New America Foundation

Decent Jobs Forum

A Series of the Next Social Contract Initiative

It Takes a Policy Agenda

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June 2011

Multiple Policy Changes Caused the Wage-Growth Slowdown, Multiple Changes Will Be Needed to Fix It

This forum's focus on the problems of sluggish wage-growth for much of the American workforce is most welcome. Before the overwhelming surge of joblessness and underemployment of the last four years caused by the bursting housing bubble, the failure of the wages of most American workers to track economy-wide productivity growth was one of the most conspicuous failures of U.S. economic performance.

Between 1979 and 2007, productivity in the business sector grew by 72 percent while the median wage grew by only 7.8 percent. One can quibble about the calculations: which deflators to use; the growth of non-wage compensation that has exceeded wage-growth; the fact that total-economy productivity has lagged business sector productivity growth. But even taking these factors into account, it is clear that economy-wide productivity has grown much faster than wages over this period. And this long-run performance would look even worse, were it not for a brief-but-welcome respite during the late 1990s, when wages grew quickly across the board.

Even worse, a durable literature links elevated unemployment to reduced wage growth. If one applies the historical relationships to projections about unemployment in coming years, the implications for wages are almost too grim to be believed. Median compensation could well end up in 2015 a full 13 percent lower than where they would have been, absent the Great Recession. In short, tackling the problem of wage growth will be a key challenge, remaining even when we eventually return to more-normal unemployment rates.

So how should we tackle this challenge? It turns out that there is no silver bullet likely to solve this problem; instead there is silver buckshot. To understand why, one must realize that the slow wage growth of most of the past 30 years was largely policies-driven, as nearly all levers of policy became oriented to send more and more of the overall wage bill to the top of the distribution.

It worked. The famous Piketty and Saez estimates are that the top 1 percent of the wage-bill saw its share of the total double between 1979 and 2007 – from 6 percent to 12 percent.

What were the policy changes that led to this vast concentration of wage incomes?

- Labor law changes accelerated the decline of unions in the private sector; the more-insulated public sector saw unionization rates hold steady or even increase.
- The purchasing power of the minimum wage was allowed to be eroded by inflation for almost decades-long stretches – resulting in a minimum today that remains far below its late-1960s peak in purchasing power.
- Global integration with much-poorer trading partners occurred under a regime of trade agreements that provided detailed and firm protections for capital-incomes but none at all for labor-incomes in any country.
- The financial sector was deregulated and began paying exorbitant rents to its most-privileged employees, who dominate the upper reaches of the wage-distribution.
- Tax-rates on high-incomes were radically reduced.
- And, perhaps most important, the Federal Reserve let its mandate to pursue full-employment wither.

These policy changes affected both pre- and post-tax and transfer wage growth, so countervailing changes going forward must similarly address pre- and post-outcomes. However, given that there is substantial agreement on the center-left that tax policy has played an important role in rising inequality and that returning to a more progressive tax code is a top priority in generating shared prosperity, we focus here on a set of policies that are often neglected because they impact the pre-tax and transfer wage distribution.

Policies changes to improve wage growth

- First, labor law should be reformed to allow willing workers to form a union and be guaranteed the right to collective bargaining. A 2007 survey by Harvard economist Richard Freeman found that fully half of non-unionized private-sector workers wanted to be represented in the workplace by a union. The huge gap between the desire for representation and actual representation is prima facie evidence that policy has become an active impediment to organizing workers.
- The minimum wage should be raised to at least levels that we deemed affordable in the late 1960s, when the economy's labor force was less than half as productive as today's.
- Financial sector regulation should try to muffle the monopoly power enjoyed by firms in this sector, reducing the labor market rents paid to its most-privileged employees.
- Global integration should be better managed, with capital owners, not just workers, subject to globalization's competitive pressures and with workers, not just capital owners, protected from unfair competition.
- Last, genuinely full employment should be the priority target of the Federal Reserve, not low rates of inflation, and the Fed should reach deep into its toolkit, well past just control of the short-term policy interest rates, to insure that full employment is achieved and then safe-guarded.

The Importance of a Pre-Tax and Transfer Agenda

Because this agenda focuses on the pre-tax and transfer wage distribution, it is at odds with the preferences of many economists – even those within the center-left coalition. We would argue, however, that this pre-tax and transfer focus is quite important, for a number of reasons.

First, many of these policy interventions would not only boost wage growth, but would accomplish other useful policy goals as well. For example, hitting a genuine full-employment target is not just good for low- and moderate-wage growth; it is the very definition of economic efficiency. No single intervention has the potential to boost overall incomes as much as insuring idle resources are put into productive use. For far too many years we have allowed resources to remain idle for fear that employing them would spark runaway inflation. It is time to end this irrational fear over moderate rates of inflation and prioritize full employment.

Similarly, taming financial sector excess will not just keep the highest incomes in this sector from inflating the wage distribution, it will mean that the economy overall will not need to pay as much for whatever valuable bits of service that the financial sector does actually manage to provide. The financial sector grew from 4.9 percent of GDP in 1979 to 8.3 percent in 2006, yet this increase did not yield appreciable higher rates of capital formation and certainly did not leave us with a more stable, less risk-exposed macroeconomy. If the same or better performance can be delivered by the financial sector for less money after intelligent reforms, this would provide a huge potential boost to the rest of the economy.

Trade agreements in recent decades have pressured trading partners of the U.S. to harmonize a range of their own policies – policies often not even tangentially related to trade – with those of the U.S., particularly when it comes to protecting the rights of capital owners. This dynamic restricts the potential scope for comparative advantage to operate by taking different national policies regarding capital owners out of the realm of competition. It also means that one of the prime potential gains from trade – eroding the market power of key monopoly industries (software and pharmaceuticals, for example) – are left on the table. Reversing this pro-corporate bias in our trade regime would not only help workers both in the United States and in our trading partners' economies, but would also increase economic efficiency.

Second, there is little reason to believe that meddling in the pre-tax and transfer wage distribution would be particularly bad for the economy. Ample research has proven that the labor market is not well-characterized as a perfectly competitive spot market for a homogenous good. Instead, bargaining power is a hugely important determinant of wages and policies that helps boost the power of low- and moderate-income workers, and can often do so without any negative fallout. This can be seen most clearly in the now-enormous literature on the economic effect of increasing the minimum wages; they do indeed boost wages and yet leave no discernible impact on employment. The malign effects of many labor interventions that are predicted in the simplest models of labor markets – whether they be legislated minimum wages, labor market protections, increased generosity of unemployment compensation, high degrees of centralization of wage-bargaining – are very rarely found in actual data. Does this mean policymakers have carte blanche to legislate the wage structure? Surely not. But it does mean that labor markets are much more flexible than the most naïve models would expect, and policy interventions that merely returned some labor market institutions like unions and minimum wages to the level of strength they enjoyed in previous decades, characterized by strong economic performance, can be done without fear that the economy will somehow be wrecked along the way.

A third consideration is much more in the realm of politics than economics. If there is one lesson that recent debates over the budget should have taught us, it is that tax revenue is a seriously scarce resource. While there is little economic reason to suspect that raising enough revenue to fully offset the damage done to low- and moderate-income households by sluggish wage growth would lead to great harm to the economy, there are political reasons to suspect this would be very hard to engineer. Given this obvious political reality, it makes sense to see how much we could reverse the adverse wage-trends of most of the previous decades without calling on taxpayer money. Comprehensive social insurance and public investments are sufficiently expensive and worthwhile endeavors with very little to be done through pre-tax and transfer systems. Adding the amelioration of inequality to the cost of government, when it can be done through other means, seems foolhardy.

It is important to note, however, that as worthy as all of the policies enumerated above are, simple job creation must be our top priority in the current moment. With unemployment hovering around 9 percent, we cannot afford to allow "recession-fatigue" to lead us to lose interest in the policies that have the most promise to spur a quick recovery, namely more fiscal support. But we also must keep in mind that the changes described in this essay will not happen on their own. They will require that we reverse course on the policies of the last 30 years, policies that were designed to further enrich the economic elite while leaving the rest behind. The good news is that this course reversal toward increased worker bargaining power via all the avenues described above can work both to ensure that the typical family shares in the growth of income and wealth in this country, as well as to provide a more stable economy that is resistant to colossal failures like the Great Recession.

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