

## Ignorance

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August, 2007

One of the most striking features of this underperforming economy is the redistribution of income from the middle to the rich. Between 1995 and 2005, the share of income accounted for by the highest 20 percent (quintile) of the population (roughly those making above \$ 100,000 per year) has increased by almost two percentage points. Thus, by 2006, the highest quintile received a little over half of all income, a record percentage. In contrast, the income share for every other quintile in the income distribution fell. Additionally, hourly wages have been stagnant in real terms. To put the cherry on the sundae, all this has occurred while productivity has grown at an historically high rate.

Yet, despite all this, the economy has grown. Why? The answer is simple, and we are unfortunately seeing it now in the collapse of credit markets and the rise in foreclosures. The middle class kept up with the van Jones by using their houses as piggy banks and maxing out on multiple credit cards. Unless you're the United States government, you can't borrow forever and never have to pay. The day of reckoning has arrived and this economy is not so soundly based that it can pay the piper without some significant trauma. The odds are that this economy will, at best continue to underperform and at worst slip into recession.

There are three reasons for this basic weakness in the economy:

1. The tax system now favors the rich. The Bush tax cuts of 2003 allowed upper income households to retain more of their income, while penalizing the middle and lower income classes. This is fact, whether your politics agree with this approach or not. In addition, the proposed repeal of the estate tax, and the extension of the 2003 measures would continue and intensify this effect. The upshot is that the ability of the middle class to support the economy through consumption has been hindered. For a while the run up of home prices sustained this consumption, but the base income is just not there, and upper income households are neither numerous enough nor spend enough to replace the lost purchasing power of the middle class.
2. The returns to productivity have accrued to capital rather than labor. Right now, corporate America is awash in cash. Profits have blossomed during this decade at the expense of wages. Normally, businesses would reinvest these profits in the U.S. creating jobs and growing the economy. Not so. For the most part, profits show up as retained earnings (cash under the mattress) or investment abroad (thus creating jobs in China to make goods that American consumers struggle to buy). Recently, profits have been devoted to a new use, the repurchase of stock to sustain a high

share price. None of these uses contributes significantly to American economic growth, the expansion of jobs or the welfare of the middle class.

3. We have not created the high-complexity jobs that have been the hallmark of the American economy. The economic history of the United States has been a progression of outsourcing lower complexity jobs and creating higher complexity jobs. We continue to do the former but have ceased doing the latter. The problem is not that manufacturing jobs are going to Mexico, India, China and Vietnam. Rather it's that technical jobs are. And they are going there because we cannot and will not educate enough scientists and engineers. The ones we do educate, we immediately send back to their home countries on the suspicion that an Carnegie-Mellon electrical engineering Ph.D. from India may be a sleeping terrorist. So, U.S. companies (see above) hire that newly minted scholar in India where they have built manufacturing plants. Makes perfect sense, doesn't it?

Is there an answer to this economic weakness? There is, but it requires a tremendous amount of focus and will. We need to begin by substantially increasing national investment, both in plant and equipment and in education. Right now the governing doctrine in education is "no child left behind". The reality is that this means "no child pushed ahead ". We need to recognize that true national security lies with a highly educated labor force that pushes productivity and creates more jobs. To pay for this we also need to overhaul the tax system. The rich should pay more in taxes than the poor. Even at higher rates, they still will be better off than the middle and poorer classes. These are just the beginning. The beginning of wisdom is to admit ignorance. It's time we took a hard look at this economy and recognized our own ignorance.