Center for American Progress

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Retailer Revelations

Why America's Struggling Middle Class Has Businesses Scared

By Brendan V. Duke and Ike Lee October 2014

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Introduction and summary

The decline of the U.S. middle class has corporate America and Wall Street scared. And nobody is more frightened than America's biggest retailers.

Five years after the 2001 recession ended, real retail spending per person had climbed 7 percent above its prerecession level. More than five years after the end of the Great Recession—August 2014—retail spending per person had finally reached its prerecession level.[1]

Former Walmart U.S. CEO Bill Simon, whose company had seen consumer traffic drop for six straight quarters and same-store sales drop for five quarters, explained in July 2014 that "we've reached a point where it's not getting any better but it's not getting any worse—at least for the middle (class) and down."[2] Kip Tindell, CEO of the Container Store, put retailers' feelings best when he said, "consistent with so many of our fellow retailers, we are experiencing a retail 'funk.'"[3]

The culprit is obvious: low wage and income growth for the middle class. Median household income in 2013 stood 8 percentage points below its 2007 prerecession level.[4] The simple fact of the matter is that when households do not have money, retailers do not have customers. The failure of incomes to keep up with the growing cost of college, child care, and other middle-class staples leaves even less money for retail spending. A previous analysis by the Center for American Progress shows that this so-called "middle-class squeeze"—stagnant incomes and the growing cost of middle-class security—leaves the median married couple with two kids with $5,500 less to spend annually on food, clothes, and other essentials that retailers sell.[5]

Or, as officials of J.C. Penney—whose sales fell 9 percent in 2013[6]—put it when listing the risks to its stock value: "the moderate income consumer, which is our core customer, has been under economic pressure for the past several years."[7] Moreover, retail spending—which includes spending on everything from clothing to groceries to dining out—has broad implications for the entire economy since it accounts for a large fraction of consumer spending, which itself makes up 70 percent of U.S. gross domestic product, or GDP.

This report gathers new evidence to show that middle-class weakness and stagnant wage growth are holding the economy back. We use the financial statements, known as 10-Ks—the annual report required by the Securities and Exchange Commission, or SEC—of the top 100 retailers in America and words of some of Wall Street's top economists to underscore the point.

Time and again, America's leading corporations warn investors that "decreased levels of consumer spending" (Kohl's),[8] "a renewed decline in consumer-spending levels" (Sears),[9] and "decreased salaries and wages" (Burger King)[10] could have a huge negative impact on their financial performance. The corporate consensus is clear: It is this cycle of stagnation—low wages, leading to weak demand, leading to slow growth, leading back to low wages—that is hurting companies, their consumers, and the U.S. economy at large.

This report finds that:

- Eighty-eight percent of the top 100 U.S. retailers cite weak consumer spending as a risk factor to their stock price.[11]

- Sixty-eight percent of the top 100 U.S. retailers cite falling or flat incomes as risks. Looking just at companies that were publicly held in 2006, the percent listing consumers' incomes as a risk factor has doubled since that year. A majority of retailers—57 percent—cite rising energy, health care, housing, and other essential costs as risks, showing the middle-class squeeze of rising costs and stagnant incomes.[12]

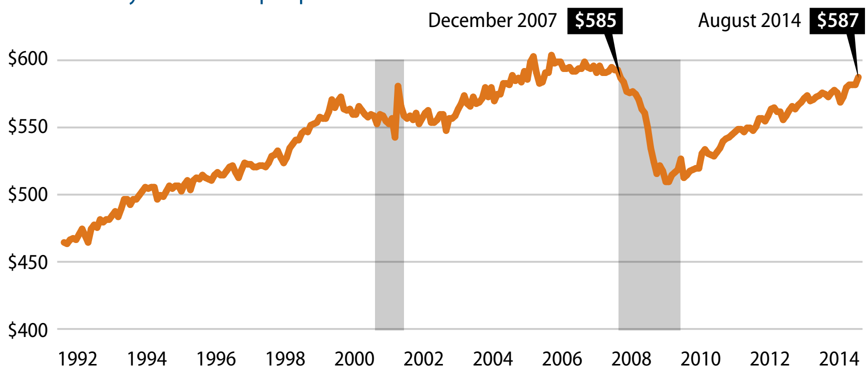
- Wall Street economists are even more explicit about the risk that low wages pose to the economy, arguing that they drive low demand and high unemployment.

- Retailers could improve their profits by embracing a middle-class-growth-oriented agenda instead of spending their political energy on preventing policies that increase wages. Policies such as a minimum-wage increase could provide the perfect mechanism for coordinating wage growth that could benefit the entire retail sector by fueling more consumer spending.

FIGURE 1

Retail's long and slow recovery

Real monthly retail sales per person



Note: Shaded areas indicate recessions

Source: Authors' analysis using Federal Reserve Economic Database, "Real Retail and Food Services Sales" and "Population Total for the United States," available at http://research.stlouisfed.org/fred2/ (last accessed September 2014).

The evidence assembled in this report directly repudiates "trickle-down economics"—the idea that the only way to produce economic growth is to redistribute money to the rich, who will create jobs for everyone else. Conservative politicians, lobbyists, and commentators may still be stuck in the trickle-down mindset of the 1980s, but corporate America and the Wall Street analysts who closely follow it know better.

While it may at first seem obvious that low consumer demand impedes growth, conservative think tanks and other believers in trickle-down economics ignore the evidence. Stephen Moore, chief economist at the Heritage Foundation, approvingly quotes Arthur Laffer, the father of trickle-down economics, who said, "All economic problems are about removing impediments to supply, not demand."[13]

The U.S. Chamber of Commerce's "Jobs, Growth, and Opportunity Agenda" report similarly focuses on "expanding trade, producing more domestic energy, improving infrastructure, modernizing the regulatory process, making essential changes to entitlements, fixing the flaws in Obamacare, curbing lawsuit abuse, and advancing American innovation by protecting intellectual property… revitalizing capital markets, passing immigration reform, and improving education and training, which will expand opportunity, address inequality, and create jobs."[14] At the same time, it opposes any measures "that would automatically increase labor costs."[15] There is literally no policy in the agenda focused on immediately increasing aggregate demand and consumer spending other than perhaps the jobs created by infrastructure improvements and higher wages produced by immigration reform.

If the Heritage Foundation, the U.S. Chamber, and other proponents of trickle-down economics refuse to believe the overwhelming academic evidence that clearly shows low consumer spending[16] and income growth[17] are holding the economy back, they should listen to corporate America and Wall Street when they say that a consumer base with large, growing discretionary incomes—in other words, a strong middle class—is the vital ingredient for job growth and a strong economy. Or, as Ellen Zentner, executive director and senior economist at Morgan Stanley, explained, "faster employment and wage growth for those at the bottom, were it to have staying power, would help lift consumer spending, the biggest part of the economy."[18]

The corporate case for middle-out economics

Publicly traded companies in the United States are required to list risk factors to their business in SEC 10K forms, the annual filings that companies are legally required to send to shareholders to disclose their financial data, compensation structure, physical assets, and more. These 10-K filings are not glossy public relations documents, but rather offer a window into the workings of the real economy, free from the rhetoric of political ideology.

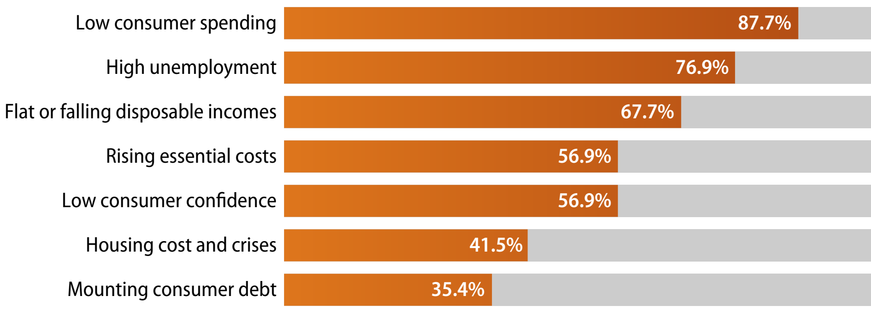
In compiling this report, we reviewed the risk-factor sections in 10-Ks, Item 1A, from the country's top 100 retailers of 2014—a list compiled by the National Retail Federation that ranks retailers based on revenue. SEC 10-Ks exist for only 65 companies on the list since the rest are privately owned, such as Albertsons; foreign-owned, such as 7-Eleven; or government-owned, such as the Defense Commissary Agency, and thus do not have to file 10-Ks. The 10-K filings reviewed for this report are from the SEC's public database—the Electronic Data Gathering, Analysis, and Retrieval system, or EDGAR. We also excluded firms that are no longer publicly traded since their most recently filed 10-K, such as OfficeMax and Safeway. The results are current as of August 20, 2014.

In reviewing the filings, we searched for mentions of consumer demand and spending as well as a few of their critical drivers: unemployment, consumer confidence, essential costs, housing, debt, and income. Figure 2 breaks down the percentage of companies listing each risk factor while Table 1 (in the Appendix) indicates which companies pointed to which factor.

FIGURE 2

A weak middle class scares retailers

Percent of the top 100 retailers citing each risk factor



Source: Authors' analysis of the 10-K forms of the America's 100 largest retailers. List of retailers from National Retail Federation, "Top 100 Retailers Chart 2014," available at https://nrf.com/2014/top100-table (last accessed August 2014). 10-K forms from the Securities and Exchange Commission, "EDGAR Database," available at https://www.sec.gov/edgar/searchedgar/companysearch.html (last accessed August 2014).

While many of these companies' lobbyists and trade associations continue to promote a low-wage agenda, their 10-K statements reveal how low consumer spending levels undermine their stock prices. In fact, 88 percent of top retailers explicitly cite weak consumer spending as a risk factor.[19]

That retailers depend on consumer spending is not a revelation, but that many retailers see flat or declining incomes as a risk factor is: 68 percent of companies point to flat or falling disposable incomes as a risk. Sixty-four percent of these companies that filed 10-Ks in 2006 cited incomes as a risk factor in their most recent 10-K, compared to just 32 percent in 2006.[20]

How do these factors affect companies' bottom lines? Let's take a look at each and hear what companies have to say via their 10-K filings.

Low consumer spending

Retailers can only sell goods and services if consumers are buying; slow growth in consumer spending translates directly into slow sales growth for retailers. Retailers are especially concerned about consumers' "discretionary spending"—their ability to buy more than food, housing, and basic clothing—a hallmark of the middle class.

Starbucks, for example, describes itself as a "retailer that is dependent upon consumer discretionary spending."[21] Meanwhile, Williams-Sonoma, Inc., the high-end kitchen products retailer, reports that "adverse changes in factors affecting discretionary consumer spending have reduced and may continue to further reduce consumer demand for our products, thus reducing our sales and harming our business and operating results."[22]

High unemployment

Unemployment has strong negative effects on consumption because it can greatly reduce consumers' incomes. Almost all retailers listed the unemployment rate and its effects on consumer spending as a risk factor. By all indications, the labor market is far from being fully recovered. The broadest measure of unemployment—the so-called "U-6 measure"—stood at 12 percent in August 2014—compared to 8.4 percent in August 2007.[23]

Flat or falling incomes

The fundamental component driving consumer spending and confidence is consumers' incomes. Consumers can use credit to increase consumption temporarily—as the lead up to the financial crisis showed—but in the long run consumption levels cannot be higher than incomes. Two-thirds of the top 100 retailers cited flat or falling incomes as a risk to their stock price. Of these companies that released 10-Ks in 2006, 64 percent cited incomes as a risk factor in their most recent 10-K—double the 32 percent in 2006, the year before the Great Recession began.

Gap Inc. writes that "Consumer purchases of discretionary items, including our merchandise, generally decline during periods when disposable income is adversely affected."[24] DineEquity—which owns Applebee's and the International House of Pancakes, or IHOP, describes flat or falling incomes as a risk in great detail: "If our customers' disposable income available for discretionary spending is reduced … our business could experience lower sales and customer traffic as potential customers choose lower-cost alternatives (such as quick-service restaurants or fast casual dining) or choose alternatives to dining out."[25]

Rising essential costs

Discretionary income depends not just on wage growth but also on how it relates to the rising costs of items essential to middle-class families: gas, health care, housing, and other goods. Unfortunately, middle-class families have felt increasingly "squeezed" as the costs of these items have outpaced overall inflation and income growth.

Darden Restaurants, the owner of Olive Garden and until recently, Red Lobster, describes the threat of the squeeze perfectly: "if gasoline, natural gas, electricity and other energy costs increase, and credit card, home mortgage and other borrowing costs increase with rising interest rates, our guests may have lower disposable income and reduce the frequency with which they dine out, may spend less on each dining out occasion, or may choose more inexpensive restaurants."[26]

Falling consumer confidence

Consumer spending, especially discretionary spending, depends on how consumers are feeling about their personal financial situations now and in the near future—in other words, their "consumer confidence." Metrics reflecting confidence are obsessively scrutinized on a daily basis on Wall Street and in financial news, and exert strong influence on market performance.

Signet Jewelers Ltd. in its 10-K filing states, "jewelry purchases are discretionary and are dependent on consumers' perceptions of general economic conditions, particularly as jewelry is often perceived to be a luxury purchase."[27] Brinker International—which owns Chili's restaurants—writes, "consumer confidence has not fully recovered from recent lows impacting the public's ability and/or desire to spend discretionary dollars."[28]

Housing costs and crises

Housing played a critical role in the Great Recession as families with too much housing debt or families who experienced large reductions in housing wealth cut back on spending.

Unsurprisingly, companies such as Lowe's, the retail chain of home-improvement stores, describe the continuing depressed housing market as a risk factor:

> *Sales of many of our product categories and services are driven by the activity level of home improvement projects. Although the housing market has been strengthened by favorable interest rates and lower home prices, the large number of households that continue to have little available equity, mortgage delinquency and foreclosure rates that remain abnormally high, tighter restrictions on the availability of mortgage financing, slower household formation growth rates, and lower growth in housing turnover through existing home sales, have limited, and may continue to limit, consumers' discretionary spending, particularly on larger home improvement projects that are important to the growth of our business.*[29]

High consumer debt

High levels of consumer debt can reduce spending since consumers may use up all of their available credit and are forced to spend within their incomes. Macy's, the national department-store chain, describes how consumer debt levels can hurt its sales this way: "Consumer spending may be affected by many factors outside of the Company's control, including … the availability, cost and level of consumer debt and consumer behaviors towards incurring and paying debt."[30]

Explaining the "retail funk"

America's retail sector as a whole is struggling. Five years after the 2001 recession ended, retail spending per person had grown 7 percent above its prerecession level.[31] Retail spending per person in August 2014—more than five years after the Great Recession ended—had finally reached its prerecession level.[32] Recently, Container Store CEO Kip Tindell said that, "consistent with so many of our fellow retailers, we are experiencing a retail 'funk.'"[33]

A look at a few retailers and their risk factors explains how low consumer spending and stagnant wage growth help drive the retail funk.

Kohl's

As one of the country's largest retailers with 1,158 stores[34] and all operations and sales occurring within the United States, Kohl's employs around 137,000 workers as sales associates, store managers, and cashiers.[35] It targets middle-class consumers with an inventory focused on discounted, low-tier brand names, attracting a median customer of 45 years old to 54 years old [36] in a household earning between $50,000 and $75,000 annually.[37] However, Kohl's sales growth rate has declined steadily since 2011, from 2.25 percent to -1.29 percent in fiscal year 2013.[38]

Kohl's 10-K filing:

> *Recent economic conditions have caused disruptions and significant volatility in financial markets, increased rates of default and bankruptcy and declining consumer and business confidence, which has led to decreased levels of consumer spending, particularly on discretionary items. A continued or incremental slowdown in the U.S. economy and the uncertain economic outlook could continue to adversely affect consumer-spending habits resulting in lower net sales and profits than expected on a quarterly or annual basis. As all of our stores are located in the United States, we are especially susceptible to deteriorations in the U.S. economy.*[39]

Sears

Sears maintains its status as the 16th-largest U.S. retailer,[40] and has long been targeting middle-class consumers with its 1,980 stores nationwide.[41] However, it has recently been pressured on both sides of the retail market by low-end stores such as Walmart and luxury chains such as Nordstrom. With 226,000 employees,[42] Sears has struggled with its revenues as sales growth has slipped consistently since 2011 from -2.2 percent to -3.8 percent last year.[43] These pressures in part caused the company to close its flagship store in Chicago in February 2014.[44]

Sears' 10-K filing:

> *Our business has been and will continue to be affected by worldwide economic conditions; a failure of the economy to sustain its recovery, a renewed decline in consumer-spending levels and other conditions, including inflation and changing prices of energy, could lead to reduced revenues and gross margins, and negatively impact our liquidity.*
>
> *Many economic and other factors are outside of our control, including consumer and commercial credit availability, consumer confidence and spending levels, including the impact of payroll tax and medical cost increases on U.S. consumers, inflation, employment levels, housing sales and remodels, consumer debt levels, fuel costs and other challenges currently affecting the global economy, the full impact of which on our business, results of operations and financial condition cannot be predicted with certainty. These economic conditions adversely affect the disposable income levels of, and the credit available to, our members and customers, which could lead to reduced demand for our merchandise.*[45]

Burger King

Burger King is the second-largest hamburger chain in the United States and one of the country's most recognized brands. It and its franchisees employ a workforce of around 210,000 individuals, the majority of them working in the chain's restaurants at 7,183 locations across the country.[46] Burger King franchises are concentrated in heavily populated metropolitan areas and along highway routes. Burger King's restaurant sales growth has also been volatile and frequently negative: Sales growth was -3.4 percent in 2011, recovering to 3.5 percent in 2012, but falling again in 2013 to -0.9 percent.[47]

Burger King's 10-K filing:

> *We believe that our sales, guest traffic and profitability are strongly correlated to consumer discretionary spending, which is influenced by general economic conditions, unemployment levels, the availability of discretionary income and, ultimately, consumer confidence. A protracted economic slowdown, increased unemployment and underemployment of our customer base, decreased salaries and wage rates, increased energy prices, inflation, foreclosures, rising interest rates or other industry-wide cost pressures adversely affect consumer behavior by weakening consumer confidence and decreasing consumer spending for restaurant dining occasions. During the last recession, as a result of these factors we experienced reduced revenues and sales deleverage, spreading fixed costs across a lower level of sales and causing downward pressure on our profitability. These factors also reduced sales at franchise restaurants, resulting in lower royalty payments from franchisees.*[48]

J.C. Penney

J.C. Penney operates 1,094 stores in the United States, employing 117,000 full- and part-time workers. As one of the hardest-hit retailers in recent years, its store sales plummeted by more than 25 percent in 2012.[49] Although 2013 showed some improvement with only a 8.7 percent decrease in store sales, investors have since lost confidence that the big-name company will ever get its middle-class consumer base to fuel apparel sales,[50] despite a multiyear turnaround campaign being waged by executives.

J.C. Penney's 10-K filing:

> *Our results of operations are sensitive to changes in overall economic and political conditions that impact consumer spending, including discretionary spending. Many economic factors outside of our control, including the housing market, interest rates, recession, inflation and deflation, energy costs and availability, consumer credit availability and terms, consumer debt levels, tax rates and policy, and unemployment trends influence consumer confidence and spending. The domestic and international political situation and actions also affect consumer confidence and spending. In particular, the moderate income consumer, which is our core customer, has been under economic pressure for the past several years, and may have less disposable income for items such as apparel and home goods.*[51]

Best Buy

Best Buy, the largest American electronics retailer, has suffered a substantial decline during the recent economic conditions. In recent years, its 1,495 stores have consistently seen negative sales growth of -1.5 percent in 2012, -3.4 percent in 2013, and -0.8 percent in 2014,[52] as Best Buy's target middle-class consumers—households with a median income of $75,000[53]—as a group have scaled back on discretionary spending. The company employs 140,000 workers worldwide.[54]

Best Buy's 10-K filing:

> *For the past several years, we have experienced the impact of difficult and uncertain macroeconomic conditions in the geographic markets in which we operate. Some of our products and services are viewed by some consumers to be discretionary items rather than necessities. As a result, our results of operations are sensitive to changes in macroeconomic conditions that impact consumer spending. Consumer confidence, employment levels, interest rates, tax rates, availability of consumer financing, housing market conditions, and costs for items such as fuel, energy and food, can adversely affect consumers' demand for the products and services that we offer.*[55]

The fortunes of the retail sector and the middle class are inherently linked—when family incomes fail to rise, when the cost of living increases, or when workers cannot find jobs, retailers' sales decline.

The Wall Street analyst case for middle-out economics

Wall Street credit rating agency Standard & Poor's made headlines in August 2014 when it cited rising inequality as a reason for cutting its U.S. growth forecast.[56] Yet, this argument is not new or unique—even on Wall Street. To dig deeper into the causes behind stagnant consumer spending and disposable incomes, we examined the statements and reports of private-sector economists—analysts who work for banks and other financial institutions—whose job it is to interpret the forces behind the economy so their firms can allocate capital efficiently.

The conclusions from our analysis of retailers' 10-K filings are backed up by the analysis of Wall Street economists: Both corporate America and our relentlessly squeezed middle class are stuck in a vicious cycle of low wages and low demand, an economic crisis that trickle-down solutions can never fix.

Our findings

Weak demand, slow consumer spending growth, and low wages are holding the economy back

Economists for major financial institutions point to weak demand, specifically the lack of consumer spending growth, as the major reason why companies are hiring so slowly. And the culprit for the lack of consumer spending is stagnant wage growth in the recovery.

> *As far as business investment goes, there are multiple factors that have been holding things back. But I think probably the most important is that demand has been relatively weak in this expansion, with consumer spending growth slow, with exports, which were actually doing quite well early in the—in the recovery, but then faltered when Europe went into recession.*[57]
>
> *— Chris Low, chief economist, FTN Financial, January 16, 2014*

Companies are concerned about future demand for their products. The recent economic recovery, as muted as it has been (both in absolute terms and relative to most expectations), has been driven by the experimental policies that central banks have pursued to sustain consumption. Now, with the US Federal Reserve beginning to withdraw monetary stimulus, and with growth in emerging countries slowing, most companies are simply unable to point to massive expansion opportunities.[58]

— Mohamed El-Erian, chief economic advisor, Allianz, March 1, 2014

Faster employment and wage growth for those at the bottom, were it to have staying power, would help lift consumer spending, the biggest part of the economy.[59]

— Ellen Zentner, executive director and senior economist, Morgan Stanley, May 20, 2014

Wage growth has been, as you know, extremely lackluster. So that's one of the factors that's weighing on primary home buying.[60]

— Michelle Meyer, senior economist, Bank of America Merrill Lynch, February 6, 2014

Private-sector economists disagree with the dominant conservative narrative that the economy's short-term obstacles are purely on the supply side such as regulations or low incentives to invest produced by the tax code. Rather, slow consumer spending and flat wage growth are preventing companies from hiring.

The employment and wage Catch-22

More specifically, private-sector economists argue that the weak demand is driven by an important tension between wages and hiring: Companies are not raising wages because the labor market is weak, but the labor market is weak because low wages are holding back consumer demand and thus hiring.

This is an important tension. We need more income to get more consumption and we need more consumption to get more income—that is, stronger consumer demand for firms to be willing to hire and pay more.[61]

— Nathan Sheets, former global head of international economics, Citigroup, September 10, 2012

And it's tied to employment. And employment in the developed world is not going to be growing that fast. If you don't get employment and you don't get wage growth, you don't have consumption. If you don't have consumption, that's 2/3 of GDP in the developed markets, it's going to be slow.[62]

— *William Priest, CEO, Epoch Investment Partners, November 11, 2013*

The unemployment rate has fallen considerably from its peak levels, but it's still high. There—there are shortages of labor in some select industries, but for the most part, it's still fairly easy to find people. And for that reason, companies have been able to hold the line on wages. We expect that wage growth will accelerate as the labor markets tighten.[63]

— *Chris Low, chief economist, FTN Financial, January 16, 2014*

A reasonable weighing of the evidence suggests there is still anywhere from 1pp to 2.5pp of slack in the labor market. The pockets of wage pressure are just that: labor compensation is weak by almost any measure.[64]

— *Ethan Harris, co-head of global economics research, Bank of America, December 12, 2013*

On the one hand, disappointing growth and persistent unemployment worsens the 'inequality trio' of income, wealth, and opportunities. On the other hand, the greater the inequality trio, the more it undermines consumption, discourages investments, and exacerbate harmful debt overhangs – all of which curtail growth and job creation.[65]

— *Mohamed El-Erian, chief economic advisor, Allianz, March 1, 2014*

This Catch-22 suggests a genuine market failure—a "tragedy of the commons"—where firms cut wages to reduce their costs but simultaneously lower the incomes of other businesses' consumers, reducing profits for everyone.

Low-wage job growth means low consumer spending growth

Perhaps an even greater challenge for wage growth—and thus consumer spending—is the growth of low-wage jobs at the expense of middle-class jobs. Private-sector economists worry that even if the unemployment rate returns to normal levels, consumer spending might never fully recover, because low-wage jobs will leave consumers with less discretionary income.

'We are not seeing job gains translate into wage pressures. It's a question not just of quantity but also of quality' of the new jobs being created, with many temporary or part-time jobs coming in low-paying industries.[66]

— Lindsey Piegza, chief economist, Sterne Agee, June 3, 2014

We also know that a significant percentage of these are part time jobs, not full time jobs. We also know that wage growth is moderate… but certainly not what we're used to for a typical economic recovery after World War II.[67]

— John Silvia, chief economist, Wells Fargo, April 4, 2014

Of those 8.8 million jobs recouped in the private sector, most of them were in low-wage jobs when the bulk of the jobs we lost were in higher wage, manufacturing, construction, business services, and it`s not the number of jobs we create, but the quality of the jobs we create as well.[68]

— Diane Swonk, chief economist and senior managing director, Mesirow Financial, April 18, 2014

This is retail, food service, manual labor, in-home healthcare, and those have replaced very high-wage jobs that we lost during the great recession in the manufacturing, construction, and the office sector.[69]

— Diane Swonk, chief economist and senior managing director, Mesirow Financial, April 5, 2013

People are getting weary of the 'things-are-getting-better' story. We're hiring more workers, but we're not paying them more.[70]

— Steven Ricchiuto, chief economist, Mizuho Securities, May 16, 2014

The low-wage shift these economists describe is real: 37 percent of job losses in the recession were in middle-class jobs—jobs paying between $14 and $21 per hour—which account for just 24 percent of job growth during the recovery. Low-wage jobs—jobs paying less than $14 per hour—on the other hand, account for 44 percent of job growth.[71] The low-wage shift may be saving firms on labor costs, but it is also costing them revenue.

The political case for middle-out economics

America's retailers need a big and robust middle class to maintain sales growth, but they also need to pay their workers wages that grow the middle class and keep it strong. The two go hand in hand: strong sales growth and a well-paid labor force. Yet, too often retailers pay their representatives in Washington to oppose policies that raise wages. Lobbying groups such as the U.S. Chamber of Commerce and the National Retail Federation have spent millions of dollars opposing a minimum-wage increase, modern collective bargaining rights, and the types of sick and family leave policies that would build and strengthen the middle class, which in turn would expand retailers' customer and revenue bases.

Consider the minimum wage. Research shows that an increase in the federal minimum wage to $10.10 an hour would immediately bring 4.6 million Americans out of poverty—in other words, grow the middle class.[72] Indeed, it would almost halve the increase in the poverty rate caused by the Great Recession.[73] The Chicago Federal Reserve quantified how raising the minimum wage would benefit consumer spending: A $1 increase in the minimum wage would increase consumer spending the next year by about $2,800 per minimum-wage household.[74] A $10.10 minimum wage would grow the U.S. GDP by 0.3 percent, which does not even take into account that retailers would increase hiring to meet demand and thus further spur growth—the so-called "multiplier effect."[75] Increasing the minimum wage would increase the labor costs of some companies but businesses would also benefit from more middle-class customers and the corresponding increase in consumer spending.

Yet, the National Retail Federation called the minimum wage "an anti-job tax."[76] The National Restaurant Association, which also represents many of the retailers included in this report, boasts blocking minimum-wage increases in 27 of the 29 states considering an increase.[77] And the chief operating officer of the U.S. Chamber of Commerce called the very existence of the minimum wage "ultimately counterproductive," adding that it "does not help job growth."[78] In total, groups opposing the minimum wage spent more than $5.5 million in political contributions to Congress in the past two election cycles and $91 million in lobbying last year alone.[79]

These trade associations and lobbyists so concerned about the effects of a minimum-wage increase should listen to Walmart, which made perhaps the most persuasive argument for middle-out economics this year. America's largest retailer stayed neutral in the current minimum-wage fight because increased consumer spending could "offset and maybe even exceed whatever impact you pay out to associates," according to company officials.[80] Similarly, the co-founder of the world's largest fast-food chain by units—Subway—said a minimum-wage increase "won't have a negative impact" and came out in favor of pegging the minimum wage to inflation.[81] Craig Jelinek, CEO of Costco, which pays hourly workers an average of $20.89 per hour[82] and has seen its stock price triple since 2009,[83] has said: "I just think people need to make a living wage with health benefits. It also puts more money back into the economy and creates a healthier country. It's really that simple."[84] In February, Gap Inc. put its minimum wage on track to rise to $10 per hour. [85] Glenn Murphy, Gap's CEO, explained, "to us, this is not a political issue. Our decision to invest in frontline employees will directly support our business, and is one that we expect to deliver a return many times over."[86] Likewise, in June, the giant Swedish furniture retailer IKEA announced plans to raise its minimum hourly wage in its U.S. stores to $10.76.[87]

It may be too much to expect every retailer to follow the lead of Gap and IKEA and raise wages without receiving a commitment by other companies to raise their wages as well. Or as entrepreneur Nick Hanauer put it: "The thing about us businesspeople is that we love our customers rich and our employees poor."[88] It may make sense for a single retailer to minimize its labor costs by paying its workers as low a wage as possible. The problem comes when every company pays poverty wages because each company's workers are another company's customers. When every company reduces its labor costs, the result is less consumption and lower profits than would have been the case if companies had kept wages for their workers high.

Economist Nouriel Roubini summed up the problem nicely:

> *Firms in advanced economies are now cutting jobs, owing to inadequate final demand, which has led to excess capacity, and to uncertainty about future demand. But cutting jobs weakens final demand further, because it reduces labor income and increases inequality. Because a firm's labor costs are someone else's labor income and demand, what is individually rational for one firm is destructive in the aggregate.*

> *The result is that free markets don't generate enough final demand. In the US, for example, slashing labor costs has sharply reduced the share of labor income in GDP. With credit exhausted, the effects on aggregate demand of decades of redistribution of income and wealth—from labor to capital, from wages to profits, from poor to rich, and from households to corporate firms—have become severe, owing to the lower marginal propensity of firms/capital owners/rich households to spend.*[89]

Economists have a variety of terms for this: a "market failure," a "coordination failure," or a "tragedy of the commons." What these terms have in common is that they are precisely the sorts of problems where government intervention is more economically efficient than the free market. This wage-consumption coordination failure is a critical economic justification for a higher minimum wage, real overtime laws, and modern leave policies. They may raise companies' labor costs by putting money into their workers' pockets, but they would also increase revenue by putting money into their customers' pockets.

The National Retail Federation may be slowly coming around to this logic: Incoming National Retail Federation Chair Kip Tindell of the Container Store said in October 2014 that "It's unbecoming to speak out against raising the minimum wage" and that he was "working, frankly, to get the [National Retail Federation] to maybe moderate its view on that."[90]

His members should hope they succeed. Instead of knee-jerk opposition to any policy "that would automatically increase labor costs" as the U.S. Chamber does, corporate America should embrace a set of policies that would put money into their customers' pockets.[91] Otherwise, companies will continue to race to the bottom on wages, sending all of their stock prices spiraling to the bottom as well.

Conclusion

American retailers will only grow if American consumers buy more. Absent another credit-fueled consumption boom, American retail spending will grow only if incomes do. Unfortunately, too many in Washington, D.C.—including retailers' own representatives—are focused on keeping wages as low as possible by opposing sensible minimum-wage, overtime, and leave policies that would fix the coordination failure that is hurting retailers.

For retailers, the worry is all about a so-called "new normal" where consumers look for bargain prices and steep discounts.[92] But instead of fretting, it is time that retailers and the rest of corporate America work to create an economic environment where the middle class sees its incomes grow, fueling more consumer spending, growing sales, and dramatically improving corporate bottom lines.

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Appendix

TABLE 1

What scares retailers

Retailers in the National Retail Federation's "Top 100 Retailers" that are publicly traded in the United States and which middle-class risk factors they listed in their most recent SEC filing

National Retail Federation ranking	Company or owner	Low consumer demand or spending	Flat or falling incomes	High unemploy-ment	Rising essential costs	Low consumer confidence	Housing cost and crises	Mounting consumer debt
1	Walmart	✓	✔	✓	✓		✓	✓
2	Krogers	✓	✔	✓	✓	✓	✓	
3	Costco			✓		✓	✓	✓
4	Target		✔***			✓		
5	Home Depot			✓	✓	✓	✓	
6	Walgreens	✓	✓	✓		✓		
7	CVS Caremark	✓	✓					
8	Lowe's	✓	✔	✓			✓	✓
9	Amazon.com	✓						
11	McDonald's	✓	✓	✓				
12	Best Buy	✓		✓	✓	✓	✓	
13	Publix	✓	✔	✓	✓		✓	
14	Macy's	✓	✓	✓	✓	✓		✓
15	Apple	✓	✔	✓	✓	✓		
16	Sears Holdings	✓	✓	✓	✓	✓	✓	✓
18	RiteAid	✓						
19	TJX (T.J. Maxx, Marshalls)	✓	✔	✓	✓	✓	✓	
22	Kohl's	✓	✔	✓	✓	✓	✓	✓
24	Yum! Brands (Taco Bell, KFC, Pizza Hut)	✓	✓	✓		✓		
25	Dollar General	✓	✓	✓	✓			✓
30	Gap	✓	✓	✓	✓		✓	✓
32	Whole Foods Market	✓	✓	✓	✓	✓	✓	
33	Nordstrom	✓				✓		

✔ In 2006, the company was public and did not list incomes as a risk factor; however, it listed them in its most recent filing.

National Retail Federation ranking	Company or owner	Low consumer demand or spending	Flat or falling incomes	High unemploy-ment	Rising essential costs	Low consumer confidence	Housing cost and crises	Mounting consumer debt
34	J.C. Penney	✓	✔	✓	✓	✓	✓	✓
36	Bed Bath & Beyond	✓		✓	✓		✓	✓
37	SuperValu	✓		✓	✓	✓	✓	
40	Family Dollar Stores*	✓	✓	✓	✓			✓
41	Ross Stores		✔	✓	✓	✓		
42	Starbucks	✓	✓	✓	✓		✓	✓
43	L Brands	✓	✓			✓		
45	Triarc Companies (Wendy's and Arby's)**	✓	✓	✓		✓		
47	Staples	✓		✓	✓	✓		
49	Burger King Worldwide	✓	✓	✓	✓	✓	✓	
51	AT&T	✓						
52	Verizon	✓	✔					
53	Darden Restaurants (Olive Garden)	✓	✔	✓	✓		✓	✓
54	Dollar Tree	✓		✓	✓			✓
56	AutoZone	✓		✓	✓			
58	McKesson (Health Mart Systems)							
60	Dunkin Brands	✓	✓	✓				
61	Office Depot	✓		✓				✓
63	Dine Equity (Applebee's & IHOP)	✓	✔	✓	✓		✓	
65	O'Reilly Automotive	✓	✔	✓	✓	✓		✓
66	Advance Auto Parts		✔	✓		✓		✓
67	Dillard's	✓	✔	✓	✓	✓		
68	Sherwin Williams	✓		✓			✓	
69	Dick's Sporting Goods	✓				✓		
70	Game Stop	✓						
71	Barnes & Noble	✓				✓		
72	PetSmart	✓	✓	✓	✓	✓		
73	Liberty Interactive Corporations (QVC)	✓				✓		

✔ In 2006, the company was public and did not list incomes as a risk factor; however, it listed them in its most recent filing.

National Retail Federation ranking	Company or owner	Low consumer demand or spending	Flat or falling incomes	High unemploy-ment	Rising essential costs	Low consumer confidence	Housing cost and crises	Mounting consumer debt
77	Tractor Supply Co	✓	✔	✓	✓			
78	Big Lots	✓	✓	✓	✓			
81	Foot Locker	✓	✓	✓	✓		✓	✓
84	Ascena Retail Group (Dress Barn)	✓	✓	✓	✓	✓	✓	✓
87	Burlington Coat Factory	✓	✓	✓	✓	✓	✓	✓
89	Williams-Sonoma	✓	✓	✓	✓	✓	✓	✓
90	Michaels Stores	✓	✔	✓	✓	✓	✓	
92	Bloomin' Brands (Outback Steakhouse)	✓	✓	✓	✓	✓		
93	Belk	✓	✔	✓		✓		✓
94	Roundy's Supermarkets	✓	✓	✓	✓	✓	✓	
95	Sonic							
98	Brinker International	✓	✓	✓		✓	✓	
99	Signet Jewelers	✓	✓	✓		✓		✓
100	Ingles Markets							

✔ In 2006, the company was public and did not list incomes as a risk factor; however, it listed them in its most recent filing.

* Family Dollar Stores did not have a 2006 10-K, so the 10-K filed in March 2007 was used.

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