THE AMERICAN
The Journal of the American Enterprise Institute

The American Scene

By THE AMERICAN
From the Magazine: Tuesday, January 6, 2009

Filed under: Culture, Public Square

His and her happiness, giving Grant his due, the global middle-class boom, and more.

Healthy Choice

Allowing consumers to buy health insurance across state lines would help expand coverage.

We went to press before Election Day, so we don't know whether to congratulate President-elect McCain or President-elect Obama. But we do know that the next administration, Republican or Democratic, will seek to reduce the number of Americans without health insurance.

Here's one suggestion: let consumers purchase their health insurance policies across state lines. In recent years, Senator Jim DeMint (R-SC) and Representative John Shadegg (R-AZ) have introduced legislation that would do just that. Candidate McCain made the idea a centerpiece of his healthcare platform. A new study from the University of Minnesota estimates that creating a national marketplace for health insurance would boost the number of insured Americans by a minimum of nearly 2.8 million and by a maximum of almost 17 million. The moderate expected effect would be an increase of more than 12 million.

The gains would be largest in heavily regulated states where mandates have inflated the costs of insurance. In New Jersey, for example, a national marketplace for health insurance would swell the number of insured by 49 percent. Oregon, Massachusetts, New York, and West Virginia would see increases of 25 percent, 23 percent, 22 percent, and 21 percent, respectively.

If such a national marketplace were combined with the health insurance tax deduction that President Bush proposed in his 2007 State of the Union Address—$7,500 for individuals and $15,000 for families—the jump in overall coverage would be even greater. According to the University of Minnesota study, "For the individual market, the combination of these two policies is fairly substantial with a 70 percent reduction in the uninsured among those earning less than $45,000 a year. "

The combination of a national marketplace with the aforementioned tax deduction would increase health insurance coverage by a remarkable 79 percent in New Jersey, by 44 percent in Massachusetts, by 44 percent in West Virginia, by 41 percent in New York, by 38 percent in Maryland, and by 36 percent in Oregon.

Source: Stephen T. Parente, Roger Feldman, Jean Abraham, and Yi Xu, "Consumer Response to a National Marketplace for Individual Insurance," June 2008.

The Global Middle Gets Bigger

Despite all the gloomy economic news, the world's middle class is expanding rapidly and global inequality is falling.

Amid severe financial turmoil and fears of a global recession, it is easy to lose sight of the more encouraging international economic trends, such as a rapidly expanding middle class and falling inequality. As a Goldman Sachs study points out, "we are in the middle of an unprecedented explosion in what might be considered a 'world middle class,' which we define as those with incomes between $6,000 and $30,000 in PPP [purchasing power parity] terms. And global income distribution is getting narrower, not wider."

According to Goldman authors Dominic Wilson and Raluca Dragusanu, "an astonishing two billion people could join the global middle class by 2030! At around 30 percent of the world's population, this dwarfs even the 19th-century middle-class explosion in its global scale." Wilson and Dragusanu estimate that the global Gini coefficient (a measurement of relative inequality that gets smaller as inequality decreases) has declined from approximately 71 percent around 1970 to under 64 percent today. In terms of poverty reduction, "the percentage of people living with less than $1,000 per year" (as measured "in 2007 international dollars") has dropped "from close to 50 percent in the 1970s to 30 percent in the 1990s, to 17 percent in 2000." The Goldman authors project that it will fall to 6 percent by 2015.

Source: Dominic Wilson and Raluca Dragusanu, "The Expanding Middle: The Exploding World Middle Class and Falling Global Inequality," Goldman Sachs Global Economics Paper, July 2008.

Closing the Happiness Gap

Are Americans happier today than they were in the 1970s and 1980s?

Since the early 1970s, the General Social Survey has offered an annual update on America's gross national happiness. In a new paper, Wharton economists Betsey Stevenson and Justin Wolfers note some interesting trends.

"We find that, on average, happiness has failed to grow since the 1970s." Indeed, there has been "a small, statistically significant overall decline in average happiness" since the late 1980s. But the relative happiness of certain demographic groups has changed: "Two-thirds of the blackwhite happiness gap has been eroded, and the gender happiness gap has disappeared entirely, with more recent data suggesting that it may even have inverted. Paralleling changes in the income distribution, differences in happiness by education have widened substantially."

In the early 1970s, women were, on balance, happier than men. Today, however, "women typically report lower levels of happiness than men."

What about overall happiness inequality? Stevenson and Wolfers reckon that it "declined until the mid- or late 1980s, despite the fact that both income and consumption inequality rose through most of this period. Subsequently, happiness inequality rose through the 1990s, although the most recent estimates of inequality still remain below the higher levels seen in the early 1970s. These movements are quite substantial, as we observe an initial decline in the variance of happiness of about 25 percent from the early 1970s to the late 1980s, followed by a rise of about 10 percent by the mid-2000s."

Source: Betsey Stevenson and Justin Wolfers, "Happiness Inequality in the United States," National Bureau of Economic Research Working Paper, August 2008.

Jumping on the 'Change' Bandwagon
Slashing corporate taxes is one type of change that has proved remarkably popular across the world. When will the United States start catching up?

A few months ago, we noted that countries around the world were slashing corporate income taxes at a furious pace. Since then, the turmoil on Wall Street has worsened—which makes the case for cutting U.S. business taxes even stronger.

In its latest "Corporate and Indirect Tax Rate Survey," the accounting firm KPMG found that "average corporate tax rates among the 106 countries surveyed this year have fallen again, from 26.8 percent in 2007 to 25.9 percent in 2008." The average rate among European Union members dropped to 23.2 percent, while the averages in Latin America and the Asia-Pacific region fell to 26.6 percent and 28.4 percent, respectively.

Compare those figures to the net effective corporate tax rate in the United States—roughly 40 percent, according to KPMG (though "the effective rate may vary significantly depending on the locality in which a corporation conducts business"). With the exception of Japan, America has the highest rate in the developed world. Despite a brief dip earlier this decade, the effective U.S. rate in April 2008 was virtually the same as it had been in January 1999.

Over that same period, consider what other Western countries did. Between January 1999 and April 2008, corporate tax rates fell from 36 percent to 30 percent in Australia; from 32 percent to 25 percent in Denmark; from 40 percent to 33.33 percent in France; from over 52 percent to under 30 percent in Germany; from 35 percent to 25.5 percent in Holland; from 28 percent to 12.5 percent in Ireland; from 41.25 percent to 31.4 percent in Italy; from 33 percent to 30 percent in New Zealand; from 35 percent to 30 percent in Spain; and from 31 percent to 28 percent in the United Kingdom.

Our current political climate is marked by a perceived need for "change." Reducing corporate taxes is one type of change—economically sensible change—that has proved remarkably popular across the world. When will the United States start catching up?

Source: "KPMG's Corporate and Indirect Tax Rate Survey 2008," August 2008.

The Human Capital Factor
Economists Jaison R. Abel and Todd M. Gabe confirm that 'educational attainment has a positive effect on GDP per capita in urban America.'

In an interesting report, economists Jaison R. Abel of the New York Fed and Todd M. Gabe of the University of Maine examine the linkage between human capital and economic activity in American cities. They conclude that "differences in the amount of human capital across metropolitan areas…may explain much of the difference observed in average GDP per capita." More specifically, "a one-percentage point increase in the proportion of residents with a college degree is associated with a 2.3 percent increase in U.S. metropolitan area GDP per capita."

Abel and Gabe note that "the level of economic activity is also determined by the types of knowledge possessed by workers located within the region. Specifically, we find that the percentage of a metropolitan area's workforce in the knowledge- based occupation clusters of 'executives and managers,' 'financial and legal,' 'information technology,' and 'artists and designers' have a positive and statistically significant effect on GDP per capita. Further analysis shows that knowledge in specific areas such as administration and management, economics and accounting, mathematics, computers and electronics, and telecommunications are particularly important drivers of economic activity in urban America."

Source: Jaison R. Abel and Todd M. Gabe, "Human Capital and Economic Activity in Urban America," Federal Reserve Bank of New York Staff Report, July 2008.

Measuring American Generosity
Why traditional foreign aid statistics are misleading

Official development assistance (ODA) is the traditional yardstick for measuring foreign aid. As a percentage of its GDP, America's ODA is relatively low. But as former White House aide and State Department official Don Eberly notes in his new book, *The Rise of Global Civil Society*, the ODA-to-GDP ratio paints a misleading picture of American generosity.

"America's commitment of private sector resources far exceeds that of other nations and is growing every year, with private contributions to developing countries representing 62 percent of all worldwide charitable contributions," Eberly writes. Such private sector donations do not count as ODA. In other words, the "official" foreign aid data exclude "the many forms of engagement sponsored by the American private sector, including philanthropies, universities, businesses, and hundreds of religious and humanitarian enterprises that are producing results, often more effectively than government assistance programs."

"According to the most recent survey," Eberly observes, "Americans give over $250 billion annually to private

charity." A few years ago, the American private sector donated around $1.6 billion to help with tsunami reconstruction, an amount that represented "the most generous outpouring of private assistance in American history" and also "far exceeded the $657 million in public monies appropriated by Congress." But not a dollar of it counted as ODA.

Eberly places private charity in a broader international context. "Two decades ago, 70 percent of the resource flow to developing countries was official development assistance, whereas today, over 80 percent of all outflows come in the form of private philanthropy, remittances, and foreign direct investment. The accusation of American stinginess misses this point. Neither does it account for the full range of nonfinancial support that flows to the needy from American schools, universities, and religious organizations in the form of knowledge products, technology, and powerful NGO partnerships."

Source: Don Eberly, "The Rise of Global Civil Society: Building Communities and Nations from the Bottom Up" (Encounter Books, 323 pp., $27.95).

Ranking the Presidents

Presidential scholar Alvin Felzenberg offers a fascinating and provocative new list of America's best and worst chief executives.

What criteria should we employ to rank American presidents? In a fascinating new book, presidential scholar Alvin Felzenberg lays out six: "character," "vision," "competence," "economic policy," "preserving and extending liberty," and "defense, national security, and foreign policy."

Not surprisingly, Felzenberg deems Abraham Lincoln (#1) and George Washington (#2) America's two greatest presidents. They are followed by Theodore Roosevelt and Ronald Reagan (who tie for #3); Dwight Eisenhower (#5); Franklin Roosevelt (#6); and a five-way tie for seventh place among Zachary Taylor, Ulysses S. Grant, William McKinley, Harry Truman, and John F. Kennedy. (Felzenberg does not evaluate George W. Bush, nor does he grade the two presidents who died within a year of taking office).

All readers will have their quibbles with the list. But Felzenberg's book is well researched and thought provoking. We were struck, in particular, by his efforts to boost the reputations of Presidents Taylor, Grant, Calvin Coolidge, and Benjamin Harrison, all of whom the author regards as underrated and underappreciated.

Had Taylor not died 16 months into his presidency, he "might well have killed secessionist agitation in its cradle." Coolidge and Harrison both get high marks on character. As Felzenberg points out, Harrison fought (unsuccessfully) to guarantee African-American voting rights and was "the first president to call for a federal antilynching law." Civil rights icon Frederick Douglass gave Harrison high praise: "To my mind," Douglass said, "we never had a better president."

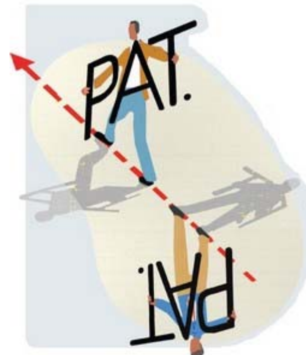
Grant, meanwhile, "was the last president before Dwight D. Eisenhower to send federal troops to the South to protect the right of blacks to vote." He "destroyed" the earliest version of the Ku Klux Klan and signed the Civil Rights Act of 1875. His administration was plagued by scandals, but "when compared to scandals of more recent vintage, those that transpired under Grant were of short duration, inflicted no long-term damage on governmental institutions, did not involve Grant personally, and did not encroach upon the civil liberties of other Americans."

Source: Alvin Stephen Felzenberg, "The Leaders We Deserved (and a Few We Didn't): Rethinking the Presidential Rating Game" (Basic Books, 480 pp., $29.95).

Immigrants and Innovation

What is the connection between skilled immigration and U.S. patenting?

According to economists Jennifer Hunt of McGill University and Marjolaine Gauthier-Loiselle of Princeton, skilled immigrants have had a substantial effect on the number of patents per capita in the United States. "We find that a college graduate immigrant contributes at least twice as much to patenting as his or her native counterpart," they write. "The difference is fully explained by the greater share of immigrants with science and engineering education, implying immigrants are not innately more able than natives."



Between 1990 and 2000, "The 1.3 percentage point increase in the share of the population composed of immigrant college graduates increased patenting per capita by about 20 percent. The 0.7 percentage point increase in the share of post-college immigrants increased patenting per capita by about 21 percent, and the 0.45 percentage point increase in immigrant scientists and engineers increased patenting per capita by about 22 percent."

Could it be that these immigrants are merely crowding out native-born Americans? If so, their actual impact on U.S. innovation would be overstated by the above statistics. But Hunt and Gauthier-Loiselle "do not find evidence that immigrants crowd out natives from certain occupations or states," and they conclude that "immigrants increase patenting per capita without reducing native patenting."

Source: Jennifer Hunt and Marjolaine Gauthier-Loiselle, "How Much Does Immigration Boost Innovation?" National Bureau of Economic Research Working Paper, September 2008.

A Closer Look at Middle-Class 'Stagnation'

The data are more complicated than you've been told.

Has the American middle class been stagnating? It's a claim we heard nearly every day during the 2008 election campaign. Writing in Fedgazette, a publication of the Federal Reserve Bank of Minneapolis, editor Ronald A. Wirtz and Minneapolis Fed senior economist Terry J. Fitzgerald show that the middle class has been doing much better than commonly assumed.

As Wirtz and Fitzgerald observe, "many reports that fret over sluggish income growth adjust for inflation using the consumer price index. Though logical at face value, the CPI has long been criticized—for example, by the Boskin Commission in 1996—for likely overstating inflation, possibly by as much as 1

percent or more per year. The personal consumption expenditures deflator (used in this analysis) is widely believed to be a more accurate gauge of inflation over time. Such a matter might seem trivial, but in the long term it becomes significant. When income figures are adjusted using the PCE, nationwide median household income growth from 1979 to 2006 jumps to 20 percent—seven percentage points higher than the same income figures that use the CPI."

Wirtz and Fitzgerald offer a detailed analysis of income trends in the Ninth Federal Reserve District, which encompasses Minnesota, Montana, North Dakota, South Dakota, Michigan's upper peninsula, and northwestern Wisconsin. After adjusting for inflation with the PCE, they report that between 1979 and 2006, the median income of married households in the Ninth District grew by 32 percent, which is "15 percentage points greater than the district's overall (adjusted) median income growth of 17 percent."

Wirtz and Fitzgerald also distinguish between "money income" and "personal income," the latter of which includes "employment-based fringe benefits" such as health insurance coverage and 401(k) contributions. Among Ninth District households, "Growth in personal income exceeds that of money income by about 10 percentage points over the period studied in this analysis [1979 to 2006], which suggests that real median household income has grown more than Census money income figures indicate."

If we adjust for PCE inflation, household composition, and total compensation, it appears that between 1979 and 2006, "median household income growth for most household types in the district" ranged from "25 percent to 50 percent." These figures provide "pretty strong evidence that middle America has not stagnated over the past generation."

Source: Ronald A. Wirtz and Terry J. Fitzgerald, "Say hello to the modest good life for me," Fedgazette, September 2008.

What You Don't Hear About CEO Pay
Before increasing regulations on corporate America, U.S. lawmakers should get the full story on executive compensation.

A recent study by Watson Wyatt Worldwide consultants Ira T. Kay and Steven Van Putten should be mandatory reading for all U.S. lawmakers eager to slap new federal regulations on CEO pay.

Amid much howling about boardroom cronyism and corporate greed, Kay and Van Putten help put executive compensation in perspective. They show that the current system—the "pay-for-performance" model—is working effectively: in other words, "pay levels track corporate performance." Are there instances where certain executives are wildly overpaid? Of course. But Kay and Van Putten reckon that such anomalies can be addressed "without regulating the overall market and abandoning the core model of pay-for-performance." Indeed, "various external and competitive pressures already work effectively to reform executive pay practices over time."

Kay and Van Putten analyzed "the relationship between the total return to shareholders generated by companies and the related stock option compensation for executives. A review of the largest 1,088 companies in the United States in 2006 shows that the higher-performing companies provided larger stock option profits to executives and the largest increase in stock option profits over the prior year. Thus, executives in companies that performed well were rewarded for that better performance."

While executive compensation packages often seem exorbitant, "CEO pay is a very small part of the overall cost structure of companies." Kay and Van Putten "compare[d] total CEO pay to total sales, market capitalization, and net income for a sample of 1,398 U.S. corporations. Total CEO pay in 2004 was just 0.09 percent of sales, 0.06 percent of market capitalization, and 1.3 percent of net income for the companies."

A CEO's "realizable pay" represents "the actual cash bonus paid, the in-the-money value of stock options, the real value of restricted stock, plus the payout from performance plans." Kay and Van Putten pored over "data on 1,072 major corporations in the S&P Super 1500 between 2004 and 2006" and found that "CEOs in high-earning companies earned far more realizable pay than CEOs at companies with low earnings." The former "earned three times as much in realizable long-term incentives (LTI), which comprise the in-the-money value of stock options, period-end value of restricted stock, and payouts from long-term performance plans.

"These higher returns for high-performing executives are not 'baked in the cake' when executive pay packages are originally offered. The proof is that the correlation between company performance and LTI *opportunity* is very weak…. Thus, executive skill at producing high returns for shareholders is what generally determines the actual compensation that CEOs receive."

Source: Ira T. Kay and Steven Van Putten, "Executive Pay: Regulation vs. Market Competition," Cato Institute Policy Analysis, September 2008.

Illustrations by Mick Wiggins.