About the Author:
Robert Reich is professor of public policy at the University of California, Berkeley. He served in three presidential administrations, most recently as secretary of labor under President Bill Clinton. He is the author of twelve books including *The Work of Nations* and *Supercapitalism*. Dr. Reich is cofounder of *The American Prospect* magazine and provides weekly political commentaries on public radio’s *Marketplace*.

General Overview:
When the US economy foundered in 2008, blame was directed almost universally at Wall Street. The real reason for the meltdown, however, was much more structural – there was an increasing concentration of income and wealth at the top rather than being spread across the American middle class. Specifically, in 2007, the richest 1 percent of the population took in 23.5 percent of total national income. By comparison, in the late 1970s, the richest 1 percent took in less than 9 percent of the nation’s total income. As a consequence, the middle class in recent times has had to go deeply into debt in order to sustain a decent standard of living which is a situation which is clearly and obviously unsustainable.

This concentration of income is at the heart of America’s current ongoing economic predicament. The challenge to move forward is not to get Americans to save more and borrow less from the rest of the world but to rebalance the American economy so the benefits of commercial activity are shared more widely than they are at present. Until this transformation is made, the US economy will experience phantom recoveries and damaging speculative bubbles. The only way sustainable growth will be achieved for the American economy is if the purchasing power of the middle class is restored. This is the central choice of the current political era and it is vital that we respond to this issue now rather than hoping it will go away.

* Please Note: This political book summary does not offer judgment or opinion on the book’s contents. The ideas, viewpoints and arguments are presented just as the book’s author had intended.
THE BROKEN BARGAIN

In February 1933, just weeks before Franklin D. Roosevelt was sworn in as president, the Senate Finance Committee held hearings on what should be done about the ongoing economic crisis America faced at that time. Some suggested reducing the national debt and balancing the federal budget was the way forward out of what would later come to be termed the “Great Depression”. Marriner Eccles, a Utah banker who had been tapped by Roosevelt’s incoming Treasury secretary Henry Morgenthau, Jr. to work in the Treasury department had a different suggestion. Eccles told the senators the US government had to go deeper into debt in order to offset the lack of spending by consumers and businesses. Eccles suggested a government program needed to be developed which would get more money into the hands of the beleaguered middle class so there would be “an increase in the purchasing power on the part of all the people.”

When the governor of the Federal Reserve Board resigned unexpectedly a few months later, Eccles was appointed as his replacement and he ultimately ended up chairing the Board from November 1934 until April 1948. Eccles had told Roosevelt he would only take the job if the Federal Reserve in Washington had more power over the money supply than the New York Fed which wanted to keep a tight money supply and correspondingly high interest rates. Thereafter, for the next fourteen years, Eccles maintained a loose money supply and low interest rates as the US economy worked its way out of the Depression and through World War II. Today, Eccles is considered to be one of the architects of the prosperity the nation and much of the world enjoyed after the war. When Eccles wrote his memoirs, he noted the cause of the Great Depression had nothing whatsoever to do with excessive spending during the 1920s. The trigger Eccles suggested was the vast accumulation of income in the hands of the wealthiest people in the nation which siphoned purchasing power away from middle class Americans. It was this shrinkage in consumer spending and widening inequality which were the key drivers of the Great Depression in the view of Marriner Eccles.

What’s noteworthy about this is other economists who have studied the “Great Recession” which officially began in December 2007 have noted an interesting pattern. The share of total income going to the richest one percent of Americans peaked at just over 23 percent in both 1928 and in 2007. Between the two peaks have been long, deep valleys. By comparison, the richest one percent garnered around 16-17 percent of the national income in the 1930s, 11-15 percent in the 1940s, 9-11 percent in the 1950s and 1960s and 8-9 percent in the 1980s before climbing to 15-19 percent in the late 1990s. Two other parallels between the Great Depression of the 1930s and the Great Recession starting in 2007 have also been highlighted by economists:

- Between 1913 and 1928, the ratio of private credit to the national economy doubled as people borrowed more. Similarly, household debt rose from 55 percent of household income in the 1960s to an unsustainable 138 percent by 2007.
- In both lead-up periods, Americans used their soaring incomes and access to credit to speculate in a limited range of assets. The Dow Jones Stock Index went from 63.9 in mid-1921 to 381.2 in mid-1929 before it plunged in the Great Crash of 1929. Similarly, The Dow Jones Industrial Average went from 8,000 in mid-1997 to 13,000 in mid-2007 as so many dollars chased the same assets.

Admittedly, the Great Recession starting in 2007 has not produced the same kind of upheaval in society as the Great Depression because the government stepped in quickly with enough money to contain the downward slide but in some ways this has only delayed the inevitable changes which need to occur. After the $700 billion stimulus package wears off, median incomes will remain flat, inequality will continue to widen and most families will remain financially insecure. In short, the middle class will be unable to buy enough to keep the economy going and from this will likely emerge a political backlash against trade, immigration, foreign investment, Wall Street, big business and ultimately the government itself.
Henry Ford is widely considered to be the first example of what would later come to be termed the “Basic Bargain.” In January 1914, Ford announced workers on his Model T assembly line in Highland Park, Michigan would be paid $5 per eight-hour day – almost three times what typical factory workers of that era were earning. The higher wage turned Ford’s own autoworkers into customers who could eventually pay $575 to buy their own Model T’s. Ford’s profits grew from $25 million in 1914 to $57 million two years later on the strength of his understanding of the basic economic reality which lies at the heart of any economy – workers are also consumers and there is an inescapable correlation between the level of wages and overall demand for the products and services those workers produce.

Influential British economist John Maynard Keynes formalized the Basic Bargain. He stated a government should maintain aggregate demand so that the productive capacity of the economy doesn’t outrun the ability of ordinary people to buy, which would give businesses less incentive to invest. There must be a Basic Bargain which gives workers a proportionate share of the fruits of economic growth. Whenever the Basic Bargain is maintained, the entire economy is balanced. When the Basic Bargain breaks down, government must step in to reinstate it again or the economy will inevitably shrink.

The problem is America has forgotten the lesson about the importance of maintaining the Basic Bargain which was learned in the Great Depression. From 1947 until about 1977, increases in average hourly compensation for American workers pretty much tracked gains in productivity. From the late 1970s onwards, however, productivity has continued to steadily rise but real hourly compensation has remained flat. The reasons for this are varied and seem logical:

- Globalization and the loss of good jobs to workers in foreign nations.
- Increasing use of automation in manufacturing.
- The ebb and flow of industries which has seen millions of workers forced to take lower paying jobs.
- The deregulation of the financial industry which favored short-term profits over long-term growth.
- Failure on the part of the government to regulate to enforce and maintain the Basic Bargain.
- Companies were left to set CEO salaries and slash jobs and wages without any regulatory oversight.

Overall, there was a loss of generational memory about the lessons of the Great Depression combined with the spread of the political dogma that free markets always know best. Ronald Reagan, Margaret Thatcher, Alan Greenspan, Milton Friedman and others all reiterated the same theme over and over: The choice was between a free market and big government. Government was the problem. Free markets were the solution.

As wages flattened out from the mid-1970s onwards, many Americans were able to keep buying for a while by utilizing three basic coping mechanisms:

1. More women were joining the work force meaning families had two incomes.
2. Many employees started working longer hours to try and earn more.
3. Families drew down savings and borrowed to the hilt.

All three of these coping mechanisms had pretty much run out of steam and reached their inevitable limits by 2007. That meant when the debt markets had a meltdown, Americans suddenly realized they could no longer afford to live the way they had been living. They would have to face the future without any coping mechanisms – meaning the American economy had reached something of a watershed moment. The Great Recession has accelerated all of the various structural changes which began in the late 1970s. The concentration of wealth in the hands of a smaller and smaller number of people has destabilized the economy and potentially has the potential to undermine democracy if left unaddressed. What lies ahead will be a moral challenge, an economic challenge and a political challenge of the character of the American people. What’s broken is the Basic Bargain linking pay to production and purchasing power to the middle class consumer. The obvious solution is to remake and reinstate that bargain.
THE BACKLASH

Jobs and the economy are always at the forefront of voter’s minds in any election. History has shown politics has always been inextricably bound up with economics and whether it is fair or not, US presidents have always been held accountable for the general state of the economy. Some presidents have won office on the strength of their promises to fix the economy while others have lost reelection because of their perceived economic mismanagement. This is going to be born out in the future of President Obama who won election in 2008 just as the US economy teetered on the edge of a precipice.

Once the impact of the 2008 economic stimulus ends and the Federal Reserve is forced to tighten the money supply and raise interest rates, a powerful political backlash is likely to arise. There will be several factors which contribute to this backlash in meaningful ways:

- Large numbers of middle-class Americans will be forced to accept lower wages if they want to stay employed as more employers look at new software, automated equipment and equally productive workers elsewhere in the world who are prepared to work for less. Since most of these families will have already exhausted their coping mechanisms, they will have no choice but to make do with less. A new ethic of frugality will emerge and take root even though this goes against the American spirit and tradition.

- Middle-class Americans have always idolized the “Great American Dream” – that you can go into business for yourself and make it succeed by dint of the shear hard work and sweat equity you put into it. Part of that dream is an expectation the future will be materially better than the present. America has a tradition of surpassing itself or of always trading up. As middle-class Americans are forced to lower their standard of living and make do with less, they will start to feel anger and resentment about the political and business leadership of the country. Disappointment and anxiety will come to the surface.

- To add insult to injury, while the middle-class will be adjusting to a lower standard of living, the incomes of America’s rich are very likely to keep on soaring. Forbes magazine estimated the four hundred wealthiest people in America lost $300 billion in 2008 alone (although they did still have $1.27 trillion to get by on) and yet by 2009 most had bounced back. On Wall Street, new pay packages were negotiated as if the crash had not occurred. One major reason for this phenomena is the fact the majority of the assets of rich Americans are in stocks, bonds and financial instruments which have risen in value whereas the major asset of middle-class Americans tends to be their homes which have taken a beating and likely won’t return to their 2007 values for years to come. Many executives also have employment contracts in place which guarantee them fixed remuneration regardless of the state of the economy. All in all, the rich are well positioned to keep increasing their incomes even as many Americans battle obsolescence in the workplace. As this income gap continues to widen in the future, the rich will have access to all kinds of different things – like admission to prestigious universities and high-quality private schools, access to the best hospitals and health-care facilities or even the desirable oceanfront properties. A widening income gap generally has the effect of making Americans who are not in the inner circle feel increasingly frustrated.

In other nations at various times, frustrations over widening gaps in income levels have led to social discontent and widespread political instability. America’s traditional response to opulent displays of wealth is this tends to provoke ambition rather than hostility. People here see the lifestyles of the rich and famous as something they aspire to enjoy themselves rather than as economic royalists who should be taught a lesson or two in the harsh realities of life. Given the chance, most Americans aspire to join the ranks of the wealthy and all they want is a level playing field which will allow them to earn their way to the top. Accordingly, when people start to believe the dice are loaded against their personal financial success this can be the figurative last straw for some.
The Wall Street Crash of 2008 and the subsequent $700 billion federal bailout package which addressed it may have been enough to generate something of a political backlash. In the years leading up to 2008, Wall Street had made large and risky bets using other people’s money. Some of the investment banks had even simultaneously bet against their own bundles of mortgage debt so when the bottom fell out of the market, those banks made huge profits. Government regulators stood by and did nothing so when the giant bailout of Wall Street was sold to the American people as being necessary to save Main Street jobs, many voters cried “Enough already!” This perception was reinforced when it became clear the majority of the taxpayer’s money ended up being used to keep banks sufficiently solvent so they could do a new round of deals which would generate them billions of dollars the next time around. It soon became clear little of the bailout billions ever trickled down to Main Street but instead everything got sucked up by Wall Street.

So why aren’t politicians more active in trying to regulate Wall Street excesses? This may be a case of following the money for clues. In 2009 alone, the financial industry spent more than $300 million lobbying members of Congress. When that figure is added to the $88 million Wall Street contributed to Democratic candidates for their 2008 election campaigns and $67 million given to the Republicans in that same election, it’s clear Wall Street is an integral part of funding any reelection campaigns for most politicians. There is a clear and obvious incentive in place which preclude politicians from being too heavy handed in regulating Wall Street’s behavior. It’s also clear at least some of the taxpayer’s own money has been used to lobby lawmakers to keep the game going much as it had before the Great Recession. Lobbying is now a highly lucrative profession as evidenced by the fact today around 30 percent of retiring members of Congress go on to become Washington lobbyists. This, in turn, means that before any major legislation can be introduced, all kinds of payoffs to powerful corporations and industries have to be organized lest these moneyed interests use their clout to stop the proposal before it gets to first base.

The end result is the middle-class in particular has moved from resentment to anger about the political process and its failure to address the surging inequality between the haves and have-nots. Economic resentment and frustration is evident in the increasing bitterness and virulence of the nation’s political debates. The self-described Tea Party has gained momentum as a way for the voters to vent their feelings and express their disquiet about what’s happening in national politics. Thus far, America’s backlash against what is perceived as a rigged game between Wall Street and Washington has been relatively tame and it might yet stay that way, but equally there is the chance economic resentment will propel someone to the White House in the future who is extremely and damagingly nationalistic, isolationist and paranoid. History has shown on a number of occasions prolonged economic stress can open the doors to demagogues who prey on public anxieties in order to gain power.

One of the distinguishing hallmarks of the American political system has always been its ability and knack for stopping backlashes before they get too far out of hand. The only question is whether meaningful economic reform will come soon enough and on a scale that’s needed to genuinely address the growing concerns and issues of middle-class Americans. Political leaders need to be spending more time talking about what can be done about the nation’s surging income inequality and the flattening of middle-class incomes before it becomes too late to head off more extreme and damaging schools of thought. Politics always abhors a vacuum almost as much as nature does and if the big political parties don’t get their acts together and start working to reinvigorate and reinstate the Basic Bargain sometime soon, some other political party with a far more extremist agenda might gain traction with American voters.
WHAT SHOULD BE DONE:
WAYS TO REINVIGORATE THE BASIC BARGAIN

It’s time to restore the Basic Bargain for America’s middle-class. Doing this will most certainly require costly strategies but ways to pay for them which do not increase the national debt can be found. In fact, most of them are more likely to produce a budget surplus because of the stronger and more sustainable economic growth that would result. The costs of inaction would be much higher. America should:

1. Introduce a reverse income tax
   Full-time workers earning $20,000 or less (in 2009 dollars) should receive a wage supplement of $15,000 which would then decline incrementally to $10,000 for those earning $30,000, $5,000 for full-time workers earning $40,000, and zero for those earning $50,000 or more. The yearly cost of these wage supplements would be $633 billion to the federal government but those lost revenues would be more than replaced by a carbon tax and higher taxes on the top 5 percent of incomes.

2. Introduce a carbon tax
   The United States should tax fossil fuels such as coal, oil and gas on the basis of how many tons of carbon dioxide emissions such fuels release into the atmosphere. I would propose setting the carbon tax at $35 per metric ton of carbon dioxide or its equivalent initially and then letting the market set the price in the future through a yearly auction for carbon rights. At $35 per metric ton, this tax would raise $210 billion so if the rights were to rise to $115 per metric ton, the carbon tax would yield $600 billion per year. A tax of $115 per ton would add $1 to the price of gasoline at the pump and 6c per kilowatt-hour to the price of electricity. A carbon tax would encourage investment in more efficient sources of energy and boost aggregate demand for alternative fuels.

3. Raise marginal tax rates for the wealthy
   The changes I would propose in income taxes are:
   • All income should be taxed alike regardless of source – wages, salaries or capital gains.
   • Marginal tax rate for top one percent (incomes over $410,000) to be set at 55 percent.
   • Marginal tax rate for top two percent (incomes over $260,000) to be 50 percent.
   • Marginal tax rate of top five percent (incomes over $160,000) to be 40 percent.
   • Marginal taxes for someone earning $50,000 - $90,000 to be set at 10 percent.
   This would bring in about $600 billion more than the current tax system raises each year. When added to the revenues generated by the carbon tax, this would more than pay for the reverse income tax and other measures listed below. These proposed tax rates are not high by historical precedents. Note raising marginal tax rates is not an attempt to redistribute wealth. Rather, the wage supplements combined with tax reductions for those outside the top five percent of earners would enable middle-class consumers to spend more. This surge in domestic demand and consumer spending would move the US economy to full capacity and underpin hoped-for future growth. It would also logically follow companies would enjoy higher profits and the stock market would rise. The higher taxes paid by the rich would in all likelihood be more than offset by an increase in the value of their investments as a result of the economic growth which would be fueled by the US economy’s better overall performance. Hence, it is not unreasonable to project richer Americans would actually come out ahead compared to where they were before as a result of the cumulative impact of the reverse income tax, a new carbon tax and a better structured progressive tax system.
4. **Develop a reemployment system to supercede the current unemployment system**

Unemployment insurance was originally designed to tide people over until they got their jobs back at the end of a downturn. When people lose their jobs today, it’s often because those jobs have disappeared and they join the ranks of the long-term unemployed. A better reemployment system needs to be introduced to replace the unemployment system. The new reemployment system should feature wage insurance where anyone who loses a job and takes on a new job which pays less will be eligible for 90 percent of the difference for up to two years. That same level of income – 90 percent of former wages – should also be provided for up to a year to anyone who enrolls in approved training or educational programs. I would estimate this kind of reemployment system would cost $3 billion a year over and above the $2.35 billion which the federal government currently spends on unemployment insurance. Profitable companies which lay off their workers could pay a severance tax as a way of raising the additional revenue required to run a reemployment system.

5. **Replace public school spending with school vouchers based on family income**

The obvious and essential way to boost the earnings of Americans in the bottom half is to improve their education and skills training. To make this happen more effectively, spending on public schools should be replaced by vouchers which families can cash in at any school which meets minimum standards. Low income families should receive $14,000 per year for each school-age child. Wealthy families should receive $2,000 in vouchers per child. Vouchers would inject a healthy dose of competition into the school system, give lower- and middle-class families greater purchasing power and see billions of dollars being injected into schools which are located in lower-income neighborhoods. It would also leave the door open for wealthy suburban schools to arrange vans to transport children from poorer neighborhoods as well. I would also suggest around $20 billion a year from the reverse income tax should be applied to early childhood education which has been proven to produce children who ultimately earn more, commit less crime and experience lower levels of teenage pregnancy.

6. **Link college loans to subsequent earnings**

Fundamental systemic changes are needed in the way higher education is funded in America. Public colleges and universities should offer free tuition and anyone who elects to attend a private university should be eligible for a federal loan. Higher education could be funded by the graduates of public universities and borrowers of federal loans being required to pay a fixed percentage – say 10 percent – of their taxable earnings for their first ten years of full-time work into the fund which finances public universities and provides private educational loans. After that ten year repayment period, their individual loans would then be considered fully paid.

7. **Sizable increase spending on public goods such as transportation, parks and other facilities**

In recent years, there has been a trend towards charging “user fees” to everyone who wants to take advantage of public transportation, public parks and recreational facilities, public museums and libraries. This discourages use. They should be available free of charge. Public goods improve the quality of life, especially for those who cannot afford the equivalent private goods. By making public goods of all kinds free, resources will be utilized more effectively and many other benefits would accrue to society. To take just one example, if America had an expanded system of free public transportation including high-speed rail available, traffic congestion which is estimated to cost Americans more than $85 billion a year would be reduced dramatically. The benefits of increased spending on public goods would easily outweigh the costs.
8. **Allow everyone to sign up for Medicare**

   The passage of health care legislation in 2010 is a promising first step towards health care reform but it doesn’t go far enough. The next stage should be Medicare for all. This will hands-down be the most efficient way to provide middle-class and low-income families with high-quality care in the years ahead. Americans already spend more on health care per person than any other nation in the world and yet health costs are still rising faster than inflation. We still have the highest infant mortality rate of all the world’s industrialized nations and a life expectancy which is shorter than that of forty other nations including Jordan and the Cayman Islands. Our current health care system is complicated, expensive and fundamentally inequitable – as evidenced by the fact some 45 million Americans still don’t have health insurance in 2010. Around 30 percent of U.S. health care spending goes to administrative costs yet Medicare’s administrative costs are in the range of 3 percent. If Medicare were to cover the entire population, it would have even more bargaining power with drug companies and health care providers. It’s reasonable to expect that would bring down medical costs still further in the future and would likely generate between $58 billion and $400 billion a year in savings. This surely would be enough to subsidize the costs of making Medicare available to all Americans. I believe once the 2010 health bill is implemented and its costs become apparent, the public will be ready to support the idea of extending Medicare to all Americans.

9. **Get big money out of politics**

   In recent years, there is no question political decision making at the national level has been distorted by the money flowing from large corporations, Wall Street and their executives and traders. There is now a clear need for strengthened campaign-finance laws, more generous public funding of elections, stricter limits on campaign contributions and enforceable limits on issue advertising. We should require that all financial contributions to a political party go through a “blind trust” mechanism so candidates never know who contributed what to their campaigns. Put another way, we need to do those things which would severe the quid from the quo in the traditional quid pro quo.

   This is a practical and workable rather than an unrealistic agenda. Most of these proposals are commonsensical in nature because they move towards greater shared prosperity – which is always hard to argue against. Admittedly, to implement this agenda would require cooperation at all levels of society and that degree of political goodwill will generally only comes to the fore in the face of an immediate crisis but it can be done. Perhaps an aftershock in the form of another deep recession will be enough to spur reforms.

   Sooner rather than later, the chief executives of America’s largest corporations and Wall Street banks will become concerned about the lackluster domestic economy. Firms cannot and will not generate profits year after year if the American middle-class cannot afford to purchase what is on offer. The global marketplace will always be there but this alone will not generate enough business to totally offset the shortfalls generated in home markets if the American economy is weak. At some point, even the most ardent critics of change will come to the conclusion the alternatives to making the changes needed to reinvigorate the Basic Bargain look far worse.

   America has a huge reservoir of resilience and common sense we have drawn on whenever we faced a crisis as a nation. Time and again, we have put partisan politics aside and gotten on with what needed to be done. As it becomes clear none of us can thrive in a nation divided between a small number of people getting a huge share of the nation’s income and everyone else receiving a declining share, we will choose reform. It is the only sensible option we have and the logical way forward. Let’s get to work.