The State of
Working Pennsylvania
2009

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The Keystone Research Center
Harrisburg, Pennsylvania

The Keystone Research Center

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Overview

Just six months ago, the U.S. and Pennsylvania economies appeared to be plunging off a cliff, spiraling down at a rate unmatched since the 1930s. Now, these economies have pulled back from that cliff. Unemployment has stopped rising as rapidly and the number of jobs has stopped falling so fast.

The reason is simple: The actions by the federal government to stimulate the economy are working. That is one bottom line of this report: Whatever qualms you may have about the details of federal economic policy this year—and we have our share of qualms—decisive government action has slowed our economy's free fall. Looked at through the lens of history, economic policy makers have taken to heart the failure of their counterparts—the Federal Reserve and the Hoover Administration—to act decisively to counter the collapse of the private sector economy at the beginning of the Great Depression. Both federal and state governments need to keep their feet on the economic accelerator at least this year and next, because it will take at least that long for private-sector demand to rebound.

The second theme of this report is that the government has not yet taken decisive action on a longer-run challenge that lies just below the surface of the current recession—the erosion of the middle class that helped trigger the economic crisis by leading families to finance their consumption through unsustainable debt (sometimes in the form of subprime mortgages). This report documents that wages for the broad middle class in Pennsylvania are now falling, in some cases quite rapidly. In the 1930s, in addition to stimulating the economy through increased public spending, the government took decisive action to build the middle class so that middle-class consumption could keep the economy growing for the long term. That second part of the New Deal, needed today to *re*build the middle class, is not yet on the radar screen. It needs to be.

Government to the Rescue...

The economic news of the last few months suggests that the federal government's response to the financial market crisis that began in September 2008, while far from perfect, pulled the national economy back from the brink, transforming what might have become the Great Depression II into the Great Recession.

- While job loss in Pennsylvania averaged 31,067 per month from February 2009 to April 2009, it has averaged "only" 9,200 per month in the last three months.
- The unemployment rate in Pennsylvania climbed two percentage points in the five months from October 2008 to March 2009, but "only" 0.7 percentage points in the four months between March and July 2009.
- National data reveal quite clearly why job losses fell and unemployment rates stopped rising so quickly. Increases in public spending and middle-class tax cuts, direct results of the American Recovery and Reinvestment Act (ARRA), helped slash the decline of Gross Domestic Product (GDP) from 6.4% in the first quarter of this year to 1% in the second quarter. Goldman Sachs and Mark Zandi of Economy.com estimate that without ARRA the GDP would have fallen by 3.2% to 4% in the second quarter.

...But the Great Recession Has Still Hit Pennsylvania Hard

While government action slowed the decline in economic activity, this recession is already quite severe and is also far from over.

- Since the start of this recession in December 2007, the Pennsylvania economy has lost 192,300 jobs, a decline of 3.3%. In the same period, the national economy has shed 6.6 million jobs, a decline of 4.8%.
- As of July 2009, there were more than half a million unemployed people in the Commonwealth.
- The Pennsylvania *underemployment* rate reached 14.1% in the second quarter of 2009. While below the U.S. rate of 16%, this is still one out every seven workers. (The underemployment rate includes all those who cannot find the amount of work that they want, as a share of the employed plus the unemployed.)
- To bring the share of the employed working-age population back to its level in Pennsylvania at the start of the recession would require another 230,000 jobs.
- Most economists expect the unemployment rate to continue to rise over the next 12 months.

Middle Class Wages Fell in the Last 12 Months...

Now we come to the second theme of our report: the struggling middle class. The essential fact: Inflation-adjusted wages have fallen for most Pennsylvania workers in the last year.

- In the 12-month period ending June 2009, inflation-adjusted hourly earnings for the typical Pennsylvania worker (the median or 50th-percentile wage earner), who now earns $15.65 per hour (about $33,000 per year for a full-time worker) fell 2% compared to the previous 12 months.
- Wages fell even for Pennsylvania workers above the median—at the 60th, 70th, and 80th percentiles. Workers at the 80th percentile saw their wages plunge by over 4%, more than a dollar per hour, or $2,000 per year for a full-time, full-year worker.

...After a Decade in Which Wages and Income Grew Only at the Top

Recent wage declines come on the heels of a period since 2000, including the entire economic expansion from 2001 to 2007, in which wages for most workers stagnated.

- From 2001-2002 to 2008-2009, virtually all Pennsylvania workers up to the 95th percentile (workers earning more than $42 per hour in 2008-09) experienced a decline in inflation-adjusted wages.

While earnings for most workers stagnated during the past decade, the income of the very wealthiest Pennsylvanians surged to new highs.

- In Pennsylvania, the incomes of the richest 1% increased by 37% between 2001 and 2006 (the latest year for which data are available), and the income of the wealthiest 0.01% (1 out of every 10,000 taxpayers) rose by 50%.
- Income inequality in Pennsylvania in 2006 and 2007 increased to its highest level since 1986 (the earliest date for which comparable data from the Pennsylvania Department of Revenue is available).
- In the United States, income inequality in 2007 also exceeded that in any year for which data exist—in this case since 1917.
- The top 1% of Pennsylvania earners captured 68% of the total growth in Pennsylvania personal income between 2001 and 2006.

What Economic Trends Mean for Policy: Keep the Pedal to the Metal and Rebuild the Middle Class

In the early 1930s, once President Franklin Roosevelt came to power, the federal government responded in two broad ways to the Great Depression. First, it stabilized financial markets and used deficit spending to get the economy moving again. Second, U.S. policy makers directly countered the stark risk in inequality of the 1920s.

More specifically, the federal government enacted four *structural reforms* to strengthen the middle class and restore growth in middle-class consumption: They established the federal minimum wage and passed a law protecting workers' right to form unions, and they established unemployment insurance and social security, thereby ensuring that jobless and retired workers could sustain their purchasing power. Nearly four decades of broadly shared prosperity resulted from these structural changes.

So far during the current recession, U.S. policy makers have taken actions analogous to those taken by the Roosevelt Administration in 1933 and 1934 to address the short-run economic collapse. The banking sector has been stabilized and government spending has risen to stabilize the labor market. As it did in the 1930s, the economy today has responded positively.

Looking forward, the experience of the 1930s suggests two guidelines for policy makers. The first guideline is that policy makers need to keep using government spending, at both the state and federal levels, to pull the economy out of recession. When the Roosevelt Administration made the mistake of contracting spending in 1937, the U.S. economy sputtered again, growth fell, and unemployment climbed. With unemployment likely to rise for the next year, and wages already falling (in Pennsylvania), government *must* remain the primary source of increasing economic demand. If government retrenches, the chance of a "double-dip" economic recession increases. An immediate priority for policy makers in Washington is an extension of unemployment insurance benefits for the 61,000 Pennsylvania workers estimated to exhaust their unemployment insurance benefits over the next three months.[1] Another component of sustained federal and state economic stimulus should be continued investment in the green economy—from energy efficiency to renewable energy to more environmentally sustainable manufacturing, agricultural production, and transportation systems.

The second guideline is that today's policy makers need to take to heart the second lesson of the New Deal—the need for *structural reforms* to, in this case, *re*build the middle class. So far in the Great Recession, however, the idea of structural reforms—to strengthen the middle class and to ensure growth in consumption and private investment once the federal government no longer runs large deficits—is not under consideration. Without such structural reforms, many U.S. and Pennsylvania families will remain income-constrained and unable to increase their consumption. Without a prosperous middle class, the long-run health of our economy remains at risk.

Employment and Wage Trends

The Great Recession

When *The State of Working Pennsylvania 2008* was released last September, the visible impact of the recession on the Pennsylvania economy was, in hindsight, quite small. The Pennsylvania economy had shed fewer than 10,000 jobs between December 2007 and September 2008, and the unemployment rate had only climbed by one percentage point (to 5.6%).

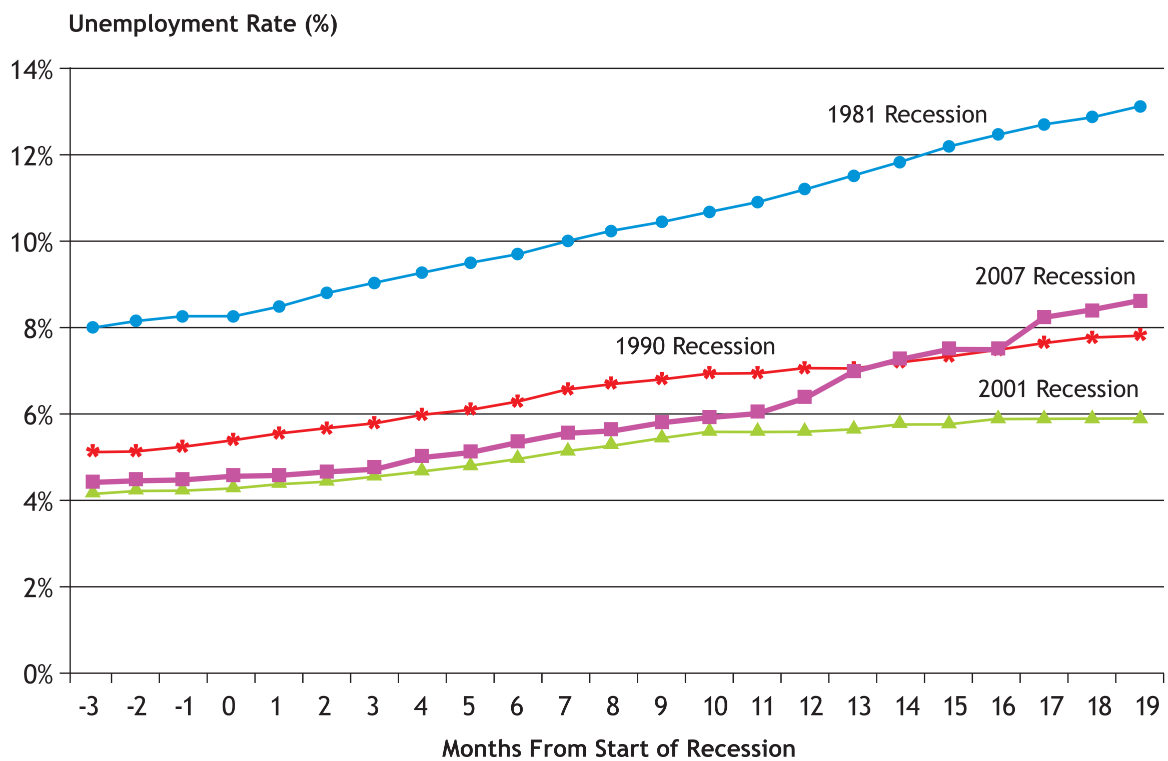
But then, on September 15th the financial services firm Lehman Brothers declared bankruptcy after being denied financial assistance by the U.S. Treasury Department and the Federal Reserve Bank. The Lehman Brothers bankruptcy triggered a panic in credit markets all across the globe. Shortly thereafter, faced with the impending bankruptcy of the insurer AIG, policy makers reversed course and intervened in unprecedented ways in financial markets.

In the months that followed, job loss in Pennsylvania skyrocketed to over 18,000 jobs per month. (Prior to October 2008 the Pennsylvania economy had been losing roughly 1,000 jobs per month.) The unemployment rate as of July reached 8.5%, the highest unemployment rate in Pennsylvania since December 1984.

While the recession has hit the Pennsylvania economy hard, the recession has been worse for the U.S. as a whole. For example, total job loss in Pennsylvania since the start of the recession equals 192,300, or 3.3%. In the United States, the number of jobs has declined by 4.8%, or 6.6 million jobs. The U.S. unemployment rate now stands at 9.4%.

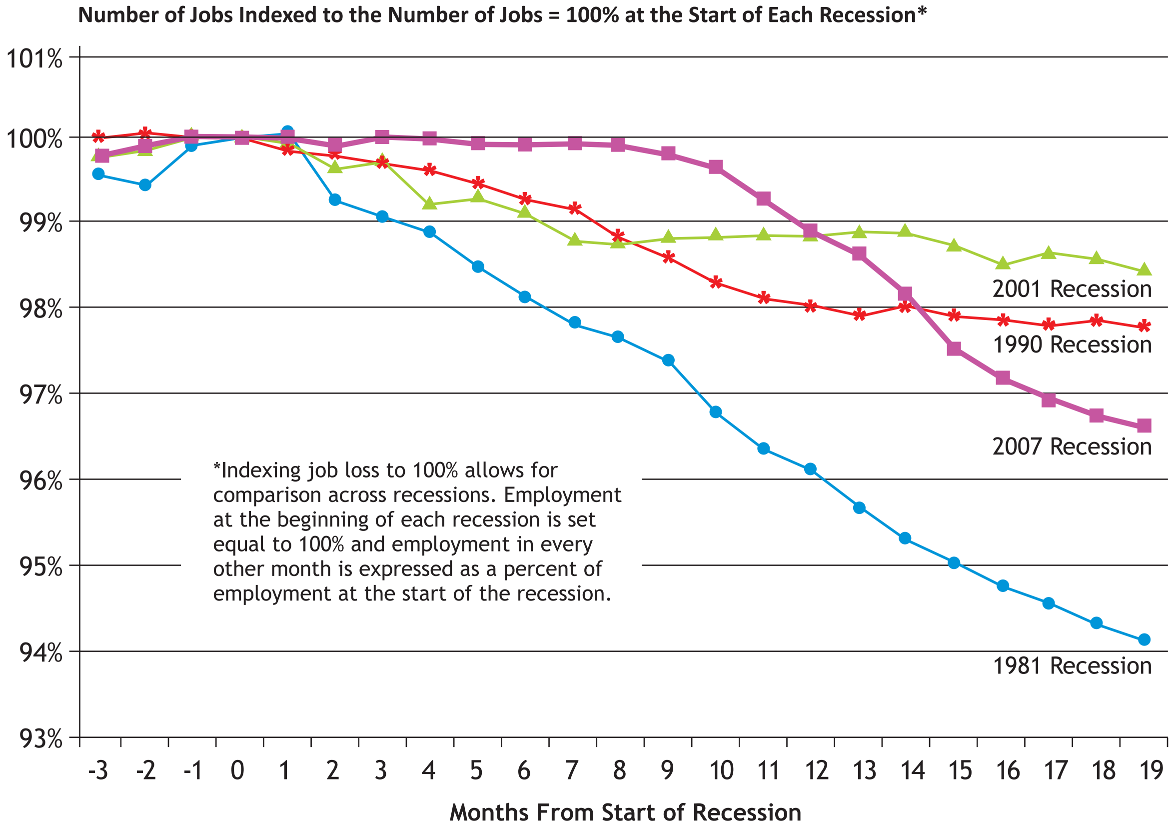
For Pennsylvania, the impact of the Great Recession on employment has yet to surpass the grim 1981 recession (Figure 1 and Figure 2).

Figure 1. In Pennsylvania the Unemployment Rate Has Yet to Surpass the Highs Reached During the 1981 Recession



Source. The Economic Policy Institute (EPI) analysis of Local Area Unemployment Statistics (LAUS)

Figure 2. So Far, Employment in Pennsylvania Has Fallen 3.3% Since the Recession Began, Compared to 5.9% During the 1981 Recession



Source. EPI analysis of LAUS

Falling Employment Rates and Rising Underemployment

The most comprehensive measures of the health of the labor market are the employment rate (employment as a percent of the working-age population) and the underemployment rate. (The underemployment rate is, loosely, the number of people who would like more work (or some work) as a share of the employed plus the underemployed.[2]

Since underemployment and employment rates are not seasonally adjusted, in the discussion that follows we compare these rates in the second quarter of 2009 with the second quarter in previous years. Looking at the same quarter in each year eliminates seasonality as a source of fluctuation in the rates.

- In the second quarter of 2009, the underemployment rate in Pennsylvania increased to 14.1%, up from 8.2% during the same period in 2008. The U.S. underemployment rate in the second quarter of 2009 was 16%, up from 9.5% during the same period last year.

In Pennsylvania and the United States, the surge in underemployment rates is due in part to an increase in the number of workers who want full-time employment but can only find part-time employment. In the second quarter of 2009, more than 320,000 Pennsylvania workers reported working part-time involuntarily (i.e., because their employer could not provide them full-time work), almost double the number in the previous year.

- Also illustrating a weakening economy, the employment rate (again, employment as a percent of the working-age population) declined in the second quarter of 2009 to 59.9% from 62.6% in the same period in 2008. The U.S. employment rate in the second quarter of 2009 was 59.7%, down from 62.6% in the second quarter of 2008.

While a total of 192,300 jobs has been lost between the start of the recession and July 2009 (the most recent month of data), this figure underestimates the shortfall of employment in the economy, because it does not take into account growth in the working-age population in Pennsylvania. It is estimated that since December 2007 the working-age population in the Commonwealth has grown by 0.7%. This leaves the Commonwealth short of the employment level needed for a stable employment rate by nearly 232,000 jobs.

Government to the Rescue

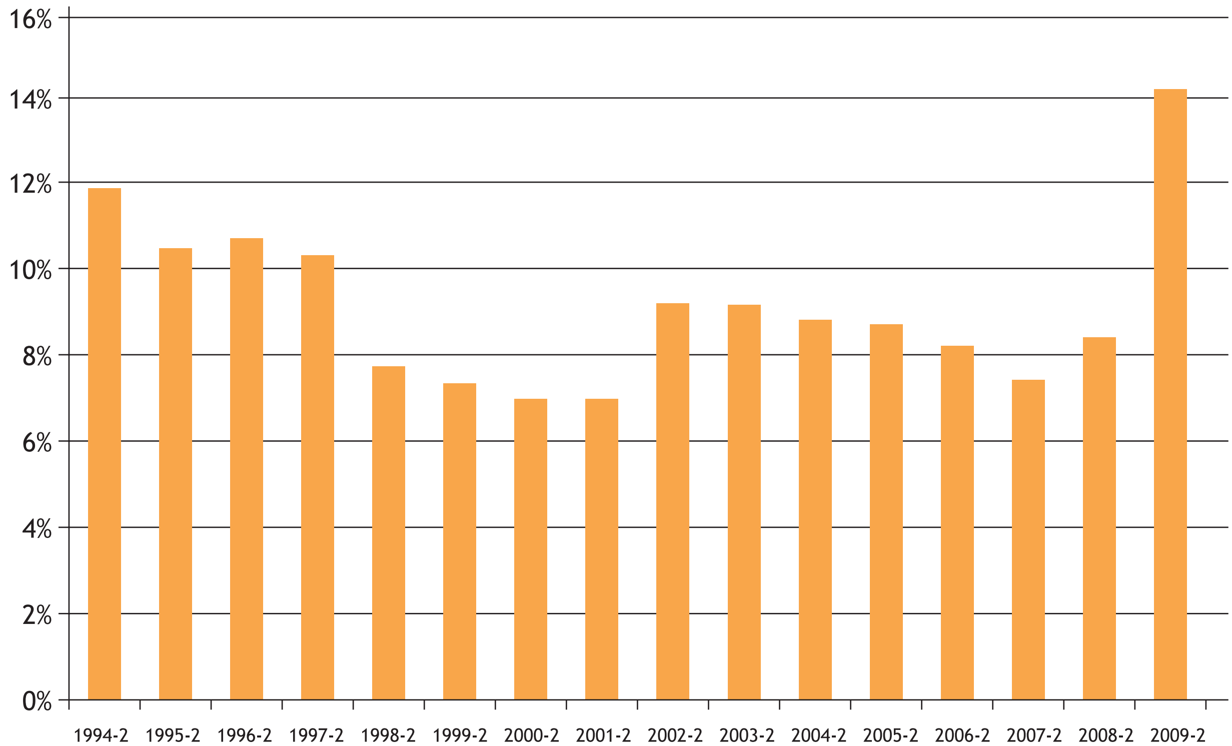
Although the preceding paragraphs paint a grim picture of the Pennsylvania economy, that portrait could have been much worse if not for the decisive action taken by the government. Guided by the lessons of the Great Depression policy makers took decisive steps which pulled the economy back from the brink, transforming what could have been the Great Depression II into “merely” the Great Recession.

- While job loss in Pennsylvania averaged 31,067 per month from February 2009 to April 2009, it has averaged “only” 9,200 per month in the last three months.
- The unemployment rate climbed two percentage points in the five months between October 2008 and March 2009. In the four months from March to July 2009, the unemployment rate climbed less than half as fast—by seven-tenths of a percentage point.

National data reveal quite clearly the source of the slowing pace of job loss. The Gross Domestic Product, after falling at an annual rate of 6.4% in the first quarter of this year, declined at an annual rate of only 1% in the second quarter. This relative improvement was driven in part by increases in public-sector spending and middle-class tax cuts made possible by the American Recovery and Reinvestment Act (ARRA). Independent estimates from Goldman Sachs and Mark Zandi of Economy.com suggest that without ARRA the GDP would have fallen by 3.2% to 4% in the second quarter.[3]

Figure 3. In the Second Quarter of 2009, the Underemployment Rate in Pennsylvania Was 14%

Percentage of Underemployed Pennsylvania Workers in the Second Quarter of Each Year, 1994 to 2009

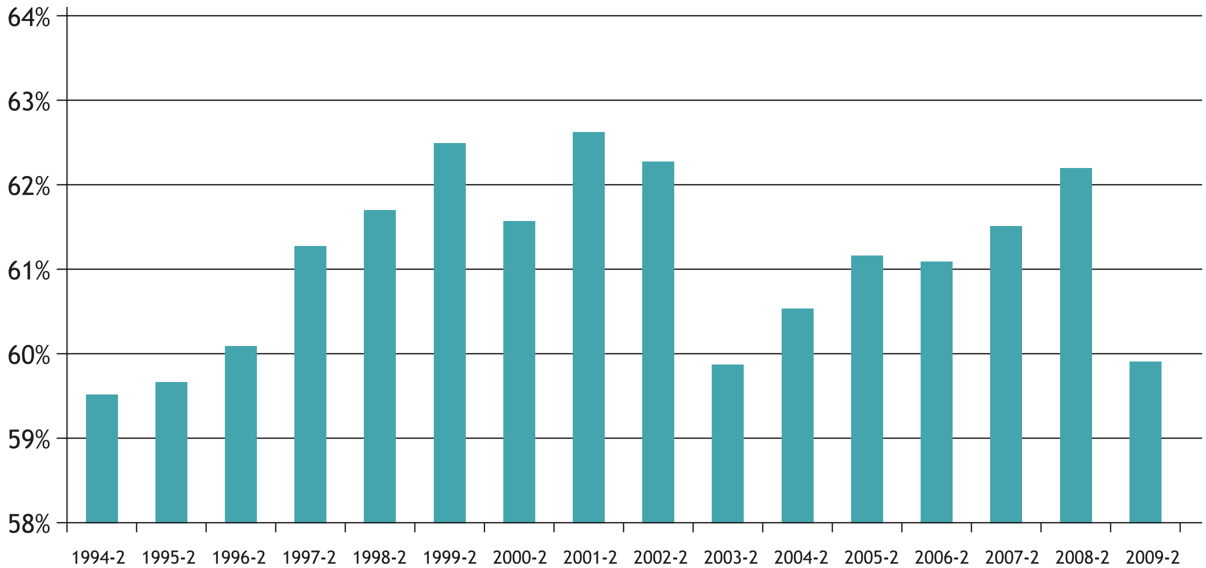


Note. The underemployment rate, officially referred to by the U.S. Bureau of Labor Statistics as the "U-6 measure of the underutilization of labor," is calculated as the sum of the unemployed, those reporting being employed part-time for economic reasons, and marginally attached workers as a share (in percent) of the sum of these groups plus the employed. Marginally attached workers are individuals not in the labor force who want, and are available for, work and who have looked for a job at some time in the prior 12 months.

Source. Keystone Research Center (KRC) analysis of the Current Population Survey (CPS) data

Figure 4. The Pennsylvania Employment Rate Declined in the Second Quarter of 2009 to Just Under 60%

Employment as a Share of the Working-Age Population in Pennsylvania in the Second Quarter of Each Year, 1994 to 2009



Source. KRC analysis of CPS data

Recession Drives Down Pennsylvania Wages

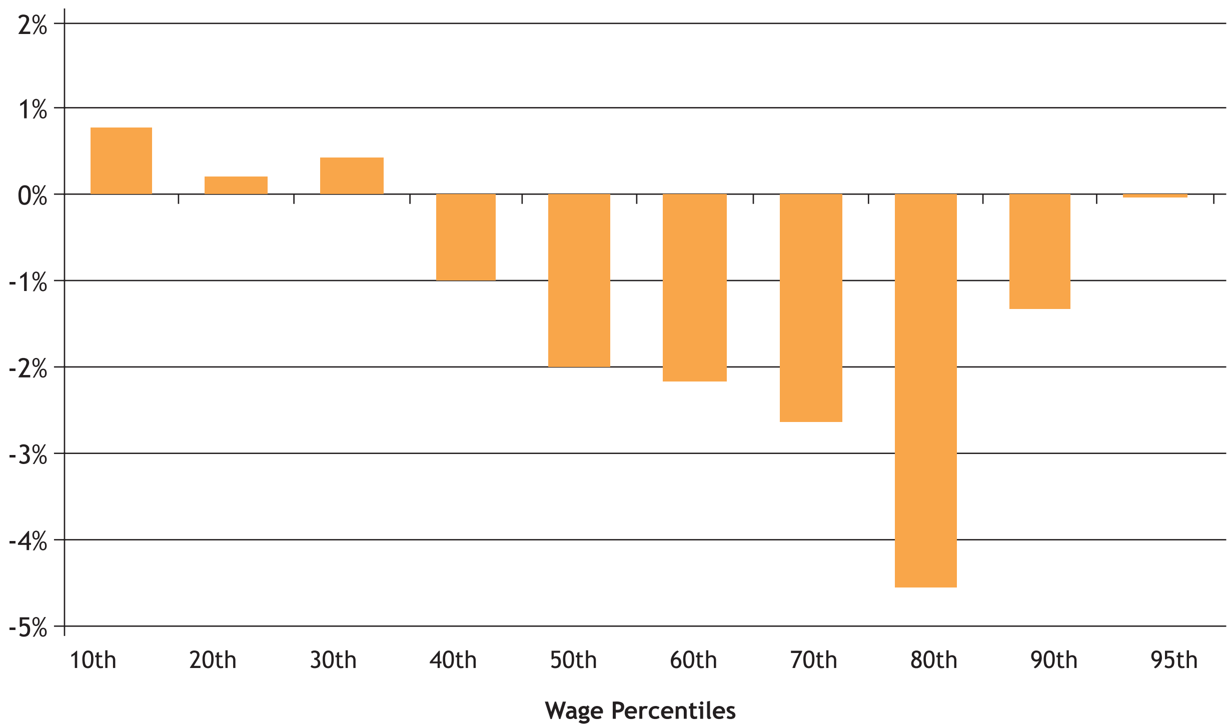
While recessions are hardest on those who lose their jobs, even those fortunate enough to hold on to their jobs may experience slow growth in wages.

To gauge the impact of the recession on wages, we compare wages in the 12 months from July 2008 to June 2009 to wages in the previous 12 months. We find that, adjusted for inflation, the wages for the typical Pennsylvania worker (the median or 50th-percentile wage earner) fell 2% in the period July 2008 to June 2009 compared to the previous 12 months (Table 1 and Figure 5).

Adjusted for inflation, Pennsylvania low-wage earners (defined as those at the 10th percentile in Figure 1) earned $8.17 per hour in the 12 months ending June 2009, a gain of 6 cents per hour over the previous year (see also Table 1). Small gains were also enjoyed by workers at the 20th and 30th percentiles.

Throughout the rest of the wage distribution, from the 40th all the way up to the 95th percentile, inflation-adjusted earnings declined. At the 80th percentile, at which workers earn slightly over $25 per hour (roughly $53,000 per year), wages fell $1.18 per hour between the 12 months ending June 2008 and the 12 months ending June 2009.

Figure 5. The Inflation-Adjusted Hourly Earnings of the Typical Pennsylvania Worker Declined by 2% in the 12-Month Period Ending June 2009



Note. Wage estimates show the percent change in inflation-adjusted hourly earnings in the 12-month period ending in June 2008 (2007-2008) from the same 12-month period ending in June 2009 (2008-2009).

Source. KRC analysis of CPS data

Table 1. Inflation-Adjusted Change in Hourly Wages From 2007-2008 to 2008-2009 for Each Wage Decile, Pennsylvania and the United States

Percentiles	Inflation-Adjusted Wage (2008-2009 Dollars)					
	United States			Pennsylvania		
	2007-2008	2008-2009	Percent Change	2007-2008	2008-2009	Percent Change
10th	$8.02	$8.02	0.1%	$8.11	$8.17	0.8%
20th	$9.80	$9.82	0.2%	$9.99	$10.01	0.2%
30th	$11.38	$11.61	2.0%	$11.77	$11.82	0.4%
40th	$13.39	$13.58	1.4%	$13.82	$13.69	-1.0%
50th (Median)	$15.57	$15.79	1.4%	$15.97	$15.65	-2.0%
60th	$18.46	$18.61	0.8%	$18.69	$18.29	-2.1%
70th	$22.07	$22.20	0.6%	$21.93	$21.37	-2.6%
80th	$27.20	$27.59	1.4%	$26.51	$25.33	-4.5%
90th	$36.48	$37.29	2.2%	$34.63	$34.20	-1.2%
95th	$47.07	$47.89	1.8%	$42.62	$42.61	0.0%

Note. Wage estimates compare inflation-adjusted hourly earnings in the 12-month period ending in June 2008 (2007-2008) to the same 12-month period ending in June 2009 (2008-2009).

Source. KRC analysis of CPS data

Seven Years of Wage Stagnation

The 2001 recession, the jobless recovery that followed, and now a deep recession mean that the wages of most workers in Pennsylvania remain lower today than they were seven years ago.

Pennsylvania 10th-percentile earners (Table 2)—those who earn more than 10% of all workers and less than the other 90%—earned $8.31 per hour in the 12-month period between July 2001 and June 2002. In the 12-month period ending June 2009, wages were down 14 cents, or 1.7%, from seven years earlier.

Median wages fared little better, falling from $15.87 seven years ago to $15.65 in the 12-months ending June 2009, a decline of 1.4%.

Even most higher-paid Pennsylvania wage earners—all the way up to 95th-percentile earners, who make more than 19 out of every 20 workers—experienced a decline in inflation-adjusted wages in the last seven years.

Thirty Years of Wage Stagnation

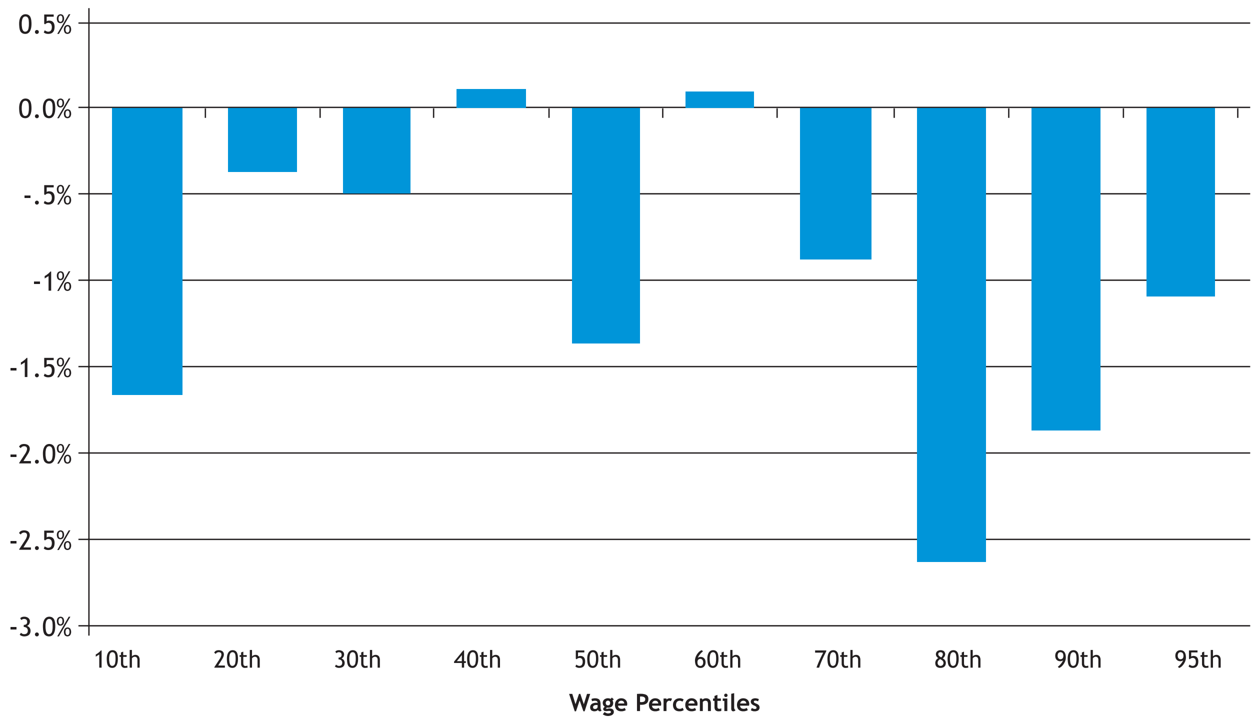
While most Pennsylvania workers have gained no ground in the last seven years, the picture improves little when you consider the last 30. For instance, at $15.65 per hour the typical Pennsylvania worker (at the median) has gained 62 cents over the last 30 years, an increase of just 4% (Table 3).

Over the same time period, the earnings of low-wage workers (the 10th percentile) have increased by 15 cents, to $8.17 per hour.

Workers at the 90th percentile in Pennsylvania (those who earn more than 90% of all workers and less than the other 10%) have fared better. Their inflation-adjusted hourly earnings increased by $7.47, to $34.20, an increase of 28%.

In the last 30 years, wage growth throughout the wage distribution (from the 10th percentile to the 90th percentile) has generally only occurred in tight labor markets with unemployment rates below 6%. Last month, IHS Global Insight projected that unemployment in Pennsylvania will not fall below 6% until sometime after 2017.[4] The Congressional Budget Office is projecting a return to full employment in the U.S. economy as a whole by 2014.[5] Under either projection, absent changes in policy, there is little hope of healthy wage growth in the Commonwealth over the next several years.

Figure 6. The Inflation-Adjusted Hourly Earnings of Most Workers in Pennsylvania Are Lower Than Seven Years Ago



Note. Wage estimates show the percent change in inflation-adjusted hourly earnings in the 12-month period ending in June 2002 (2001-2002) from the same 12-month period ending in June 2009 (2008-2009).

Source. KRC analysis of CPS data

Table 2. Inflation-Adjusted Change in Hourly Wages From 2001-2002 to 2008-2009 for Each Wage Decile, Pennsylvania and the United States

Percentiles	Inflation-Adjusted Wage (2008-2009 Dollars)					
	United States			Pennsylvania		
	2001-2002	2008-2009	Percent Change	2001-2002	2008-2009	Percent Change
10th percentile	$8.22	$8.02	-2.5%	$8.31	$8.17	-1.7%
20th percentile	$9.85	$9.82	-0.4%	$10.04	$10.01	-0.4%
30th percentile	$11.79	$11.61	-1.5%	$11.87	$11.82	-0.5%
40th percentile	$13.47	$13.58	0.8%	$13.68	$13.69	0.1%
50th percentile (Median)	$15.72	$15.79	0.4%	$15.87	$15.65	-1.4%
60th percentile	$18.32	$18.61	1.6%	$18.27	$18.29	0.1%
70th percentile	$21.91	$22.20	1.3%	$21.54	$21.37	-0.8%
80th percentile	$26.60	$27.59	3.7%	$26.00	$25.33	-2.6%
90th percentile	$35.21	$37.29	5.9%	$34.88	$34.20	-1.9%
95th percentile	$45.26	$47.89	5.8%	$43.07	$42.61	-1.1%

Note. Wage estimates compare inflation-adjusted hourly earnings in the 12-month period ending in June 2002 (2001-2002) to the same 12-month period ending in June 2009 (2008-2009).

Source. KRC analysis of CPS data

Table 3. In 30 Years, the Wages of the Typical Pennsylvania Worker Have Increased by Just 4%

Year (ending in June of second year listed)	United States			Pennsylvania		
	Percentiles					
	10th	50th (Median)	90th	10th	50th (Median)	90th
1979-1980	$7.90	$14.46	$28.23	$8.02	$15.03	$26.73
1980-1981	$7.82	$14.18	$28.39	$7.88	$14.63	$26.65
1981-1982	$7.68	$14.09	$28.05	$7.71	$14.34	$26.98
1982-1983	$7.38	$14.16	$28.52	$7.45	$14.32	$26.69
1983-1984	$7.18	$14.15	$29.11	$7.22	$14.49	$27.30
1984-1985	$7.05	$14.25	$29.18	$7.08	$14.37	$27.91
1985-1986	$6.96	$14.41	$29.54	$6.92	$14.39	$27.91
1986-1987	$6.98	$14.63	$30.22	$6.88	$14.49	$27.87
1987-1988	$6.94	$14.57	$30.60	$6.90	$14.55	$28.49
1988-1989	$6.96	$14.42	$30.46	$7.11	$14.40	$28.63
1989-1990	$7.03	$14.52	$30.32	$7.42	$14.63	$28.26
1990-1991	$7.12	$14.39	$30.84	$7.33	$14.57	$28.91
1991-1992	$7.22	$14.55	$30.44	$7.36	$14.79	$29.53
1992-1993	$7.17	$14.55	$30.39	$7.28	$14.70	$29.65
1993-1994	$7.12	$14.42	$31.16	$7.29	$14.72	$30.15
1994-1995	$7.09	$14.21	$31.17	$7.18	$14.41	$30.92
1995-1996	$7.07	$14.09	$31.46	$7.07	$14.53	$31.28
1996-1997	$7.06	$14.25	$31.31	$7.25	$14.83	$32.12
1997-1998	$7.55	$14.59	$32.07	$7.53	$15.20	$31.42
1998-1999	$7.75	$15.15	$32.87	$7.75	$15.22	$32.64
1999-2000	$7.80	$15.28	$33.80	$7.79	$15.38	$33.25
2000-2001	$7.96	$15.42	$34.51	$8.05	$15.71	$34.04
2001-2002	$8.22	$15.72	$35.21	$8.31	$15.87	$34.88
2002-2003	$8.17	$15.71	$35.46	$8.24	$15.52	$35.15
2003-2004	$8.13	$15.99	$35.77	$8.24	$16.18	$35.47
2004-2005	$7.97	$15.85	$35.85	$8.20	$16.02	$34.48
2005-2006	$7.88	$15.66	$35.87	$7.80	$15.44	$33.47
2006-2007	$8.02	$15.73	$36.20	$8.21	$15.62	$33.50
2007-2008	$8.02	$15.57	$36.48	$8.11	$15.97	$34.63
2008-2009	$8.02	$15.79	$37.29	$8.17	$15.65	$34.20
1979-1980 to 1989-1990	-11%	0%	7%	-8%	-3%	6%
1989-1990 to 2001-2002	17%	8%	16%	12%	8%	23%
2001-2002 to 2007-2008	-3%	-1%	4%	-2%	1%	-1%
1979-1980 to 2008-2009	2%	9%	32%	2%	4%	28%

Source. KRC analysis of CPS data

Income Inequality in Pennsylvania

Since the initial publication of *The State of Working Pennsylvania* in 2006, this annual report has been tracking income inequality using detailed data on the incomes of the very highest Pennsylvania earners. We rely on a Pennsylvania-specific data source, because confidentiality considerations and a small sample size make it impossible to examine trends at the top of the earnings distribution using our source for wage data (the Current Population Survey).[6]

By contrast, the Pennsylvania Department of Revenue has information on the incomes of the entire universe of taxpayers, 5.9 million in 2006, including earners at the very top.

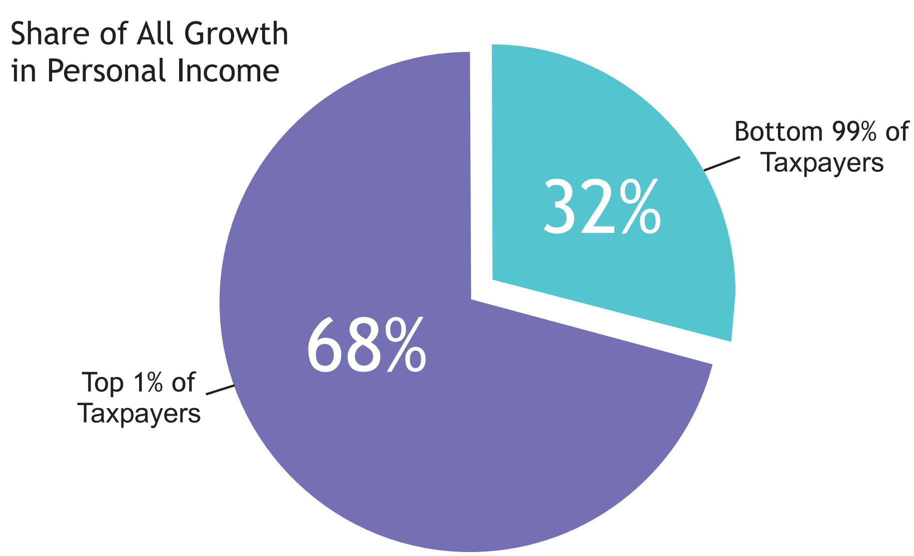
As this report went to press, the most recent year of Pennsylvania taxable income data available was 2006. (Given the normal lag in the collection of taxable income data, it will be two to three years before we can examine the impact of the Great Recession on top incomes.)

How Did Income Inequality Change Near the Peak of the Business Cycle?

Thanks in large part to healthy growth in total personal income in 2006, inflation-adjusted total personal income overall grew in Pennsylvania by 7.5% between 2001 and 2006.[7] How was this increase in the economic pie distributed? Very unequally.

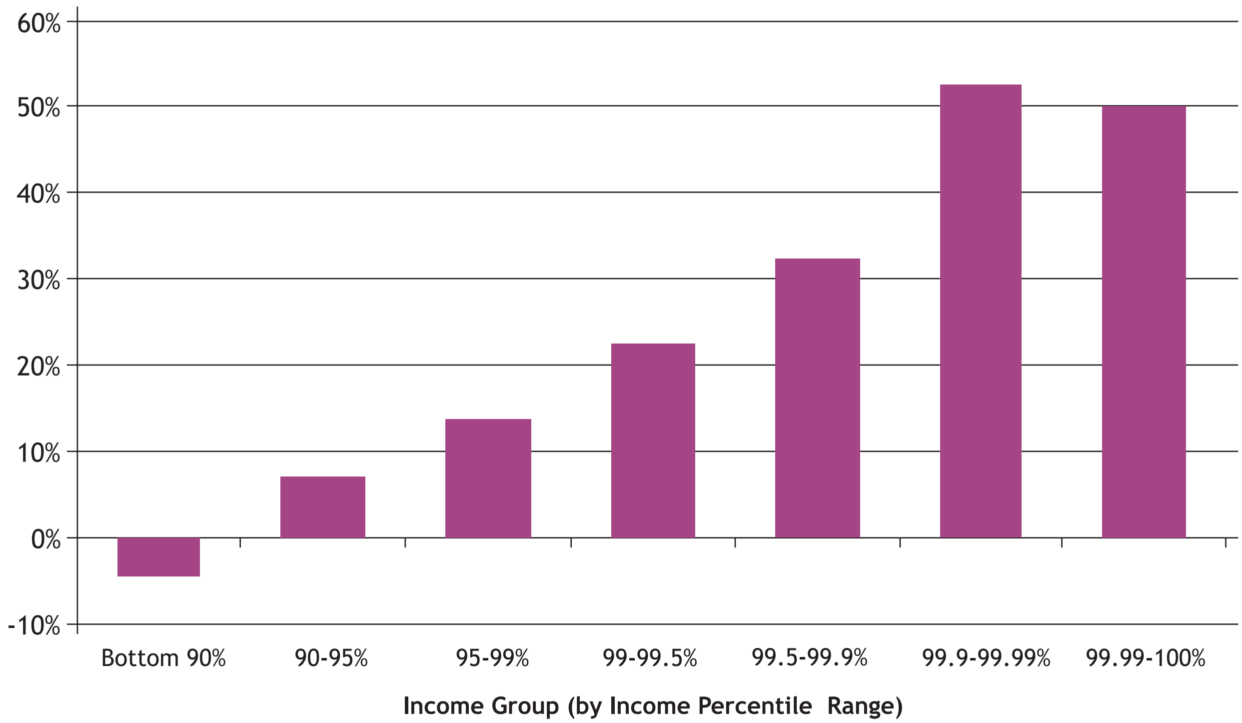
- The top 1% of earners (roughly 59,000 taxpayers) captured 68% of the total growth in Pennsylvania personal income from 2001 to 2006 (Figure 7).[8]
- The average income of the top 1% of taxpayers rose by just over $300,000 between 2001 and 2006, an increase of 37% (Table 4 and Figure 8).
- The top 1% of the top 1%, the richest 1 out of every 10,000 Pennsylvania taxpayers, however, enjoyed a 50% increase in average income between 2001 and 2006; taxable incomes for this group climbed from $15 million to $22.5 million.
- Meanwhile, the average income of the bottom 90% of Pennsylvania taxpayers declined by 4% between 2001 and 2006.[9]

Figure 7. The Wealthiest 1% of Pennsylvania Taxpayers (60,000 Taxpayers in 2006) Captured Nearly 68% of All Personal Income Growth From 2001 to 2006



Source. KRC analysis of Pennsylvania Department of Revenue (PA DOR) and Bureau of Economic Analysis (BEA) data

Figure 8. Percent Change in Average Income by Income Group in Pennsylvania, 2001 to 2006



Source. KRC analysis of PA DOR and BEA data

Table 4. Average Income by Pennsylvania Income Group, 2001 and 2006

Income Group	2001	2006	Percent Change
Bottom 90%	$52,931	$50,569	-4%
90-95%	$113,601	$121,137	7%
95-99%	$185,734	$209,081	13%
99-100%	$807,661	$1,110,514	37%
99-99.5%	$372,164	$452,245	22%
99.5-99.9%	$682,058	$897,318	32%
99.9-99.99%	$2,205,534	$3,343,218	52%
99.99-100%	$15,040,664	$22,485,924	50%

Source. KRC analysis of PA DOR and BEA data

IRS data, already available for 2007 (although less detailed than our PA DOR data), suggest that inequality in Pennsylvania increased again in 2007. This increase took place even as unemployment reached an expansion low of 4.4% in 2007, leading to healthier wage growth for the middle class. The share of income captured by the top 10% of Pennsylvania families increased, according to the 2007 IRS data, to its highest level in the period for which these data exist (since 1986).[10]

Looking Forward

Starting last September, U.S. policy makers have taken actions analogous to those taken by the Roosevelt Administration to restore the U.S. economy in 1933 and 1934. Current policy makers have stabilized financial markets and have enacted the American Recovery and Reinvestment Act (ARRA)— a mix of government spending and (predominantly) middle-class tax cuts— to pump up economic growth. The economy today has responded positively as it did in the 1930s.

The actions taken by national policy makers were literally informed by close historical analysis of what had been done wrong, and what had been done right, by policy makers in the 1930s. For example, Federal Reserve Bank Chairman Ben Bernanke, having focused much of his academic career on monetary policy in the 1930s and the failure of the Federal Reserve to act decisively in the 1929 to 1932 period, has not repeated that error.

If we've digested the lessons of 1933 and 1934, what do the rest of the 1930s and 1940s tell us about economic policy looking forward the next several years? The rest of the New Deal suggests two basic guidelines for policy makers: avoid a double-dip recession and rebuild a strong middle class.

Avoid a Double-Dip Recession

The first guideline is that policy makers should not take their foot off the economic accelerator. When the Roosevelt Administration did that in 1937, the U.S. economy sputtered again, growth slowed, and unemployment increased. Federal (and state) policy makers should continue to stimulate the economy until we have strong evidence that private investment and consumption will pick up the slack. With unemployment likely to rise for the next year, according to most forecasts, and wages (at least in Pennsylvania) falling, government *must* remain the primary source of increasing economic demand for the near future.

If government *were* to take its foot off the economic accelerator, the probability of a "double- dip" economic recession would increase. (In a double-dip recession, after economic growth starts to recover, it then reverses course and falls a second time. On a graph of output over time, these second declines look like a "double-dip.")

One immediate context in which Pennsylvania policy makers should focus more on the impact of their actions on jobs is the state budget. So far, much of the debate about the state budget has focused on the importance of not increasing state spending, with a surprising failure to consider whether this helps or harms our faltering economy. In fact, for straightforward economic reasons, maintaining spending levels through higher taxes on affluent Pennsylvanians actually *increases* aggregate demand and jobs relative to deeper cuts in spending and no change in taxes. What are those straightforward economic reasons? State government spends all the revenue it collects in higher taxes, whereas, particularly for upper-income taxpayers, a substantial portion of income is saved. We estimate that each $1 billion in spending cuts reduces the number of jobs by 20,000, as compared to maintaining spending through higher taxes on affluent Pennsylvanians (see http://keystoneresearch.org/media-center/op-eds/state-must-choose-course-action-does-least-harm-economy).

Beyond this year's state budget debate, both state and federal policy makers should continue to support expansionary policies. One component of sustained federal and state economic stimulus should be continued investment in the green economy—from energy efficiency to renewable energy to more environmentally sustainable manufacturing and agricultural production and transportation systems. If green investments are financed through bonds, even state government has significant power to stimulate job creation. For next year's budget debate, instead of focusing on the preoccupations of latter-day Hooverites with short-run state spending, perhaps we can have a more timely conversation about the biggest possible green economic stimulus that would be fiscally prudent for the long term.

Has Anybody Seen My Old Friend...the Middle Class?

The second guideline from the 1935-1950 period is that today's policy makers need to take to heart—OK, to start by remembering—a second lesson of the New Deal. In this period, policy makers enacted four *structural reforms* to create the middle class and ensure long-term growth driven by middle-class consumption. The Wagner Act of 1935 aimed at giving factory workers a real right to form unions. The Social Security Act, also enacted in 1935, established both Social Security and our unemployment insurance system. Presto! Jobless and retired workers had an income and the ability to help sustain national purchasing power. In 1938, the Fair Labor Standards Act established the federal minimum wage. Together with the rise of industrial unions enabled by the Wagner Act, periodic increases in the federal minimum wage helped ensure that wages across the board rose at roughly the rate of national productivity growth from the 1930s to the 1970s. These four reforms did more than any other measures to create the American middle class. These four reforms provided a foundation for the unprecedented economic growth of the late 1930s to the 1970s.

Last year, in *The State of Working Pennsylvania 2008* (accessible at http://keystoneresearch.org/sites/keystoneresearch.org/files/SWP2008.pdf), we mapped out in considerable technical detail a modernized set of structural reforms that would lead to a "New Deal for a New Economy." We also spelled out in more detail ideas for additional economic investments (many of which overlap portions of the ARRA).

Here our point is simpler: We want to underscore that half of the debate we should be having about how to respond to the current economic crisis is missing. So far, in the Great Recession, the idea of structural reforms that rebuild the middle class, and ensure growth in consumption once the federal government no longer runs large deficits, is not even under consideration. Without those reforms, many U.S. and Pennsylvania families will remain income-constrained, unable to increase their consumption and/or fearful of taking on debt to do so. Without a strong middle class, will America ever again enjoy a period of sustained and steady economic growth? Probably not.

Appendix

Table A1. Income Thresholds and Average Incomes, All Returns, Pennsylvania 2006

Income group (by income percentile range)	90%		95%		99%		99.50%		99.90%		99.99%	
Minimum Income for group	$103,237		$146,288		$369,730		$572,758		$1,755,077		$9,416,985	
Percentile of tax units by income level	**Count**	**90-100%**	**Count**	**95-100%**	**Count**	**99-100%**	**Count**	**99.5-100%**	**Count**	**99.9-100%**	**Count**	**99.99-100%**
Cumulative percentage of taxpayers		10%		5%		1%		0.50%		0.10%		0.01%
Average income of taxpayers in each group interval	598,786	$255,251	299,391	$389,368	59,878	$1,110,514	29,939	$1,768,788	5,987	$5,255,251	598	$22,485,924
Percentile of distinct tax units by income level	**Count**	**90-95%**	**Count**	**95-99%**	**Count**	**99-99.5%**	**Count**	**99.5-99.9%**	**Count**	**99.9-99.99%**	**Count**	**99.99-100%**
Percentage of taxpayers within each group interval		5%		4%		0.50%		0.40%		0.09%		0.01%
Average income of taxpayers in each interval	299,395	$121,137	239,513	$209,081	29,939	$452,245	23,952	$897,318	5,389	3,343,218	598	$22,485,924
	Count	Average Income										
Millionaire Taxpayers	**13,017**	**$3,112,912**										

Note. These results are slightly different than those in the original 2006 Personal Income Tax (PIT) Booklet due to difference in the overall data population used. The PIT Booklet excludes returns that are suspended at the time of the creation of the booklet.

Source. PA DOR tabulations from the 2006 Annual Personal Income Tax Return data set

Notes

[1]Estimates by the National Employment Law Project.

[2]The underemployment rate, officially called by the U.S. Bureau of Labor Statistics the "U-6 measure of the underutilization of labor," is calculated as the sum of the unemployed, those reporting being employed part-time for economic reasons, and marginally attached workers, all divided by the sum of the employed, unemployed, and marginally attached workers. Marginally attached workers are individuals not in the labor force who want, and are available for, work and who have looked for a job sometime in the prior 12 months.

[3]John Irons and Ethan Pollack, "The Recovery Package In Action: Economy is already benefitting, but full force of stimulus is yet to come," Economic Policy Institute, Briefing Paper #239, August 13, 2009.

[4]Center for Workforce Information and Analysis, *Pennsylvania's Employment Situation: July 2009,* August 21, 2009.

[5]Congressional Budget Office, *The Budget and Economic Outlook: An Update,* August 2009. Available at http://cbo.gov/doc.cfm?index=10521.

[6]The two technical reasons are sample size and the suppression of information on the earnings of the top earners. Sample size is particularly important because of the increasing concentration of income inequality. As Thomas Piketty and Emmanuel Saez have shown (see "Income Inequality in the United States, 1913-1998," *Quarterly Journal of Economics,* 118(1), 2003), much of the growth in incomes in the United States has been concentrated among the top .01% of taxpayers, a group too narrow to be examined reliably using the Current Population Survey.

[7]All figures in this section of the report are adjusted for inflation using the CPI-U-RS.

[8]The share of personal income of the top 10% of taxpayers is estimated by dividing the total taxable income of the top 10% of taxpayers by total Pennsylvania personal income reported by U.S. Department of Commerce, Bureau of Economic Analysis (BEA). The income of the bottom 90% of taxpayers is calculated by subtracting the total taxable income of the top 10% of taxpayers from total personal income in Pennsylvania. This assumption guarantees that the total share of personal income of all groups adds to 100%. However, it should be noted that total personal income is greater than total taxable income, in part because personal income also includes Social Security, pension income, and the dollar value of transfers and health benefits. This calculation, therefore, allocates all of the difference between total personal income and total taxable income to the bottom 90% of taxpayers. In reality, of course, high-income taxpayers obtain transfers, such as Social Security and private pensions, and as a result these and any other source of income not considered taxable (which are also included in the BEA personal income data) are being allocated to the bottom 90% of taxpayers. As a result, we are understating the share of all income held by the top 10% of taxpayers.

[9]From 2001 to 2005 the average personal income of the bottom 90% of taxpayers declined by 5.2%.

[10]Comparisons of income data derived from tax returns is complicated by the inconsistent treatment of capital gains as taxable income, where prior to 1986 only a fraction of capital gains income was included in adjusted gross income on federal tax returns. Estimates which attempt to remove capital gains income suggest the share of personal income (minus capital gains) of the top 10% Pennsylvania families in 2006 to be at its highest level since the 1940s.