

# DAVID E. FELLER MEMORIAL LABOR LAW LECTURE

April 2, 2008

## How a Low Wage Economy with Weak Labor Laws Brought Us the Mortgage Credit Crisis

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Good evening. It is a great honor to be invited here to Boalt Hall to give the David E. Feller Memorial Labor Law Lecture. Professor Feller lived a life in the law that melded intellectual curiosity and rigor together with a profound commitment to the cause of justice and dignity for all Americans. I hope that my remarks are in the intellectual and moral spirit in which he lived his life. I also wish to extend my thanks and gratitude to Brandon Rees, my longtime colleague and friend, and to David Rosenfeld for helping to arrange this event, and really for both of their dedication to the rights of working people.

This lecture is an effort to link the field of labor law to the crisis that is unfolding in our economy. As such it may seem a rather peculiar lecture in labor law—as I intend to range rather far afield into questions of corporation finance, trade policy, and even environmental policy. Please bear with me, as what I want to do is to show that in the end, labor law, in its broadest sense and as the legal structure shaping how we as a society regard the fate of the vast majority of us who work for a living, is central to what sort of society and economy we are, and what our possibilities as a society can be. This insight—that the fate of working people is the central question to the fate of our society—is the founding idea of labor law. It is what motivated the working lives of the founders of labor law and labor policy—people like Louis Brandeis, Frances Perkins and Felix Frankfurter, and David Feller. Whether we make the right choices or the wrong choices, the results are far

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reaching. But most importantly, it is never too late to start making the right choices.

We are living through a profound global financial crisis. That crisis has many proximate causes in the governance and deregulation of Wall Street. We have seen the astounding bailout of Bear Stearns using \$30 billion plus in public money—Bear Stearns—an investment bank, an enterprise that prided itself on being in the business of cowboy capitalism, business without a safety net.<sup>1</sup>

But the real roots of the crisis do not lie on Wall Street. The cause of the crisis can be found in the long-term weakening of the real American economy in an era of globalization—in closed factories, outsourced high tech jobs and low wage jobs with no benefits, and in the unsustainable effort to maintain middle class living standards through borrowing. It is to be found in the reality of lives like that of Kimberly Somsel of Westland Michigan, a member of the AFL-CIO's community affiliate Working America, an unemployed single mother of two battling breast cancer and facing foreclosure due to a ballooning "2 and 28" loan payment. She is selling the family car and her furniture just to get by. Five houses on her block are threatened with foreclosure.

Powerful voices in our country say that public resources should be there for Bear Stearns, but not for Kimberly Somsel, to keep the champagne flowing on Wall Street, but not to build a future for Michigan. But there is another way—a return to a high wage economy driven by productive investment in the United States. This way requires not that we retreat from the global economy, but that we insist that the globalized economy have real rules that work for working people. At the center of these rules must be labor market regulation, and in particular, regulation that empowers workers to speak for themselves by acting together. But rules are not enough. The United States must pursue a real national economic strategy in a globalized world economy.

For thirty years, America's economic elites and their political allies have pursued a combination of economic and social policies designed to produce a low wage economy. These policies—our labor laws and our broader system of labor market regulation, our tax policies and our approach to globalization, have yielded decades of stagnant wages and rising economic inequality.

But at the same time, policymakers of both parties have sought, with some success, to maintain high levels of consumer spending. The pursuit of the contradiction of a low wage, high spending economy has systematically destroyed the various ways we individually and collectively save and in-

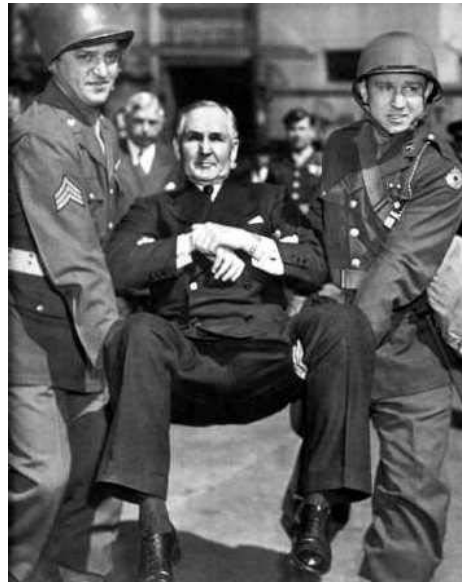
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1. Andrew Ross Sorkin, *In Sweeping Move, Fed Backs Buyout and Wall St. Loans*, N.Y. TIMES, Mar. 17, 2008, at A1.

vest. Instead of an income driven economy, we have become an economy driven by asset bubbles fueled by cheap debt. The ultimate unsustainability of this strategy has brought us to our current economic crisis.

To grasp what needs to be changed, it is necessary to review the thirty years of policy that got the United States to where we are. But in the area of labor market regulation, we really need to go back further, to give the background of a time when we had a high wage national labor market policy. Between the passage of Section 7 of the National Recovery Act in 1933 and the passage of the Taft-Hartley Act in 1948, it was pretty clearly the policy of the United States government to foster unionization in the private sector.<sup>2</sup> This policy found its clearest expression in the preamble to the National Labor Relations Act,<sup>3</sup> but its most powerful political expression in the actions taken by the War Labor Board. Here is the War Labor Board in action. This man was the CEO of Montgomery Ward, the Wal-Mart of its day.

*Army Seizes Montgomery Ward President Sewell Avery on April 27, 1944<sup>4</sup>*



If you saw this picture in your newspaper, as most American employ-

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2. One of Congress's principal purposes in passing the National Labor Relations Act ("NLRA") was to foster unionization. *United Food and Commercial Workers Locals 951, 7 and 1036*, 329 N.L.R.B. 730, 737 (1999). However, while the Taft-Hartley Amendments to the NLRA maintained language stating that the policy of the United States is to encourage collective bargaining, those amendments also codified an individual's right to refrain from collective bargaining. 29 U.S.C. §§ 151, 157 (2006).

3. 29 U.S.C. § 151.

4. Louthier S. Horne, *Biddle Gets Court Order to Restrain Ward Staff; Avery Evicted by Army*, N.Y. TIMES, Apr. 28, 1944, at 1.

ers did in 1944, it didn't take much legal analysis to understand that there could be serious consequences to opposing workers' right to organize.

The passage of the Taft-Hartley Act, and what Professor Karl Klare of Northeastern University Law School some years ago labeled the judicial deradicalization of the NLRA, moved the posture of the federal labor laws more in the direction of preserving the status quo and away from the active encouragement of the growth of private sector unions.<sup>5</sup> But it was a status quo that centered on collective bargaining. The growth of labor arbitration in substantial part as a result of David Feller's work, of national collective bargaining in industries like auto manufacturing, steel, coal, and trucking, of structured employee benefit plans, all were aspects of the institutionalization of collective bargaining at the heart of the structure of the American labor market.



And here you can see the results. During the postwar era, America's workers were able through collective bargaining to capture most of the productivity gains in the American economy. This was the period of the

5. Karl E. Klare, *Judicial Deradicalization of the Wagner Act and Origins of Modern Legal Consciousness, 1937-1941*, 62 MINN. L. REV. 265 (1978).

6. The data used to generate this graph was compiled by researchers at the Economic Policy Institute. Their sources were the Bureau of Labor Statistics, Nonfarm Business Sector Productivity Series and Bureau of Labor Statistics, Hourly Wage Series for Production and Nonsupervisory Workers, converted to compensation using the ratio of compensation to wages developed for the table available at: Lawrence Mishel, Jared Bernstein & Heidi Shierholz, *The State of Working America 2008/2009 Table 3.3*, (2009), available at [http://www.stateofworkingamerica.org/tabfig/2008/03/SWA08\\_Wages\\_Table.3.3.pdf](http://www.stateofworkingamerica.org/tabfig/2008/03/SWA08_Wages_Table.3.3.pdf); see also American Federation of Labor and Congress of Industrial Organizations, *An Economy That Works: We Make it, Big Business Takes it*, <http://aflcio.org/issues/jobseconomy/bigbusiness.cfm>.

dramatic growth in the real income of most Americans, and the reduction in inequality to levels that at the time were thought to be indicative of a modern economy that had put the economic royalist and inequality of the robber baron age forever behind us.<sup>7</sup>

Then, in the 1980s, the United States began to set the course that led to the present economic crisis. This was the period when both the Reagan administration and the business community began to seriously attack the institutions that drove the high wage postwar economy.

In labor market policy, this was not a gradual development. In 1981, something fundamentally changed. You can see it here on the graph of real wages and productivity. They were decoupled. The mechanism for their decoupling was a fascinating development in labor law. You can search Lexis and Westlaw and you won't find it. It was neither a statute, nor a regulation or a case. It was instead a policy decision that on its face applied to the very narrow circumstances of a strike by air traffic controllers. In the first days of his administration, President Ronald Reagan responded to a strike by air traffic controllers by ordering the firing of the striking controllers and their replacement by "replacement workers."<sup>8</sup>

By this act, Reagan sent a signal to private sector employers, a signal comparable in power to that sent forty years earlier by the War Labor Board. The message was—the federal government fires strikers and hires replacement workers; you can too. By doing so, the right of employers to hire permanent replacement workers, a right that had been recognized in theory by the NLRB in the 1950s, but never acted on, became a living part of American labor law. Employers used permanent replacements to break strikes across the industrial landscape in campaigns like International Paper, Hormel, Caterpillar, Continental and Eastern Airlines.<sup>9</sup> Of course, PATCO was followed by the effective cessation of labor law enforcement by the Reagan NLRB, a pattern, which after a hiatus under the Clinton Administration, has been resumed with renewed vigor in the George W. Bush Administration.<sup>10</sup> In the decade that followed PATCO, even where union density remained, bargaining power was fundamentally weakened. And not just for union members. Though there has been a dramatic revolution in

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7. Paul Krugman, Professor of Econ. and Int'l Affairs, Princeton Univ., *Politics, Policy and Inequality, Keynote Address at Work That Works* (Feb. 22, 2007) (transcript available at [http://www.epi.org/content.cfm/webfeatures\\_viewpoints\\_politics\\_policy\\_inequality](http://www.epi.org/content.cfm/webfeatures_viewpoints_politics_policy_inequality)).

8. Louis Uchitelle, *Ousting Strikers A Costly Tactic*, N.Y. TIMES, Apr. 21, 1992, at D2.

9. Catherine S. Manegold, *Senate Republicans Deal A Major Defeat to Labor*, N.Y. TIMES, July 13, 1994, at D18; Jonathan P. Hicks, *Still Bitter, Caterpillar Workers Return*, N.Y. TIMES, Apr. 21, 1992, at A16; William Glaberson, *Misery on the Meatpacking Line*, N.Y. TIMES, June 14, 1987, § 3, at 1.

10. Steven Greenhouse, *Labor Rallies in Support of Bill to Back the Right to Join Unions*, N.Y. TIMES, Dec. 11, 2003, at A41; Steven Greenhouse, *Labor Board Chief Takes Assertive Stance*, N.Y. TIMES, June 2, 1996, § 1, at 32.

workplace productivity driven by the information technology revolution, America's workers have, with the exception of a brief period in the late 1990s, been unable to bring those gains home with them in their paychecks.<sup>11</sup> And the root of this disconnection between worker productivity and worker income lies in the change in the spirit of American labor law that took hold in 1981.

But labor law proper is not the only area of the law that underwent a transformation in the 1980s in a manner that fueled our transition to a low wage economy. The labor movement and the institution of the progressive income tax grew together in the New Deal era, and they declined together after 1981. This genuinely progressive tax system, with marginal rates of over 90% in the Eisenhower administration, was a major contributor both to America's ability to make major public investments that drove increases in our standard of living, and to our increased levels of income equality after World War II.<sup>12</sup>

Today, primarily as a result of changes to the tax code under Reagan and the second Bush, we have a tax system that taxes upper middle income workers and individuals whose income is measured in billions at the same marginal rate, unless those billions come from managing hedge funds and private equity, in which case the billionaire's marginal tax rate is actually lower than that of middle income workers.<sup>13</sup>

The third legal source of our national low wage strategy is our approach to globalization. In the 1990s, the United States entered into a series

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11. *America's Workers and Education for the 21st Century: Hearing Before the Subcomm. on Labor, HHS, Educ. and Related Agencies of the H. Comm. on Approp.*, 110th Cong. (2007) (statement of Lawrence Mishel, President, Economic Policy Institute), available at [http://www.epi.org/content.cfm/webfeatures\\_viewpoints\\_living\\_standards\\_and\\_ed\\_testimony](http://www.epi.org/content.cfm/webfeatures_viewpoints_living_standards_and_ed_testimony); Jared Bernstein & Lawrence Mishel, *Wages Gain Ground: Workforce Benefits in 1998 from Tighter Labor Markets, Higher Minimum Wage*, ECON. POL'Y INST. ISSUE BRIEF 129 (1999), [http://www.epi.org/content.cfm/issuebriefs\\_ib129](http://www.epi.org/content.cfm/issuebriefs_ib129). For the competing theory that a focus on real wages rather than total compensation along with discrepancies in the conversion of nominal wages and nominal output to real values are the actual reasons why analysts have concluded that productivity growth has outpaced wage growth, see Martin S. Feldstein, *Did Wages Reflect Growth in Productivity?*, 30 J. POL'Y MODELING 591 (2008). Feldstein asserts that increased employer spending on healthcare accounts for a portion of the discrepancy between wages and productivity. However, increased healthcare spending does not necessarily result in a benefit to employees. According to the World Health Organization, over the last decade, Canada has consistently spent about 45% less on healthcare than the United States (measured as a per capita expenditure; when measured as a percentage of GDP, Canada spent between 28% and 35% less on healthcare than the United States during the same time). However, during the same time, Canada has enjoyed life expectancy rates two to three years greater than in the United States. WORLD HEALTH ORGANIZATION, STATISTICAL INFORMATION SYSTEM DETAILED DATABASE SEARCH, <http://www.who.int/whosis/data/Search.jsp>.

12. Marc Linder, *I Like Ike: Bringing back Eisenhower-Era Progressive Taxation*, 67 TAX NOTES 833 (1995); Tax Policy Center, *Historical Individual Income Tax Parameters*, <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=543>.

13. 26 U.S.C. § 1 (2006); Chris William Sanchirico, *The Tax Advantage to Paying Private Equity Fund Managers with Profit Shares: What Is It? Why Is It Bad?*, 75 U. CHI. L. REV. 1071, 1073-83 (2008).

of trade agreements that, combined with technological developments, fully expose the U.S. economy to goods and services produced by low wage labor around the world.<sup>14</sup> Prior to 1989, both China and India, the world's two most populous countries, were pursuing economic policies of internally driven development, and were not participants in larger global markets as exporters. Mexico, our closest low wage neighbor, was not economically integrated into the United States. American business historically had been supportive of high trade barriers, fearing competition from foreign manufacturers.

All this changed as these countries and others began to pursue economic strategies centered on becoming export platforms integrated into the global economy, and most importantly, as U.S. based global corporations began to see their non-U.S. operations not just as sources of raw materials, but also as cheap production sites. NAFTA was the first legal embodiment of these changes.<sup>15</sup> NAFTA was followed by the development of the World Trade Organization in the later 1990s,<sup>16</sup> and then, and ultimately most consequentially, by the granting of permanent most favored nation status to China in 2000.<sup>17</sup>

From the first Bush Administration, through the Clinton Administration, and in the second Bush Administration with a vengeance, the United States has pursued global economic integration through legal vehicles that have had no meaningful rules for the global economy in the area of labor market regulation. Of equal importance to the absence of rules in the context of globalization has been the absence of a meaningful national strategy for preserving and increasing incomes in a globalized economy. The result has been, not surprisingly, America's workers being fully exposed to competition from low wage economies, often economies where workers are subject to violent repression when they seek to improve their lives.

Since 1981, the labor law regime, the tax regime and our approach to globalization have resulted in downward pressure on wages in the United States and a soaring trade deficit.<sup>18</sup> As I showed a moment ago, although the productivity of U.S. workers has improved dramatically since 1981, U.S. workers real wages have remained flat, with the exception of a brief period in the late 1990s, at the height of the tech and telecom asset bubbles

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14. North American Free Trade Agreement Implementation Act, 103 P.L. 182 (1993); Jesse Rothstein & Robert Scott, *NAFTA and the States: Job Destruction is Widespread*, ECON. POL'Y INST. ISSUE BRIEF 119 (1997), [http://www.epi.org/content.cfm/issuebriefs\\_ib119](http://www.epi.org/content.cfm/issuebriefs_ib119).

15. Rothstein & Scott, *supra* note 14.

16. David E. Sanger, *U.S. Threatens \$2.8 Billion of Tariffs on China Exports*, N.Y. TIMES, Jan. 1, 1995, § 1 at 14.

17. Act of Oct. 10, 2000, PUB. L. NO. 106-286, 114 Stat. 880.

18. Jeff Faux, *Globalization That Works For Working Americans*, ECON. POL'Y INST. BRIEFING PAPER 179 (2007), <http://www.sharedprosperity.org/bp179.html>.

and before China really became a force in U.S. markets. You might think that downward pressure on wages would mean less consumer spending. But up until recently, there was a solution to the threat that stagnant real wages would mean stagnant consumer spending.

That solution was debt financed asset bubbles. And oddly enough, the trade deficit itself, combined with strategic behavior by our trading partners, for a time provided the debt financing for these asset bubbles and the high levels of consumer spending associated with those bubbles.

The strategic behavior was the refusal by the Chinese and others to allow their currencies to appreciate by either formally or informally pegging the value of their currency to the dollar.<sup>19</sup> In this way our trading partners financed our continued purchasing from their factories, even as our real economic capacity was declining. But in the end neither individuals nor countries can borrow forever to fund current consumption—and thus came the collapse of the debt-financed housing bubble and the global credit crisis.

But this story of the decoupling of wages and productivity really underestimates how destructive our low wage strategy has been.

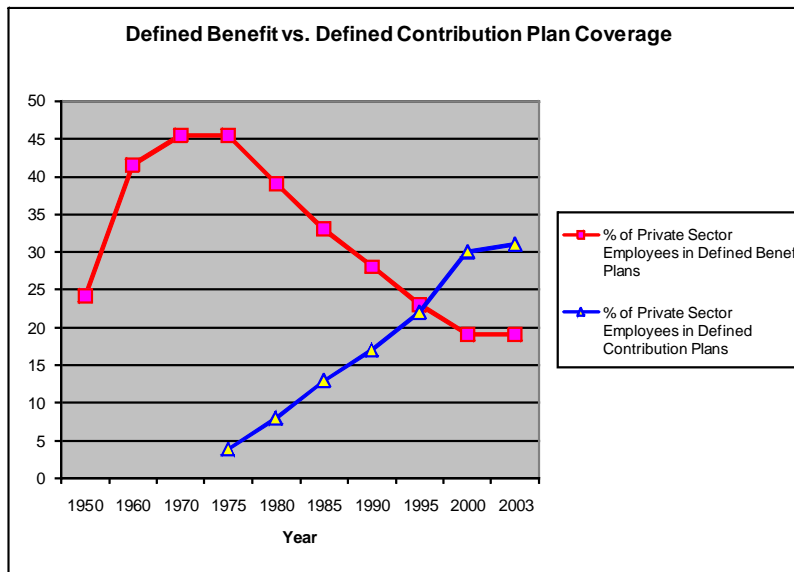
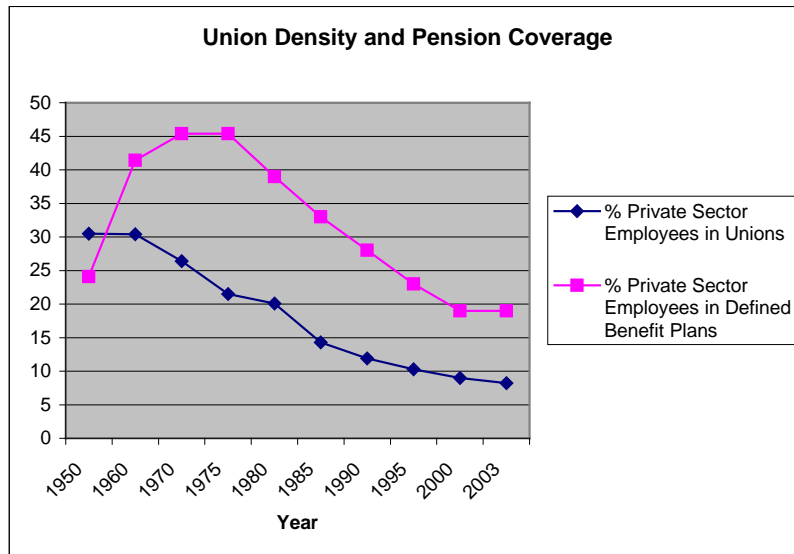
To understand the full extent of the destructive consequences of a low wage economy, consider how we have managed to maintain increases in consumption while wages stagnate. First we stopped saving and started eating our seed corn. In the public sector, starting in the 1980s, tax cuts in the name of supply side economics robbed the government of revenues necessary to fund public investment, both at the state and federal level.<sup>20</sup> The result has been, in all but the most affluent school districts, is that schools do less and less just when we need them to do more and more. No money for infrastructure, just when the roads and bridges we built during the great postwar infrastructure boom are wearing out. And, perhaps worst—no public resources to take on the great challenge of global warming and sustainable energy.

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19. Robert E. Scott, *The China Trade Toll: Widespread Wage Suppression, 2 Million Jobs Lost in the U.S.*, ECON. POL'Y INST. BRIEFING PAPER 219 (2008), <http://www.epi.org/content.cfm/bp219>.

20. MICHAEL ETTLINGER & JOHN IRONS, TAKE A WALK ON THE SUPPLY SIDE: TAX CUTS ON PROFITS, SAVINGS AND THE WEALTHY FAIL TO SPUR ECONOMIC GROWTH (2008), [http://www.epi.org/briefingpapers/supply\\_side.pdf](http://www.epi.org/briefingpapers/supply_side.pdf).

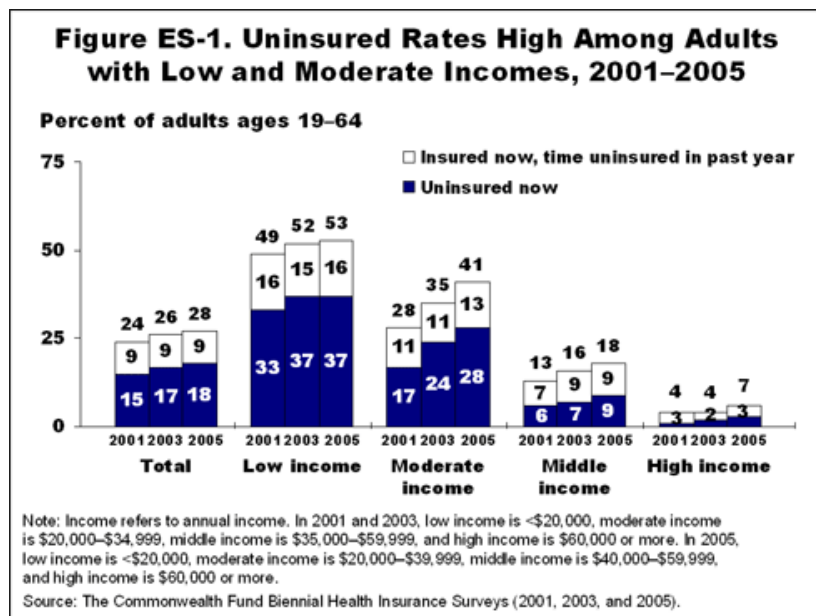
In the private sector we ate our seed corn through employers dismantling our pension system.



In 1980, 50% of the private sector workforce was covered by a defined benefit pension plan, with typical employer contributions of around 8% of

payroll.<sup>21</sup> Today, less than 20% of the private sector workforce has such a plan.<sup>22</sup> The other 30% has a 401-k or other savings account, with employer contributions averaging less than 3%.<sup>23</sup>

Hidden in this change is a 5% real pay cut, but one with no impact on current consumption.<sup>24</sup> The corporate retreat from employer provided health care, particularly retiree health care, is a similar story. Of course both the rise and fall of employer provided pension and health coverage is a sub-story to the larger story of the rise and decline of private sector unionism since 1935—the larger story of labor law in our time.



21. Alicia H. Munnell, Jean-Pierre Aubry & Dan Muldoon, *The Financial Crisis and Private Defined Benefit Plans*, CTR. FOR RET. RES. AT BOSTON COLLEGE ISSUE BRIEF 8-18, 2 (2008), [http://crr.bc.edu/images/stories/Briefs/ib\\_8-18.pdf](http://crr.bc.edu/images/stories/Briefs/ib_8-18.pdf); Alicia H. Munnell & Mauricio Soto, *The Outlook for Pension Contributions and Profits in the U.S.*, 27 (CTR. FOR RET. RES. AT BOSTON COLLEGE WORKING PAPER 2003-13, 2003), [http://crr.bc.edu/images/stories/Working\\_Papers/wp\\_2003-13.pdf?phpMyAdmin=43ac483c4de9t51d9eb41](http://crr.bc.edu/images/stories/Working_Papers/wp_2003-13.pdf?phpMyAdmin=43ac483c4de9t51d9eb41).

22. Bureau of Labor Statistics, 2006 Employment Benefits Survey, [http://data.bls.gov/PDQ/servlet/SurveyOutputServlet;jsessionid=f030f7148daeK\\$09\\$3F\\$](http://data.bls.gov/PDQ/servlet/SurveyOutputServlet;jsessionid=f030f7148daeK$09$3F$).

23. Alicia H. Munnell & Annika Sundén, *401(k) Plans are Still Coming Up Short*, CTR. FOR RET. RES. AT BOSTON COLLEGE ISSUE BRIEF 43 (2006), [http://crr.bc.edu/images/stories/Briefs/ib\\_43.pdf?phpMyAdmin=43ac483c4de9t51d9eb41](http://crr.bc.edu/images/stories/Briefs/ib_43.pdf?phpMyAdmin=43ac483c4de9t51d9eb41).

24. Alicia H. Munnell, Francesca Golub-Sass, Mauricio Soto & Francis Vitagliano, *Why are Healthy Employers Freezing Their Pensions?*, CTR. FOR RET. RES. AT BOSTON COLLEGE ISSUE BRIEF 44, 4 (2006), [http://crr.bc.edu/images/stories/Briefs/ib\\_44.pdf?phpMyAdmin=43ac483c4de9t51d9eb41](http://crr.bc.edu/images/stories/Briefs/ib_44.pdf?phpMyAdmin=43ac483c4de9t51d9eb41); Munnell & Soto, *supra* note 21.

Ultimately, though, the retreat from public and private savings was not enough to maintain a healthy consumer driven economy in an environment of falling wages. So we went as a nation from eating our seed corn to borrowing money to buy more seed corn to eat that. Ironically, though, the very conditions that were driving down wages created a ready and willing source of a temporary rescue in the form of cheap debt. As our trade regime produced a skyrocketing trade deficit, our trading partners in Asia were accumulating trillions of dollars. China, Japan and more recently the oil producing countries lent their dollars back to us,<sup>25</sup> and did so even at the very low interest rates offered by the Federal Reserve during the run up to the tech bubble and then even more so in the aftermath of the tech bust.

But it was not just consumer spending that was artificially inflated by the availability of cheap debt. The last five years have seen historically unprecedented investment returns in residential real estate, leveraged buyout funds (now called private equity) and hedge funds.<sup>26</sup> These returns encouraged the belief that it was not necessary to fund retirement, because real estate value appreciation made pensions unnecessary, or because hedge fund and private equity returns could make up in investment returns what pensions were lacking in direct contributions from employers.

But at the heart of each—real estate, private equity and hedge funds are unsustainably cheap credit and no meaningful credit market regulation. Housing booms when mortgages are cheap, and housing really booms when anyone, regardless of actual earnings capacity, can obtain a mortgage, if only for a brief period of time. If banks and others are willing to lend to leverage buyout firms at low interest rates, it become much easier for buyout firms to buy companies, and much easier to make outsize profits. Finally, the cheaper it is to lend, the more profitable a leveraged hedge fund will be, and the more credit that is available, the easier it is to start hedge funds and make money managing them.

Of course, all these trends reverse with a vengeance when credit dries up and the downside of the business cycle kicks in. And that brings us back to the subprime crisis and the broader credit market crisis we are facing today.

The U.S. mortgage market is the financial market most closely linked to the lives of American working families. The lack of effective regulation of mortgage markets has allowed these markets to be flooded with products that are misleading and exploitative,<sup>27</sup> products marketed to tens of millions

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25. Department of the Treasury, Federal Reserve Board, Major Foreign Holders of Treasury Securities, Nov. 18, 2008, <http://www.treas.gov/tic/mfh.txt>.

26. Shawn Tully, *Risk Returns With a Vengeance*, FORTUNE, Sept. 3, 2007, at 50.

27. Edmund L. Andrews, *Fed and Regulators Shrugged as the Subprime Crisis Spread*, N.Y. TIMES, Dec. 18, 2007, § 4, at 1.

of Americans who work at low wage jobs or who have inadequate retirement income, so they are desperate for a financial short cut to either home ownership or adequate income.

The result was millions of mortgages structured with teaser rates, and more than a trillion dollars lent out on the assumption that housing prices would rise forever.<sup>28</sup> Subprime lending has grown from 5% of mortgage originations in 2001 to 20% in 2006.<sup>29</sup> Subprime loans have gone from predominantly 30-year fixed rates to predominantly exploitative structures with teaser rates, the so-called 2 and 28 structures.<sup>30</sup> As a result, in the next 18 months, over \$300 billion in teaser rate mortgages will reset at high cost interest rates.<sup>31</sup> Total defaults in the subprime market are now estimated to exceed \$600 billion.<sup>32</sup> Of course, the victims are the very people historically shut out of our credit markets. According to the Federal Reserve Board, in 2005 these high cost mortgages accounted for 55% of purchase mortgages obtained by African Americans, 46% of purchase mortgages obtained by Latinos, and 17% of purchase mortgages obtained by non-Latino whites.<sup>33</sup> And the majority of subprime mortgages are re-financings, where the racial data are even more skewed.

When housing prices fell, millions of Americans were stuck with mortgages they could not afford. The banks that put this all together are looking at the financial abyss. Mutual funds, money market funds and pension funds are facing major losses in bonds that were sold to them as investment grade.<sup>34</sup> And throughout our economy, credit is drying up. The lack of regulation in our financial markets means no one knows which hedge fund or investment bank will be the next to go bankrupt; so lending ceases. As former Secretary of the Treasury Paul O'Neill recently said, it is as "if you know one bottle out of six is poison, but you don't know which

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28. *Id.*; David M. Herszenhorn, *Administration is Seeking \$700 Billion for Wall Street in Possible Record Bailout*, N.Y. TIMES, Sept. 21, 2008, at A1; David Leonhardt & Motoko Rich, *Homeowners Take Risks in a Bid for Lower Mortgage Payments*, N.Y. TIMES, June 16, 2005, at C1.

29. Center for Responsible Lending, *A Snapshot of the Subprime Market*, Nov. 28, 2007, <http://www.responsiblelending.org/pdfs/snapshot-of-the-subprime-market.pdf>;

*see also* CONGRESSIONAL RESEARCH SERVICE, REPORT FOR CONGRESS RL 33930, SUBPRIME MORTGAGES: PRIMER ON CURRENT LENDING AND FORECLOSURE ISSUES 1 (2007).

30. Anthony Pennington-Cross & Giang Ho, *The Termination of Subprime Hybrid and Fixed Rate Mortgages*, 1 (Fed. Reserve Bank of St. Louis Working Paper 2006-042A, 2006), <http://research.stlouisfed.org/wp/2006/2006-042.pdf>.

31. Leonhardt & Rich, *supra* note 28.

32. Vikas Bajaj & Michael M. Grynbaum, *Drumbeat of Grim Reports Sends Markets Tumbling*, N.Y. TIMES, Mar. 1, 2008, at A1.

33. Robert B. Avery, Kenneth P. Brevoort & Glenn B. Canner, *Higher-Priced Home Lending and the 2005 HMDA Data*, Federal Reserve Bulletin 2006, A160, <http://www.federalreserve.gov/Pubs/Bulletin/2006/hmda/bull06hmda.pdf>.

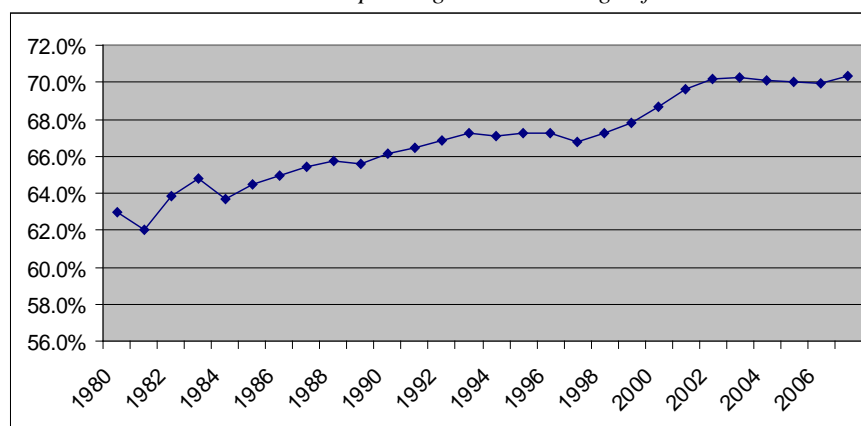
34. Jeff Sommer, *Watch Out for Risk in the Middle of the Road*, N.Y. TIMES, Dec. 14, 2008, at BU6.

one you want to drink.”<sup>35</sup>

Already we see falling real estate values undermining the debt-financed consumer spending that has been powering economic growth over the past seven years and the tightening of credit markets constraining business investment spending. The result is the looming prospect of global recession with the most serious consequences for the living standards of working families.

The punch line to all of this—at the beginning of the 1980s, just over 60% of the U.S. Gross Domestic Product was consumer spending.<sup>36</sup> Today, consumer spending is over 70% of GDP.<sup>37</sup>

*Consumer Spending as a Percentage of GDP*



The increase is the measure of the extent to which we are eating our seed corn in an effort to hide the real erosion in our living standards. It is a measure of the extent to which we have maintained consumer spending by not investing in our future as a nation or our futures as individuals, and ultimately it is a measure of the unsustainability of our current economic policies. To be an affluent society in the long run, we cannot stop saving to fund current consumption.

During the same period, we have engaged in another long delusion, the delusion that we can run an oil-intensive economy forever. These two delusions have merged, as our payments to oil-producing nations have, with the rise in oil prices, become a growing part of the flows of dollars into the

35. Deborah Solomon, *Market Leader, Questions for Paul O'Neill*, N.Y. TIMES, Mar. 30, 2008 at M17.

36. Bureau of Economic Analysis, National Income and Product Accounts Table, Table 1.1.5. Gross Domestic Product, <http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=5&ViewSeries=NO&Java=no&Request3Place=N&3Place=N&FromView=YES&Freq=Year&FirstYear=1979&LastYear=2008&3Place=N&Update=Update&JavaBox=no#Mid>.

37. *Id.*

global credit markets. What was until recently a glut of dollars in the global credit markets were recycled back to us in the form of cheap debt financing for our real estate bubble, and in the form of financing for our multi-trillion dollar expenditure of national wealth in Iraq.<sup>38</sup>

The key thing to understand about the U.S. economic strategy of the recent past is that so long as cheap credit flowed from our trading partners, energy suppliers, and financial engineers, our economy looked much healthier than it really was. Vast amounts of economic activity in areas such as housing construction and other real estate, the transportation, marketing and sale of consumer goods, and government related spending was an artifact of our ability to borrow, not a measure of our overall productiveness as a society or our sustainable ability to support our national consumption.

Today the consequences of these policies are very clear. Our financial system is in prolonged crisis. We have just gone through the first post-war economic expansion in which real wages did not rise.<sup>39</sup> Pension and health care coverage for Americans has shrunk dramatically.<sup>40</sup> Poverty rates have been rising since 1999, and are now again above where they stood in 1973.<sup>41</sup> Our negative balance of payments keeps growing, and the dollar, which remains unnaturally high in relation to China's pegged currency, keeps falling against the Euro.<sup>42</sup> We are losing the very high tech jobs that we were supposed to keep in an era of globalization—jobs in aerospace and information technology. The price of oil is over \$100 a barrel, and oil production on a daily basis is not increasing, while demand from other countries is growing apace.<sup>43</sup> And hanging over our future is the threat of a radically destabilized climate because of our refusal to address the damage done by our carbon emissions.

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38. Faux, *supra* note 18; Linda J. Bilmes & Joseph E. Stiglitz, *The Iraq War Will Cost Us \$3 Trillion, and Much More*, WASH. POST, Mar. 9, 2008, at B1; Paul Krugman, *Don't Cry for Me, America*, N.Y. TIMES, Jan. 18, 2008, at A21.

39. Jared Bernstein & Lawrence Mishel, *Economy's Gains Fail to Reach Most Workers' Paychecks*, ECON. POL'Y INST. BRIEFING PAPER 195 (Sept. 3, 2007).

40. See Craig Copeland, *Employment-Based Retirement and Pension Plan Participation: Declining Levels and Geographic Differences*, EMP. BENEFIT RES. INST. POL'Y BRIEF 262, Oct. 2003; see also Milt Freudenheim, *Workers See Health Care Menu Shrink*, N.Y. TIMES, Nov. 15, 2008, at B1.

41. Bureau of the Census, Consumer Income, *Characteristics of Low Income People: 1973*, 1, <http://www.census.gov/hhes/www/poverty/prevcps/p60-98.pdf>; Bureau of the Census, Consumer Income, Current Population Reports, *Income, Poverty, and Health Insurance Coverage in the United States: 2007*, 12, <http://www.census.gov/prod/2008pubs/p60-235.pdf>.

42. Donald Greenlees, *As the Dollar Slides, Two Continents Feel the Side Effects in Divergent Ways*, N.Y. TIMES, Mar. 27, 2008, at C8; Robert E. Scott, *China Escalates Dollar Purchases to Depress Value of Yuan*, Economic Policy Institute, Economic Snapshots, Oct. 24, 2007, [http://www.epi.org/content.cfm/webfeatures\\_snapshots\\_20071024](http://www.epi.org/content.cfm/webfeatures_snapshots_20071024); Adam S. Hersh, *China's Currency Manipulation and U.S. Trade*, Economic Policy Institute, Economic Snapshots, Oct. 30, 2003, [http://www.epi.org/content.cfm/webfeatures\\_snapshots\\_archive\\_10302003se](http://www.epi.org/content.cfm/webfeatures_snapshots_archive_10302003se).

43. Jad Mouawad, *Oil Tops Inflation-Adjusted Record Set in 1980*, N.Y. TIMES, Mar. 4, 2008, at C1.

So this is not an ordinary business cycle downturn—it is a crisis of a failed economic, social, environmental and legal model. But out of this crisis can come a different economic strategy for the United States—one that makes a country that once again invests in ourselves, whose economic engine is the wages paid to middle class Americans, and that takes on the great economic and technological challenges facing the globalized world of the twenty first century.

As a new President takes office, he or she will face the terrible symptoms of this failed model. Some will urge an intensification of the very policies that brought us here, like medieval doctors who recommend bleeding to the weak patient. We saw some of that approach in Secretary of the Treasury Hank Paulsen's plan for weakening financial services regulation announced earlier this week.<sup>44</sup> Others will urge half measures—the continuation of the approach of the last Clinton Administration—expressions of concern about all the issues I have discussed, but policies that continue to the downward pressure on wages.

So our nation now faces a choice. But it is not just our choice. What we do now, what our real economic strategy is in the coming decade, will have enormous consequences for the rest of the world. We can go in a new direction, one with enormous benefits not just for Americans but for a world facing a future of rising energy costs and a destabilized climate, a world that currently fears that America's only answers are more thinly veiled efforts to use force to compete for natural resources.

Our choice is between continuing the low wage, high consumption economy until we truly bankrupt ourselves, or to become a high wage economy again, driven by investment in our human capital, in our physical capital, and most of all, investment in technologies the world desperately needs—the energy technologies of the 21st century.

The United States needs a strategy—an idea about what our role will be in the global economy. We need to shed a third delusion, that we are so big and important in the global economy that we do not need a strategy—that the global economy will inherently work to benefit us.

In the short term, our national economic strategy must begin with stabilizing our communities by putting an end to the downward spiral of the subprime market. First there must be an immediate moratorium on foreclosures on subprime mortgages—any mortgage with a teaser rate structure. We cannot have homes foreclosed and fear stalking our communities while banks and government agencies negotiate over loan restructuring programs. Only a moratorium will create real incentives to restructure loans.

Second, the mortgage industry and government must create a struc-

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44. Nelson D. Schwartz & Floyd Norris, *Reluctant Eye Over Wall Street*, N.Y. TIMES, Mar. 30, 2008, at A1.

tured program providing for the replacement of teaser rate loans, 2 and 28 loans, with conventional thirty-year mortgages at the teaser rate. Third, mortgage servicers must renounce those servicing agreements that reward mortgage companies for foreclosing on homes rather than encourage refinancing or other workout strategies. Fourth, mortgage servicers must commit to publicly reporting company by company how many subprime loans they are servicing; how many have reset; how many have been restructured, and how many foreclosures are occurring and where. Fifth, there must be massive outreach under federal government auspices to subprime borrowers to let them know how they can keep their homes.

But stabilizing the housing market is a short-term fix to stabilize a crisis. The real policy challenge is to develop a strategy for dealing with the long-term crisis brought on by a generation of downward pressure on incomes. At the heart of this strategy must be returning to a legal and public policy regime that fosters a high wage economy.

That means national health care—not allowing employers who do not provide health care to be subsidized by the rest of us. And it means a national pension policy to restore adequate retirement savings. And it means restoring the connection between productivity and wages by making workers' right to organize and collectively bargain, and strike, real again. And finally it means an end to a caste system in our labor markets, where we hire undocumented workers and then deny them all rights in the workplace. These measures have to be paired with improvements to our public schools at every level, so that worker productivity continues to increase.

Revitalizing labor law must not simply be a national project. It must be at the heart of a system of rules for the global economy. The right to organize and strike is, more than any other legal concept, the most transportable principle across countries at different levels of economic development, and that realization is the most effective way to promote a global high wage economic order.

At the same time we must address our staggering public investment deficit. Public investment has historically meant infrastructure—now it needs to mean the integration of infrastructure with energy technology. We need to understand energy infrastructure investing as a cornerstone of a national economic strategy. Energy technology should be understood in the broadest possible sense, including energy production technology like improved solar and wind generators, but also and of equal importance, energy distribution technologies like the technologies that drive digital electrical grids, and energy conservation technologies, like advanced building materials.

Climate scientists tell us that time is running out—that we need to change the way we fuel the global economy very quickly. For the United States, time is running out in a different sense. We have a window now in

which we can act. We remain prosperous; we are wealthy enough as a nation to have the resources to devote to this strategic shift, and to have more resources than key competitors in the global economy. We have the resources to be the first mover and to reap first mover advantages. But this state of affairs is quickly deteriorating—so we need to act quickly.

To do so, we need a wartime level sense of urgency—both in the development of new energy technology and in its deployment. We need to think about redesigning our electrical grid, renovating our entire commercial building landscape to be energy efficient, deploying wind and solar power at scale, and radically accelerating the timetable for development of a variety of technologies—critical technologies like carbon emission capture and sequestration for coal and plug in hybrids and other advanced automotive technology. To do these things fast will require tens of billions of dollars just at the development stage. But we as a nation are at our best in taking on these kinds of challenges. We are the nation that went from making a few hundred airplanes a year in 1940 to making 125,000 in 1943.<sup>45</sup> We are the nation that said we would go to the moon in ten years, and did it.

These policies should point the way toward a reinvigorated middle class in the United States, a middle class founded in part on the United States' role as the provider of the technologies at the heart of a global revolution in how we generate, distribute and use energy, in part on the vast work that must be done to retool our own infrastructure, and in part on policies designed to make sure that ours, like other developed countries, is a society of rough economic equality, and not a society of grotesque disparities of wealth, power and human possibility.

But this new direction is about more than incomes, energy and the environment. It is about making us a nation of savers, not of borrowers, a nation whose economy is no longer founded on borrowing money from those who supply us with cheap goods, but on providing the most sophisticated technologies to the rest of the world. And finally, this approach is about turning away from an energy and foreign policy that leads to us fighting futile wars over oil.

The United States, led by its economic elites, has made choices for a generation about how to approach globalization under the influence of a fundamentally false ideology. This ideology says that incomes can fall while consumption rises, that rules to protect the public interest have no place in a global economy, and that while strategy is good for businesses and good for wars, it has no place in U.S. economic thinking or policy making. The choices this ideology has fostered have eroded the American middle class, damaged our national competitiveness, and helped expose the en-

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45. Franklin D. Roosevelt, State of the Union Address (Jan. 6, 1942) (transcript available at <http://www.presidency.ucsb.edu/ws/index.php?pid=16253>).

tire world to catastrophic environmental risk. Debt has been used to hide these consequences, and now that appears to have only made the problems worse.

So the next President will come into office facing a multitude of challenges—a housing and credit market driven recession, rising energy prices, global warming, a current account deficit that is spiraling out of control, the war in Iraq, a collapsing dollar, a rising China and India, long term crises in health care and retirement provision. Treating each of these crises individually while either intentionally or unintentionally continuing our low wage, high debt economic strategy will certainly result in failure.

We must understand that there is a choice, a different direction we can go in—a direction that leads to revitalizing the middle class, putting the great energies of this nation to work to solve the crisis of energy and the environment, and really having a strategy for how the American people can prosper in the global economy. At the heart of the choice that we face is a choice about whether we want to pretend that consumption can go up while real wages fall.

This is a choice fundamentally about whether we will have a real labor law regime that makes it possible for workers to take home the value they create, or whether we will continue the ruinous path of borrowing our standard of living from the countries that continue to make things and that feed our oil habit. We must hope that we as a nation will come to understand that a middle class society requires high wages, which requires real labor laws, real investment, both private and public, and a real integrated economic, energy, and environmental strategy for a globalized world. The path out of the trap we are in today exists, let us hope we have the wisdom as a nation to take it. Thank you.