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The State of Working America 2006/2007

GROWTH BYPASSES ALL BUT WEALTHIEST FEW
WAGES STAGNATE DESPITE RAPID PRODUCTIVITY GROWTH

Young workers' wages trail their predecessors'
Less upward mobility in U.S. than in other countries

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The Economic Policy Institute is an independent, nonprofit, nonpartisan research institute - or "think tank" - that researches the impact of economic trends and policies on working people in the United States and around the world.

The five-year-old economic expansion that began in late 2001 has posted some impressive results, most notably faster productivity growth. Yet, real income is lower for the typical family than in 2000, while the incomes of the best-off families have grown rapidly. These highly unbalanced economic outcomes present a stark contrast to the latter 1990s, when wages and incomes of low-wage and middle-wage workers grew in much closer step with rising productivity, the measure of goods and services produced per hour worked. The dimensions of these disparities and trends in living standards are painted in detail in the 2006-2007 edition of *The State of Working America*, released today by the Economic Policy Institute.

In this 10th edition of EPI's definitive volume, authors Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto have updated and expanded the book's scope to offer the most comprehensive portrait yet of the economic challenges facing today's middle- and low-income working families. It's a portrait centered around a seeming contradiction. On the one hand, the economy is frequently characterized as robust in terms of big-picture indicators such as the gross domestic product. On the other hand, the wages and incomes that shape most Americans' living standards continue to fall behind expectations.

The Productivity Puzzle

Productivity growth, historically tied to compensation growth, has accelerated in recent years, yet inflation-adjusted wages for most people have been flat or falling. Instead of being more or less evenly dispersed among the broad working public, the fruits of this growth are increasingly flowing to the top, fueling rising inequality between the top 1% at the apex and other families, especially those in the middle and bottom of the income pyramid.

The divergence of wages from productivity gains is forcing economists to rethink the nature of the link between the two. Where it once seemed safe to assume that wages would rise more or less in tandem with productivity, it now seems more accurate to say only that rising productivity creates the *potential* for wage growth. Productivity growth, even stellar productivity growth, cannot alone assure widely shared prosperity.

"Productivity growth has been seen as the tide that lifts all economic boats," explains EPI President Lawrence Mishel, "but today we're seeing more and more Americans rowing harder and harder but not moving forward, while the big boats zoom farther ahead."

Income & Wages Stall

Productivity grew 13.4% during the booming period from 1995 to 2000 and even faster, 16.6% from 2000 to 2005, even though that more recent period included a recession. Yet median family income, which grew 11.3% in the latter 1990s, reversed course and fell nearly 3% (2.9%) in the fast-productivity growth 2000s. The share of the population living in poverty, which dropped by 13.3% in the latter 1990s rose by 17.1% (about 5.4 million people) in the 2000s, while an additional 15.1% (6 million people) lacked health care coverage.

When fast productivity growth was coupled with rapid job growth and truly low unemployment in the latter 1990s, the most disadvantaged families made real progress. In the 2000s, African American, Hispanic, and young families all suffered income losses, a stark turnaround from the

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exceptional median income gains they had made in the late '90s. African-American families went from a 15.6% gain from 1995 to 2000 to a 4.8% loss from 2000 to 2005; Hispanics from a 24.9% gain to a 6.3% loss; and young families (25-34) from a 12.3% gain to a 5.8% loss.

Family incomes were pummeled in the 2000s by the one-two punch of slower hourly wage growth and fewer hours of work. Hourly wage growth lost momentum for both high school (only) and college graduates, although the drop-off was larger for college graduates: Their real hourly wage, which had grown 11.3% from 1995 to 2000, grew just 1.3% from 2000 to 2005, a change attributable in part to the drying up of jobs in information technology and financial services and to greater offshoring of white-collar jobs.

"Younger workers have been hit the hardest as new high school and college graduates are taking jobs with lower pay and fewer benefits compared to those available to them a few years ago," said economist Sylvia Allegretto. "This economy just isn't providing the opportunities people need and expect."

The Fix? More and Better Jobs – and Faster

The authors identify a central problem in today's lackluster wage growth as the economy's failure to consistently produce enough jobs to generate a truly "full employment" labor market, where employers need to raise wages to attract and keep the workers they need. There have been only 2% more jobs created over the 63 months (since March 2001) of this business cycle. In contrast, job growth this far into the 1990s cycle (also a jobless recovery) reached 7%, and the average at this point in all other business cycles this long was 12%. If today's economy were performing as well as in the previous jobless recovery, it would have generated 7 million more jobs by now.

The *unemployment* rate only counts those actively seeking work. In this protracted period of slow job growth it has generally understated the true degree of labor market slack, since those who have given up the search for work are no longer counted, thus artificially lowering measured unemployment. The share of the population that is working, the *employment* rate, gives a truer picture: In mid-2006 it was 1.6 percentage points below its 2000 peak, suggesting that, on top of the 7 million currently counted as unemployed, up to 2.4 million more people were missing from the employment rolls.

The authors identify other factors as key to the recent weakness in wage growth. Among them are the declining membership and bargaining power of unions, which have in the past given working people leverage to claim a fairer share of the benefits of economic growth. Other factors include the failure to raise the federal minimum wage, now at a 50-year low in real dollars; and the rise of globalization and greater offshoring of blue- and white-collar jobs.

As we prepare to observe Labor Day 2006, job creation has downshifted further, and unemployment may have begun to trend upward. Thus, the possibility of achieving full employment conditions appears to be fading.

"Whether your collar is blue or white, whether you wear a hard-hat or a lab coat, your ability to bargain for a fair share of the economy's growth is diminished," said Jared Bernstein. "This fact alone goes a long way towards explaining an economy that looks fine until you take a closer look at how working families are really faring."

Starting Lower, Growing Slower

The authors note that most workers' earnings grow over their lifetime as they age and gain experience, even though workers as a group, by education or occupation, have lost ground. Workers entering the workforce today generally start at a lower point and advance more slowly than their predecessors did. In 1970, a 50-to-54-year-old worker with some college (but not a degree) earned about $48,000 per year (in 2005 dollars) and a 20-24 year-old entering the workforce that year was paid about $23,000. But by 2000, when that same young worker reached

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the age of 50-54, his annual wage was just under $44,000 – substantially higher than his entry-level earnings but some $4,000 per year less than a similarly educated person in his parents' generation 30 years earlier.

Another view yields the same conclusion: Starting wages (in 2005 dollars) for two different groups of workers (high school-educated workers and those with some college but not a degree) peaked in 1970 at $30,903 and $33,550, respectively, and in 2000, despite ups and downs, still remained below that peak (at $25,944 and $29,180).

Lesser Expectations: Income Mobility Trends

What lies ahead for working families? A chapter on income mobility, new in this edition, explores how people move through the economic landscape over time, measuring their progress as they age and comparing it to other groups that came before them.

Far from being a nation of Horatio Algers who can work their way up even from humble beginnings, we find that many families remain in a similar income class throughout their lives, and children's incomes correspond significantly to their parents'. One study the authors cite, for example, finds that it would likely take children from a poor family of four with two children approximately nine to 10 generations—over 200 years—to reach the income of the typical middle-income, four-person family.

These income mobility trends also reveal how limited the chance is that people can make great leaps up the income scale in the course of a lifetime. Sons of low-income fathers have less than a 5% chance of making it above the 80th income percentile – into the upper 20% – as adults.

Conventional wisdom has it that mobility is greater in the United States than in other advanced economies, many of which are accused of tamping down economic incentives with their comprehensive social protections. The facts show otherwise. The economic fortunes of sons in Finland, Canada, Sweden, and Germany are less determined by their fathers' status than in the United States. Even though these other countries provide far more extensive safety nets, families there appear to face fewer class barriers.

To Become Wealthy, Be Wealthy

The answer to be gleaned from this year's edition for people who want to know how to get rich is the same as for the little girl who wants to know how to become a queen: Be born that way. The book shows how the growing concentration of capital income and wealth among the very wealthiest few and the parallel shift within the economy from labor-based to capital-based income is fueling the widening inequality gap not just between the top and the bottom, but also between the top and both upper-middle and middle income families. The authors calculate that the shift is equivalent to an annual transfer of $3,043 from every wage-and-salary employee in the bottom 80% of workers to those in the top 20%.

About the authors:

Lawrence Mishel, president of the Economic Policy Institute, where he also directs the institute's education research. He holds a Ph.D. in economics from the University of Wisconsin and is widely published and cited on a wide range of economic issues, especially on labor markets. He is the originator of *The State of Working America* and has been an author of all ten editions.

Jared Bernstein, senior economist, directs EPI's living standards program. This is his eighth *State of Working America*. His current book is *All Together Now: Common Sense for a Fair Economy* (Berrett-Koehler). He holds a Ph.D. in Social Welfare from Columbia University.

Sylvia Allegretto, economist, specializes in labor markets and wage and income inequality. This is her second *State of Working America*. Recent work includes analysis of the basic family budget needs in over 400 metropolitan areas. She holds a Ph.D. in economics from the University of Colorado.