

Standard of Living Is in the Shadows as Election Issue

By DAVID LEONHARDT

WASHINGTON — Taxes and government spending. Health care. Immigration. Financial regulation.

They are the issues that have dominated the political debate in recent years and have played a prominent role in this presidential campaign. But in many ways they have obscured what is arguably the nation's biggest challenge: breaking out of a decade of income stagnation that has afflicted the middle class and the poor and exacerbated inequality.

Many of the bedrock assumptions of American culture — about work, progress, fairness and optimism — are being shaken as successive generations worry about the prospect of declining living standards. No question, perhaps, is more central to the country's global standing than whether the economy will perform better on that score in the future than it has in the recent past.

The question has helped create a volatile period in American politics, with Democrats gaining large victories in 2006 and 2008, only to have Republicans return the favor in 2010. This year, economic anxiety, especially in industrial battlegrounds like Ohio, is driving the campaign strategies of both President Obama and Mitt Romney.

The causes of income stagnation are varied and lack the political simplicity of calls to bring down the deficit or avert another Wall Street meltdown. They cannot be quickly remedied through legislation from Washington. The biggest causes, according to interviews with economists over the last several months, are not the issues that dominate the political debate.

At the top of the list are the digital revolution, which has allowed machines to replace many forms of human labor, and the modern wave of globalization, which has allowed millions of low-wage workers around the world to begin competing with Americans.

Not much further down the list is education, probably the country's most diffuse, localized area of government policy. As skill levels have become even more important for prosperity, the United States has lost its once-large global lead in educational attainment.

Some of the disconnect between the economy's problems and the solutions offered by Washington stem from the nature of the current political debate. The presidential campaign has been more focused on Bain Capital and an "apology tour" than on the challenges created by globalization and automation.

But economists and other analysts also point to the scale of the problem. No other rich country — not Japan, not any nation in Europe — has figured out exactly how to respond to the challenges. “The whole notion of the American dream,” said Frank Levy, an M.I.T. economist, “described a mass upward mobility that is just a lot harder to achieve right now.”

For the first time since the Great Depression, median family income has fallen substantially over an entire decade. Income grew slowly through most of the last decade, except at the top of the distribution, before falling sharply when the financial crisis began.

By last year, family income was 8 percent lower than it had been 11 years earlier, at its peak in 2000, according to inflation-adjusted numbers from the Census Bureau. On average in 11-year periods in the decades just after World War II, inflation-adjusted median income rose by almost 30 percent.

Matching the growth rates of the postwar period — when the country was poorer, when harsh discrimination against women and minorities was receding and when the rest of the world was weaker — is probably impossible. Yet there is still a vast difference, both economically and politically, between incomes that are rising modestly and not at all.

Historically, periods of economic stagnation have tended to bring pessimism, political turmoil and a lack of social progress, said Benjamin Friedman, an economic historian and the author of “The Moral Consequences of Economic Growth.” The political volatility and partisan rancor of the last several years seem to fit the pattern.

The recent stagnation has also led, economists say, to confusion and even scapegoating about the real sources of the problem. The causes that can seem obvious, and that often shape the political debate, are not necessarily the correct ones.

Take immigration, especially illegal immigration. Whatever other problems it may cause, evidence suggests that it has not played a significant role in the income slump.

It may have caused a slight decline in the wages of native-born workers without a high school diploma (and maybe not even that). But most illegal immigrants lack the skills to compete with the bulk of native workers, according to research by Giovanni Peri, Chad Sparber and others. Notably, incomes in some states with large immigrant populations, like California, have risen faster than in states with relatively few immigrants, like Ohio.

The minimum wage, similarly, appears to play only a minor role in the income slump. It has risen faster than inflation since 2000, even as overall pay at the bottom of the income distribution has not. And the size of the federal government also looks like a dog that is not barking: Washington collected taxes equal to 15.4 percent of gross domestic product last year, down from 20.6 percent in 2000.

A second group of much-cited forces have indeed played a role in middle-class stagnation and inequality, many economists argue, just not as big a role as automation, globalization or education.

Health care costs have grown sharply over the last decade, leaving employers with less cash to use on salaries. Labor unions have shrunk; all else equal, unionized workers earn more, often at the expense of corporate profits. Tax rates have fallen more for the affluent than for anyone else, directly increasing the take-home pay of top earners and indirectly giving them more incentive to earn large amounts.

But many of these factors are particular to the United States, while globalization and automation are obviously universal forces.

One of the more striking recent developments in economics has been economists' growing acceptance of the idea that globalization has held down pay for a large swath of workers. The public has long accepted the idea, but economists resisted it, pointing to the long-term benefits of trade. "That is starting to change only in the face of very strong evidence over the past decade," said Edward Alden of the Council on Foreign Relations.

In particular, job growth and wage growth have been weaker in sectors exposed to global competition — especially from China — than in sectors that are more insulated.

Automation creates similar patterns. Workers whose labor can be replaced by computers, be they in factories or stores, have paid a particularly steep price. The American manufacturing sector produces much more than it did in 1979, despite employing almost 40 percent fewer workers.

Workers with less advanced skills have also suffered disproportionately. The pay gap between college graduates and everyone else is near a record. Despite the long economic slump — and the well-chronicled struggles of some college graduates — their unemployment rate is just 4.1 percent.

What is the solution to this thicket of economic forces?

That question is the one that Mr. Obama and Mr. Romney are trying to convince voters that they can best answer. They both accept that the government and the market have a role, but they put a different emphasis on those roles.

It is hard to see how either globalization or automation can be stopped. The proposed solutions instead tend to involve managing them.

If the economy can be made to grow fast enough, incomes can still rise across the board, as they did when the unemployment rate fell below 5 percent in the 1990s and briefly below 4 percent in 2000. If educational attainment rises, more people will be able to get jobs that benefit from technology and global trade, rather than suffer from it. And if inequality continues to soar, the government could choose to use the tax code to ameliorate it — a solution that Democrats favor and Republicans say will hurt economic growth.

Maybe the biggest reason for optimism is that there is still a strong argument that both globalization and automation help the economy in the long run. This argument remains popular with economists: Trade allows countries to specialize in what they do best, while technology creates opportunities to extend and improve life that never before existed.

Previous periods of rapid economic change also created problems that seemed to be permanent but were not. Neither the cotton gin nor the steam engine nor the automobile created mass unemployment.

“When technology reduces the need for certain kinds of labor, we know that some inventive people will one day come along and find a way to use that freed-up labor making things that other people want to buy,” said Mr. Friedman, the economic historian. “That’s what in the long run made the Luddites wrong.”

He added, “How long does it take the Luddites to be wrong — a few years, a decade, a couple of decades?”

Perhaps just as important, what happens to the workers who happen to be living during a time when the Luddite argument has some truth to it?
