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Low-Wage Jobs and No Wage Growth

Is There A Way Out?

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We need to distinguish two problems. One is the decline of middle-paying jobs. The other, equally worrisome, is wage stagnation. Neither will be easily solved, but policy can help.

Low-Wage Jobs

The American economy has been producing fewer middle-paying jobs. Studies by Erik Olin Wright and Rachel Dwyer[1] and by David Autor[2] have examined the profile of job creation in the United States since the 1960s. Each finds a shift toward a U-shaped pattern, with the bulk of new jobs in the 1990s and 2000s coming in occupations with either high or low wages. For many people in the bottom half of the skill and education pools, this means a greater likelihood of ending up in a low-paying job.

Why has this happened? One reason is the shift from manufacturing to services. Like the earlier shift out of agriculture, this results in part from rising productivity in manufacturing. It is also a function of globalization. Manufacturing now accounts for less than 10% of employment in the United States, and there is little likelihood of a reversal.

Second, technological change enables replacement of routine jobs, including mid-level ones in high-paying sectors such as finance, law, and manufacturing.

A third factor is growing competition in product markets. This results partly from globalization, but there is also heightened competition in all industries, regardless of whether or not firms are exposed to international markets. Think of retail stores, restaurants, and hotels. Competition encourages management to hire fewer employees, to lay off more when times are tough, to cut the hours of those paid by the hour (while requiring longer hours of those paid on salary), and to resist wage increases.

Finally, within firms there has been a shift toward pay for performance.[3] As companies have devised new ways to calculate value added and moved to pay by (real or perceived) contribution rather than by the job, we've seen a growing chasm between the pay and benefits of those at the top versus that of the bulk of employees underneath them.

Will the trend continue? I see no compelling reason to think not, in part because it is not unique to America. A number of European nations have experienced a similar development.[4]

Wage Stagnation

From the end of World War II through the mid-1970s, inflation-adjusted wages for most Americans rose steadily, more or less in line with productivity. Since then, the median real wage has barely budged.[5] Median compensation (wages plus benefits) has grown, but not very rapidly.[6] Median household incomes have risen, but mainly because a growing share has two earners rather than just one.

The culprits are numerous, including many of the same as those behind the decline in middle-paying jobs: heightened competition, technological change, lack of increase in educational attainment, a rise in less-skilled immigration, a shift in corporate governance, union weakening, growing prevalence of winner-take-all labor markets, a shift toward pay for performance, and minimum wage decline.

What To Do

I recommend three guiding considerations. First, the American economy's new reality of low-wage jobs and no wage growth has multiple causes, no one of which far outweighs the others in importance. That means we are unlikely to find a silver bullet. Second, some of the contributing causes, such as technological change, globalization, and immigration, have beneficial consequences that it would be a shame to forego.[7] In devising remedies we should look to these last, if at all. Third, the best solutions need not necessarily target the most important causes.

What, then, should we do?

One possibility is to ignore the problem. We're an affluent country; perhaps we don't need to get any richer. I disagree, largely on grounds suggested by Benjamin Friedman in *The Moral Consequences of Economic Growth*.[8] People who feel they are better off than before are, it seems, more generous, altruistic, and participatory. The core of the American dream, and a key source of the country's social and political stability, is not the opportunity to rise from rags to riches, but rather the belief that living standards are improving. We may reach a point of affluence where people happily tolerate stagnant living standards, but I doubt we're there yet. Moreover, ever-rising polarization could at some point engender serious societal friction.

Can wealth appreciation substitute for rising wages and household incomes? Prior to the economic crash this seemed plausible. With home values appreciating, American families could take on more and more debt to fund rising consumption. But no longer.

Two-earner households are now the norm, and that helps to offset the limited supply of middle-paying jobs. Though the median wage has been stagnant for the past three decades, the median income (adjusted for inflation) of families with two earners rose from $63,000 in 1979 to $84,000 in 2007. But we are approaching the end of our ability to use rising household employment as a substitute for rising wages. And in any case this is not a solution for single adults.

Perhaps our living standards can continue to rise via improvement in product quality and invention of new gadgets. During the past few decades we've benefited from new and better medical technology, personal computers, cell phones, the internet, MP3 players, e-readers, and so on. This could continue inexorably, but it doesn't seem wise to simply assume it will. Nor is it certain that Americans will, or should, be satisfied even if it does.

Perhaps wage growth will return. An optimistic view might suggest that the past generation was an aberration, characterized by a one-time surge in the supply of low-productivity labor: movement of women into the workforce, increase in low-skill immigration, and no rise in the high school graduation rate. These will abate, putting supply and demand for low-skill labor back in balance and thereby facilitating growth in low-end wages. This is conceivable, but I don't recommend we count on it.

The key to rising wages in the early post-World War II decades was that many American firms faced limited product market competition, limited pressure from shareholders to maximize short-term profits, and significant pressure from unions (or the threat of unions) to pass on a "fair" share of profits to employees. Each of these three institutional features is gone, and I find it difficult to envision them coming back. A shift away from reliance on equity markets might diminish pressure from shareholders.[9] But competition is not going away. Nor are unions likely to get back to anything like their early postwar influence. Indeed, they have been weakening in most rich nations.[10]

Since the 1970s there has been only one brief period in which real wages in the bottom half of the distribution have increased: the late 1990s. The key seems to have been low unemployment ("full employment").[11] That too would be good to replicate. But if and when we once again get near 4% unemployment, I suspect the Federal Reserve will be less willing than it was in the late 1990s to resist stepping on the brakes.

Improving educational attainment might well help, and it would be good to do in any case.[12] But even if it works, the payoff is likely to come only in the long run.

Frank Levy and Thomas Kochan suggest encouraging the spread of high-performance work organization and "shared capitalism" practices such as employee ownership, profit sharing, and stock options.[13] I agree.

Ultimately, though, I suspect we may have to turn to an expansion of the Earned Income Tax Credit (EITC), making it a full-blown middle-class earnings subsidy. The EITC is a subsidy that increases with household earnings up to about $13,000 (for a family with two children), then stays at a flat level, and then begins to decrease, reaching zero at earnings of about $40,000. The maximum EITC benefit amount is around $5,000. It is a very good program, supplementing the incomes of households with low earnings while encouraging employment. It could be enlarged so that it reaches households farther up the distribution. If the benefit were tied to average wages, it would rise over time in real terms, helping to stem the widening gap between growth of the economy and growth of household incomes.

Wouldn't this let employers off the hook? To some extent, yes. Is that bad? Well, consider how we think about health insurance, pensions, unemployment insurance, and sickness/disability insurance. Like income, these contribute to economic security and material well-being. In affluent nations most or all of these programs are financed at least partly by taxpayers, and few object to the fact that firms are not the sole funders. Should it be objectionable, then, for taxpayers to also fund what amounts to insurance compensation for low earnings? In any event, it may be the best available option in the new economy.

Another key contribution policy can make is via public services. Services expand the sphere of consumption that is either free or low-cost. We do it already with safety, education, health care (for some), and more. We ought to fully cover the costs of health care and add early education, not to mention better infrastructure, high-speed internet access, roads, and public transportation.

I'm not certain how far these proposals will take us in addressing the twin problems of low-wage jobs and no wage growth. But at the moment they strike me as our best bet options.

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