prices are rising, it's that they're rising so much faster than pay.

What are the most effective interventions to offset these negative trends? Given the protracted nature of the current downturn, Congress is beginning to discuss a second stimulus package. For reasons I articulate in my written testimony, I suggest that this next round again includes direct payments to families, but I strongly recommend that the resources in this second package be heavily weighted toward fiscal relief to states and toward infrastructure investment.

Both of these options would yield considerable stimulative bang for the buck, relative to other options right now. Many states are strapped, and since they are required to balance their budgets, they are forced to undertake service cuts or tax hikes, both of which push exactly the wrong way in terms of family budgets and the macro economy.

Given the deficits in much of the nation's public capital, along with the need to create quality jobs, infrastructure investment also deserves consideration.

However, it's commonly argued that such projects have too long of a lead time to serve as effective stimulus. I think this argument is overplayed.

In my testimony, I identify many current infrastructure needs that could quickly be converted into productive, job-producing projects. Consider, for example, the August 2007 bridge collapse in Minneapolis. The concrete for the replacement bridge began flowing last Winter, the bridge is now halfway done, with full completion expected by December.

State transportation officials claim that their departments could award and begin more than 3,000 highway projects totaling approximately $18 billion, within 30 to 90 days from enactment of federal stimulus legislation.

Long-term, the regulatory agenda I offer is ultimately targeted at the problem of what might be called the "shampoo economy" of the last few business cycles, with their pattern of bubble/bust/repeat.

The last two, and possibly three, recessions were caused by bubbles that were fairly widely recognized as they inflated, yet key policymakers ignored the signs, and, in some cases, even nudged the bubbles along by endorsing the practices that inflated them.

This was a major contributor to the middle class squeeze, all the more unfortunate in that this economic pain is largely self-inflicted. My testimony offers numerous options for correcting these imbalances that comprise our financial markets, markets that are among the historically most innovative and effective in the world, proven to be integral to both providing credit to household and business sectors, but excessive deregulation, the absence of common-sense oversight, threaten to undermine this vital track record. Congress must not let this occur.

The agenda contains these components elaborated in my written testimony: Apply oversight based on what entities do, not who they are; increase capital reserve requirements; improve transparency

by limiting off-balance-sheet entities and monitoring market positions and liquidity; improve and enforce mortgage underwriting standards; for Fannie Mae and Freddie Mac, resolve the ambiguity regarding their public/private status; and from the perspective of executive compensation, treat government bailouts as bankruptcies, clawing back bonuses and excessive compensation.

I thank you for your attention, and I await any questions you may have.

[The prepared statement of Jared Bernstein follows in Submissions for the Record on page 67.]

Chairman Schumer. Thank you, Dr. Bernstein. Ms. Lewis.

STATEMENT OF KRISTEN LEWIS; CO-DIRECTOR, AMERICAN HUMAN DEVELOPMENT PROJECT; NEW YORK, NY

Ms. Lewis. I would like to thank Chairman Schumer and the members of the Committee for inviting me to testify today. It's a great honor to be here and to speak alongside scholars whose work has so enriched our understanding of America.

I'm Co-Director of the American Human Development Project. It's an independent project funded by Oxfam America, the Conrad Hilton Foundation, the Rockefeller Foundation, the Social Science Research Council, and the Annenberg Foundation.

With their support, we've just released a first-ever human development report for the United States, or any other affluent, industrialized country, "The Measure of America."

The centerpiece of the work is the American Human Development Index. The Index is an easy-to-understand numerical measure that embraces what most people believe are the basic building blocks of a good life: Health, education, and income.

The Index ranks the 50 states, the 436 Congressional Districts, and our major racial and ethnic groups on a scale of well-being and opportunity.

The rankings reveal that some groups of Americans are living ten, 20, even 50 years behind in terms of their health, education, and living standards, whereas others are enjoying levels of well being and human development that the rest of the country will not reach for decades.

Countries around the world use this human development approach to understand and track progress and setbacks in their own countries, and the UN uses it to gauge global development trends.

So what did we find? Overall, we found tremendous variation. There's a map there that shows the Index results by Congressional District—first, I'll talk about the states.

In terms of states, Connecticut was the top-ranked state, followed closely by Massachusetts. Washington, D.C. ranked third overall, tied with New Jersey. D.C. has the best performance on education and income, but it ranked last on health, with a life expectancy approximately that of the average American in 1980. Residents of Hawaii and Minnesota are living the longest lives.

There is much greater variation, of course, in the smaller population size in the Congressional Districts. New York's Congressional District 14 has the highest score in the country, and California's 20th District, in the Central Valley near Fresno, has the lowest score.

These two Districts are far apart in human development terms, with the New York resident ten times more likely to have a college degree, earning three times more, and even living four and a half years longer.

Put another way, District 14 is where the country, as a whole, will be in about 2040, if current trends continue, whereas District 20 is where the country, as a whole, was in the late 1970s, a six-decade gap in human development terms.

Some of the largest differences we saw in the Index were in terms of race, gender, and ethnicity. I can talk about this in greater detail, if you're interested, later, but, overall, Asian Americans have the highest human development level, primarily driven by their high education score; followed by whites, Latinos, Native Americans, and then African Americans.

African Americans are ranking third in income and education, but they have a huge gap in life expectancy. They are basically living 13 years less than the highest-ranked group, Asian Americans.

This 13-year lifespan gap, is about the same as the gap between people living in Japan and people living in Guatemala.

So, what do these disparities mean for American families, given the current economic downturn? Those groups of Americans with higher Index scores, indicating better health, higher levels of educational attainment, and higher earnings, have greater human security and resilience in the face of shocks.

Those with lower scores, on the other hand, are significantly more vulnerable to economic downturns, as well as shocks to individual households, such as divorce, serious mental illness, or job loss.

The effects of these trends we've heard about today can be seen, not just in people's everyday lives; they can also be seen in our global standing, compared to our peer countries. In 1990, the U.S. occupied the second place on the Global Human Development Index of the United Nations.

Today, we've tumbled to 12th place. The 11 countries ahead of us, particularly fast-moving countries like Australia and Ireland, have been much more successful and efficient in transforming income into positive health and education outcomes for their people.

How are they doing it? I'll just touch on three areas: Healthcare is the obvious first one. We are spending more, by a significant margin, than any other country. In fact, we'll spend more than $230 million in the next 60 minutes, but we aren't getting our money's worth.

We're living shorter lives than people in 41 other nations, including every single Western European nation and all the Nordic countries, except for one.

The U.S. infant mortality rate is on par with that of Croatia, Cuba, Estonia, and Poland. If the U.S. rate were equal to that of first-ranked Sweden, 21,000 more American babies would have lived to celebrate their first birthday in 2005.

It's not a question of whether we can afford something better; we're already paying caviar prices.

Education is another area in which our peer countries are spending less and doing better. Only 74 percent of American public school high school students graduated on time with a regular di-

ploma in 2004. This is an 18th place finish among industrialized countries, and American 25-year-olds are also far behind their international peers in math, at 24th place, and science, 17th place.

Chairman Schumer. How many total countries is that?

Ms. Lewis. This was the OECD, so it's 30.

Chairman Schumer. Thirty?

Ms. Lewis. Thirty countries, yes.

And a third area in which the U.S. is far behind is in the support we give to working families. Two of the last century's most far-reaching transformations have been the wholesale entry of women into paid work and the sharp increase in single motherhood, yet our country has been slow to adapt to this new normal of working mothers.

Our peer countries have faced similar social transformations, and they have responded with policies to help. To give just one of many, many examples, today the U.S. is in the company of Swaziland, Liberia, and Papua New Guinea as one of the only four countries in the world with no federally-mandated paid maternity leave.

In conclusion, greater security for middle class families, will require greater attention to and investment in the core ingredients of human well-being: Health, education, and income. Thank you.

[The prepared statement of Kristen Lewis follows in Submissions for the Record on page 87.]

Chairman Schumer. Thank you, Ms. Lewis. Finally, Dr. Kreutzer.

STATEMENT OF DR. DAVID KREUTZER, SENIOR POLICY ANALYST IN ENERGY ECONOMICS AND CLIMATE CHANGE, THE HERITAGE FOUNDATION, WASHINGTON, DC

Dr. Kreutzer. My name is David Kreutzer, and I am the Senior Policy Analyst for Energy Economics and Climate Change at the Heritage Foundation, however, the views I express in this testimony, are my own and do not necessarily represent official positions of the Heritage Foundation.

Mr. Chairman, I want to thank you and the other members of the Joint Economic Committee for this opportunity to address you concerning the impacts of higher energy prices on household income and expenses.

I note that many colleagues have helped lay the foundation for the analysis I present here, however, they should not be held responsible for any errors. In particular, I want to thank Dr. Karen Campbell, and request that her essay, "How Rising Gas Prices Hurt American Households," be inserted into the record.

[The essay appears in Submissions for the Record on page 101.]

Chairman Schumer. Without objection.

Dr. Kreutzer. Though many commodity prices have recorded large increases in the past two years, those of crude petroleum and its derivatives, have been especially severe.

My testimony today focuses on gasoline price increases and their effects on households. According to figures from the EPA and the Department of Transportation, the average household will pay about $1,100 per year for every one dollar increase in the price of gasoline.

In addition, higher gasoline prices impose indirect costs on these households. Higher gasoline prices squeeze the production side of the economy, from both the demand and cost directions.

Consumer demand for output drops, as they divert expenditures from other items to gasoline. In addition, gasoline is a factor of production in the distribution of goods and services.

Faced with higher costs, producers raise their prices, but the lower demand prevents the prices from rising enough to completely offset their cost increases. This leads to production cuts, and, therefore, to lower employment.

In turn, these conditions put downward pressure on wages and salaries.

This summer the Center for Data Analysis at the Heritage Foundation estimated what the impact on households would be if gasoline prices rose $2 per gallon over two years, which is very close to the situation of the past two years.

We estimate that total employment drops by 586,000 jobs. Disposable personal income drops by 532 billion. Because households must dig into their savings, personal consumption expenditures dropped by the smaller, but significant, amount of $400 billion.

For the household category of Married, 2 children, the median income in 2006 was $86,807. The impact of the gasoline prices reduces the household's income by over $1000 per year. The response of the households is to both cut expenditures and withdraw from savings to make up for the loss. Of course for many households withdrawing from savings means borrowing.

It is notable that the impact of gasoline price increases extends beyond the period of the price increases. This holds even if prices return to their original levels because withdrawals from savings and household borrowing force wealth below the baseline level—that is, the level that would have occurred otherwise—unless and until the wealth is rebuilt with increased future savings.

And any periods with increased savings will lead necessarily to lower consumption. Because higher gasoline prices have serious negative impacts on household incomes, savings, employment, and expenditures, it is important that Federal policy not inhibit efficient responses to market shocks.

First, impediments to environmentally sensitive exploration and production of petroleum should be removed. Maintaining and increasing the supply of crude oil is critical to avoiding high fuel prices.

That there may be a significant delay between leases issued today and increases in supply is an argument for moving more quickly on this issue. It is not an argument for not expanding supply at all.

In addition, a windfall profits tax would penalize those who make the decision to invest in oil resources and will only limit current and future oil supplies, raise fuel prices, and further harm American households.

In 1974, 1979, and 1990—and I should point out that there was an error in the written testimony on that date, it is not 1992, but 1990—there were supply shocks that sent world petroleum and gasoline prices skyward.

In 1974 and 1979, government policies, including price controls, distribution regulations, and profits' taxes, while very popular, extended and deepened the problems. In 1990 there was little interference with market adjustments and there were no gas lines nor extended high prices.

Substituting government mandates for market flexibility is politically tempting but ultimately harmful.

[The statement of Dr. Kreutzer follows in Submissions for the Record on page 96.]

Chairman Schumer. Thank you, Dr. Kreutzer.

I want to thank each of our witnesses. Each tried to stay within the five-minute limit, but I think my colleagues would agree with me it is some of the best five minutes that we have heard in this Committee.

Just a quick factual question for Professor Warren. You said that the average credit card debt was $8400, I believe? I don't remember the number.

Ms. Warren. For families carrying credit.

Chairman Schumer. For families carrying——

Ms. Warren. For families carrying credit card debt.

Chairman Schumer. Right. What would be the average debt of the median family, the person you talked about in that chart. A little lower I'd guess, right? Is this debt higher in the middle income, upper middle income, or lower income? That is what I am trying to get at.

Ms. Warren. It is a fair question. Credit card debt and the expenses of managing a credit card are borne in the middle. It is not an issue for high income families and, frankly, it is not an issue for the lowest income families.

So it tends to be concentrated. We do not have good data that break this down because the credit card companies have not revealed the sources of all of their profits, but we know that this is a sharply humped curve.

This is really about working families. Those are the people who are turning to credit cards.

Chairman Schumer. Right. And the second question for you, succinctly because I would like to get to the others if I could, but what is the single most important step Congress could take right now to ease the financial burdens affecting middle class families?

Now that is a hard question, because your chart shows, but maybe you can—if there was one thing—and maybe you can factor in political doability, not this six months but over the next two years.

Ms. Warren. We have got to repair the holes in the boat on credit.

Chairman Schumer. Okay.

Ms. Warren. We talk up here about income and expenses, but the reality is this is driving more and more families into a unregulated credit market. And that credit is becoming an independent and ballooning expense that puts the family both further at risk and diverting more of its income to debt service, thereby creating a downward spiral both for the family independently and for the larger economy of the country and the world.

Chairman Schumer. Thank you.

Dr. Bernstein, you know we are seriously on, certainly on our side, exploring a second stimulus package, which you recommend, and your concern is not to repeat the first stimulus package but rather to focus particularly on infrastructure and payments to the States.

I know some of this is touched on in your testimony a bit, but just elaborate why that would be preferable than just putting money right into the middle class person's pocket?

Dr. Bernstein. Well for one reason, given the elevated price of oil you have to worry that too much of that stimulus in terms of payments to individuals leaks out and stimulates the economy of petro states instead of our own.

Also the debt burdens that Professor Warren has talked about mean that for perfectly good and reasonable reasons people may decide to use stimulus payments to offset credit or debt burdens, which may make sense for them but does not, demonstrably does not trigger the macroeconomic multipliers that we need right now to generate employment growth, which would be my key response to what needs to happen to get middle class families back on track.

The other measures I suggest I believe would have a bigger bang in that regard.

Chairman Schumer. Okay. And finally, to all of our witnesses here—well, I would like first, I am going to try to do a second round from Dr. Bernstein first, and maybe Professor Warren—why is it. No one has given me a very good answer.

Why is productivity going up so much and wages going down? Have we ever seen a period where that happens over an extended period of time? And Dr. Kreutzer, I would be interested in your answer, too. So this would be to the whole panel.

That is a fundamental problem here, that the gain that workers are actually doing in production is not coming back into their paychecks.

Dr. Bernstein. Would you like me to begin?

Chairman Schumer. Yes, you start, Dr. Bernstein.

Dr. Bernstein. I do not consider this a big head-scratcher. If you look at the history, the two set of data, the median family income and productivity growth, they grew in lockstep between 1947 and the mid-1970s. They both doubled.

Starting in the mid-1970s, productivity continued its upward trend, accelerating post-'95 quite sharply, median family income began to stagnate more so.

The key wedge between those two trends is economic inequality. Productivity is just another measure of growth. It is output divided by hours. And as the economy has grown, ever more of that growth has gone to the top realms of the income scale, the wealth scale that we heard today, leaving less for middle income families who are contributing to that productivity growth yet because of this wedge of inequality are getting much fewer of the benefits.

Now we could have a longer discussion of all those factors that are responsible for the inequality push that has been kind of channeling that——

Chairman Schumer. You are saying earned income—I mean, because one of the charts you have in here—I do not have it in front of me—is just productivity and wage growth.

Dr. Bernstein. Right.

Chairman Schumer. Doesn't that extend across, someone could be making a wage of $250,000?

Dr. Bernstein. I mean whether you look at average wage growth, median wage growth, you are still going to see that output gap.

So again, as the broad middle of the wage or the income class, as you have been hearing today, simply is not benefitting from the growth, it is going to show up as a productivity income gap.

Chairman Schumer. Professor Warren agrees?

Ms. Warren. I agree.

Chairman Schumer. Okay, Ranking Republican Saxton.

Representative Saxton. Mr. Chairman——

Chairman Schumer. Oh, I didn't give Dr. Kreutzer a chance.

Dr. Kreutzer. I would have a slightly different interpretation. It is actually not unusual as the economy heads into a recession for wages to go down, obviously, but the odd thing is the productivity goes up. Because the firms lay off their least productive workers first. So we are looking at a measure of how much——

Chairman Schumer. And this has been going on for more than the last year.

Dr. Kreutzer. Yes, this happens frequently when economies go into recession.

Chairman Schumer. This has been going on for the last 10 or 15 or 20 years, recession or not.

Ms. Warren. Since—excuse me, Senator—since the early 1970s.

Chairman Schumer. Right.

Ms. Warren. If we look at these, as Dr. Bernstein said, wages and productivity used to move together.

Chairman Schumer. Right.

Ms. Warren. In other words, as the pie got larger, the middle of America got an ever bigger piece. And what happened is those two began to decouple in the mid–1970s. American families started putting two people in the work force to try to make up some of that difference. But the reality is productivity as we measure it skyrocketed because the top ate more of the pie.

And the size of the pie for middle class America as a proportion just kept shrinking——

Chairman Schumer. Does income match productivity growth? Forgetting wage.

Dr. Bernstein. No. It is the same phenomenon. And if I might add one little wrinkle——

Chairman Schumer. It's a little confusing.

Dr. Bernstein. Well, median family income——

Chairman Schumer. Because, no, no, no. Let me ask the question.

Dr. Bernstein [continuing]. Tracks median wages.

Chairman Schumer. I know, but you had overall—you said "average," which is different. So if some guy making a million dollars now makes two million dollars, that should pull the average up.

Dr. Bernstein. Yes. The data in my report are on median income, not average income.

Chairman Schumer. Oh, okay.

Dr. Bernstein. And average income would track productivity more closely for precisely that reason.

Chairman Schumer. Got it.

Dr. Bernstein. Could I just make one tiny point?

Chairman Schumer. Yes.

Dr. Bernstein. There was a period—it lasted about a New York minute, with deference to the Chairman——

[Laughter.]

Dr. Bernstein. There was a period in the 1990s where productivity and wages actually did track each other for a few years. And that had to do with the fact that job markets really tightened in those years in a way we had not seen in 30 years, and certainly has not been the case since.

Chairman Schumer. Got it.

Dr. Kreutzer. There needs to be some perspective here. When you look at first graders in 2001 and you say what's their age? You're going to get something like 6 years old. If you looked at first graders this year, you would also get 6 years old. You would say, therefore first graders do not ever get older, isn't that a shame?

The median income earner in 2001 is not the same household as a median income earner in 2008. And the report that Mr. Saxton referred to, the Treasury report from last November, actually tracked something that median figures do not track. They looked at the—they found a set of people in 1996.

They followed them for 10 years. All right? And indeed the incomes, while median incomes would look stagnant if you took the overall population, if you look at particular families they grew by 24 percent.

What happens is the base is coming in. We have people coming from overseas more than before, and that is bringing that down. I don't want to argue about immigration, but that is how the numbers cannot be treated strictly comparable.

Chairman Schumer. Right. Okay.

Sorry, to Ranking Republican Jim Saxton.

Representative Saxton. Mr. Chairman, let me just say that yesterday I was very excited about coming here, but I am really disappointed in the tone of this hearing.

When Ms. Maloney for example talked about families being hurt on President Bush's watch, and then Mr. Hinchey talked about Bush's elicit military operation, I was kind of surprised by that. And then Mr. Sanders talked about 5 million Americans slipping into poverty under Bush. And then Mr. Doggett talked about the economic crisis as a result of the disastrous effect of the Bush/Cheney Administration. And even you, Mr. Chairman, blasted both President Bush and Senator McCain in your opening statement. And I think that sets a really bad tone for the American people.

I guess I should not have been surprised. When I got in my office this morning I found an article on my desk from The Politico that says "Obama economic advisors testifying today," and the article says: Wonder what Barak Obama is thinking about——

Chairman Schumer. That's not today. That's tomorrow at the——

Representative Saxton. It says "drop by room 608 at the Dirksen Senate Office Building at 10 a.m., Wednesday for some hints.

Jared Bernstein and Elizabeth Warren, two economists who are informally advising Barak Obama, are scheduled to testify in front of the Joint Economic Committee."

Mr. Chairman, this is—you know, I think it is just a shame that we are here doing politics on the people's money. In fact, Mr. Chairman, you are the Chairman of the Democrat Senate Committee. Don't you think it would be more appropriate for the Democrat Senate Committee to pay for this hearing today inasmuch as it is all about politics?

Chairman Schumer. Okay, let me just say, because this was direct, first Dr. Kreutzer is your choice. But second, why don't you combat what they said based on the facts of what they said?

It may be—I did not know this until you brought it up—that Professor Warren and Dr. Bernstein are informally advising the Obama Campaign. For all we know Dr. Kreutzer is talking to the McCain Campaign. But who cares?

We are here to talk about a phenomena. I have not heard any one of them mention anything political. They are rather talking about middle class squeeze.

You can deny it. It has gotten worse under President Bush's watch. I think that is a legitimate issue for us to pursue. And, you know, I think the testimony of our witnesses here was quite profound. Quite profound——

Representative Saxton. May I reclaim my time?

Chairman Schumer [continuing]. And instead of just—please, I am going to give you all the time. This will not be part of your time. But I find, again, this is not a political hearing; this is a substantive hearing. Most of the talk has been about numbers and remedies.

We as elected officials are entitled to blame who we want, and the public can let the chips fall where they may, but I have not heard a political thing come out of any one of the four of their mouths.

Representative Saxton. Well, Mr. Chairman, thank you very much. And there was not a single Democrat who spoke earlier who was not totally political in their remarks.

And so, Mr. Chairman, I yield back the balance of my time.

Chairman Schumer. Well thank you. You are my good friend, Jimmy, but I do not think you are right on this. Okay? I would again say, judge by what they said not by who they support or who they advise, or whatever. And that is what we are all trying to do here.

Vice Chair Maloney.

Vice Chair Maloney. Thank you. I would like to follow up on a statement that Ms. Lewis made that we are falling behind other countries in terms of our response to social policies to balance work and family, and to adjust to what Professor Warren said is a trend that started in the 1970s where families were losing income and both the wife and the husband had to go to work.

Then with the troubling report that has come out that both men and women are losing jobs, so that the wife will not be there to buffer the jobs.

I would like to ask the panelists: Why do you think our country has not responded with social policies to adjust to the changing re-

ality that both the wife and the husband has to work in order to pay down the credit cards, pay for the food, pay for the mortgage, and everything else?

I think Ms. Lewis said we ranked 169th in terms of the paid family leave; that we are tied with Papua, New Guinea and Swaziland. And I would like to ask you: Why do you think we have not adjusted our policies to the reality that both the husband and wife have to work? And what is the implication of this new report that shows that wives are losing their jobs in the same proportion, if not more, than men, and what is that going to mean for our economic recovery and strategies that we may be looking at?

Let's start with Professor Warren, and any comment by any of you.

Ms. Warren. Congresswoman, I think you ask exactly the right question. It is a deeply disturbing question. My view is that you are asking the question of who wields power in America?

There was a time when any legislation passed that would support and help and extend the stability of middle class families could pass this body with very little dissent. Look at the 1930s, the 1940s, the 1950s, the 1960s, and frankly that has changed.

This is no longer about legislation to support the middle class, to help what it means to be out there and to be a working family trying to get up every morning and go to work, take care of the kids, and make it to the end of the month.

The middle class has been served up as the turkey at the Thanksgiving Dinner. They have become the profit source for other corporate interests. And frankly our policies have not supported middle class families because the people who are pulling many of the levers of power are not themselves middle class and are not involved in these struggles directly.

Vice Chair Maloney. Dr. Bernstein.

Dr. Bernstein. I would add that I think, in answer to your question—and it is a very good question—why don't we have more of these policies? Because they make tremendous sense to you, and they make tremendous sense to me. I think that my brother and sister economists are partly to blame for this.

Because in economics, I would argue, there has been an erroneous conception—perception that if you introduce these family-flexible policies, it will lead to job losses, and employers will just lay people off as a result of the mandate.

There is very little evidence to support that, and good evidence to the contrary, and I urge this body to have hearings on precisely these points. Because I believe the public is where you are, and where I am, and the research is actually much more supportive than I think conventional wisdom would suggest.

Vice Chair Maloney. Ms. Lewis.

Ms. Lewis. I'll just make two quick points. One is that we are the bottom for mandatory maternity leave, but in addition we are also at the bottom for so many other policies—and I will just give you a few examples.

98 countries have 14 or more weeks of paid leave for mothers. And 31 have 14 or more weeks of paid leave for men, as well.

As you know, the United States has no federally mandated paid leave.

107 countries protect the right to breast feed with 73 offering paid breaks. And 137 countries mandate annual paid leave. So other countries, not just our peers in the industrialized world, but all over the world, are far ahead. So in comparison, we are doing badly.

One thing that might contribute to it is that the work that primarily women have done for years in caring for families, providing the care that workers need, providing the care that families need, that older people need, our aging parents, our young children, this is invisible to the economy.

We do not track the economic value of the work that women do. And there is a lot of work now on this care economy, and until we measure it it is hard to value it and track it. So we need to make a lot of progress in this area.

Vice Chair Maloney. Thank you. Dr. Kreutzer.

Dr. Kreutzer. Yes. I am an energy economist but I have a very family-friendly proposal that would seem to harm only the very wealthy.

The Arctic National Wildlife Refuge holds perhaps 10 billion barrels of petroleum and is visited by, at most, 1700 tourists per year at a cost of $3000, $4000, to $10,000. Only very wealthy or devoted tourists will make that trip.

That, by the way, is one fourth the number of visitors that the Cuyahoga Valley National Park receives on an average day.

The 10 billion barrels of petroleum in ANWR would be enough to provide fuel for 7 million cars for a century. I think it is very important that we balance things. The caribou do not care. There are more caribou in Alaska after the Alaska Pipeline was built than there were before. And if we are protecting a pipeline vista for 1700 tourists per year who are going to pay $10,000 to get there and denying 7 million households for a century the fuel, I think we are way out of balance.

Vice Chair Maloney. Well I feel that your comment did not answer the question, but since you brought it up, the Democratic Caucus met yesterday with T. Boone Pickens who really said we cannot drill our way out of this challenge that we have, and that we have to move towards energy independence here in our own country; that it has got to be issue number one on page one.

And he outlined some of his proposals, some of which have been embraced in a bipartisan way, some by the Democrats, some by individuals, to moving to more wind, and solar, and biofuels. And really I applaud the Democratic leadership for pushing for fuel efficiency.

The first proposal in 32 years requires that we get more fuel efficient cars in our country. This is priority number one. It is impacting all of our families.

I am hearing from my constituents that not only can they not drive but they are putting a surcharge on everything for the cost of the oil. This is a huge challenge, and it is one we should confront in a bipartisan way, and it certainly does affect the middle class squeeze.

In terms of the drilling, the Democratic leadership has just pushed Use It Or Lose It. We have leased over 68 million acres of

land owned by the American Taxpayer to oil companies, and we are saying: Drill on them.

We have 300 million that are up right now to be leased, if people bid in a competitive way for those leases. If they have a lease and they do not want to use it, then let's let another American who is a bigger entrepreneur, who has the time and wants to invest in making that happen, do it.

But it is a complex problem. It is one that the Chairman is interested in. Maybe we will have another hearing on energy policy, but on this one we are working on this middle class squeeze.

I thank all of the panelists today. You have provided many important insights, and I am very grateful.

Chairman Schumer. Thank you, Vice Chair Maloney. Congressman Hinchey.

Representative Hinchey. Well thank you very much, Mr. Chairman.

Mr. Kreutzer, I am interested in what you are saying about the Arctic National Wildlife Refuge and how that might provide some kind of benefit for the price of gasoline or other petroleum products.

But if you look at the way in which the oil companies are handling the leases that they have, and the availability of land on which they can drill, and not doing it, then I don't know why anyone would speculate that they need to be given control of the Arctic National Wildlife Refuge.

They have already got 68 million acres that they are not using. They have had leases on those that they are not using. And there is a national—I am not asking you a question; I am just saying something to you. [Laughter.]

Dr. Kreutzer. You did ask. You said why would we want to——

Representative Hinchey. No, I am just making a statement to you just to clarify what you were saying. I think that the point of why you are doing this is very, very clear. But the fact of the matter is that the situation is very different.

The problem that we are confronting is an increase in the price of a barrel of oil, which is driven by a number of things including the significant drop in the value of the dollar, the threat to invade Iran—which is causing additional speculation in the price of a barrel of oil—the situation in Iraq, which has also caused speculation rising in the price of a barrel of oil.

And then when you get internally here in our own country, what you see is the oil companies, which are now international corporations, manipulating the price of refined product by not drilling in the land that they already have available to drill on, including 20 million acres of land just adjacent to the Arctic National Wildlife Refuge, which is completely available to them, and which has more oil on it than the Arctic National Wildlife Refuge does, and larger than it, but they are not touching it.

So what you are saying, I just want to draw to your attention, is completely senseless. Because it is—the way in which this Administration has administered its own economic circumstances, including the value of the dollar, the way in which it has engaged in international activities which have driven up speculation, and the way in which the local oil companies here, which are inter-

national but working here in the United States, have driven up the price of the refined product.

And by the way, one of the reasons why the refined product is going up is because they have not built a refinery since I think 1975. It has been a long, long time. But the economic circumstances that we are confronting here as a Nation, which you all talked about, I think is one of the most challenging set of circumstances that any government in this country has ever faced.

I think that, as we have pointed out, some of the facts that we have got to deal with are very, very similar to what they were back in 1929.

I can remember a meeting of the Joint Economic Committee here with the Chairman of the Federal Reserve Board about a year ago talking to him about recession, and he was saying that we are not in a recession. We talked about the fact of inflation, and suggested to the Chairman of the Federal Reserve that we may be confronting an issue like stagflation, which is something we confronted back in the 1970s, where you have the economy dropping and the inflation rate going up.

And now we see that the Federal Reserve, in spite of the fact that the economy is in dire circumstances so far as the middle class is concerned—and when the middle class is hurting, everybody is hurting—in spite of that, the Federal Reserve now is more focused on inflation, for their own reasons.

The situation that we have to deal with is the way in which the middle income people have been adversely confronted over the course of the last six or eight years. The gross domestic product of our country is determined by a number of things, but principally by the way in which median income people are able to participate in the economy.

A little more than two-thirds probably of the Gross Domestic Product is driven by median income people. And with the decline of the income of median income people, the whole economy is suffering.

We are trying to deal with this in a number of ways. One of the interesting ways is a bill that passed the House of Representatives just within the last week or so which would provide a significant investment in a part of the infrastructure, education, which is probably one of the most important parts of the infrastructure, probably the most important part of the infrastructure, but that investment alone would produce probably something in the neighborhood of 100,000 jobs across the country.

This is a piece of legislation which the President has said he is going to veto. It is just consistent with his policy of not wanting to invest any of our money in ourselves, not putting any of our money back into our own economy, not trying to stimulate our own economy. But simply by wasting it across, whatever he wants to, across the world.

So I do not think that is a political statement. That is just a factual statement. That is just the facts that we have to deal with.

And if we are not going to face an economic circumstance which is similar to what was occasioned in 1929, we have got to be much stronger. Much stronger in this Congress, and much stronger with this President to get him to do some of the most responsible things.

So I would just ask you: What do you think we should be doing? What do you think the most practical activities are that we could engage in now, even over the course of this next year, to try to get something strongly done so that the next President coming in is not facing something like a depression and the consequences we would have to deal with would be much more complex and much more difficult?

I would appreciate it if—yes.

Dr. Bernstein. I——

Ms. Warren. Go ahead. You start.

Dr. Bernstein. I will be brief, because my testimony, which I commend to you in this regard—I am not saying you are going to agree with everything in there, but I wrote my testimony with that question in mind.

I espouse two points right off the bat:

I absolutely think that the way you are framing this question is exactly right. This is not a matter of waiting six, eight, twelve months until the next President and Congress can agree on what to do. I think we need to get started right away.

I articulate a set of five or six infrastructure investment ideas that are ready to go. These are off-the-shelf projects that are either underway and capital-restrained because of the ongoing downturn, or could be moved into production very quickly.

I believe these are critical in terms of American production and the preservation of our public capital stock, but also in terms of creating good jobs. But the second part, which we have not talked about, is that I believe there is a window that is narrowly open to implement very important reforms in our financial and mortgage market system.

These are critical markets in our economy that have historically operated efficiently, effectively, and productively but have been undermined by lack of oversight and by bad rules over the past decade or so.

I urge this body to take both of those steps.

Chairman Schumer. Thank you.

Representative Hinchey. Professor Warren.

Chairman Schumer. Sure.

Ms. Warren. If I could just add, and I will try to be brief, but let me just offer one more way because I agree with Dr. Bernstein, I think you have phrased this exactly right. You have framed the question right.

But much of the attention is all directed how at the top—rescuing Bear Stearns, rescuing Fannie and Freddie, and rescuing who knows who we are going to be asked to rescue next with American Taxpayer dollars.

Let me make a point about that. I think there are real questions about how much we can do at the top end. The Chairman of the Federal Reserve has been here to talk about reaching out and trying to do some regulation of nonbank financial institutions.

The reality is, those are a lot of electronic blips, and there is a real problem about they've moved to London, they've moved to Beijing and we have lost our control.

This bubble would never have inflated. The American family would never have been in this kind of trouble if we had had basic

safety regulations in place on all financial products, not just mortgages but mortgages, credit cards, payday loans, across the spectrum.

The reason this bubble could inflate the reason that money flowed into these markets, was because in a deregulated environment in effect the promise was made to investors that we can give you a risk-adjusted rate of return of 16 percent, 18 percent, 22 percent, and money came in.

The only way you could do that was if you were tricking the customer at the bottom end: selling them things they could not possibly pay for.

We did not create this problem at the top. This is not a problem of asset securitization or collateralized debt obligations. We created this problem at the bottom by permitting the sale of literally hundreds of millions of financial products across this country that can promise more than was possible to deliver.

That is why the money went in. That is why we created this bubble. That is why we are on the way down. And now the American Taxpayer who, thank you very much, paid for this on the front end has paid for it all the way through and now being asked to dig deeper into the family budget and pay for it on the way out.

Chairman Schumer. Thank you. Senator Klobuchar.

Senator Klobuchar. Thank you very much.

As we were talking about what was going on here, I was thinking that probably not many of the panelists had the privilege of seeing the "Kit Kittredge" American Girl Movie that I did with my daughter, but it was actually quite interesting because it was set during the Depression. And part of the story was about these families who were middle class, upper middle class families who were apparently doing fine, and they hid everything from people.

Then suddenly a foreclosure sign would come out, and their furniture would be carried out, but up to that point they had not told anyone about what was going on.

I think we see that time and time again with the subprime mortgage crisis. And my question is, first of all, Professor Warren, I know you have written about this overconsumption myth, this feeling I talk about with those Minnesota families who think somehow this is my fault, that I did this, when in fact the money that people have been spending on clothes and groceries have actually been spending less recently.

Could you talk a little bit about that?

Ms. Warren. Yes. I wish I had one of my charts here for this because the charts are really impressive. What has happened is that families have tightened their belt. We could look at this over a generation. We could look at it over the last seven years.

They have cut down in every discretionary spending area that they possibly can. They have cut down on what they spend on cars. The problem is now they are getting hit by gasoline. They had cut back on food. The problem is of course they are hit by rising prices.

In terms of consumption, they have cut back. They have cut back on clothing. They have cut back on floor covering. They have cut back on tobacco. They have not cut back on alcohol—I will not talk about whether or not these things are related to each other. The pressures on families.

But the key point to understand is that the American family has fundamentally shifted. It has big, fixed expenses. The expenses that have to be fed month after month. The mortgage, health insurance payments, the fact that you have to have two cars to get this family to work with both mom and dad in the work force.

Child care, an expense that a family a generation ago did not have. These families are paying more on these big fixed expenses, and that means when anything goes wrong this family cannot make it.

I just want to say this the way I say this to families, because I get the same message over and over and over:

I don't understand it. We shop at second-hand stores to buy clothes for our kids. We have not been to a movie in nine years. I can't live in the house my parents grew up in. I can't send my kids off to college the way my parents did.

The rules of the game have changed.

Senator Klobuchar. So in other words, where you try to save a nickel, save a dime, compared to these large fixed expenses is just not going to help them to make it. I am not saying they shouldn't do it, and they are, but that is the problem.

Ms. Warren. Exactly. You cannot save enough on Lattes, cut out enough Lattes, to pay for health insurance in America. It just cannot be done.

Senator Klobuchar. So you see the solution—and again you can answer this—but part of it is what you were just raising with the Congressman in looking at how we can help in terms of the credit that is extended, and trying to rein that in.

We can do the health care reform, the energy reform we have been talking about, but what do we do about these families that are just on the brink who we know—or we are lying to ourselves if we don't admit it—are going to teeter over the brink.

Is bankruptcy going to be their only protection? What can we do to stop that from happening?

Ms. Warren. It is the right question, Senator. Part of the answer is, yes, we do need a safety net on the bankruptcy side. But part of the answer—I do not want to sound like Johnny One Note on this—is about credit, at least not to make it worse to push these families over.

I think Dr. Bernstein is right when he says we have to think in terms of stimulus, how we create more jobs, how we put more people into the work force to try to give them a chance not to be the next statistics in terms of crashing and burning.

This is a critical moment in American history. There have never been, since the Depression, so many families standing right on the edge.

Senator Klobuchar. Dr. Bernstein, I appreciated you bringing up our bridge in Minneapolis. I did want to tell you, I think it is going to open in a month-and-a-half.

Dr. Bernstein. Wow.

Senator Klobuchar. It has been an amazing feat. It is six blocks from my house.

Dr. Bernstein. I will update my testimony.

Senator Klobuchar. Okay. But this eight-lane highway just one day in the middle of a sunny day just fell into the Mississippi River and is something that just should not happen in this country.

But it made me think very hard about this infrastructure issue, not only because of our bridge but what we are seeing in rural areas where we have this energy boon with the potential with wind, and more wear and tear on our highways, and our rail, and seeing at the same time when we look at another stimulus package, I just think at some point we have to have something that lasts longer than when those rebate checks are cashed.

Dr. Bernstein. Exactly.

Senator Klobuchar. And, we need to have more of a national focus on putting people to work by having tangible things that will last to actually help build our economy.

So could you elaborate a little bit on your infrastructure plan? Of course we know at this point when gas prices are so high we are most likely not going to raise the gas tax to pay for this, so we have to look at it as a job stimulus issue in order to get this infrastructure back on the table and going again.

Dr. Bernstein. Yes. I think it is interesting to recognize that these views that you and I are espousing are widely held.

The Chamber of Commerce—who does not necessarily agree with a lot of the things I argue for—ranks infrastructure as very high on their lists, public infrastructure, very high on their list of things that ought to be done.

Many such as Bill Gross, a renowned investment banker, says the same thing. These issues are I think well understood, the urgency.

One thing I will emphasize is that again this argument that infrastructure is inappropriate or a short-term stimulus is based on the notion that the lead time is too long. I have offered a number of examples that I think push back against that argument, but it is also important to recognize, as your question suggests, that these are long-term needs.

Secondly, recall that in the last two recoveries employment recovered long after output began to recover. We had the jobless recoveries. Jobless, wageless, income problems. Even though GDP was rising, unemployment rose for 19 months after the last recovery began in November of 2001.

So the idea that you have to have a short-term plug stimulus for infrastructure that is in there for three months and then ends is very wrong. These are projects that need to be undertaken.

We are going to have weakness in the job market that is likely to be protracted, and there are investments that private firms will not make. They simply cannot claim a return on them. So there are great rationales for pursuing these.

Chairman Schumer. Thank you, witnesses. Thank you, Senator Klobuchar. This was really an excellent hearing, and really talked about issues I think people of both parties have to talk about.

We have to do something about these things. We may have different policy prescriptions, but no one denies it is a real problem. It is not just a problem in the abstract. Millions of people are hurting every day and every week, and we thank you for shedding light on those.

I want to thank my colleagues for being here, and the hearing is adjourned.

[Whereupon, at 11:48 a.m., Wednesday, July 23, 2008, the hearing was adjourned.]

Submissions for the Record

JOINT ECONOMIC COMMITTEE
SENATOR CHARLES E. SCHUMER
CHAIRMAN

Opening Statement of Senator Charles E. Schumer
Chairman, Joint Economic Committee
Hearing: "How Much More Can American Families Be Squeezed By Stagnant Wages, Skyrocketing Household Costs, And Falling Home Prices?"
July 23, 2008

Good morning. I convened today's Joint Economic Committee hearing to examine the tightening Middle Class Squeeze -- the serious impact of rising household costs and stagnant wages in a slumping economy. We are fortunate to have a distinguished panel of experts to discuss the stranglehold these tough economic times have on middle class households.

There is a silent cry going out as middle class families gather around their dinner tables each night to talk about how to pay their ballooning bills. Middle class families are the engine of our economy, but their earning power and economic security has actually declined in the last seven years.

What are most American families talking about around their dinner tables? Perhaps they're discussing gas prices, which have more than doubled since 2001. They're probably talking about how much more their supermarket trip cost this week, or how they could be paying so much more for college tuition or child care or health care.

We have worked on many of these issues in the last year and a half here at the Joint Economic Committee – holding hearings on rising food prices, the energy crisis, unemployment, the economic costs of the Iraq war, and countless other kitchen table issues facing America's middle class. What we've learned is that all of these problems are serious and all affect real people everyday. We had a baker from Long Island talk about rising wheat prices and dwindling profit margins for his small business. We heard from folks who have firsthand experience with the subprime mortgage mess and have seen the rash of foreclosures in Slavic Village in Cleveland. And we have had veterans testify to the serious economic and health consequences of this war in Iraq.

I can tell you one thing Americans are NOT doing. Americans are not whining about the mental recession they are experiencing, as John McCain's top economic adviser, former Senator Phil Gramm might have you believe. This year's Republican presidential campaign isn't the only place to find questionable economic commentary.

Just last week, President Bush said, "I'm not an economist, but I do believe that we're growing. And I can remember this press conference here where people yelling 'recession this, recession that' -- as if you're economists. And I'm an optimist. I believe there's a lot of positive things for our economy."

At the end of February, President Bush was also caught by surprise when he was asked about predictions of $4 a gallon gas, he said, "That's interesting. I hadn't heard that."

It is views like these that prevented quick action on the part of this administration to respond to the subprime housing and credit crises last year, and delayed action on other measures to help Americans in danger of losing their jobs or cope with skyrocketing energy costs.

When Americans hear President Bush and John McCain address serious economic concerns, it is like they are on a different planet entirely. It is no wonder that American families today are feeling increasingly anxious about their jobs, their wages, and their economic security. Every day it seems we learn more bad news about the economy:

Last week we learned that the already anemic housing market continues to plummet. Sales of existing homes fell an additional 4.7 percent in May – down 14 percent from where they were a year ago; and foreclosures are up over 50 percent from last year. By all accounts the bottom is nowhere in sight, leaving millions of Americans with less access to credit and increasingly worried about whether they owe more on their homes than they are worth.

The June Labor report showing that the country lost another 62,000 jobs last month – marking the 6th straight month of job losses and bringing the total number of jobs lost just this year to almost 440,000. More than 8.5 million Americans are unemployed; 2.5 million more than were unemployed in 2001 when President Bush took office. Underemployment is nearly 10 percent, and unemployment rates for blacks and Hispanics are far higher than the national unemployment rate of 5.5 percent.

And last week the Consumer Price Index data for June showed that inflation jumped over 1 percent, the second highest monthly rise in 26 years. **So now we're now seeing danger for the economy on both sides -- growth is too slow and inflation is too high and for the first time worries about stagflation are getting real.**

It isn't time for us to throw up our hands and say forget it. In fact, your testimonies, while shedding light on the difficult economic times at hand for most American families, also suggest that we can do much better. Hopefully Washington won't need any more wake up calls to shore up our battered housing and job markets and take some proactive steps to address our energy crisis. I'm looking forward to our witnesses' testimonies and ideas to address some of these problems.

I am happy now to turn to the Ranking Republican Jim Saxton from New Jersey for an opening statement. He'll be followed by Vice Chair Maloney, who just released a JEC report on women and recession. I encourage all members to make brief opening statements today.

Witnesses:

- **Elizabeth Warren**, Leo Gottlieb Professor of Law, Harvard Law School
- **Dr. Jared Bernstein,** Senior Economist, Economic Policy Institute
- **Kristen Lewis,** Co-Director, *American Human Development Project*
- **David Kreutzer,** Senior Policy Analyst, Heritage Foundation *(Republican witness)*

CONGRESS OF THE UNITED STATES

JOINT ECONOMIC COMMITTEE

Congressman Jim Saxton
Ranking Republican Member

PRESS RELEASE

For Immediate Release
July 23, 2008

Press Release #110-46
Contact: Christopher Fre
Republican Staff Directo
(202) 225-3923

OPENING STATEMENT OFCONGRESSMAN JIM SAXTON
Ranking Republican Member

It is a pleasure to join in welcoming the panel of witnesses before us today. We are all concerned about the increases in the cost of living that threaten to erode American living standards.

As I talk to my constituents in New Jersey, the number one concern on their minds is the high cost of oil and gasoline. This year, the oil price has risen about 40 percent so far, with further price increases a distinct possibility. These higher energy costs leave families with less money to cover other expenses, such as food. Of course, rising food prices also reflect higher costs for fertilizer, transportation, packaging, and the impact of our ethanol tariff, among other things. As a first step we should repeal the ethanol tariff, and also seek to produce more energy here in the United States.

With gasoline and food prices surging, it is no wonder that incomes and wages adjusted for the cost of living are stagnating. Unfortunately, Congress has done little except pass more farm subsidies that increase food prices, and ignore the need to produce more domestic energy. Many American families are experiencing economic stress due to high energy and food prices, but Congress is not acting to address their concerns.

There are a number of different measures of household income, and different ways to interpret them. The nonpartisan Congressional Budget Office (CBO) publishes a comprehensive measure of household income trends as well as taxes. I recently asked CBO to supplement these data by providing a measure of real median after-tax household income. The most recent year for which these CBO data are available is 2005. This measure shows a gain of 5.3 percent since 2000 and 26.8 percent since 1980. The 2005 level of $55,900 includes various benefits as well as the effect of tax changes.

The moderate increase since 2000 does not mean that many families are not experiencing hardship, but it does put some of the other data into perspective. It is also important to recall that there is quite a lot of income mobility in the economy. A recent Treasury study on income mobility found that the median income of all taxpayers increased by 24 percent between 1996 and 2005, after adjustment for inflation.

Other measures of income show less positive results. The reference period chosen can also be important. For example, Census Bureau data can be used to suggest that median income began to stagnate between 2000 and 2006. However, the stagnation in this measure actually started in the 1999-2000 period. In other words, the trend started in the last year of the Clinton Administration, not the first year of the Bush Administration. Neither administration had much to do with causing it, but those unaware of the facts might think the trend was triggered by the current Administration's economic policies.

Another issue that often arises is the increase in income inequality, with suggestions this has worsened significantly in recent years. However, the CBO data show that inequality rose most rapidly in the 1990s. For example, between 1992 and 2000, the income share of the top 1 percent surged from 12.3 to 17.8 percent, a startling increase of 5.5 percentage points. Since 2000, this income share has edged up by only three-tenths of a percentage point. In summary, the increase in inequality during the 1990s was much, much greater than anything since 2000.

The ongoing decline in housing prices is something many American families are right to be concerned about. Government policies promoting homeownership may have been useful up to a point, but they contributed to a giant housing bubble that has now burst, causing widespread problems. For example, the regulations finalized in 2000 by HUD encouraging Fannie Mae and Freddie Mac to finance more subprime mortgages is only one part of a much larger policy

failure. Both institutions are too highly leveraged but have manipulated the political system to the point that an expensive taxpayer bailout unfortunately may become the only realistic option.

In closing, American families face a number of challenges. Unfortunately, Congress has failed to help address them. The Congress has acted to support high food prices and not acted to reduce high oil prices. Congress has coddled Fannie Mae and Freddie Mac, institutions that contributed to creating the housing bubble and now threaten to cost taxpaying families many billions of dollars in bailouts. The economic problems now confronting the country have their origins in mistakes made by both public officials as well as private parties, so there is plenty of blame to go around. The truth is that government policy has contributed to the challenges currently faced by American families, and ill-considered policies are capable of doing even greater damage.

###

JOINT ECONOMIC COMMITTEE
SENATOR CHARLES E. SCHUMER, CHAIRMAN
REPRESENTATIVE CAROLYN B. MALONEY, VICE CHAIR

Statement of Carolyn Maloney, Vice Chair
Joint Economic Committee Hearing
July 23, 2008

Good morning. I would like to thank Chairman Schumer for holding this hearing to examine the middle class squeeze and to the witnesses, thank you for speaking with us today.

While my district, New York's 14th, is lucky enough to rank the highest on the American Human Development Project's well-being index, economic insecurity lurks in all corners of the nation during this downturn.

Families are being squeezed from all sides. Unemployment is rising and private employers have shed over half a million jobs so far this year.

We learned from a report the Joint Economic Committee released yesterday, which I requested, that both men and women were hurt in the most recent recession, in 2001, and that the weak recovery led women's employment rates to stop rising, a sharp departure from the trend over the latter half of the 20th century.

Wives and mothers may no longer be able to shelter their families from the economic storm that's hitting now. Over the past three decades, only families who have a working wife have seen real increases in family income. Higher job losses for women will be devastating for families.

Rising job losses are occurring alongside rising prices and falling real wages. Families are spending more and more on the rising costs of basic necessities, like gasoline and milk, leaving little left for much of anything else.

Annual wage growth has fallen for the past eight months. Adjusting for higher prices, wages are lower today than they were over a year and a half ago.

Too many families have lost ground on President Bush's watch. The weak recovery has left families heading into the current downturn with income that is about $1,000 lower than it was when President Bush took office.

Families coped with the lack of income gains by taking on more debt, but this is no longer an option. As Elizabeth Warren will speak about today, over the economic recovery of the 2000s, families took on more debt of all kinds. Much of it was mortgage debt, but there were also sharp increases in consumer debt.

Now, families are seeing falling home values, rising foreclosures, and tightening credit conditions. Millions have little to fall back on if the economy continues to deteriorate.

The Federal Reserve has now joined me in recognizing that greater consumer protections are needed so that the credit card house of cards does not come crashing down next.

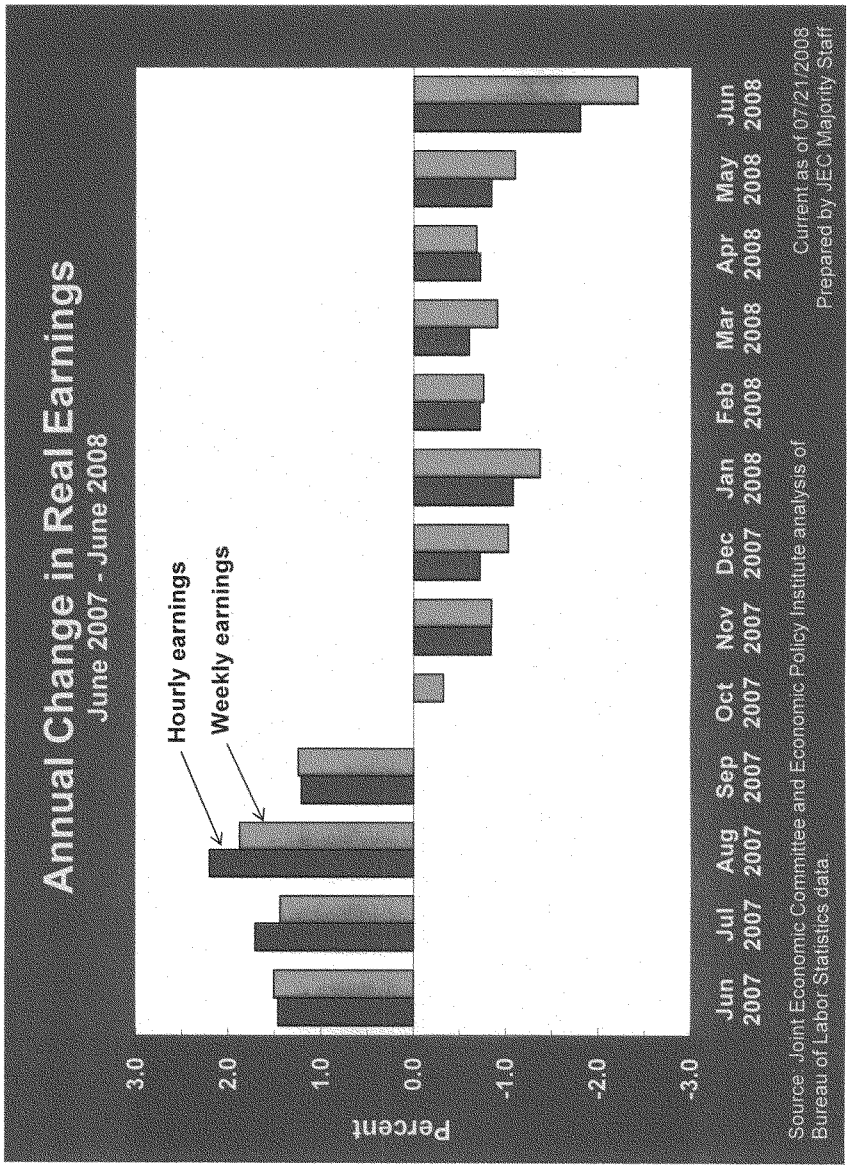
Congress has already taken steps to help blunt the effects of the downturn on families by passing the first stimulus package and by extending unemployment benefits to the long-term unemployed. We can see the boost from the Recovery Rebates in the upticks in personal income and retail sales last month, but the data show that we still must do more.

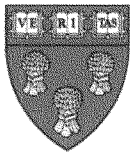
The President should work with Congress to enact a second stimulus package of aid to the states and infrastructure investment to get the economy back on track.

Over half of the states are projecting budget shortfalls for fiscal year 2009 and this will lead not only to cutbacks in necessary services, but likely higher unemployment – especially for women who disproportionately work in social service agencies and education.

Mr. Chairman, thank you for holding this hearing and I look forward to gaining some insights into what we can do to help America's working families.

###


Annual Change in Real Earnings
June 2007 - June 2008
Hourly earnings
Weekly earnings
Percent
3.0
2.0
1.0
0.0
-1.0
-2.0
-3.0
Jun 2007
Jul 2007
Aug 2007
Sep 2007
Oct 2007
Nov 2007
Dec 2007
Jan 2008
Feb 2008
Mar 2008
Apr 2008
May 2008
Jun 2008
Source: Joint Economic Committee and Economic Policy Institute analysis of Bureau of Labor Statistics data
Current as of 07/21/2008
Prepared by JEC Majority Staff



HARVARD LAW SCHOOL
CAMBRIDGE, MASSACHUSETTS

ELIZABETH WARREN
LEO GOTTLIEB PROFESSOR OF LAW

PHONE: 617 495 3101
FAX: 617 496 6118
EWARREN@LAW.HARVARD.EDU

Testimony of

Elizabeth Warren
Leo Gottlieb Professor of Law
Harvard Law School

Before the
Joint Economic Committee
of the United States Senate
and
the United States House of Representatives

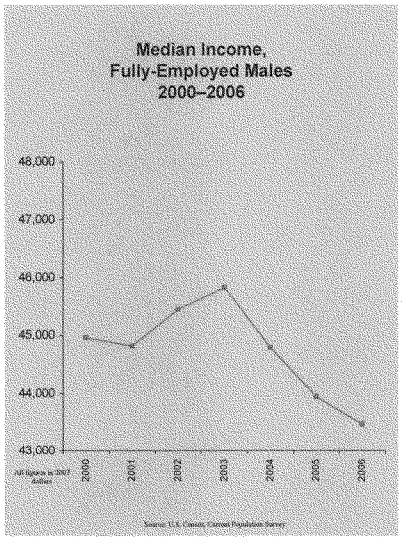
Hearing: How Much More Can Consumers Be Squeezed by Stagnant Income, Skyrocketing Housing Costs, and Falling Home Prices?
July 23, 2008

Losing Ground:
Middle Class Families 2000-2007

Thank you for this opportunity to speak to the Joint Economic Committee on the economic condition of American families.[1]

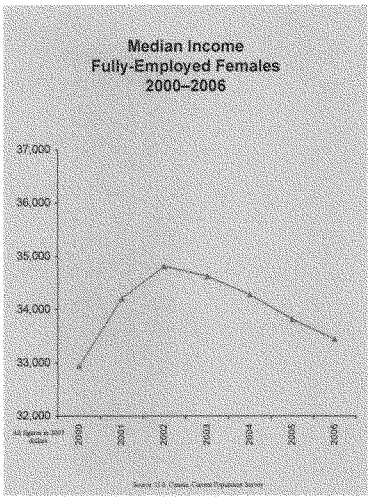
For many families in America, the recession did not begin in the past six months. The real recession began seven years ago. From 2000 to 2007, measured in real dollars, incomes declined while basic expenses increased sharply. The difference is sharp, with incomes declining by over $1000, and a handful of basic expenses increasing by more than $4000.

By every measure, incomes are down—down for fully employed males, down for fully employed females, down for households. *Adjusted for inflation, median household income has declined across America by $1175.*

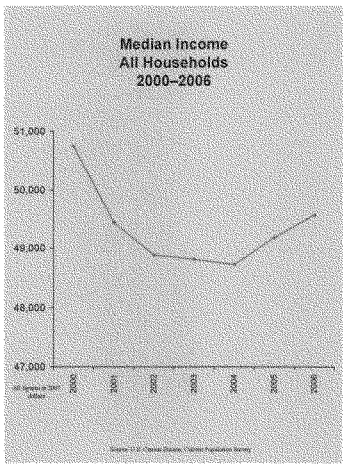


[1] *A note about the data:* All the economic data quoted here come from published government sources. All the numbers have been adjusted to constant 2007 dollars to account for inflation. The data are the latest available. Because the government reports for different economic indicators come out on different schedules, there is some mixing of 2007 and 2008 numbers. This work was completed with the valuable contributions of Eric Nguyen, Harvard Law School Class of 2009.

For women working full-time, incomes initially rose, then also declined.



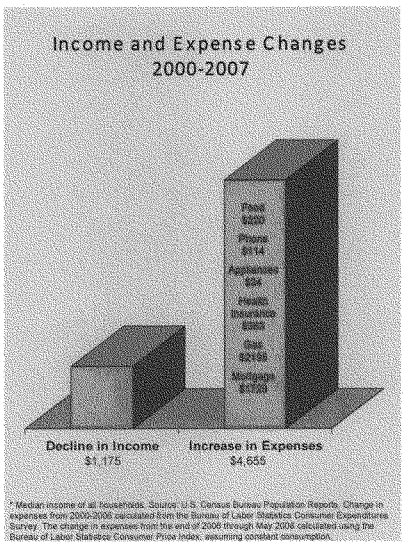
With pressure on wages for both men and women, households have coped as best they can. Even so, from 2000 to 2007, household income registered a net loss.



The problems brought on by lower annual incomes were exacerbated by rising expenses.

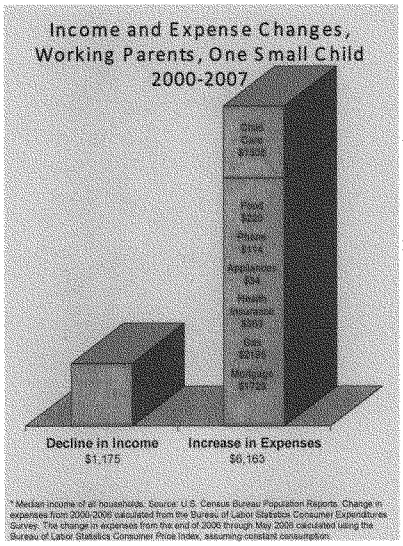
Every American family has been looking for ways to cut expenses, but some expenses have been hard to cut. The most current story is in gasoline: Families making the same commute are spending an average of $2195 more for gas than they did in 2000. (The costs discussed here are the official figures from May 2008, omitting the most recent price shocks.)

Increases in mortgage costs took another big bite—$1729 annually. A falling housing market means that many families struggling with ballooning mortgages can neither refinance nor move. They either pay or default.

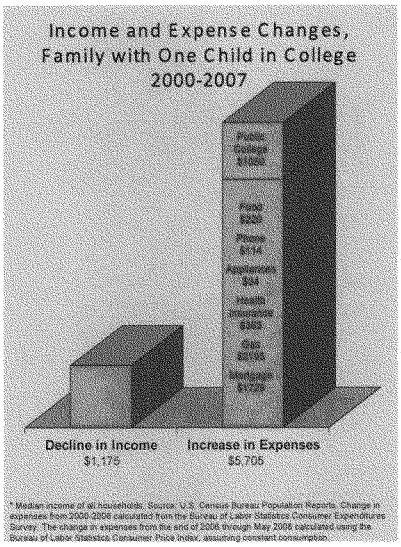


Increases in health insurance, food, basic telephone, and appliances knocked another $731 hole in the family budget. Increases in these unavoidable expenses—gas, mortgage, food, health insurance, appliances and phone—mean that the average family is spending $4655 more for this handful of basic expenses than they did in 2000.

The burden has been even greater for working families with children. Child care costs for a child under five increased by $1508—more than $125 a month. For those with an older child, the cost of after-school care increased by $622.



All parents, regardless of the ages of their children, have watched with alarm as the costs for college spiraled upward. At a time when hundreds of thousands of good paying blue-collar jobs have disappeared, families have seen a college diploma as their children's best chance for a secure economic future. But the costs of college keep growing. From 2000 to 2007, the net cost of state college (including scholarships and grants) increased by $1050.



The numbers tell the story from 2000 to 2007. At the same time that incomes are down across the board, about $1175 for a typical household, real expenses for an average family have shot up. Here are the changes in what average Americans are spending.

• Higher Mortgage Payments	$ 1729
• Higher Gas Bills[2]	$ 2195
• Higher Food Costs	$ 220
• Higher Phone Bills (land line)	$ 114
• Higher Appliance Costs	$ 34
• Higher Health Insurance Costs	$ 363
Total Increased expenses	$ 4855[3]

[2] Consumers spent $1052 more on gasoline in 2006 than they did in 2000. Gas prices in May 2008—the most recent data available from the government—were more than 45 percent higher than the average price in 2006—and nearly 150 percent higher than in 2000. Assuming that consumption in May 2008 was the same as the average monthly consumption in 2006, the latest year for which we have data, consumers are projected to spend $2195 more on gas in 2008 than they did in 2000. The average family would have to cut consumption by 50 percent to avoid spending more than it did in 2000, or by about 25 percent just to get back to 2006 spending levels. See Appendix for more details.

[3] As noted above, median household income, adjusted for inflation, declined by $1175 between 2000 and 2006. For the average family of four, the increase in inflation-adjusted cost of living was more dramatic. One way to understand this is to compare the actual expenditures—not the weighted basket of the CPI—families reported making in 2000 with the actual expenditures in 2006. The difference is more than $3000 for the average family:

Mean expenditures by a family of four in 2000 was $52,021—$62,637 in 2007 dollars.
Mean Expenditures in 2006 were $63,897—$65,717 in 2007 dollars.
Difference = $3080.

These data are derived from the 2000 and 2006 Consumer Expenditure Survey published by the Bureau of Labor Statistics. Detailed expenditures appear in Table 1400, "Size of consumer unit: Annual means, standard errors and coefficient of variation."

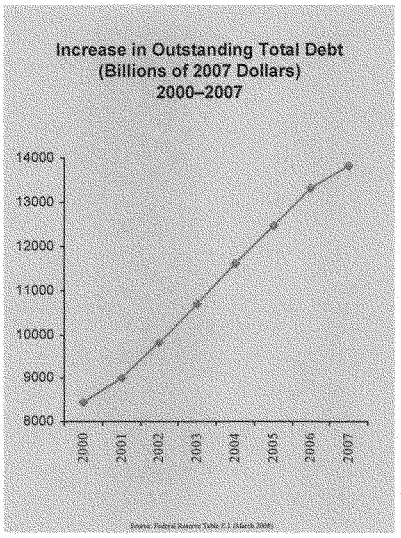
To be sure, some real costs have declined slightly. But the consequences of substantial deviations between the CPI and actual expenses in some areas (e.g., housing), the failure of the CPI basket of goods to reflect actual purchasing patterns, and the significant increases in large *necessary* expenditures on items such as homes, gas, food, and heath insurance mean that the financial pressure on families is growing. Cost increases between 2006 and today—including gas prices nearly fifty percent higher—have increased the pressure even more.

For families with children, there are even more cost increases:

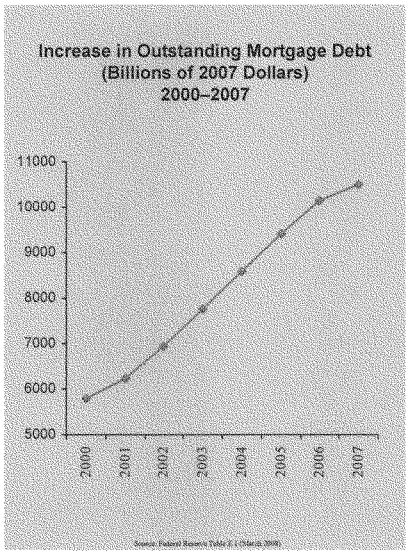
- Increased day care expenses $ 1508
- Increased after school care cost $ 622
- Increased state college costs (net) $ 1050

With median household income of $48,200, these cost increases tear a hole in the budget that is almost impossible to close.

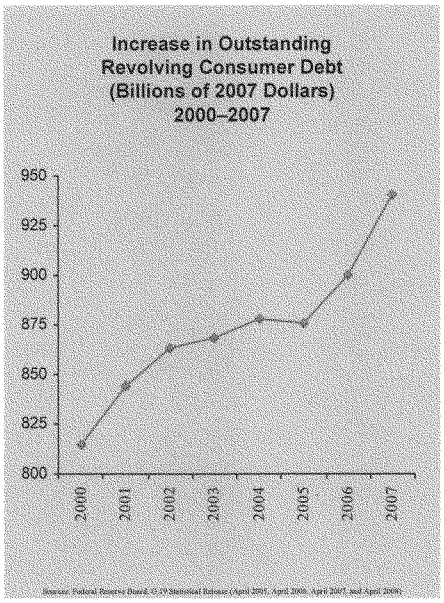
It is no surprise that millions of families have turned to debt to try to bridge the gap between their incomes and their expenses. Debt of every kind has increased sharply.



Much of that debt was mortgage debt—driven upward by rising prices for homes. But refinancing and home equity lines of credit were also used to pay off credit cards, to pay for college and to finance medical bills. Those debts must now all be repaid or families will lose their homes.



The difficulties facing families who are unable to pay their mortgages and home equity lines of credit have grabbed all the headlines, but families are struggling with credit card debt, car payments, student loans and payday loans. Debts must be repaid—and that is more money out of tomorrow's budget. Worse yet, debts represent an additional expense as future income goes to interest payments, fees and penalties—money that simply evaporates from their paychecks.



Credit cards provide one example of the stress for middle class families. Year after year, credit cards have generated record-breaking profits. Their revenues have increased substantially. In 2007, all-purpose cards generated $117 billion, up from $115 billion in 2006 and up from $110

billion in 2005. The breakdown in card income shows that most money comes from those customers who cannot pay in full each month.[4]

Consumer spending on Credit Cards, 2007
(in billions)

Interest	$75.45
Interchange	23.56
Penalty fees	7.54
Cash advance fees	5.60
Annual fees	4.60
Enhancements	1.01

The impact of these numbers at a household level is staggering. About 43.5% of all households in the US carry a balance on their credit cards.[5] For those who carry debt, the average debt per household in 2006 was reported as an astonishing $8,467.[6] Since then, debt has continued to grow. A household earning the median income would have to turn over every paycheck for nearly three months to pay that bill.[7] Of course, they would have to find a way to stop eating, stop paying rent, stop driving to work, stop making car payments, and, most importantly, stop the interest from continuing to accumulate on their debt loads.

Money spent to service debt is money not spent on to buy goods and services. Credit card debt now consumes a sizeable portion of a family's income, leaving families with less to spend elsewhere. Currently, nearly 10 percent of total disposable income in the U.S. is committed to revolving debt.[8]

---

[4] "Exclusive Bankcard Profitability Study and Annual Report 2008," *Cards & Payments*, at 37 (May 2008); "Bankcard Profitability 2007," *Cards & Payments*, at 27 (May 2007), *available at* http://www.cardsandpayments.net.

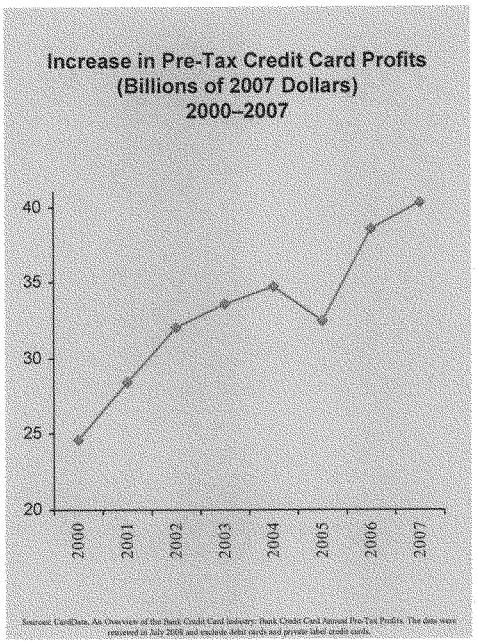
[5] As of 2004, the Survey of Consumer Finance documented that three-fourths (74.9%) of all households held at least one credit card, and 58% of those with credit cards carried balances. Other estimates place those with balances even higher. CardData reports that in 2006, 61.3% of cardholders *consistently* revolved a balance. http://www.carddata.com.

[6] *Bank Credit Card Annual Revolving Balances Per Carded Households*," CardData.com (data are calculated excluding "balances paid-off before interest accrues; also excludes commercial cards, debit cards and private label credit cards").

[7] Median household income in the U.S. in 2007 was $48,201. http://www.census.gov/prod/2007pubs/p60-233.pdf at 4.

[8] Calculations from Federal Reserve Bank, Flow of Funds Accounts (March 2008); Table B-77, Economic Report of the President (2008). Revolving debt was $937 billion in November 2007.

In effect, a huge wealth transfer is taking place. Families, facing stretched thin by rising costs for food, gasoline, and health care, turn to credit cards to make it to the end of the month. An unexpected expense—a medical emergency, a cut-back in hours—can send the debt load spiraling. Over time, as expenses keep rising, families pay off a little less, and their debt balances grow. Credit issuers take a bigger and bigger bite of each paycheck, as interest and fee revenues keep expanding. The news is good for the credit card companies, with year after year of record-breaking profits. But it is bad news for the families generating those profits.



This graphic could be replicated in other industries, as American families have handed over more money for mortgages and more money for payday loans. The point, however, is that in addition to their other expenses to keep their families afloat, a growing number of families must also shoulder the burden of debt. Families are caught in a spiral of lower

incomes, higher expenses, and a debt load that must be paid with interest and fees.

The income, expense and debt numbers are particularly disturbing because economists tell us that the boom is over the economy is heading toward recession. In past years, families got ahead during boom times so that they hit recessions with some cushion. But the boom of the early 2000s bypassed working families, leaving them in a deeper hole at the end of the cycle than they were at the beginning. This time around, boom times made the rich richer, but ordinary working people got poorer—and that will make the coming hard times even harder.

The wave of mortgage foreclosures is the first sign of extraordinary stress on the middle class. But there are signs of more trouble to come. Spiraling debt loads signal future economic stress, with no obvious exit strategy in sight. If household earnings continue to decline, households are caught between decreasing consumption and defaulting on their loans. Both have significantly negative effects on the economy, and both exert additional downward pressure on job opportunities and wages. In short, as the middle class weakens, the economy weakens, creating a downward cycle.

Day-by-Day for an American Family

Anxiety has become a constant companion for Americans struggling with rising costs and stagnating incomes. Families have cut the fat out of their budget; now they are cutting bone. Last year 18% of Americans did not seek needed medical treatment because of the cost, and 17% did not have prescriptions filled because they could not pay.[9] Today about one in every seven families is dealing with a debt collector.[10] Forty percent of families worry whether they can make all their payments every month.[11]

In 2006, a then-record 1.3 million families received foreclosure notices, followed by another 2.2 million families who were in foreclosure in

[9] The Rockefeller Foundation, American Worker Survey (2007).
[10] Tom W. Smith, Troubles in America: A Study of Negative Life Events, National Opinion Research Council (December 2005); Lucy Lazarony, Denying Our Debt, Bankrate.com (July 2006 (11% in collection on credit cards).
[11] Consumer Federation of America, Rising Energy Costs Dampen Holiday Spending Plans (November 19, 2007).

2007.[12] At the current rate of foreclosures, there will be about 3 million in 2008.[13]

Americans are optimistic by nature, but their future is not looking bright. Of those lucky enough to have health insurance, 27% are worried that they could not afford a major hospital stay.[14] Forty percent worry about how they will pay for college for their children, and 58% say they are not saving enough for retirement.[15] One in five Americans is losing hope, saying that even when they don't count their mortgages, they expect to die still owing money to their creditors.[16]

Seven years of flat or declining wages, seven years of increasing costs, and seven year of mounting debts have placed unprecedented stress on the ordinary families. By every critical financial measure, these families are losing ground. Without changes in critical economic policies, the strong middle class that has been the backbone of the American economy and the American democracy is in jeopardy.

---

[12] Nationwide Foreclosures Jumped 75% in 2007, Credit & Collections World (Feb. 8, 2008), *available at.* http://www.creditcollectionsworld.com/article.html?id=20080129S4FTCWQT&from=creditandcollectionnews.

[13] The mid-year update, shows even higher levels for 2008, averaging 250,000 foreclosures per month. http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=4873&accnt=64847). Foreclosures increased 50% from June 2007 to June 2008.

[14] The Rockefeller Foundation, American Worker Survey (2007).

[15] Id.

[16] Smart Borrow Survey, Marketwise, prepared with support from Lending Tree, at 145 (April 2007).

Data Appendix: Income

Income for Fully Employed Men[17]

Between 2000 and 2006, median income of fully employed males fell **$1494**.

In 2000: 37,339 (inflated to 44,959)
In 2001: 38,275 (inflated to 44,811)
In 2002: 39,429 (inflated to 45,444)
In 2003: 40,668 (inflated to 45,827)
In 2004: 40,798 (inflated to 44,781)
In 2005: 41,386 (inflated to 43,938)
In 2006: 42,261 (inflated to 43,465)

Between 2000 and 2006, median income of all households fell **$1175.**

In 2000: 42,148 (inflated to 50,749)
In 2001: 42,228 (inflated to 49,439)
In 2002: 42,409 (inflated to 48,878)
In 2003: 43,318 (inflated to 48,813)
In 2004: 44,389 (inflated to 48,723)
In 2005: 46,326 (inflated to 49,182)
In 2006: 48,201 (inflated to 49,574)

[17] Values inflated to 2007 dollars. Data for income in 2000: U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS: CONSUMER INCOME, MONEY INCOME IN THE UNITED STATES: 2000, P60-213, at tbl.A, *available at* http://www2.census.gov/prod2/popscan/p60-213.pdf. For 2001: U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS: CONSUMER INCOME, MONEY INCOME IN THE UNITED STATES: 2001, P60-218, at tbl.1, *available at* http://www2.census.gov/prod2/popscan/p60-218.pdf. For 2002: U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS: CONSUMER INCOME, MONEY INCOME IN THE UNITED STATES: 2002, P60-221, at tbl.3, *available at* http://www2.census.gov/prod2/popscan/p60-221.pdf. For 2003: U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS: CONSUMER INCOME, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2003, P60-226, at tbl.1, *available at* http://www2.census.gov/prod2/popscan/p60-226.pdf. For 2004: U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS: CONSUMER INCOME, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2004, P60-229, at tbl.1, *available at* http://www2.census.gov/prod2/popscan/p60-229.pdf. For 2005: U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS: CONSUMER INCOME, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2004, P60-231, at tbl.1, *available at* http://www2.census.gov/prod2/popscan/p60-231.pdf. For 2006: For 2006: U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS: CONSUMER INCOME, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2006, P60-233, at tbl.1, *available at* http://www2.census.gov/prod2/popscan/p60-233.pdf.

Between 2000 and 2006, median income of all family households fell **$712**.

In 2000: 51,751 (inflated to 62,312)
In 2001: 52,275 (inflated to 61,202)
In 2002: 52,704 (inflated to 60,743)
In 2003: 53,991 (inflated to 60,840)
In 2004: 55,327 (inflated to 60,728)
In 2005: 57,278 (inflated to 60,810)
In 2006: 59,894 (inflated to 61,600)

The number of full-time employees has increased more rapidly than the number of part-time employees. Between January 2000 and December 2007, the number of part-time workers increased 6.4 percent (from 23,233,000 to 24,740,000). Full-time employment has increased 7.3 percent (from 113,189,000 to 121,428,000). *See* Bureau of Labor Statistics, Labor Force Statistics, Series LNS12600000 (part-time) and Series LNS12500000 (full-time).

Data Appendix: Expenses[18]

Mortgages[19]

Between 2000 and 2006, expenditures on mortgages rose $1681 in 2006 dollars.

Expenditures in 2000: $8977 (inflated to $10,510 in 2006 dollars)
Expenditures in 2006: $12,191
Increase: $1677.86 (1729 in 2007 dollars)

*No BLS Update on mortgage costs.

Gas[20]

Between 2000 and 2006, expenditures on gas rose $1023 in 2006 dollars.

Expenditures in 2000: $1813 (inflated to $2123 in 2006 dollars)

---

[18] Government expense data at this level of detail are reported by means, not medians. Income data used in this testimony are reported by medians. This makes direct comparisons more challenging. The impact of this difference in reporting, however, is likely to be modest. Unlike income data, which are right-biased and suffer from substantial distortions when the incomes of billionaires are included in means, expense data are more compressed. See, Eric S. Nguyen, Parents in Financial Crisis: Fighting to Keep the Family Home, 82 Am. Bankr. L.J. 229, 233 n.15 (2008).

> "Wealthier families are likely to spend more on necessary expenditures, but they will devote a smaller share of total income to them. See, e.g., Jean-Thomas Bernard, Denis Bolduc, and Donald Belanger, Quebec Residential Electricity Demand: A Microeconomic Approach, 29 CAN. J. ECON. 92–113 (1996) (income elasticity of demand for electricity is 0.1); Teresa Garin Munoz, Demand for National Telephone Traffic in Spain from 1985–1989: An Econometric Study Using Provincial Panel Data, 8 INFO. ECON. & POL'Y 51–73 (1996) (income elasticity of demand for telephone service is 0.5); cf. Michael R. Baye, Dennis W. Jansen, and Jae-Woo Lee, Advertising Effects in Complete Demand Systems, 24 APPLIED ECON. 1087–96 (1992) (income elasticity of demand for clothing is 1)."

[19] Data for consumption in 2000 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2000, *available at* http://www.bls.gov/cex/2000/stnderror/cusize.pdf. Data for consumption in 2006 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2006, *available at* http://www.bls.gov/cex/2006/stnderror/cusize.pdf.
Calculation of 2000 and 2006 total mortgage costs as reported by BLS:
In 2000: $6643 / 74% reporting = $8977 per respondent
In 2006: $9265 / 76% reporting = $12,191 per respondent

[20] Data for consumption in 2000 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2000, *available at* http://www.bls.gov/cex/2000/stnderror/cusize.pdf. Data for consumption in 2006 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2006, *available at* http://www.bls.gov/cex/2006/stnderror/cusize.pdf. Data on the increase in gasoline costs from 2006 (average) through May 2008 are reported by the Bureau of Labor Statistics in its Consumer Price Index for All Urban Consumers, series CUUR0000SETB01 (U.S. City Average, Gasoline (All Types)).

Expenditures in 2006: $3146
Increase: $1023 (1052 in 2007 dollars)

Between 2006 and May 2008, the cost of gas increased by 45.42 percent (index moved from an average of 128.6 in 2000 to an average of 219.9 in 2006 to 319.8 in May 2008). *Assuming that consumption remained the same between 2006 and May 2008*, expenditures on gasoline have gone up $2195 (in 2007 dollars) since 2000.

Expenditures in 2000: $1813 (inflated to $2123 in 2006 dollars)
Expenditures in 2006: $3146
Expenditures in 2008: $4575 (deflated to $4258 in 2006 dollars)
Increase: $2135 in 2006 dollars (re-inflated to $2195 in 2007 dollars)

Food[21]

Between 2000 and 2006, expenditures on food rose $205 in 2006 dollars.

Expenditures in 2000: $7122 (inflated to $8338)
Expenditures in 2006: $8543
Increase: $204 (inflated to $210 in 2007 dollars)

Between 2006 and May 2008, the nominal cost of food increased by 7.57 percent (index moved from an average of 197.0 in 2006 to 211.918 in May 2008). Assuming that consumption remained the same, expenditures on food have gone up $220 (in 2007 dollars) since 2000.

Expenditures in 2000: $7122 (inflated to $8338 in 2006 dollars)
Expenditures in 2006: $8543
Expenditures in 2008: $9190 (deflated to $8552)
Increase: $214 in 2006 dollars (inflated to $220 in 2007 dollars)

Basic Phone Service[22]

---

[21] Data for consumption in 2000 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2000, *available at* http://www.bls.gov/cex/2000/stnderror/cusize.pdf. Data for consumption in 2006 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2006, *available at* http://www.bls.gov/cex/2006/stnderror/cusize.pdf. Data on the increase in food costs from 2006 (average) through May 2008 are reported by the Bureau of Labor Statistics in its Consumer Price Index for All Urban Consumers, series CUSR0000SAF1 (U.S. City Average, Food, Seasonally Adjusted).

[22] Data for consumption in 2000 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2000, *available at* http://www.bls.gov/cex/2000/stnderror/cusize.pdf. Data for consumption in 2006 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2006, *available at* http://www.bls.gov/cex/2006/stnderror/cusize.pdf. Data on the increase in telephone costs from 2006

Between 2000 and 2006, expenditures on telephone service (land line) rose $142 in 2006 dollars.

Expenditures in 2000: $1108 (inflated to $1297 in 2006 dollars)
Expenditures in 2006: $1439
Increase: $141 (inflated to $145 in 2007 dollars)

Between 2006 and May 2008, the cost of telephone service increased by 5.07 percent (index moved from an average of 69.6 in 2006 to 73.127 in May 2008). Assuming that consumption remained the same, expenditures on telephone service have gone up $109 (in 2006 dollars) since 2000.

Expenditures in 2000: $1108 (inflated to $1297 in 2006 dollars)
Expenditures in 2006: $1439
Expenditures in 2008: $1512 (deflated to $1408)
Increase: $111 in 2006 dollars (inflated to $114 in 2007 dollars)

Major appliances[23]

Between 2000 and 2006, expenditures on major appliances rose $52 in 2006 dollars.

Expenditures in 2000: $260 (inflated to $304 in 2006 dollars)
Expenditures in 2006: $356
Increase: $52 (53 in 2007 dollars)

Between 2006 and May 2008, the cost of major appliances increased by 1.55 percent (index moved from an average of 88.0 in 2006 to 89.364 in May 2008). Assuming that consumption remained the same, expenditures on appliances have gone up $41 (in 2006 dollars) since 2000.

Expenditures in 2000: $260 (inflated to $304 in 2006 dollars)
Expenditures in 2006: $356
Expenditures in 2008: $362 (deflated to $337)
Increase: $33 in 2006 dollars (34 in 2007 dollars

(average) through May 2008 are reported by the Bureau of Labor Statistics in its Consumer Price Index for All Urban Consumers, series CUSR0000SEED02 (U.S. City Average, Land-line Telephone Services, Long Distance Charges).

[23] Data for consumption in 2000 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2000, *available at* http://www.bls.gov/cex/2000/stnderror/cusize.pdf. Data for consumption in 2006 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2006, *available at* http://www.bls.gov/cex/2006/stnderror/cusize.pdf. Data on the increase in appliance costs from 2006 (average) through May 2008 are reported by the Bureau of Labor Statistics in its Consumer Price Index for All Urban Consumers, series CUSR0000SEHK (U.S. City Average, Appliances).

Health Insurance[24]

Between 2000 and 2006, expenditures on health insurance rose $318 in 2006 dollars.

Expenditures in 2000: $1620 (inflated to $1897 in 2006 dollars)
Expenditures in 2006: $2250
Increase: $352 (363 in 2007 dollars)

*No BLS Update on health insurance costs.

Child Care[25]

Between 1999 and 2005, expenditures on child care rose either $497 (child 5-14) or $1017 (child under 5) in 2006 dollars

For a child under age 5:

Expenditures in 1999: $5148 (inflated to $6229.51 in 2006 dollars)
Expenditures in 2005: $7246.45
Increase: $1017 (1046 in 2007 dollars)

---

[24] Data for consumption in 2000 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2000, *available at* http://www.bls.gov/cex/2000/stnderror/cusize.pdf. Data for consumption in 2006 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2006, *available at* http://www.bls.gov/cex/2006/stnderror/cusize.pdf.
Calculation of 2000 and 2006 health insurance costs as reported by BLS:
In 2000: $1061.70 - $43.42 (Medicare) = $1018.28 / 62.8% reporting = $1620 per reporter
In 2006: $1512.69 - $101.72 (Medicare) = 1410.97 / 62.7% reporting = $2250 per reporter
Medicare costs are available from Prepublished Table 1400, available from BLS. Fraction reporting was reported in personal email communication from BLS.

[25] Data for consumption in 2000 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2000, *available at* http://www.bls.gov/cex/2000/stnderror/cusize.pdf. Data for consumption in 2006 are from the following source: Bureau of Labor Stat., Table 1400: Size of Consumer Unit: Annual Means, Standard Errors, and Coefficient of Variation, Consumer Expenditure Survey, 2006, *available at* http://www.bls.gov/cex/2006/stnderror/cusize.pdf. Data on the increase in child care costs from 2006 (average) through May 2008 are reported by the Bureau of Labor Statistics in its Consumer Price Index for All Urban Consumers, series CUSR0000SEEB03 (U.S. City Average, Child Care and Nursery School).
Calculation of 2000 and 2006 child care costs as reported by Kristin Smith, U.S. Census Bureau, *Who's Minding the Kids? Child Care Arrangements: Spring 1999*, at tbl.6 (1999); Kristin Smith, U.S. Census Bureau, *Who's Minding the Kids? Child Care Arrangements: Spring 2005*, at tbl.6 (2005), *available at* http://www.census.gov/population/www/socdemo/child/ppl-2005.html.
For a child under 5:
In 1999: $99/week = $5148/year (inflated to $5321 for 2000 and $6229.51 for 2006).
In 2005: $135/week = $7020/year (inflated to $7246.45 for 2006).
For a child between 5 and 14:
In 1999: $81/week = $4212/year (inflated to $4353.58 for 2000 and $5096.87 for 2006).
In 2005: $100/week = $5200/year (inflated to $5367.74 for 2006).

Between 2005 and May 2008, the cost of child care increased by 14.14 percent (index moved from an average of 195.35 in 2005 to 222.976 in May 2008). Assuming that consumption remained the same, expenditures on child care have gone up $1321 (in 2006 dollars) since 2000.

Expenditures in 1999: $5148 (inflated to $6230 in 2006 dollars)
Expenditures in 2005: $7246
Expenditures in 2008: $8270 (deflated to $7696)
Increase: $1466 in 2006 dollars (1508 in 2007 dollars)

For a child age 5-14:

Expenditures in 1999: $4353.58 (inflated to $5096.87 in 2006 dollars)
Expenditures in 2005: $5367.74
Increase: $270.87 (279 in 2007 dollars)
Expenditures in 2008 (assuming same increase since 2000): $6127 (deflated to $5702)
Increase: $605 (622 in 2007 dollars)

State University[26]

Between 1999-2000 and 2005-2006, expenditures on **public university total costs** rose from $10,053 to $12,824 in constant 2007 dollars, or $2771 in 2007 dollars

Between 1999-2000 and 2007-2008, net expenditures rose from $10,053 to $13,589 in constant 2007 dollars, or $3536 in 2007 dollars

Between 1999-2000 and 2005-2006, expenditures on **public university net total costs** rose from $1530 to $2410 in constant 2007 dollars, or $880 in 2007 dollars

Between 1999-2000 and 2007-2008, net expenditures rose from $1530 to $2580 in constant 2007 dollars, or $1050 in 2007 dollars

[26] Data are from The College Board, Trends in College Pricing 2007, at 11 tbl.4b & 17 (2007).

Data Appendix: Debt

Total Consumer Debt[27]	Home Mortgage Debt[28]	Consumer Credit[29]
2000: 7008.8 (8439.1)	4818.3 (5801.6)	1741.3 (2096.7)
2001: 7680.3 (8991.8)	5324.9 (6234.2)	1892.0 (2215.1)
2002: 8514.0 (9812.7)	6034.1 (6954.5)	1999.9 (2305.0)
2003: 9496.8 (10701.6)	6882.4 (7755.5)	2104.4 (2371.4)
2004: 10575.4 (11607.9)	7837.6 (8602.8)	2219.4 (2436.1)
2005: 11754.1 (12478.9)	8866.2 (9412.9)	2313.9 (2456.6)
2006: 12948.3 (13317.1)	9854.0 (10134.7)	2418.3 (2487.2)
2007: 13825.4	10508.8	2550.6

- *Billions of 2007 dollars in parentheses*

Consumer Debt + Mortgage Debt (inflation-adjusted to billions of 2007 dollars)

2000: 7898.26
2001: 8449.27
2002: 9349.51
2003: 10126.85
2004: 11038.85
2005: 11869.45
2006: 12621.84
2007: 13059.40

Federal Reserve Table Z1, at tbl.D.3 ("Debt Outstanding by Sector") (March 6, 2008 release).
Federal Reserve Table Z1, at tbl.D.3 ("Debt Outstanding by Sector") (March 6, 2008 release).
Federal Reserve Table Z1, at tbl.D.3 ("Debt Outstanding by Sector") (March 6, 2008 release).

Testimony of

Jared Bernstein
Senior Economist, Economic Policy Institute

Joint Economic Committee
of the United States Senate
and
the United States House of Representatives

How Much More Can Consumers Be Squeezed by Stagnant Income, Skyrocketing Housing Costs, and Falling Home Prices?

July 23, 2008

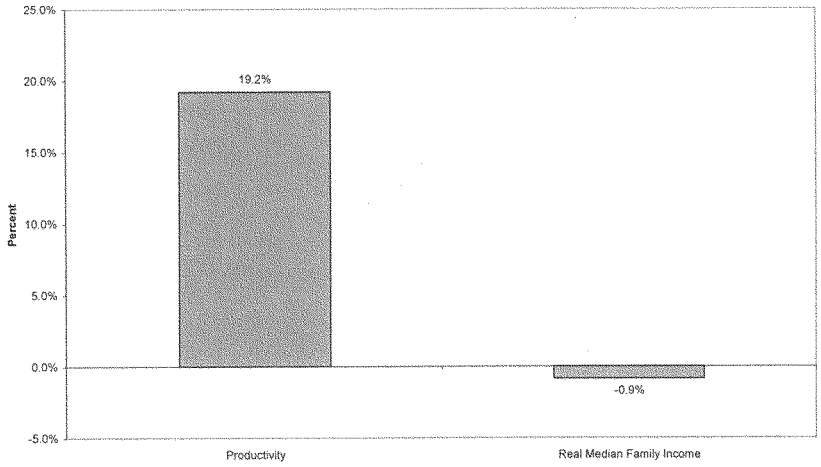
Introduction

Chairman Schumer, Ranking member Saxton, I thank you for the opportunity to testify today. I particularly applaud your decision to focus on the impact of our current economic difficulties on middle-income American households.

Everyday, the nation's business pages focus report the ongoing stressors in financial markets. These difficulties are of course real and important, given the centrality of these markets and the critical importance of free-flowing credit in our economy. Understanding the causes of these bubbles and busts is also crucial, and I will devote considerable space in this testimony to these matters, including the bursting of the housing bubble, bad underwriting, low capitalization, shadow financial arrangements, rating failures, and other distortions that helped get us where we are today.

But in today's hearing, I have also been asked to focus on the squeeze currently facing households who depend more on their paychecks than their stock portfolios. Many of these households are facing an economic onslaught for which they are ill-prepared. Though they were highly productive over the business cycle of the 2000s—the productivity of the US labor force grew by 19%, 2000-07, their incomes failed to reflect their contributions (see **Figure 1**). In fact, as my co-authors and I show in our upcoming release of the State of Working America, 2008/09, the gap between productivity growth and that of median income or compensation has never been larger. In what is arguably the most telling indictment of recent economic outcomes, for the first time on record, it appears that real median family income will be lower at the end of this business cycle than it was at the beginning.

Growth of productivity and real median family income, 2000-07



Source: EPI's analysis of Census and BLS data. 2007 real family income is an EPI forecast (we forecast that real family income rose 0.8% in 2007)

Meanwhile, for those who own homes, the value of that asset is falling, and falling fast. In a pointed jab at what the Bush administration called "the ownership society" the rate of homeownership is declining for the first time in years. At the same time, macro-economic weakness is taking a notable toll on the job market, and both job and real wage growth has been negative. Finally, prices of key market basket items, such as food and energy, are growing much faster than average inflation, and again, much faster than their paychecks.

These are, of course, unsettling outcomes. But one is reminded that in Japanese, the word for "crisis" is the same as the word for "opportunity." To the extent that the problems elaborated at today's hearing stem at least partially from misguided public policies, this body is in a position to implement necessary changes. To that end, I recommend the following actions.

--In the short term, a second stimulus package is necessary. While some of the package should again include direct payments to strapped households, more of the stimulus should be targeted to direct spending on relief to states and infrastructure investment.

--In the medium term, over the next few years, a return to common-sense regulation is needed in mortgage and financial markets. Some of this involves enforcing rules already on the books but ignored, and some involves creating new rules designed to preclude bubbles by bringing greater transparency and stability to these markets.

A second stimulus package appears quite necessary given the protracted period of below-trend growth in the macro-economy. Smartly crafted, it has the potential to help generate more economic growth until the imbalances and necessary corrections in key markets play themselves out. The regulatory agenda is ultimately targeted at the longer-term problem of what might be called the shampoo economy of the last few business cycles, with their pattern of "bubble, bust, repeat."

The last two, and possibly three, recessions were caused by bubbles that were fairly widely recognized as they inflated. Yet key policy makers ignored the signs, in some cases even nudging the bubbles along by endorsing the practices that inflated them. The economic pain caused by the inevitable implosion was, and is, deep. It is a major contributor to the middle-class squeeze, all the more unfortunate in that this economic pain is largely self-inflicted.

I am well aware that members of this committee are interested in learning about options for correcting these imbalances that comprise our financial markets. These markets, as I argue below, are historically among the most innovative and effective in the world, and they have proven to be integral to providing credit to both the household and business sectors. But excessive deregulation and the absence of common-sense oversight threaten to undermine this vital track record, and Congress must not let this occur.

The regulatory agenda I outline is simple and commonsensical. It contains these components, elaborated below:

Apply oversight based on what entities do, not who they are.

Increase capital reserve requirements.

Improve Transparency: Eliminate off-balance sheet entities and monitor positions/liquidity

Improve and enforce mortgage underwriting standards

Fannie Mae and Freddie Mac: Clarify their public/private status

From the perspective of executive compensation, treat government bailouts as bankruptcies, clawing back bonuses and excessive compensation.

Create a new financial watchdog agency to implement and oversee these reforms

The Economic Stressors Facing the Middle-Class

Most working-age households depend on a robust labor market for their economic well-being. About three quarters of the income of middle income families comes from their labor earnings, compared to about one-third for the top one percent.[1] In this regard, one

[1] State of Working America, 2006/07, tbl 1.20.

of the significant problems faced by middle-income (and lower income) families in the 2000s has been the lack of opportunity in the job market. As shown below, labor demand—the creation of jobs and annual hours of work—was uniquely low in the 2000s, and this had clear negative effects on the living standards of working families.

Between 2000 and 2006 (the most recent data on annual earnings), the average annual earnings of middle-income families (summing across all working family members) fell by about $800 in today's dollars. This loss was largely driven by a combination of weak, but positive, real hourly wage growth, and a significant decline in hours worked. In 2006, middle-fifth families worked almost 90 hours less per year than in 2000.

In fact, the slight decline (-1%) in real family income in the 2000s is more than explained by the decline in hours worked, which shaved 2.2% off of the growth of middle incomes. Had annual hours worked simply remained flat for these groups, their incomes would have risen slightly; had their hours grown as much as in the 1990s, their incomes would have grown by 5%, an increase of $3,800 over their actual income growth over this period.

As Professor Warren's testimony stresses, these income losses occurred over a period when prices of goods which comprise the heart of the middle-class market basket were growing considerably faster than average inflation. Such price data are particularly revealing of American's sour mood regarding the economy. The table below shows annual price growth from June 2000 through last month. The second line of the table shows the growth rate over the past year, to examine evidence of recent acceleration.

With the exception of food, all of these items grew faster than average prices over this period. College tuition grew more than twice as fast and the price of gas grew at almost four times the average rate. In the past year, prices have clearly accelerated across the board, but all items except child care accelerated faster than average, especially gasoline. Gasoline prices spiked in June 2008, but averaging over the quarter, they are still up 25% over the same quarter last year.

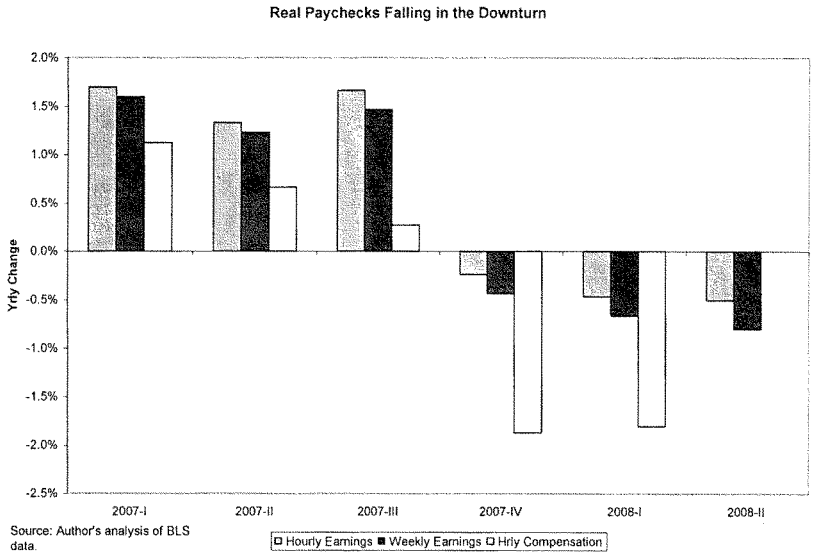
Inflation: annual growth rates, key items, 2000-08

	All Items	Food At Home	College Tuition	Child Care	Gas (unleaded)
2000-08	3.0%	3.1%	7.0%	4.6%	11.4%
2007-08	4.9%	6.1%	6.4%	4.5%	33.0%

Source: BLS, Data are for June of each year.

These price data cannot be viewed absent the wage side of the equation. While the most recent data on family income go through only 2006, data on prices, wages, and compensation are available through this year. These data reveal increasing real wage losses. Weaknesses in the job market, in tandem with energy-induced spikes in inflation, are taking a toll on wage growth. **Figure 2** shows the annual growth rates in three wage

series. The first bar is the average hourly wage of the 80% of the workforce in blue-collar or non-managerial jobs, the second bar is this group's weekly paycheck, and the third bar is a measure of average compensation—wages plus benefits—for all workers. As of late 2007, all three series are falling in real terms. Note that weekly earnings—the middle bar—are falling more quickly than hourly earnings, due to declining weekly hours worked. Also, total compensation is falling particularly quickly, as both wages and benefits are lagging inflation in the downturn.



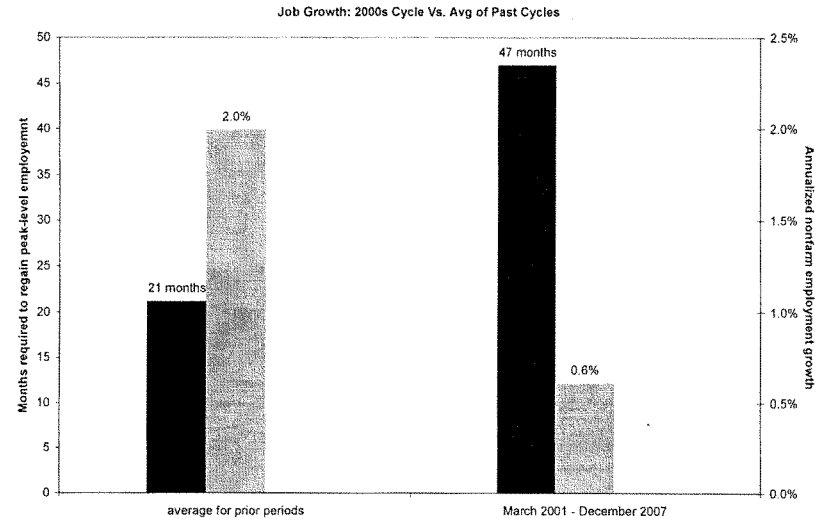
Source: Author's analysis of BLS data.

Of course, the negative pressures on wage growth are causally related to the weakening job market. Most recently, the nation's employers have shed over 400,000 jobs on net. Unemployment is up to 5.5% from its low point of 4.4% in March of 2007, an addition of 1.8 million to the jobless roles. The lack of job creation has led to longer spells of joblessness, and problem that persisted throughout this expansion. By June of 2008, 18% of the unemployed had been so for at least half of a year.

However, for two reasons, the unemployment rate is an inadequate gauge of labor market weakness right now. First, by mid-2008, many employers were adjusting their workforces more by cutting back on hours than by layoffs. So we need a measure that takes that into account. Second, recall that the unemployment rate fails to count those jobless persons who give up looking for work. This is important in the current context, because the labor force participation rate, which does fall when such persons leave the job market, never regained its prior peak over the cycle. This decline suggests that the unemployment rate was biased down when instead of facing unemployment, jobless individuals instead left the labor market.

The *under*employment rate adds to the unemployed a large number—over five million in mid-2008—of part-time workers who would rather have full time jobs but can't find them. It also includes so called "discouraged workers," a group that gave up looking for work due to slack job opportunities. As of June of this year, underemployment was just below 10 percent.

In order to appreciate what's behind the uniquely weak income results for middle income families in the 2000s, it is necessary to give these recent labor market results in some historical context. First, the recovery began in late 2001, but there ensued a period dubbed the "jobless recovery" and payrolls did not begin to grow until the autumn of 2003. **Figure 3** shows two measures of this weakness: the number of months it took to regain the prior payroll peak, and the yearly rate of job growth. The figure shows that prior to the 2000s, it took an average of 21 months to regain peak-level employment after a recession, but that during the 2000s recovery, it took over twice that long – nearly four years. It also shows that prior to the 2000s, average employment growth over a business cycle was 2.0% per year, but that in the 2000s, employment growth averaged only 0.6% a year, well below the growth needed to generate any tautness in the job market.

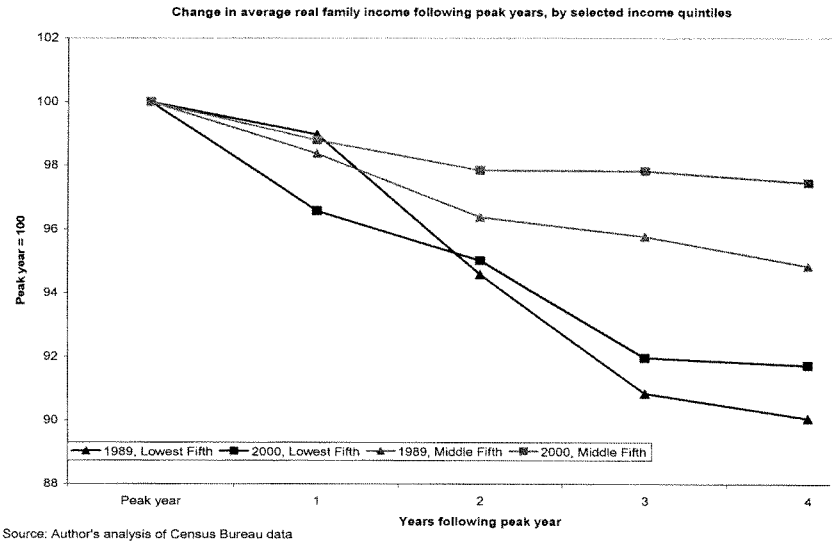


Source: Authors' analysis of BLS data.

The previous analysis provided a retrospective look at middle class incomes over the business cycle of the 2000s. But what might we expect in coming years, particularly given the ongoing economic downturn? **Figure 4** makes the important point that in the last two downturns, middle and low real incomes did not just fall in the recessions, but continued to slide in the ensuing recoveries. It is widely recognized that both of the last

two recoveries began with protracted "jobless" phases, but it is less well known that real incomes for many families continued to fall as well.

The figure plots the percentage losses for low and middle-income families in the first few years including and following the last two downturns. The x-axis marks the years out from the peak; thus, for the 1990-91 (2001) recession, "peak year" represents 1989 (2000), 1: 1990 (2001), etc.



Source: Author's analysis of Census Bureau data

Both low and middle income families lost ground through year four of these cycles, with larger losses for low-income families than for middle income families. In the early 1990s downturn, average income fell 10% for the bottom fifth over these years (1989-1993) and about half that for the middle fifth. In the 2000s (2000-04), the pattern was similar, with real income losses of about 8% for the lowest fifth and 3% for the middle.

Episodes like these have enabled economists to quantify the relationship between rising unemployment and falling real incomes for the various income classes shown in the previous figure. Applying those estimates to the unemployment forecasts in the current downturn (we expect unemployment to be in the mid-sixes—6.5%—by the end of next year) reveals real predicted income losses that follow the historical pattern, with bottom fifth real incomes down about 5%, middle incomes down about 4%. For middle-income families, that constitutes a loss of over $2,000 in today's dollars.[2]

[2] See forthcoming State of Working America, 2008/09, Chapter 1, for details.

In sum, when it comes to the economy, middle-income families are being hit from many sides. Despite stellar productivity growth, their real incomes were stagnant in the 2000s, in part due to persistent weakness in the job market. Economic inequality is an obvious factor here, and the share of income accruing to the top one percent of households was higher in 2006 than in any year since 1913 except one: 1928. Meanwhile, prices of key goods and services, from energy to medical care, have risen much faster than average inflation. More recently, the weakening job market in tandem with these price spikes is driving real compensation down. And, as discussed in greater detail below, homeowners are experiencing significant price declines in their primary asset, as housing prices continue a long correction from the bursting of the housing bubble.

Near Term Relief: Stimulus II

I am well-aware that the members of this committee are acutely interested in taking steps to ameliorate these negative trends. The question is: what are the most effective interventions? Both fiscal policy and regulatory interventions must be undertaken with serious concerns regarding market forces, the use of taxpayers' dollars, and deficit/debt implications. There are also distributional concerns to consider: the federal government has repeatedly shown its willingness to commit its resources—our resources—to financial institutions deemed "too big to fail." Fairness concerns militate that struggling households are also considered to be viable targets of policies to offset the economic pain they're experiencing.

The first round of economic stimulus was designed with this in mind. Over $100 billion in payments to households were sent out in recent months, and early indicators show that some share of these payments have found their way into the economy. Retail sales and personal income reports, for example, showed fairly clear evidence of the impact. Both of these measures factor directly into gross domestic product, and forecasters generally agree that stimulus package will raise real GDP by something between one-half and one percentage point in the middle months of this year.

The recent extension of unemployment insurance benefits should also be viewed as a potent stimulus, as well as an important policy intervention to meet the needs of many hurt by the recent labor market trends noted above. Research by Moody's economy.com finds that since unemployed persons typically spend their checks to meet basic needs, the program yields a particularly large "bang for the buck:" a dollar spent on the UI extension yields $1.64 in terms of GDP growth.[3]

Unfortunately, some of the initial stimulus package was not spent so wisely. Accelerated depreciation of business expenses, for example, generates only $0.27 extra GDP per dollar spent, the smallest multiplier in the cited study (see previous footnote).

While direct payments to individuals, referred to as rebate checks (though since they are not tax rebates, this title is misleading), have considerable political and economic appeal, given the current economic climate, they may not be the most effective form of stimulus.

[3] See Moody's economy.com, Assessing the Macro Impact of Fiscal Stimulus, 2008.

For one, with the price of oil so elevated, more of these expenditures are liable to leak out of the country through spending on imported oil than would otherwise be the case. Second, the overleveraging of American households in a period when home prices are falling suggest the possibility that the checks will also be used to deleverage. Of course, while this may be a fine and responsible thing for check recipients to do with their money, the domestic economic multipliers connected to these activities are surely low.

Based on past experience, most economists assumed that two-thirds of the payments would be spent, with perhaps 10-15 percent of that leaking out as imports. In the current case, we might see considerably less spent—maybe 50 percent—and a larger share—perhaps 25 percent—of that on imported oil.

So, while stressed households arguably need another round of direct payments to offset the toll on their budgets from high fuel and food costs amid weak jobs and wages, I urge the JEC to emphasize grants to states and infrastructure spending in the next stimulus package.[4]

According the Center on Budget and Policy Priorities, "at least 29 states faced or are facing a combined $48 billion in...budget shortfalls."[5] These states typically must balance their budgets. Thus, in the absence of help from the federal government, they will be forced to draw down rainy-day reserves or take actions that would exacerbate the negative macroeconomic cycle (tax hikes or service cuts). The CBPP reports that states are actively tapping their reserves, but that these funds "generally are not sufficient to avert the need for substantial budget cuts or tax increases."

Thus, a second stimulus package should contain considerable aid to states. The two mechanisms through which such grants are typically made are a temporary increase in the federal government's contribution to the state's Medicaid program or general grants to the states. Following the last downturn, each of these programs received $10 billion. CBPP analysts note that these grants had their intended effects of preventing state actions that would deepen the negative cycle. But they also point out that "The major problem with that assistance was that it was enacted many months after the beginning of the recession, so it was less effective than it could have been..."

Most analysts, myself included, view the current downturn as likely to be protracted, in part because housing corrections can take considerably longer than those in other markets. In this regard, we have often warned of an "L-shaped" cycle, where GDP falls and remains below trend for numerous quarters. This cycle has been underway all year, and given the recent deepening in labor, financial, and housing market stressors, is likely to continue for a number of quarters going forward. Thus, states are unlikely to recover in the medium term and would be likely to put any federal stimulus dollars to good use.

---

[4] Relief for homeowners facing foreclosure has also be mentioned as part of a stimulus package. I support this idea but since this legislation appears to be moving on a separate track, I exclude it from this testimony.
[5] http://www.cbpp.org/1-15-08sfp.htm

The other area left out of the last stimulus package was infrastructure investment, and I urge this body to strongly consider its inclusion in a second package.

Three facts motivate this contention. First, American households are highly leveraged, and may well be poised for a period of enhanced savings and diminished consumption. In this context, public investment should be viewed as an important source of macro-economic stimulus and labor demand—the creation of new, and often high quality jobs—which is clearly lacking from our current labor market.

Second, there are deep needs for productivity-enhancing investments in public goods that will not be not made by any private entities, who by definition cannot capture the returns on public investments in roads, bridges, waste systems, water systems, schools, libraries, parks, etc. Three, climate change heightens the urgency to make these investments with an eye towards the reduction of greenhouse gases and the conservation of energy resources.

One area of particularly significant job loss has been in construction. Jobs in residential building and contracting are down 480,000 over the past two years, and when we include other jobs related to housing, such as real estate, we find a decline of over 600,000 jobs since June 2006. In other words, there exists considerable labor market slack that will certainly deepen if the economy is in or near recession.

In this regard, infrastructure investment serves a dual role of deepening on investments in pubic capital while creating good jobs for workers that might otherwise by un- or underemployed. One common argument against such investment in the context of a stimulus package is that the water won't get to the fire in time, i.e., the implementation time lag is too long to quickly inject some growth into the ailing economy. However, research by EPI economists has carefully documented current infrastructure needs that could quickly be converted into productive, job-producing projects (Mishel et al, 2007).

Take, for example, the August 2007 bridge collapse in Minneapolis. The concrete for the replacement bridge began flowing last winter, and the bridge is now halfway done, with full completion expected by December. The American Association of State Highway and Transportation Officials claim that according to their surveys, "state transportation departments could award and begin more than 3,000 highway projects totaling approximately $18 billion within 30-90 days from enactment of federal economic stimulus legislation."[6]

The following are other relevant examples identified by these researchers:

- There are 772 communities in 33 states with a total of 9,471 identified combined sewer overflow problems, releasing approximately 850 billion gallons of raw or partially treated sewage annually. In addition, the Environmental Protection Agency (EPA) estimates that between 23,000 and 75,000 sanitary sewer

[6] http://www.transportation.org/news/96.aspx

overflows occur each year in the United States, releasing between three to 10 billion gallons of sewage per year.

- According to a survey by the National Association of Clean Water Agencies, communities throughout the nation have more than $4 billion of wastewater treatment projects that are ready to go to construction, if funding is made available. Funds can be distributed immediately through the Safe Drinking Water and Clean Water State Revolving Funds and designated for repair and construction projects that can begin within 90 days.
- The National Center for Education Statistics (NCES) put the average age of the main instructional public school building at 40 years. Estimates by EPI find that the United States should be spending approximately an [additional] $17 billion per year on public school facility maintenance and repair to catch up with and maintain its K-12 public education infrastructure repairs.
- According to a 1999 survey, 76% of all schools reported that they had deferred maintenance of their buildings and needed additional funding to bring them up to standard. The total deferred maintenance exceeded $100 billion, an estimate in line with earlier findings by the Government Accounting Office (GAO). In just New York City alone, officials have identified $1.7 billion of deferred maintenance projects on 800 city school buildings.
- The U.S. Department of Transportation has identified more than 6,000 high-priority, structurally deficient bridges in the National Highway System that need to be replaced, at a total cost of about $30 billion. A relatively small acceleration of existing plans to address this need—appropriating $5 billion to replace the worst of these dangerous bridges—could employ 70,000 construction workers, stimulate demand for steel and other materials, and boost local economies across the nation.
- The House Committee on Transportation and Infrastructure has identified more than $70 billion in construction projects that could begin soon after being funded. An effective short-term stimulus plan could include $16 billion directed at projects for roads, rails, ports, and aviation; only projects that can begin within three months would be considered.

Finally, while I have discussed these infrastructure needs in the context of recession and stimulus, it is important to recognize that a) these are all necessary and productivity-enhancing investments that should be made regardless of the state of business cycle, and b) recent history suggest that it is a mistake to think that labor market slack will no longer be a problem when the recession officially ends.

This last point deserves a bit of elaboration. Much of the current recession/stimulus debate has stressed that recent recessions—the ones in 1990-91 and 2001—were both mild and short-lived, and perhaps the next recession will follow the same pattern. It is critical to recognize that these claims are based solely on real output growth, and not on job market conditions. The allegedly mild 2001 recession, wherein real GDP barely contracted, was followed by the longest "jobless recovery" on record. Though real GDP grew, payrolls shed another net 1.1 million jobs. The unemployment rate rose for another

19 months and for just under two years for African-Americans. The pattern was similar, though not quite as deep, after the early 1990s recession.

Part of the explanation for this disjuncture has to do with the way recessions are officially dated by the committee at the National Bureau of Economic Research, as they have apparently given less weight to the job market and greater weight to output growth. But policy makers are likely to give greater consideration to working families whose employment and income opportunities are significantly weakened as unemployment rises and job growth contracts. Thus, from a stimulus perspective, these investments will be still be relevant well after the recession is officially ended.

Regulating Excesses in Financial Markets

The US hosts some of the largest, most innovative, and deepest financial markets in the world. Access to credit, equity financing, and investors' ability to hedge through future's markets have long been hallmarks of our system, both for businesses and households. US entrepreneurialism is world renown, and no small part of that deserved reputation is due to our historically safe and deep markets for credit and equity.

Yet, every aspect of these markets is in trouble. At the heart of the recent upheaval is the inability of financial markets to accurately and reliably price risk, and in any free-market economy, faulty price signals are problematic. When these price signals are particularly distorted for extended periods, with the bias going in one direction—the underpricing of risk—investors and households are prone to buy into bubbles. And large bubbles have proven to be the source of very serious economic instability in recent years.

The current case has been and will be discussed in many other Congressional hearings, and I will not go over the details here. For a variety of reasons, including new forms of securitization and the increased distance between mortgage originator and ultimate debt holders, existing underwriting standards were ignored, and not simply in the subprime market. As George Soros has emphasized, the process fed on itself: irresponsible lending practices fed the housing bubble, leading banks to ratchet up their lending with appreciating real estate as collateral.[7]

At the same time, deregulatory changes, particularly the ending of Glass-Steagall firewalls between commercial and investment banks, meant that more borrowing was financed by non-commercial entities that faced less regulation regarding transparency and capital reserve requirements. Rating agencies gave undeservingly high ratings to risky debt, in some cases because of poor evaluations, but in others, conflicts of interest were invoked as the raters were too often hired by lending institutions. Finally, for reasons that appear to be as much ideologically motivated as anything else, the Federal Reserve ignored early warnings regarding potential problems in the subprime market.

It was a perfect storm, and we will be buffeted by its winds for many months, perhaps years, to come. There are, however, lessons that should be learned, rules that should be

[7] http://www.georgesoros.com/creditcrisis08

changed. I emphasize that the ideas I am espousing here can be heard in many circles. These are not liberal or conservative ideas. In fact, some of the most vocal critics of the current crunch, those calling for changes like those below, are long-time market investors established (Wall) "street cred." The Federal Reserve and the Security Exchange Commission are actively discussing many of the measures discussed below.

Applying oversight based on what entities do, not who they are

Before Glass-Steagall was repealed, most lending by American households was from commercial banks, which are more heavily regulated by the Federal Reserve. Since the repeal, the majority of borrowing is from non-commercial entities, including investment banks and mortgage lenders. Yet, these institutions face relatively lax requirements.

Now, in the wake the collapse of Bear Stearns, the Federal Reserve has accorded investment banks the same borrowing privileges of commercial banks. It is also clear that taxpayers may be called upon to save these institutions if they face insolvency. Based on these new relations, lending institutions should be regulated based on what they do, not who they are. Clearly, this approach would result in apply some of the same regulations that apply to commercial depository institutions to non-commercial entities. Some examples follow.

Capital reserve requirements

A basic principle of risk management is that as an institution's exposure to market risk increases, so should its capital reserves. Obviously, it's necessary to seek balance, because resources kept on reserve cannot be used to finance potentially productive ventures. But it remains the case that the vast majority of bank failures come as a result of violating the principle of holding adequate reserves. This concept is especially important to hedge funds, which make highly leveraged deals with considerable exposure, and, contrary to their names, often without much of a hedge in case things go badly. Yet, in the US we have turned this principle on its head: the greater the portfolio risk, the lower the reserve ratios. Overleveraging must be a target of the new approach to regulating today's financial markets.

As investment advisor Michael Lewitt has written, "Allowing investment banks to be leveraged to the tune of 30 to 1 is the equivalent of playing Russian roulette with 5 of the 6 chambers of the gun loaded. If one adds the off-balance sheet liabilities to this leverage, you might as well fill the 6th chamber with a bullet and pull the trigger."[8]

The question is how should non-commercial bank reserve requirements be set and at what levels. So-called "tier one capital ratios," wherein the Fed judges banks to be adequately capitalized, tend to be in the range of five to ten percent, depending on the size and structure of the banks. This is well below the Bear Stearns or especially Fannie/Freddie reserves, which were said to be in the range of three percent or less (some reports found that Fannie and Freddie had debt to capital holding ratios of 65 to 1).

[8] http://www.harchcapital.com/Pdfs/how%20to%20fix%20it-%20welling.pdf

The Federal Reserve guidelines for depository institutions have generally worked well, but given the more complicated dealings of investment banks, it will take more research to determine whether these guidelines are practical for non-commercial settings. I return to this question below and suggest an initiative to answer the question as to what constitutes adequate reserve requirements.

Improving Transparency: Eliminate off-balance sheet entities and monitor positions/liquidity

The fact that investment banks are allowed to maintain investment vehicles that are not required to show up on their balance sheets is, simply put, a recipe for failure. Whatever rationale there might be for hidden liabilities, policy makers should unequivocally recognize that the benefits are not worth the costs.

But this common sense elimination does not go far enough. The fact that investment banks voluntarily submit to SEC monitoring of their positions has demonstrably failed to provide adequate oversight. The new commission that I propose below should have regular access to the books and balance sheets of all types of lending institutions of significant magnitude, from non-commercial lenders to hedge funds. Once again, the rationale here is that any firm that is so interconnected to the financial system such that their failure would threaten the integrity of that system is arguably too big to fail, and, in the interest of taxpayers, must be monitored.

Improve and enforce mortgage underwriting standards

In this area, along with a need for new regulations, there is an obvious concern that existing regulations were under-enforced, especially by the Federal Reserve, which has a clearly articulated mandate to regulate mortgage lending. The Fed is required, for example, to "prohibit acts or practices in connection with a) mortgage loans that the board finds to be unfair, deceptive, or designed to evade the provisions of this section; and b) refinancing of mortgage loans that the board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower."[9]

As regards the subprime market in particular, these basic guidelines were ignored. Yet, as home prices fall such that their market value is below that of their outstanding debt, higher quality loans are also in danger of default. Again, a detailed review of needed reforms is beyond my scope, but the most egregious practices are obvious: "no doc" and "low doc" loans, fudging the incomes of borrowers, and quick and sharply resetting ARMs are clearly responsible for both the housing bubble and our current difficulties.

But beyond these practices, Congress needs to look at the process of mortgage backed securities. This process of bundling mortgage debt into bonds comprised of tranches of

[9] This section was quoted in a New York Times editorial, http://www.nytimes.com/2007/12/19/opinion/19wed1.html?scp=5&sq=greenspan+mortgage+subprime&st=nyt, Dec 19, 2007.

varying quality was designed in part to diversify, and thus reduce, risk of default. But it clearly had the opposite effect, such that bad debt infected that of higher quality debt in ways that eluded both rating agencies and investors. Part of this problem, as noted, stems from the larger distance that now prevails between the original lender and the ultimate debt holder. This development requires stricter lending standards, because market discipline once again is unlikely to punish careless lenders when they're not holding the loan.

Clearly, these lax lending standards fed into the housing bubble in ways discussed above (see Soros reference). In fact, since real estate is susceptible to the self-reinforcing process of price increases leading to over-leveraging, it is a common source of bubbles. Moreover, real estate bubbles can be particularly damaging, because once they burst, they take longer than other bubbles to deflate. In this regard, I raise monitoring of real estate bubbles as one responsibility of the new oversight board recommended below.

Fannie Mae and Freddie Mac: Clarify their public/private status

Sticking with real estate regulation, the near-insolvency threat from these giant mortgage financers may turn out to be the most recent casualty of the housing bubble. If the federal government comes to their aid, it could well be at a cost of hundreds of billions of taxpayers' dollars.

Given the magnitude of these companies, any changes involving their regulatory oversight or their status will be the source of considerable discussion by this body. I will thus only add these broad guidelines that I view as integral to arriving at a workable solution to the challenge they pose.

The problem facing Fannie and Freddie is that by dint of their implicit government guarantee, they create deep moral hazard. As economist and columnist Paul Krugman recently noted, "This implicit guarantee means that profits are privatized but losses are socialized."[10] Given discussions underway regarding an infusion of credit from the Federal government, this implicit guarantee may well soon become explicit.

If that occurs, ending the amorphous status of Fannie and Freddie seems highly desirable. The fact that they are private "on paper" but public in the minds of investors is highly distortionary. Their indistinguishable status has conferred upon them considerable advantages relative to other actors in the secondary mortgage market, and this unfair advantage has distorted the market. Together, Fannie and Freddie hold or guarantee about 20 percent of household debt, and they have sold much of that debt to banks throughout the world. Virtually all commentators have agreed that their magnitude and global linkages render them too big too fail.

---

10 http://www.nytimes.com/2008/07/14/opinion/14krugman.html?scp=1&sq=krugman+fannie+freddie&st=nyt

Given that reality, if the firms do face insolvency and a government bailout, I recommend this committee consider one of two paths: ratchet up the regulatory oversight to protect taxpayers, lower the firms' competitive advantages, and avoid moral hazard, or, preferably, change Fannie and Freddie into public institutions.

Congress was wise to initially sponser these companies, as they have contributed to a robust and liquid primary mortgage market. But at this point, their status is clearly such that the government will not allow them to fail. Thus, the only way to offset the moral hazard that this guarantee requires is either strict regulation of a private entity or the simpler, more transparent option of making them explicit public entities.[11]

The regulation discussion is already underway, as the Treasury Department has proposed a new regulatory agency to oversee Fannie and Freddie. However, Congress will want to carefully scrutinize this new regulator, since its existence will presumably diminish their authority. Early reports suggest the new regulator may not have the necessary power to provide needed regulation, such as setting adequate reserve standards.[12]

The nationalization strategy—making Fannie and Freddie agencies of the Federal government—has been raised by various parties. There are of course downsides—equity would be lost, and taxpayers would then hold much more debt. But even under worse-case scenarios, the vast majority of the debt held by the companies is high quality and should be viewed as new national assets under this scenario. Most importantly, this change would end the deeply harmful ambiguity of Fannie and Freddie's semi-public status. In other words, nationalization is the most sure-fire way to shut down the moral hazard caused by the firms' implicit government guarantee.

From the perspective of executive compensation, treat bailouts as bankruptcies.

The job of bankers, hedge fund managers, mortgage brokers and dealers is to manage risk. Any person in this occupation can make a mistake, but when those mistakes are systematic, there is compelling evidence of negligence. In the absence of federal interventions to save these institutions from insolvency, market discipline would be enough to punish such negligence.

But when the Feds come to rescue of these firms, as in the cases of Bear Stearns and Fannie and Freddie, such discipline is precluded and moral hazard is invoked. The taxpayer foots the bill, often taking on the same bad debt that got these bad actors into trouble in the first place. Yet, too often, the bailout also saves these managers' compensation packages.

Were these officers to undergo bankruptcy-like proceedings, certain components of their compensation, such as earlier bonuses, would be subject to repayment. Congress should

---

[11] This transition will be facilitated if near-insolvency leads to the extreme dilution or wiping out of equity held by Fannie and Freddie's shareholders.

[12] http://www.nytimes.com/2008/07/21/washington/21fannie.html?ref=business

consider amending these rules to clawback more of their compensation over the period proceeding the bailout.

A new financial watchdog agency to implement and oversee these reforms

There are, of course, many, if not too many, agencies in Washington whose task is to oversee some dimension of financial markets. Various policy makers have proposed consolidation, and certainly some amount of this would be useful. Most recently, the Federal Reserve and the SEC have pledged to work more closely is overseeing the risks to the system.

However, simply consolidating agencies without adding necessary new functions would not be adequate to the task of re-regulating financial markets. Therefore, I urge the members of the committee to consider an idea put forth by various members of Congress, most recently by Senator Obama in a speech on these matters given last March:[13] the creation of a new, financial market oversight commission.

The commission would have a few very specific mandates. It's overarching goal would look across markets (mortgage markets, bonds, equities) for signs of systemic risk. That is, the commission would not be responsible for the basic functioning of these markets; that role would remain with current oversight institutions. Instead, the members would have access to information on capital reserves, assets and liabilities, liquidity positions, and so on, in order to spot potential trouble spots. Part of this role would be one of "transparency cop." If commission members were unable to clearly assess the balance sheets of the firms they oversee, corrective action would need to be taken.

For example, one explicit role of the commission would be to identify bubbles. Clearly, this is as much an art as a science, but a few economists using simple metrics have consistently identified bubbles in recent years. For example, in the early 2000s, economist Dean Baker raised warning signals of the housing bubble when he noted that home prices were rising much more quickly than rental prices. Other economists, including Alan Greenspan, warned of the IT bubble in the latter 1990s. Another explicit role of the commission would be to identify over-leveraged firms, such as those with low reserves given the riskiness of their positions.

The explicit focus here would be on the "too big to fail" institutions, and this too implies a new, important role for this commission: tracking the interconnections between financial institutions, such that decisions to provide public aid to firms facing insolvency is clearly warranted. As currently practiced, it is not clear to outsiders what criteria the government is using to define those firms that should be allowed to face market discipline and failure, and those that are interconnected to the point where that fate threatens the overall system.

---

[13] http://www.nytimes.com/2008/03/27/us/politics/27text-obama.html?_r=1&pagewanted=print&oref=slogin

Such a commission, in its initial stages, could also be tasked with questions raised in the above discussions, such as what are appropriate metrics and levels for reserve requirements for investment banks and hedge funds. Both in these initial matters and in its later oversight work, the commission would report to the president and Congress.

Conclusion

As members of this committee are well aware, many of America's working families have far too little to show for an economic period characterized by impressive productivity growth. The 2000s may well be the first business cycle on record where real median family income is lower at the end of the cycle than it was at the beginning. Now, as the 2000s cycle appears to be over, weakness in key markets—housing, labor, financial—is taking a further toll on these already stressed families. Prices of key items, such as energy and food, are rising much more quickly than average inflation, and more to the point, much faster than their earnings. These weaknesses are also leading to the net loss of jobs, and payrolls are down by over 400,000 so far this year.

In addressing these economic challenges, I have recommended short and medium term responses. In the short run, a second stimulus package is warranted. It may be useful for this second package to focus less on payments to individuals and more on state fiscal relief and especially, infrastructure improvement.

In the longer term, recent stressors in financial markets require legislators' attention, and new regulatory solutions are necessary. Regulators always walk a fine line, particularly in financial markets, where innovation and leverage have long played important and useful roles. It is also the case that when disaster strikes, the tendency among policy makers can be to become too zealous and overcompensate, imposing regulations that go too far in restricting the freedoms that yield optimal outcomes.

Yet few objective observers would disagree that the pendulum has swung much too far in the direction of unregulated markets, and the results have been costly. They can be measured in macro, micro, and financial terms. Lending institutions are in the process of writing off hundreds of billions of dollars in failing debt. Millions of homeowners face foreclosure, and tens of millions face "underwater" debt burdens. The spillovers from the bursting housing bubble helped pave the way for what will likely be labeled a recession, one for which working families are uniquely unprepared, given their failure to benefit from much of the growth over the 2000s business cycle.

In fact, I would argue forcefully that to not make some version of these changes would pose a greater threat to financial markets than those posed by the recommendations themselves. Michael Lewitt puts it well:

> "[One] often hears the argument that too much regulation will force business offshore and render the U.S. financial industry less competitive. Our response to that argument is that institutions and fiduciaries in the end will gravitate to the system with the strongest and wisest regulatory protections. Moreover, we should

> be pushing the most reckless practices out of our markets and into other markets. We should be creating global competition over best regulatory practices, not worst ones."

Our system of borrowing, lending, and financing investments by both businesses and households is a national treasure, one which we have squandered in recent years. Excessive deregulation has thwarted the transparency that is integral to creating appropriate price signals. Risk has been consistently underpriced, contributing to bad underwriting, negligent risk management, and deeply damaging bubbles. When we ignore these dynamics, as we have in recent years, we put our economy at great risk.

Testimony before the Joint Economic Committee

Hearing entitled "How Much More Can American Families Be Squeezed By Stagnant Wages, Skyrocketing Household Costs, And Falling Home Prices?"

Kristen Lewis
American Human Development Project
July 23, 2008

I would like to thank Chairman Schumer and members of the committee for inviting me to testify about what the research of the American Human Development Project tells us about the well-being and human security of American families. It is a great honor to be here and to testify alongside scholars whose work has so enriched our understanding of America today.

I am co-director, with Sarah Burd-Sharps, of the American Human Development Project, an independent, non-partisan, non-profit initiative funded by Oxfam America, the Conrad N. Hilton Foundation, the Rockefeller Foundation, the Social Science Research Council, and the Anneneberg Foundation.

With their support, we have just released a first-ever human development report for the U.S. or any other affluent, industrialized country, *The Measure of America.* The centerpiece of this work is the American Human Development Index, which ranks the 50 states, the 436 congressional districts, and our major racial and ethnic groups on a scale of well-being and opportunity. The rankings reveal that some groups of Americans are living ten, twenty, even fifty years behind in terms of their health, education, and living standards, while others are enjoying levels of human development that the rest of the country will not reach for decades. The rankings also spotlight which parts of our nation are moving forward and which are stalled or even falling behind. Overall, the American Human Development Index paints a portrait of progress and opportunity in America today and sets a benchmark for gauging change over time.

Today, I'll tell you briefly about the project and discuss what our research reveals about the state of the American Dream and middle class security today. I will take a closer look at the different components of the index to highlight particularly worrisome areas of vulnerability for different groups of Americans in today's faltering economy. Then I will briefly touch upon where we stand in comparison with our peer countries and why we have slipped from #2 in 1990 to #12 today on the global human development index. And I'll conclude by highlighting a few of the report's recommendations that are particularly relevant to this morning's hearing.

First, let me say a few words about the project. Our aim with the American Human Development Project is to introduce to our own country a well-honed international approach and tool that have been very successful around the world in broadening the way in which we understand, measure, and track people's well-being – from strictly economic metrics to a measure that captures some of the other things, besides money, that expand our opportunities, choices, and freedoms. Developed in the early 1990s by the United Nations and based on the work of Nobel laureate Amartya Sen, the human development approach is, in Sen's words, about "advancing the richness of human life" – not just the richness of the economy. Human development is defined as a process of enlarging people's freedoms and opportunities and improving their well-being. It is about the real liberty ordinary people have to decide who to be, what to do, and how to live.

Countries around the world use this approach to understand and track progress and setbacks in their own countries, and the UN uses it to gauge global development trends. Since the early 1990's, in addition to the annual UN global report, more than 500 national and regional Human Development Reports have been produced in developing countries from Afghanistan to Zambia.

The hallmark of human development reports is the **Human Development (HD) Index**, an easy-to-understand numerical measure that embraces what most people believe are the fundamental ingredients of human well-being: health and longevity, access to knowledge, and a decent standard of living. The HD Index has become one of the world's most widely used indices of well-being.

So what, you may wonder, is the **relevance of this approach to the affluent United States**, home of the world's largest economy? The indicators most frequently deployed in evaluating how we are faring in the United States—GDP, the Dow Jones and NASDAQ, consumer spending, and the like—only address one aspect of the American experience. Our work presents a more comprehensive alternative, one that measures the basic building blocks of a good life. The modified American Human Development Index uses different indicators than the standard index to better reflect the U.S. context and to maximize use of available data, but it still focuses on the same three basic dimensions. Health is measured in the modified American HD Index by life expectancy. Knowledge is measured by a combination of educational degree attainment and school enrollment. Standard of living is measured using median earnings. All data are from official 2005 U.S. government sources; 2005 is the most recent year for which all the data required to calculate the index were available.

Unlike the many existing measurements used to assess health, education, or income alone, the American Human Development Index combines these indicators into a single measurement expressed as a number that falls between zero and ten. When disaggregated by state, gender, and ethnic group, this Index sheds light on the opportunities open to different groups of Americans and allows for apples-to-apples comparisons over time and among groups.

What did we find?
Overall, we found human development progress since 1960: on average, we are living eight years longer, are twice as likely to have a high school diploma, and are earning nearly twice as much in 2005 dollars.

But by combining current information with historical data, the report reveals that some groups of Americans are living ten, twenty, even fifty years behind others in human development terms, constrained by limited access to education, well-paying jobs, and adequate health care, whereas others are far ahead of the country as a whole. Today, some groups experience levels of human development typical of the whole country as far back as the 1960s. At the other end, if present trends continue, the country as a whole will not catch up to high-performing groups until at least 2030. Income is an important part of the story, but not the only part. Health and education are critical factors in determining how much freedom people have and the quality of the lives they lead.

Regional variation: The American HD Index reveals large disparities among the country's four major geographic regions. The Northeast is ranked number one and outperforms other regions in education and income, while the West, ranked number two, has the best performance in health. The South, ranked fourth, has the worst performance in all three dimensions of human development – the shortest lifespan, the lowest levels of educational attainment and enrollment, and the lowest earnings.

The ten states with the highest HD Index are mostly in the Northeast—Hawaii, Maryland, and Minnesota being the exceptions. At the other end of the spectrum, nine of the ten states with the lowest HD Index are in the South—the exception being Montana.

State variation: The level of overall human development in Connecticut is the highest in the United States, followed closely by Massachusetts. Neither of these states ranks highest on any of the three indices that make up the HD Index, but both score well across the board, yielding a balanced and high outcome. The District of Columbia, ranked third overall (tied with New Jersey), has the best performance on education; an impressive 45 percent of its adult residents have a college degree and one-quarter have a graduate or professional degree, far more than in any other state and well above the national average. It is also first in income. But the District of Columbia ranks last on health, with a life expectancy, at 73.8 years, approximately that of the average American in 1980. Wyoming has the highest percentage of the adult population with at least a high school diploma, but settles fairly far down on the overall state ranking table. Residents of Hawaii and Minnesota are living the longest lives,

Congressional District variation: New York's Congressional District 14 (the east side of Manhattan, Roosevelt Island, and parts of Queens) has the highest score in the country; California's 20th District (the Central Valley, near Fresno) has the lowest score. These two districts are far apart in human development terms, with the NY resident ten times more likely to have a college degree, earning three times more, and even living 4 ½ years longer.

New York's 14th has the highest median earnings of any district (more than $50,000); people in Virginia's 8th district, not far from here, are living the longest lives (82.9 years); and California's 30th district (Hollywood, Santa Monica, Beverly Hills) has the highest educational score.

California's 20th is the poorest district, with typical earnings of less than $17,000; Texas's 29th has the lowest education score, with nearly half of adults lacking a high school diploma or its equivalent; and people in Kentucky's 5th district are living the shortest lives. A baby born today in Kentucky's 5th can expect to live 72.6 years – more than a decade of life less than a baby born today in Virginia's 8th. The overall index scores of the bottom twenty congressional districts are comparable to the scores of the country as a whole in the 1970's and early 1980's.

New York and California have the highest human development gaps among districts – some of the lowest and highest scores are to be found in these two states, often within the same city – Los Angeles and New York, for example. A telling example is the comparison between two New York congressional districts, the 14th, Manhattan's east side, and the 16th, which is in the South Bronx. The 14th district is where the country as a whole will be in 2041, if current trends continue; the 16th is where the country as a whole was in 1985 – a gap of 56 years between two communities located some two miles apart.

Differences across race, gender and ethnicity: Some of the largest disparities in human development outcomes occur across different gender and race/ethnicity combinations. When we look at gender alone, men have a slightly higher HD Index than women, but the difference is small; American men and women have virtually the same human development level. However, examining each of the three dimensions of the HD Index individually, outcomes for men and women are anything but equal.

Women have a higher education index and live, on average, about five years longer. But advantages in education and health are wiped out by lower earnings. American men earn 50

percent more than women. (While the income measure used in this report is personal earnings, as a way to capture the gender differences in earnings and control over economic resources, this measure can underestimate women's standard of living in cases where household earnings are pooled.) One particularly striking finding is that in every ethnic group except for Asian Americans, women are getting more education than their male counterparts, but earning less. The difference is greatest among whites, with a $14,000 gap separating men and women. Given that median earnings are just a bit more than $27,000, this is a huge gap. The earnings differential between men and women makes female-headed households particularly vulnerable to economic shocks as well as reducing the income available to two-earner families.

Turning to Index by ethnicity, the picture is highly uneven. Overall, Asian Americans have the highest HD Index, outperforming the other ethnic groups in all three human development dimensions. They earn slightly more than whites, the second-ranked group, but have a large advantage in health and are ahead by a mile in education. For instance, about half of Asian Americans have bachelor's degree, compared to 30 percent of whites, 17 percent of African Americans, and 12 percent of Latinos.

Latinos have the lowest ranking for education—more than 40 percent do not have a high school diploma—as well as for income, but score well on health, resulting in a number-three ranking overall. African Americans, on the other hand, rank third in income and education, but have a large gap in life expectancy—five years less than American Indians, the second lowest-ranking group on health, and more than thirteen years less than Asians. The thirteen-year lifespan gap between Asian Americans and African Americans is about the same as the gap between Japan and Guatemala. African Americans are living today shorter lives than the average American in the late 1970's. Poor scores on health are the main drivers of African Americans' last-place ranking on the Index.

Gender adds another layer of difference to an already highly unequal picture. Among Asians and whites, men have an income advantage over women that more than compensates for their relative disadvantages in health (Asians and whites) and education (whites only). At the opposite end of the spectrum, the reverse is true. Among African Americans, American Indians, and Latinos, men all have lower HD Indices than women. While men's earnings are higher in these three groups, advantages in education or longevity, or a combination of the two, outweigh superior earnings to yield a higher HD Index for women.

Looking in greater depth, the high level of educational attainment among Asian men drives their #1 rank on the American Human Development Index. While Asian and white men have similar high school graduation rates, 53 percent of Asian men have at least a college degree, compared to 32 percent of white men. Asian women have the highest health index and rank second overall in terms of human well-being, followed by white men, who have the highest earned income.

Latino men score last on education (with less than 60 percent graduating from high school and only 12 percent graduating from college) and rank ninth out of ten overall; African American males have the lowest health index, and occupy the number-ten overall ranking, in spite of being ranked fourth in income. Latino men, on average, are as likely to have a high school diploma as the typical American in the mid 1970s; African American men today are living shorter lives than the typical American in 1960, half a century ago, one of our study's most stunning and dismaying findings.

America as a whole can expect to reach the HD Index of Asian males by the year 2035, while African American males are living at a level that prevailed in America circa 1986. In sum, the human development gap between Asian and African American males is half a century.

Income vs. Investment in People's Capabilities

Looking at congressional districts with similar incomes but highly divergent well-being outcomes helps to illustrate a key rationale of the human development approach: that consideration of income alone produces an exceedingly narrow and incomplete portrait of the human condition. For example, Vermont's only congressional district has about the same average income as Nevada's First District, about $26,300 per year. However, they are separated by 223 places on the HD Index. Why? Vermont residents can expect to live on average three and a half more years, and about nine in ten Vermonters have at least a high school diploma; in Nevada's First District, only about three in four adults has a high school diploma. College and graduate school completion rates are higher as well in Vermont.

In order to fully understand why two districts with nearly identical income levels have such different outcomes in health and education, one would need to examine a full range of indicators, analyzing each district's conditions, circumstances, and historical backgrounds. But the data make clear that money is buying neither a better education nor a longer life for the average Nevadan.

Let's now take a closer look at what this might mean for American families given the current economic downtown.

In the post-war period, the country grew together. Now we are growing apart. In 1980, the average executive earned forty-two times as much as the average factory worker; today, executives earn some four hundred times what factory workers in their industries earn. According to the U.S. Census Bureau, the richest 20 percent of all U.S. households earned more than half of the nation's total income in 2006, whereas the bottom 60 percent earned less than one quarter of the total income. The average income in the top quintile of U.S. households in 2006 was $168,170. This is almost fifteen times the average income of the lowest quintile, with an average income of $11,352 per year.

While income is critical for life's necessities, wealth, also called net worth, provides financial security and opportunity. Wealth allows families to keep their homes and maintain their standards of living in the event of illness, job loss, natural disaster, divorce, or death. It enables parents to invest in the next generation—to buy a home in a safe neighborhood with good public schools, finance a college education, or help an adult child with a down payment on a house or financing for a new business venture. It can buy autonomy, influence, and power. At the opposite end of the spectrum, debt is negative net worth, which often absorbs income and can make it harder to get an affordable loan, a car, or an apartment.

The top 1 percent of households possesses 33.4 percent—one-third—of America's wealth, and the bottom 60 percent of households only 4.2 percent of all wealth[1]. Net worth by race reveals stark disparities. In 2004, median net worth was $140,800 for whites, and $24,900 for non-whites[2], a nearly six fold difference fueled largely by difference in the rate of home ownership. Minority families have much less to fall back on than white families, on average. And the reality for many Americans is negative net worth; the average household has more than $8,000 in credit

[1] Wolff, "Changes in Household Wealth in the 1980s and 1990s in the U.S."
[2] Federal Reserve Survey of Consumer Finance.

card debt; the average college graduate emerges from his or her course of study with a B.A. degree in one hand and $20,000 worth of educational debt in the other.

In the post–World War II years, unionized manufacturing jobs in workplaces like steel mills and auto plants brought a middle-class lifestyle to a generation of Americans. The credential required for this secure, well-paying work—other than being a man—was, at most, a high school diploma. Today the world has changed. The demand for skills is becoming increasingly hourglass-shaped—with high demand for highly educated workers at the top and high demand for less-educated, low-wage workers at the bottom. The middle is becoming increasingly wasp-waisted as domestic demand for skilled manufacturing workers drains away.

As a result, for many families today, the cornerstones of middle-class life since the post–World War II era—steady, well-paying work; a home of one's own; security in ill health and old age; and a general confidence that life will be better for your kids—have cracked. Job security and many benefits have eroded for all but the wealthiest Americans. Wages for workers at the middle and bottom of the income scale have hardly budged in real terms. Well-paying manufacturing work has been shipped overseas. Young adults are facing huge challenges in the transition to independent adulthood: staggering college debt, run away credit card balances, and skyrocketing housing costs that land them back in their childhood bedrooms.

The American meritocracy, the foundation of the American Dream, is at risk. Social mobility is now less fluid in the United States than in other affluent nations. Indeed, a poor child born in Germany, France, Canada, or one of the Nordic countries has a better chance to join the middle class in adulthood than an American child born into similar circumstances.[3] Moving into the middle class – and staying there – is particularly challenging for African Americans and Latinos. For instance, a recent study found that nearly half of African Americans born to middle-class parents in the 1960s ended up among the bottom 20 percent of earners as adults.[4]

Today's families have a tenuous hold on middle-class status; the social safety net is frayed and frequently unable to support the weight of a serious shock such as natural disaster, death, divorce, job loss, or serious illness. Those groups of Americans with higher index scores – indicating better health, higher levels of educational attainment, and higher earnings – have greater ability to seize and even create opportunities as well as greater human security and resilience in the face of shocks. Those with lower scores, on the other hand, are significantly more vulnerable to economic downtowns as well as to shocks to individual households, such as divorce, serious mental illness, or job loss.

Stagnating wages, high child-care costs, and increases in housing and health prices mean that most families need two full-time workers to sustain the kind of middle-class life enabled by a single wage-earner just a few decades ago. "The American standard of living is based on the earnings of the main breadwinner," declared the United Steelworkers in 1945. With more than seven in ten mothers in the workforce, no one can credibly make that claim today.

Yet despite a massive social and economic transformation from one-earner/one-caregiver families to two-earner and single-parent families, neither institutions nor expectations have significantly adjusted to the "new normal" of mom in the workforce. Overstretched families must cobble together the care and maintenance that families and communities alike require to function. The

[3] Sawhill and Morton, "Economic Mobility."
[4] Fletcher, "Middle-Class Dream Eludes African American Families."

well-known deficiencies in our health care and educational systems intensify the struggle of Americans in the middle to hang on to their quality of life.

The effect of these trends can be seen not just in people's every day lives; they can also be seen in our global standing compared to our peer countries. Indeed, comparisons with affluent nations reveal some awkward truths. First, others have achieved better outcomes in many vital areas, including infant mortality and longevity, than we have. Second, they have achieved superior results with less spending per capita.

In 1990, the U.S. occupied the #2 place on the global Human Development Index of the United Nations. Today, we have tumbled to 12th place. Though we have made progress in health, education, and income during that 18-year period, other countries have made much quicker progress, overtaking us on the global Index. It is important to note that the U.S. has higher income scores than every country but Luxembourg on the global scale – we're still #2 in income. But the eleven countries ahead of us – particularly fast-moving countries like Australia and Ireland – have been more successful and efficient in transforming income into positive health and education outcomes for their people.

Let's look at a few examples.

Healthcare is the obvious one. Public and private spending on health care in the United States adds up to $2 trillion, and it continues to rise. We are spending more money by a significant margin than any other country. But we aren't getting our money's worth. We are living shorter lives than people in 41 other nations. The U.S. infant mortality rate is on par with that of Croatia, Cuba, Estonia, and Poland. If the U.S. rate were equal to that of first-ranked Sweden, twenty-one thousand more American babies would have lived to celebrate their first birthday in 2005. It is not a question of whether we can afford something better—we are already paying caviar prices. So the question is this: Can we reform health care so that our number-one rank in spending leads to a number-one rank in outcomes?

Health insurance for everyone is the clear solution. For the 47 million people who lack insurance, the consequences are higher levels of insecurity and shorter lives. In the lower forty-eight states, 43 percent of the variations in age at death can be explained by the percentage of a state's population without health insurance. For society as a whole, the uninsured entail tremendous costs. The uninsured are generally connected to employment, and many are in their most productive years. While higher-income workers without employment-based insurance can afford to obtain coverage and can even deduct some out-of-pocket expenses from their taxes, there is little recourse for those in low-wage jobs, young adults, self-employed middle-class workers, and those who are on the cusp of Medicare eligibility without qualifying. Many simply cannot afford private health insurance premiums. In addition to 47 million Americans without health insurance, more than 80 million go without coverage during a two-year period.[5] Others avoid moving jobs to advance their careers or skills in order to maintain employer-based health coverage. The economic impact of this "job lock" phenomenon is difficult to measure. However, it is clear from voluminous anecdotal evidence as well as surveys and studies that job lock constrains employment choices and likely creates an inefficiency drag on economic activity.

Like the United States, other countries around the globe are struggling to balance rising costs and quality care. Yes, it is a complicated problem to address. Yet all of our peer countries have managed to do it, covering their entire population with health insurance in one way or another.

[5] Committee on the Consequences of Uninsurance, *Hidden Cost, Value Lost*.

No solution will be perfect, but a pragmatic approach to comprehensive health coverage for all is both necessary and feasible.

Another area in which the U.S. is far behind is in the **support we give to working families**. Two of the last century's most far-reaching socioeconomic transformations have been the wholesale entry of women into the paid workforce and a sharp increase in single motherhood. Yet our policies, workplaces, social institutions, and societal expectations have been slow to adapt to the altered landscape. As a consequence, we have millions of overstretched, overstressed families cobbling together caregiving crazy-quilts while still trying to pay the bills. Our peer countries have faced similar social transformations, and they have responded with policies to help. Today the U.S. is in the company of Swaziland, Liberia, and Papua New Guinea as one of only four countries on the planet with no federally mandated paid maternity leave.[6] In addition:

- 66 countries guarantee paid paternity leave. Ninety-eight countries have fourteen or more weeks of paid leave for mothers, 31 have fourteen or more weeks of paid leave for men as well.
- At least 107 countries protect the right to breastfeed, with 73 offering paid breaks. This right is not guaranteed in the United States.
- One hundred thirty-seven countries mandate annual paid leave. U.S. firms are not required to provide annual paid vacation.
- One hundred forty-five countries have paid sick leave for short- or long-term illness, with 136 having at least one week annually, and 81 allowing at least twenty-six weeks or until recovery. Sick leave is offered in the United States through the Family and Medical Leave Act, but it is unpaid and does not cover all workers.[7]

Helping middle-income families build assets needs to become a greater priority. A study commissioned by the Federal Reserve in 2006 demonstrated the strength of a patchwork of federal asset-building policies, but found that they are largely reaching higher-income households. Through various incentive programs, the federal government subsidizes home buying, retirement savings, and small businesses through direct outlays from the federal budget and from tax deductions (considered an expenditure for the government) like the mortgage interest deduction. The study estimated a total cost of $367 billion in 2005 for these programs. However, the study found that over 45 percent of the benefits went to households with annual incomes of more than $1 million. These households received an average benefit of $169,150. By contrast, the bottom 60 percent of the population shares among them less than 3 percent of the benefits of these policies.[8] Policies like the UK Baby Bond Act of 2005, which provides a universal, long-term savings and investment account that ensures all British young people begin adulthood with at least a modest level of financial assets, warrants close study and may offer a useful model to consider.

Conclusion

Based on the data in the American Human Development Index and the information and analysis in the American Human Development Report, a steady, broad-based advance of human development in the United States as well greater security for middle class families will require attention to several priorities.

---

[6] Heymann, Earle, Hayes, "The Work, Family and Equity Index."
[7] Ibid
[8] Woo et al, "Subsidies for Assets."

- For Americans to live longer, healthier lives as well as remain solvent when serious illness strikes, it is obvious from the report that progress depends in large part on a comprehensive resolution of the problem of health insurance. Today, some 47 million Americans lack health insurance; this is the number one reason that although we spend more than any other country on healthcare, we live shorter lives than every other Western European and Nordic country save one. Indeed, we rank a dismal #42 in global life expectancy. The one in six Americans without health insurance are not just courting financial ruin – they are also facing an early death sentence. The nation appears unlikely to make significant strides in health until every American has adequate health coverage.

- The days when basic skills were sufficient to ensure a life of reasonable economic security and full participation in society are past; the labor market today is unkind to those who lack high school diplomas, and jobs that afford financial security increasingly require college degrees. Yet only 74 percent of American public high school students graduated on time (within four years) with a regular diploma in 2003–04 – an 18th place finish among industrialized countries. American 15-year-olds are also far behind their international peers in math and science. In terms of relevance, the content of education needs revitalization. To seize opportunities brought by globalization and technological change, young people need to know how to think, create, and relate—to work with others unlike themselves to solve problems. Schools need to teach twenty-first-century skills and content, expand the scope of school assessment, and create meaningful career education tracks for teens who are not headed for college. In terms of fairness, we must tackle the appalling disparities in educational quality that persist more than half a century after the landmark *Brown v. Board of Education* ruling. The American Human Development Index reveals vast educational attainment gaps among congressional districts and racial and ethnic groups that undermine America's claim to a level playing field.

- For Americans to sustain, or obtain, a decent standard of living, the wages and opportunities of millions of Americans must improve. Growing inequality in income distribution and wealth raises a profound question for Americans: Can the uniquely middle-class nation that emerged in the twentieth century survive into the twenty-first century? Or is it fracturing into a land of great extremes?

The answers to these questions will determine not only the future of America, but also the future of the idea of America—that of a land of opportunity where those who work hard and live honestly can prosper in freedom and security. The American Dream has drifted beyond the reach of many, while fading from view among others. To reinvigorate it, to make it real for millions of middle-class and poor Americans, the stagnation and decline of middle and low incomes must be reversed, and opportunity must once again reach down to the lowest rungs of society.

American history is in part a story of expanding opportunity to ever-greater numbers of citizens. Practical policies such as the GI Bill, which opened the gates of higher education and expanded home ownership, and Social Security, Supplemental Security Income, and Medicare, which provide income and health security to the elderly, have allowed more Americans to realize their potential for a good life. We hope that *Measure of America* and the human development approach it champions can contribute to efforts to build upon these policy successes of the past and to create an infrastructure of opportunity and security that serves a new generation of Americans.

214 Massachusetts Avenue, NE • Washington DC 20002 • (202) 546-4400 • heritage.org

CONGRESSIONAL TESTIMONY

The Impact of Higher Gasoline Prices on Household Costs and Income

Testimony before
Joint Economic Committee
United States Senate

July 23, 2008

David W. Kreutzer, Ph.D.
Senior Policy Analyst for Energy Economics and Climate Change
Domestic Policy Studies
The Heritage Foundation

My name is David Kreutzer. I am Senior Policy Analyst for Energy Economics and Climate Change at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Mr. Chairman, I want to thank you and the other members of the Joint Economic Committee for this opportunity to address you concerning the impacts of higher energy prices on household income and expenses. I note that many colleagues have helped lay the foundation for the analysis I present here. In particular I want to thank Dr. Karen Campbell and request that her essay "How Rising Gas Prices Hurt American Households" be attached to the official record.[1]

Though many commodity prices have recorded large increases in the past two years, those of crude petroleum and its derivatives have been especially severe. My testimony, today, focuses on gasoline price increases and their effects on American households.

The EPA estimates that the typical light vehicle travels 12,000 miles per year and averages about 20 miles per gallon.[2] Doing the division indicates that the typical vehicle uses about 600 gallons per year. Further, the Department of Transportation data show that the average household owns nearly two cars.[3] Therefore, the direct impact of the past year's dollar per gallon price increase costs the average household about $1,100 per year.

Of course, a portion of this increased cost comes back to some households in the form of more hours or higher wages for those employed in the petroleum industry. A portion also works its way back via pension funds, IRAs, money-market funds and other financial instruments that contain stocks of companies benefiting from higher gasoline prices.

On the other hand (I am an economist), higher gasoline prices can have indirect impacts on income and employment that are distinctly negative.

Among other things, the Center for Data Analysis at the Heritage Foundation has the capability to analyze broad, economy-wide impacts of changes in energy prices. This past spring we analyzed the impacts of higher energy costs that might result from policies to restrict carbon dioxide emissions.

More recently, the Center analyzed what would be the impact of a two-dollar per gallon increase in the price of gasoline on employment, aggregate income and expenditure.[4] In addition to economy-wide impacts, this exercise also measured the impact on three

---

[1] Karen A. Campbell, "How Rising Gas Prices Hurt American Households," *Backgrounder*, No. 2162, The Heritage Foundation, July 14, 2008, http://www.heritage.org/Research/Economy/bg2162.cfm.

[2] http://www.epa.gov/oms/climate/420f05004.htm

[3] 1.9 per household for 2001. http://www.fhwa.dot.gov/ohim/hiq/bar2.htm

[4] Karen A. Campbell, op. cit.

representative households. Though the analysis is forward-looking and investigates the impacts of gasoline price increases (as opposed to general energy-price increases), the results are useful in reflecting on the similar-sized gasoline price increases of the past couple of years.

As already mentioned, price increases have the obvious direct impact on gasoline expenditures. But, these direct impacts ripple through the economy to produce additional burdens on households.

Higher gasoline prices squeeze the production side of the economy from both the demand and costs directions. Consumers' demand for output drops as they divert expenditures from other items to gasoline. In addition, gasoline is a factor of production in the distribution of goods and services. Faced with higher costs, producers raise their prices. But the lower demand prevents the prices from rising enough to completely offset cost increases. This leads to production cuts and, therefore, to lower employment. In turn, these conditions put downward pressure on wages and salaries.

This model assumes a two-dollar price increase over a two-year period, with the majority of the price increase occurring in the first year. In this situation, total employment drops by 586,000 jobs. Disposable personal income drops by $532 billion. Because households dig into their savings, personal consumption expenditures drop by the smaller, but significant, amount of $400 billion.

For the category "Married, 2 Children" the median income in 2006 was $86,807. The impact of the gasoline prices reduces the household's income by over $1,000 per year. The response is to both cut expenditures and to withdraw from savings to make up for the loss. Of course, for many households the economists' term "withdrawing from savings" means borrowing.

The income losses are, on average, a combination of reduced wages and reduced hours. These reductions are in comparison to the baseline of no gasoline price increase.

It is notable that the impact of gasoline price increases extends beyond the period of the price increases, even if prices return to their original levels. This is because withdrawals from saving and household borrowing, forces wealth below the baseline level unless and until the wealth is rebuilt with increased future savings. And periods with increased savings will necessarily have consumption that is lower than it otherwise would have been.

Recommendations

Higher gasoline prices have serious negative impacts on household incomes, savings, employment and expenditures. It is important that federal policy not inhibit efficient responses to market shocks.

First, impediments to environmentally sensitive exploration and production should be removed. Maintaining and increasing the supply of petroleum is critical to avoiding high fuel prices. That there may be a significant delay between leases issued today and an increase in supply is an argument for moving more quickly on this issue. It is not an argument for not expanding supply at all.

In addition, a windfall profits tax would penalize those who made the decision to invest in oil resources and will only limit current and future oil supplies, raise fuel prices and further harm American households.

In 1974, 1979 and 1992 there were supply shocks that sent world petroleum and gasoline prices skyward. In 1974 and 1979 government policies, including price controls, distribution regulation and profit taxes, while very popular, extended and deepened the problems. In 1992, there was little interference with market adjustments and there were no gas lines nor extended high prices.

Substituting government mandates for market flexibility is politically tempting but ultimately harmful.

****

The Heritage Foundation is a public policy, research, and educational organization operating under Section 501(C)(3). It is privately supported, and receives no funds from any government at any level, nor does it perform any government or other contract work.

The Heritage Foundation is the most broadly supported think tank in the United States. During 2007, it had nearly 330,000 individual, foundation, and corporate supporters representing every state in the U.S. Its 2007 income came from the following sources:

Individuals	46%
Foundations	22%
Corporations	3%
Investment Income	28%
Publication Sales and Other	0%

The top five corporate givers provided The Heritage Foundation with 1.8% of its 2007 income. The Heritage Foundation's books are audited annually by the national accounting firm of McGladrey & Pullen. A list of major donors is available from The Heritage Foundation upon request.

Members of The Heritage Foundation staff testify as individuals discussing their own independent research. The views expressed are their own, and do not reflect an institutional position for The Heritage Foundation or its board of trustees.

Backgrounder

Published by The Heritage Foundation

No. 2162
July 14, 2008

How Rising Gas Prices Hurt American Households

Karen A. Campbell, Ph.D.

The upward march of retail gasoline prices has affected U.S. households regardless of whether their members drive, take public transportation, or walk. In a modern economy, the interdependency created by supplying specialized labor and trading for all other goods and services produced by other people leaves virtually no one unaffected by the price of gas at the pump.

Analysts at The Heritage Foundation recently examined how going from $3 and $4 retail to $5 and $6 retail per gallon of gasoline would affect the U.S. economy. If prices continue to rise at an accelerated pace over the course of a year:[1]

- Total employment would decrease by 586,000 jobs,
- Disposable personal income would decrease by $532 billion,
- Personal consumption expenditure would decrease by $400 billion, and
- Personal savings would be spent to help pay the cost.

What the Numbers Mean

Table 1 shows what these numbers mean for three representative households' income, consumption, and saving patterns. The first column is the actual data from the 2006 Bureau of Labor Statistics Consumer Expenditure Survey.[2] The simulated impact is in the second column for each type of household, and the third column shows the dollar loss for households.

The estimate is a best case in that mortgage and interest payments remain constant. More likely,

Talking Points

- Higher gas prices lower employment, income, and spending.
- Households initially tap their savings to pay the higher prices.
- Consumption growth slows as households adjust to higher gas prices.
- Slower growth in consumption and higher fuel prices for businesses result in lower employment.
- Employment is also decreased by workers trying to change their work patterns to avoid burdensome commutes.
- Lower employment slows the growth in income, which means slower economic growth over time.
- Markets are signaling a need for more supply. Businesses are trying to respond by making investments in refining capacity and finding new energy sources. This should be encouraged.
- Deficit reduction and inflation vigilance are needed to strengthen the dollar and ease pressure on prices and speculation in commodity markets.

This paper, in its entirety, can be found at:
www.heritage.org/Research/Economy/bg2162.cfm

Produced by the Center for Data Analysis

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The Heritage Foundation
LEADERSHIP FOR AMERICA

How Rising Gas Prices Will Affect Households

Projections are based on the price of gas increasing by $2 per gallon. Income and expenditure figures are median values from 2006, the most recent data available.

	Husband and Wife			Married, 2 Children, Oldest Child Age 6–17			Single		
	Actual	Gas Price Effect	Change in 2008	Actual	Gas Price Effect	Change in 2008	Actual	Gas Price Effect	Change in 2008
Disposable personal income	$69,350.00	$68,483.13	**–$866.88**	$86,807.00	$85,721.91	**$1,085.09**	$37,795.00	$37,322.56	**–$472.44**
Income after paying mortgage and interest	$65,468.78	$64,601.91	**–$866.88**	$79,934.71	$78,849.62	**–$1,085.09**	$35,648.05	$35,175.61	**–$472.44**
Average annual purchases of goods and services	$55,631.38	$55,130.70	**–$500.68**	$69,157.47	$68,438.23	**–$719.24**	$33,996.55	$33,690.58	**–$305.97**
Personal savings	$9,837.40	$9,082.89	**–$754.51**	$10,777.24	$9,984.52	**–$792.72**	$1,651.50	$1,424.15	**–$227.35**

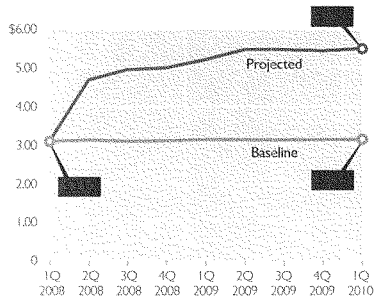
Source: Bureau of Labor Statistics Consumer Expenditure Survey 2006, at *http://www.bls.gov/cex/2006/stnderror/cucomp.pdf*. Effects are calculations made by analysts at The Heritage Foundation.

Table 1 • B 2162 heritage.org

increased borrowing and less saving will result in higher interest payments, constraining spending and decreasing the savings of households yet more. It also does not show the increased likelihood that a member of the household will be unemployed.

Chart 1 illustrates the baseline gas price forecast and the higher gas price simulation. The effect of gas prices operates directly and indirectly. Chart 2 shows the effect on employment. Both the demand for labor and the supply of labor are negatively affected, and this lowers overall employment. On the demand side, businesses rely heavily on transportation to get their goods and services to the consumer. Many suppliers have their own fleets; others, who outsource their transportation service, must pay higher costs for this service. Higher costs along with decreased consumer purchases will cause businesses to cut back on jobs. The decrease in employment is not entirely attributable to labor demand, though; labor supply may also decrease. Individuals with

Forecasted Price of Retail Gas



Source: Data for the employment series are from the Bureau of Labor Statistics Employment series. Personal Disposable Income and Expenditure series are from the Bureau of Economic Analysis National Personal Income and Outlays Accounts. Retail gas price data are from the Energy Information Administration. Heritage Foundation forecast simulation uses RATS econometric software.

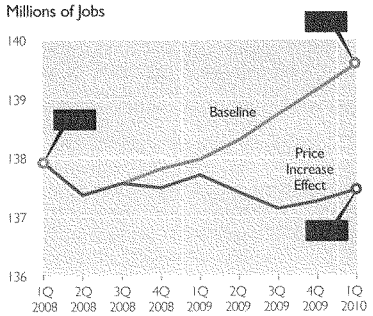
Chart 1 • B 2162 heritage.org

1. Dollar prices are in nominal terms.
2. U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey, 2006, at *http://www.bls.gov/cex/2006/stnderror/cucomp.pdf* (July 3, 2008).

The Heritage Foundation
LEADERSHIP FOR AMERICA

High Gas Prices Will Lead to Job Losses

If the cost of a gallon of gasoline increases by $2, total employment in the U.S. will decrease by 2.1 million in 2010.



Source: Data for the employment series are from the Bureau of Labor Statistics Employment series. Personal Disposable Income and Expenditure series are from the Bureau of Economic Analysis National Personal Income and Outlays Accounts. Retail gas price data are from the Energy Information Administration. Heritage Foundation forecast simulation uses RATS econometric software.

Chart 2 • B 2162 heritage.org

long commutes may decide to look for other jobs closer to home or give up working altogether.

Chart 3 shows the effect on other household variables. Households tap into personal savings immediately to pay for higher fuel costs because personal consumption expenditures (buying habits) are not adjusted downward as fast as real[3] disposable income is decreased. Disposable income decreases almost immediately. Growth in income rebounds but then adjusts to a slower rate as the feedback from job losses begins to drag it down. Consumption expenditure is then further crimped by decreased disposable income, and higher interest payments from increased borrowing start to crowd out other purchases. This results in more losses to savings. As prices continue to rise, consumers do adjust their spending. This can be seen by the slower growth in spending as compared to the baseline. The overall effect after just two years can be seen by the gap between the baseline and the simulation with higher gas prices.

The rise in energy prices at a time when food prices and other commodity prices are rising may solicit a monetary policy response to fight inflationary pressures. Although this effect was not included in the analysis, this would further increase interest rates and constrain the pocketbooks of businesses and households. However, if this policy sends a signal that the Fed is once again targeting inflation, this may go a long way to ease pressure on commodity prices and strengthen the U.S. dollar. Both of these two effects would serve to ease pressure on prices.

Conclusion

Americans are now facing the prospect of even higher prices at the pump. While there are many other economic influences on household expenditure, personal savings, personal disposable income, and total employment, the Heritage analysis simulated the dynamic movement of these variables in response to movements in the retail price of gasoline.

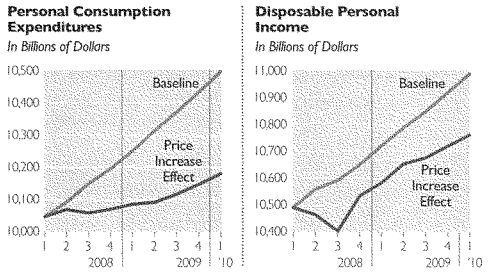
The results of the analysis show that households react by using personal savings in the short term. This reduction in assets slows other spending, leading to slower growth in purchasing.[4] On the supply side, businesses experience higher production costs while demand for their goods is lower, causing them to adjust their employment downward. Individuals, too, may begin to adjust their work choices as longer commutes make working outside the home less beneficial. These two effects reduce overall employment.

There is a feedback effect between employment and personal disposable income. After a sharp decrease, disposable income starts to grow, but this growth is quickly slowed by the loss of jobs.

3. Real variables are adjusted for inflation and therefore are a measure of what people can "really" purchase with their income (purchasing power).
4. At these prices, it is arguable that the elasticity of demand for gasoline is higher, which should reduce expenditures. The income effect of the higher prices also has a ripple effect throughout the economy.

Higher Gas Prices Will Affect the Entire Economy

If the cost of a gallon of gasoline increases by $2, personal expenditures and disposable income will be affected. The charts below show projections, by quarter, through the first quarter of 2010:



Source: Data for the employment series are from the Bureau of Labor Statistics Employment series. Personal Disposable Income and Expenditure series are from the Bureau of Economic Analysis National Personal Income and Outlays Accounts. Retail gas price data are from the Energy Information Administration. Heritage Foundation forecast simulation uses RATS econometric software.

Chart 3 • B 2162 heritage.org

The overall result after just two years is lower employment, lower disposable income, and lower overall consumption of goods and services.

This is purposefully a short-term forecast. The U.S. economy is known for its innovative responses to economic scarcity. Markets that are unconstrained by excessive regulation can give a clear price signal. Higher prices signal the need for more oil. Businesses are attempting to respond to that need by finding new reserves to drill and increasing investment in refining capacity. The high price also signals entrepreneurs to look for new, more efficient ways to supply the energy needs of consumers.

To the extent that the high price is not a clear signal because of excessive taxes and regulations that artificially make oil scarcer, the government can implement policies that would allow for more oil production. The government can also encourage innovations in energy supply by keeping regulatory burdens to a minimum.

Congress should focus on reining in spending and reducing the deficit. This would serve to lower long-term interest rates and strengthen the U.S. dollar, which would help to ease the pressure on prices. Monetary policy that is expected to be inflation-fighting could also aid in stabilizing prices and curb the current flight to commodities.

—Karen A. Campbell, Ph.D., is Policy Analyst in Macroeconomics in the Center for Data Analysis at The Heritage Foundation.

APPENDIX
DATA, METHOD, AND RESULTS

Analysts used Vector Autoregression (VAR) analysis to decompose the historical data and conduct a dynamic forecast simulating a two-dollar increase in the retail price of gasoline. Vector Autoregression is a tool now widely used by economists to gain insights into the dynamic interactions of historical data, measure the impact on other variables to a shock in one of the variables, and make economic forecasts.[5]

This analysis uses the quarterly series for retail gasoline prices (GAS) from the International Energy Agency. Real disposable personal income (DPI) and real personal consumption expenditure (PCE) are from the Bureau of Economic Analysis, and total employment (TE) is from the Bureau of Labor Statistics. The data run from the first quarter of 1980 to the first quarter of 2008. The log of the data was first differenced to achieve stationarity,[6] resulting in 107 usable observations. The series were in real terms.

The following model was estimated.[7] Difl is the logged difference of the variable. J = {1,2,3,4}.[8]

Diflgas(t) = constant + diflgas(t) + diflgas(t-j)

Diflpce(t) = constant + diflgas(t) + diflgas(t-j) + diflpce(t-j) + difldpi(t+1-j)

Difldpi(t) = constant + diflgas(t) + diflgas(t-j) + diflte(t-j)+ difldpi(t-j)

Difite(t) = constant + diflgas(t) + diflgas(t-j)+ diflte(t-j) + diflpce(t-j)

Factor variance decomposition of the model shows that after its own lags, retail gas accounts for much of the variance in personal consumption expenditure over the longer term (22 percent). The analysis also shows that over time, rather than diminishing, gas prices have an increasing effect on all three variables.

A forecast from the second quarter of 2008 to the first quarter of 2010 was generated to establish a baseline. The baseline predicted an average retail gas price of $2.61 in the second quarter of 2008, which is slightly higher than the average price in the first quarter of 2008 of $2.58 (in real terms). A shock in gas prices was implemented via a price path that increases the difference in gas prices by 40 percent in the first two quarters, 5 percent in the following quarter, and 10 percent in the quarter after that. The remaining quarters were not "shocked." This resulted in a forecast of average gas prices in the second quarter of 2008 of $3.90 and climbing to $4.58 (in real terms).

In order to estimate the nominal prices, the real gasoline prices were adjusted by a deflator of 1.2. This was the deflator used by the Bureau of Economic Analysis to adjust the consumption and income series. Arguably, this is a best-case scenario of the differences in the baseline versus forecast because the same rate of inflation is assumed for both. To the extent that higher gas prices help to fuel inflation, the gap between the baseline and forecasted amounts will be wider.

5. An analysis was run using the Global Insight model of the U.S. economy. These results also showed significant decreases in the variables, with savings being hit hardest first and the employment impact being felt a few quarters later. The Global Insight simulation was for a $1 increase in the price, and the effect on employment was 544,000 jobs lost.

6. The Kwiatowski, Phillips, Schmidt, and Shin test for stationarity was used. See D. Kwiatowski, P. C. B. Phillips, P. Schmidt, and Y. Shin, "Testing the Null Hypothesis of Stationarity Against the Alternative of a Unit Root: How Sure Are We That Economic Time Series Have a Unit Root?" *Journal of Econometrics*, Vol. 54 (1992), pp. 159–178.

7. The model was run on RATS v. 6.2 on a PC using the Windows XP OS. Different lag structures were tested and resulted in qualitatively similar results.

8. Durbin–Watson statistics were between 1.89 and 2.04 for the four equations estimated. The standard errors of the estimates for each of the four equations were 0.07, 0.005, 0.007, and 0.003, respectively.