Delivering on promises to the middle class

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US President Donald Trump owes his electoral victory largely to the older white middle- and working-class voters who have missed out on many of the benefits of the economic-growth patterns of the last three decades. Yet his administration is preparing to pursue an economic program that, while positive in some respects, will not deliver the reversal of economic fortune his key constituency was promised.

Trump gave voice to a group of voters who had long faced worsening job prospects and stagnant or even declining real incomes – trends that have accelerated since 2000. As the number of middle-class jobs fell, the middle-income group shrank, exacerbating income polarization. This phenomenon, while particularly severe in the United States and the United Kingdom, can be seen in various forms throughout the developed world.

The economic challenges facing developed-country middle classes are largely the result of two factors: the rapid loss of white- and blue-collar routine jobs to automation, and the shift of middle and lower value-added jobs to countries with lower labor costs. The latter pattern depressed income and wage growth not only in the tradable sector directly, but also in the non-tradable service sectors, owing to the spillover of displaced labor.

The result was surplus labor conditions in the middle- and lower-middle-income ranges, not dissimilar to the surplus labor in early-stage developing countries, where it suppresses income growth (for a period of time) even as the economy expands. A decline in the bargaining power of labor and a falling real minimum wage may have also contributed to income polarization, though these are probably secondary factors.

Though the challenges facing the middle class are well documented, US leaders have largely failed to recognize fully the struggles of middle-class households, much less implement effective countermeasures. This has contributed to a growing sense of hopelessness – particularly among men – which has manifested in rising non-participation in the workforce, aggravated health problems, drug abuse, elevated suicide rates, and anti-government sentiment.

Countries that experience high and rising economic inequality often face political instability and policy dysfunction. As policymaking becomes erratic, loses credibility, and becomes choked by gridlock, growth suffers, and the chances of achieving a prosperous form of inclusiveness decline. The result is a vicious circle, in which government finds it increasingly difficult to do what is needed.

But government intervention is crucial to tackle the problems facing developed-country workers today, which markets can't address alone. Whether by renegotiating trade arrangements, investing in infrastructure and human capital, or facilitating redistribution, government must work proactively to achieve a rebalancing of growth patterns.

The Trump administration now faces at least two major challenges. The first is to steer the political process away from paralyzing polarization, toward some vision of an achievable and more inclusive growth pattern. The second challenge – conditional on achieving the first – is to respond to the legitimate concerns of the voters who helped Trump reach office.

On the first challenge, the signs so far are not encouraging. The electoral process is essentially a zero-sum game for the participants. But governance is not a zero-sum game. Treating it that way produces gridlock, political fragmentation, and inaction, undermining efforts to address critical challenges.

To be sure, elements of the Trump administration's proposed economic policy, if implemented, would surely have a positive impact. For example, with the support of a Republican-dominated Congress, the Trump administration could finally be able to end America's excessive reliance on monetary policy to support growth and employment.

Moreover, the public-sector investment in infrastructure and human capital that Trump has promised, if properly targeted, would raise returns on – and thus the level of – private-sector investment, with tax and regulatory reform providing an additional boost. Some renegotiation of trade and investment agreements could also help to redistribute the costs and benefits of globalization, though any changes should fall well short of protectionism. And the impact of the Trump administration's economic policies is likely to be buoyed by the economy's natural structural adaptation to technological development.

But this will not be enough to combat the forces that have been squeezing American workers. Even if the Trump administration manages to boost economic growth, thereby diminishing the "surplus labor" effect and generating jobs, the labor market will struggle to keep up. At a time of rapid and profound technological transformation, the US also needs a strong commitment from the public and private sectors to help workers adapt.

A useful first step would be substantially increased support for training, retraining, and skills upgrading. In his book *Failure to Adjust*, Ted Alden, a fellow at the Council on Foreign Relations, observes that the US spends just 0.1% of its GDP on retraining, compared to 2% in Denmark. And Denmark and its Nordic counterparts seem to have done better than most in balancing imperatives like efficiency, dynamism, structural flexibility, competitiveness, and economic openness with the need for social-security systems that support adaptation to a shifting employment environment.

Furthermore, some income redistribution will be needed, in order to enable low-income workers to invest in themselves – which is impossible when they have just enough to cover their basic needs. Here, conditional cash transfers for training and skills acquisition could be beneficial.

Universal access to high-quality education is also critical. Right now, when some part of the US educational system fails, the well-off bail out to the private system, and the rest are left behind. That's individually rational, but collectively suboptimal. Indeed, without high-quality education at all levels – from preschool through university or the equivalent professional training – it is nearly impossible to achieve inclusive growth patterns.

Finally, the Trump administration should rethink its proposed deep cuts to funding for basic research, which would undermine innovation and economic dynamism down the road. While weeding out less promising programs is certainly acceptable, as is fighting vested interests, the money saved should be redirected to more promising areas within the sphere of basic research.

The Trump administration's current economic plan may be pro-growth, but it is incomplete on inclusiveness. Shifts in trade policy cannot be depended on to rebalance growth patterns in favor of middle- and lower-income households. They may even pose a risk to growth.

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