

# The institutional foundations of middle-class democracy

To protect and restore the hallmarks of a well-functioning market democracy, progressives in the United States and elsewhere must rebuild its institutional foundations and shift back the uneven organisational balance between concentrated economic interests and the broad public

**Jacob S. Hacker**

---

The financial crisis of 2008 seemed almost tailor-made to discredit the governing economic philosophy of the prior generation. Not only did it occur on the watch of an unpopular Republican president; it also laid bare the vast and growing gaps between ordinary Americans and the super-rich – and in particular between the economic travails of Main Street and the reckless behaviour of Wall Street. Yet, just two years after electing Democratic President Barack Obama in November 2008, American voters devastated the president’s congressional majority. Within weeks, the political agenda shifted entirely from measures to create jobs and bolster economic security to big spending cuts, the expansion of favourable tax provisions for the affluent and corporations, and a state-by-state push for deregulation, programmatic cuts and anti-union rules.

The temptation is to see these developments in personal terms, as a reflection of the poor strategies of Democrats or the savvy tactics of their opponents. But the immensity of the gap between expectations and outcomes calls on us to dig deeper into the sources of American liberalism’s contemporary woes. This digging suggests that the most fundamental problems are structural rather than personal. They reflect the way in which the “rules of the game” of the economy and polity have changed – changes that have played out distinctively in the United States but whose echoes can be seen in other English-speaking nations and,

increasingly, in affluent democracies more broadly. Against the backdrop of these structural shifts, progressives cannot simply play the game with more determination or intelligence. They will need to reshape the rules as well.

## **The great reversal**

The last generation has seen a remarkable turnaround in US economic outcomes. In the generation after the Second World War, the economy and the earnings of all income classes grew roughly in tandem. Since the 1970s, the economy has slowed modestly, but the big change has been where the rewards of growth have gone. In a word, they have gone to the top. Over the last generation, the share of pre-tax national income received by the richest 1% of Americans has more than doubled. The share received by the richest 0.1% has more than quadrupled, rising from less than 3% in 1970 to more than 12% in 2007 – the highest proportion since the creation of the income tax in 1913.

This is not a story of stagnant productivity or general economic malaise. It is a story of the decoupling of aggregate productivity and most workers’ wages. Even a college-educated, entry-level male worker earns barely more than a worker in the same position did a generation ago. While the economic boom of the 1990s temporarily reduced the pay-productivity gap, the gap returned with a vengeance in the 2000s. Indeed, the expansion

of the 2000s was the first on record in which a typical family's income was at the end lower than at the close of the prior business cycle.

As job security has eroded and gains have shifted towards the top, other pillars of security and opportunity have also come under strain. The first of these is education and social mobility. Class lines have hardened. American inequality is sky-high and American social mobility is below the advanced industrial norm. The United States has gone from the world leader in college completion to a middling performer. More and more of the skyrocketing college costs are financed through loans, placing a burden on students and their parents – except in the case of children of the rich, who gain a huge headstart.

The second pillar is pensions and social insurance. America's job-based framework of economic security has gone from basic to broken. Defined, secure pensions – once the hallmark of a good job – are vanishing, and tax-deferred savings accounts like the 401(k)s are not filling the gap. As medical costs continue to outstrip inflation, employment-based health insurance benefits are becoming rarer and less protective.

The third pillar is housing and economic assets. Beside their homes, most middle-class families have strikingly little in the way of private assets to cushion economic shocks or build their futures. And those homes look far less secure than they once did. The traditional strategy of gradually accumulating wealth through housing has taken a perhaps fatal hit, with implications for the economic security not just of the middle-aged but also of the young, aspiring middle class.

### **Winner-take-all politics and its discontents**

Apologists for this staggering shift often attribute it to impersonal forces of technological change and globalisation. Along this view, computers and automation have reduced the rewards for routine skills while the entry of hundreds of millions of literate low-wage workers into the global workforce

has undermined the earnings of less-educated Americans. Compared to these vast tides, the conventional wisdom suggests, American politics and policy have played only a bit role.

As Paul Pierson and I have recently argued in our book *Winner-Take-All Politics*, this view is profoundly mistaken. Politics and public policy have in fact played an absolutely central role. One clue that they have been central is the diversity of experiences among rich democracies. All rich countries have experienced the impact of technological change and globalisation and yet in many rich democracies increases in inequality and declines in economic security have been modest, and few have seen anything like the sharp upward shift of economic rewards, the implosion of unions or the breakdown of social benefits that have occurred in the United States. Moreover, in many nations where wage inequality has risen, policymakers have pushed back through active labour market policies and through taxes and public spending that are designed to reduce the remaining income gaps. Not so in the United States. According to the Congressional Budget Office, even after taking into account all public and private benefits and federal taxes, almost 40% of all household income gains between 1979 and 2007 accrued to the richest 1% of Americans – more than received by the bottom 90% combined.

Another clue that politics and policy have been crucial is that America's newly unequal economy developed hand in hand with a new politics. In the late 1970s, corporate America organised on an unprecedented scale to influence government policy, not just through campaign donations but also through vast lobbying efforts. At the same time, with campaign costs skyrocketing, money became a far more important resource for politicians – and, as we have seen, a far more unequally distributed resource in American society.

The rising role of money and the increasing imbalance between business and other organised interests fundamentally changed Washington. For the contemporary Republican

party, these changes were welcome and encouraged the party to shift ever rightwards on economic issues. Democrats, by contrast, found themselves increasingly torn between their historical commitment to the little guy and the pull of money from the big guys, including, for much of the 1990s and early 2000s, the ascendant titans of Wall Street. The result was an ever more polarised economic debate in which a significant faction of one party, the Democrats, repeatedly proved willing to cut bargains that undermined the middle class's standing.

The recent US tax-cut deal extending huge tax reductions to the richest highlighted the long-term role of the American tax system in abetting inequality. Even as the pre-tax incomes of the richest have skyrocketed, politicians have slashed federal taxes on the affluent. The effective federal rate paid by the top 0.1% – that is, what these super-rich taxpayers actually pay in federal corporate, capital gains, income, payroll and estate taxes as a share of income – has fallen from over 60% in 1960 to around half that in 2004. Just since 1995, the top 400 US households have enjoyed a 45% cut in their federal income taxes (they paid 30% of individual income in 1995 and 16.5% in 2007). In 2007 alone, that saved the top 400 filers US\$46m per household.

Far more important and less recognised, however, have been the ways in which Washington has remade markets to advantage the top. Failure to enforce policies supporting workers' organising rights has undermined labour unions as a force for good pay while corporate governance rules all but asked top executives to drive up their own earnings. Financial deregulation brought great riches for some while crashing the rest of the economy.

Perhaps the least visible policy changes have been passive-aggressive – deliberate failures to address changing economic conditions, such as the need to balance work and family. Entire categories of support that have become essential to middle-class life, such as good

childcare, are simply not a public responsibility in the United States. Meanwhile, responsibilities once shouldered by corporations are shifting back onto families. Uniquely among industrial nations, the United States came to rely on employers to provide healthcare, pensions and other benefits that elsewhere enjoyed state sponsorship. But as employers have pulled back, government has not filled the gap.

It is not so surprising, then, that many middle-class Americans feel abandoned. Asked in mid-2010 whom government had helped “a great deal” during the downturn, 53% of Americans said banks and financial institutions. Forty-four% pointed to large corporations. Just 2% thought federal policies had helped the middle class a great deal.

### **The lessons of winner-take-all politics**

Three key features of these developments are crucial for grasping – and overcoming – the challenges that progressives face today. The first feature is the role of pre-distribution. When we think of government's effects on inequality, we think of redistribution – government taxes and transfers that take from some and give to others. Yet many of the most important changes have been in what might be called “pre-distribution” – the way in which the market distributes its rewards in the first place. Policies governing financial markets, the rights of unions and the pay of top executives have all shifted in favour of those at the top, especially the financial and non-financial executives who make up about six in 10 of the richest 0.1% of Americans.

The moral of this story is that progressive reformers need to focus on market reforms that encourage a more equal distribution of economic power and rewards even before government collects taxes or pays out benefits. This is not just because pre-distribution is where the action is. It is also because excessive reliance on redistribution fosters backlash, making taxes more salient and feeding into the conservative critique that government simply meddles with “natural” market rewards. Further, it is because societies in

which market inequality is high are, ironically, ones where creating common support for government action is often most difficult. The regulation of markets to limit extremes and give the middle class more voice is hardly easy – witness the fight over financial reform in the United States. But it is both more popular and more effective than after-the-fact mopping up.

The second feature is the problem of drift. Over the last generation, across a wide range of areas, public officials have deliberately failed to update policy in the face of changing economic circumstances, allowing outcomes to drift away from a more equal equilibrium. Although particularly pronounced in the United States, drift seems characteristic of many rich democracies today as they confront a rapidly changing economy and society. If this is so, preserving existing policies is not the only challenge. The welfare state traditionally understood remains deeply rooted. But the broader environment of the welfare state – a mixed economy characterised by a healthy civil society – is much more vulnerable.

To protect and restore these larger hallmarks of a well-functioning market democracy, progressives must preserve an effective capacity for robust governance. They should resist institutional reforms that abet gridlock. In the United States, this means altering the procedural rules that encourage the growing use of the filibuster, the Senate tradition of unlimited debate that has increasingly amounted to a universal supermajority requirement of 60 votes in the 100-member chamber. Progressives should also ensure that policies retain the capacity for over-time adjustment, whether automatically (as in benefits indexed to wages or prices) or structurally (through the preservation of basic regulatory, tax and spending powers that are too often sacrificed on the conservative altar of privatisation and delegation).

The third feature is the declining organisational might of the middle. The transformation of America's political economy over the last

generation has far less to do with the shifting demands of voters than with the changing organisational balance between concentrated economic interests and the broad public. Indeed, the sharp shift of economic policy towards business and the affluent occurred despite remarkable stability in public views on many economic issues, including views of government redistribution, progressive tax policy and the importance of key programmes of economic security. The agenda disconnect that we see today, as politicians ignore Americans' concerns about the lack of jobs in favour of cutting programmes that the public likes and preserving tax reductions for the rich that it does not, is not new. It has characterised the politics of the last generation.

The root of the problem, once again, is organisational. Middle-class democracy rested on organisations, such as unions and cross-class civic organisations, that gave middle-class voters knowledge about what was at stake in policy debates as well as political leverage to influence these debates. Without this organisational grounding, voters simply have a very hard time drawing connections between what politicians do and the strains they face in their lives, much less formulating a broad idea of how those strains could be effectively addressed. So far, however, the most effective organising has taken place not among progressives but on the conservative side, with the rise of the loose organisation of conservative voters, right-wing media figures and corporate-funded ideological activists that travels under the "Tea Party" banner.

The Tea Party's success is instructive. It rests on a combination of champions inside government and organisers working at the grassroots level; it has a clear agenda (scale back government) and enemy (President Obama); and it has effectively utilised both old-style organising (through local chapters) and new communications technologies. While the Tea Party cannot and should not simply be emulated by progressives, its three key features – grassroots organising linked to national reform leaders, a forward-looking

vision that is directed against a perceived contemporary threat, and the use of flexible participatory modes enabled by new media – are preconditions for effective progressive organising.

### **Rebuilding the institutional foundations of middle-class democracy**

The diagnosis outlined here is both encouraging and challenging. It is encouraging because there is nothing natural about the harsh divisions that have arisen in the United States. They are rooted in politics and policy, not the inexorable forces of globalisation or technological change. In many cases, moreover, they require not major programmes of redistribution – never easy to enact – but rather measures to reshape the market so that it distributes its rewards more broadly in the first place.

Nor does popular opinion dictate that this sort of politics and policy must reign. If progressives are losing the public, it is not mainly because citizens buy into the free-market fundamentalism of the right or are so distracted by social issues or racial animosity that they cannot see their own interests. The hallmark of contemporary public attitudes is not public conservatism but public cynicism and distrust, fuelled by the economic trend of the last generation and a sense that government is out of touch. To rebuild the middle class requires rebuilding a sense that government can make a positive difference. And that means addressing the bread-and-butter concerns of the middle class while also calling for responses to long-term threats, such as global warming and runaway health costs, that jeopardise US society.

The challenge, however, is that progressive reform will require using a broken political system to fix a broken political system. The main obstacle to change and the main vehicle for change are one and the same. This catch-22 affords no easy resolution. But it does suggest where reformers' energies should be directed, and it points to opportunities that are too often missed by those narrowly focused on

rhetorical messages and strategic moves. Perhaps the most important implication is that those seeking to achieve a new governing economic philosophy will have to rebuild the organisational foundations of democratic capitalism. An inspiring economic vision will be grounded in an institutional blueprint for using active democratic government to meet the challenges facing US society – challenges that, while frequently most pressing in the United States, are growing for all affluent democracies.

Jacob S. Hacker is Stanley B. Resor professor of political science at Yale University and co-author (with Paul Pierson) of *Winner-Take-All Politics* (Simon and Schuster, 2010)