

**America's president writes for us about four crucial areas of unfinished business in economic policy that his successor will have to tackle.**



WHEREVER I go these days, at home or abroad, people ask me the same question: what is happening in the American political system? How has a country that has benefited—perhaps more than any other—from immigration, trade and technological innovation suddenly developed a strain of anti-immigrant, anti-innovation protectionism? Why have some on the far left and even more on the far right embraced a crude populism that promises a return to a past that is not possible to restore—and that, for most Americans, never existed at all?

It's true that a certain anxiety over the forces of globalisation, immigration, technology, even change itself, has taken hold in America. It's not new, nor is it dissimilar to a discontent spreading throughout the world, often manifested in scepticism towards international institutions, trade agreements and immigration. It can be seen in Britain's recent vote to leave the European Union and the rise of populist parties around the world.

Much of this discontent is driven by fears that are not fundamentally economic. The anti-immigrant, anti-Mexican, anti-Muslim and anti-refugee sentiment expressed by some Americans today echoes nativist lurches of the past—the Alien and Sedition Acts of 1798, the Know-Nothings of the mid-1800s, the anti-Asian sentiment in the late 19th and early 20th centuries, and any number of eras in which Americans were told they could restore past glory if they just got some group or idea that was threatening America under control. We overcame those fears and we will again.

But some of the discontent is rooted in legitimate concerns about long-term economic forces. Decades of declining productivity growth and rising inequality have resulted in slower income growth for low- and middle-income families. Globalisation and automation have weakened the position of workers and their ability to secure a decent wage. Too many potential physicists and engineers spend their careers shifting money around in the financial sector, instead of applying their talents to innovating in the real economy. And the financial crisis of 2008 only seemed to increase the isolation of corporations and elites, who often seem to live by a different set of rules to ordinary citizens.

So it's no wonder that so many are receptive to the argument that the game is rigged. But amid this understandable frustration, much of it fanned by politicians who would actually make the problem worse rather than better, it is important to remember that capitalism has been the greatest driver of prosperity and opportunity the world has ever known.

Over the past 25 years, the proportion of people living in extreme poverty has fallen from nearly 40% to under 10%. Last year, American households enjoyed the largest income gains on record and the poverty rate fell faster than at any point since the 1960s. Wages have risen faster in real terms during this business cycle than in any since the 1970s. These gains would have been impossible without the globalisation and technological transformation that drives some of the anxiety behind our current political debate.

This is the paradox that defines our world today. The world is more prosperous than ever before and yet our societies are marked by uncertainty and unease. So we have a choice—retreat into old, closed-off economies or press forward, acknowledging the inequality that can come with globalisation while committing ourselves to making the global economy work better for all people, not just those at the top.

A force for good

The profit motive can be a powerful force for the common good, driving businesses to create products that consumers rave about or motivating banks to lend to growing businesses. But, by itself, this will not lead to broadly shared prosperity and growth. Economists have long recognised that markets, left to their own devices, can fail. This can happen through the tendency towards monopoly and rent-seeking that this newspaper has documented, the failure of businesses to take into account the impact of their decisions on others through pollution, the ways in which disparities of information can leave consumers vulnerable to dangerous products or overly expensive health insurance.

More fundamentally, a capitalism shaped by the few and unaccountable to the many is a threat to all. Economies are more successful when we close the gap between rich and poor and growth is broadly based. A world in which 1% of humanity controls as much wealth as the other 99% will never be stable. Gaps between rich and poor are not new but just as the child in a slum can see the skyscraper nearby, technology allows anyone with a smartphone to see how the most privileged live. Expectations rise faster than governments can deliver and a pervasive sense of injustice undermines peoples' faith in the system. Without trust,

capitalism and markets cannot continue to deliver the gains they have delivered in the past centuries.

This paradox of progress and peril has been decades in the making. While I am proud of what my administration has accomplished these past eight years, I have always acknowledged that the work of perfecting our union would take far longer. The presidency is a **relay race**, requiring each of us to do our part to bring the country closer to its highest aspirations. So where does my successor go from here?

Further progress requires recognising that America's economy is an enormously complicated mechanism. As appealing as some more radical reforms can sound in the abstract—breaking up all the biggest banks or erecting prohibitively steep tariffs on imports—the economy is not an abstraction. It cannot simply be redesigned wholesale and put back together again without real consequences for real people.

Instead, fully restoring faith in an economy where hardworking Americans can get ahead requires addressing **four major structural challenges**: boosting **productivity** growth, combating rising **inequality**, ensuring that everyone who wants a **job** can get one and building a **resilient economy** that's primed for future growth.

### Restoring economic dynamism



First, in recent years, we have seen incredible technological advances through the internet, mobile broadband and devices, artificial intelligence, robotics, advanced materials, improvements in energy efficiency and personalised medicine. But while these **innovations have changed lives, they have not yet substantially boosted measured productivity growth**. Over the past decade, America has enjoyed the fastest productivity growth in the G7, but it

has slowed across nearly all advanced economies (see chart 1). Without a faster-growing economy, we will not be able to generate the wage gains people want, regardless of how we divide up the pie.

A major source of the **recent productivity slowdown has been a shortfall of public and private investment** caused, in part, by a hangover from the financial crisis. But it has also been caused by self-imposed constraints: an anti-tax ideology that rejects virtually all sources of new public funding; a fixation on deficits at the expense of the deferred maintenance bills we are passing to our children, particularly for infrastructure; and a political system so partisan that previously bipartisan ideas like bridge and airport upgrades are nonstarters.

We could also help **private investment and innovation with business-tax reform** that lowers statutory rates and closes loopholes, and with **public investments** in basic research and development. **Policies focused on education** are critical both for increasing economic growth and for ensuring that it is shared broadly. These include everything from boosting funding for early childhood education to improving high schools, making college more affordable and expanding high-quality job training.

Lifting productivity and wages also depends on **creating a global race to the top in rules for trade**. While some communities have suffered from foreign competition, trade has helped our economy much more than it has hurt. **Exports helped lead us out of the recession**. American firms that export pay their workers up to 18% more on average than companies that do not, according to a report by my Council of Economic Advisers. So, I will keep pushing for Congress to pass the Trans-Pacific Partnership and to conclude a Transatlantic Trade and Investment Partnership with the EU. These agreements, and stepped-up trade enforcement, will level the playing field for workers and businesses alike.

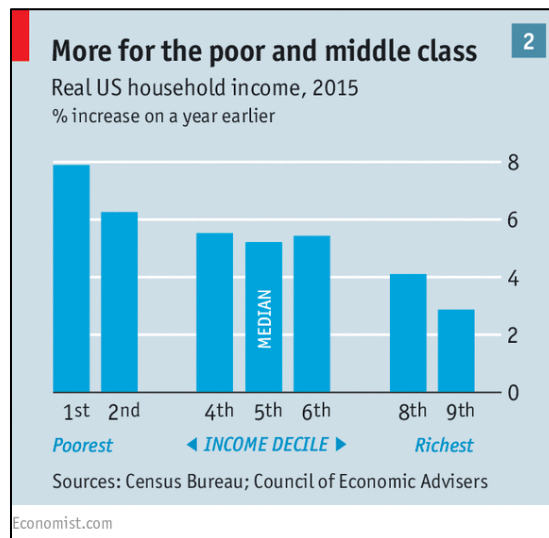
Second, alongside slowing productivity, **inequality has risen in most advanced economies**, with that increase most pronounced in the United States. In 1979, the top 1% of American families received 7% of all after-tax income. By 2007, that share had more than doubled to 17%. This challenges the very essence of who Americans are as a people. We don't begrudge success, we aspire to it and admire those who achieve it. In fact, we've often accepted more inequality than many other nations because we are convinced that with **hard work**, we can improve our own station and watch our children do even better.

As Abraham Lincoln said, "while we do not propose any war upon capital, we do wish to allow the humblest man an equal chance to get rich with everybody else." That's the problem with **increased inequality—it diminishes upward mobility**. It makes the top and bottom rungs of the ladder "stickier"—harder to move up and harder to lose your place at the top.

Economists have listed many causes for the rise of inequality: technology, education, globalisation, declining unions and a falling minimum wage. There is something to all of these and we've made real progress on all these fronts. But I believe that **changes in culture and values have also played a major role**. In the past, differences in pay between corporate executives and their workers were constrained by a greater degree of social interaction between employees at all levels—at church, at their children's schools, in civic organisations.

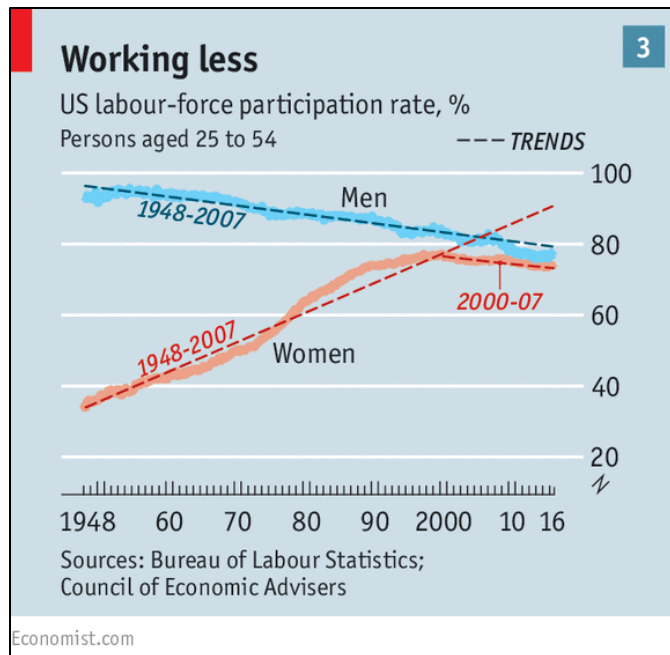
That's why CEOs took home about 20- to 30-times as much as their average worker. The reduction or elimination of this constraining factor is one reason why today's CEO is now paid over 250-times more.

**Economies are more successful when we close the gap between rich and poor and growth is broadly based.** This is not just a moral argument. Research shows that growth is more fragile and recessions more frequent in countries with greater inequality. Concentrated wealth at the top means less of the broad-based consumer spending that drives market economies.



America has shown that progress is possible. Last year, income gains were larger for households at the bottom and middle of the income distribution than for those at the top (see chart 2). Under my administration, we will have boosted incomes for families in the bottom fifth of the income distribution by 18% by 2017, while raising the average tax rates on households projected to earn over \$8m per year—the top 0.1%—by nearly 7 percentage points, based on calculations by the Department of the Treasury. While the top 1% of households now pay more of their fair share, tax changes enacted during my administration have increased the share of income received by all other families by more than the tax changes in any previous administration since at least 1960.

Even these efforts fall well short. In the future, we need to be even more aggressive in enacting measures to reverse the decades-long rise in inequality. Unions should play a critical role. They help workers get a bigger slice of the pie but they need to be flexible enough to adapt to global competition. Raising the Federal minimum wage, expanding the Earned Income Tax Credit for workers without dependent children, limiting tax breaks for high-income households, preventing colleges from pricing out hardworking students, and ensuring men and women get equal pay for equal work would help to move us in the right direction too.



Third, a successful economy also depends on **meaningful opportunities for work** for everyone who wants a job. However, America has faced a long-term decline in participation among prime-age workers (see chart 3). In 1953, just 3% of men between 25 and 54 years old were out of the labour force. Today, it is 12%. In 1999, 23% of prime-age women were out of the labour force. Today, it is 26%. People joining or rejoining the workforce in a strengthening economy have offset ageing and retiring baby-boomers since the end of 2013, stabilising the participation rate but not reversing the longer-term adverse trend.

**Involuntary joblessness takes a toll on life satisfaction, self-esteem, physical health and mortality.** It is related to a devastating rise of opioid abuse and an associated increase in overdose deaths and suicides among non-college-educated Americans—the group where labour-force participation has fallen most precipitously.

There are many ways to keep more Americans in the labour market when they fall on hard times. These include providing **wage insurance** for workers who cannot get a new job that pays as much as their old one. Increasing access to high-quality community colleges, proven job-training models and help finding new jobs would assist. So would making unemployment insurance available to more workers. Paid leave and guaranteed sick days, as well as greater access to high-quality child care and early learning, would add flexibility for employees and employers. **Reforms to our criminal-justice system and improvements to re-entry** into the workforce that have won bipartisan support would also improve participation, if enacted.

### Building a sturdier foundation

Finally, the financial crisis painfully underscored the need for a more resilient economy, one that grows sustainably without plundering the future at the service of the present. There should no longer be any doubt that a free market only thrives when there are rules to guard against systemic failure and ensure fair competition.

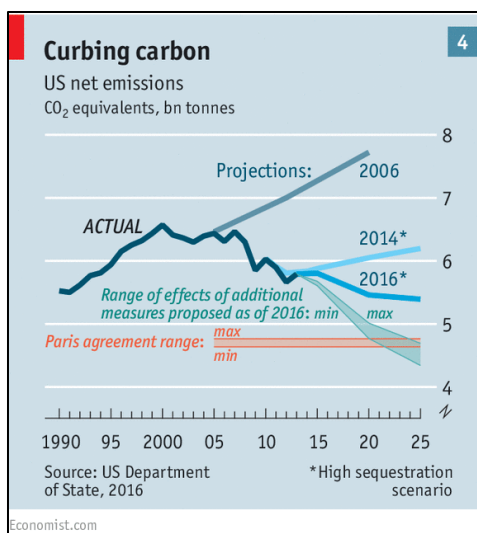


Post-crisis reforms to Wall Street have made our financial system more stable and supportive of long-term growth, including more capital for American banks, less reliance on short-term funding, and better oversight for a range of institutions and markets. Big American financial institutions no longer get the type of easier funding they got before—evidence that the market increasingly understands that they are no longer “too big to fail”. And we created a first-of-its-kind watchdog—the Consumer Financial Protection Bureau—to hold financial institutions accountable, so their customers get loans they can repay with clear terms up-front.

But even with all the progress, segments of the **shadow banking system** still present vulnerabilities and the housing-finance system has not been reformed. That should be an argument for building on what we have already done, not undoing it. And those who should be rising in defence of further reform too often ignore the progress we have made, instead choosing to condemn the system as a whole. Americans should debate how best to build on these rules, but denying that progress leaves us more vulnerable, not less so.

America should also do more to prepare for negative shocks before they occur. With today’s low interest rates, fiscal policy must play a bigger role in combating future downturns; **monetary policy should not bear the full burden of stabilising our economy**. Unfortunately, **good economics can be overridden by bad politics**. My administration secured much more fiscal expansion than many appreciated in recovering from our crisis—more than a dozen bills provided \$1.4 trillion in economic support from 2009 to 2012—but fighting Congress for each commonsense measure expended substantial energy. I did not get some of the expansions I sought and Congress forced austerity on the economy prematurely by threatening a historic debt default. My successors should not have to fight for emergency measures in a time of need. Instead, support for the hardest-hit families and the economy, like unemployment insurance, should rise automatically.

Maintaining fiscal discipline in good times to expand support for the economy when needed and to meet our long-term obligations to our citizens is vital. Curbs to entitlement growth that build on the Affordable Care Act’s progress in reducing health-care costs and limiting tax breaks for the most fortunate can address long-term fiscal challenges without sacrificing investments in growth and opportunity.



Finally, **sustainable economic growth requires addressing climate change**. Over the past five years, the notion of a trade-off between increasing growth and reducing emissions has been put to rest. America has cut energy-sector emissions by 6%, even as our economy has grown by 11% (see chart 4). Progress in America also helped catalyse the historic Paris climate agreement, which presents the best opportunity to save the planet for future generations.

### A hope for the future

America's political system can be frustrating. Believe me, I know. But it has been the source of more than two centuries of economic and social progress. The progress of the past eight years should also give the world some measure of hope. Despite all manner of division and discord, a second Great Depression was prevented. The financial system was stabilised without costing taxpayers a dime and the auto industry rescued. I enacted a larger and more front-loaded fiscal stimulus than even President Roosevelt's New Deal and oversaw the most comprehensive rewriting of the rules of the financial system since the 1930s, as well as reforming health care and introducing new rules cutting emissions from vehicles and power plants.

The results are clear: a more durable, growing economy; 15m new private-sector jobs since early 2010; rising wages, falling poverty, and the beginnings of a reversal in inequality; 20m more Americans with health insurance, while health-care costs grow at the slowest rate in 50 years; annual deficits cut by nearly three-quarters; and declining carbon emissions.

For all the work that remains, a new foundation is laid. A new future is ours to write. It must be one of economic growth that's not only sustainable but shared. To achieve it America must stay committed to working with all nations to build stronger and more prosperous economies for all our citizens for generations to come.