the State of Working America 1996-97

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The Economic Policy Institute's Web site contains current analysis of issues addressed in this book. There is also a section that provides more comprehensive information on some of the income, wage, and poverty data series used in *The State of Working America*. These data series are updated with the latest information.

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To my partner and wife, Sharon Simon.

L.M.

To my mother, Evelyn Bernstein, for her support and inspiration,
and to Kay, for her help throughout the writing of this book.

J.B.

To Sarah.

J.S.

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THE STATE OF WORKING AMERICA

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EXECUTIVE SUMMARY

USING A WIDE VARIETY OF DATA ON FAMILY INCOMES, TAXES, WAGES, UNEMployment, wealth, and poverty, *The State of Working America 1996-97* closely examines the impact of the economy on the living standards of the American people. The story we tell is one of great disparities.

As this book goes to press, the economy is in an expansion, but many of the economic problems first evident in the 1980s continue to be felt. For example, despite growth in both gross domestic product and employment between 1989 and 1995, median family income in 1995 was still $1,438 lower than it was in 1989, suggesting that overall growth does not, under current economic circumstances, lead to improved economic well-being for typical families. The 1980s' trends toward greater income inequality and a tighter squeeze on the middle class show clear signs of continuing in the 1990s.

The problem of deteriorating wages, which was primarily responsible for the slow growth in incomes and widening inequality in the past, has not only continued in the 1990s, but it has also pulled down new groups of workers. After more than a decade of wage growth for most women, the bottom two-thirds of women in the workforce saw their wages decline between 1989 and 1995. In the 1980s, families compensated for stagnant and declining male wages by working longer and sending more family members to work, a trend that appears to have reached its maximum capacity. As a result, the incomes of middle-class families have stagnated and fallen in the 1990s. At the same time, jobs have become less secure and less likely to offer health and pension benefits. Middle-class wealth (the value of tangible assets such as houses and cars, plus financial assets, minus debts) has also fallen. These same factors have kept economically less-advantaged families in poverty despite an extended economic recovery.

American workers might be able to take some solace if their sacrifices now would eventually guarantee an improved standard of living for themselves or their children. Unfortunately, the country has little to show for the belt-tightening of the last 15 years: productivity growth and capital investment have been lackluster; only corporate profits and CEO pay are doing better than in the past.

To be sure, some bright spots have appeared. The unemployment rate in mid-1996 stands at 5.3%. Inflation hovers around 3.0% per year. Changes to the tax code in 1994 reversed some of the inequities built into the federal tax structure in the 1980s. The expansion of the earned income tax credit, in particular, was largely responsible for boosting the earnings of poor workers.

Nevertheless, the typical American family is worse off in the mid-1990s than it was at the end of the 1970s. The following is a summary of the economic realities that characterize the state of working America.

Family Incomes: Slow and Unequal Growth

Since 1979, the most important development regarding American incomes has been slow growth and increasing inequality. In the most recent period for which we have data, 1989-95, median family income fell by over $1,400, or 3.4%, despite a substantial rise in both 1994 and 1995. If the current economic recovery should end within the next two years or so, it is unlikely that the median family's income will have recovered its 1989 level. Meanwhile, the increase in income inequality has continued unabated in the first half of the 1990s.

This trend is disturbing for at least two reasons. First, although it is not surprising that incomes fell as unemployment rose between 1990 and 1992, the amount of the decline is greater than would be expected from a rise in the unemployment rate from 5.5% to 7.4%. Second, it is unique in the postwar period to have median family income fall during a recovery year, as it did in 1992-93 when unemployment fell, *average* incomes rose, and gross domestic product expanded.

Why have income trends continued to be negative in the 1990s? Along with overall slow growth, the primary reason is the continuing wage deterioration among middle- and low-wage earners, now joined by white-collar and even some groups of college-educated workers. Another key factor in understanding recent trends is the contribution of working wives.

In the 1980s, many families compensated for falling hourly compensation, which was particularly steep for male workers, by working more hours. Some families increased the number of family members in the paid workforce. In other families, the number of hours worked by members already in the labor force increased. In middle-income, married-couple families, for example, the average wife worked 314, or 35.8%, more hours in 1989 than in 1979. In the absence of increased hours and earnings by working wives, the incomes of the bottom 60% of married-couple families with children would have fallen in the 1980s. The 1990s, however, saw a notable slowdown in the growth (and, for some groups, even a decline) in hours and earnings of working wives in families with children. Wives' contributions were no longer able to offset the lower earnings of their husbands (whose wages continued to fall, except for the top 5% of earners). By 1994, all but the top 5% of married couples with children would have experienced flat or declining incomes in the absence of wives' work. Even with wives' contributions, the incomes of middle-class, married-couple families with children fell 0.7% between 1989 and 1994.

These trends toward slower and more uneven growth began in the 1980s. Upper-income groups experienced substantial income growth (for the top 1%, average income grew 87.5% between 1979 and 1989), while the bottom 40% of families experienced a decline. These developments produced a dramatic rise in the income gap between high- and low-income families, reversing uninterrupted progress in the postwar period toward lower inequality.

Younger families have been especially hard hit by overall slow family income growth and widening inequality. A cohort, or intergenerational, analysis of income growth shows that recent groups of young families have started out at lower incomes and obtained slower income gains as they approached middle age. One result of this trend has been to constrain income mobility, which had worked in the past to offset increasing income inequality.

Another major factor fueling growing inequality in the 1980s was the acceleration of capital-income growth due to high real interest rates and the stock market boom, both of which primarily benefited the richest families. The capital income of families in the top 1%, for example, doubled between 1979 and 1989.

The large increases in the capital incomes of the rich stem in large part from the increase in the rate of profit (the return to capital holdings). Profit rates continue to soar in the 1990s, and these gains have not led to increased investment in capital stock, nor have they been accompanied by increases in efficiency, as measured by productivity growth. Their main effect has been to increase the incomes of the richest families at the expense of the broad working class.

Taxes: A Further Cause of Worsening Inequality

Overall, taxes have increased little since 1973, with the total U.S. federal, state, and local tax burden (at about 30% of GDP) remaining one of the lightest among industrialized countries. Most of the increase since 1959 in the total tax burden (up 5.3 percentage points of GDP) has resulted from higher state and local taxes (up 3.3 percentage points of GDP). Federal taxes over the same period grew by less (2.0 percentage points). The effective federal tax rate for a middle-class family of four has changed little since 1980. In that year, such a family paid about 23.7% of its income in federal income tax and Social Security and Medicare contributions. By 1985, the contribution had increased slightly to 24.4%, a level maintained through 1995.

While average federal tax rates for most Americans have changed little since 1979, effective tax rates have changed substantially for those with the highest incomes. Between 1977 and 1985, for example, changes in tax laws reduced the tax bill for the wealthiest 1% of families by an average of $95,482 per family relative to what these families would have paid in the absence of those changes. Meanwhile, these same changes increased the tax payments of the bottom 80% of families by an average of $209 per family relative to what they would have paid without the new tax code. Progressive tax changes in 1986 and again in 1993 partially reversed some of these inequities. On net, however, the wealthiest 1% of families have seen their tax bill fall by $46,792 since 1977 relative to what it would have been without changes in the law.

The sharp reduction in the effective federal tax rates facing the richest 1% of taxpayers has contributed to the rise in income inequality since 1979. Nevertheless, since the typical family faces the same effective tax rates in the mid-1990s as in the late 1970s, changes in tax policy cannot account for the decline in living standards of the broad middle class. Most of the rise in inequality and fall in living standards, then, reflects what employers are putting into paychecks, not what the government is taking out.

Wages: Working Longer for Less

Since wages and salaries make up roughly three-fourths of total family income (more for the broad middle class), wage and salary trends are the primary determinant of the recent slow growth in income and the accompanying rise in income inequality. The real wages of the majority of workers fell between 1989 and 1995, with the bottom 80% of male earners and the bottom 60% of female earners suffering declines in their after-inflation wages. The typical male worker (half earn more, half earn less) saw a 6.3% drop in his hourly wage between

1989 and 1995, consistent with the pace of wage declines in the 1980s. The typical female worker experienced a 1.7% fall in hourly wages between 1989 and 1995, reversing some of the 5.7% increase during the 1980s for women at the median. The falling wages that the blue-collar, non-college-educated workforce experienced throughout the 1980s, then, have gone upscale toward the end of the 1980s and through the first half of the 1990s, spreading to higher-wage, white-collar men and to middle-wage women.

The worst declines in wages have been for entry-level jobs. The average hourly wage for high school graduates with one to five years of work experience, for example, fell almost 7% between 1989 and 1995. For male high school graduates, entry-level wages in 1995 were 27.3% below what they were in 1979; for females, wages in 1995 were 18.9% below their 1979 level. Young college graduates have not been spared. Male college graduates with one to five years' experience earned 9.5% less in 1995 than in 1989 (after a 10.7% decline in the 1980s). Their female counterparts were earning 7.7% less in 1995 than in 1989 (after an 11.2% increase in the 1980s).

Including fringe benefits in the preceding calculations does not significantly alter the picture of widespread wage decline, because growth since 1979 in average compensation (wages plus fringe benefits) has been only about 0.1% per year faster than average wage growth, making little difference even over 15 years. The 1980s and 1990s have also seen a decrease in the share of workers covered by employer health and pension benefits: the share of all private-sector workers with employer-provided health benefits fell from 79% in 1979 to 64% in 1993; the share with employer-provided pension coverage declined from 48% to 45% over the same period. Since those who lost benefits are generally less well-off than those who did not, it seems likely that a closer study of the changing distribution of fringe benefits would reveal another aspect of growing inequality over the last 15 years.

The tremendous increase in total compensation for corporate chief executive officers (CEOs) underscores the severity of the increase in wage inequality since the late 1970s. In 1978, for example, CEOs earned about 60 times the pay of the average worker. In 1989, their pay reached 122 times the average worker's earnings. By 1995, the ratio had increased to 173.

While economists continue to grapple with explanations for falling wages and widening wage inequality, a number of factors appear to account for most of the shifts in the wage structure. These include severe drops in the 1980s and 1990s in the value of the minimum wage and the number (and strength) of unionized workers; the decline in higher-wage manufacturing jobs and the corresponding expansion of low-wage, service-sector employment; the increasing globalization of the economy through immigration and trade; and the growth in contingent (temporary and part-time) and other nontraditional work arrangements.

Many policy makers have cited a technology-driven increase in demand for "educated" or "skilled" workers as the most important force behind wage inequality. The evidence suggests that the overall impact of technology on the wage and employment structure was no greater in the 1980s and 1990s than in the 1970s. Productivity growth, for example, was lackluster in the 1980s and 1990s, not what we would expect if technology were inducing a widespread restructuring of the economy. It is also difficult to reconcile the idea that technology is bidding up the wages of "more-skilled" and "more-educated" workers given the stagnation since 1989 in the wages of many college graduates and white-collar workers. Technology has been and continues to be an important force in shaping the economy, but no evidence exists that a "technology shock" during the 1980s and 1990s created a demand for "skill" that could not be satisfied by the ongoing expansion of the educational attainment of the workforce.

What does the future hold? The persistence of growing wage inequality in the first half of the 1990s and the expected continuation of the forces that have led to the recent growth in inequality suggest that more hard times lie ahead.

Jobs: Slow Growth and Greater Insecurity

The good news is that the average unemployment rate since the beginning of the business cycle in 1989 has been lower than during any cycle since 1967-73 and, by mid-1996, the unemployment rate stood below 5.5%. Unfortunately, job creation over the current business cycle has been well below rates for the postwar period, including the slow-growth 1980s. Fifteen years of poor job creation left 13.5 million workers (10.1% of the broad labor force) either unemployed, "underemployed," or working involuntarily in part-time jobs when they would prefer full-time employment. Furthermore, by a conservative estimate, almost 10% of those working are in "contingent" and "alternative" employment situations, which generally offer little or no job security, lower pay, and fewer benefits than comparable noncontingent or traditional work arrangements.

Job security, especially for men, is more precarious in the 1980s and 1990s than it was in the 1970s. For men, workers' attachment to their employers fell significantly between the 1980s and the 1970s, and those who switched jobs most frequently saw their inflation-adjusted incomes fall substantially. The poorer earnings performance of the frequent job changers suggests that workers were not switching jobs in order to take advantage of better opportunities with new employers. Furthermore, the share of men with 10 or more years at the same employer declined significantly between 1979 and 1993. Since the acquisition of job-specific skills is a key source of improved earnings opportunities for most workers (especially those without a college degree), the decline in the share of men with long job tenure has important implications for wage inequality and overall wage growth.

The story for women, at least with respect to job tenure, is more encouraging. The share of women with the same employer for 10 or more years increased strongly between 1979 and 1993. Nevertheless, by 1979 the share of women in long-tenure jobs was still substantially below the share of men in such jobs: for women age 35-44, for example, 25.2% had been with their employer 10 years or longer; for men of the same age the figure was 34.1%.

The rate of job loss for both men and women is higher in the 1990s than in the 1980s. Despite a 1.8 percentage-point decline in the male unemployment rate between the periods 1981-83 and 1991-93, more men reported losing a job in the previous three years in 1993 (15.0%) than in 1983 (14.5%). Over the same period, the female unemployment rate fell 2.3 percentage points, but the share of women who reported losing a job increased from 10.8% to 11.4%. "Downsizing," particularly of white-collar workers, was the most important factor contributing to the higher rate of job loss over the period. The increase in the number of downsized white-collar workers, however, does not mean that white-collar workers have suddenly become more vulnerable to job loss than are blue-collar workers. Despite a business-cycle-related decline in the job-loss rate for blue-collar workers, they are still much more likely than white-collar workers to be victims of job cutting.

The costs of job insecurity and job loss are high. On average, workers who reported losing a job in the previous three years made 15% less at their current job (if they had found one) than at the job from which they were laid off. About 25% of workers covered by their employers' health plans before they lost their jobs did not have coverage at their new jobs.

After steady increases during the 1980s in the share of workers holding multiple jobs or involuntarily working part time, both kinds of work arrangements have tapered off or declined in recent years. Workers holding more than one job for reasons of economic hardship grew rapidly in the 1980s, from 4.9% of total employment in 1979 to 6.2% in 1989. Between 1989 and 1995, however, the multiple-jobholding rate increased by only 0.2 percentage points. Meanwhile, the share of involuntary part-time workers, which grew steadily from 3.8% in 1979 to 5.5% in 1993, fell sharply, to 3.7% in 1995 (although it is not clear what portion of the decline might be due to a change in the government survey method used to measure work hours).

Wealth: The Rich Get Richer, The Rest Get Poorer

Stagnant and falling wages and incomes tell only part of the story of rising inequality. A family's ability to plan for the future and to cope with financial emergencies is strongly affected by its wealth (tangible assets such as a house and car plus financial assets such as stocks and bonds).

The distribution of wealth has historically been more unequal than the distribution of income and grew even more so during the economic recovery of 1983-89. In 1983, the richest 1% of families held 33.8% of all wealth; by 1989 their share had grown 5.2 percentage points to 39.0%. Meanwhile, the share of wealth held by the bottom 80% of families fell from 18.7% of the total to 16.3%. In the first part of the 1990s, the distribution of wealth became slightly more equal. The share of the top 1% of families fell to 37.2%, while the bottom 80% increased their share by 0.8%. From 1983 to 1992 (the most recent year for which we have complete data on the distribution of wealth), however, inequality increased.

Another worrying trend is the recent decline in total wealth per adult in the United States. Between 1989 and 1994, the value of tangible assets (the most widely held type of asset) has dropped nearly 2% each year. In contrast, the value of financial assets (held mostly by the wealthy) grew, though at only a 0.4% annual rate. Other measures also show a decline in the wealth owned by middle-class families. The net wealth of a middle-income family, for example, fell about 14.4% between 1984 and 1993. The decline in the wealth holdings of typical families has made an important contribution to the rise in economic insecurity in the early 1990s.

The stock market boom of the 1980s and 1990s has not enriched working families for the simple reason that the broad middle class does not own much stock. Less than one-third of households hold more than $2,000 in stock, and two-thirds of the value of all stock is owned by the wealthiest 10% of households. This concentrated ownership is as evident in pension and savings plans (where stock is held indirectly) as in the direct ownership of stock and mutual funds. In 1993, for example, only 15% of the bottom 80% of families (in terms of annual income) owned stocks or mutual funds; only 17% of the same families had an individual retirement account (IRA) or Keogh plan.

Poverty: Rates Remain High Despite Economic Expansion

As expected, the poverty rate increased in the recession of 1990-91. Unusually, however, poverty continued to rise through 1994 despite the economic recovery. The most recent poverty rate—13.8% in 1995—is 0.7 percentage points above the 1989 rate of 13.1%. Even with a growing economy between 1983 and 1989 and again between 1991 and 1995, poverty rates in the last 15 years have been high by historic standards, averaging 13.7% for the period 1979-89 and 14.1% for the period 1989-95.

Poverty rates for minorities and children are well above the national average. Almost one-third of blacks (29.3%) lived in poverty in 1995 (not too different from the 30.8% rate in 1989 and the 31.0% rate in 1979). More than one in five (20.8%) children were poor in 1994, up from the 20.0% rate in 1989 and the 16.4% rate in 1979. For minority children, poverty rates are especially high: 41.9% of black children and 40.0% of Hispanic children under 18 were poor in 1995. The poor also appear to be poorer now than at any time in the last 20 years: in 1994, the share of people in poverty whose incomes were below 50% of the poverty line (a pre-tax income of $7,785 for a family of four) was 38.1%.

Some argue that these rates are artificially high due to erroneous measurement. But a study by a nonpartisan panel of poverty experts shows that an updated measure of poverty would actually increase the number of poor by about 9 million persons (with most of the increase among the working poor). Regardless of the poverty definition used, poverty rates have been growing faster than economic conditions would predict.

The conventional wisdom typically defines the problem in terms of the supposedly counterproductive behavior of poor people themselves, implying that, with more effort, the poor could lift themselves up by their bootstraps. The implication is that the poor have failed to be lifted by the rising economic tide because of bad choices about family structure and lack of work effort. Recent trends in family structure and low-wage labor markets, however, contradict this analysis. The role of family structure (the shift to family types more vulnerable to poverty) has become increasingly *less* important since the 1970s. The shift to families headed by only one person, while fully explaining the increase in poverty over the 1970s, explains only half of the increase in poverty between 1979 and 1995, the rest stemming from other factors that led to poverty increases *within* each family type. Similarly, no evidence exists that welfare programs have created incentives that encourage people to live in poverty. In short, "behavioral" explanations are insufficient to explain the high and intractable poverty rates throughout the economic expansions of the 1980s and 1990s.

In fact, the problems analyzed throughout this book—heightened inequality of the income distribution, lessened progressivity of the tax system (with the exception of the recently expanded earned income tax credit), and, in particular, falling wages—all conspired to keep poverty rates historically high throughout the 1980s and into the 1990s. Moreover, the "safety net" (the social provision of assistance to those in poverty) grew less effective at providing relief to the poor.

Slight Variations Across Regions

Trends in the nation's 50 states and various regions, in broad terms, mirror those at the national level. Nevertheless, important regional differences exist in the trends for family income, employment, wages, and poverty. These different experiences underscore another dimension of inequality in the United States, one that flows from regional disparities in wage levels and job opportunities.

In general, over the 1980s most workers in the northeast did notably better on each indicator (e.g., median wages and incomes rose and poverty and unemployment fell) than did workers in the other regions. However, despite low unemployment, low-wage workers in some northeastern states (e.g., New York and Pennsylvania) lost ground. States in the West, particularly California, experienced relatively flat growth rates in terms of employment and median incomes, and wages for workers at the median and below declined.

During the 1990s, these trends in the Northeast and California have reversed. Between 1989 and 1995, incomes and employment contracted and poverty grew the most in these states (real median family income in the Northeast fell 1.7% per year). By the end of the period, indicators in these geographic areas stood well below their 1989 peak levels. Wage growth at the median was flat or negative in most areas of the country over this period; even average earnings, which include all workers from the poorest to the most wealthy and which typically expand in a recovery, did not increase between 1989 and 1994.

International Comparisons: Falling Behind in Wages, Productivity

While Americans still rank highest in the industrialized world in per capita income as measured by relative purchasing power, by many other indicators of economic well-being the United States is falling behind. American productivity and wage growth, wage and income inequality, and poverty rates, for example, all fail to meet Europe, Japan, and other industrialized economies. Even the much-touted American "jobs machine" is less impressive than its promoters claim.

U.S. productivity, defined as the value of total goods and services per worker, grew 1.1% per year between 1960 and 1994. Over the same period, productivity growth rates elsewhere were generally much higher: 4.5% in Japan, 2.7% in Germany, 2.8% in France, 2.0% in the United Kingdom, 3.5% in Italy, and 1.5% in Canada. Workers' wages mirrored these productivity trends. Compensation growth (wages plus benefits) per employee in the U.S. business sector grew at an annual rate of just 0.3% between 1979 and 1989 and 0.2% between 1989 and 1995. Meanwhile, the average growth rate in the other G-7 countries (those listed above) grew four times faster in 1979-89 (1.3%) and two times faster in 1989-95 (0.4%). Among production workers in manufacturing, relative wage performance was even more disappointing. Hourly compensation for these workers actually fell 0.6% per year between 1979 and 1989 and was unchanged between 1989 and 1994; manufacturing production workers in other advanced economies experienced an average increase of 1.5% per year in 1979-89 and 1.8% in 1989-94.

Relative to Europe, Japan, and other industrialized countries, the U.S. wage and income distribution is highly unequal and becoming more so. Data for the 1980s show that in the United States the annual earnings for high-income families (those with incomes higher than 90% of all families) were almost six times higher than for low-income families (those earning more than only 10% of all families). Among advanced industrialized countries, only Australia, Canada, and Italy came close, but there the ratio of high-income to low-income family earnings was significantly less, at about 4.0. Furthermore, while income inequality changed little during the 1980s in most comparable economies, it grew sharply in the United States, driven by a dramatic increase in the inequality of wages.

The United States also lags behind its competitors in its ability to pull its lowest-income members out of poverty. Prior to taxes and transfers, poverty (measured as 40% of median family income, adjusted for family size) is in fact higher in most other countries. The American rate in the mid-1980s, 19.9%, was lower than the rate for France, Germany, Sweden, and others. Yet after taxes and the transfer of government benefits, the U.S. rate of 13.3% was well above all other industrialized countries. Furthermore, over the course of the 1980s, as all countries suffered higher poverty rates, the American safety net became less effective at reducing poverty while other countries' systems of taxes and transfers expanded. Finally, U.S. poverty is the most persistent: in a three-year study tracking families in poverty, 14.4% of U.S. families were poor for the duration of the study, a higher percentage than in any other comparable country. (For Germany, the rate was 1.5%, for France, 1.6%.)

One area where U.S. economic performance has been praised is job creation. Between 1979 and 1989, the United States created more jobs (18.5 million net new jobs) than other comparable economies (Japan was second, with 6.5 million), but the rate of U.S. job creation was far less impressive. For instance, the rate of job creation for the United States, which takes into account its larger economy, was 18.7%—high, but less than Australia (26.5%) and Canada (20.1%), and not far ahead of double-digit performances in the Netherlands (13.5%) and Japan (12.0%). Between 1989 and 1994, the United States created almost 2 million net new jobs (less than Japan, with 3.4 million), but the rate of job creation was only 1.6%, below Australia (2.4%), Canada (6.1%), West Germany (2.5%), Japan (5.3%), and the Netherlands (5.9%). The United States is among the smallest spenders on job training and placement, a shortcoming that increases the likelihood that other countries will continue to outpace the United States in productivity and wage growth.

THE LIVING STANDARDS DEBATE

THE STATE OF WORKING AMERICA 1996-97 PRESENTS A COMPREHENSIVE statistical portrait of numerous dimensions of Americans' standard of living. By the mid-1990s, the overall economic environment facing American workers and their families had clearly improved. By 1995 the unemployment rate had fallen to the level of the previous business cycle peak in 1989, the result of steady job growth in the recovery following an initial phase of "jobless recovery." Moreover, the disturbing shift toward part-time work and multiple jobholding that was evident in the 1980s has not continued in the 1990s.

On the other hand, the financial condition of the typical worker continued the long-term deterioration that began in the late 1970s. The real wages of the majority of workers have fallen over the current business cycle, as they did in the last one (1979-89). As a result, income inequality between the richest Americans and the rest of the population is still on the rise.

The combination of falling wages and increased job loss that the blue-collar, non-college-educated workforce experienced in the 1980s has now spread upscale to higher-wage, white-collar men and to middle-wage women. Insecurity has been exacerbated by a decline in the net worth, or wealth, of middle-class families and by an erosion of good employer-provided health insurance or pension coverage. These trends indicate a disconnect between conventional measures of macroeconomic success and the actual living standards of the typical American. Our analysis suggests that wage deterioration and increased economic insecurity will continue in the near term, absent a major shift in government and management strategies.

The first part of this essay, which delineates the major income, wage, and other living-standard trends that have characterized the current business cycle from 1989 to 1995 (our latest data) and the prior business cycle from 1979 to 1989 finds that the typical American family is facing considerable economic pain. We then look at fundamental economic trends such as productivity, competitiveness, and capital accumulation (investment) in order to ask: has the economy's overall performance and efficiency been improving, or has it improved more rapidly in the 1980s and 1990s? This examination allows us to assess whether there has been some gain for all the pain. In other words, we seek to discover whether the process that is generating widespread wage deterioration, economic insecurity, and growing inequality can also be said to be generating a "better economy" or a "bigger economic pie." We find that there seems to be no overall gain or efficiency payoff associated with all of the evident pain. There is no evidence that the economic squeeze on families is part of some sacrifice that will improve economic conditions in a way that will benefit families in the future. The economic indicators that are setting records, however, are the overall profit rate, the return of all capital income (interest, profits) per dollar of assets, and the growth of executive compensation.

A different, competing view of the world states that the economy is primarily generating "good jobs" and that most families are faring well economically. If there is a problem, it is because a limited number of unskilled workers cannot keep up with the requirements of a new era of technological change and globalization or that demographic trends such as more female-headed families are generating inequality. In this view, economic forces are not creating any widespread stress on the living standards of working families.

The data compiled in this book do not support such an optimistic view. In the final sections of this essay we draw on the various chapters to examine a variety of "myths" about living standards.

Although this is an election year, including an election for president, we make no effort to assess living-standard trends by presidential or congressional period (nor have any earlier versions of this book). Given the cyclical nature of the economy, it is best to assess the economy's long-term performance by examining trends over the business cycle from peak to peak (comparing periods of relatively low unemployment) or by examining recoveries or downturns. Presidential years do not correspond to cyclical peaks or troughs and are, therefore, inappropriate time periods for economic analysis.

The Income and Wage Squeeze

The following sections describe the main features of the trends in jobs, incomes, and wages over the current business cycle from 1989 to 1995 and compare them to the trends over the 1979-89 business cycle.[1]

Employment Up, Unemployment Down

The relatively low 5.6% unemployment rate in 1995, comparable to that attained at the end of the last recovery in 1989, was achieved through steady employment growth in the current recovery following an initial phase characterized as the "jobless recovery." Involuntary part-time work and multiple jobholding are now no higher than they were at the start of the business cycle in 1989, although greater than they were in the late 1970s. Labor-force growth has been slow, however, primarily because there has been little growth in the proportion of the working-age population that wants to work.

Income Growth Slow and Unequal

Incomes typically fall in recessions and grow in recoveries, a process that leaves incomes higher at the end of the business cycle than at the beginning. In the 1979-89 cycle, the typical or median family's income grew slowly and by 1989 was only 4% higher than at the beginning of the cycle in 1979. Perhaps surprisingly, income problems have been even more severe in the 1990s. The current business cycle started with income declines from 1989 to 1993, the first such four-year stretch in the postwar period. Family incomes grew by $1,631 between 1993 and 1995, but the bottom 80% of families in 1995 still had incomes below their 1989 level, with the median family's income down 3.4%, or $1,438. If the current recovery should end within the next two years or so, it is unlikely that the median family's income will have recovered its 1989 level.

The 1980s have been rightly characterized as a period in which families "worked harder for less," meaning that it took more family members more hours at jobs that paid lower real wages to create modest growth in family income. In middle-income married-couple families with children, for instance, the average wife worked 314, or 35.8%, more hours in 1989 than in 1979. This increased work effort offset the 7% decline in the husbands' annual salary. Without an increase in the earnings of wives, the bottom 60% of married-couple families (with children) would have had lower income in 1989 than in 1979.

In the 1989-94 period, the wage deterioration among men was both more severe and more widespread. Families were no longer able to offset the lower earnings of husbands with more work or increased earnings from wives. As a result, the income of the bottom 60% of married-couple families lost ground over the 1989-94 period, driven by declines in husbands' wages that occurred across the bottom 95% of these families. Many families lost income because both wages and hours fell, while other families worked more but still lost ground.

Income growth in the 1989-95 period was as unequal as that of the 1980s. The combination of slow and unequal growth in the 1990s, however, meant higher poverty and falling incomes for the bottom 95% of families. There has been, therefore, a lack of correspondence between an economic expansion in the aggregate (more employment, more national income) and increased incomes for middle- and low-income families.

Widespread Wage Deterioration

Wage deterioration and growing wage inequality have continued from the 1980s into the 1989-95 period. For instance, wages have fallen among men, younger workers, and the 75% of the workforce without a four-year college degree in the 1990s as well as in the 1980s. For example, the wages of the average non-college-educated male fell 10.1% from 1979 to 1989 and another 7.2% between 1989 and 1995. The wages of a young male high school graduate dropped 21.8% in the 1980s and another 6.9% in the 1989-95 period. A young female high school graduate earned 18.9% less in 1995 than in 1979.

From the mid-1980s to the mid-1990s, however, even high-wage, white-collar, and college-educated men saw their wages fall or stagnate. Wage deterioration has been widespread over the 1989-95 period, as real wages declined among the bottom 80% of men. The erosion of women's wages also expanded in the 1990s: whereas real wages fell only among the bottom 20% of women in the 1980s, the bottom 60% of women experienced declining wages over the 1989-95 period. The erosion of employer-provided health insurance and pension coverage among employed men in both the 1980s and 1990s has put extra stress on families. In the 1989-93 period, health insurance coverage also began to decline among women workers.

The character of wage inequality has changed in the 1990s. In the 1980s there was a general widening of wages as high-wage earners fared better than middle-earners, and middle-earners fared better than low-earners. Since the mid- to late 1980s, however, wage inequality has taken another form: the vast majority have lost wages at the same pace while the highest wage earners are earning slightly more—that is, there has been a common, equivalent experience of wage decline affecting middle- and low-wage workers over the last 10 years. Nevertheless, the wage gap at the top of the wage scale—the gap between high-wage and middle-wage workers—has grown as quickly in the 1990s as in the 1980s among both men and women.

Another shift in the 1989-95 period is that education wage differentials—such as the well-known college–high school wage gap—have grown only modestly among men and much more slowly than in the 1980s. Consequently, a growing education wage gap has been a much less important, if not inconsequential, force in driving up overall wage inequality among both men and women in the 1990s.

Economic Insecurity on the Rise

Jobs are less secure than they used to be, and the consequence of job loss is more severe. Middle-income families have also seen their net wealth—their accumulated assets less their debt—decline in the early 1990s, leaving them with fewer resources to fall back on when a job loss occurs.

Each year over the 1991-93 period, 5% of the male workforce and 4% of the female workforce were permanently displaced from their jobs in a downsizing, facility closure, or permanent layoff. What is remarkable about these rates of displacement is that they occurred during an economic recovery and that they were higher than the rate of displacement during the depth of the early-1980s recession (the 1981-83 period) when unemployment was nearly 2% higher. White-collar workers, particularly middle managers, were significantly more likely to be displaced in the early 1990s than in the 1980s. The upscaling of displacement thus created insecurity for segments of the workforce that previously felt safe, and it required many of them to undergo the wrenching experience that was and still is relatively common among blue-collar workers.

Job loss due to downsizing, plant closings, or other reasons is often associated with a significant period of unemployment and a shift to a lower-paying job, frequently one with worse or no health care coverage. For instance, about a fourth of displaced workers who had health insurance in their old jobs were not covered in their new jobs. In today's labor market, this shift toward a "worse" job, not simply a spell of unemployment, fuels much of the anxiety and fear over job loss.

The erosion of the wealth holdings of middle-class families in the late 1980s and early 1990s has meant that many families have fewer personal resources to fall back on when paychecks are cut or disappear entirely. This wealth erosion further adds to economic insecurity. The recent decline in middle-class wealth also confirms that the benefits of the ongoing stock market boom have not accrued to typical working-class families. This should come as no surprise, since the 10% of families with the highest incomes own two-thirds of all stock, while the bottom 75% of households own less than 20%.

Explaining Wage Deterioration and Inequality

There is not one single cause of the recent growth of wage inequality and the deterioration of wages among non-college-educated workers since 1979. However, a number of factors, in total, seem to account for most of the shifts in the wage structure. All of these factors share a common characteristic: they reflect general deregulatory, laissez-faire shifts in the economy and forces that have weakened the bargaining power of workers, both union and nonunion and both blue collar and white collar. For instance, significant institutional shifts over the 1979-94 period, such as a severe drop in the value of the minimum wage and deunionization, explain one-third of the growing wage inequality among prime-age workers. The expansion of low-wage service-sector employment has perhaps contributed 20-30%. Similarly, the increasing globalization of the economy—immigration and trade—has created more wage inequality, explaining, in our judgment, from 15% to 25% of the total. Together, the combined effects of industry shifts and globalization (which overlap and are not cumulative) can conservatively account for another 25% to 40% of the growth of wage inequality. The weakening of labor-market institutions, the impact of globalization, and the shift to low-wage service industries can together account for two-thirds to three-fourths of the growth in wage inequality.

The high unemployment in the early 1980s and the high unemployment among non-college-educated workers throughout the 1979-94 period put further downward pressure on workers' wages and helped make possible radical shifts in the wage structure.

Last, in the 1990s there was a large jump in profitability that was not associated with faster growth or, in particular, faster productivity growth. If profitability had returned to rates comparable to those of earlier decades, there would have been significantly more room for compensation growth. There has been, therefore, a profit squeeze on wages in the 1990s.

All Pain, No Gain

For the vast American middle class and for low-income families, neither the 1979-89 nor the 1989-95 business cycle has brought increased prosperity. Circumstances would be worse if unemployment were high or rising and if another recession were under way. Nonetheless, American families are beset by a long-term erosion in wages, deteriorating job quality, and greater economic insecurity. To some, these are the unfortunate but unavoidable costs associated with a transition to a "new economy" or a new "global and technological age."

That there have been profound structural changes in the economy over the last two decades is beyond dispute. Whether we are making a transition to a new and better economy, however, is a matter worth examining. In the post-1979 period, economic policy has moved decisively toward creating a more laissez-faire, deregulated economy. Industries such as transportation (trucking, intercity buses, railroads, airlines) and communications have been deregulated. Management has actively pursued the weakening of union protections and the right to organize unions and to collectively bargain, goals accommodated by policy-making bodies. Social protections, such as safety, health, and environmental regulations, the minimum wage, government cash assistance (Aid to Families with Dependent Children, or AFDC), and the unemployment insurance system, have been weakened. Increased globalization, including greater international capital mobility and international trade, has also given greater scope to market forces and managerial discretion. Taxes on capital and the average and marginal tax rates for high-income families and business have been reduced. Plus, we have had the low inflationary environment preferred by investors, Wall Street, and the bond market. In sum, there has been a conscious, decided shift of national policy designed to unleash market forces and empower management decisionmakers.

The promise of all of these policies was to raise living standards and to generate more overall income growth. As with all policies and economic transformations, there were expected to be, and there have been, losers, as the large redistribution of income since 1979 attests. The question is, was there an overall improvement in the economy that would justify all of the social costs? In economists' terms, did the benefits outweigh the costs so that the winners could compensate the losers, at least potentially if not in practice? Or simply, was the gain worth the pain? Is there reason to believe we are making a transition to a *better* economy?

Our review of indicators suggests that the changes in the economy have been "all pain, no gain," that the factors causing the pain of greater dislocation, economic vulnerability, and falling wages do not seem to be making a better economy or generating a "payoff" that could potentially be redistributed to help the losers. Rather, there seems to be a large-scale redistribution of power, wealth, and income that has failed to lead to or be associated with improved economic efficiency, capital accumulation, or competitiveness.

Efficiency and Capital Accumulation

Greater economic growth can occur if there is either a faster growth in employment (or hours worked) or a faster growth in output per hour, otherwise called productivity growth. The unemployment rate in 1989 and in mid-1996 is comparable to that of 1979 (although more underemployment exists in mid-1996 than in the earlier periods), so the question of whether there was more growth boils down to whether productivity has grown faster in recent years. Or, equivalently, we can ask whether the economy is becoming more efficient or productive at a faster rate than has historically been the case.

Table A presents the trends in the two main indicators of productivity for the private nonfarm business sector. Clearly, productivity growth has been slower since 1973, and there is no evidence of any acceleration in the 1980s or 1990s. Throughout the 1979-95 period, productivity output per hour has been growing a steady 1% per year, while multifactor productivity growth (a measure of output growth due to a more efficient use of labor and capital together) has been miserably low. This is strong evidence, in terms of fundamental efficiency, that

TABLE A

Productivity Growth and Capital Accumulation, 1948-95

	Productivity*		Capital Accumulation	
Year	Output per Hour	Multifactor	Capital Services per Hour*	Equipment per Worker
Annual Growth**				
Pre-1973				
1948-73	n.a.	1.8%	2.8%	n.a.
1959-73	2.9%	1.9	2.9	3.7%
Post-1973				
1973-79	1.1%	0.3%	2.4%	4.2%
1979-89	1.0	0.0	2.4	2.8
1989-94	0.9***	0.2	1.4	2.3

* Nonfarm business sector.
** Log growth rate.
*** 1989-95.

Source: Authors' analysis.

the economy has not become better able to generate faster growth.

Two objections to this analysis are that productivity is mismeasured or understated (particularly in "services") and that the payoff is yet to come, as we learn to exploit microelectronic/computer technologies. Productivity may or may not be mismeasured, but the only relevant issue here is whether there has been a greater understatement of productivity growth in the 1980s or 1990s relative to the 1970s or earlier periods. No analysis has shown such a trend in mismeasurement. For instance, any errors in measuring service-sector productivity have been present for decades, and the service sector's *share* of output (or final demand) has not grown (although the service share of *employment* has grown), so any particular measurement error does not have growing importance.[2]

As to the other objection, it is not possible to know whether there is a payoff awaiting us in the future. Nevertheless, one expects that a large future payoff would have provided some initial, observable downpayment this far along in the process, but there is none anywhere in sight.

Another potential payoff might be large investments that build up our capital stock, thus providing a foundation for a larger economy in the near term and distant future. The two measures of capital accumulation in Table A do not indicate any acceleration of capital accumulation in the 1980s, and they suggest a deceleration in the 1990s. That is, the redistribution of income and wealth over the 1979-94 period and the high profitability in the 1990s have not been associated with the any exceptional growth in the capital stock.

Competitiveness

We are told that the U.S. economy is the most competitive it has been in years. Certainly, such a feat is a gain for the economy. Unfortunately, it is premature to claim victory over our competitiveness problems, especially if the goal is to compete successfully in global markets while maintaining a rising standard of living.

On one measure, the U.S. economy is faring better: it contributed 12.4% of the world's exports in 1994, up from 11.5% in 1979. Less noticed by observers is that the U.S. share of world imports is also at record highs, reaching a 16.5% share in 1994, up from 13.6% in 1979.[3] It should not be surprising, then, that the United States had a merchandise trade deficit equal to 2.4% of GDP in 1994 (it was 1.1% in 1979), an indication of a still existent competitiveness problem.[4]

Most disturbing is that the U.S. trade balance is in the red despite the fact that U.S. manufacturing workers are the only ones among the advanced countries to suffer real wage losses. In 1994, Japanese, Western European, and German manufacturing workers earned respectively 25%, 15%, and 60% higher hourly compensation (in dollars) than U.S. workers.[5] Moreover, the lowering of the dollar's value over the 1979-95 period contributes to a lower standard of living and should have helped to eliminate the trade deficit. That is, our trade position worsened despite falling wages and a lower dollar.

One area of improvement is that manufacturing-sector productivity grew faster in the 1980s and 1990s than in the 1970s. Manufacturing productivity grew 3.1% annually from 1959 to 1973 and then slowed to a 2.1% annual growth rate in the 1973-79 period. Manufacturing productivity recovered to a 2.7% annual growth rate in both the 1979-89 and 1989-94 periods, but that rate was in the mid-range of what other advanced countries achieved in either the 1980s or 1990s.[6] In sum, it is hard to find evidence that the United States has attained some competitive edge even though we achieved decent manufacturing productivity growth and reduced both wages and the value of the dollar.

More Schooling, Same Money

Last, we examine the growth in average hourly compensation, which includes both wages and benefits (health, pension, and payroll taxes). Given that no productivity acceleration took place, it should come as no surprise that hourly compensation in the private sector did not accelerate in the 1980s and 1990s relative to the 1970s (see **Table B**). In fact, compensation growth has been far slower since 1979, which means there would have been no improved gains in workers' pay even if wage inequality had not grown.

What has been overlooked is that compensation growth has been stagnant even though we have been steadily and rapidly upgrading the education levels of the workforce. Since 1973, for instance, there has been a 50% reduction in the share of workers who never attained a high school degree and a doubling of the share of workers with at least a four-year college degree, an increase to 25%. Table B illustrates the growth in education levels by tracking the average years of schooling in the workforce, which rose from 9.8 years in 1948 to 13.4 years in 1994. Between 1973 and 1994 the average years of education increased 1.6 years by one measure and 1.4 years by the other, significant growth in either case. Table B also presents a broader measure of labor skill, which reflects changes in the amount and economic value of experience and education levels. This skill index shows steady improvement over time and an acceleration in the 1980s and 1990s.

The growth in both schooling and labor quality outpaces that of hourly compensation in the 1979-94 period. In essence, all of the growth in average hourly compensation since 1973 can be attributed to more schooling. For instance, hourly

TABLE B

Hourly Compensation, Skill, and Education Growth, 1948-95

Year	Real Hourly Compensation* (1992=100)	Average Years of School: Private Sector	Average Years of School: Nonfarm Business**	BLS Labor Skill Index* (1987=100)
1948	n.a.	n.a.	9.8	91.0
1959	61.5	n.a.	10.5	94.7
1973	88.1	11.6	12.0	96.4
1979	95.4	12.3	12.5	96.5
1989	97.7	12.8	13.1	101.2
1994	98.4	13.2	13.4	105.0
1995	98.8	13.3	n.a.	n.a.
Annual Growth				
Pre-1973				
1948-73	n.a.	n.a.	0.8%	0.2%
1959-73	2.6%	n.a.	1.0	0.1
Post-1973				
1973-79	1.3%	0.9%	0.7%	0.0%
1979-89	0.2	0.4	0.5	0.5
1989-94	0.1	0.6	0.5	0.7
1989-95	0.2	0.6	n.a.	n.a.

* Nonfarm business sector.
** Log growth rate.

Source: Authors' analysis.

compensation grew about 12% from 1973 to 1995. If one assumes (conservatively) that there is an 8% return to a year of schooling (workers with one more year of schooling earn 8% more than they would have otherwise), then adding one year to the average schooling level of the entire workforce should generate 8% higher compensation.[7] Over the 1973-95 period, greater schooling, in this scenario, generated either a 12.8% (1.6 years times 8%) or an 11.2% (1.4 years times 8%) growth in compensation, an amount equivalent to the actual growth. In contrast, hourly compensation grew much faster than the growth in schooling in the pre-1973 period. In effect, unlike the 1950s and 1960s, the last 20 years or so have seen no growth in the hourly compensation paid per year of schooling.

In effect, hourly compensation has risen since 1973 only because the workforce has more years of schooling. This situation is analogous to earning a higher annual wage because one works more hours at the same hourly wage—working harder at the same pay. While it is certainly a good thing to be able to work more hours, it would be a far better situation if annual wages grew primarily because of higher hourly wages (and one might even voluntarily reduce hours). Similarly with education, it would be far more preferable if hourly compensation grew beyond the growth created by more schooling, as was the case in the early postwar period.

Profitability

One economic indicator that *has* accelerated in recent years is profitability, before and after taxes. After plummeting in the 1970s, the rate of return on capital, or profitability, has steadily grown since the early 1980s, paralleling a boom in the stock market. By the 1994-95 period, profitability had grown to its highest level since 1959 (the earliest year for which data are available). This rise in profitability is not the consequence of an investment boom or a surge in productivity, since none occurred.[8]

There has also been a historic revolution in the pay levels of executives at the largest U.S. firms. The rapid growth of wages, benefits, bonuses, and other forms of compensation has greatly raised the pay of chief executive officers (CEOs) in the United States relative to the pay of average U.S. workers and even to the pay of CEOs in other countries. This fast growth of CEO pay started in the 1980s and has continued in the 1990s.[9]

Whatever process is generating this large growth in CEO pay and profits failed to lead to any improvements in the fundamentals of the U.S. economy or to widespread income gains. Higher profitability and CEO pay may be the only payoff or concrete sign of accomplishment from 16 years of transition to a more deregulated economy.

The Myths That Say "It's Not Really Happening"

These income, wage, employment, and wealth trends indicate that there are income problems facing a broad array of families, including upper-middle-income, middle-income, and lower-income families. This income squeeze has been ongoing since the late 1970s and has been generated primarily by the widespread deterioration of hourly wages that has occurred throughout the ups and downs of the business cycles of the 1980s and 1990s. In the late 1980s, the income squeeze moved upscale as white-collar workers, particularly men, saw their wages decline and their probability of job loss increase.

Spurred by an increased public consciousness of these trends, a flurry of reports and analyses has surfaced that denies or minimizes the income and wage problems discussed above. This section, therefore, draws on the findings reported in the various chapters to address some of the myths.

Myth: It's Mostly Demographics

Several types of demographic shifts (changes in population characteristics) have been invoked to explain or minimize current income problems.[10] The implicit claim is that, while the economy has been performing as well as ever for working families, current demographic trends (which are outside of our control) are problematic.

It is important to distinguish between factors that can explain why there is a *level* of inequality from ones that explain a *trend* toward growing inequality. This is easiest to illustrate with a discussion of changes in family composition, such as the decline in married-couple families and the rise in single-parent families. Since single-parent families have fewer earners, they tend to have lower incomes, leading to income disparities across families in any particular year. Whether *growth* in income inequality or *growth* in poverty can be attributed to single-parent, or female-headed, households depends primarily upon whether there has been a significant growth of these kinds of families in recent years. In fact, the shift toward single-parent or female-headed families was slower in the 1980s than in the 1970s, so this particular demographic shift is not a good candidate to explain the growth in either inequality or poverty that occurred in the 1980s but did not occur in the 1970s. Moreover, the shift toward single-parent households has been going on for decades, including periods in which inequality *lessened.* Therefore, the important forces creating inequality are the economic trends (such as changes in the wage structure) that previously produced greater equality but now create more inequality.

Another way to make this point is to note that the income problems in the post-1979 period have occurred within every type of family, married-couple and single-parent, so any explanation must go beyond shifts in family composition.

The growth of poverty in recent years has frequently been attributed to the growth in households headed by single women, who are more vulnerable to poverty because of their low incomes. The growth of female-headed households has often been equated to the growth of households headed by black women who have had children out of wedlock. However, poverty among black female-headed households did not contribute to higher poverty among female-headed households over the 1979-89 period and marginally lowered it in the 1990s. The information missing in many discussions is that the poverty among members of black female-headed households has been *declining* over the entire 1973-94 period. Consequently, the proportionate increase in more black families headed by single women (and the proportionate increase in the number of female-headed families that are black) has not fueled the growth in poverty among female-headed families. All of the growth of female-headed poverty is due to the greater likelihood that white female-headed households are poor.

Another demographic factor, the decline in family size, has been invoked to suggest that income declines have been less severe in terms of declining economic well-being than is indicated by conventional trends in family income. The argument is that if two families have the same income, then the smaller family is better off since there is more income per family member.

A shrinkage in family size is not an unambiguous indicator of improved economic well-being, since families may choose to have fewer children because they have reduced incomes. In any case, taking family size into account does not significantly alter an assessment of income trends: a family size–adjusted income measure shows the same stagnation in the 1980s and declines in the 1990s as the conventional measure (it actually shows a *greater* growth in inequality). Moreover, the size of the average family has been stable over the 1986-94 period, so this demographic shift has had no bearing on the income squeeze in the 1990s.

The increase in the number of wives entering the workforce is also said to lead to greater inequality because "like marry like," meaning that high-wage men are more likely to be married to high-wage women, thereby concentrating income at the top. The presence of working wives, however, has not led to more inequality in recent years, because the women in low- and middle-income families are more likely to work, a factor that actually helps to close the income gap. Moreover, the fastest growth in wives' work effort (hours worked per year) in the 1979-89 period was among the families in the bottom 60%, so increased work by wives actually dampened the growth of inequality. This pattern changed in the 1989-94 period when the increased work time of wives came disproportionately from the upper 60% of families. However, because the growth of work time by wives was small in the 1989-94 period, this factor contributed very little to the growth of inequality. Over the entire 1979-94 period, the impact of working wives was *equalizing*.

One major demographic factor that leads to greater income growth and lesser inequality is often ignored—the continued rise in education levels (detailed above in Table B). There has also been a more even distribution of educational attainment over the entire postwar period, including the 1980s and 1990s, a trend that lessens inequality.

When discussing demographic trends, it is misleading to focus on a few factors that lead to inequality while ignoring others, like education, that have an opposite (and, in the 1980s, larger) effect. A complete analysis of demographic trends since 1979 would show that they have not been a significant factor in creating slow or unequal income growth. An explanation of growing inequality of incomes and wages and the deterioration of wages for the majority must be found in the factors that determine the wages received rather than the character of the workers or families receiving those wages.

Myth: It's in the Benefits Package

It has been suggested that the rapid growth in benefits, or nonwage compensation, has offset the wage declines experienced by workers. The rapid growth in the costs of health insurance provided by employers lends some plausibility to this view, as does the fact that the value of benefits grew 1% annually from 1979 to 1994.[11]

The bottom line, however, is that hourly compensation (which includes fringe benefits), grew, on average, just slightly more than hourly wages, on average, over the 1979-94 period, 0.5% versus 0.4%. The reason that benefit growth had such little impact on compensation growth is that benefits, defined as health insurance, pensions, and payroll taxes, make up only 19% of the total compensation package, a share that has changed little in 15 years. Benefits have also increased less than is frequently thought: the costs of insuring workers for health care has risen rapidly, but so has the ability of employers to shift some of these costs onto workers or to create jobs with little or no health insurance. The average cost of health insurance per hour worked has been rising \$.03 per year over the 1980s and 1990s (up \$.45 over the entire 1979-94 period), hardly enough to offset the wage declines that took place—a \$.75 drop for the median worker and a \$2.04 drop for the median male worker.

These compensation data are averages for all workers and, therefore, do not directly address the growth of compensation for the typical or median worker. In fact, the non-college-educated workforce is less likely to be in an employer-provided health insurance or pension plan now than in 1979. That is, there has been a growth in inequality of both wages and benefits, and the growth of benefits for the typical or median worker has probably been less than the "average" growth.

Myth: Inflation Is Overstated, Growth Is Understated

Some analysts have claimed that wages and incomes are growing much faster than we think and that their growth only *seems* slow because the conventional measure of inflation overstates the growth of prices and thereby understates the growth in family incomes.[12] Given that the research in this area is far from complete, resting on just a few studies, the claim that inflation is significantly mismeasured must be considered unproven. However, whether inflation is mismeasured or not does not affect our conclusions that the *inequality* of incomes and wages has been growing rapidly since 1979. Nor does a mismeasured inflation negate the fact that income growth has been slower in the post-1973 period than in the earlier postwar period because, if anything, there were bigger problems with the measurement of inflation in the earlier period.

One reason for skepticism about the claim of mismeasured inflation is that a revised economic history based on the view that inflation has been less than the official measures yields several implausible scenarios (see Appendix C). If one accepts the current estimate of the poverty threshold ($15,570 for a family of four in 1995), then one would have to conclude that the equivalent threshold in 1960 was near what was actually the median household's income in that year, implying that nearly half of all households were living in poverty in 1960. That is, a long-standing mismeasurement of inflation implies that, when the original poverty threshold was set in the early 1960s, "poverty" was a condition that could describe half of American households. In fact, the widespread view in the early 1960s was that there were only "pockets of poverty."

Alternatively, if one accepts the poverty threshold originally set in the early 1960s and updates it to 1994 using a revised inflation measure, then a family of four would have needed only $8,750-$10,120 in 1994 to be nonpoor. With these lower poverty thresholds, the poverty rate in 1994 (the last year for which there are data) would have been measured somewhere between 6.9% and 8.3%, substantially lower than the official poverty rate of 14.5%.

Myth: It's in Your Stock Portfolio or Pension Plan

When public attention became focused on the disparity between a booming stock market and high profits, on the one hand, and faltering incomes and wages, on the other, an argument was made that workers are benefiting from the current economy through the increased value of their stockholdings, much of which is held in pension plans. That stock market gains have somehow offset wage declines is not credible, however, because the majority of households do not own any stock, either directly or indirectly through pension plans, and because half the workforce is not even covered by any employer-provided pension plan.[13]

In 1992, the latest year for which data are available, only 28.9% of households owned stock valued at $2,000 or more, including stock owned through mutual funds, savings plans (401(k)'s or IRAs), and defined-contribution pension plans or through direct ownership. Moreover, stock ownership is highly skewed: half of all the stock held by U.S. households is owned by the best-off 5%. In contrast (as noted above), the bottom three-fourths of households own less than 20% of all stock, with the bottom half owning less than 5%. There may be millions of people who own stock, but the gains from a stock market boom primarily benefit the best-off families, not the typical working family.

Myth: It's Unskilled and Disadvantaged Workers

The long-term squeeze on working families is downplayed, mostly inadvertently, when economists and journalists describe wage problems as affecting only low-skilled, unskilled, less-educated, or disadvantaged workers.[14] These terms are sometimes twisted a bit further in the popular press so that those experiencing declining wages are sometimes labeled "poorly educated," "undereducated," "miseducated," or "those who lack solid education or skills."

The overwhelming evidence is that declining wages are not limited to a small group of workers at "the bottom" no matter how defined. Among men, there have been declining wages since 1979 among the entire non-college-educated workforce, the three-fourths of the male workforce that includes those with junior college and high school degrees. Wages have been in decline for the bottom 90% of men, including white-collar and college-educated men, since the mid-1980s. Among women, wage growth was relatively widespread in the 1980s, but in the current business cycle from 1989 to 1995 wages have been stagnant or falling for the bottom 70% of women wage earners.

Therefore, the group experiencing wage problems can hardly be considered either small, at the bottom, or unskilled, especially when one considers that the U.S. workforce has more years of schooling than workers in other advanced countries.

Myth: We're a Mobile Society

Information on the income growth of individuals over time has been used to suggest that there has been no erosion of living standards. It is true that many individuals and families improve their economic standing over a decade or two, the result of wages growing as people grow in seniority, experience, and skills. That individuals' incomes grow over time has been the case for many decades.

Nevertheless, it is also true that workers and families are starting out in their twenties with *lower* wages and incomes and then experience *slower* income gains over the next few decades, with the result that they attain a lower living standard than the group that preceded them 10 years earlier, for instance. Given this process, it is possible that the typical income in a community, or country, can be steadily declining while most individuals (from a lower starting point) experience income gains. The measure of the economy's success, however, is whether the community's standard of living is greater.

It also has been pointed out that we are a "mobile" society in which individuals and families can improve their situations, rising from poor to middle class to rich. But there is no reason to believe that the existence of mobility negates the significance of *greater* inequality: to offset a growth in inequality requires that mobility *increase*. In fact, there was no more income mobility in the 1980s than in the 1970s. It is interesting to note as well that our reputation as a mobile society may not be well deserved: mobility is as great in Europe as in the United States.[15]

The Myths That Identify the Wrong Problem

Even where the basic facts of a long-term income squeeze and the growth of inequality are accepted, they are sometimes attributed to factors that have had either no role or a very limited role. This section examines some of these myths.

Myth: It's Big Government, High Taxes, Regulation, and Deficits

Some pundits have tried to blame recent income problems on higher taxes. The problem with this idea is that federal taxes, including all payroll, income, excise, and other taxes, do not take a larger share of incomes now than in the late 1970s. Income taxation has actually declined among the middle class, but payroll taxes, primarily for Social Security, have grown. The end result, however, is that the middle class is currently paying the same share of its income to the federal government that it did in 1977 or 1980. Also, there has not been any significant growth in state and local taxes that is squeezing families.[16]

The squeeze on middle-class incomes is driven by shifts in pre-tax incomes, primarily the fall in wages. It is not what the government is taking out of paychecks but what employers are putting in that has created the income squeeze.

What about the size of government? All of the measures of government's size over the 1979-94 period show that government has been shrinking. For instance, the size of the federal workforce (especially as a share of total employment), the share of government taxes and spending in total income (or GDP), and the economic costs of regulation have all declined since 1979.[17] It is hard to see, therefore, how the "growth" of government could be associated with a deterioration of wages and a growth in inequality that began around 1979. In fact, government grew proportionately bigger in the 1950s and 1960s, a time when incomes were growing faster than today.

How about the deficit? The productivity slowdown and the accompanying slower growth in *average* compensation and wages began about 1973, many years before the explosion of federal debt. Likewise, wage deterioration and growing inequality picked up after 1979 but large structural deficits (not related to the business cycle) did not occur until 1983. Nor could one say that the period of falling fiscal deficits from 1986 to 1995 has been a better one for the growth of workers' wages. Last, studies that analyze the impact of balancing the budget over seven years show that this will raise wages less than 0.5% by the end of the seven-year period, or less than 0.1% per year. These numbers suggest that deficits have had, at most, a small negative effect on *average* wages, and they provide no reason to associate deficits with wage inequality.[18]

Myth: It's a Productivity Problem

Income problems have frequently been attributed to the fact that productivity since 1973 has grown more slowly than in the earlier postwar period. However, wage declines for large segments of the workforce took place only because there was *both* a productivity slowdown and a huge growth in wage inequality, with the latter being by far the most important factor.[19] It is true that most families would almost surely be better off today if productivity had grown by 2% rather than 1% since 1973. Nevertheless, even with slow productivity growth, there was still a 25% growth in output per hour over the 1973-95 period, an increase in the size of the economic pie that should have allowed all income groups to experience real income gains.

Myth: It's a Skills or Technology Problem

The falling wages of unskilled workers and the growth in wage inequality are sometimes attributed to technological change and the notion that workers without skills are being left behind by the "new economy." Such a claim is inherently hard to test with data because "technology" is hard to quantify. Although reasonable people can disagree about whether technology has had little impact (our view) or a significant impact on wage inequality, it is unlikely that technology is the predominant factor behind growing wage inequality.[20]

The basic portrait of wage shifts does not easily fit a technology/skill explanation. First, we have already noted that the groups experiencing wage losses are not a small group readily labeled "unskilled," since in the 1990s those for whom wages fell included the bottom 80% of men and the bottom 60% of women. Many of the workers affected have high school degrees, if not two-year or four-year college degrees. Nor can one see any bidding up of the wages of "more-skilled" or "more-educated" workers, since the wages of college graduates, especially men and *new* college graduates, have been falling.

Second, since the mid-1980s wage inequality has taken the form of the top tier of earners pulling away from both middle- and low-wage earners to an equal degree. The lowest-wage earners have been losing ground since the mid-1980s, but only as quickly as the middle-wage group, suggesting that the economic forces creating falling wages have been affecting "low-skill" and "middle-skill" earners equally. A technological explanation focused on the inadequate or outdated skills of low-wage workers cannot explain why wages for middle- and low-wage workers have moved in tandem over the last 10 years.

Third, many economists have pointed out that the technology story presumes that there has been a redeployment of skills in the workplace large enough to dramatically reduce the need for "unskilled" workers and increase the need for "skilled" workers. If so, why have we not seen a productivity boom based on this large-scale implementation of new technologies and the accompanying reorganization of work and workers?

Last, we have statistically examined whether the growth in the use of high-wage or college-educated workers and, equivalently, the shrinkage in the use of low-wage, non-college-educated workers has been greatest in the industries with the most technological change. While it is true that technologically progressive industries require more "skilled" workers, it is equally true that technological change had no greater impact, and maybe less, on the need for "skills" in the 1980s or 1990s than it did in the 1970s. There has been a continuous upgrading of the education levels of the workforce over the entire postwar period so that the growth in "skill levels" has generally met any technologically driven new need for skills. Our research shows nothing different about technology's impact on skill requirements in the 1980s and 1990s than in earlier periods and no evidence of a "technology shock," or an acceleration of technology's role. If there was no technology shock in the 1980s or 1990s, then technology cannot explain why wage inequality grew in the 1980s and 1990s but did not do so earlier (when technology's impact was similar).

Conclusion

Although employment and national income are growing and unemployment is falling, the incomes of the vast majority have not yet returned to their pre-recession, 1989 level. And if the current expansion should end within the next two years or so, it is unlikely that family incomes will be higher at the end of this business cycle than at the beginning. The primary problem is the broad-based erosion of wages and growing wage inequality that have continued as strongly in the 1990s as in the 1980s.

Policy discussions have increasingly, and usefully, characterized our options as whether we will follow a "high-wage" or a "low-wage" growth path. The panorama of indicators of economic performance and economic well-being that we present in this book suggests *that we have already taken the low-wage path.* No one in government or business has explicitly announced a program of lowering American wages and working conditions in order to become "competitive"; nevertheless, the cumulative impact of both government policy and business strategies has achieved a lowering of wages and the standard of living of most Americans.

Yet there is no evidence of our economy becoming more competitive or having improved in the fundamentals of capital accumulation or economic efficiency and productivity. In fact, the economic shift to a more deregulated economy over the 1979-94 period has been all pain and no gain. The economy is clearly in transition, but it is far from certain that it is headed to a better place. The fundamental economic problem we face is to generate adequate income growth for the majority based on jobs paying high hourly wages and benefits. Government policymakers and elected leaders must be judged on their ability to change the economic course of the country, to leave the low-wage for the high-wage path.