Growth is Not Enough

If you think a robust economy will automatically generate prosperity for all, think again

By Frank Levy

In a recent assessment of George W. Bush, *Wall Street Journal* columnist Paul Gigot noted with approval that Bush had selected policy advisers who were "credible with the party's growth wing". At first glance, Gigot's description seems out-of-date: is there any discernible non-growth wing in the Republican Party, or, for that matter, in the Democratic Party? In 1992, not even Steve Forbes would have dared to claim he could deliver the combination of low inflation and low unemployment we have enjoyed since mid-decade. Bill Clinton has taken the growth issue away from the Republicans, just as he has taken so much else. Or, I should say, "retaken the growth issue". It was, after all, John Kennedy who 39 years ago proclaimed, "A rising tide lifts all boats."

But the economy has changed in several important respects since Kennedy's time. People who think there are no economic problems left in America, and that there need be no appreciable differences between the attitudes of liberals and conservatives about economic growth, need to look at the present-day American economy more closely. If we don't generate a discussion about the nature of our prosperous economy, there's a real danger that we're going to grow our way to a society that doesn't work for a good portion of its people.

Economic growth comes in two flavors. Business cycle growth expands the gross domestic product (GDP) by lowering the unemployment rate and putting people into jobs. We have probably now reached the limit of the business cycle growth rate; few people believe unemployment can fall much lower than it is now.

Over the longer run, GDP grows through gains in productivity—output per worker. Rising output per worker translates into rising wages and incomes. The productivity gains of the last 70 years help explain why average family income today is more than three times higher than it was in 1929 (corrected for inflation) even though the 1929 unemployment rate was 3.2 percent.

In Kennedy's time, the nation was in a 26-year productivity boom in which output per worker was rising at a very high 3 percent per year. The result was a long run of upward mobility, in which most people made big income gains over their careers. For example, in 1949, the average 30-year-old man earned about $16,800 (in 1997 dollars). That isn't much money in today's terms—little more than the poverty standard for a family of four. But twenty years later, this average man, now 50, was earning almost $40,000, a more-than-doubling of income over 20 years.

Productivity growth slowed sharply in the early 1970s, and while the most recent numbers have turned up, it is not yet clear that the slump is over. Until productivity growth does revive, career income gains will, on average, be much slower than they were in the Kennedy era. In 1976, the average 30-year old male earned $31,100, almost twice as much as his 1949 counterpart. But by 1996, his earnings had increased only to $37,800—a gain of one-fifth spread over two decades. Men who were college graduates saw their incomes grow faster, but high school graduates saw virtually no growth at all: Their average income was $27,600 at age 30 and $28,400 at age 50.

The opening of a substantial college-high school earnings gap represents a second major change, after the slowing of productivity growth, since Kennedy's time. When Kennedy said that a rising tide lifts all

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boats, a lack of formal education was no obstacle to a good job. A farm laborer, displaced by mechanization, could often get on a bus to a city and find a factory job at higher pay.

Since 1980, the economy has heavily favored the better-educated over the less-educated. When technology or international trade displaces a semi-skilled manufacturing worker, moving to a good job now means getting the training to become a computer repairman or a laboratory technician. That's a lot harder than getting on a bus. In the past two years, very tight labor markets have raised all workers' wages. But in the past two decades, the labor market has changed much faster than people can change their skills. As a result, less-educated men and women have been hit hard. They are the workers whose paychecks are most hurt by economic change. They are also the parents required to make the biggest improvements in their children's education to avoid repeating the cycle.

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The post-1980 association between income and education partially explains why income inequality is substantially greater today than it was in Kennedy's time. Between 1979 and 1997, the average income of the middle one-fifth of American families rose from $42,000 to $44,600 (adjusted for inflation). Over the same years, the average income of the richest five percent of families rose from $148,000 to $235,000. These are U.S. Census figures that, for a variety of reasons, understate the highest incomes. Top incomes are better measured by U.S. Treasury summaries of tax returns. The latest data show that in 1997, taxpayers reporting over $200,000 in adjusted gross income—about 1.3 percent of all tax filers—accounted for 19.7 percent of all adjusted gross income that taxpayers reported.

From an economist's perspective, this isn't news. Economic theory clearly states that growth does not automatically benefit everyone—Kennedy's time was a happy anomaly. For this reason, economists' broad embrace of economic growth rests on a caveat: in an expanding economy, the winners ought to be able to compensate the losers and still be better off themselves.

It is here, though, that ideological differences begin to emerge. When Paul Gigot refers to the "growth wing of the Republican party," he is describing people who both want an ever-expanding role for free markets and who believe that free-market outcomes are fair almost by definition. The most exuberant members of this group—Steve Forbes again comes to mind—argue that laissez faire will automatically produce what Kennedy described—the rising tide that lifts all boats. But if the tide does not lift all boats, these conservatives say, there is little to be done about it. Making the winners help the losers would mean imposing higher (also known as "confiscatory") taxes, and so would kill the economy's growth and hurt everybody.

Conservatives bill this position as pro-growth, but the truth is that it's potentially pro-stagnation. Conservatives are probably right to argue that our best hope for raising productivity involves relying heavily on markets and the competitive pressure they bring. But in a democracy, markets have to command political support. If we permit technological change and free trade to distribute incomes in increasingly unequal ways, much of the population will come to view markets and economic growth as one more special-interest cause. When the next recession comes, people who propose to control the flows of capital and jobs—for example Pat Buchanan, with his rhetoric of restrictions on trade—will grow in appeal.

A liberal pro-growth policy must continue to emphasize education. It also must emphasize continued supports for low and moderate income families. Liberals aren't doing their job if they merely endorse, in the name of promoting growth, across-the-board tax cuts. Tax relief, if we have it at all, should focus on families with incomes under $50,000 and include refundable credits for families with no federal income tax liability. Social Security reforms should preserve Social Security's current redistribution from high to low earners. Liberals must beat back, as they did in 1997, Republican attempts to dismantle the earned income tax credit, the major income supplement to low-wage workers that some Republicans have targeted as a form of "welfare." If liberals fail to make this connection—if we believe, as conservatives appear to believe, that we can pursue GDP growth pure and simple, without concern for fairness—we may find that we have made both growth and fairness into scarce commodities.

Guess Who Saved the South Bronx? Big Government

The silent partner in "community development"

By Robert Worth

On Dec. 10, 1997, President Clinton made a surprise appearance in the South Bronx. After a brief stroll through the once-blighted neighborhood of Charlotte Street, Clinton credited local community development groups with transforming the nation's worst slum into a livable place over the past 15 years. "Look at where the Bronx was when [president] Carter came here in despair," he told the crowd at the Madison Square Boys and Girls Club. "Look at where the Bronx was when President Reagan came here and compared it to London in the Blitz. And look at the Bronx today. If you can do it, everybody can." The story he told was already becoming a familiar one: A group of local people band together to fight off the pimps and pushers and rebuild their neighborhood. "The citizens of the South Bronx set an example that can serve a hundred other slums around the country," Ted Koppel declared in a 1996 Nightline segment.

It's certainly true that the South Bronx has undergone a miraculous transformation. Japanese tourists who come by bus to see "Fort Apache, the Bronx" find themselves staring out at suburban-style homes with glossy lawns and picket fences instead. Most of the charred hulks that made the area seem like a wasteland are gone, and it's hard to walk a few blocks without hearing the buzz and hammer of construction crews. In the 42nd Precinct, which includes the worst areas of the "Fort Apache" days, the number of shootings has dropped by over two-thirds in the past five years, the number of robberies and assaults by over half.

But there's something missing from the usual story about how it happened. Yes, the local Community Development Corporations (CDCs) have made an enormous difference. But they've been around for decades. In fact, they were there when the Bronx was burning in the '70s, and if they had been the only heroes in the story, there might not be anything left in the Bronx to celebrate. The truth is that the South Bronx has come back because the government intervened. Starting in the mid-'80s, New York City started pouring some $500 million a year into affordable housing—more than the next 50 largest U.S. cities *combined*. Much of that money went into the South Bronx. Equally important, city officials used the money effectively, avoiding the terrible mistakes of old-style top-down "urban renewal." They provided both funding and expertise for the nonprofits and CDCs who have received most of the credit for the borough's revival. These groups also got help from two federal government programs, the Community Reinvestment Act and the Low-Income Housing Tax Credit, which brought banks and private companies into an area they had previously shunned.

It's understandable that government should get less than its share of the glory. "In a way, that's our role, to work behind the scenes and let local people pick it up from there," says Bronx Borough President Fernando Ferrer. But failing to acknowledge government's role can also be dangerous. It encourages the myth that government's role in cities is still a matter of evil