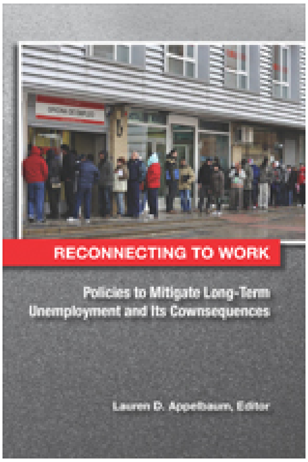
Upjohn Institute Press

Foreword:
What Happened to Shared Prosperity and Full Employment and How to Get Them Back: A Seussian Perspective



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Foreword (pp. vii-xviii) in:
Reconnecting to Work: Policies to Mitigate Long-Term Unemployment and Its Consequences
Lauren D. Appelbaum, ed.
Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2012
DOI: 10.17848/9780880994095.fwd

Reconnecting to Work

Policies to Mitigate Long-Term Unemployment and Its Consequences

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Editor

2012

W.E. Upjohn Institute for Employment Research
Kalamazoo, Michigan

Library of Congress Cataloging-in-Publication Data

Reconnecting to work : policies to mitigate long-term unemployment and its consequences / Lauren D. Appelbaum, editor.
p. cm.
Papers presented at a conference held on Apr. 1–2, 2011.
Includes bibliographical references and index.
ISBN-13: 978-0-88099-406-4 (pbk. : alk. paper)
ISBN-10: 0-88099-406-1 (pbk. : alk. paper)
ISBN-13: 978-0-88099-408-8 (hardcover : alk. paper)
ISBN-10: 0-88099-408-8 (hardcover : alk. paper)
1. Labor policy—United States—Congresses. 2. Unemployment—United States—Congresses. 3. Full employment policies—United States—Congresses. 4. Recessions—United States—Congresses. I. Appelbaum, Lauren D.
HD5724.R337 2012
331.13'770973—dc23
2012034390

W.E. Upjohn Institute for Employment Research
300 S. Westnedge Avenue
Kalamazoo, Michigan 49007-4686

Cover design by Alcorn Publication Design.
Index prepared by Diane Worden.
Printed in the United States of America.
Printed on recycled paper.

Foreword

What Happened to Shared Prosperity and Full Employment and How to Get Them Back: A Seussian Perspective

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The conference "Reconnecting to Work" was held on April 1–2, 2011, as the United States suffered its worst job market since the Great Depression. Reconnecting to work, indeed! With 9–10 percent unemployment and little sign of substantive job growth in the foreseeable future, American workers needed more help to find work than at any time since the 1930s. Even if job growth were to miraculously pick up, most workers would have trouble keeping their heads above water for years to come. For nearly four decades the benefits of economic growth have gone almost entirely to a small sliver of wealthy Americans. The vast bulk of workers struggled with stagnant real wages and high consumer debt to remain in the middle class. Inequality rose to levels off the map for a major advanced country and exceeded levels in most third-world countries. Contrary to what many Americans believe, social mobility in the United States was below that for most other advanced countries.[1]

Something or someone had taken shared prosperity and full employment from the American people. Something or someone was dismantling the road to the middle class on which the United States was built, and with it the American dream. Who or what could that be?

The first place where economists seek an answer to changes in economic outcomes is in the operation of markets. Viewing the U.S. labor market as highly competitive and responsive to market forces, some economists explain the stagnation of real wages in terms of (unmeasured) technologically driven shifts in demand for labor that favor the highly skilled over the less skilled. But changes in skill premium explain only a small proportion of increased inequality. Most of the rise in inequality occurs within observationally equivalent groups—among persons with the same age, gender, race, education, math and literacy test scores, and so on—rather than across skill groups. And it is difficult to understand why in a highly flexible job market firms cut employment rapidly in recession but failed to increase employment in the ensuing recovery. To fit the observed pattern of change, analysts must go beyond the basic flexible market model to consider institutions, unions, executive compensation, modes of corporate governance, and governmental policies.

In the spirit of the interdisciplinary Reconnecting to Work conference, I explored what other social sciences said about the loss of shared prosperity and jobs crisis. Sociology focuses on the behavior of the poor and the measurement/meaning of class but also offers network analysis that quantifies the connections among the elite. Political science documents the importance of lobbying in determining the rules that govern how markets operate and of the revolving door between public service and lobbying activities. Social psychology shows how readily authority figures and settings can influence people to behave with little regard to others even without monetary incentives. But neither economics nor the other social sciences gave me the overarching vision or narrative about who or what was undoing the U.S. middle class.

With the time for my presentation at the conference growing short, I widened my search. As a youth I read widely in literature, from the Greek tragedies to Alice in Wonderland to Charles Bukowski. Did the world of literature offer an analogy or a clue to the story? Eureka! Yes, there was one narrative that seemed to provide insight into the economics of lost prosperity and jobs, and it was by the world's most famous and accomplished writer and poet of children's verse—Dr. Seuss, master of the trisyllabic meter.

Dr. Seuss? Many of the experts at the conference would recall *The Cat in the Hat* (1957a) and wonder what hat I was wearing when Seuss popped into my head as offering a framework for understanding the country's economic woes. Hopefully the evidence would convince them (and you), as it convinced me, that the answer to who stole American prosperity and full employment lies in the classic Seuss tale *How the Grinch Stole Christmas* (1957b) and its successor stories.

THE GRINCHES OF WALL STREET

The *Grinch* is an illustrated book. Rereading your copy, you will surely notice, as I did, the uncanny resemblance of the illustrations of the snarly heartless cave-dwelling Grinch to the bankers, mortgage brokers, and Wall Street–dwelling financiers who sold “liars’ loans” to Americans seeking home ownership, sliced and diced mortgages to hide the risks to investors seeking safe assets, created credit default swaps and exotic derivatives that paid if businesses collapsed or people absconded on debts, and sold clients financial products that they believed would fail. Those dark brows, sour Grinchy grin, and piercing eyes—if the Grinch were a bit pudgier or Bernard Madoff a bit leaner, they’d be kissing cousins.

So who plays the Grinch in the U.S. economy? According to the Wall Street occupiers, it is the upper 1 percent of the income distribution. More accurately, it is the upper 0.1 percent that gained essentially all of the economic growth of the past 40 years. In 1970 the top 0.1 percent in income had 2.7 percent of national income. Their income was 27 times the mean income. In 2007 the top 0.1 percent had 12.3 percent of national income.[2] Their income was 123 times the mean. But these figures understate the disparity in income between the top 0.1 percent and the average American. The average includes the income of the top 0.1 percent. Comparing the income of those in the top 0.1 percent with the income of those in the bottom 99.9 percent raises the estimated ratio to 140 times in 2007. Moreover, income distributions are “right-skewed” so that a person in the median of the income distribution makes less than the average. In 2007 the median income of families was 77.8 percent of the mean income in the United States, suggesting that the income of the upper 0.1 percent was on the order of 180 times the median income (U.S. Census Bureau 2011, Table F-8).

Who, you may ask, comprises the upper 0.1 percent? Bakija, Cole, and Heim (2010, Table 3) find that in 2005, about 64 percent of the top 0.1 percent were executives, managers, supervisors, and financial professionals, or worked in real estate. The 403 or so billionaires in the annual Forbes list are there. The top corporate executives and Wall Street bankers are there. Following the 1999 repeal of the Glass-Steagall Act provisions that separated commercial banks that hold deposits from the riskier investment banks that issue securities, the finance sector expanded. Finance absorbed a disproportionate 40 percent of business profits. It hired some of the country's best and brightest to develop new financial instruments, which it peddled as essentially risk free, all the while enveloping the real economy with a highly leveraged financial house of cards—an estimated $22 of derivatives for every dollar of goods and services produced in 2009 (Matai 2009)!

While some high-income recipients made their money primarily through salaries, for many, million-dollar salaries were chump change, dwarfed by earnings from stock options or restricted shares that gave them ownership claims on the firm or by bonuses paid as incentive pay. When the firm's share price rises, the owners of the options and shares benefit even if the price rise was due to factors outside their control. When the stock market crashed after the 9/11 terrorist attacks, some firms gave out new options at the abnormally low market prices, which paid off handsomely when the market recovered. In general, when share prices fall and drive options "under water," boards of directors give out new options at the low prices to "reincentivize" executives. At the top of the income distribution, the IRS reports that the 400 persons with the highest adjusted gross income earned 10 percent of all capital gains, 4 percent of all interest, and 4 percent of all dividends received in the United States in 2007 (Mi2g 2009). Great ways to make a living if you can get it.

The implosion of Wall Street and ensuing recession affected the entire economy. The federal government bailed out the banks with Troubled Asset Relief Program (TARP) monies. The Federal Reserve loaned $1.2 trillion dollars to the banks to help them recapitalize. The Obama administration's stimulus package—tax cuts, support of state and local governments, and spending initiatives—helped the economy recover while adding to the federal deficit. But just as the gains from the economic growth had gone disproportionately to a small number, the gains from the recovery went disproportionately to a small number. Firms gave out options at low share prices when the stock market was weak, which allowed executives to clean up in a market that owed its recovery to the bailout and stimulus. On the day the Reconnecting to Work conference began, *USA Today* reported that CEO pay had jumped 27 percent in 2010 under the headline "CEO Pay Soars While Workers' Pay Stalls" (Kantz and Hansen 2011).[3]

But while executive pay and corporate profits recovered smartly, there was virtually no recovery in the job market. And the recession-induced deficits in the public sector produced cutbacks in government employment and spending with threats of more to come.

The Resilience of the Grinches

How the Grinch Stole Christmas ends when the Whos overcome their disappointment at the stolen Christmas stockings, presents, and cookies, and join hands to celebrate Christmas because Christmas meant more to them than material goods bought in a store. This behavior shocked the Grinch to a born-again moment. Seuss reports the event: " . . . in Who-ville they say, That the Grinch's small heart grew three sizes that day."

Given the physiological problems of tripling even a small interior organ, note that Seuss does not himself claim this is what happened. He just reports what folks in Who-ville say. In any case, caught up with the Christmas spirit, the Grinch returned the stolen goods to the community. Then, to the surprise of all, "He himself . . . The Grinch carved up the roast beast" for Christmas dinner.

This is where Seuss and economic reality part. No one, least of all an economist, expects Americans to take the loss of prosperity and full employment in the Christmas spirit of the Whos, holding hands and singing. Unemployment reduces happiness, creates mental distress, worsens lifetime career prospects, and reduces family income, leading some into poverty.[4] Surveys show that the vast majority of Americans have a dim view of the direction in which the country is heading: less than 25 percent believe that their children will do better economically than they do (Bendavid 2011; Rasmussen Reports 2011).

Similarly, no one, least of all an economist, expected the Wall Street Grinches to have a spiritual rebirth and return their bailout-created gains to the country. But given the near-death experience of finance, I anticipated some change in behavior: apologies for what Wall Street had done to the country, thanks to taxpayers for bailing them out, and special thanks to the Obama administration for not siccing the FDIC and FBI onto them, as Presidents Reagan and Bush had done to the bankers who created the 1980s savings and loan crisis, and as New Deal investigators had done to their predecessors in the Great Depression. Given that even conservative Americans harbored distrust and anger toward the bankers, it seemed a good time for them to lay low, take a modest million or two in pay, donate to philanthropic causes, and maybe even volunteer to help the nation rebuild shared prosperity for all.

Instead, the Grinches of finance behaved just as the economists' model of homo oeconimicus predicts people behave when money is at stake. Evincing neither remorse nor interest in any interest but their own, Wall Street financiers fought to restore the past economic order in which they and their compatriots in the upper income brackets garnered all the gains from economic growth. A consumer financial protection agency to protect citizens in financial transactions? A Tobin tax on financial transactions? The Volcker rule? Higher capital requirements on banks? A policy to break up the banks too big to fail? Strengthened regulatory powers for the Securities Exchange Commission? Tax increases on the wealthy? "Nevermore," quoth the Grinch—or was that the Raven? Increased unionization to protect the interests of the middle class? Unions? "Forget them." The middle class? "Charge them debit card fees, the dumb marks."

After the conference, I worried that *How the Grinch Stole Christmas* had too rosy an ending to represent the U.S. economy. The Grinch looked like a Wall Street operator, but his born-again soft spot would have made Gordon Gekko and his cronies cackle. After all, "Greed is right, greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit."[5] Perhaps I needed a tougher vision of the grinches of the world than Dr. Seuss offered.

Fourteen years after he published the *Grinch*, Dr. Seuss developed that tougher vision in *The Lorax* (1971). This is the only Seuss book that puts economic behavior at the heart of the story. It is a dark, grim tale of how the entrepreneurial Once-ler found a way to turn Truffula trees into Thneeds, "which everyone, EVERYONE, EVERYONE needs!" Crazy with greed, the Once-ler pushed production to the point where it destroyed the environment, destroyed every Truffula tree, turned the land into a horrific rustbelt of empty factories and buildings fallen apart, with "no more work to be done." Sadly, the book displays only the Once-ler's green hands and beady eyes, so whether the Once-ler looks more like Gordon Gekko or Mr. Madoff or—name your favorite or least favorite Wall Street banker—I do not know. My guess is that the Once-ler is in the Grinch family, but I could be wrong.

I did a Google search to find out more about the Grinch after his Christmas epiphany. The slithery sneering creature starred in a 1977 TV show called *Halloween Is Grinch Night*. Here Seuss painted a harsher character whose sole goal was to terrorize the Whos on Halloween by releasing his bag of horrors onto Who-ville. The only thing that stopped the Grinch was a brave, bespectacled little Who, who delayed the Grinch until past the witching hour. At the show's end the Grinch threatens to come back the next Halloween to do his evil work. In the Hollywood remake of the show, I envision Brooksley Born, the head of the Commodity Futures Trading Commission under President Clinton, playing the brave little Who. Born wanted to regulate the risky derivatives market, a move for which she was viciously attacked by Bob Rubin, Alan Greenspan, Larry Summers, and Arthur Levitt, and forced to resign from her job. As for the bag of horrors, we all know what it contains: more and more dangerous derivatives, credit default swaps, mortgage-backed securities. If the Christmas Grinch is too soft for you, think of Once-ler or the Grinch of Halloween.

THE WAY FORWARD: HORTONOMICS

There is another side to the economics of Dr. Seuss—a positive message that economists of every political stripe find particularly appealing. This is the story of investment in *Horton Hatches the Egg* (1940). Recall, if you will, the situation. Mayzie, a lazy bird, has laid an egg and wants someone to replace her atop the nest so she can have a "short" holiday. She inveigles Horton to sit on the egg—not an easy task for a huge elephant—but he fixes the tree branch to hold him until Mayzie returns. Horton sits on the egg through summer, autumn, winter, and spring, and all the while, Mayzie does not appear. Seuss reports that she was partying in Palm Beach, but I heard that she was actually on the Cayman Islands with the corporate Grinches who find the tax haven more profitable than building job-creating businesses. If only we had her Tweets to resolve the issue. In any case, Horton kept sitting on the egg, repeating the motif that we all know so well. "I meant what I said, and I said what I meant . . . An elephant's faithful—one hundred percent."

Hunters capture Horton and sell him, the tree, and the egg to a circus, which sees money-making potential in an elephant hatching an egg in a tree. It charges 10 cents a peek. When the egg hatches, Mayzie suddenly appears and tries to foreclose the property: "It's MY egg!" she sputters. "You stole it from me. Get off of my nest and out of my tree." But when the egg pops, out comes "something brand new"—an elephant-bird with elephant ears, tail, and trunk and wings, who stays with Horton.

Horton Hatches the Egg has two messages for understanding our current economic situation. The first is that economic growth requires long-term investments—sitting on the egg. Investment in infrastructure, in R&D, in new plants and equipment, in risky innovations, and, in the case of the egg, the investment in human capital. Economic growth is harmed by short-term investments based on balloon loans or financial manipulations. The second message is that trust is important in a well-functioning economy. "I meant what I said, and I said what I meant." Sellers of securities who are faithful to their clients instead of betting against them. Management and employees who work cooperatively knowing that they will divide the resultant profits. Consumers who know that when they pay their debts, the bank will apply their payments to the debt with the highest interest rate.

In the tradition of attaching names to economic policies—the New Deal, the Fair Deal, Reaganomics, Clintonomics—I propose that policies to reverse the trend in inequality and restore full employment be labeled Hortonomics. I offer one specific policy that would fit the Horton label. This is to modify the corporate tax code so that firms cannot deduct as a cost of business huge payments to top executives in the form of pay for performance unless the incentive plan covers all workers.[6] Currently firms cannot deduct health and retirement plans as costs of business unless the plans cover all workers, so this modification would extend that practice to incentive pay plans. The proposal would increase the proportion of American workers covered by incentive pay. The workers would benefit from their firms' economic performance to a greater extent than now, which would motivate them to produce more.

During the Great Recession, firms in most OECD countries adapted work-sharing policies that traded lower productivity to save jobs while firms in the United States did the opposite, shedding workers so rapidly that productivity increased at record levels (Bureau of Labor Statistics

2011). In developing countries also, policies were shifting in favor of workers. Brazil and other Latin American countries raised minimum wages, used tax monies from the wealthy to fund education and transfer programs for the poor, and experienced both falling inequality and increased economic growth. Perhaps most telling, China adopted a policy of strengthening unions and labor laws to fight inequality.

But while Hortonomics had traction in other countries, it seemed outside U.S. political discourse, which was focused on cutting the federal deficit, and where many viewed discussion of inequality as raising a red banner of class warfare. The Whos in the United States who suffered from stagnant real earnings and unemployment seemed invisible in debates over economic policy. In April I could not see what would change the situation.

And Then . . . the American Whos Speak

They spoke up first in New York City on September 17, 2011, when the Occupy Wall Street protestors sat down in Zuccotti Park around Wall Street under banners that read "We are the 99 percent." The protestors targeted economic inequality, corporate greed and corruption, and the dominance of Wall Street over the government as the main problems that troubled them. But they offered no explicit political or policy agenda and were suspicious of both Democrats and Republicans. The New York event set off similar protests in other U.S. cities and communities and spread to other parts of the world.

It is unclear how much staying power the occupiers have or whether their protests will influence policy. Unions, environmentalists, and many others on the left support them. Many leaders, from the president of the United States to the mayor of New York to the head of the Federal Reserve, expressed sympathy for and recognition of the validity of their concerns. Republican politicians have been more critical of the occupiers and defensive of Wall Street. At the minimum the occupiers have brought the rise in inequality and joblessness to the forefront of national discourse.

The 1954 book *Horton Hears a Who!* offers Seussian insight into what happens when Whos speak up and others hear their voice. The book begins "on the fifteenth of May" (in the big scheme of things, just a smidgeon away from the occupiers' first protest on September

17). Horton is taking a bath when he hears a small noise from a speck of dust in the air. His elephant ears allow him to hear the voices of the Whos even though he cannot see them. The smaller-eared denizens of the jungle mock Horton for hearing voices until the mayor of Who-ville gets every Who "to make noises in greater amounts." Crying out as a group, "Their voices were heard! They rang out loud and clear." Horton and the other animals then join to protect the Whos because "a person's a person, no matter how small."

Now that the Whos in this country have spoken and some leaders have begun to listen to their concerns, I am more optimistic than I was at the Reconnecting to Work conference that the United States will come out of Wall Street's financial implosion and the Great Recession with reforms that will restore full employment and prosperity for all citizens. I hope that economics and social science and, more broadly, policy analysis, are up to the task of developing efficient programs to help attain this goal.

Notes

1. For data on inequality, see the Gini coefficients from the Central Intelligence Agency and the United Nations: http://en.wikipedia.org/wiki/List_of_countries_by_income_equality (accessed June 5, 2012). For data on social mobility, see OECD (2010, Chapter 5).
2. These data are from Piketty and Saez (2003). The figures for 2008 show a small drop in the share of the upper 0.1 percent due to the collapse of the stock market. I use 2007 data as likely to be more representative of the situation after the market recovered. There are only modest differences in the shares between 2007 and 2008.
3. An updated and lengthier analysis is available at http://www.usatoday.com/money/companies/management/story/CEO-pay-2010/45634384/1 (accessed June 5, 2012).
4. See Chapters 2 and 4 in this volume. In Chapter 4 of the 2008 *Employment Outlook*, the OECD documents the deleterious effects of unemployment on mental health using panel data for several countries. Sullivan and von Wachter (2009) show that job displacement of blue-collar males increases mortality by 50 percent to 100 percent. Studies of college graduates (Kahn 2010; Oreopoulos, von Wachter, and Heisz 2006) show that a cohort that graduates in a recession suffers lower income for the bulk of its working life. Finally, Gallup polls show that the proportion of unemployed Americans diagnosed with depression is twice as high as the proportion of fully employed persons, and rises with the length of unemployment. http://www.gallup.com/poll/139604/worry-sadness-stress-increase-length-unemployment.aspx (accessed June 5, 2012).

5. IMDb's page for *Wall Street*, http://www.imdb.com/title/tt0094291/quotes (accessed June 5, 2012).
6. For the details of this plan see www.americanprogress.org/issues/2011/03/worker_productivity.html (accessed June 5, 2012).

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