



The DENNY CENTER for  
*Democratic Capitalism*

GEORGETOWN LAW

THE DENNY CENTER

# Inaugural Report on the Health of Democratic Capitalism

MAY 2022



---

*The Denny Center for Democratic Capitalism at Georgetown Law exists to reconcile the benefits of free market capitalism with the needs and expectations of a democratic society.*

---

#### THE DENNY CENTER AND ITS MISSION

Established in 2020 by a generous gift from Georgetown Law alumnus James McCahill Denny (L'60) and charged with a unique vision grounded in life experience, the Denny Center for Democratic Capitalism at Georgetown Law exists to reconcile the benefits of free market capitalism with the values and expectations of a democratic society. To carry out its mission, the Denny Center pursues work in three areas: (1) producing research, beginning with the center's signature Report on the Health of Democratic Capitalism (the "Report"), to analyze the current health of democratic capitalism (i.e., both its economic vitality and its broader contribution to the well-being of citizens, households, and society), (2) convening leading voices from business, government, and societal institutions to discuss the existing tensions and recommend potential paths forward, and (3) creating student experiences to enrich their education, engage them in the center's work, and prepare them for lifelong contributions.

# *Contents*

<b>I. Executive Summary</b> .....	4
<b>II. Report Introduction</b> .....	8
<b>III. Vital Statistics: Datasets and Descriptions</b> .....	10
1. Efficacy and Vitality .....	11
2. Fairness and Social Mobility .....	16
3. Social Well-being and Stability .....	23
4. Business Environment .....	31
5. International Comparisons .....	38
<b>IV. Reactions</b> .....	52
Betsey Stevenson: An Imperfect Labor Market Recovery .....	53
Michael R. Strain: The State of Democratic Capitalism: 2022 .....	63
<b>V. Suggested Readings</b> .....	69
<b>VI. Addendum: A Vision of Democratic Capitalism</b> .....	70

# Executive Summary

The goal of the *Denny Center Inaugural Report on the Health of Democratic Capitalism* is to evaluate how well the benefits of free market capitalism are balanced with the needs and expectations of a democratic society, focusing primarily on the United States. While almost everyone agrees that free market capitalism is the most efficient wealth creation system, reconciling the benefits of capitalism with broader societal needs and aspirations is a perennial tug of war. The Denny Center was founded on the belief that maintaining balance between the two is critical to the future of both capitalism and a flourishing democratic society.

## CONTEXT

Since the Industrial Revolution, people around the world are better off in a number of ways. Over the last 200 years, annual gross domestic product (GDP) per capita in western economies has grown by a multiple of almost 50 times—from \$1,100 to \$50,000; the average global life expectancy has more than doubled from 29 to 72 years old; and the percentage of the world’s population living in extreme poverty has shrunk from 84% to less than 10%.<sup>1</sup> Despite a long-run track record of success, free market capitalism is under pressure on multiple fronts, motivating some to argue that the system has run its course—and that it’s time to consider alternatives. However, based on the Denny Center’s core research, (conducted with support from leading economists<sup>2</sup>) we believe that democratic capitalism is still the world’s best option, though there are real problems that need to be addressed.

In this report we have used a clinical approach to study objective data that sheds light on democratic capitalism’s overall health, confirming where the system continues to perform well, and also identifying where it’s falling short. The report then summarizes critical questions to focus future research and potential paths forward.

## DENNY CENTER RESEARCH PROCESS

To construct the report, the Denny Center team (a) identified and grouped vital statistics relevant to the health of democratic capitalism in the U.S., (b) recorded U.S. trends for each vital statistic dataset, and (c) compared a subset of these vital statistic results to those of a handful of other developed countries.<sup>3</sup> Based on these observations, we have summarized key outstanding questions and areas for further research that highlight potential paths forward. In addition, we have also compiled suggested readings for anyone desiring to take a deeper dive.

## INITIAL FINDINGS

In the Vital Statistics section of the report, we have organized the datasets and accompanying descriptions into five categories: (1) efficacy and vitality, (2) fairness and social mobility, (3) social well-being and stability, (4) business environment, and (5) international comparisons. The first four dataset groups focus on trends in the U.S. with the fifth group set aside for select international comparisons.

Below we summarize our findings by category:

- **Efficacy & vitality:** *Does our economic system generate growing total wealth?* The U.S. economic system

<sup>1</sup>Our World in Data, “GDP per capita over the long run, 1820-2018”, using a 60/40 weighting for “Western Offshoot Countries” and “Western Europe” data points, respectively; “Rising life expectancy around the world, 1820-2018”; “Share of the world population living in absolute poverty, 1820-2015”, citing Bourguignon and Morrison (2002), *Inequality among World Citizens*, in the *American Economic Review*; and 1981-2015 World Bank (PovcalNet). Retrieved from: <https://ourworldindata.org/economic-growth>, <https://ourworldindata.org/life-expectancy>, and <https://ourworldindata.org/extreme-poverty>.

<sup>2</sup>Jay Shambaugh (Brookings Institution, George Washington University) and Michael Strain (American Enterprise Institute), with additional commentary by Betsy Stevenson (University of Michigan).

<sup>3</sup>Australia, France, Germany, Japan and the United Kingdom.

continues to generate growing total wealth and to produce new innovations—but the rate of growth is slowing down, and inputs to GDP growth face potentially daunting headwinds. A significant long-term issue is the declining fertility rate in the developed world and its potential impact on the future working age population, assuming other factors that affect country-by-country working age population remain fairly stable.

- **Fairness & social mobility:** *Does the system address the well-being of all members of society, or does it favor distinct groups?* Despite recent economic shocks, the U.S. economy continues to provide jobs and a growing level of income for most members of society. However, the overall labor share of GDP is decreasing, income is growing more slowly for most workers than it is for the very top earners, and upward mobility between generations has decreased significantly since the mid-twentieth century as more parents of college graduates are college graduates themselves.
- **Social well-being & stability:** *How does the system strengthen (or weaken) society more broadly?* In several ways, our economic system benefits society broadly: a smaller share of citizens live in poverty, Americans are attaining higher education levels than in the past, home ownership is on the rise, and CO<sub>2</sub> emissions per capita are decreasing. In contrast, life expectancy has stalled, the cost of education and level of student debt have grown, the public's views of business and capitalism are growing less favorable, trust has declined, and efforts to reduce emissions are widely considered to be insufficient to reduce the impacts of climate change.

- **Business environment:** *What is the current status and nature of free market competition, and how well is the business community positioned to address current pressures on the system?* Business sector concentration is increasing and in some sectors is threatening the essential beneficial effects of market competition. At the same time, businesses are investing less, paying out more in dividends, and repurchasing shares in record amounts; these trends may reflect a lack of long-term time horizons in business decision-making.<sup>4</sup> Also, government regulatory spending continues to increase. In addition, more business leaders are ambitiously calling for “profits with a purpose” and publicly embracing the concept of stakeholder capitalism, though it’s unclear what real follow-through looks like, and if/when it will happen at scale. In addition, a large percentage of shareholders have no voice in how the shares they own in equity funds are voted, which may distort the messages sent to boards by shareholders.
- **International comparisons:** *How does the U.S. compare to other democratic economies, and what can we learn from the differences?* Compared to other democratic economies, the U.S. is holding its own in terms of GDP growth, labor compensation as a share of GDP, reduction in CO<sub>2</sub> emissions per capita, and its citizens’ views of their own well-being. However, the U.S. is losing ground when it comes to life expectancy, labor force participation even when jobs are available, income inequality (as measured by the Gini Coefficient), social mobility, and total emissions. On top of that, U.S. government interventions have 30-50% less impact on the Gini measure of inequality than programs in other developed democratic economies which may not condition benefits on employment.

<sup>4</sup>Business behavior of this sort would normally indicate a lack of long-term thinking in the boardroom, but we use the word “may” to give boards and management teams the benefit of the doubt.

## KEY QUESTIONS FOR PATHS FORWARD

The vital statistic datasets raise many more questions than the first installment of our report can address, but we highlight the following questions given their urgency and the long-term nature of likely solutions.

- Is future **overall GDP growth under threat** (i.e., shrinking fertility rates in the developed world undermining future working age population)? And if yes, what options exist to counteract the potential impact? Can other inputs change enough to help (immigration, worker productivity, technical innovation)? Might the shorter-term focus of a growing number of companies (often revealed by declining capital investment and increased share repurchases) also be a threat to future GDP growth?
- What are the **root causes of the growing gap in incomes**, and can they be addressed in a way that improves equity but does not discourage investment and innovation? For example, what can be done to reign in CEO compensation vis-a-vis average worker pay while keeping top-level talent engaged and motivated?
- What role has **globalization played in the lack of income growth** for the average U.S. worker? Is there a way to strengthen local communities by mitigating the globalization effects on U.S. workers without significant impact to overall productivity and efficiency?
- Why has **upward social mobility slowed** significantly in the U.S., and how can business, government, and society work together to reverse the trend? Are there examples of upward mobility improving in other settings, and if yes, what can we learn? Given the increase in college graduates across generations, are we measuring mobility correctly?
- Why are many business sectors becoming more concentrated, and is concentration leading to **lower quality market competition** that will ultimately undermine the market/society balance? Why has the number of public companies in the U.S. dropped by almost 50% over the last 25 years, and what might the consequences be? Are consistent increases in lobby spending an indication that elements of crony capitalism are contributing to lower quality of competition?
- How can **corporations generate value for shareholders but also address the needs of the other stakeholders**? Are there value-creating rationales that can strengthen the purpose and profit movement? How can boards and management teams properly measure long-term benefits (and costs) of ESG initiatives? Should society expect something in return for providing corporate shareholders with limited liability? What steps can companies take to embrace a broader view of business's role in society that doesn't sacrifice profitability, innovation and investment? How can shareholders be persuaded to rethink their current high volume, autopilot-engagement with boards and companies?

## AREAS FOR FURTHER RESEARCH

Democratic capitalism is under pressure, and we should not shy away from identifying problems that need to be addressed. Using data to better understand the problems within the system and identify potential solutions can help improve and strengthen both capitalism and democratic society.

At the same time, we should not let a clear-eyed acknowledgment of real problems cause us to forget the many benefits of free market capitalism. When combined with various forms of democratic societies built upon

disciplined moral/cultural frameworks, the market economy continues to support human flourishing around the world.

Therefore, with the aim of reconciling the market economy's many benefits with society's values and needs, we recommend the following topics as areas that merit further research to (1) better define problem areas, (2) verify the existence and extent of problems and sub-issues, and (3) propose potential solutions.

- Threats to future overall **GDP growth**, including declining fertility rates and short-term corporate behaviors
- Root causes of the growing **gaps in incomes**
- Unintended **impacts of globalization** on local communities and workers
- Excessive levels of **executive compensation**
- Slowdown in **upward social mobility** outcomes
- Decreasing **quality of market competition** and apparent rise of **crony capitalism**
- **Increasing government regulatory budgets** and implications for business and lobby spending
- Lack of **value-creating rationales and tangible actions** for corporate boards and management teams that better integrate needs of all stakeholders in long-term strategy and which do not impair compensation fairness for employees or discourage investment by shareholders
- Missing incentives and common measurement protocols for collective **stewardship of natural resources** and/or rationale for **industry self-regulation**
- Inadequate attention to **society's quid pro quo** for corporate shareholder limited liability
- Apparent **concession by shareholders of the inherent right to vote shares** held by fiduciaries on their behalf

# Report Introduction

## THE CONTEXT AND RATIONALE FOR THE REPORT

Free market capitalism has proven itself an unmatched engine for driving economic growth and improving standards of living in the United States and around the world. However, big problems persist. With accelerating frequency, news headlines warn of widening gaps in wealth and incomes, degradation of natural resources, societal division and strife, and questionable integrity of business owners and corporate leaders. Capitalism as an economic system is under fire because its ability to generate wealth and innovations appears to be falling out of step with society's needs and values. Though reasonable voices may disagree on potential solutions, the Report aims to present data all sides can accept as a true reflection of the present realities—and to raise the critical issues that require long-term solutions.

---

**The Denny Center's Report will attempt to clinically measure the health of democratic capitalism, focused primarily on the United States but including key measures for a handful of other countries, both in terms of its economic vitality and its broader contribution to the well-being of society.**

---

## THE REPORT: CONTENT, OBJECTIVES, AND AUDIENCE

This first edition of the Report is rooted in the center's desire to produce a clinical, data-driven assessment of the free market economic system and how it serves the well-being of a democratic society, focusing primarily on that of the U.S. but also comparing key measures to those of a handful of additional democratic countries. The thesis of the report is that the economic well-being of society is unmatched when coupled with free market capitalism that is also responsive to the values and needs of a functioning democracy.

---

**The Report's objectives include analyzing how well the U.S. and several other developed democracies are managing the tensions presented by free market capitalism and identifying emerging trends that could undermine the balance of free markets and democratic society.**

---

The objectives of this inaugural Report are to:

(1) analyze how well the U.S. and several other developed democracies are managing the tensions presented by democratic capitalism (and their related trade-offs), and (2) identify emerging trends, which if unaddressed, may undermine the balance necessary to preserve the coalition of free market capitalism and democratic society. The Report's target audience includes corporate board members and management executives, federal and local government officials (including legislators, regulators and judges), influential institutional leaders (in academia, the arts, and religion), and the public-at-large. Though some necessary solutions will require changes in laws and/or regulations, the Denny Center believes that the majority of positive changes can be driven by business and the private sector without sacrificing long-term value creation for owners or viewing tensions among stakeholders as zero-sum trade-offs over a longer strategic time horizon.

## REPORT CONTRIBUTORS

To produce the majority of the vital statistic datasets for this initial report, the Denny Center collaborated with two external economists: Jay Shambaugh (Brookings Institution, George Washington University) and Michael Strain (American Enterprise Institute); Dr. Strain also contributed an essay in response to this report's initial findings. Dr. Shambaugh is currently a Professor of Economics and



International Affairs at George Washington University and a Senior Nonresident Fellow at the Brookings Institution. Formerly, Dr. Shambaugh served as a member of the White House Council of Economic Advisors (August 2015-January 2017) and the lead researcher for Brookings' Hamilton Project. Dr. Strain is currently a Senior Fellow and the Director of Economic Policy Studies at the American Enterprise Institute and the author of the recent book, *The American Dream Is Not Dead (But Populism Could Kill It)*. Before that, he served at the Center for Economic Studies at the U.S. Census Bureau and in the macroeconomics research group at The Federal Bank of New York. In addition, Betsey Stevenson contributed an essay in response to the report's initial findings. Dr. Stevenson is a Professor of Public Policy and Economics at the Gerald R.

Ford School of Public Policy at the University of Michigan. She is the author of a Principles of Microeconomics and a Principles of Macroeconomics textbook and the co-host of the podcast Think Like An Economist. Formerly she served as a member of the White House Council of Economic Advisors (July 2013-August 2015) and the Chief Economist of the U.S. Department of Labor (August 2010-September 2011). Duncan Hobbs also contributed to the report and its datasets; he is a Senior Research Associate in Economic Policy Studies at the American Enterprise Institute and a graduate of Georgetown University (SFS'17).

# Vital Statistics: Datasets and Descriptions

---

As a starting point to evaluate the health of democratic capitalism, focusing primarily on the U.S. but also comparing certain measures with a handful of other countries, we have grouped vital statistics into five categories—each addressing an important aspect of current tensions. Therefore, we present the vital statistic datasets in the following sections:

## **EFFICACY & VITALITY**

Does our economic system generate growing total wealth?

## **FAIRNESS & SOCIAL MOBILITY**

Does the system address the well-being of all members of society, or does it favor distinct groups?

## **SOCIAL WELL-BEING & STABILITY**

How does the system strengthen (or weaken) society more broadly?

## **BUSINESS ENVIRONMENT**

What is the current status and nature of free market competition, and how well is the business community positioned to address current pressures on the system?

## **INTERNATIONAL COMPARISONS**

How does the U.S. compare to other democratic economies, and what can we learn from the differences?

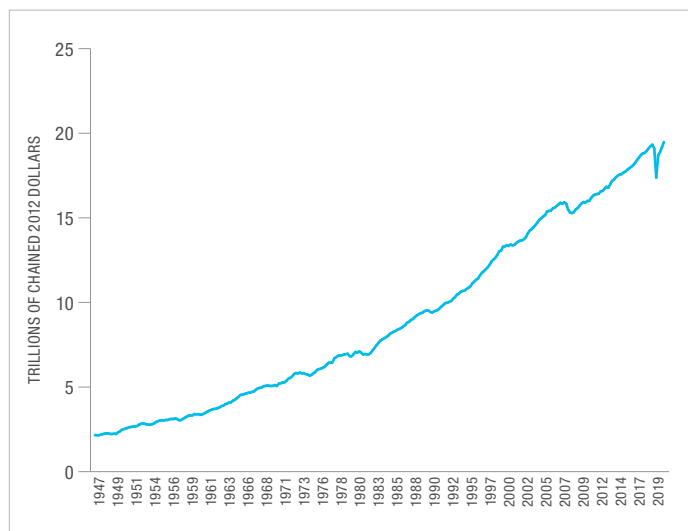


## 1. EFFICACY AND VITALITY

Does our economic system generate growing total wealth?

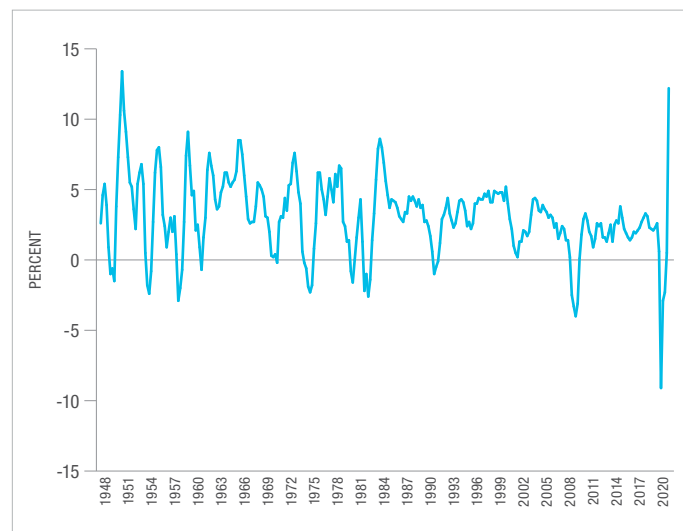
### A. Does democratic capitalism generate growing total wealth over time?

#### Real GDP Growth in Chained 2012 Dollars<sup>5</sup>, 1947-2021



Source: U.S. Bureau of Economic Analysis, Real Gross Domestic Product [GDPC1], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/GDPC1> (accessed August 8, 2021).

#### Real GDP Growth over the Previous Four Quarters, 1948-2021



Source: U.S. Bureau of Economic Analysis, Real Gross Domestic Product [GDPC1], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/GDPC1> (accessed August 8, 2021).

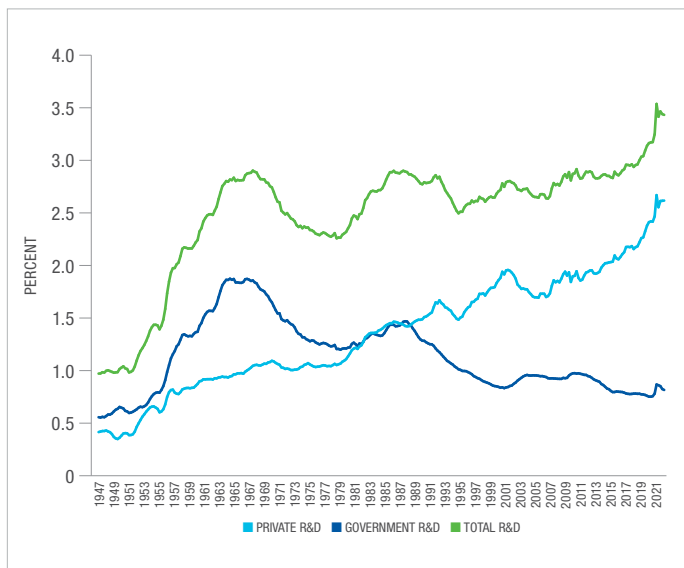
Our economic system has generated and continues to generate a growing amount of total wealth over time, including a strong bounce-back after the 2020-21 COVID-19 contraction. Inflation-adjusted gross domestic product—“real GDP”—measures the quantity of goods and services produced in the nation. It is equal to the level of domestic production purchased by consumers, businesses, and the government, and exported for purchase to other nations. Real GDP increases when the number of workers in the economy increases or when those workers become more productive. Recessions are typically defined as periods when economic output contracts. While raw economic output may leave out many factors that matter to a citizen’s well-being (e.g., leisure time, health status, or political freedom), GDP does provide a good measure of the resources available to a society, and the growth rate of that output can help describe increases in living standards.

Though total real GDP continues to grow, the rate of real GDP growth has slowed down. The rate at which GDP grows is a crucial measure of economic performance and social well being. This measure moves around sharply, turning negative during recessions when the economy is shrinking, and then rebounding into positive territory when the economy is growing. The drop in 2009 and then especially 2020 were particularly sharp in historical context. Compared to previous decades, real GDP has tended to grow more slowly in recent years. Part of this is due to slower population growth and an aging population. In addition, the growth in the productivity of the workforce has slowed in the last fifteen years. If these trends are not reversed it will not mean the U.S. is getting poorer, but it does mean that living standards will rise less rapidly.

<sup>5</sup>Chained dollars is a method for adjusting real dollar amounts for inflation over time to allow the comparison of figures for different years; it generally reflects the dollar amounts computed with 2012 as the base year.

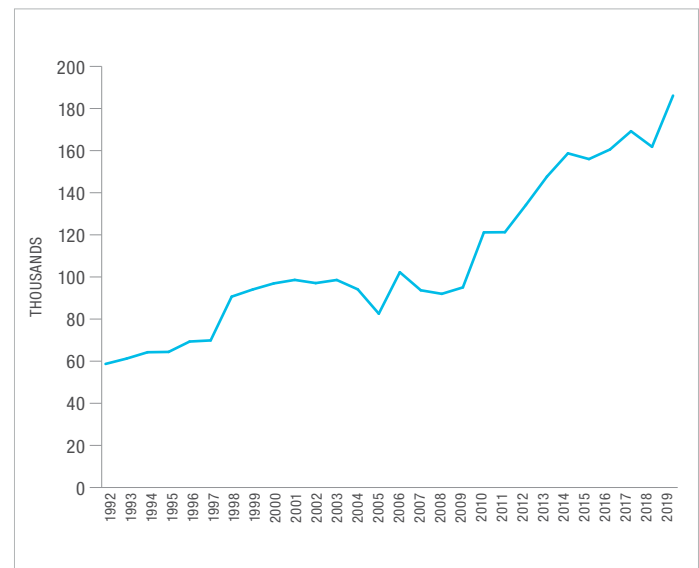
## B. Does the system support and/or produce innovations that support improved overall standards of living and productivity?

### Government and Private R&D Spending as a Share of GDP, 1947-2021



Source: U.S. Bureau of Economic Analysis, Gross Domestic Product: Research and Development [Y694RC1Q027SBEA], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/Y694RC1Q027SBEA> (accessed October 2, 2021). Author's calculations.

### Patents Originating in the U.S. Annually, 1992-2019

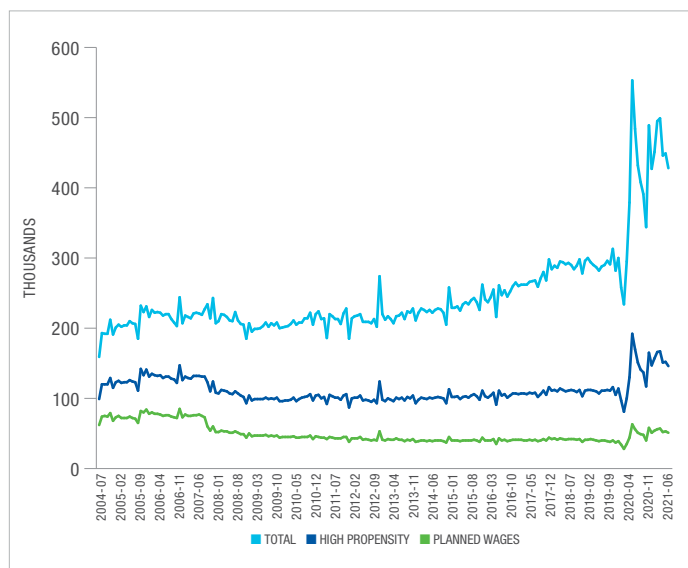


Source: U.S. Patent and Trademark Office, U.S. Granted Patents: Total Patents Originating in the United States [PATENTUSALLTOTAL], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/PATENTUSALLTOTAL>, (accessed October 2, 2021).

Technological innovation has the greatest potential to advance living standards by increasing the productivity of the workforce and improving quality of life. Investments in basic research lead to transformative, breakthrough innovations. This figure plots private and government spending on research and development (“R&D”) as a share of total output. Government spending on research and development increased rapidly at the onset of the Cold War and peaked in the mid-1960s. Research and development spending by private companies has steadily increased throughout this period. This steady increase in R&D spending, driven by the private sector, supports the conclusion that innovation is an important characteristic of democratic capitalism.

One measure of the scale of innovation is the number of patents granted per year. The more new intellectual property rights granted to inventors, the more innovation that is taking place. This figure plots the total number of patents where the first named inventor resides in the U.S. Total patents are the sum of utility, plant, design, and reissue patents granted by the U.S. Patent and Trademark Office. The number of patents granted has roughly doubled since the Great Recession in 2009. While this may signal increased innovative activity, it may also reflect rising patenting of a range of ideas (e.g. business practices) or increased low-quality patents (that do not change activity much). Still, the long-term trend points to the system’s ongoing innovation.

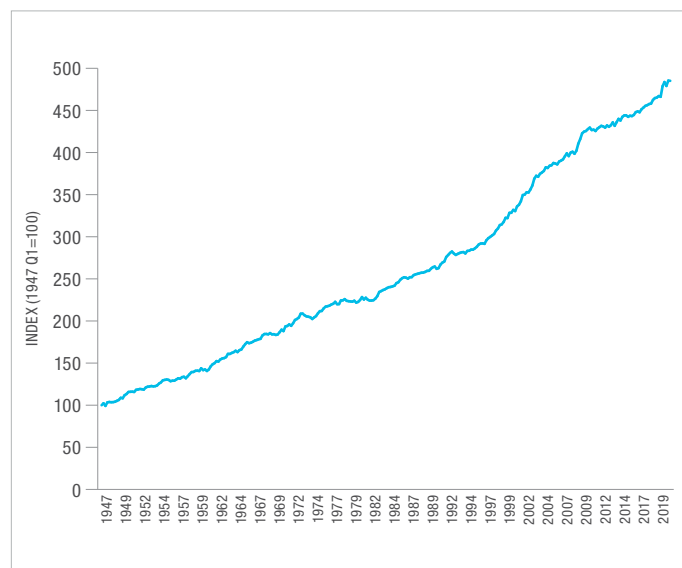
## Monthly New Business Formation in the U.S., 2004-2021



Source Total: U.S. Census Bureau, Business Applications: Total for All NAICS in the United States [BABATOTALSAUS], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/BABATOTALSAUS> (accessed October 13, 2021). Planned Wages U.S. Census Bureau, Business Applications with Planned Wages: Total for All NAICS in the United States [BAWBATOTALSAUS], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/BAWBATOTALSAUS> (accessed October 13, 2021). High Propensity: U.S. Census Bureau, High-Propensity Business Applications: Total for All NAICS in the United States [BAHBATOTALSAUS], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/BAHBATOTALSAUS> (accessed October 13, 2021).

Perhaps surprisingly, the pandemic recession may have spurred a wave of entrepreneurship. Another measure of dynamism is applications from new businesses for employer identification numbers for the purpose of tax administration, shown in total in blue in this figure. High-propensity applications include applications for a corporate entity that is hiring employees, among other characteristics. Business applications with planned wages are a subset of high propensity business applications that also contain a date for paying wages.

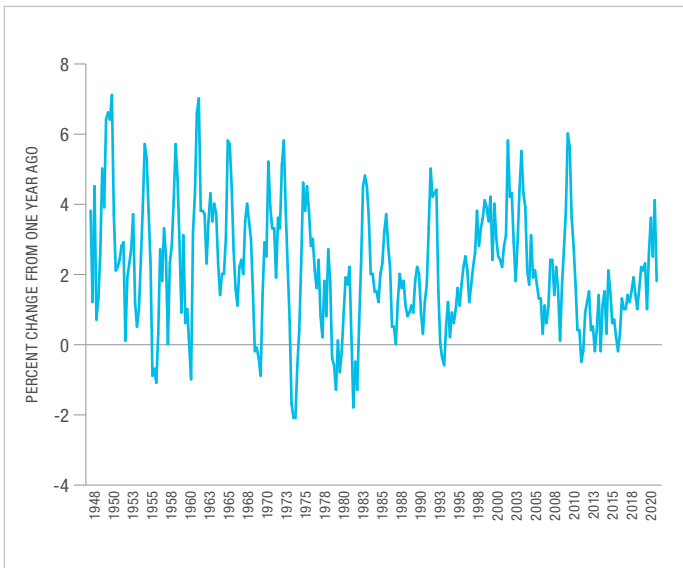
## Real Output Per Hour in the Nonfarm Business Sector, 1947-2021



Source: U.S. Bureau of Labor Statistics, Nonfarm Business Sector: Labor Productivity (Output per Hour) for All Employed Persons [OPHNFB], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/OPHNFB> (accessed September 14, 2021).

For the economy to grow, either the size of the workforce needs to grow or workers need to become more productive—that is, they need to increase the amount of economic output they can produce per every hour they work, output per hour is known as productivity. And over long time horizons, nothing is more important than productivity growth for increasing living standards. Productivity increases when businesses are able to use workers more efficiently. It can increase dramatically when new technologies are invented that allow workers to produce more, and can grow over long horizons as the labor force becomes better educated. In the U.S., productivity increased during the 1990s when businesses figured out how to use modern computers to increase output per hour of work.

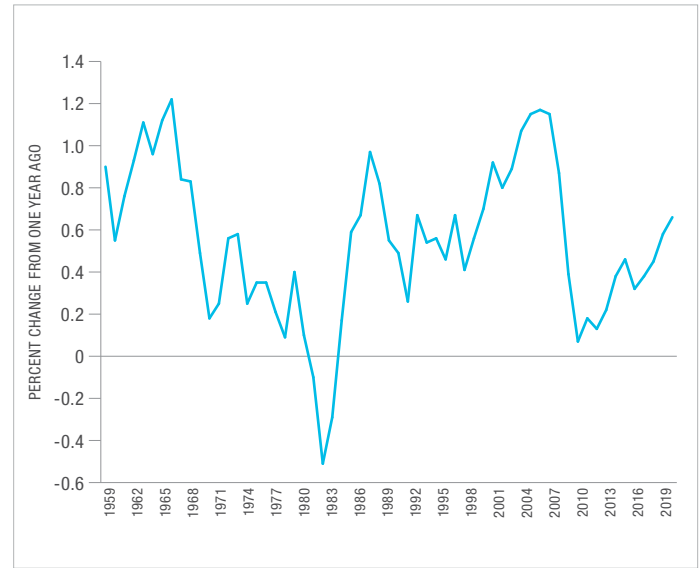
### Change in Real Output Per Hour Versus Quarter One Year Ago, 1948-2021



Source: U.S. Bureau of Labor Statistics, Nonfarm Business Sector: Labor Productivity (Output per Hour) for All Employed Persons [OPHNFB], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/OPHNFB> (accessed September 14, 2021).

Productivity growth fluctuates substantially, but some patterns are clear. Productivity often grows faster coming out of economic downturns, perhaps because lower-productivity firms go out of business and because continuing firms use downturns to figure out how to produce goods and services more efficiently. Productivity growth has slowed in the U.S. for the past decade and a half for reasons that are not fully understood. It increased following the onset of the COVID-19 pandemic due to changes in the composition of the workforce—lower-productivity workers were more likely to be laid off, increasing the average productivity level of the remaining workforce.

### Five Year Moving Average of Annual Change in Total Factor Productivity, 1959-2019

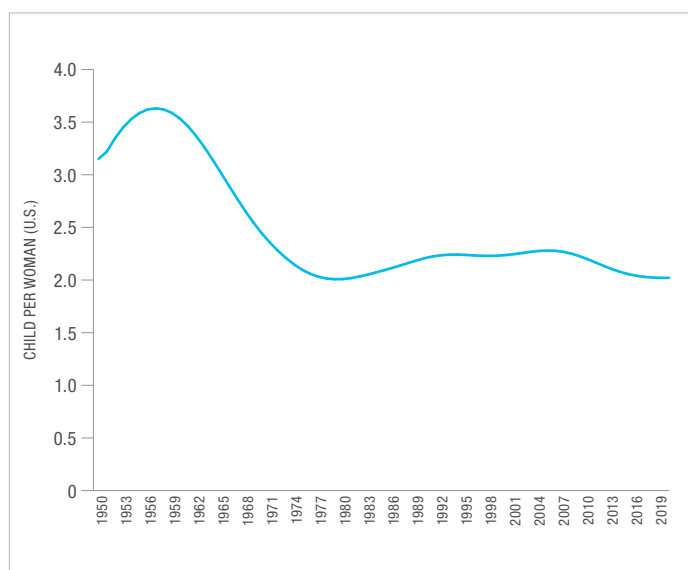


Source: University of Groningen and University of California, Davis, Total Factor Productivity at Constant National Prices for United States [RTFPNAUSA632NRUG], retrieved from FRED, Federal series/RTFPNAUSA632NRUG (accessed September 14, 2021) Author's calculations.

In addition to the productivity of the labor force, a conceptually distinct measure of productivity captures the share of increases in economic output not accounted for by increases in the inputs to production, including labor and capital. It measures the rate at which technology is improving and the extent to which businesses are making efficient use of inputs to production. Like labor productivity, this measure shows substantial growth in the early 1960s and 1990s, with slowing growth after the Great Recession in 2008.

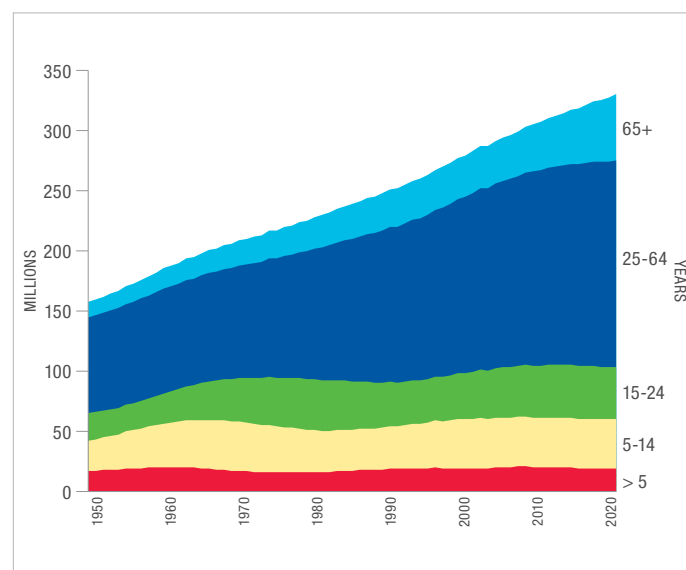
## C. Do Key Inputs Favor Future Growth?

### Fertility Rates, 1950-2020



Source: United Nations—Population Division (2019 Revision). [OurWorldInData.org/fertility-rate](https://ourworldindata.org/fertility-rate).

### Working Age Population, 1950-2020



Source: United Nations—Population Division (2019 Revision). [OurWorldInData.org/world-population-growth](https://ourworldindata.org/world-population-growth).

The total fertility rate is defined as simply the number of children per woman<sup>6</sup>, and it has roughly decreased by half since 1950. This decrease is attributed to a significant increase in access to education by women, the increase in workforce participation by women, decreasing child mortality rates, and the rising cost of bringing up children. Because fertility rates affect the size of the future workforce, this decline poses a significant headwind for GDP. It can be offset by immigration, longevity, and technological innovations, but it begs the question whether declines of this magnitude can be remedied long-term.

Fertility rates drive population growth, and “if the population is shrinking, it is close to impossible to generate strong economic growth.”<sup>7</sup> And what matters the most is the working age population, which is defined as the segment of the population between the ages of 25 and 64. While the percentage of 25-64 year-olds has remained pretty steady at 55%, the 24 and under age group has decreased from 38% to 30%, and the 65 and older segment has more than doubled from 7% to 15%. One researcher found that since 1960, national GDP grew in only 5% of the cases in which the working age population was shrinking over the course of a decade—and that the U.S. is on track for over 90 countries to experience a shrinking working age population by 2050.<sup>8</sup>

<sup>6</sup>More precisely it is average number of children that would be born to a woman over her lifetime if 1) the woman were to experience the exact *current* age-specific fertility rates through her reproductive years and 2) the woman were to survive from birth through the end of her reproductive life (most institutions define this age bracket as 15-49 years).

<sup>7</sup>Ruchir Sharma, *The Ten Rules of Successful Nations*, (W.W. Norton & Company, 2020), 19.

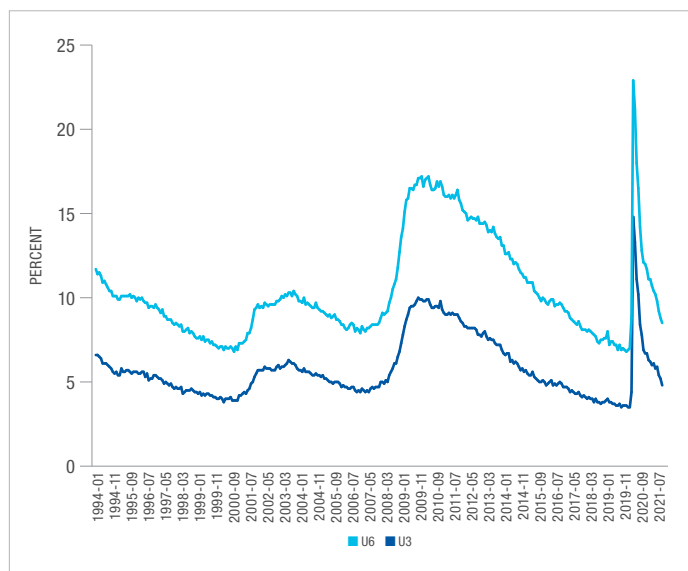
<sup>8</sup>*Ibid.*, 20.

## 2. FAIRNESS & SOCIAL MOBILITY

Does the system address the well-being of all members of society, or does it favor distinct groups?

### A. Does the system provide jobs?

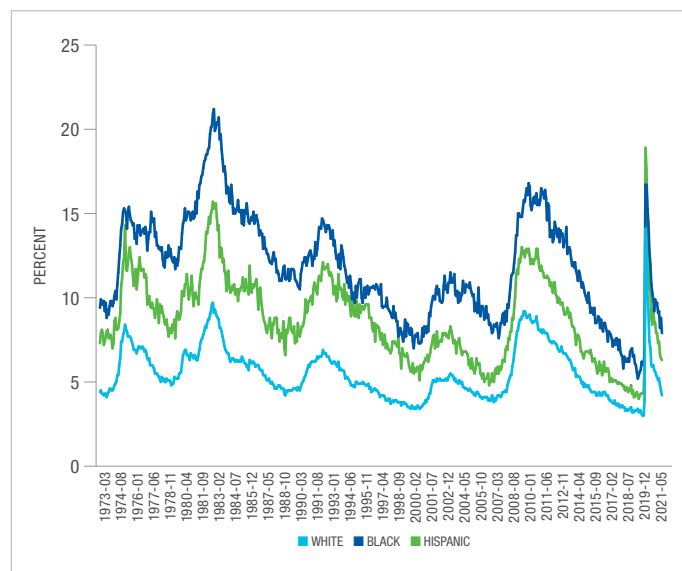
#### Monthly Unemployment Rates, 1994-2021



Source: U6: U.S. Bureau of Labor Statistics, Total Unemployed, Plus All Persons Marginally Attached to the Labor Force, Plus Total Employed Part Time for Economic Reasons, as a Percent of the Civilian Labor Force Plus All Persons Marginally Attached to the Labor Force (U-6) [U6RATE], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/U6RATE>, (accessed October 22, 2021). U3: U.S. Bureau of Labor Statistics, Unemployment Rate [UNRATE], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/UNRATE>, (accessed October 22, 2021). NBER Recession Dates: <https://www.nber.org/research/data/us-business-cycle-expansions-and-contractions>.

Economists generally agree that a 4-5% unemployment rate is acceptable and represents full employment, and by that measure, the U.S. system has provided adequate jobs over time despite short-term spikes related to recessions or recent public health events. Workers are unemployed when they are not employed and are actively seeking work. To understand the definition of unemployment, it is helpful to point out who is not counted as unemployed: for example, retirees and full-time students are typically not counted as unemployed. While they are not employed, retirees and students are not actively looking for jobs. The line labeled U3 plots the official unemployment rate which is the share of the population that is not working but actively seeking work. The line labeled U6 plots a broader measure of unemployment which includes workers captured in the U3 measure as well as people who are not currently seeking work but who want a job and have looked for one in the recent past, along with people who want full-time work but have settled for part-time work.

#### Seasonally Adjusted Unemployment Rates by Race, 1973-2021

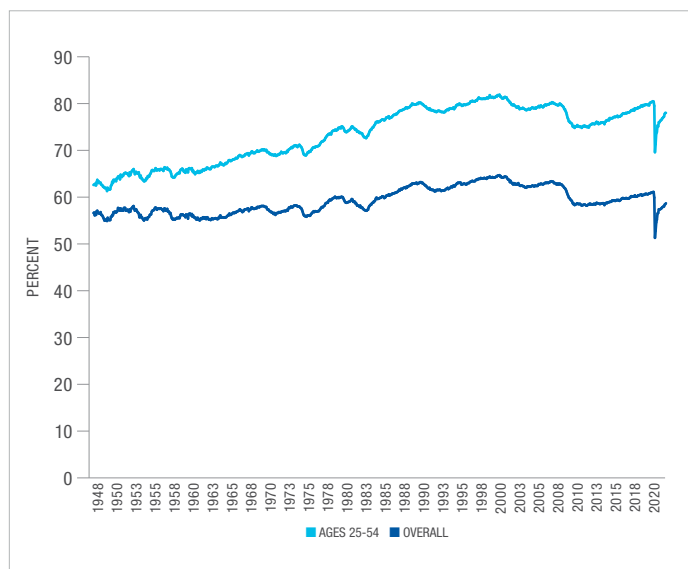


Sources: Black: U.S. Bureau of Labor Statistics, Unemployment Rate—Black or African American [LNS14000006], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/LNS14000006> (accessed October 22, 2021). Hispanic: U.S. Bureau of Labor Statistics, Unemployment Rate—Hispanic or Latino [LNS14000009], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/LNS14000009> (accessed October 22, 2021). White: U.S. Bureau of Labor Statistics, Unemployment Rate—White [LNS14000003], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/LNS14000003> (accessed October 22, 2021).

Workers of different races and ethnicities systematically experience different levels of unemployment, with unemployment among African American workers higher than among white workers—often twice as high. African American workers are more sensitive to the business cycle than white workers, with unemployment rising faster during economic downturns and falling faster during periods of economic expansion. During the COVID recession, unemployment rates for all groups shot up quickly, but as rates fell, the gap between white and African American workers is once again pronounced.



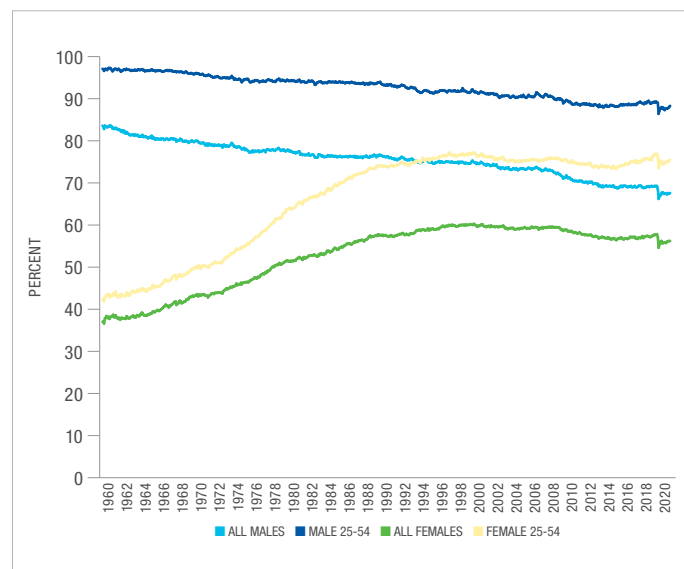
## Employment to Population Ratio for the U.S., 1948-2021



Sources: Overall: U.S. Bureau of Labor Statistics, Employment-Population Ratio [EMRATIO], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/EMRATIO> (accessed October 11, 2021). Ages 25-54: U.S. Bureau of Labor Statistics, Employment-Population Ratio—25-54 Yrs. [LNS12300060], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/LNS12300060> (accessed October 11, 2021).

The unemployment rate is primarily an indicator of the business cycle, reporting how much slack exists in the labor market. An alternative measure that captures structural changes in the economy is the share of the population that is working. In many ways, the employment-to-population ratio is a better measure of living standards, as the share of the population working will be a key input into the amount of output per person an economy can produce. For decades in the second half of the 20th century, this ratio increased as more and more women entered the labor force. This reversed after 2000 and the ratio moved down for many years. Some of the downward trend was due to people reaching retirement age, so many economists prefer to look at the share of the population ages 25–54 years that is employed. This statistic had a long recovery after the Great Recession, coming close to the previous peak before dropping considerably in the pandemic recession.

## Labor Force Participation Rate by Group, 1960-2021

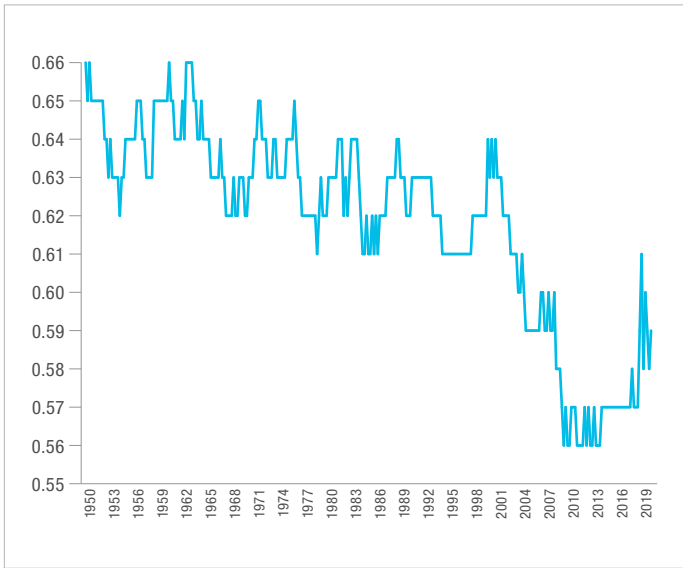


Sources: U.S. Bureau of Labor Statistics, Labor Force Participation Rate [CIVPART], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/CIVPART>. Males: U.S. Bureau of Labor Statistics, Labor Force Participation Rate—Men [LNS11300001], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/LNS11300001> (accessed September 9, 2021). Females: U.S. Bureau of Labor Statistics, Labor Force Participation Rate—Women [LNS11300002], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/LNS11300002> (accessed September 9, 2021).

Another important labor market statistic is the rate at which people participate in the labor force, defined as the share of the population that is either working or not working but actively looking for work (that is, unemployed). This figure shows trends in the labor force participation rate. Female labor force participation, particularly among prime-age women, steadily increased from the 1960s to around 2000, but has been largely flat since. Labor force participation rates among men have slowly declined since the 1960s with the majority of the decline occurring during the economic recessions denoted by the shaded areas.

**B. Does the labor share of income enable an increase in the standard of living for most households?**

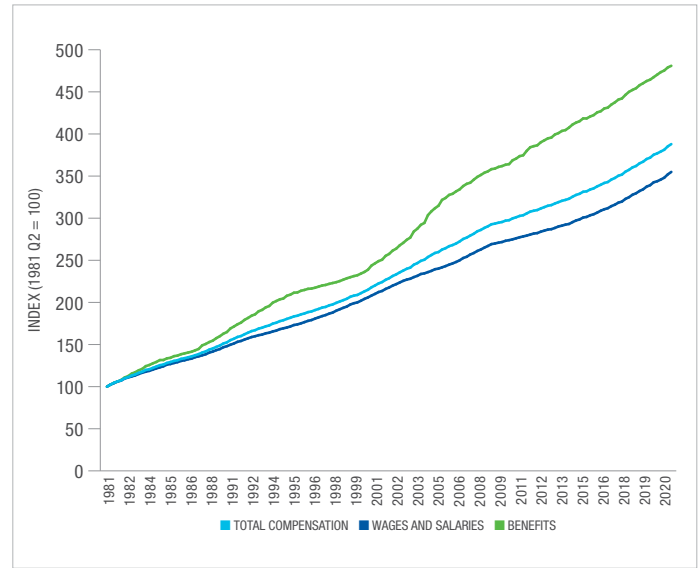
**Labor Compensation as a Share of GDP, 1950-2019**



Source: University of Groningen and University of California, Davis, Share of Labour Compensation in GDP at Current National Prices for United States [LABSHPUSA156NRUG], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/LABSHPUSA156NRUG>, (accessed October 18, 2021).

This graph shows the share of total economic output that is paid as compensation to workers and can be compared to the share of output returned to owners of capital. Labor’s share of income can fluctuate widely, but on average has declined since half a century ago. This trend makes it more difficult for standards of living to increase for the majority of workers.

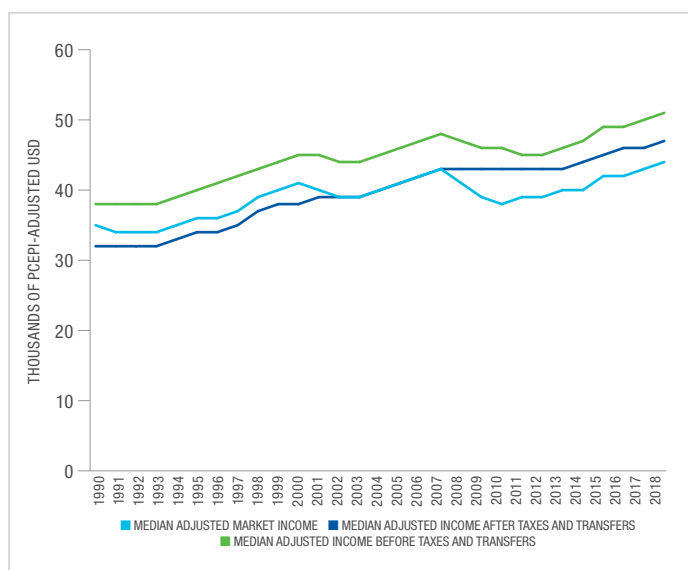
**Total Compensation, Wages & Benefits, 1981-2021**



Source: BLS Employment Cost Index.

This graph shows the growth in total compensation, wages and salaries, and benefits. Wages and salaries have more than tripled since the 1980s, but the value of benefits paid to workers has risen by nearly a factor of five over this time period.

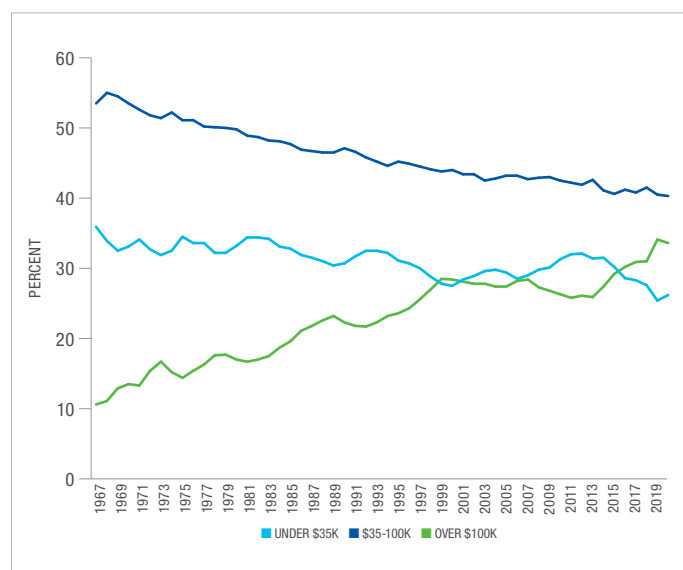
### Median Real Household Income by PCEPI-adjusted Dollars<sup>9</sup>, 1990-2018



Source: Congressional Budget Office, 2021. "The Distribution of Household Income, 2018," Report 57061, Congressional Budget Office Published August 4, 2021. (accessed October 9, 2021).

Over the past three decades, median household market income has increased by around 25 percent. For the median household, post-tax-and-transfer income has increased by about 50 percent, twice the increase in market income. This implies that most households have had the pace of their income growth increase due to the tax and transfer system. This figure shows three measures of median household income over time. Market income includes labor income, including non-cash benefits, business income, and capital income. Income before taxes and transfers consists of market income plus social insurance benefits, including payments to households from the Social Security, Unemployment Insurance, and Medicare programs. Income after taxes and transfers includes income before taxes and transfers, plus cash payments and in-kind transfers from means-tested government assistance programs minus federal taxes paid. All three series are adjusted for household size and for inflation.

### Share of Households by Total Money Income, 1967-2020

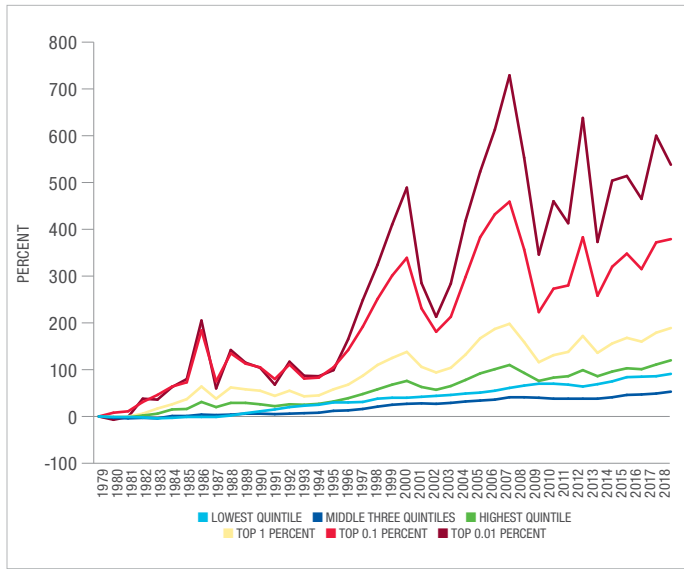


Source: EMILY A. SHRIDER, MELISSA KOLLAR, FRANCES CHEN, AND JESSICA SEMEGA. Income and Poverty in the United States: 2020 Table A2. U.S. Census Bureau. Published September 14, 2021. (accessed October 11, 2021).

Living standards have been rising over time. This chart shows the share of households with income in one of three buckets, adjusted for inflation using the consumer price index. In every year for the past five decades, more households have had incomes between \$35,000 and \$100,000 than above or below those values. Through most of the 1970s, over half of households were in this income group. The share of households in this group has been declining over this period, but the share of households earning under \$35,000 has been declining as well. Most of the movement from “the middle” has been into the \$100,000+ group. Still, roughly two-thirds of households are outside the six-figure-income range, despite substantial increases in GDP per capita. This suggests that much of overall income growth has accrued to households at the top of the income distribution.

<sup>9</sup>PCEPI stands for the Personal Consumption Expenditures Price Index and is a measure of the prices that people living in the U.S. (or those purchasing on their behalf) pay for goods and services on an inflation-adjusted basis.

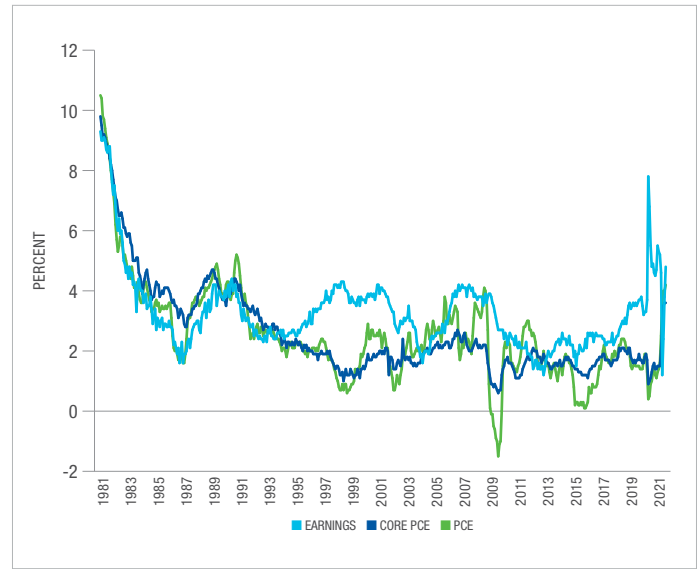
### Cumulative Growth in Real Household Income After Taxes and Transfers, 1979-2018



Source: Congressional Budget Office. 2021. "The Distribution of Household Income, 2018," Report 57061, Congressional Budget Office. Published August 4, 2021. (accessed October 9, 2021).

Over the past four decades, income for middle-class households has not stagnated. But it has grown substantially more slowly than income at the top. The top 20 percent of the income distribution has seen three times as much growth as the middle 60 percent. The higher up the income distribution, the greater income gains. The top 0.01 percent has seen cumulative income growth of over 400 percent over the past four decades. The income for the lowest 20% grew at almost twice the rate of the middle 60%; without government assistance (i.e., before taxes and transfers), the growth of the lowest 20% is almost the same as the middle 60%.

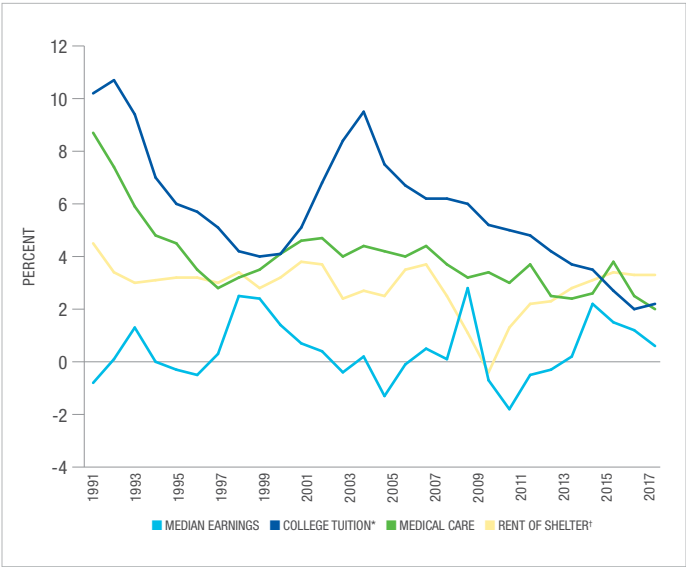
### Annual Changes in Real Wages and Prices, 1981-2021



Source: Bureau of Labor Statistics (Average Hourly Earnings). Bureau of Economic Analysis (core PCE and PCE) (accessed August 9, 2021).

Earnings are defined as average hourly earnings of production and nonsupervisory workers, and core personal consumption expenditures ("PCE") excludes food and energy. Over the last 40 years, inflation has come down considerably in the U.S. with core inflation (excluding more volatile food and energy prices) hovering near 2 percent since the mid 1990s. Average hourly earnings grew at close to 4 percent during stronger periods and as little as under 2 percent during periods of extensive slack. In 2021, prices and wages grew faster both making up for smaller price increases during the peak pandemic and as demand for goods and labor picked up faster than supply.

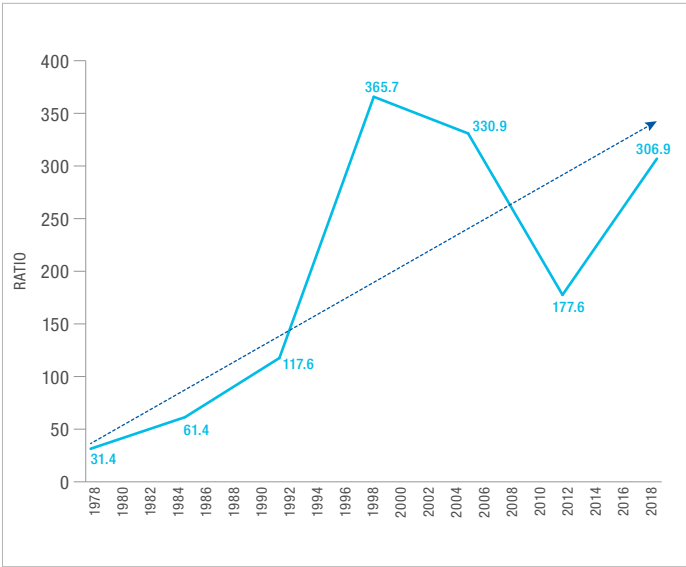
### Annual Growth in Select Prices Compared to Earnings, 1991-2021



\*College tuition and fees in U.S. city average, all urban consumers, not seasonally adjusted. †Rent of shelter includes lodging away from home, rent, and owners equivalent of rent. Source: Bureau of Labor Statistics.

Earnings growth trailed the average growth rates of several heavily weighted components of the consumer price index. The prices of college tuition, medical care and rent/shelter grew on average from 2-7% while earnings growth hovered around 0-1% on average.

### Ratio of CEO to Average Worker Compensation, 1978-2018

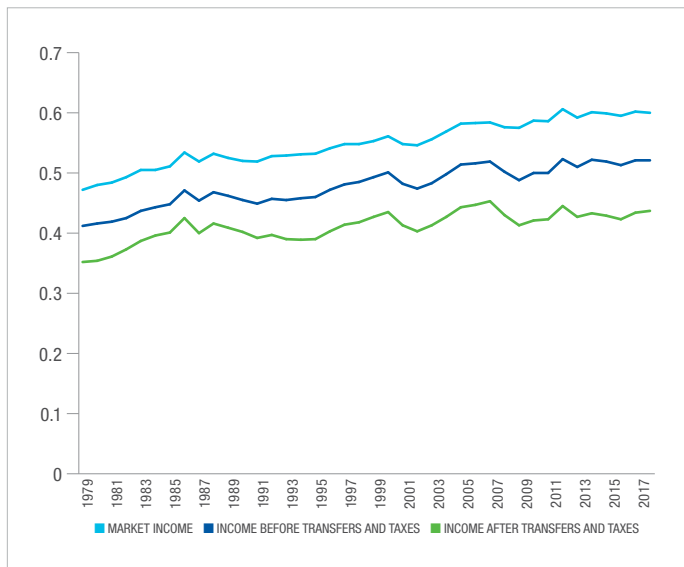


Source: Economic Policy Institute Report, August 2021.

Average annual compensation for CEOs at the top 350 U.S. firms ranked by sales is measured in two ways. Both include salary, bonus, and long-term incentive payouts, but the “granted” measure includes the value of stock options and stock awards when they were granted, whereas the “realized” measure captures the value of stock-related components that accrues after options or stock awards are granted by including “stock options exercised” and “vested” stock awards. The ratios shown here use the “realized” measure of CEO compensation. CEO compensation increased by 1200% while average worker compensation increased by 14% over the 40-year time span.

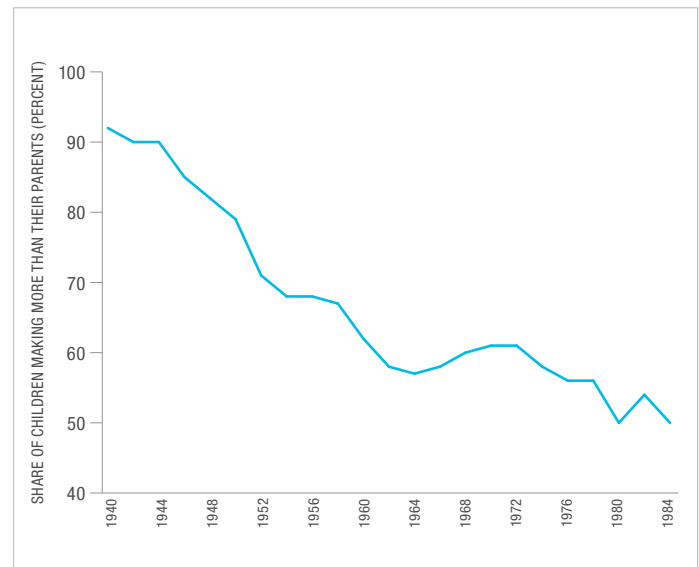
### C. Does democratic capitalism support upward social mobility?

#### Income Inequality Measured by the Gini Coefficient, 1979-2018



Source: Congressional Budget Office, 2021. "The Distribution of Household Income, 2018," Report 57061, Congressional Budget Office. Published August 4, 2021. (accessed October 9, 2021).

#### Social Mobility Between Generations



Source: Chetty et al., "The fading American dream: Trends in absolute income mobility since 1940".

The tax and transfer system is successful at reducing—but certainly not eliminating—income inequality. As measured by the Gini coefficient—a commonly used measure of inequality, for which a value of 0 implies perfect equality and a value of 1 implies maximal inequality—the tax and transfer system reduces income inequality by around 25 percent. After rising rapidly from the late 1970s through the 1990s, inequality growth has slowed. By this measure, since the 2008 financial crisis, post-tax-and-transfer income inequality has declined.

A 2016 Harvard study investigated “absolute income mobility” since 1940, defined as whether children have a higher income at age 30 than that of their parents. The study’s authors found that approximately 50% of children born in the mid-1980s (the latest sample available at the time) had higher incomes than their parents, down from 90% for those born in the 1940s. The study cites lower GDP growth rates and less equal distribution of GDP growth.<sup>10</sup>

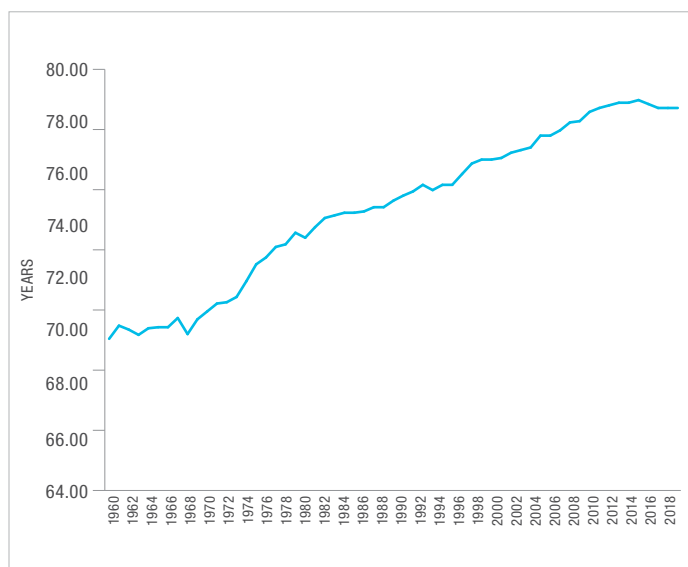
<sup>10</sup>Raj Chetty et al. "The Fading American Dream: Trends in Absolute Income Mobility Since 1940," *Science*. 356(6336) (December 2017): 398-406. Retrieved from: <https://opportunityinsights.org/paper/the-fading-american-dream/>.

### 3. SOCIAL WELL-BEING & STABILITY

How does the system strengthen (or weaken) society more broadly?

#### A. How has life expectancy and the percentage of the population living in poverty changed over time?

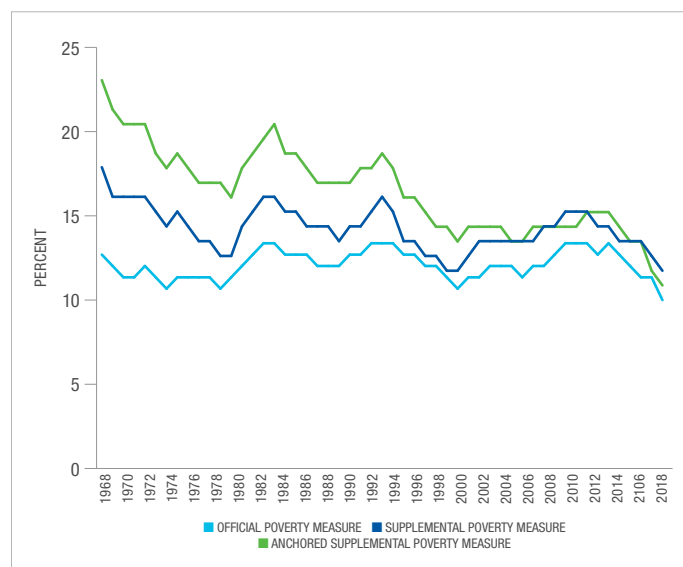
Life Expectancy at Birth, 1960-2018



Source: World Bank, Life Expectancy at Birth, Total for the United States [SPDYNLE00INUSA], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/SPDYNLE00INUSA> (accessed October 19, 2021).

Average life expectancy at birth has largely increased since 1960 from roughly 70 years to 78 years but has fallen slightly since 2014. Reductions in infectious disease deaths, infant mortality, and heart attack death rates helped boost life expectancy over time. More recently, declining life expectancy at the bottom of the income distribution has helped halt progress. There are wide gaps in life expectancy across income, race, and geography in the U.S.

Percent of U.S. Population Living in Poverty, 1968-2019

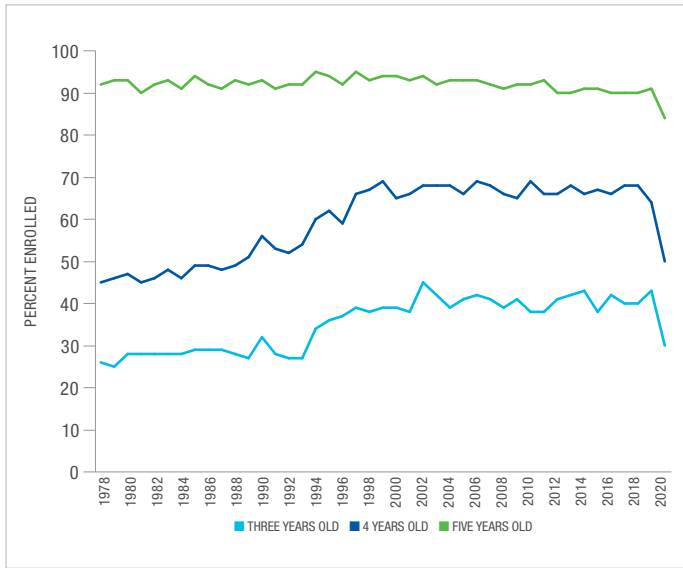


Source: Fox, Liana, Christopher Wimer, Irwin Garfinkel, Neeraj Kaushal, and Jane Waldfogel. 2015. "Waging War on Poverty: Poverty Trends Using a Historical Supplemental Poverty Measure." *Journal of Policy Analysis and Management* 34 (3): 567–92. doi:10.1002/pam. (accessed October 30, 2021). Wimer, Christopher, Liana Fox, Irwin Garfinkel, Neeraj Kaushal, and Jane Waldfogel. 2016. "Progress 8 on Poverty? New Estimates of Historical Trends Using an Anchored Supplemental Poverty Measure." *Demography* 53 (4). *Demography*: 1207–18. doi:10.1007/s13524-016-0485-7. (accessed October 30, 2021).

The official poverty measure estimates how many people are unable to afford basic needs using income and the average national cost of food adjusted for inflation. The supplemental poverty measure extends the official poverty measure by taking account of many of the government programs designed to assist low-income families and individuals that are not included in the official poverty measure. Both rates rose during the Great Recession and then trended down through the 2010s. While the official measure rose during the pandemic, taking into account government programs, poverty fell despite unemployment rates spiking to nearly 15 percent as the aggressive fiscal response to the pandemic expanded government support.

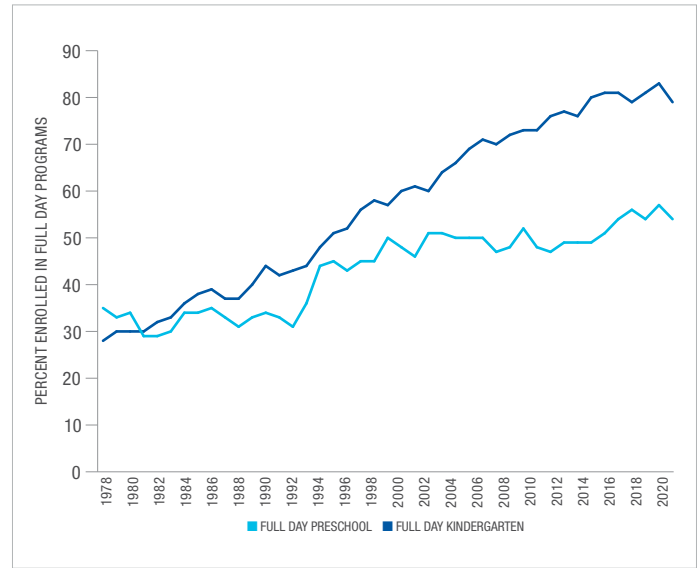
**B. What can we learn from the trends in education levels, outcomes, and quality?**

**Percent of 3-5 Year-Olds Enrolled in Preprimary Programs, 1978-2020**



Source: Current Population Survey Education Supplement 1978-2020. (accessed October 12, 2021). Authors' calculations.

**Percent of 3-5 Year-Olds in Preschool and Kindergarten Programs Attending Full Day Programs, 1978-2020**

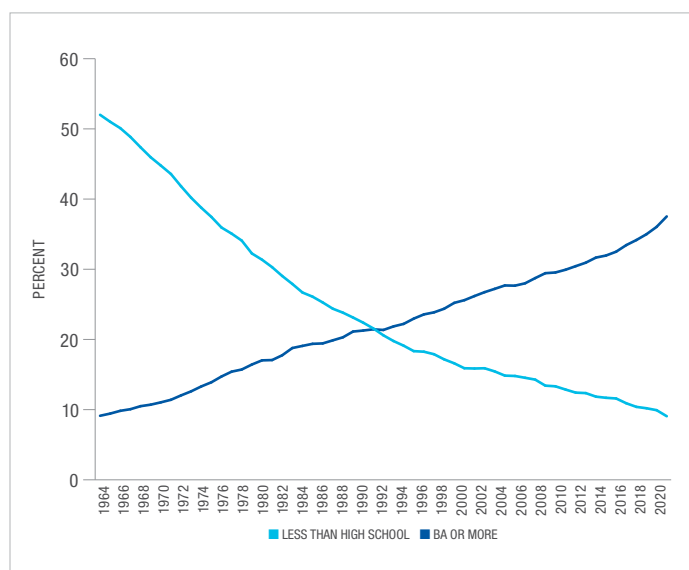


Source: Current Population Survey Education Supplement 1978-2020. (accessed October 12, 2021). Authors' calculations.

These figures plot the share of 3, 4, and 5 year olds enrolled in preprimary education programs (left panel) and the share of 3-5 year olds in preprimary programs that are full day programs (right panel). The share of 5-year olds in programs has largely remained steady around 90 percent over the past 40 years, the number of 3 and 4 year olds has steadily increased over the same period. An increasing share of children attending preschool or kindergarten are also attending full day programs. There is evidence that early life educational experiences play an outsized role in later life outcomes. Increased early childhood education does not increase GDP in the near term, but by improving long run outcomes, it can lift output and living standards over longer horizons.

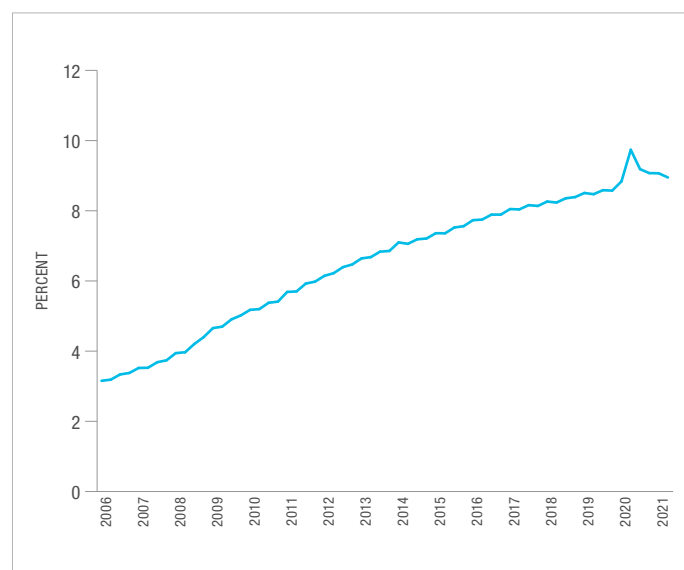


### Share of Population Ages 25 and Older by Highest Education Level Attained, 1964-2020



Source: U.S. Census Bureau. Current Population Survey. Annual Social and Economic Supplement Educational Attainment in the United States: 2020 (accessed April 26, 2021) Authors' Calculations.

### Student Loans as a Share of Real GDP, 2006-2021



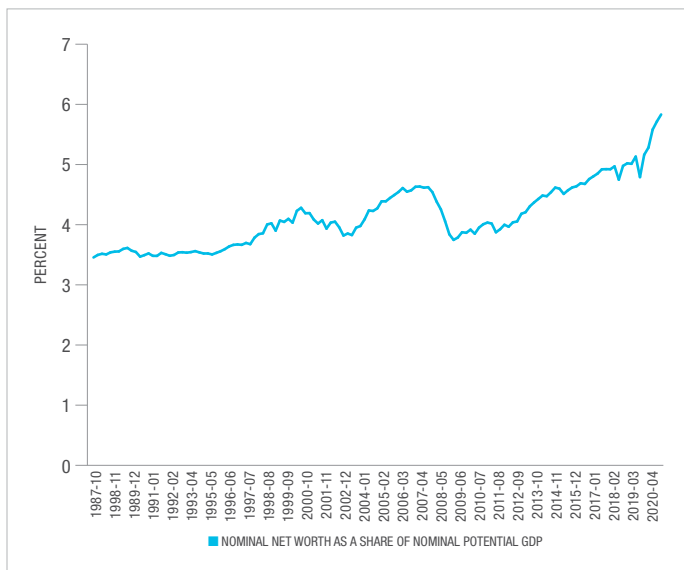
Source: Board of Governors of the Federal Reserve System (U.S.), Student Loans Owned and Securitized [SLOAS], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/SLOAS>, (accessed October 18, 2021). Authors' calculations.

Educational attainment is an input into living standards because education imparts skills, and workers with more skills are more productive. Formal education is not a perfect measure of skill level, of course, and when businesses are too rigid about educational requirements they may be shutting out workers with the skills they desire, but who simply lack the educational credentials. In addition, educational attainment may function more as a signal of underlying ability than as a measure of skills acquired. Regardless of these issues, educational attainment is a key driver of the skill level of the workforce. This figure plots the share of the total population 25 and over that did not finish high school and that completed a four-year college degree or more. In the 1960s more than half of Americans 25 and older had not completed high school and less than ten percent had finished college. By 2020, less than ten percent of Americans 25 or older had not completed high school and almost forty percent of Americans 25 and over had completed at least four years of college.

This figure shows student debt as a share of real GDP. Student loans have increased from roughly three percent of GDP to nearly 10 percent of GDP in the past 15 years. On the one hand, if student loans were not available, many individuals would not have been able to attend college barring other changes in higher education funding, likely reducing their lifetime earnings. On the other hand, the higher debt burden for more recent cohorts could impact their ability to build wealth or buy homes. The rate of return on a college degree remains high. Student loan debt is much less a problem for college graduates than it is for individuals who incur debt but do not end up graduating.

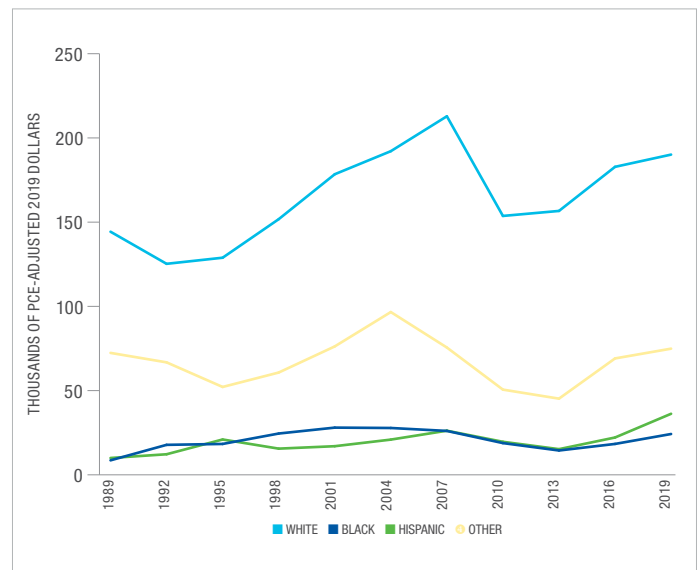
### C. Have household (HH) net worth and home ownership changed?

Median HH Net Worth as Share of GDP, 1987-2021



Source: Board of Governors of the Federal Reserve System (U.S.), Households; Net Worth, Level [BOGZ1FL192090005Q], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/BOGZ1FL192090005Q>, (accessed October 11, 2021).

Median HH Net Worth by Race, 1989-2019

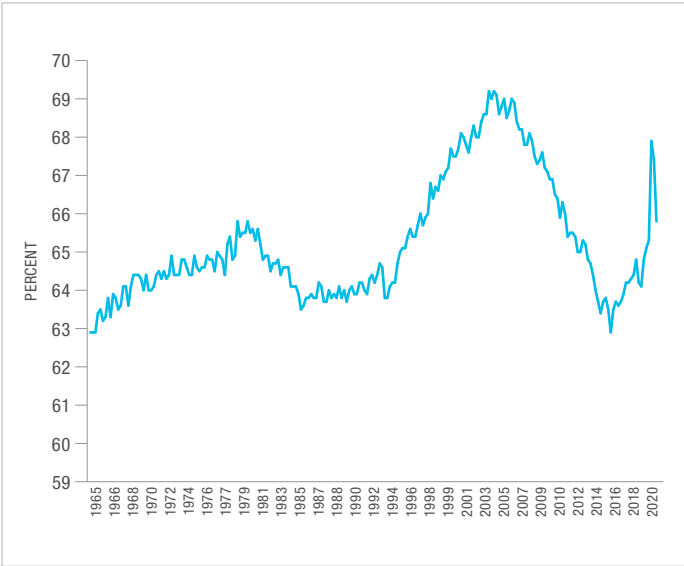


Source: Survey of Consumer Finances 1989-2019 (accessed August 9, 2021).

In addition to household income increasing, household wealth has grown as well. Note that the 2008 global financial crisis and Great Recession wiped out a decade of wealth accumulation. Household wealth has been rising since around 2011, and grew rapidly during the pandemic thanks in part to the U.S.’s aggressive fiscal policy response to the recession.

Median household net worth has fluctuated with house prices (a key asset for many households) as well as other economic factors. By 2013, real net worth was lower than it had been in over two decades before recovering in recent years. There is a large difference in net worth between white and black households, with the net worth of black households nearly one tenth that of white households. This reflects differences in income, but also historical inequities that are passed down via inheritance and family gifts.

### Homeownership Rate for the U.S., 1965-2021

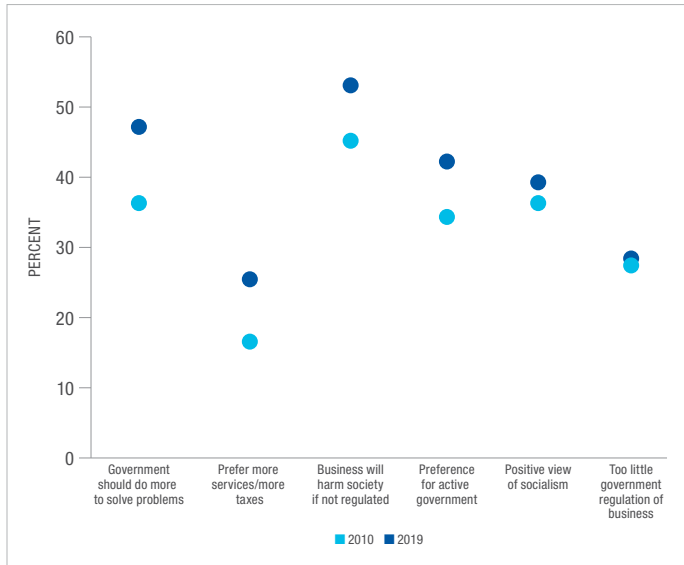


Source: U.S. Census Bureau, Homeownership Rate in the United States [RHORUSQ156N], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/RHORUSQ156N> (accessed September 14, 2021).

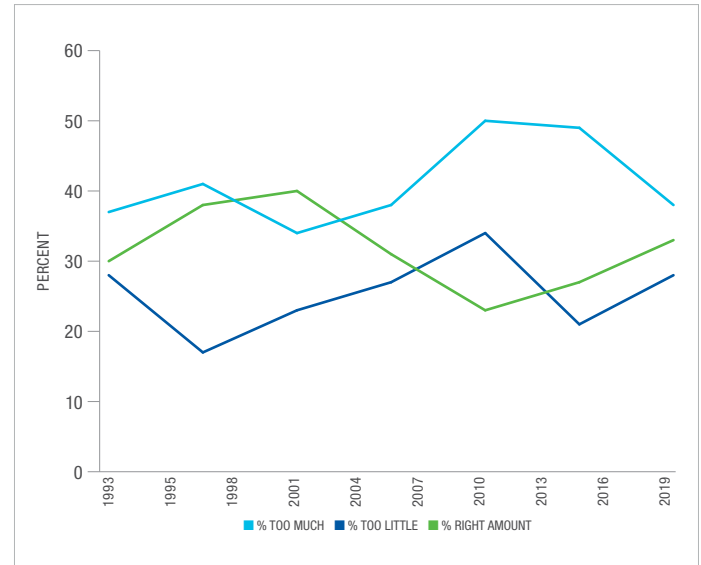
The homeownership rate has stayed in a relatively narrow band over the last 50 years, between 60 and 70 percent of households own their home. The rate grew during the housing boom before shifting back down rapidly during the Great Recession.

### D. What is the current public perception of capitalism and institutions more generally?

Americans' Pro-Government, Pro-Socialism Positions, 2010-2019



Views of Government Regulation of Business and Industry, 1993-2019

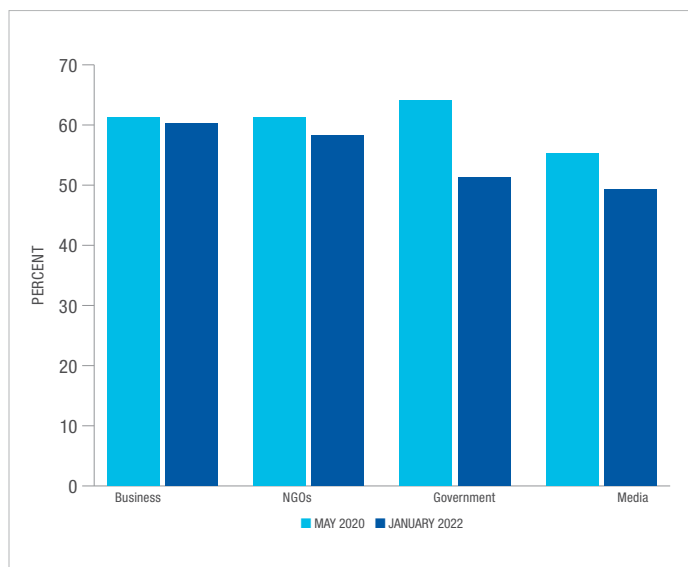


Source: "Socialism, Capitalism Ratings in U.S. Unchanged," Gallup (Dec 2021) (<https://news.gallup.com/poll/357755/socialism-capitalism-ratings-unchanged.aspx>).

The majority of Americans view capitalism more favorably than socialism, and general perceptions of capitalism and socialism have remained relatively stable since 2010. Positive views of capitalism have remained around 60% while positive views of socialism trend slightly below 40%. Additionally, Americans' expectations of government have increased by more than 10% since 2010. The perception that business will harm society if it is not regulated has also increased by nearly 10% since 2010. However, most Americans believe that current business regulations are sufficient.

## E. What do environmental measures tell us about the system's ability to properly steward natural resources?

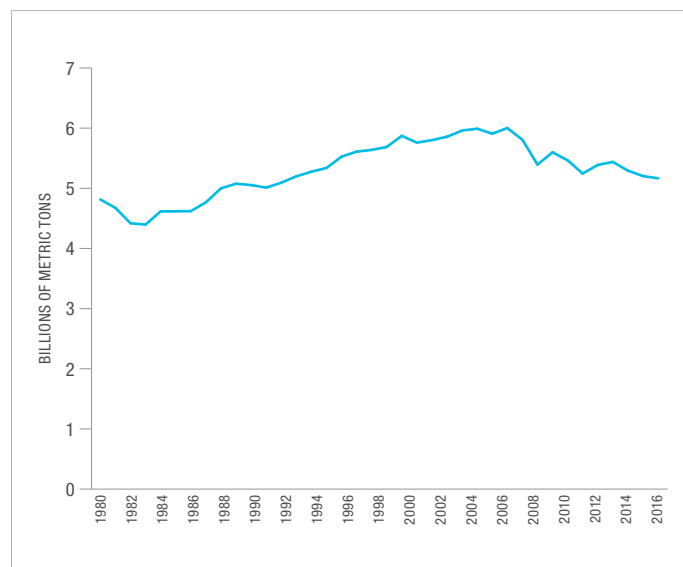
### Trust in Institutions, May 2020 versus Jan 2022



Source: Edelman Trust Barometer Report (January 2022).

For the last 22 years, Edelman has conducted an annual trust survey to gauge the public's trust in societal institutions (i.e., business, government, NGOs, media) and institutional leaders. In the most recent addition, the firm surveyed more than 36,000 respondents in 28 different countries asking, "for each [institution], please indicate how much you trust that institution to do what is right." Those that received scores from 60-100 are deemed trustworthy, those from 50-59 are neutral, and those from 1-49 are considered to be distrusted. Currently, business is the only institution to barely hang on to a trustworthy ranking, while the rest are seen as neither trusted or distrusted.

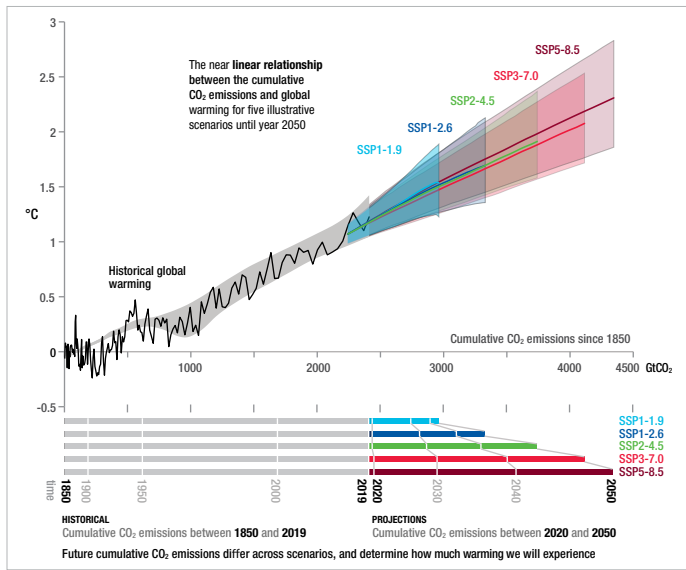
### Annual CO<sub>2</sub> Emissions from All Sources for the U.S., 1980-2017



Source: U.S. Energy Information Administration, Total Carbon Dioxide Emissions From All Sectors, All Fuels for United States [EMISSCO2TOTVITTOUSA], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/EMISSCO2TOTVITTOUSA> (accessed May 19, 2021).

This figure shows total U.S. CO<sub>2</sub> emissions from all sectors compiled by the Energy Information Administration. Total CO<sub>2</sub> emissions increased slowly from the 1980s to 2008, but fell during and after the Great Recession almost returning to 1990 levels. Since then, they have continued to drop despite consistent economic growth. Goals such as reaching 50% of the 2005 level by the end of the decade will require much faster decarbonization. The UN's Intergovernmental Panel on Climate Change (IPCC) has shown CO<sub>2</sub> to be a major driver of climate change. CO<sub>2</sub> levels are shaping the future impacts of climate change. IPCC predictions show that without significant reductions in CO<sub>2</sub> emissions, climate change impacts will continue to worsen.

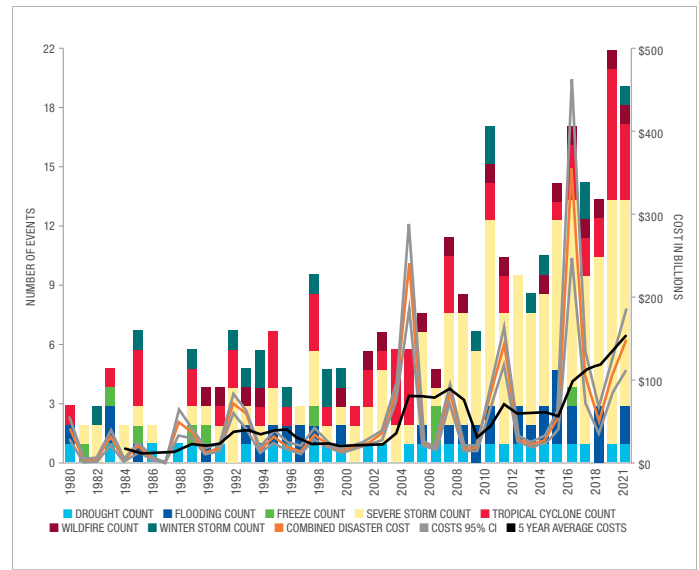
### Every Tonne of CO<sub>2</sub> Emissions Adds to Global Warming



Source: Intergovernmental Panel on Climate Change ("IPCC"), (<https://www.ipcc.ch/report/ar6/wg1/#SPM1>).

The effects of climate change have important implications for society broadly, including both the economy and the lives of Americans and others around the world. Climate change impacts include more frequent and intense hurricanes, fires, floods, and other disaster events. Other forms of extreme weather and extreme temperatures are also becoming more common and more intense. These effects have direct economic costs including emergency management spending, damages from disaster events, as well as disruption to work and supply chains.

### U.S. Billion-Dollar Disaster Events, 1980-2021 (CPI Adjusted)



Source: National Oceanic and Atmospheric Administration, (<https://www.ncdc.noaa.gov/billions/time-series>).

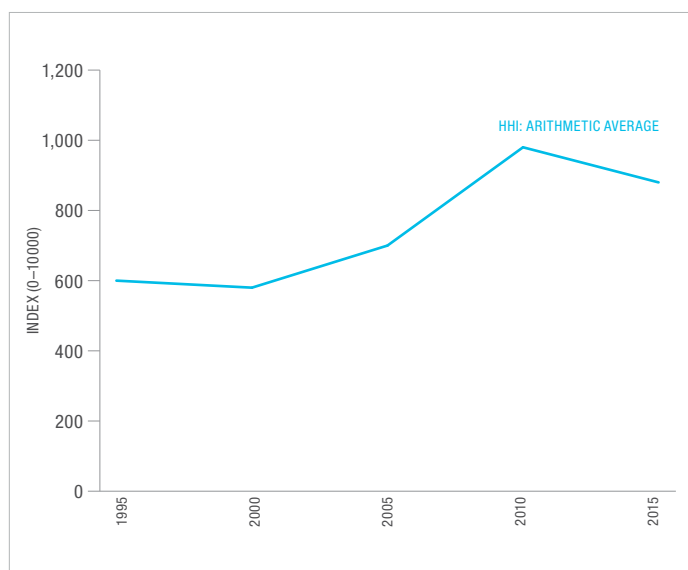
Along with the number and intensity of disaster events, the cost of disasters is also increasing. In addition to the direct costs of damages and emergency management spending, disaster events can have secondary economic effects including disruption to work, lost productivity, and disruption to supply chains and essential infrastructure. Failing to reduce CO<sub>2</sub> emissions has significant economic costs and could severely affect society. Though the costs of transitioning towards cleaner energy are often discussed, free-market capitalism should also factor in the costs of maintaining the status quo. The costs of continued environmental degradation and the effects of climate change have concrete impacts for society, long-term business interests, and the lives of every American.

## 4. BUSINESS ENVIRONMENT

What is the current status and nature of free market competition, and how well is the business community positioned to address current pressures on the system?

### A. Have business sectors become more or less competitive?

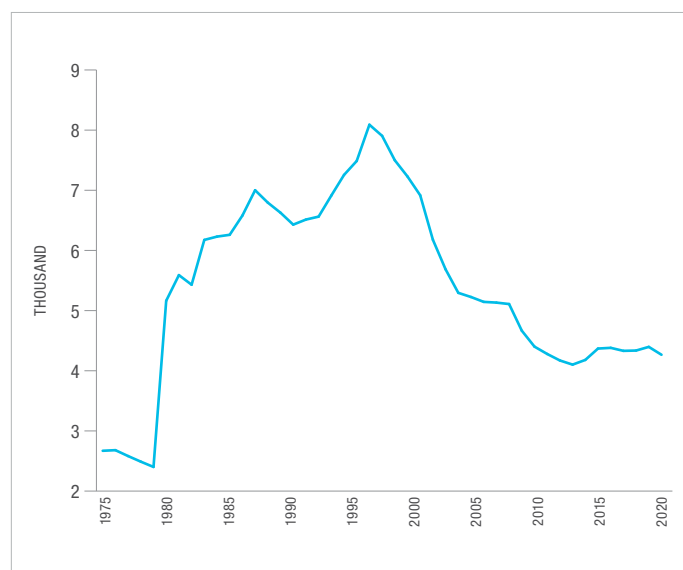
#### Business Sector Concentration, 1995-2015



Source: "Increased Corporate Concentration and the Influence of Market Power", Barclays, March 26, 2019, [https://www.cib.barclays/content/dam/barclaysmicrosites/ibpublic/documents/our-insights/MarketPower/Barclays-ImpactSeries5-MarketPower\\_final\\_2.4MB.pdf](https://www.cib.barclays/content/dam/barclaysmicrosites/ibpublic/documents/our-insights/MarketPower/Barclays-ImpactSeries5-MarketPower_final_2.4MB.pdf).

A recent Barclays analysis concludes that increased industry concentration (i.e., fewer competitors per sector) is not just a trend in the technology space. Since 2000, concentration has increased by more than 50% in nearly three-quarters of the non-financial sectors they examined.<sup>11</sup> Technologies that allow the most productive firms to take share from the least productive may explain the phenomenon (leading to higher efficiencies and value creation), but the increased concentration could undermine market health in the long-term.

#### Number of Publicly Listed Companies, 1975-2019



Source: The World Bank via <http://theglobaleconomy.com>.

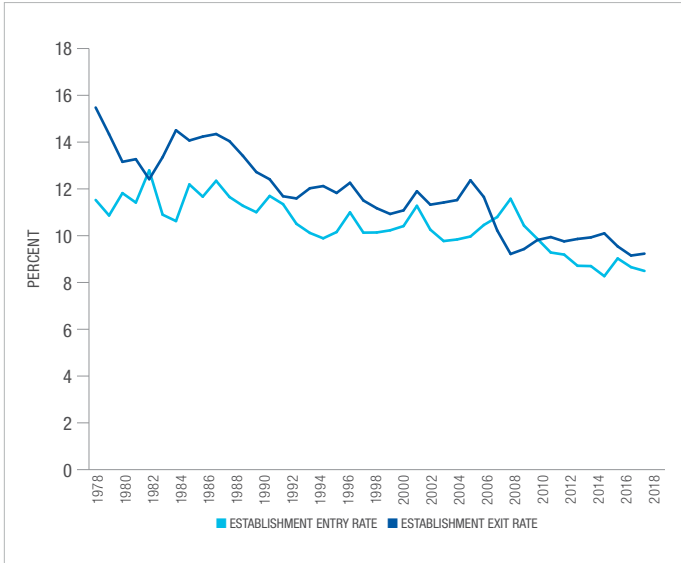
Since a peak of over 8,000 publicly listed companies in 1996, the U.S. has seen a drop by almost 50% to approximately 4,200 public companies by 2019. On its face, this trend could be seen as a threat to the dynamism needed to fuel appropriate levels of competition, future growth, and prospects for innovation. However, recent analysis by McKinsey cautions that the decline might not be as consequential as it appears. They demonstrate that: the dropoff in listings can be attributed primarily to three sectors (banking, industrials, and technology); the drops occurred primarily because of exits between 2001-2010; and 95% of the exits were the result of acquisitions (not company failures).<sup>12</sup> This doesn't negate the fact that business sectors are more concentrated, but it does confirm that firm exits are not driven by weaker firms being run out of business.

<sup>11</sup>In the study, Barclays used the Herfindahl-Hirschmann Index for publicly traded firms grouped by three-digit NAICS industry.

<sup>12</sup>McKinsey & Company, "Reports of Corporates' Demise Has Been Greatly Exaggerated," October 2021.

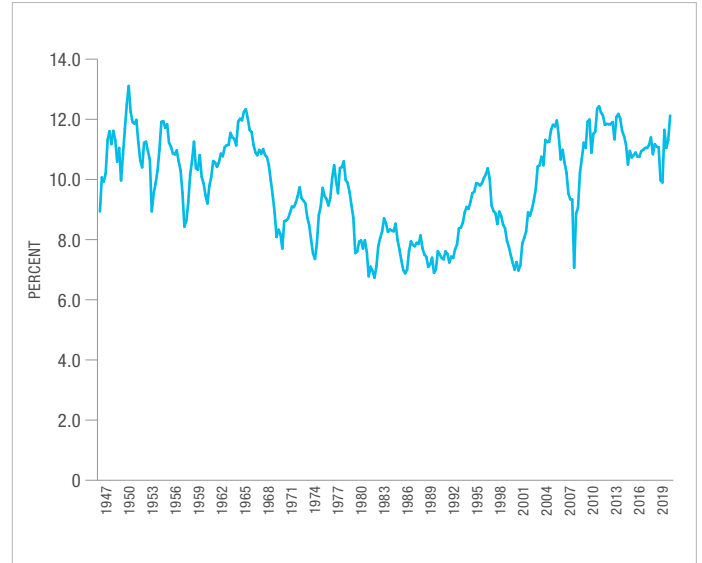
## B. What does the current landscape and profile of companies look like?

**Establishment Entry and Exit Rates, 1978-2019**



Source: U.S. Census Bureau. Business Dynamics Statistics 2019. Released September 30, 2021 (accessed January 5, 2022).

**Corporate Profits as a Share of Gross Domestic Income, 1947-2020**



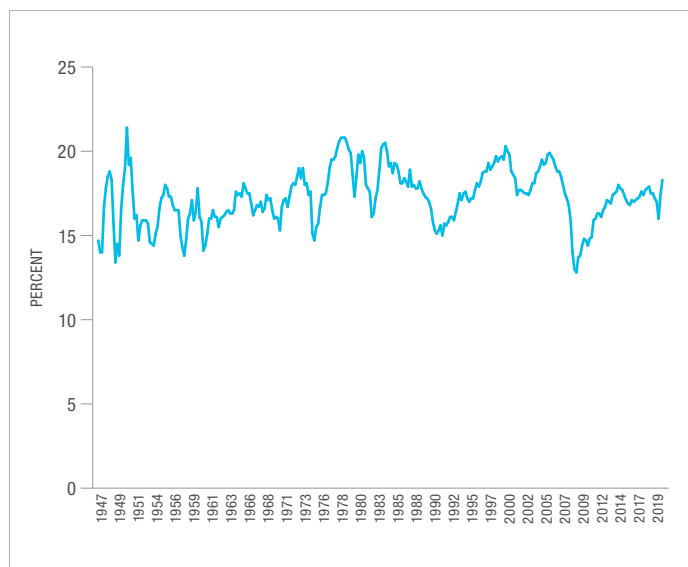
Source: U.S. Bureau of Economic Analysis, Shares of gross domestic income: Corporate profits with inventory valuation and capital consumption adjustments, domestic industries [A445RE1A156NBEA], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/A445RE1A156NBEA>, (accessed October 19, 2021).

Dynamism and entrepreneurship fuel innovation, which in turn drives living standards. New firms coming online and other firms shutting down fuels productivity growth. Young firms create a disproportionate share of new jobs, and better matches between workers and firms also increase productivity. As measured by firm entry and exit rates, business dynamism has been declining in the U.S., particularly since the onset of the 2008 global financial crisis.

This figure shows the portion of total income in the U.S. generated by corporations. Corporate profits rose sharply following the Great Recession but have declined some as a share of GDP since 2015 when the labor market started to tighten significantly.



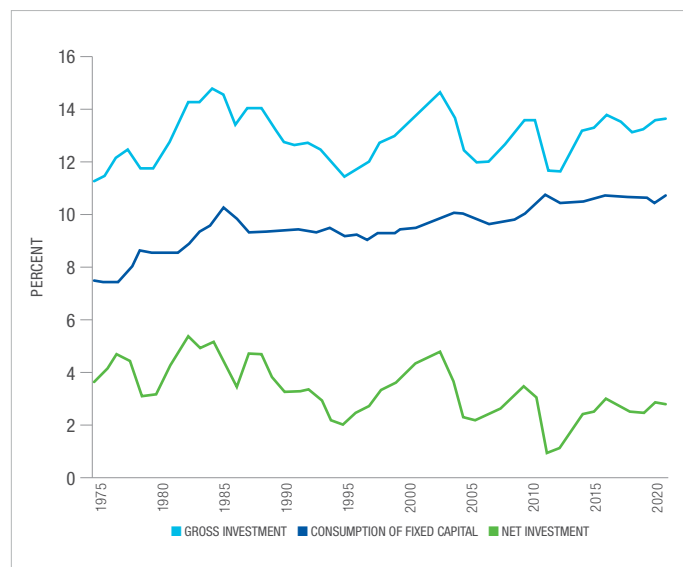
## Gross Private Domestic Investment as a Share of GDP, 1947-2020



Source: U.S. Bureau of Economic Analysis, Shares of gross domestic product: Gross private domestic investment [A006RE1Q156NBEA], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/A006RE1Q156NBEA>, (accessed October 18, 2021). Authors calculations.

Gross private domestic investment is the total amount of investment spending by domestic businesses in the U.S. and includes business expenditures on plant or equipment, investments in new or existing buildings by property owners, or changes in inventories. Investment adds to GDP directly, but can also be an important part of driving productivity growth. According to this analysis, gross private domestic investment has remained relatively flat over the last 70 years, hovering between 15–20% of GDP. One researcher found that few countries have maintained high investment rates (measuring both private and public investments), and that many have demonstrated investment rates less than 20% of GDP for a decade. For those countries with low investment rates, 60% have seen GDP grow at less than 3% over the same period.<sup>13</sup> The U.S. generated 3.1% GDP growth on average between 1970 and 2020; however, the Congressional Budget Office projects GDP growth of 1.6% on average from 2021–2050.<sup>14</sup>

## Net Business Investment, 1970-2020



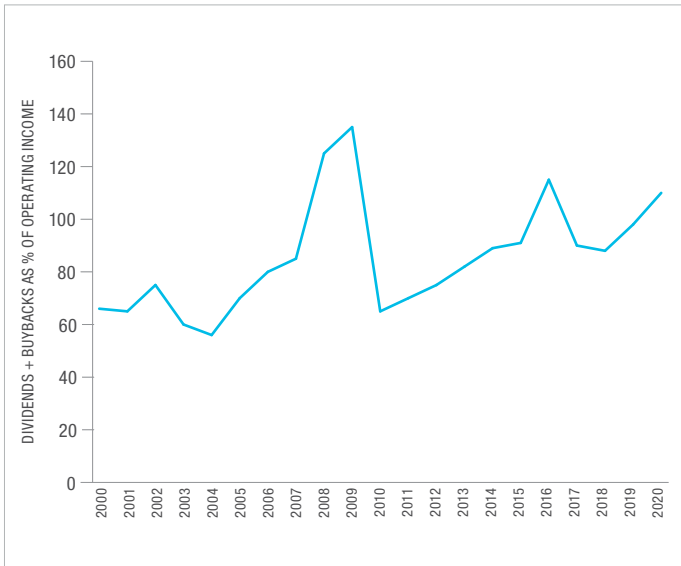
Source: "The Rise of Wall Street and the Fall of American Investment", American Compass, March 2021, <https://americancompass.org/essays/speculating-wall-street-investment/>.

However, American Compass recently released research demonstrating that net private investment (gross investment less annual consumption of fixed capital) is actually decreasing as firms consume more of investments already in place than they replace via new investment annually. Researchers found that over time, company fund flows back to investors are greater than those going into new investment opportunities (and requiring new market funding), and the number of companies that are depleting their fixed investments and paying more in share repurchases and dividends than they earn in net income is growing significantly.

<sup>13</sup>Sharma, "The Ten Rules of Successful Nations", 119.

<sup>14</sup>Congressional Budget Office, "The 2021 Long-term Budget Outlook", March 2021, Figure 5.

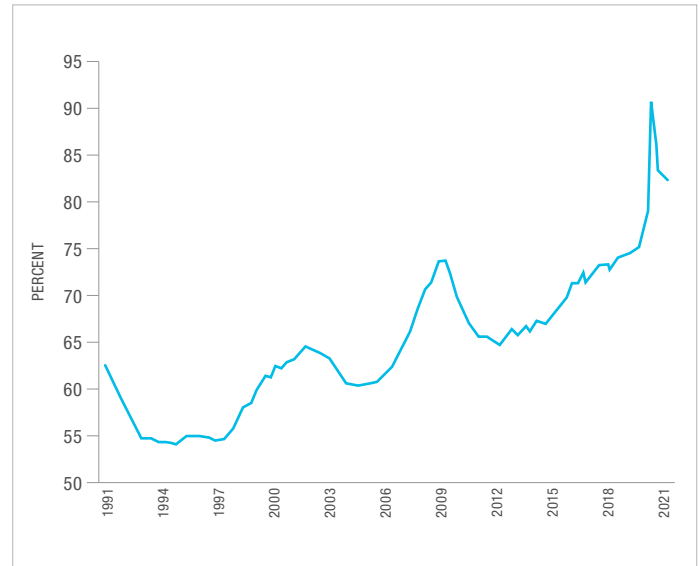
### Growing Evidence of “Zombie Companies”, 2000-2020



Source: Standard & Poor's.

Zombie companies are defined here as those paying out as much or more to shareholders (via dividends and/or buybacks) as they are generating profits as measured by annual operating income. As a whole, the dollar amount of buybacks and dividends have grown as a percentage of operating income—from near 60% in 2000 to over 100% by 2020.

### Nonfinancial Corporate Debt as Percent of GDP, 1950-2021



Source: Federal Reserve Board; Bureau of Economic Analysis, Haver Analytics.

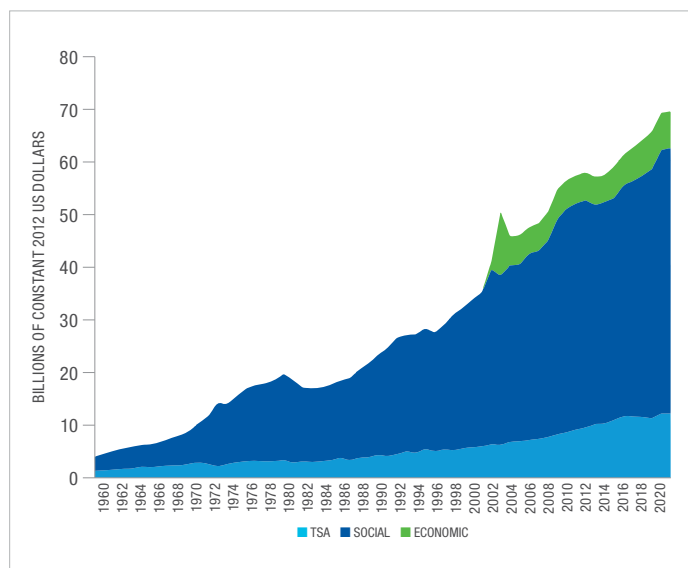
Nonfinancial corporate debt has grown from the low 55% range in the early 1990s to the 80-85% range beginning by 2021.

Taken together, these trends—the decline of corporate profits as a share of GDP, the sluggishness of business investment, the amount of dividends and buybacks surpassing operating profits, and the growth of corporate debt—may point to an increase in short-term behavior among corporations.<sup>15</sup>

<sup>15</sup>These trends may also result from a lack of attractive investment opportunities, but this observation also begs the question, “over what time horizon are investment opportunities being evaluated?”.

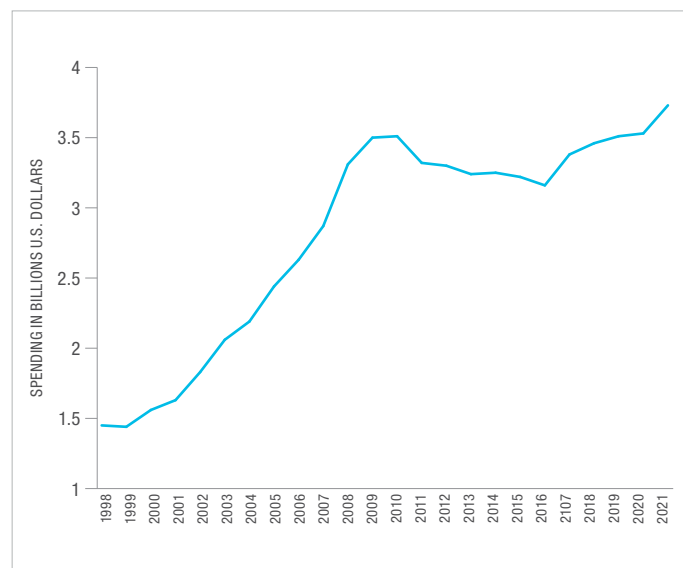
## C. What about government regulation, degree of lobbying, and emerging evidence of the effects of crony capitalism?

### Industry Regulation as Measured by Regulatory Spending, 1960-2020



Source: Regulatory Studies Center, George Washington University, FY2021 Regulators' Budget report.

### Lobbying Spending in the U.S., 1998-2021



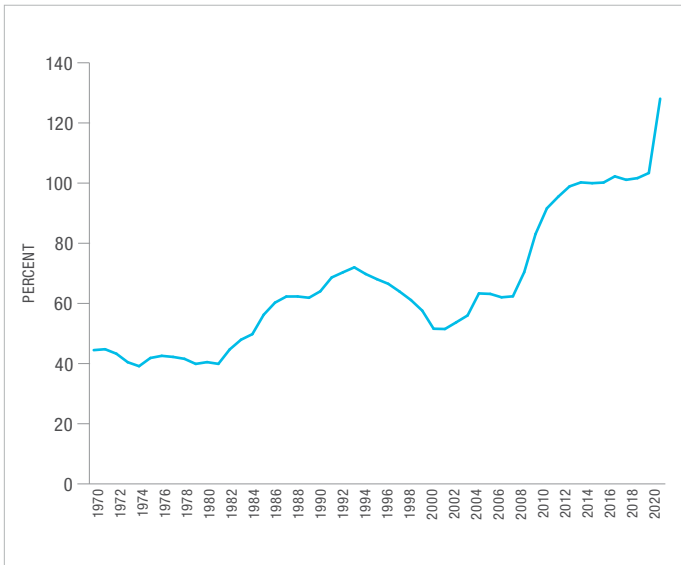
Source: <https://www.statista.com/statistics/257337/total-lobbying-spending-in-the-us/>.

The president's FY2021 budget requests \$79.8 billion in regulatory outlays, compared to estimated outlays of \$77.8 billion in 2020 (a 0.3 percent increase in real terms). Consistent with previous budget requests from the Trump administration, regulatory activities in the Department of Homeland Security would receive a 3.1 percent real increase in resources in 2021, building on even larger increases the previous year. Proposed reductions for agencies with other regulatory functions largely offset increases, keeping overall regulatory spending relatively flat. Agencies involved in environmental and energy regulation would bear the biggest cuts—a proposed reduction of 13.1 percent below 2020 spending levels in real terms. Agencies conducting economic regulation would receive a 0.1% increase in real resources. The overall increase comes from 2.5 percent more funding proposed for general business regulation, while spending for the other two categories would fall under the FY2021 request.<sup>16</sup>

Since the turn of the millennium, the amount spent on lobbying in the U.S. has more than doubled. The intention of firms employing lobbyists, who in turn lobby government officials, is to gain a degree of influence on the legislative process in the hope of legislation more favorable to their business or cause being passed. Lobbying occurs at all levels from local government to presidential elections. The industries utilizing lobbying as a means to gain influence come from a range of industries with the biggest spenders including pharmaceuticals, insurance, business associations as well as oil and gas.

<sup>16</sup>George Washington University Regulatory Studies Center, "FY2021 Regulators' Budget Report."

### National Debt as Percent of GDP, 1970-2020



Source: [https://www.theglobaleconomy.com/rankings/Government\\_debt/](https://www.theglobaleconomy.com/rankings/Government_debt/), accessed March 2022.

U.S. national debt is the total fixed-term obligations to others on a particular date. It includes both domestic and foreign liabilities such as currency and money deposits, securities (other than shares), and loans. The gross amount of government liabilities is offset by the amount of equity and financial instruments held by the government. Since 1970, the U.S. national debt as a percent of GDP has increased from 44% to more than 125%. The U.S. trajectory is compared to that of other economies in Section 5, International Comparisons (See page 38).

### D. Business leaders talk about “profit with a purpose” and stakeholder capitalism, but is anything really happening as a result?

#### Analysis of Business Roundtable Members and Follow-through After 2019 Purpose Restatement

##### No Evidence of Tangible Follow-through by Business Roundtable Signatories

In 2019, the Business Roundtable updated its Statement on the Purpose of the Corporation, committing to creating value for all stakeholders and not just shareholders.

A recent study by Harvard Law School professors found that little, if any, tangible action was taken by signatories to the BRT statement as reflected in their publicly filed corporate documents in the 2 years after signing.

Source: “Will Corporations Deliver Value to All Stakeholders?”, L. Bebchuk, R. Tallarita, SSRN, 2021.

A recent study by Harvard Law School professors, Lucian Bebchuk and Roberto Tallarita, investigated a wide array of corporate documents from 128 U.S. public companies that signed the 2019 Business Roundtable’s restatement of purpose. The research concluded that the vast majority of signatories took no tangible actions to shift more focus on stakeholders to better balance their interests with shareholders. These findings bring into question whether business leaders (boards and management teams) actually have the rationale, know-how and resolve to build strategies that integrate value creation with broader stakeholder concerns over the long-term.

## Survey Results of Why Business Executives Focus on Short-term Results

### Business Leaders on Short-term Performance Pressure

Business executives cite three sources of pressure to focus on short-term results:

- Shareholders
- Boards of directors
- Executive compensation structures

87% of executives and directors feel pressure to demonstrate strong financial results in 2 years or less.

Sources: "Corporate Long-term Behaviors", McKinsey & Company and FCLTGlobal, 2019; "Rising to the Challenge of Short-termism", FCLTGlobal (D. Barton, J. Bailey, J. Zoffer), 2016.

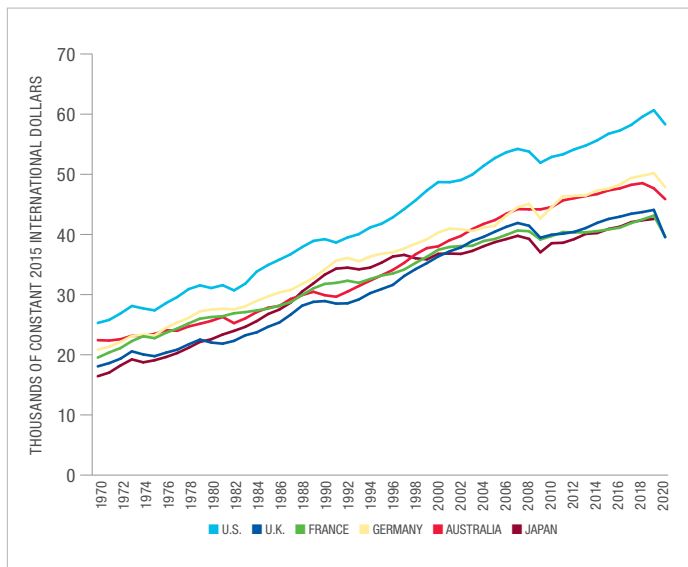
McKinsey & Company conducted an online survey in 2020 of executives at North American and European companies with annual revenues of \$250 million or more. More than 480 participants (at the director level or above) identified three continuing concerns that they felt pressured them to focus on short-term results: their shareholders, their boards, and their compensation structures. In addition, as recently as 2016, researchers found that 87% of executives and directors feel most pressured to demonstrate strong financial performance in two years or less.

## 5. INTERNATIONAL COMPARISONS

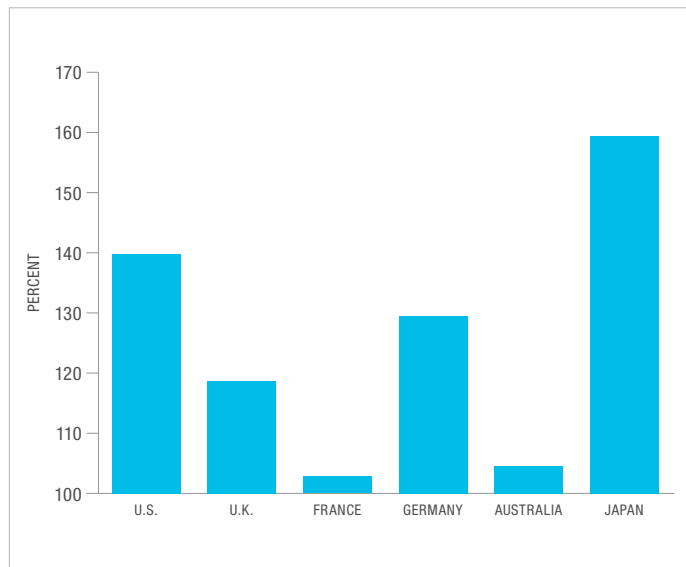
How does the U.S. compare to other democratic economies, and what can we learn from the differences?

### A. Efficacy & vitality

GDP per Capita Adjusted for Purchasing Power and Inflation, 1970-2020



Cumulative GDP Growth, 1970 – 2019<sup>17</sup>

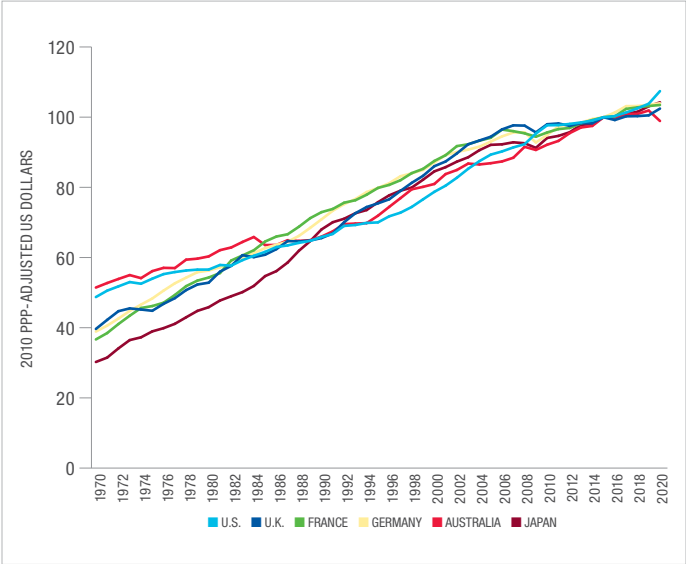


Source: OECD (2021), "GDP per capita and productivity levels", OECD Productivity Statistics (database), <https://doi.org/10.1787/data-00686-en> (accessed on 15 September 2021).

One core fact when comparing the U.S. economy to many of its large advanced economy peers is that the U.S. has a higher level of output per capita. This figure shows the level of GDP per capita for the U.S. and 5 other nations from 1970 to the present. The data are shown in constant prices (adjusting for inflation) and in international dollars (adjusting for exchange rates and price differences across countries) to show an apples to apples comparison of GDP per person. Growth rates over time have been reasonably similar, with all 6 economies growing between 100 and 160 percent over this period, with the U.S. maintaining its lead in output per capita throughout. As noted above, output per capita is a function of the share of the population working, the number of hours worked per worker, and the productivity of labor (output per hour).

<sup>17</sup>2019 is used here because it is the most recent year that cumulative growth data is available for all countries.

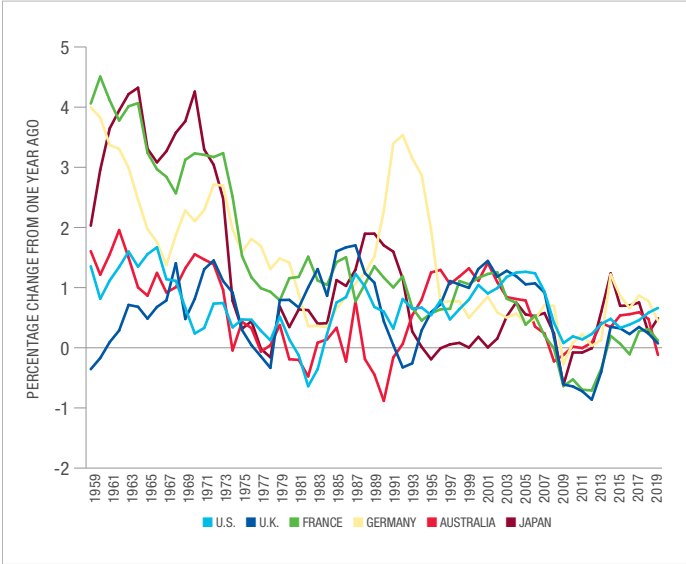
### GDP per Hour Worked, 1970-2020



Source: OECD (2021), GDP per hour worked (indicator). doi: 10.1787/1439e590-en (accessed on 14 September 2021).

GDP per hour worked is a measure of labor productivity that captures how efficiently labor is combined with other factors of production and used in the production process. Over the end of the 20th century, advanced economies that were behind the U.S. in output per hour largely caught up as the countries have essentially similar education levels and levels of technology. The U.S. lead in GDP per capita is not a function of being more productive, but because cumulative hours of work are relatively higher in the U.S.

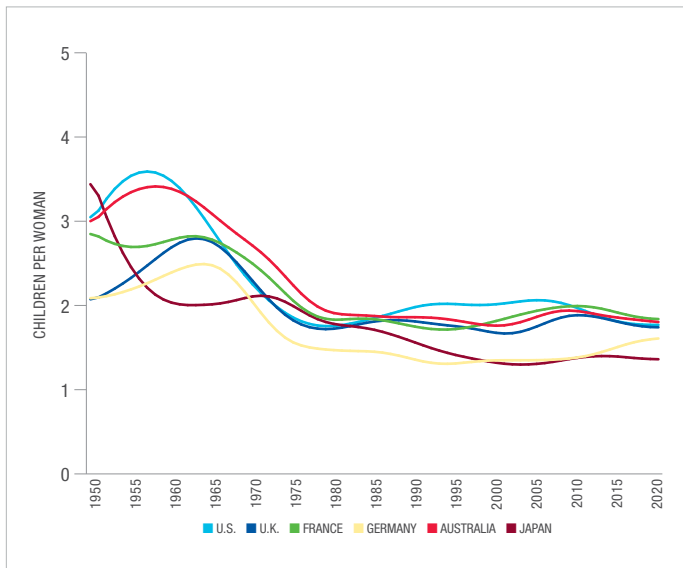
### Five-year Moving Average of Annual Change in Total Factor Productivity, 1959-2019



Source: University of Groningen and University of California, Davis, Total Factor Productivity at Constant National Prices, retrieved from FRED, Federal Reserve Bank of St. Louis, (accessed September 3, 2021).

This figure plots the change in total factor productivity over time across advanced economies. In the mid-20th century, France, Germany, and Japan saw rapid productivity growth as they rebuilt their economies after World War II. In more recent decades, productivity growth has been more similar as nations at the world’s technological frontier grow at roughly the same pace.

## Fertility Rates, 1950-2020

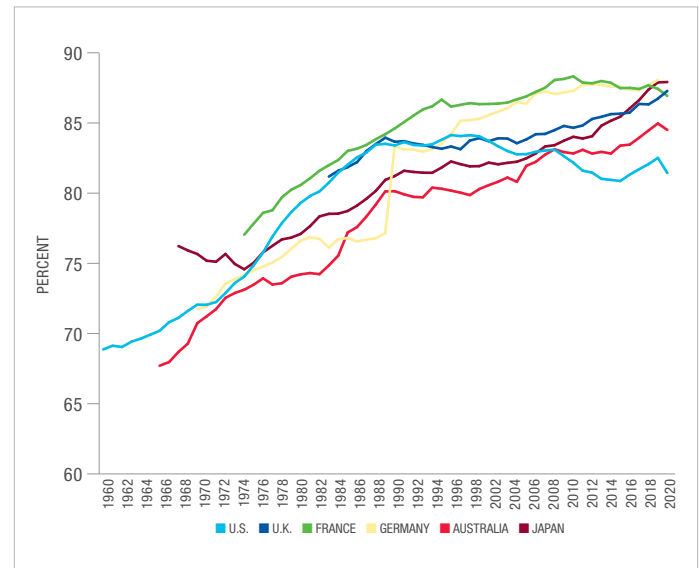


Source: United Nations—Population Division (2019 Revision). [OurWorldData.org/fertility-rate](https://ourworlddata.org/fertility-rate).

The total fertility rate is defined as simply the number of children per woman, and it has roughly decreased by half since 1950. This decrease is attributed to a significant increase in access to education by women, the increase in workforce participation by women, decreasing child mortality rates, and the rising cost of bringing up children. Because fertility rates directly affect the size of the future workforce, this decline poses a significant headwind for GDP. It can be offset by immigration, longevity, and technological innovations, but it begs the question whether declines of this magnitude can be remedied long-term. Of interest here is not so much the difference between the countries shown, but the similarity in declines.

## B. Fairness & social mobility

### Average Labor Force Participation Rates for All Persons Ages 25-64, 1960-2019

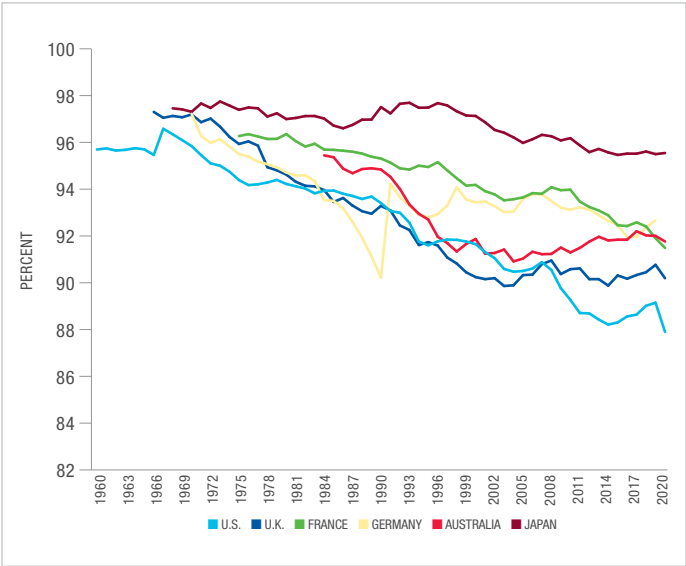


Source: OECD (2021), "Labour Market Statistics: Labour force statistics by sex and age: indicators", OECD Employment and Labour Market Statistics (database), <https://doi.org/10.1787/data-00310-en> (accessed on 03 September 2021).

This graph shows the share of individuals ages 25-54 who are either employed or looking for work across six OECD member countries. The U.S. has the lowest labor force participation rate of these six major economies. In the U.S. prime-age labor force participation peaked around 1990 and fell following the financial crisis until 2015, when it slowly began to recover. In contrast, prime-age labor force participation in other advanced economies has steadily increased over the entire period. The U.S. leads in output per capita despite having a lower share of the prime age population in the labor force.

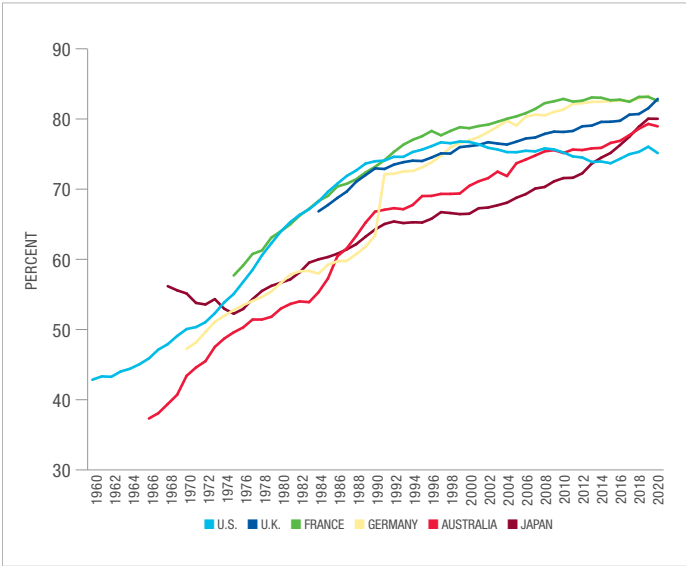


### Average Labor Force Participation Rate for Males Ages 25-54, 1960-2019



Source: OECD (2021), "Labour Market Statistics: Labour force statistics by sex and age: indicators", OECD Employment and Labour Market Statistics (database), <https://doi.org/10.1787/data-00310-en> (accessed on 03 September 2021).

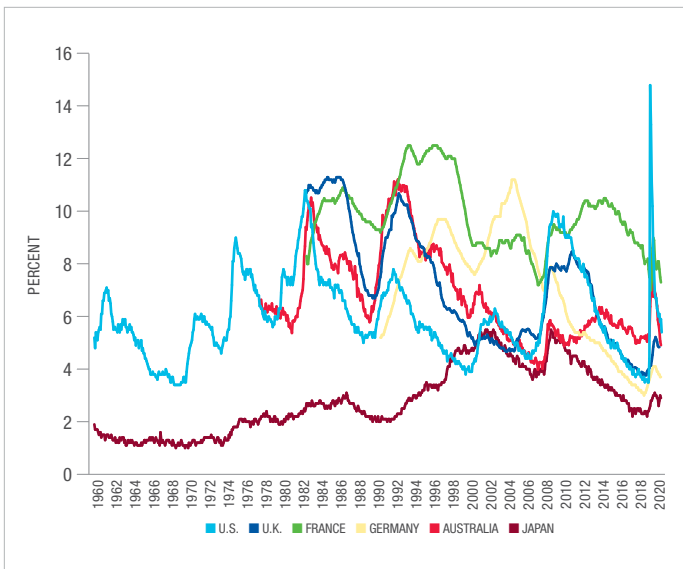
### Average Labor Force Participation Rate for Females Ages 25-54, 1960-2019



Source: OECD (2021), "Labour Market Statistics: Labour force statistics by sex and age: indicators", OECD Employment and Labour Market Statistics (database), <https://doi.org/10.1787/data-00310-en> (accessed on 03 September 2021).

These figures compare changes in prime-age labor force participation over time for males and females. Labor force participation among prime-age males has fallen in all OECD member countries we examine, though the declines for the U.S. and Australia are particularly steep. The decline in male labor force participation in advanced economies has been accompanied by a rise in female labor force participation across all the countries we examine. The U.S. used to be a leader in female labor force participation, but participation flattened out in the U.S. while it continued to rise in other countries. As with men, the U.S. has the lowest rate of female workforce participation among these six major economies.

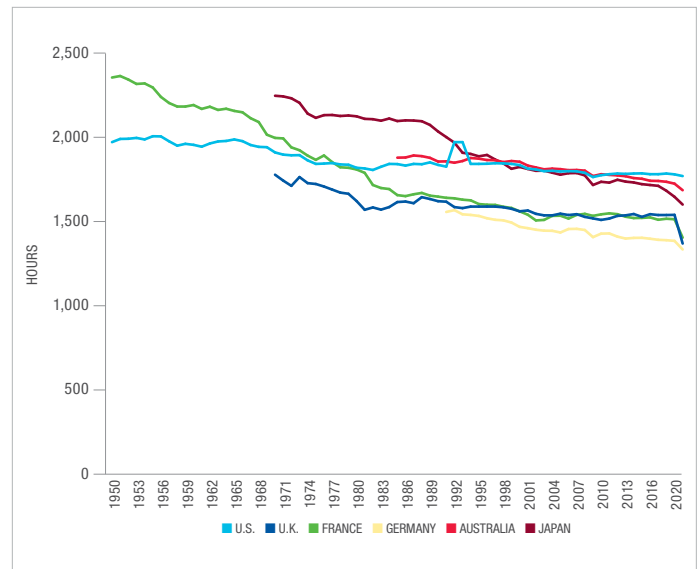
### Harmonized Unemployment Rate, 1960-2021



Source OECD (2021), Harmonised unemployment rate (HUR) (indicator). doi: 10.1787/52570002-en (accessed on 15 September 2021).

Harmonized unemployment rates enable comparison of jobless rates among countries, using a common definition of unemployment. Throughout much of the late 20th century, the U.S. had lower unemployment rates than many other countries, offsetting its slower growing labor force participation. But, in the last two global recessions, U.S. unemployment rates shot up much faster than in other countries during the downturn and fell further during the subsequent expansion. Germany has shifted from being a relatively high unemployment rate country to a low one in the last few decades.

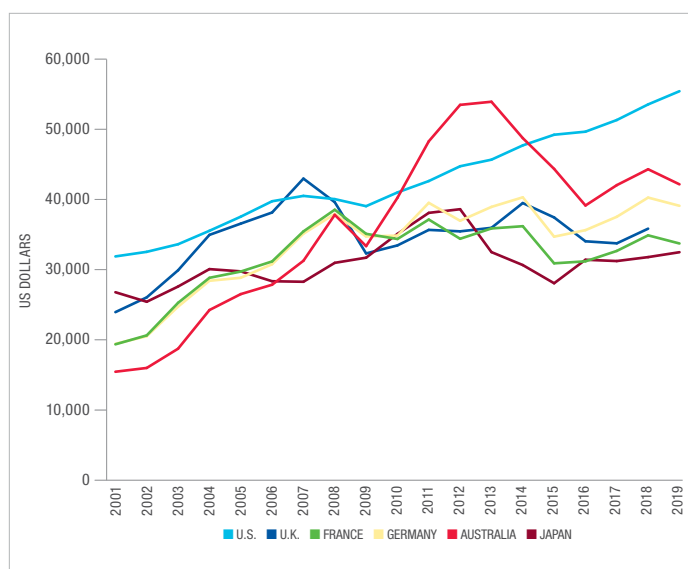
### Average Annual Hours Worked, 1950-2020



Source: OECD (2021), "Hours worked" (indicator), <https://doi.org/10.1787/47be1c78-en> (accessed on 03 September 2021).

Average annual hours worked is defined as the total number of hours actually worked per year divided by the average number of people in employment per year. As societies become richer it is not unusual for hours worked to decline as people choose to “buy” more time away from work. In many ways, the U.S. is an outlier in that the total hours worked per worker has not declined since the 1980s. The U.S. now has the highest hours worked per worker of the comparison group, helping explain its higher output per capita.

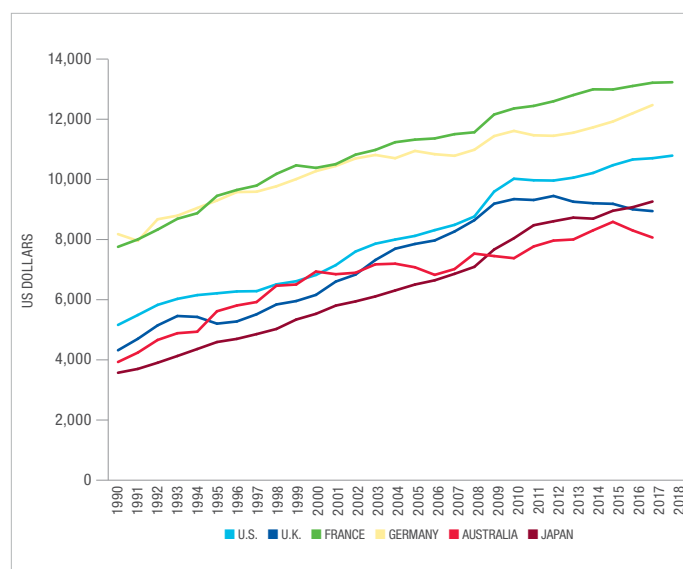
## National Income Per Capita, 2001-2019



Source: "The Changing Wealth of Nations: Measuring Sustainable Development in the New Millennium", The World Bank (2011).

As estimated by The World Bank, adjusted net national income is defined as gross national income minus consumption of fixed capital and natural resource depletion. The U.S. leads using this measure (as in GDP per capita) though both the U.K. and Australia have challenged the U.S. over this time period. World Bank staff estimates are based on sources and methods in World Bank's "The Changing Wealth of Nations: Measuring Sustainable Development in the New Millennium" (2011).

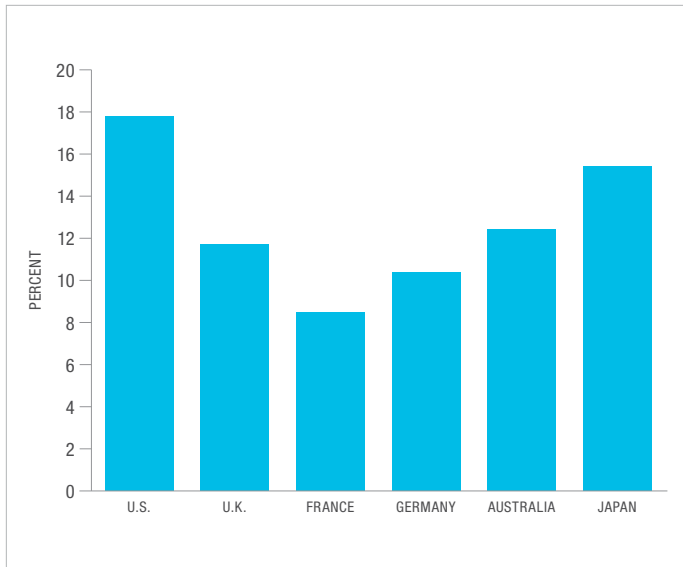
## Government Social Spending Per Capita, 1990-2018



Source: OECD, <https://data.oecd.org/socialexp/social-spending.htm>.

Social expenditure comprises cash benefits, direct in-kind provision of goods and services, and tax breaks with social purposes. Benefits may be targeted at low-income households, the elderly, disabled, sick, unemployed, or young persons. To be considered "social," programs have to involve either redistribution of resources across households or compulsory participation. Social benefits are classified as public when the government (that is central, state, and local governments) controls the relevant financial flows. All social benefits not provided by the government are considered private. Private transfers between households are not considered as "social" and not included here. Net total social expenditure includes both public and private expenditure. It also accounts for the effect of the tax system by direct and indirect taxation and by tax breaks for social purposes. This indicator is measured as a percentage of GDP or USD per capita.

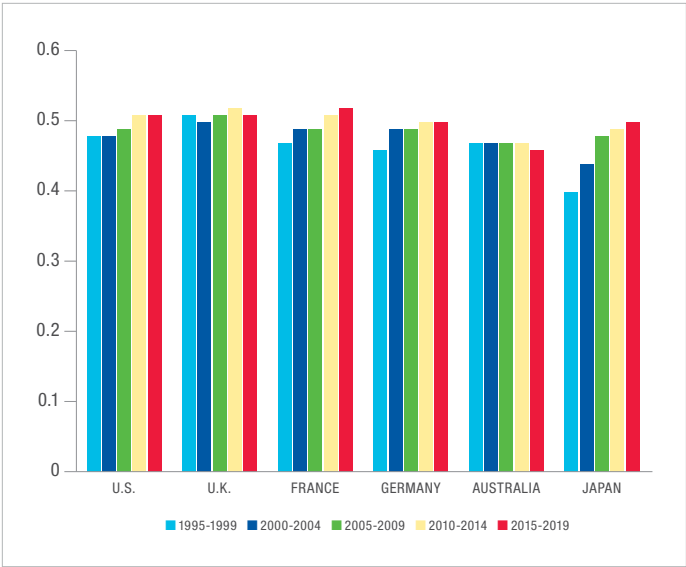
## Poverty Rates, 2018



Source: OECD, <https://data.oecd.org/inequality/poverty-rate.htm>.

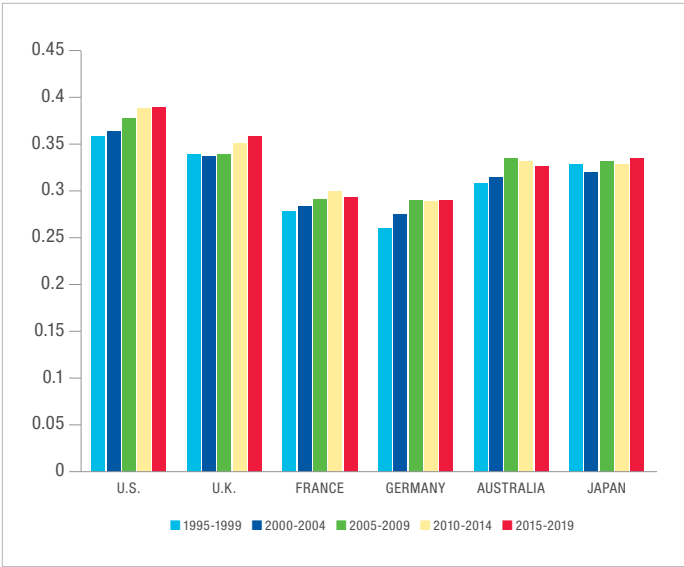
The poverty rate is the ratio of the number of people (in a given age group) whose income falls below the poverty line; taken as half the median household income of the total population. However, two countries with the same poverty rates may differ in terms of the relative income-level of the poor.

Five-Year Averages of Gini Coefficient Calculated Using Market Income, 1995-2019



Source: OECD (2021), Income inequality (indicator). doi: 10.1787/459aa7f1-en (accessed on 02 October 2021).

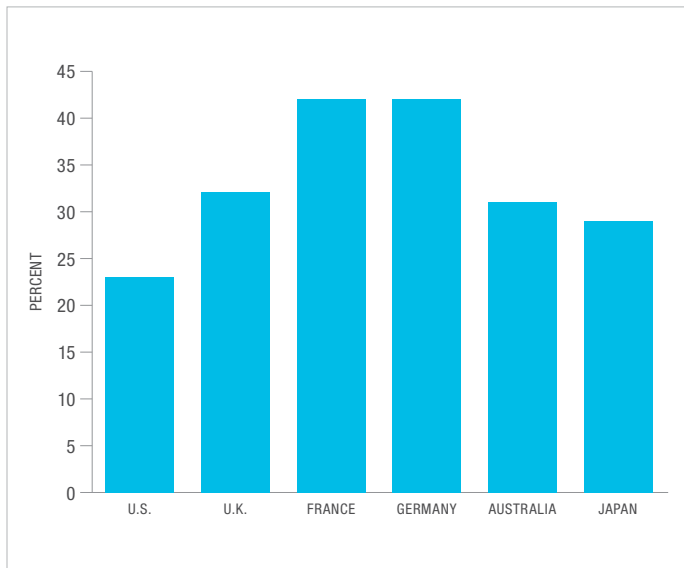
Five-Year Averages of Gini Coefficient Calculated Using Income after Taxes and Transfers, 1995-2019



Source: OECD (2021), Income inequality (indicator). doi: 10.1787/459aa7f1-en (accessed on 02 October 2021).

These figures plot average inequality for market income (left panel) and gross income before taxes (right panel) measured using the Gini coefficient in 5-year bins for 6 OECD countries. Average inequality measured using market income has increased in the U.S., France, Germany, and Japan and stayed mostly flat in Australia and the U.K. The level of inequality was fairly similar across these countries (except Australia) in the 2015-19 period. Adjustments for tax and transfer systems brought the level of inequality down far more in other peer nations than it did in the U.S., though, such that post-tax and transfer inequality is notably higher in the U.S., especially compared to Germany and France.

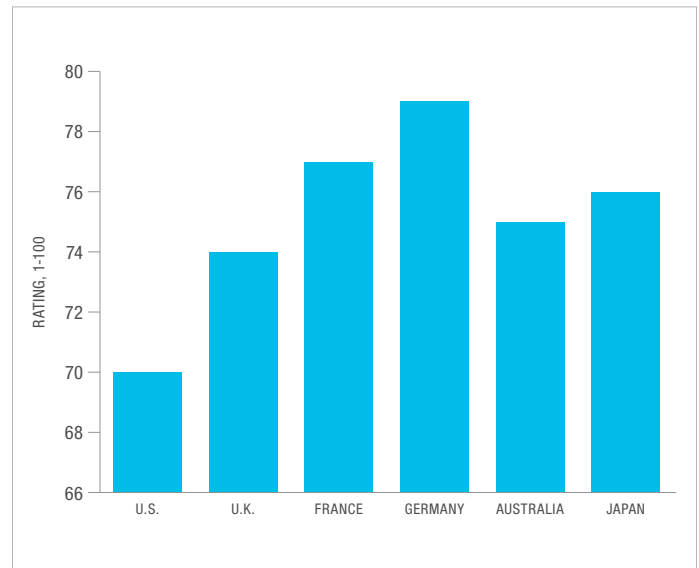
### Percent Improvement in Gini Coefficient After Government Taxes and Transfers, 1995-2019



Source: OECD (2021), Income inequality (indicator). doi: 10.1787/459aa7f1-en (accessed on 02 October 2021); Denny Center analysis.

This chart represents the percent improvement in the Gini Coefficient five-year averages by country after government programs (taxes and transfers) are incorporated in the calculations. All countries show improvement in their inequality scores, but the U.S. lags the comparison countries, most notably France and Germany that demonstrate improvements over 40% (while the U.S. shows an improvement of close to 20%).

### Social Mobility Index, 2020

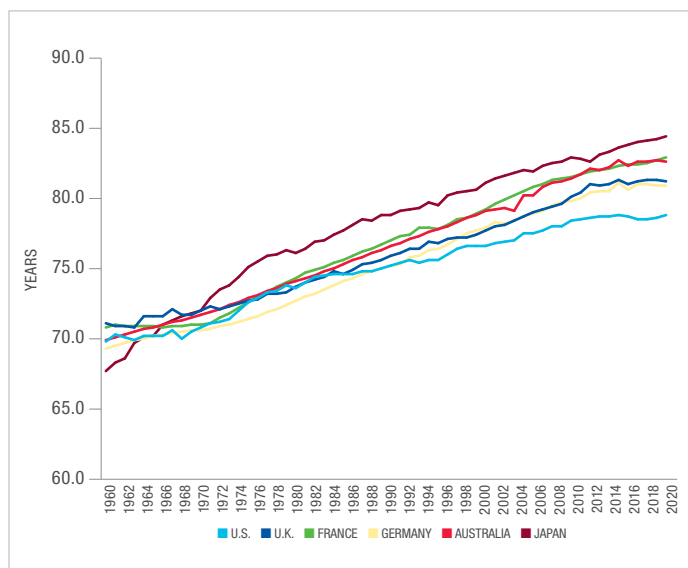


Source: World Economic Forum, <http://reports.weforum.org/social-mobility-report-2020/social-mobility-rankings/>.

The World Economic Forum’s Global Social Mobility Index provides a new, holistic assessment of 82 global economies according to their performance on five key dimensions of social mobility distributed over 10 pillars: 1) Health; 2) Education (access, quality and equity, lifelong learning); 3) Technology; 4) Work (opportunities, wages, conditions); 5) Protection and Institutions (social protection and inclusive institutions). Economies with greater social mobility provide more equally shared opportunities—namely, an equal and meritocratic footing irrespective of socio-economic background, geographic location, gender or origin. There is a direct and linear relationship between a country’s income inequality and its social mobility score on the index. Low social mobility entrenches historical inequalities and higher income inequalities fuel lower social mobility. Enhancing social mobility can convert this vicious cycle into a virtuous one and has positive benefits on broader economic growth.

## C. Social well-being & stability

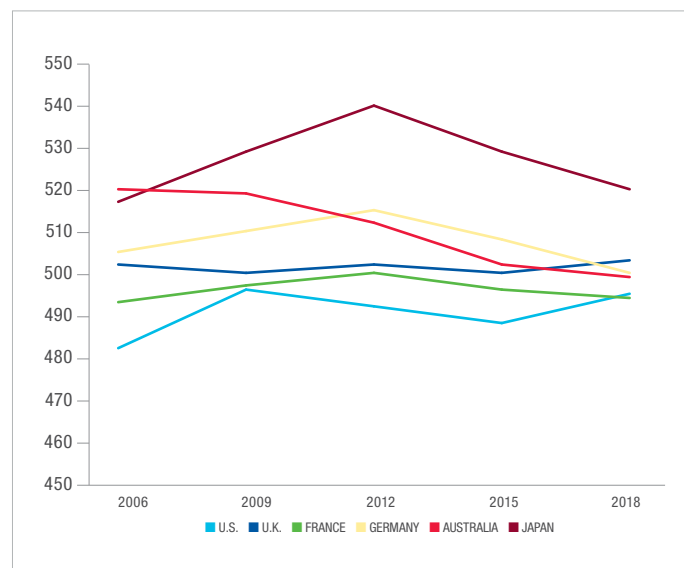
### Life Expectancy at Birth, 1960-2019



Source: World Bank World Development Indicators. (accessed on 02 October 2021)

Since the 1980s, the U.S. has lost considerable ground on life expectancy to these comparison nations. Australia and France have gained nearly 5 years of life expectancy in the U.S. in the last 45 years. Research has found a large and growing gap in life expectancy based on income in the U.S., with essentially no gains in life expectancy from 2001-2014 for the lowest income Americans.

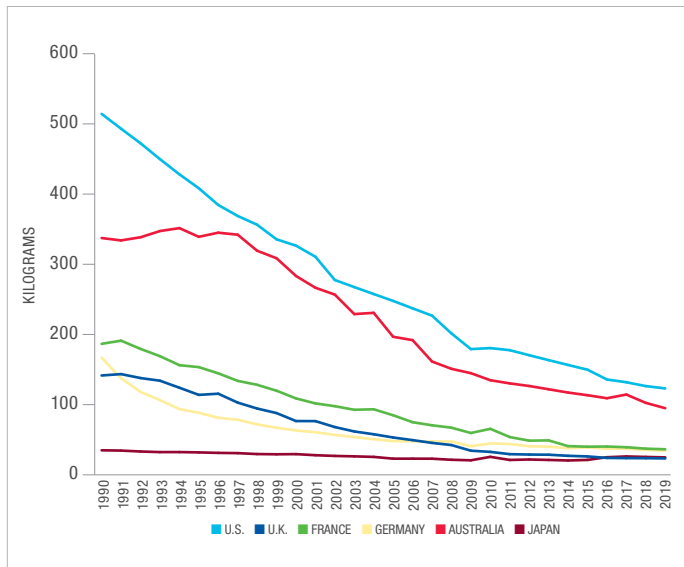
### Education Quality, Avg Scores, 2006-2018



Source: Program for International Student Assessment, National Center for Education Statistics, 2019.

Since 2000, the Program for International Student Assessment (“PISA”) measures math, science and reading literacy for 15-year-old students every three years. The data presented is the average of the three scores by benchmark country, and begins with 2006, since complete data is not available for the benchmark countries in 2000 or 2003. The scores are not correlated with spending per student; the U.S. spends the most per student while Japan and France spend the least.

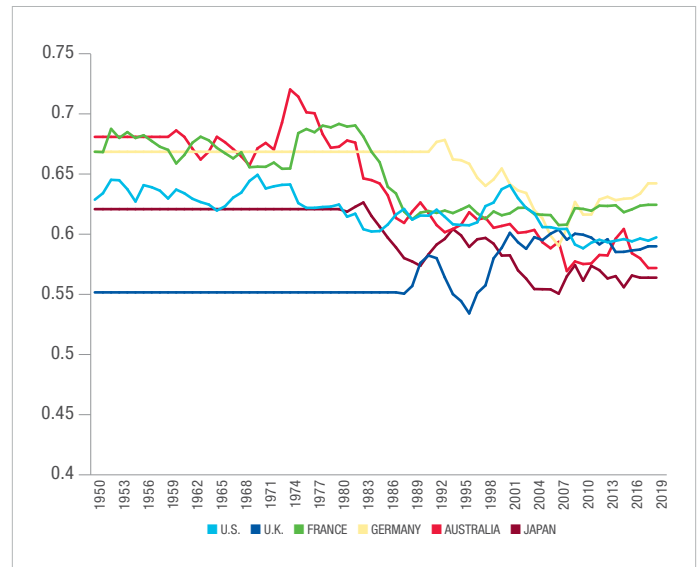
### CO2 Emissions Per Capita, 1990-2019



Source: OECD (2021), Air and GHG emissions (indicator). doi: 10.1787/93d10cf7-en (Accessed on 02 October 2021).

Carbon dioxide emissions per person have fallen substantially since 1990 (by 76% in the U.S., 83% in the U.K., 80% in France, 79% in Germany, 72% in Australia, and 29% in Japan). This drop comes despite the considerable increase in GDP per capita over this time period (meaning emissions per dollar of output is falling faster). At the same time, population growth means that emissions overall are not falling as quickly as this figure shows, and they remain at levels that could cause considerable warming for the planet. Despite large drops, the U.S. and Australia still have considerably higher emissions per capita than other advanced economies.

### Labor Compensation as a Share of GDP, 1950-2019

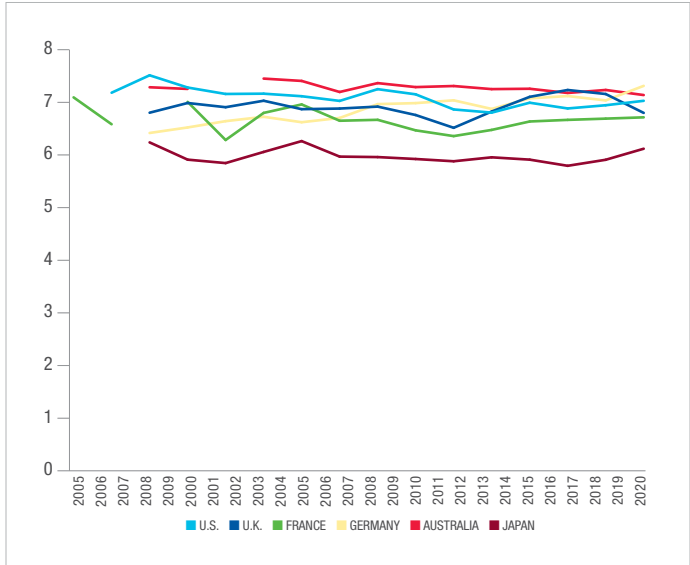


Source: University of Groningen and University of California, Davis, Share of Labour Compensation in GDP at Current National Prices for United States [LABSHPUA156NRUG], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/LABSHPUA156NRUG>. (accessed September 3, 2021).

This figure compares the share of total output paid as compensation to labor across advanced economies over time. The decline in the labor share seen in the U.S. appears in other advanced economies as well with the exception of the U.K. which started from a lower level.



### Subjective Well Being Over Time, 2005-2020

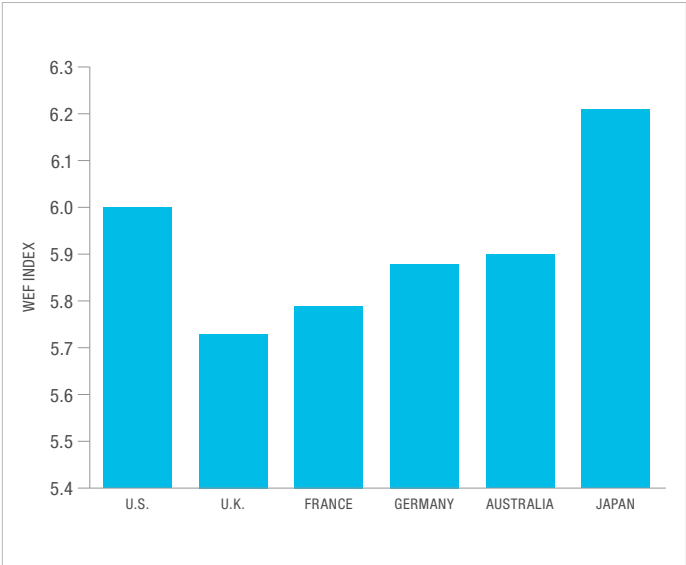


Source: Helliwell, John F., Richard Layard, Jeffrey Sachs, and Jan-Emmanuel De Neve, eds. 2021. World Happiness Report 2021. New York: Sustainable Development Solutions Network. <https://worldhappiness.report/ed/2021/#appendices-and-data>. "Please imagine a ladder, with steps numbered from 0 at the bottom to 10 at the top. The top of the ladder represents the best possible life for you and the bottom of the ladder represents the worst possible life for you. On which step of the ladder would you say you personally feel you stand at this time?" from the Gallup World Poll. Gaps in the data mean that the question was not asked for that year. (accessed September 3, 2021).

“Please imagine a ladder, with steps numbered from 0 at the bottom to 10 at the top. The top of the ladder represents the best possible life for you and the bottom of the ladder represents the worst possible life for you. On which step of the ladder would you say you personally feel you stand at this time?” from the Gallup World Poll. Gaps in the data mean that the question was not asked for that year. Overall happiness indicators show relatively little movement over time for this group of countries. In general, individuals with jobs and higher income tend to report higher satisfaction and when comparing countries at very different levels of income, advanced economies often report higher life satisfaction. As these countries are all relatively high income, life satisfaction gaps may be more a function of cultural differences.

### D. Business environment

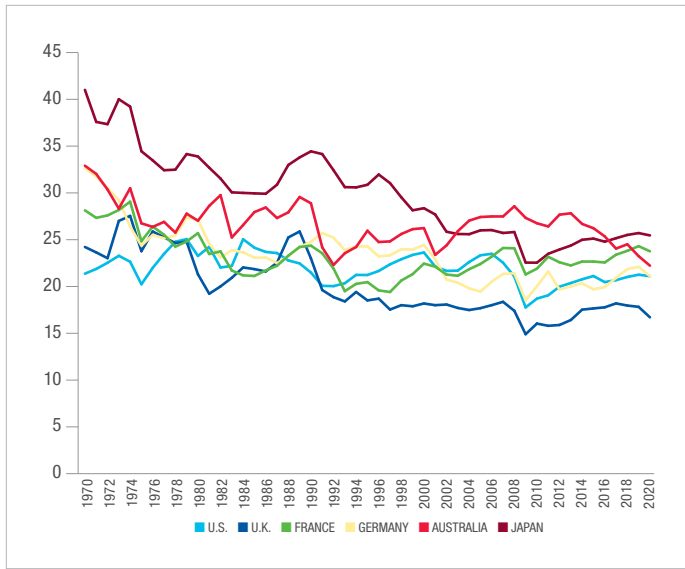
#### Intensity of Local Market Competition, 2017



Source: Global Competitive Index, World Economic Forum, <http://reports.weforum.org/global-competitiveness-index-2017-2018/>.

The World Economic Forum, in its Executive Opinion Survey, asked respondents to answer the following question: “In your country, how intense is competition in the local markets? [1 = not intense at all, 7 = extremely intense]”. This chart represents the averages for 2017 which is the most recent year data is available.

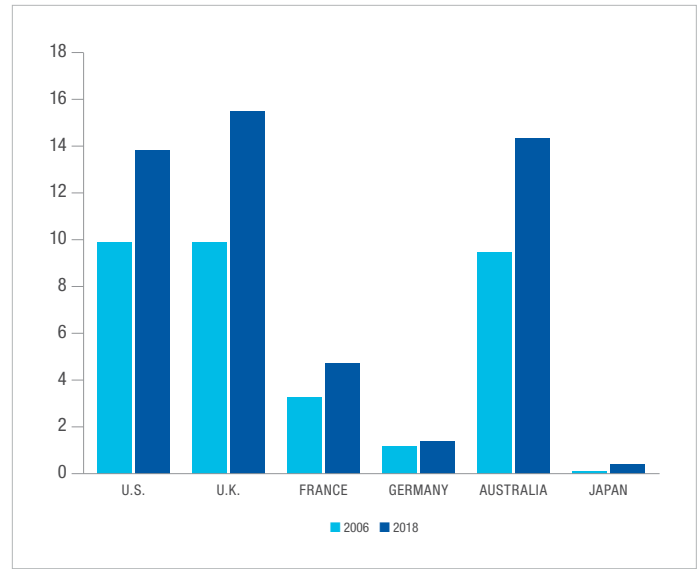
### Capital Investment as Percent of GDP, 1970-2020



Source: The World Bank.

Capital investment consists of outlays on additions to the fixed assets of the economy plus net changes in the level of inventories. Fixed assets include land improvements (fences, ditches, drains, and so on); plant, machinery, and equipment purchases; and the construction of roads, railways, and the like, including schools, offices, hospitals, private residential dwellings, and commercial and industrial buildings. Inventories are stocks of goods held by firms to meet temporary or unexpected fluctuations in production or sales, and work in progress. Capital investment as a percent of GDP has fallen in all countries over this time period except in the U.S. which has maintained a relatively consistent level.

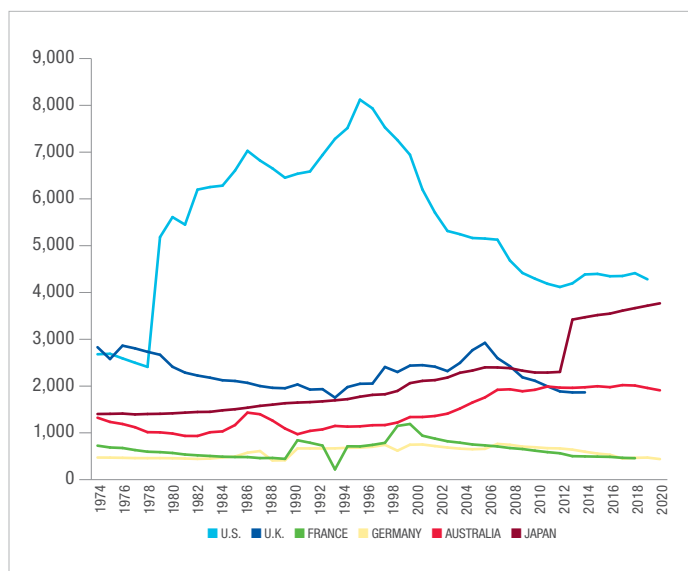
### New Business Density (Applications Per 1000 People Ages 15-64)



Source: The World Bank, <https://data.worldbank.org/indicator/IC.BUS.NDNS.ZS?locations=AU-FR-DE-JP-GB-US>.

Researchers used data from the World Bank to calculate “new business density” which is the annual number of new business applications divided per 1000 people ages 15-64 that reside in the country. The Oxford website, Our World in Data, calculates the density for Australia, France, Germany, Japan, and the United Kingdom. We used new business applications data from the U.S. Census Bureau and U.S. population data from Our World in Data to estimate the new business density ratio for the U.S.

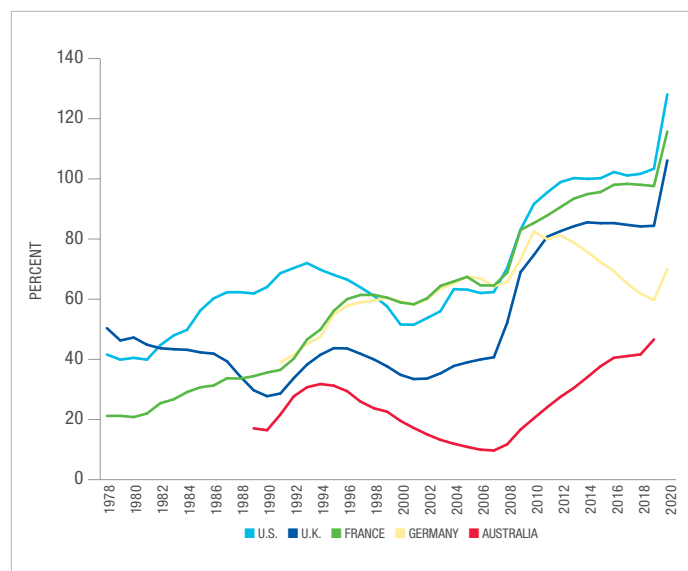
### Number of Listed Companies, 1975-2020



Source: The World Bank via <http://theglobaleconomy.com>.

Listed domestic companies, including foreign companies which are exclusively listed, are those which have shares listed on an exchange at the end of the year. Investment funds, unit trusts, and companies whose only business goal is to hold shares of other listed companies, such as holding companies and investment companies, regardless of their legal status, are excluded. A company with several classes of shares is counted once. Only companies admitted to listing on the exchange are included.

### National Debt as Percent of GDP, 1978-2020



Source: The World Bank via <http://theglobaleconomy.com>.

National debt is the total fixed-term obligations to others on a particular date. It includes both domestic and foreign liabilities such as currency and money deposits, securities (other than shares), and loans. The gross amount of government liabilities is offset by the amount of equity and financial instruments held by the respective government. Data availability differs by country, and Japan is omitted since their data is only available beginning in 2013—and is over 200% in each year, making the comparison among other economies hard to distinguish.

# Reactions: Betsey Stevenson and Michael Strain

---

Two economists—Betsey Stevenson (University of Michigan) and Michael Strain (American Enterprise Institute)—share their views on the current state of democratic capitalism in the United States.

# An Imperfect Labor Market Recovery

AN ESSAY BY BETSEY STEVENSON (MAY 11, 2022)

Both GDP and the labor market have recovered from the pandemic-induced recession much more rapidly than many predicted. In less than two years following the worst employment decline since the Depression, unemployment fell to 3.6%. In comparison, it took more than eight years for unemployment to fall below 4% following the 2008 recession. Real GDP recovered to its 2019 fourth quarter level by the middle of 2021 and was near most estimates of potential GDP by the end of 2021. Perhaps most surprising is that GDP recovery has been so robust despite the ways the pandemic reduced potential GDP, at least temporarily, with increased worker illness and death, lower labor force participation, supply chain disruptions, and lower business investment.<sup>18</sup>

The economic recovery was undoubtedly fueled by record high government spending that kept families out of poverty and prevented millions from facing financial hardship. Wages were completely replaced by unemployment insurance and millions of workers who would not have qualified for benefits because of inadequate earnings or self-employment were covered. Long lines of people waiting to collect from food banks in the early months of the pandemic disappeared as robust safety nets ensured that families could afford to buy food and pay rent. Broad payments—known as economic impact payments—provided assistance to nearly every person in the United States regardless of need. Many families used these payments to pay down debt and build their savings account. The result has been a demand-fueled recovery.

The downside of the demand-fueled recovery has been that demand has accelerated faster than supply could respond, particularly since consumer spending patterns have not followed pre-pandemic trends. The most obvious threat to the recovery is rising prices, with inflation at 8.3% over the 12 months ending in April 2022. Inflation has been concentrated in the goods producing sector, energy prices, and housing. The concern is that the primary source of growth over the past half century in the United States has been in the labor-intensive service sector and that is the sector that has yet to recover.

While GDP has fully recovered and supply is struggling to keep up with demand, employment has yet to fully recover. There were 1.3 million fewer jobs as of April 2022 and the employment to population ratio remains 1.2 percentage points below its pre-pandemic level. And yet 6 million people who are out of the labor force report wanting a job now, which is roughly a million people more than pre-pandemic levels.

Job openings are at a record high, with companies posting to fill more than 11 million job openings.<sup>19</sup> This is more than three times the number of job openings four years into the recovery from the 2008 recession and roughly 50% more than the number of job openings available prior to the pandemic.

Will workers return to the labor market to fill these openings? Whether the labor market returns to its pre-pandemic employment will ultimately determine the shape

<sup>18</sup>Fernald, J., & Li, H. (2021). *The Impact of COVID on Potential Output*. Federal Reserve Bank of San Francisco Working Paper 2021-09. <https://doi.org/10.24148/wp2021-09>; Furman, J., & Powell, W. (2022, January 27). *The economy grew faster than expected in 2021, but the pandemic transformed its composition*. Peterson Institute for International Economics. <https://www.piie.com/blogs/realtime-economic-issues-watch/us-economy-grew-faster-expected-2021-pandemic-transformed-its>.

<sup>19</sup>The Bureau of Labor Statistics Job Openings and Labor Turnover Survey began in 2000.

of the economy: in the near-term by impacting the rate of inflation in services over the next few years and in the longer-term by determining the level of potential GDP.

This essay explores the broad shifts in the U.S. economy, the trends in pre- and post-pandemic employment, and the policy challenges that the pandemic exposed. Many of these challenges pre-date the pandemic. Low labor force participation has held back economic growth and presented challenges to the economy for decades. Solving the problem of low labor force participation requires investing more in our youngest citizens, including prioritizing, and supporting caregiving work. For families, the urgent need is access to more reliable, affordable, and higher quality childcare. More broadly, the future of the U.S. economy will ultimately depend on how we support and nurture workers and their talents, and that in turn depends on how we share the benefits of economic growth.

### RECKONING WITH FUNDAMENTAL SHIFTS IN THE ECONOMY

The pandemic forced a reckoning with two fundamental shifts in the U.S. economy. The first shift is that most of the expansion of the U.S. economy over the past fifty years has been in the service sector. There are currently roughly 2 million fewer people working in the goods-producing sector compared to January 1970. In comparison, the service-providing sector has grown by more than 72 million jobs. Over that period the goods producing sector went from employing nearly 1 in 3 workers in the economy to only 1 in 8 workers.

However, the goods producing sector remains the most sensitive to business cycles. In a typical recession, job loss is concentrated in the goods-producing sector and not all of

those jobs return. In contrast, the upward trend in service-sector job growth combined with the sector's less cyclical nature has meant fewer jobs lost in recent recessions. However, pandemic job loss was concentrated in the service sector and hit some subsectors, such as health and education services, that have typically experienced little job loss during recessions.

The second fundamental shift is that women's role in the labor force and in the home has undergone a profound shift. Women's labor force participation surged in the last few decades of the 20th century. While women have yet to achieve equality in every aspect of the economy, by the end of 2019, women held more than half of the jobs in the economy. Women have more education than their male counterparts and have closed work experience gaps with men.

As women's working lives shifted, so did their personal lives. Women marry and have children at older ages and many women are single parents. The result of these changes is that most children are raised in homes in which all parents work.<sup>20</sup> Mothers are primary earners in 40 percent of families, contributing at least half of total household income.<sup>21</sup> Forty percent of families have children under age 18 in the home, and more than one in ten adults provide care to another adult who needs caregiving.<sup>22</sup>

The two trends intersect because women are the majority of service-sector workers in the United States. As demand for service-sector workers has risen, particularly for caregiving positions, women have stepped into the labor force to take the jobs. In every past recession, women's employment has recovered faster than men's as service-sector job growth has accelerated in the recovery. Historically, faster relative growth

<sup>20</sup>The Council of Economic Advisers, 2014, "Nine Facts About American Families and Work" [obamawhitehouse.archives.gov/sites/default/files/docs/nine\\_facts\\_about\\_family\\_and\\_work\\_real\\_final.pdf](https://obamawhitehouse.archives.gov/sites/default/files/docs/nine_facts_about_family_and_work_real_final.pdf).

<sup>21</sup>Glynn, S. J. (2019, May 10). *Breadwinning Mothers Continue To Be the U.S. Norm*. Center for American Progress. <https://www.americanprogress.org/issues/women/reports/2019/05/10/469739/breadwinning-mothers-continue-u-s-norm/>.

<sup>22</sup>Betsy Stevenson and Isabel V. Sawhill "Paid Leave for Caregiving: An Introduction" November 2020 AEI Brookings Paid Leave Project.

in women's employment offset the slow return of men to work and allowed the economy to recover more quickly overall.<sup>23</sup> (Figure 1) Roughly two-thirds of the job growth since the start of the 2008 recession were jobs that went to women. In the five years prior to the pandemic, women drove the rebound in the prime-age labor force participation rate.<sup>24</sup> With the growth in women's employment came growth in the number of childcare workers. But unlike prior cycles, in the current recovery it is women's employment—particularly employment in the care sectors—that has lagged. The question is whether this lag reflects changes in women's preferences that have shifted their labor supply. Alternatively, it may reflect shifts in labor demand as the service-sector adjusts from an unprecedented shake up.

#### A SERVICE-SECTOR SHAKE UP

The pandemic was not a normal cyclical downturn. The virus-driven downturn was caused by changes in behaviors to avoid the virus and public health measures designed to reduce illness and death. The result was a downturn that ravaged jobs in the service sector. Service-sector employment fell by 18.5 million jobs, while employment in the goods-producing sector declined by 2.5 million jobs. In contrast, between January 2008 and February 2010, employment declined by 19% in the goods sector, while employment in the service sector declined by 4.8%.

This unique nature of pandemic job loss caused the greatest job loss among women, particularly lower-income women and women of color.<sup>25</sup> Women's employment fell more than men's because women hold the majority of the jobs in the sectors that experienced the largest declines. Employment in leisure and hospitality fell by half between February

and April 2020 and 3 out of every 5 jobs lost were held by women. Similarly, nearly 3 million jobs were lost in education and health services and 4 out of every 5 jobs lost were held by women.<sup>26</sup> Education and health services employs a quarter of all women and had never experienced a decline in employment throughout a recession.

Beyond the unique nature of who was impacted, this is the first time the service sector has experienced such widespread adjustment. To keep pace with its historical trajectory of job growth over the past several decades, the service sector requires adding even more jobs than it lost to constitute a full recovery. Between January 2010 and February 2020, the service sector expanded by 19 million jobs. Projecting this rate of job growth through to April 2022 shows a shortfall of 5 million service-sector jobs relative to this trend. (Figure 2)

Why have service sector jobs failed to recover? These sectors have some of the greatest shortfalls in employment relative to the pre-pandemic trend (see Figure 3). The high level of job vacancy rates suggest that the problem is labor supply. Perhaps workers no longer want to work in leisure and hospitality or in education and health services. If this were the case, one would expect to see rapid wage and subsequent price increases as businesses struggle to meet demand. However, as of January 2022, 12-month price increases in most services were roughly 2% or lower. In April 2022, the price of education and communication services had risen 1.7% over the preceding twelve months. Inflation in recreational services had picked up to 4.4% over the preceding twelve months while the price of medical care services had risen 3.5%. These price increases were well below the overall rate of 8.3%.

<sup>23</sup>U.S. Bureau of Labor Statistics. (n.d.) *Employment Level – Women [LNS12000002]*. Retrieved from FRED, Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/LNS12000002>.

<sup>24</sup>Tüzemen, D., & Tran, T. (2019, December 18). *Women Are Driving the Recent Recovery in Prime-Age Labor Force Participation*. Federal Reserve Bank of Kansas City. <https://www.kansascityfed.org/research/economic-bulletin/women-driving-recent-recovery-labor-force-participation-2019/>.

<sup>25</sup>Stevenson, B. (2020, July). *The Initial Impact of COVID-19 on Labor Market Outcomes Across Groups and the Potential for Permanent Scarring*. The Hamilton Project. [https://www.hamiltonproject.org/assets/files/Stevenson\\_LO\\_FINAL.pdf](https://www.hamiltonproject.org/assets/files/Stevenson_LO_FINAL.pdf).

<sup>26</sup>Stevenson, B. (2020, July). *The Initial Impact of COVID-19 on Labor Market Outcomes Across Groups and the Potential for Permanent Scarring*. The Hamilton Project. [https://www.hamiltonproject.org/assets/files/Stevenson\\_LO\\_FINAL.pdf](https://www.hamiltonproject.org/assets/files/Stevenson_LO_FINAL.pdf).

One explanation is simply that consumer demand for services has not yet fully recovered. Surveys by Morning Consult still find that a third of people are not comfortable going on vacation and a quarter are not comfortable dining in a restaurant or café.<sup>27</sup> While goods expenditures were 9% above trend in 2021, services expenditures were 2.7% below trend.<sup>28</sup> If this shift toward goods and away from services reverses as the pandemic further recedes, then it creates a risk that demand for services may outstrip the ability of service suppliers to meet that demand. Without an offsetting shift in labor supply from workers ready to return to in-person work, the result of a rise in demand for services will likely be rising prices. In short, while the signs of a tight labor market have appeared, the labor market risks being even tighter in the coming months.

Alternatively, service-sector employers may have learned to make do with fewer workers. Even in sectors that largely shifted to work from home, such as financial services workers, job growth has been below the pre-pandemic trend (see Figure 4). As the pandemic-induced recession was the first massive disruption in the service sector, employers have had the opportunity to question the way in which they organize tasks. As some of these employers make technological changes, such as adopting self-service kiosks at grocery stores and restaurants, fewer workers may be needed.

While reorganization may be driving some of the service sector employment lag, it's not the sole driver. Within services, it is the care sector, a sector in which people are difficult to replace or streamline, that has seen some of the slowest recovery in employment (see Figure 5). Adults and children who need care depend on people who can devote

attention to them. While the care industry languishes, families are left providing care on their own, often disrupting their own careers. To better understand the challenges of the care sector, it is useful to take a closer look at the fundamental shift of women's role in the labor force.

## WOMEN'S RISING ROLE IN THE LABOR FORCE

When women first began entering the labor force in droves in the 1970s, their employment was often a small part of household earnings. Between 1970 and 1999, the labor force participation rate of prime age women rose from 50 percent to 77 percent. Over the same time period, the labor force participation rate of prime age men fell by 4 percentage points. The decline in male participation was overshadowed by the dramatic rise of women. However, on average, female workers in the 20th century had less work experience and less education than their male contemporaries and earned substantially less than men. In the early 1990s, women's educational attainment began to surpass that of men, leading young women to have more formal training than young men. In the decades since, women's education has continued to exceed that of men and women are now the most educated workers in the U.S. economy.

Throughout the 21st century, more education, deeper work experience, and shifting family patterns led women to close gender gaps in work experience and reduce gaps in earnings. Both men's and women's labor force participation declined in the first 15 years of the 21st century. Between 2000 and 2015, prime age male labor force participation declined 4 percentage points and prime age female labor force participation declined 3 percentage points. However, between 2015 and 2020 prime age women's labor force participation had fully recovered to

<sup>27</sup>Morning Consult. (n.d.). Tracking the Return to Normal. <https://morningconsult.com/return-to-normal/>.

<sup>28</sup>Furman, J., & Powell, W. (2022, March 4). US gained surprising number of jobs in February but wage growth was nearly flat. Peterson Institute for International Economics. <https://www.piie.com/blogs/realtime-economic-issues-watch/us-gained-surprising-number-jobs-february-wage-growth-was>.



the highs seen at the end of the 20th century. While prime age male labor force participation increased during this period, it did so at a much slower rate and was far from fully recovering.

As women deepened their connection to work, their fertility declined, and they postponed having children. But the cohort-level decline in fertility began to turn around about a decade and a half ago. For the women in their mid-to-late 40s as the pandemic began, completed fertility was higher than it had been for similarly aged women for much of the 21st century. Both the average number of children born and the probability of having at least one child rose compared to the previous generation.<sup>29</sup>

These recent new mothers were also more likely to continue working outside the home. In 2019, the labor force participation of mothers of children 6 years old and younger hit a new high.<sup>30</sup> Mothers with kids in the home as the pandemic hit were older and had more education and work experience than mothers with kids in the home during previous recessions. The culmination was a large share of families relying on childcare. Stepping out of the labor force for these mothers was a less viable option, and yet, for some of them, it was the only option available.

### AN ONGOING CRISIS IN CAREGIVING

The pandemic shone a spotlight on the problems of childcare and the failure of the federal government to adequately invest in children. The U.S. economy has evolved in a way

that makes childcare central to its functioning, and yet families have struggled to find affordable, high-quality childcare for decades. This failure impacts women's choices about whether and when to have children, as well as their decision about whether to work when they have young children. In turn, these decisions ultimately shape the trajectory of women's lives and therefore of our society.

The pandemic decimated the childcare industry, and the market is still far from recovering to pre-pandemic levels of access. Two-thirds of childcare centers had closed by April 2020 and the number of child-care workers fell by 34 percent.<sup>31</sup> By April 2022, employment in childcare was still struggling to recover and was 11 percent below February 2020 levels. Research has found that childcare is particularly sensitive to economic downturns—with availability falling sharply with the unemployment rate and then recovering more slowly than the rest of the economy.<sup>32</sup>

Parents of school-aged children were also affected, as schools around the country turned to remote learning, and many remained remote or partially remote for more than a year.<sup>33</sup> More than two-thirds of children live in households in which all parents work.<sup>34</sup> For most parents, school is a primary provider of childcare, offering roughly 30 hours a week of not only education but also supervision of children. The pandemic highlighted the dual purpose of schools and childcare: educating and caring for children.

<sup>29</sup>Barroso, A. (2021, May 7). *With a potential 'baby bust' on the horizon, key facts about fertility in the U.S. before the pandemic*. Pew Research Center. <https://www.pewresearch.org/fact-tank/2021/05/07/with-a-potential-baby-bust-on-the-horizon-key-facts-about-fertility-in-the-u-s-before-the-pandemic/>.

<sup>30</sup>Bureau of Labor Statistics, Current Population Survey [https://www.bls.gov/bls/data\\_finder.htm](https://www.bls.gov/bls/data_finder.htm).

<sup>31</sup>Lee, E. K., & Parolin, Z. (2021). *The Care Burden during Covid-19: A National Database of Child Care Closures in the United States*. *Socius*. <https://doi.org/10.1177/23780231211032028>; U.S. Bureau of Labor Statistics, All Employees, Child Day Care Services [CES6562440001], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/CES6562440001>, April 14, 2022.

<sup>32</sup>Brown, J. H., & Herbst, C. M. (2021). *Child Care over the Business Cycle*. IZA Institute of Labor Economics. <https://ftp.iza.org/dp14048.pdf>.

<sup>33</sup>Bauer, L., Dube, A., Edelberg, W., & Sojourner, A. (2021, June 3). *Examining the uneven and hard-to-predict labor market recovery*. The Hamilton Project, Brookings Institution. <https://www.brookings.edu/blog/up-front/2021/06/03/examining-the-uneven-and-hard-to-predict-labor-market-recovery/>.

<sup>34</sup>U.S. Census Bureau. (2021). American Community Survey, Table B23008: Age of Own Children Under 18 Years in Families and Subfamilies by Living Arrangements by Employment Status of Parents. <https://data.census.gov/cedsci/table?q=B23008&tid=ACSDT5Y2020.B23008>.

Parents need their children to have a safe and enriching place to learn and develop while they are at work.

Research has found that childcare-related constraints led to more women than men losing jobs during the pandemic.<sup>35</sup> However, childcare disruptions to work affected more than whether parents were able to work. A survey I conducted in the summer of 2021 found that childcare responsibilities during the COVID-19 crisis impacted the employment outcomes of 59% of parents.<sup>36</sup> While fathers were less likely than mothers to leave employment, they were more likely than mothers to point to childcare constraints as a reason for turning down a promotion, changing employment, or pausing further education or training. Mothers also made these types of sacrifices in addition to leaving jobs. Although these other choices do not show up as a smaller labor force, they can lead to a lower potential output for the U.S. economy and lower lifetime earnings for many parents.

Much of the press around childcare challenges has focused on the impact on women. However, the decades-long shift toward greater equality in the home has increased fathers' responsibilities for child and eldercare. As we entered the pandemic, dads had become more likely to be stay-at-home parents and overall dads were dedicating more time to parenting activities compared to previous generations.<sup>37</sup> Both men and women need access to more affordable and stable childcare as well as the flexibility in their jobs to effectively balance their caregiving and work responsibilities.

Long before the pandemic, the tensions between work and family were increasing—and increasingly impacting fathers. A 2014 survey found that 49% of parents had passed up a job because it conflicted with family obligations.<sup>38</sup> A 2016 survey by the Society of Human Resource Managers found that 46% of men and 43% of women reported facing work–family conflict on a regular basis.<sup>39</sup>

While many men have increased the amount of childcare, eldercare, and household tasks they do, the fundamentally gendered nature of both formal and informal caregiving has not gone away. The men who seem to be stepping most easily into caregiving roles at home are men who tend to be more educated and have strong labor force attachment. And yet, the men who have become disconnected from work are not stepping up to fill the care giving needs of their family.<sup>40</sup> Men out of the labor force tend to point to their own health or inability to find work as a reason they are out of the labor force, while women are more likely to cite care-giving responsibilities as the primary reason they are out of the labor force.<sup>21</sup>

Our failure to adapt to a modern society in which caregiving plays a more central economic role has limited men's willingness to provide care to their own families and limited their willingness to enter caregiving fields. Over the past 50 years, strong job growth has occurred in occupations that are perceived as “women's work” such as health and educational services. This growth has facilitated women's rising labor

<sup>35</sup>Fairlie, R. W., Couch, K., & Xu, H. (2021). *The Evolving Impacts of the Covid-19 Pandemic On Gender Inequality in the U.S. Labor Market: The Covid Motherhood Penalty*. NBER Working Paper. [https://www.nber.org/system/files/working\\_papers/w29426/w29426.pdf](https://www.nber.org/system/files/working_papers/w29426/w29426.pdf); Heggeness, M. (2020). Why Is Mommy So Stressed? Estimating the Immediate Impact of the COVID-19 Shock on Parental Attachment to the Labor Market and the Double Bind of Mothers. Institute Working Paper 33. Federal Reserve Bank of Minneapolis. <https://www.minneapolisfed.org/research/institute-working-papers/why-is-mommy-so-stressed-estimating-the-immediate-impact-of-the-covid-19-shock-on-parental-attachment-to-the-labor-market-and-the-double-bind-of-mothers>.

<sup>36</sup>Survey conducted between May 27 and July 7, 2021 using RIWI's Random Domain Intercept Technology, a patented, machine-learning technology that delivers anonymous opt-in surveys to Web users who are surfing online. Data published in Stevenson, B. (2021). Women, Work, and Families: Recovering from the Pandemic-Induced Recession. The Hamilton Project. [https://www.brookings.edu/wp-content/uploads/2021/09/20210929\\_Hamilton\\_stevenson\\_womenWorkFamilies.pdf](https://www.brookings.edu/wp-content/uploads/2021/09/20210929_Hamilton_stevenson_womenWorkFamilies.pdf).

<sup>37</sup>Livingston, Gretchen and Kim Parker (2019) “8 Facts About American Dads” <https://www.pewresearch.org/fact-tank/2019/06/12/fathers-day-facts/>.

<sup>38</sup>Harris Poll of 4,096 U.S. adults conducted online May 27-30, 2014. Reported in Council of Economic Advisers. (2014). *Eleven Facts about American Families and Work*. [https://obamawhitehouse.archives.gov/sites/default/files/docs/eleven\\_facts\\_about\\_family\\_and\\_work\\_final.pdf](https://obamawhitehouse.archives.gov/sites/default/files/docs/eleven_facts_about_family_and_work_final.pdf).

<sup>39</sup>Society for Human Resource Management. (n.d.) SHRM's Effective Workplace Index: Creating A Workplace That Works For Employees And Employers. <https://www.shrm.org/hr-today/trends-and-forecasting/special-reports-and-expert-views/Documents/SHRM-NSCW-Effective-Workplace-Index-Summary.pdf>.

<sup>40</sup>Stevenson, Betsey (2016, December). *Manly Men Need to Do More Girly Jobs*. Bloomberg.

<sup>41</sup>Dawson Ulrich, Laura Q1 2021 “Male Labor Force Participation: Patterns and Trends” Federal Reserve Bank of Richmond Econ Focus. [https://www.richmondfed.org/publications/research/econ\\_focus/2021/q1/district\\_digest](https://www.richmondfed.org/publications/research/econ_focus/2021/q1/district_digest).

force participation and has likely contributed to men's declining labor force participation given their reluctance to enter these fields. The problem for men is not only do these fields have cultural connotations of being feminine, but they also have the reality of being low-paid with few benefits and little access to pathways for promotion. The result is that of the 5 million jobs added in education and health services between 2010 and 2020, 3 out of 4 went to women.

### IT IS TIME FOR POLICY CHANGE

The United States has failed to adapt to the changing workforce's needs, and the pandemic revealed how this failure has created weaknesses in the U.S. economy. When all adults in a household work, there is a greater need for flexibility so that workers can address the responsibilities and hurdles of managing one's life outside of work. When all adults work, it is more difficult for households to insure themselves as there are no longer any residual workers in the household. When all adults work, those who provide care to children or adults may face difficult trade-offs between providing care and working to earn a living.

These forces have left families struggling with an inadequate safety net and high levels of stress. All OECD countries—except the United States—provide paid maternity leave, and half provide paid paternity leave.<sup>42</sup> Most OECD countries ensure that workers have access to paid sick leave in addition to their annual vacation leave.<sup>43</sup> The United States is the only advanced economy that does not ensure that workers have access to paid vacation.<sup>44</sup> A common concern in U.S. policy discussions is that government support will reduce incentives to work. The reality is that Americans are less

likely to work precisely because they lack other countries' generous social supports. U.S. labor force participation for both men and women are below the OECD average for 25 – 64-year-olds and well below participation rates in countries with larger safety nets and greater support for working families like Canada, Norway, Sweden, New Zealand, the United Kingdom, and Australia.<sup>45</sup>

More specifically, research has shown that the failure to adopt such policies has led the United States to fall behind in women's labor force participation. In the latter half of the 20th century, the United States had one of the highest female labor force participation rates of any OECD country. Yet, in the ensuing decades, the U.S. rank has fallen to near the bottom among 22 OECD countries.<sup>46</sup> The difference is that many OECD countries have expanded family friendly policies including parental leave and subsidized, high-quality childcare.

Childcare in the United States suffers from being both unaffordable for parents and under compensated for workers. In 2020, the median childcare worker earned just \$12.24 an hour, meaning that half of childcare workers make less than that. Children need committed professionals to provide care and skill development. But few people have the luxury of gaining training in early childhood education and committing to the profession for \$12 an hour. While the number of childcare workers had grown prior to the pandemic, that growth had been insufficient to keep up with rising demand. Moreover, there is a high level of turnover in the childcare workforce, which is a typical consequence of low wages.<sup>47</sup> The cost

<sup>42</sup>OECD. (2016, March). *Parental leave: Where are the fathers? Men's Uptake of Parental Leave Is Rising but Still Low*. OECD Policy Brief. <https://www.oecd.org/policy-briefs/parental-leave-where-are-the-fathers.pdf>.

<sup>43</sup>Raub, A., Chung, P., Batra, P., Earle, A., Bose, B., Jou, J., de Guzman Chorny, N., Wong, E., Franken, D., & Heymann, J. (2018). *Paid Leave for Personal Illness: A Detailed Look at Approaches Across OECD Countries*. WORLD Policy Analysis Center. [https://www.worldpolicycenter.org/sites/default/files/WORLD%20Report%20-%20Personal%20Medical%20Leave%20OECD%20Country%20Approaches\\_0.pdf](https://www.worldpolicycenter.org/sites/default/files/WORLD%20Report%20-%20Personal%20Medical%20Leave%20OECD%20Country%20Approaches_0.pdf).

<sup>44</sup>Maye, A. (2019, May). *No-Vacation Nation, Revised*. Center for Economic and Policy Research. <https://cepr.net/images/stories/reports/no-vacation-nation-2019-05.pdf>.

<sup>45</sup><https://data.oecd.org/emp/labour-force-participation-rate.htm>.

<sup>46</sup>Blau, F. D., Kahn, L. M. (2013). *Female Labor Supply: Why is the US Falling Behind?* National Bureau of Economic Research. <https://www.nber.org/papers/w18702>.

of low wages and high turnover is borne by the children for whom stability and consistency in care help build socio-emotional skills that lead to better life outcomes.

The challenge for parents is that what they can pay is limited by what they themselves earn. In more than half of states, the cost of full-time childcare exceeds the cost of in-state college tuition.<sup>48</sup> Among those who use formal childcare, one survey found nearly 6 out of 10 parents plan to spend more than \$10,000 on childcare in 2021, which was roughly the cost of center-based care in 2020.<sup>49</sup> However, most parents cannot afford to pay \$10,000 a year on childcare, and the result is parents who cannot afford to work. Nine out of 10 parents are considering reducing hours, changing jobs, or leaving the workforce to help cut their childcare costs.<sup>50</sup> In another survey, a quarter of fathers and 22% of mothers report wanting to reduce their working hours permanently compared to prior to the pandemic, while an additional 17% of fathers and 13% of mothers want to pursue a less demanding job.<sup>51</sup> Childcare costs are going to rise in the coming years. The question will be whether it pushes more parents out of the labor force or whether policymakers help to ensure affordability and access to high quality care.

### **AFFORDABLE, HIGH QUALITY CHILDCARE AND EDUCATION DETERMINES FUTURE ECONOMIC GROWTH**

Parents want high quality affordable childcare because they realize that it allows them to raise their household's income through work and it develops skills in their children

that research has shown lead to higher lifetime earnings.<sup>52</sup> Research suggests that expanding early learning initiatives would create benefits to society of nearly \$9 for every \$1 invested, about half of which comes from higher earnings among the children who receive these investments.<sup>53</sup> If the returns are so great on early childhood education, why don't parents make these investments themselves? Research shows that it is their inability to afford high quality care and difficulty identifying quality among programs that limit kids' access to these important investments.<sup>54</sup>

The distinction between an inability to afford rather than an unwillingness to pay is important: parents would invest more in their children if they could. Parents with high incomes do invest more in their children. Lower income parents are aware of the benefits, but they simply cannot afford the high cost of high-quality programs. The result is unequal investment in children that fundamentally erodes the level playing field necessary for a competitive market economy to thrive.

### **CONCLUDING THOUGHTS**

Despite the lack of family-friendly policies like affordable childcare and paid parental leave, the United States has relied on women to fuel economic growth for decades. It is long past time for policy to recognize and support the contributions of women and the role of caregiving in society.

Economic growth comes from combining new ideas with workers, their energy and skills, and tools. Our inadequate support for families and children is failing

<sup>47</sup>Bassok, D., Fitzpatrick, M., Loeb, S., and Paglayan, A. S. (2013). The early childhood care and education workforce from 1990 through 2010: Changing dynamics and persistent concerns. *Education Finance and Policy*, 8(4), 581-601. [https://doi-org.proxy.lib.umich.edu/10.1162/EDFP\\_a\\_00114](https://doi-org.proxy.lib.umich.edu/10.1162/EDFP_a_00114).

<sup>48</sup>Economic Policy Institute. (2020). *Child care costs in the United States*. <https://www.epi.org/child-care-costs-in-the-united-states/>.

<sup>49</sup>Child Care Aware. (2022). *Demanding Change: Repairing our Child Care System*. <https://www.childcareaware.org/demanding-change-repairing-our-child-care-system/#Affordability>; Care.com. (2021, June 10). This is how much child care costs in 2021. <https://www.care.com/c/how-much-does-child-care-cost/>.

<sup>50</sup>Care.com. (2021, June 10). *This is how much child care costs in 2021*. <https://www.care.com/c/how-much-does-child-care-cost/>.

<sup>51</sup>Care.com. (2021, June 10). *This is how much child care costs in 2021*. <https://www.care.com/c/how-much-does-child-care-cost/>.

<sup>52</sup>Havnes, T., & Mogstad, M. (2011). No Child Left Behind: Subsidized Child Care and Children's Long-Run Outcomes. *American Economic Journal*, 3(2), 97-129. <https://www.aeaweb.org/articles?id=10.1257/pol.3.2.97>.

<sup>53</sup>Inequality in Early Childhood and Effective Public Policy Interventions. (2016). *In Economic Report of the President* (pp. 153-206). <https://www.govinfo.gov/content/pkg/ERP-2016/pdf/ERP-2016-chapter4.pdf>.

<sup>54</sup>Gordon, J., Hebster, C. M., Tekin, E. (2018). *Who's Minding the Kids? Experimental Evidence on the Demand for Child Care Quality*. National Bureau of Economic Research. <https://www.nber.org/papers/w25335>.

to invest in the human capital of workers. Research has shown that young children who grow up in stable homes, with adequate incomes, and get access to developmentally appropriate skills development throughout their lives grow up to be more productive workers. By focusing more attention on ensuring that the needs of children are met, policymakers can foster economic growth in the short run by allowing their parents to better devote their energy to paid work. And it fosters economic growth in the long run by ensuring that the next generation of workers are even better prepared to be productive workers.

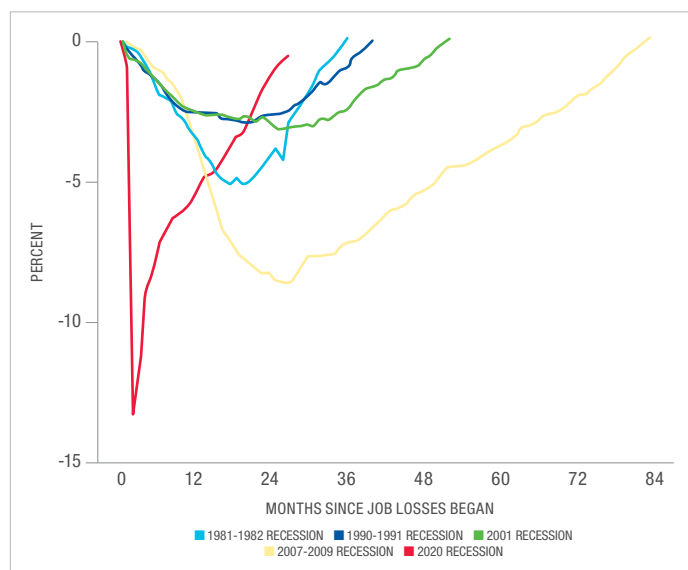
Ultimately, what matters for societal well-being is not overall economic growth, but economic growth per capita. And even then, we should not always seek to maximize GDP per capita. Reducing working hours to take time to enjoy life is consistent with maximizing well-being even if it does reduce GDP per capita. A society that has more space for all workers to take time off to look after their loved ones, care for themselves when they are sick, and even go on vacation builds a richer society in

terms of well-being and perhaps even in terms of productivity. The current approach in the United States of giving only the most highly compensated workers access to these “luxuries” has contributed to rising inequality. Moreover, it may be contributing to the high rates of burnout that American workers are reporting and the reluctance of workers in the bottom half of the income distribution to participate in the labor force.

People are at the heart of a society. Our youngest people depend on both their families and society to help them thrive. It is time for us to take advantage of the riches that the United States has amassed to ensure that our children do not go hungry, that our families have the support they need to focus on their work, and that they can care for their loved ones with less stress. Only with these supports can we ensure that the next generation has every opportunity to build their social, emotional, and cognitive skills. Policy changes are needed to better support working families and adapt to the modern workforce. These adjustments are ultimately essential to fostering inclusive economic growth.

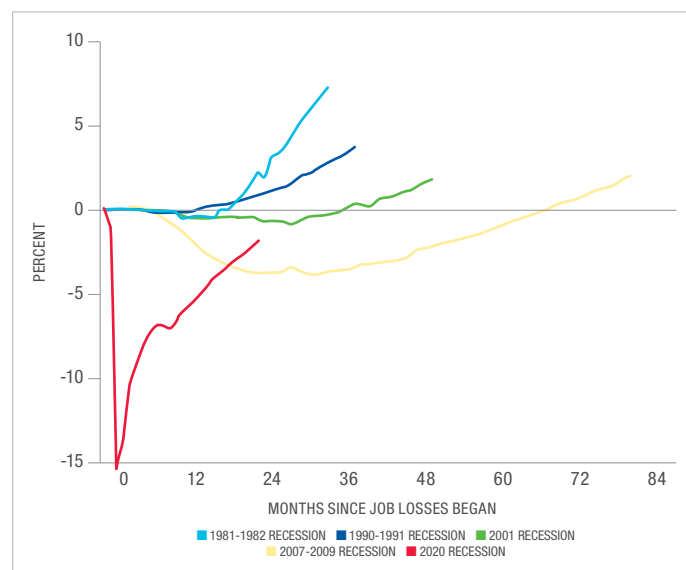
**Figure 1: Growth In Jobs Held by Women Has Previously Led Recoveries**

**Employment of Men Relative to Pre-Recession Peak**



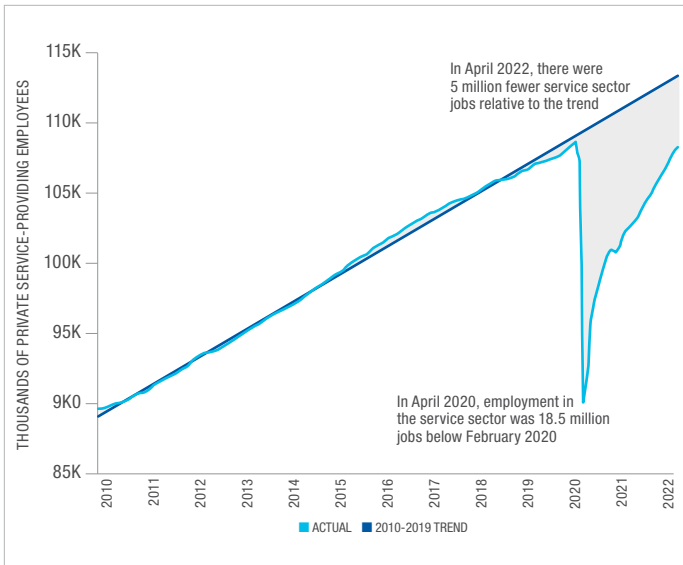
Source: U.S. Bureau of Labor Statistics. Created with Datawrapper.

**Employment of Women Relative to Pre-Recession Peak**



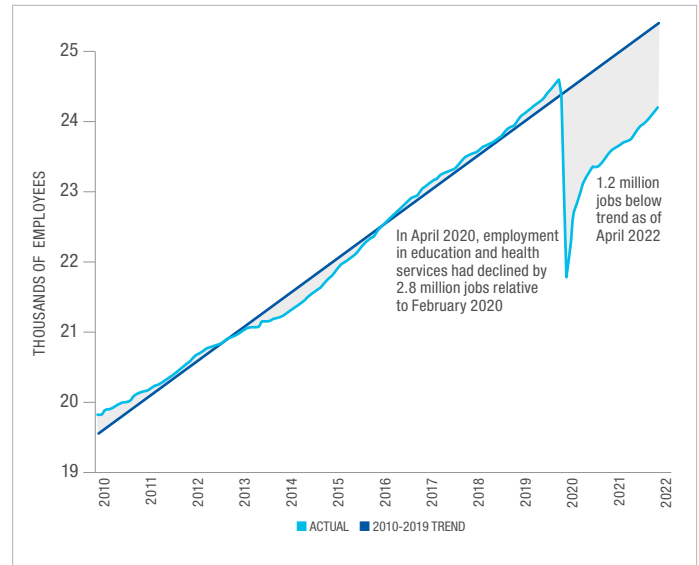
Source: U.S. Bureau of Labor Statistics. Created with Datawrapper.

**Figure 2: A Large Loss Of Service-Sector Jobs**



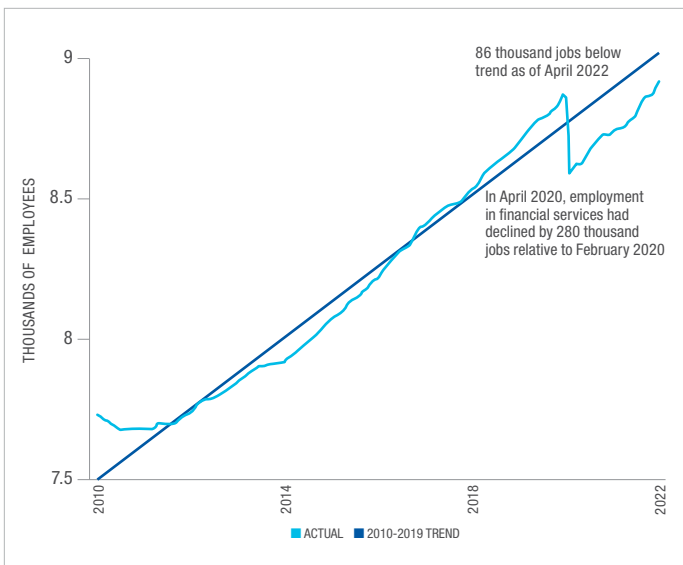
Source: BLS. Get the Data.

**Figure 3: Number of Health and Education Services Workers**



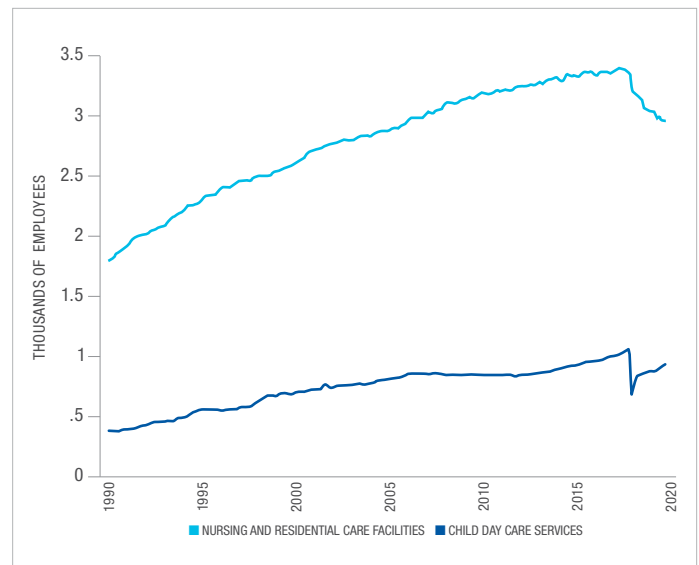
Source: BLS. Created with Datawrapper.

**Figure 4: Number of Financial Services Workers**



Source: BLS. Created with Datawrapper.

**Figure 5: Care Industries are Languishing**



Source: U.S. Bureau of Labor Statistics. Created with Datawrapper.

# The State of Democratic Capitalism: 2022

A ESSAY BY MICHAEL R. STRAIN (MAY 8, 2022)

The state of democratic capitalism is strong. Since the onset of the COVID-19 pandemic, the marriage of the U.S.'s democratic polity and free-market economy held firm because public policy allowed markets to allocate economic resources and generate wealth and because markets created economic opportunity for citizens to lead dignified lives through work. And the marriage is strong because of widespread recognition among American citizens and policymakers that market outcomes may not always be in the best interest of society as a whole, as defined by our collective citizenry and interpreted through democratic institutions. Public policies designed to advance opportunity and to make sure that no one falls too far typically strengthen democratic capitalism—this has been especially true during the past two pandemic years.

In this essay I will discuss some notable aspects of democratic capitalism during the recent past. My goal is not to be comprehensive, but to highlight some key aspects: wages, incomes, jobs, fiscal policy, and inflation. I will also discuss looming threats to the current economic expansion—including inflation, which has been driven in large part by an imbalance in our system of democratic capitalism in which our politics misunderstood fundamental economic constraints. In addition, I will assess the longer-term health of two of the foundational promises of democratic capitalism.

My subject here is *democratic capitalism*, but as I am an economist, most of the analysis that follows will be on the *capitalism* component. This essay is about economic issues

in the main. But where salient I will discuss issues at the intersection of economics, politics, and public policy.

## DEMOCRATIC CAPITALISM SINCE THE PANDEMIC

Two of the most important roles our society looks to markets to fulfill are to generate jobs and wage gains. Post-pandemic, the U.S. economy has certainly met that expectation. The number of payroll jobs is only 0.8 percent below its pre-pandemic level. Over the six-month period ending in April, the economy added 552,000 net new payroll jobs per month, a stunning pace that reflects voracious demand for workers on the part of employers. Indeed, there are nearly two job openings for every unemployed worker.

With employers needing to chase workers, it is not surprising that wages are growing rapidly. Average hourly wages throughout the economy are growing at an annual rate above five percent. Wages for the lowest-wage workers are growing 85 percent faster than wages at the top, according to the Federal Reserve Bank of Atlanta. Similarly, workers with college degrees are experiencing slower wage growth than those who do not have any formal education beyond the high-school level.

Wage gains are fueling increases in income. After-tax personal income (from all sources) was ten percent higher in January than in the month prior to the onset of the pandemic (February 2020). After accounting for inflation, after-tax personal income was up by around one percent.

While there is a lot of talk in the press about the “great resignation,” what I see in the labor market is better described as the “great move upward.” It is correct that more workers are quitting their jobs each month than has been the case during the two decades for which the Department of Labor has been collecting these data. But the same is also true for the number of workers who are hired each month. In March, for example, 4.5 million workers quit their jobs and 6.7 million workers were hired into new jobs. Changing jobs is a way to boost wages. According to the Atlanta Fed, wages for continuing workers who change jobs are growing around one-third faster than workers who stay at their current job.

Moreover, people are returning to the labor force, not permanently leaving it. In April, 62.2 percent of the working-age population were participating in the workforce, either employed or actively looking for a job. This is still almost two percent lower than prior to the pandemic, and does remain a blot on the recovery and one of the reasons the labor market is so tight. Still, it has finally begun improving.

After showing relatively no improvement since the end of the summer of 2020, people began moving from the sidelines into the workforce this fall. They were likely pulled back in through a combination of the receding pandemic, the expiration of generous pandemic-era unemployment benefits, dwindling savings, the start of the school year, and rapid wage growth.

Some people close to retirement age may have opted for early retirement as a consequence of the pandemic. If so, this will weigh on overall workforce participation, though recent evidence suggests that a good share of early retirements may have been temporary. Setting early retirements aside, the rate among the “prime-age” working population—people ages 25 to 54, who

are generally too old to be in school and too young to retire—is only one percent below its pre-pandemic level.

*Democratic* capitalism, and not simply capitalism, is in large part to thank for these outcomes. In the face of the economic consequences of the pandemic and associated restrictions on business activity, Congress passed legislation—most notably, the March 2020 landmark CARES Act, which passed the House of Representatives with a vote of 419 to 6 and which no senator voted against—which helped to prevent business failure and supported household income and spending.

The effect of the CARES Act was substantial. In the second quarter of 2020, for example, the economy contracted by a stunning nine percent relative to the same quarter one year before. In the same quarter, personal income *increased* by ten percent. On top of that, the poverty rate plunged. It wasn’t the free market alone that produced this extraordinary combination of outcomes. Public policy played a decisive role.

The response of market participants was impressive, as well. Even with help from the Paycheck Protection Program—designed in part to replace the revenue small businesses would lose during the pandemic—many economists, myself included, expected a wave of business failures as a consequence of lockdown orders. That wave never materialized in large part because of the creativity, resilience, and hard work of business owners and entrepreneurs. Similarly, households and workers responded with impressive resilience, balancing work and family life in the face of abrupt change and new challenges.

All in all, the time following the onset of the pandemic and through the end of 2020 was impressive in showing how public policy and market forces can complement



and support each other. Unfortunately, fiscal policy overshot around the turn of 2021. The \$900 billion economic stimulus and relief laws signed in December 2020 and the \$1.9 trillion American Rescue Plan signed in March 2021 provided considerably more support for the economy than it was able to absorb productively.

Payments to households and unemployed workers increased consumer demand in an environment that was already characterized by strong potential demand due to the pandemic fading, lockdown orders being lifted, over \$2 trillion in excess household savings (driven in part by previous stimulus laws), and unemployment falling. The supply side of the economy was unable to cope with this surge of demand, in part due to limits on the economy's underlying productivity capacity, generous unemployment benefits and remaining concern over the virus that held back labor supply, and pandemic-related supply chain disruptions.

The upshot of this supply-demand imbalance is more rapid consumer price inflation than the U.S. has experienced in the past four decades. Consumer prices are currently 11 percent higher than they were when the pandemic began. In March, the consumer price index was growing at an 8.6 percent annual rate—faster inflation than any month since the early 1980s. The latest reading of the Federal Reserve's preferred measure of inflation—derived from data on personal consumption expenditures and excluding volatile food and energy prices—shows 5.2 percent inflation.

Inflation is the biggest threat facing the economy today for three reasons. First, it is overwhelming wage gains for the majority of workers, such that the purchasing power of most workers' wages has declined even though their nominal pay has increased. It is stretching household budgets. It is making it harder for households to plan.

Households expect inflation to stay. According to a University of Michigan survey, the median household expects 5.4 percent inflation over the next year. These expectations have been increasing—six months ago, households expected 4.8 percent inflation over the coming year. This is troubling because expectations of inflation can be self-fulfilling if households demand higher wages today in response to their belief that prices will continue to rise rapidly, and if businesses raise prices in response to forecasts of higher labor costs.

So far, the economy has experienced boomflation. Economic output was 14 percent higher in the first quarter of 2022 than its pre-pandemic level. After adjusting for inflation beginning of this output had grown by four percent relative to its level prior to the onset of the pandemic. At the beginning of this year, gross domestic product was growing at an 11 percent annual rate—and was growing at a four percent rate after adjusting for inflation.

The second reason inflation is such a threat to the economy is that this period of boomflation likely is coming to an end. At some point, households will pull back on spending as inflation continues to reduce the purchasing power of their wages and salaries. The U.S. could find itself in a period of high prices, a slowing economy, and rising unemployment. Stagflation could even lead to a recession.

There are already signs that the U.S. is heading into a stagflationary environment. Consumer sentiment is lower today than it was during the pandemic, according to the University of Michigan's index. Sentiment hasn't been as low as it is today since the aftermath of the 2008 global financial crisis. Consumers are sour because prices are rising so rapidly, and periods of depressed consumer sentiment align with economic slowdowns.

Finally, the current inflationary environment threatens the economy because it increases the chances of a recession-inducing policy mistake by the Federal Reserve. One way to conceptualize the Fed's challenge is to dampen households' demand for goods and services enough to slow the rate of inflation, but not so much that the economy tips into recession. The challenge is that eight-percent inflation is so rapid. It's likely that the current economic expansion could not withstand the Fed doing what it would take to cool inflation to adequately near its two-percent target over the course of the next year. But not doing so risks inflation dynamics taking root even more firmly, which could require even more aggressive interest rate hikes in the future. The scope for a policy mistake in this environment is considerable.

Is the current inflationary environment a failure of *democratic* capitalism? To some extent, yes. The economy experienced (roughly) seven-percent inflation in 2021, and I calculate that the American Rescue Plan is responsible for three of those seven percentage points. For democratic capitalism—a system in which some of the most important goals of a democratic polity are achieved by free markets, and in which market activity and outcomes are influenced and altered by the will of the people expressed through democratic institutions and public policy—to be healthy, our political system needs to take economic constraints much more seriously than Congress did in the spring of 2021.

## TWO FOUNDATIONAL ISSUES

What I discussed in the previous section relates to the current business cycle. In the limited space I have for this essay, I also want to briefly discuss two foundational

promises of democratic capitalism: that workers receive their just deserts and that markets foster upward mobility.

Markets produce unequal outcomes, in which the wages of some workers and the incomes of some households are substantially higher than the wages and incomes of others. In a democratic society, this inequality is tolerable if it is understood to be driven at least in large part by differences in underlying economic (as distinct from moral) value held by certain workers due to the supply of and demand for their skills in labor markets and due to different choices made by different workers and households, including choices about education, occupation, effort, and attachment to the labor force.

Indeed, one of the central moral properties of the free-enterprise system—a moral property that allows capitalism to coexist with a democratic polity—is that workers receive their just deserts in the labor market. That they are rewarded fairly, according to the market value of their skills and their effort. Formulated as an economic question, the issue is whether worker compensation is determined by worker productivity, or whether it is determined by non-market forces like corporate power.

Of course, in the real world, the answer is all of the above:<sup>55</sup> wages are determined by market forces, by the relative bargaining power of workers, and by labor market institutions and regulations (like the minimum wage). But how large a role does productivity play in wage determination?

In my reading of the evidence,<sup>56</sup> a large one. This is a difficult question to answer empirically because data

<sup>55</sup>Clemens, J. & Strain, M. (2020). "Understanding 'Wage Theft': Evasion and Avoidance Responses to Minimum Wage increases. NBER.

<sup>56</sup>Strain, M. (2019) "The link between wages and productivity is strong." Aspen Institute. Retrieved from: <https://www.aspeninstitute.org/wp-content/uploads/2019/01/3.2-Pgs.-168-179-The-Link-Between-Wages-and-Productivity-is-Strong.pdf>.

on any individual worker's productivity is hard to come by. (What is the dollar value of the output per hour I generate for the American Enterprise Institute?) But economists have made progress on this question.

In a [2019 paper](#),<sup>57</sup> economists Anna M. Stansbury and Lawrence H. Summers confirm a substantial link between pay and productivity. Specifically, over the period 1973–2016, they find that a one percentage point increase in productivity growth is associated with 0.7 to 1 percentage point higher median and average compensation growth. Moreover, they cannot statistically reject the hypothesis that productivity growth maps to compensation growth one-to-one, but they can statistically reject the hypothesis that there is no relationship between the two. I would also highlight a [2020 paper](#)<sup>58</sup> by the late economist Edward P. Lazear which studies productivity at the industry level and compares industries that employ highly skilled (and presumably higher-productivity) workers with those that employ lesser-skilled workers. Over the period 1989–2017, Lazear found that pay actually increased faster than productivity in industries with lesser-skilled workers and slower than productivity in industries with higher-skilled workers. He concluded that “productivity inequality” may have grown faster than wage inequality over this period.

Compensation being determined by productivity is central to the health of democratic capitalism. On this score, democratic capitalism in the U.S. is in very good health. Another central issue is whether the market economy is delivering consistent increases in wages and living standards, and is fostering upward economic mobility.

Here too, I think the U.S. experience in recent decades has been strong, as I discuss in greater detail in my recent book, *The American Dream Is Not Dead: (But Populism Could Kill It)*.<sup>59</sup> In the three decades prior to the pandemic, wages for typical workers grew by one-third and median household income grew by nearly one-half after adjusted for inflation, taxes, and government transfers. Households in the bottom 20 percent of the income distribution saw their inflation-adjusted, post-tax-and-transfer income increase by two-thirds over this period. In the years following the Great Recession and prior to the pandemic, income inequality (as broadly measured by the Gini coefficient) stagnated or even declined. I also find substantial evidence of upward economic mobility in the United States. Around three-quarters of people in their 40s have higher inflation-adjusted household income than their parents did when their parents were of roughly the same age. Eighty-six percent of people raised in the bottom 20 percent have gone on to have higher incomes than their parents. Around eight in 10 men in their 40s who were raised in the bottom 20 percent have higher inflation-adjusted earnings than their fathers did when their fathers were of similar age.

There is much debate about the magnitude of these statistics, of course. For example, Harvard economist Raj Chetty and his colleagues find that only half of adults have higher income than their parents. Economists can debate the precise magnitudes, but the overall narrative of pessimism that exists outside of academic debate is so overstated as to be qualitatively incorrect.

## LOOMING THREATS TO DEMOCRATIC CAPITALISM

Inflation poses a looming risk to the current economic expansion. Similarly, there are risk on the horizon that

<sup>57</sup>Stansbury, A. & Summers, L. H. (2018). “Productivity and Pay: Is the Link Broken?” PIEE.

<sup>58</sup>Lazear, E. (2020). “Productivity and Wages: Common Factors and Idiosyncrasies across Countries and Industries.” NBER.

<sup>59</sup>Strain, M. (2020). *The American Dream is Not Dead (But Populism Could Kill It)*. Templeton Press.

pose a threat to the longer-term viability of democratic capitalism. There are many economic challenges. To name a few: too-slow productivity growth, a decline in dynamism and a diminished appetite for risk taking, falling rates of entrepreneurship, and an education and training system that is inadequate to the needs of 21st-century workers.

Liberalism is in retreat, both at home in the United States and abroad. Liberal society—characterized by free people, individual rights, government by the consent of the governed, equality under the law, and free markets—is an accomplishment to which democratic (free people) capitalism (free markets) contributes and from which it benefits. It can be lost. In the U.S., the growing influence

of economic nationalism and populism on the political right and of democratic socialism on the political left are each threats to the democratic-capitalist system that has produced so much prosperity and opportunity for the American people. A growing acceptance of authoritarian tendencies, a reluctance to embrace a competitive market in ideas, and a society more divided along racial and ethnic lines pose a threat to the basic social stability required for free people and free markets to thrive. These challenges are among our most pressing and most urgent.

*Michael R. Strain holds the Arthur F. Burns Chair in Political Economy at the American Enterprise Institute*

# Suggested Readings

“Capitalism for the Long-term”, Dominic Barton (Harvard Business Review, 2011)

“The Error at the Heart of Corporate Leadership”, Joseph Bower & Lynn Paine (Harvard Business Review, 2017)

*Value(s): Building a Better World for All*, Mark Carney (2021)

“The Biggest Contract”, Ian Davis (The Economist, May 2005)

*Grow the Pie: How Great Companies Deliver Purpose and Profit*, Alex Edmans (2020)

“Walking the Talk: Valuing a Multi-Stakeholder Strategy”, FCLTGlobal (2022)

*Reimagining Capitalism in a World On Fire*, Rebecca Henderson (2020)

“Whose Wages Are Rising and Why?”, Ryan Nunn and Jay Shambaugh, (Brookings, 2020)

*Can American Capitalism Survive? Why Greed is Not Good, Opportunity is Not Equal, and Fairness Won't Make Us Poor*, Steven Pearlstein (2018)

“Capitalism and the Future of Democracy”, Isabel Sawhill (Brookings Institution, 2019)

*The 10 Rules of Successful Nations*, Ruchir Sharma (2021)

“Economic Growth and Subjective Well-being: Reassessing the Easterlin Paradox”, Betsey Stevenson and Justin Wolfers (Brookings Institution, 2008)

*The American Dream is Not Dead (but Populism Could Kill it)*, Michael R. Strain (2019)

*The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public*, Lynn Stout (2012)

# Addendum: A Vision of Democratic Capitalism

Ideally, capitalism, the provider of the bulk of society's needs for goods and services, thrives in a free, competitive market where (i) investment decisions rely on and reflect market input, (ii) economic freedom coupled with disciplined individualism, innovative ingenuity, motivation and courage are critical ingredients, (iii) governments do not control or seek to influence or preempt private sector decisions, and (iv) governments provide law and order, pursue fiscal and monetary stability, enforce laws to preserve competitive markets, issue administrative regulations only to the extent they are justifiable, and establish a broad system of basic public, quality, affordable and accessible services and safety nets to insure equal opportunity and protection from misfortune while simultaneously striving to achieve generational equity.

Society looks to capitalism to (i) provide jobs, (ii) consistently generate wealth and growth sufficient for the government to fulfill its obligations, (iii) generate household labor income adequate for households to enjoy a constantly improving life style sustained by increasing GDP per capita, (iv) focus on individual merit, effort, potential and character rather than societal classifications thereby enabling and increasing social mobility and achievement of the American dream, (v) facilitate business's pursuit of innovative R&D to enable long-term investments required for the future, (vi) enable and encourage shareholders to invest in long term growth, and (vii) rely on corporate boards to temper market wisdom when incompatible with societal values, to recognize the need for fair compensation, and to respect and support the common good. How well capitalism is

fulfilling the principal needs of a democratic society is the standard which will determine capitalism's continuation as a country's economic system. In a democracy, that decision will be made by a majority of citizens eligible to vote.

Less obvious is the impact of the governmental role at the state and local levels in the regulation of cultural issues including education, family support, and tax policies which have an effect on fertility rates, the maturation process of young people and their preparation for adulthood, employment, and citizenship. In addition, the record of government's engagement in asset allocation is checkered compared to the success of the private sector and needs to be examined.

Neither capitalism nor democratic governments have consistently measured up to all of the foregoing standards. The success so far is remarkable, but a lot of work remains to be done. Repetitive shortcomings, such as executive compensation and questionable regulations, undermine trust in the system and are frequently exacerbated by the involvement of lobbyists serving as agents of crony capitalism. The future of capitalism is largely in the hands of corporate boards because they have the power to live up to the ideals articulated above—seek fair compensation, invest for long term wealth creation, maintain the competency to excel, and abide by values compatible with the common good. Failure to exercise this authority may induce the electorate to transfer authority to the government with adverse impacts on the vitality of capitalism and its ability to fulfill the needs of society. Shareholders also have a stake

in the future of capitalism but a large percentage of them own their shares derivatively through mutual funds and index funds which control the voting rights of the shares. A number of initiatives are in process to give investors in these funds a voice in how fund shares should be voted. If the point is reached where a significant percentage of investors control voting rights, they will also be held accountable for the future of capitalism. If, with the passage of time, they fail to fulfill this responsibility, it might ultimately lead legislators to question the rationale for continuation of the shareholder exemption from liability for corporate debt.

There is considerable turmoil in the U.S. and the world. The challenges are daunting for capitalism, governments,

and decision-makers of all types. Now is the time for realistic assumptions, clear thinking, and relevant fact-based decisions. Our goal is for the center and this report to be meaningful contributors to the achievement of those goals. Under the aegis of the Georgetown University Law Center and with the participation of other academic disciplines of the university, the Denny Center will use the conclusions of this initial report as a guide as we sponsor research papers, symposia and conferences to examine in greater depth issues in need of solutions. Boards, shareholders, and governments are center stage. Hopefully, each group will rise to the challenge and be able to achieve meaningful change.



*The DENNY CENTER for*  
*Democratic Capitalism*

GEORGETOWN LAW

---

The Denny Center for Democratic Capitalism at Georgetown Law  
600 New Jersey Avenue N.W. Washington, D.C. 20001  
dennycenter@georgetown.edu | 202-662-9366 |  @TheDennyCenter  
[www.law.georgetown.edu](http://www.law.georgetown.edu)