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Challenges to achieving the American Dream

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Is the American Dream coming to an end? With people being “one paycheck away from homelessness” and with rising foreclosures, you might think so.

Beltway organizations of both left and right recently added fuel to the debate when the Economic Mobility Project (www.economicmobility.org) suggested that generation-to-generation income growth was slowing and even reversing.

“Economic Mobility: Is the American Drive Alive and Well?” is the first product of a partnership involving several heavy hitters in the world of beltway punditry, including the conservative-leaning American Enterprise Institute and the liberal-leaning Urban Institute.

The study, which offers no policy recommendations, inspired newspaper headlines because of a chart that was labeled “Today, Men in their Thirties Have Less Income Than Men in their Father’s Generation.”

In 2004, it reported men in their 30s had “on average 12 percent less income than their father’s generation at the same age.” The numbers, which are adjusted for inflation, sound gloomy. But dig deeper, starting with the footnotes, and you’ll find a more complex story.

Start with a footnote, which states that the numbers do “not include the value of non-cash compensation such as employer-contributions to health insurance and retirement benefits, nor do they include the effect of taxes or non-cash benefits such as food stamps.”

Excluding non-cash compensation makes a big difference. For example, the Information Technology and Innovation Foundation (www.innovationpolicy.org) estimates that between 1979 and 2005, employers increased their payments for Medicare, Social Security, and health insurance.

Taken together, these forms of compensation increase of median household income by \$2,740. The researchers at the Employment Mobility Project promise to address this issue in future reports.

The report also does not, in the words of another footnote, “explore the role that changes in family structure and second earners have had on economic mobility.” It’s quite possible that these changes have had significant effects.

Political Fallout

What can policymakers do? Some will use these numbers to launch populist campaigns against trade liberalization and outsourcing, and for more income redistribution. But when it comes to

making positive contributions, policy makers are limited in what they can do about the income mobility of any family.

One reason is that the population is incredibly diverse in habits and wants. The preference for buying now instead of saving for future purchases, working in a demanding but potentially better-paying job, when (or whether) to marry, several (or one, or no) children and many other factors all have effects on income. All of these decisions and attributes will be unevenly distributed whenever the population has even the slightest bit of personal freedom.

But there are still ways for policymakers to promote income mobility and stave off populist folly. I'll mention just two. They can reduce the opportunities for "rent-seekers." That's a term economists use for people who get rich through political skills rather than actually creating something that is valued in the open market.

Examples of rent-seeking abound. Through abuse of eminent domain, one private company (Best Buy) can use government to take over the property of another business. Through its political connections and sheer size, another company (Thomson) scores tax breaks while small shops must pay full freight. (Thankfully, that last act was shot down with Gov. Tim Pawlenty's veto of the tax bill.) Through the regulatory power of cities and the state, professionals and businesses make it hard for new competitors to threaten their profits.

The ethanol industry offers perhaps the best current example of rent-seeking. Ethanol use is widespread. Is this because motorists find ethanol to be a superior product? Hardly. Its use stems from favorable tax treatment (which lowers its price) and government regulations (which effectively require its use).

How can lawmakers reduce rent seeking? By reducing the opportunities for it. Focus on core government functions, not handing out favors. Cynicism will decline, and people will be forced to offer something of value to consumers, which will make everyone better off.

Lawmakers can also promote mobility by improving public education. The education industry is filled with rent seekers. Public policy favors the interests of school staff, unions, administration and board rather than students and families. Crucial reforms are prevented, money goes to red tape instead of teaching, and students lose many of the benefits from a good education. Tie funding to the backs of students, and let entrepreneurship improve education for all.

Nobody should be guaranteed a rising income. But sound policy can open the door for those who seek it.