

# 1

## Introduction and Overview

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Can the U.S. economy generate healthy growth of “good” jobs— jobs that will ensure a steady improvement in the standard of living for the middle class and that will offer a way out of poverty for low-income Americans? This is the fundamental economic policy challenge facing our country in an age of intense global competition. By some measures, the U.S. economy appears poised to perform well in the long-term, whatever its short-term difficulties. With Gross Domestic Product (GDP) and productivity growth high and unemployment relatively low in recent years, key economic indicators suggest a fundamentally strong U.S. economy that can withstand downward cyclical pressures.

Beneath these aggregate statistics, however, are signs that those at the bottom and a growing number in the middle are being left behind. Rapid globalization and technological progress have brought substantial benefits to American consumers in the form of better and cheaper goods and services. But globalization and technological improvements have also been associated with substantial dislocation, stagnant or declining real wages and benefits, and reduced job security for many workers. The gains from economic growth in recent years have accrued primarily to those at the very top of the income distribution, as evidenced by the growth of inequality in this country.

In this book, which was the outgrowth of a conference sponsored by the Upjohn Institute in Washington, D.C., in June 2007, leading policy analysts frame the major challenges facing U.S. labor policy:

- Improving the skills of American workers so that they can better compete in a global economy;
- Addressing the crisis in our system of employer-sponsored health insurance;

- Minimizing the effects of dislocation due to immigration and trade;
- Removing barriers to employment for older workers;
- Improving the quality of jobs for low-wage workers without harming the competitiveness of American companies;
- Addressing the serious employment barriers of the disadvantaged.

Each chapter in this volume tackles one of these policy challenges, identifying the key problems, evaluating the effectiveness of current policy approaches, and offering innovative, forward-thinking, but pragmatic alternative policies. Collectively, the chapters in this volume offer a clear road map for future labor market policy.

## **SIGNS OF TROUBLE FOR U.S. WORKERS**

The difficulty that the United States will have in generating good jobs and improving living standards for *all* Americans is readily apparent in problems already facing middle-class and low-wage workers.

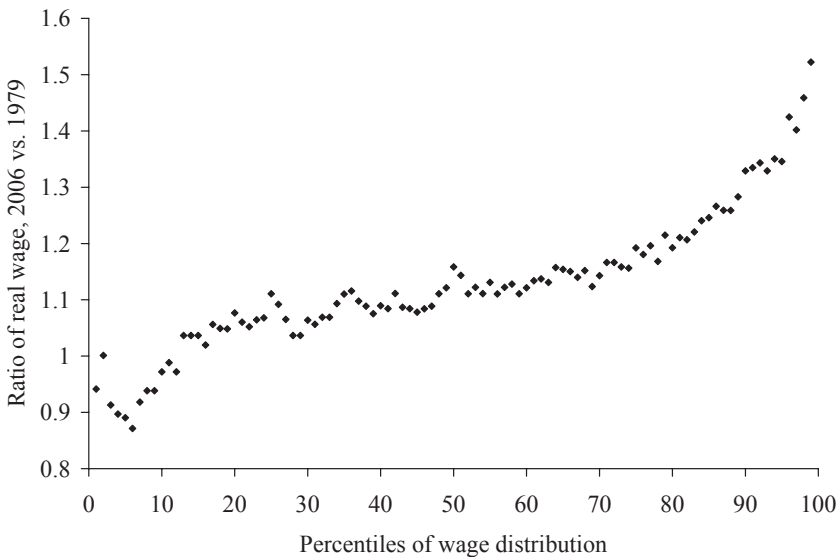
### **Growing Inequality**

Wage inequality has widened substantially in recent years. From 2000 to 2006, average real hourly wages dropped by 0.5 percent for those in the fifth to the fifteenth percentiles of the wage distribution, increased by 3.4 percent for those in the forty-fifth to fifty-fifth percentiles, and rose by 5.9 percent for those in the eighty-fifth to ninety-fifth percentiles.<sup>1</sup> Indeed, this recent increase in inequality is a continuation of a general trend evident since the 1980s, during which time wages for the middle and lower classes have risen far less than the rate of productivity growth, and most of the increased wealth generated by productivity gains has gone to the highest income households. From 1979 to 2006, hourly wages for the median worker grew only 16 percent in real terms, or about 0.5 percent per year.<sup>2</sup> In contrast, the U.S. economy's total output per hour over that same period grew 58 percent, or about 1.7 percent per year.<sup>3</sup> Figure 1.1, which shows the growth in real hour-

ly wages at various percentiles of the overall U.S. wage distribution between 1979 and 2006, depicts the increase in inequality.<sup>4</sup> Wages at the bottom 10 percent of the distribution have actually declined in real terms since 1979. Real wage growth has been low for workers between the tenth percentile and the eightieth percentile—increasing by less than 20 percent over this 27-year period—compared to the much more rapid wage growth for those at the ninetieth percentile and above.

Real hourly wage growth of approximately 1.1 percent per year from 1979 to 2006 would have been needed for the growth in total compensation to match labor productivity growth over the period.<sup>5</sup> Only earnings at the ninetieth percentile and above matched or exceeded this rate. To understand the extent to which inequality in this country has grown, consider the fact that if wages below the ninetieth percentile had grown at a rate consistent with productivity growth from 1979 to 2006, earnings for these workers would have been \$734 billion higher in 2006.<sup>6</sup> This amount represents about 12 percent of all wage and salary income and about 7 percent of GDP in 2006.

**Figure 1.1 Growth in Wage Inequality in the United States, 1979–2006**



NOTE: These data are based on our calculations from the CPS-ORG for 1979 and 2006. See Note 4 for details.

## **Declining Coverage and Generosity of Benefits**

Employer-sponsored health insurance has been the foundation of the U.S. health insurance system for over 50 years. Yet the fraction of the nonelderly population with employer-sponsored health insurance has dropped sharply in recent years, accompanying the steep increase in health insurance costs. In 2005, health insurance was as costly to employers as paid leave, historically the most expensive benefit (GAO 2006). From 2000 to 2006, the percentage of firms offering health insurance benefits declined by 8 percentage points, and the percentage of the nonelderly adults with employer-sponsored health insurance coverage declined by 5 percentage points. By 2006, only 62 percent of the nonelderly population was covered by employer-sponsored health insurance.

The fraction of the working population with retiree health insurance benefits similarly has dropped. The largest drop occurred among private-sector workers following an accounting rule change in 1993 that required companies to show future retiree health-benefit costs as liabilities on their financial statements. The fraction of private-sector workers working in companies that offer some type of retiree health-insurance benefits has continued to fall since then, however, dropping from an estimated 32 percent in 1997 to 25 percent in 2003 (Buchmueller, Johnson, and Lo Sasso 2006). Analysts believe that recent changes in government accounting rules will lead to a sharp drop in the incidence of retiree health-insurance coverage offered to public-sector workers as well (Johnson 2006).

Besides health insurance and paid leave, the primary workplace benefit is a retirement plan. Although the fraction of workers who are covered by some retirement plan has not declined in recent years, companies' shift from traditional defined-benefit to defined-contribution retirement plans shifts investment risks to workers. In addition, although defined benefit plans are not intrinsically more generous than defined contribution plans, companies' shift to defined contribution plans typically has been associated with reduced benefits (Ghilarducci and Sun 2006).

## Less Job Security

Long-term employment with a single company is becoming less common. Mean and median job tenure have declined among men over the last 50 years, and the fraction of men in a long-term job (whether it be for 10 years or 20) has declined for all age groups, with the decline most notable for older men (Farber 2007). Related to this phenomenon, there is evidence of a persistent trend towards increased job loss in recent years, especially among more educated and older workers (Farber 2005). Thus, American workers appear more likely than in the recent past to experience dislocation and are more likely to have to make a late-in-life job change.

## Sharp Drop in Employment among Low-Educated Men

The employment rates of men of all ages with a high school education or less have declined precipitously since the 1980s. Among prime-age (25–54) white, non-Hispanic men, the employment rate (the percentage ratio of employment to population) has dropped by 13 percentage points since 1979 among high school dropouts and by 5 percentage points among those with only a high school degree.<sup>7</sup> Among prime-age black men, the employment rate has dropped by 21 percentage points for high school dropouts and by 10 percentage points for those with only a high school degree.<sup>8</sup> The employment rate of prime-age black men who had dropped out of high school stood at only 54 percent in 2006. The sharply declining employment rates among low-educated men contrast with the employment rate trend for college-educated men, which has changed little over this period.

Offsetting these large declines in the employment rates of low-educated men would require significant expansion of employment in the U.S. economy. For example, in 1979 the employment rate among prime-age, white non-Hispanic men without a high school degree was 84.6 percent.<sup>9</sup> If all prime-age men without a high school degree had been employed at that rate in 2006, more than 600,000 additional jobs would have been required. Similarly, if all prime-age men with only a high school degree in 2006 had been employed at the same rate as that experienced by white prime-age men with only a high school degree in 1979 (93.5 percent), an additional 2.2 million men would have been

employed. Taken together, such an expansion of employment among prime-age, less-educated men would require an additional 2.9 million jobs, or about a 2 percent expansion of employment in the U.S. economy, if all else remained the same.

Less-educated men in their 50s, which are traditionally the immediate preretirement years, have also experienced sharp declines in employment. From 1979 to 2006, employment rates among men in their 50s declined by 12 percentage points for high school dropouts and by 11 percentage points for high school graduates.

Although one might argue that declining employment rates among low-educated men reflect increased employment among women, this explanation is insufficient. Employment rates for college-educated men have not fallen, in spite of the sharp increase in employment among college-educated women. Moreover, employment rates among prime-age, high-school-dropout women have been relatively constant and thus would appear to explain none of the sharp drop in employment rates among their male counterparts.<sup>10</sup> Instead, the fact that employment rates have remained quite low among prime-age women without a high school degree—in spite of the overall high growth in employment among other prime-age women and in spite of declining marriage rates and welfare reform, which has decreased public support for many of these women—suggests insufficient employment opportunities for low-educated women as well.

## **FORCES SHAPING THE AMERICAN WORKPLACE**

These problems of growing inequality, declining generosity and coverage of benefits, reduced job security, and declining employment rates among low-educated men are attributable to a range of economic and social forces. Widespread involvement of large institutional investors in the stock market beginning in the 1980s led to greater focus on lowering costs to boost short-term earnings and stock prices, which in turn contributed to downward pressure on compensation and reduced job security.

Rapid technological advances have also played an important role. Developments in health technology have reduced mortality and im-

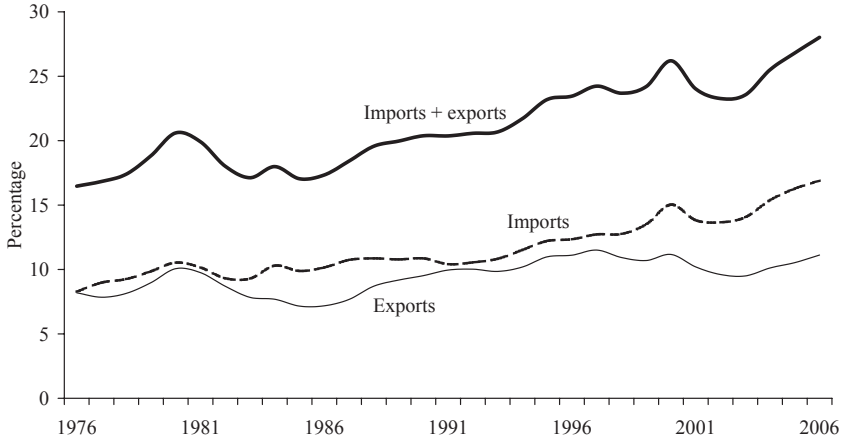
proved the quality of life for many Americans. But these advances have greatly increased the cost of health care and placed severe strains on our employer-financed system of health insurance.

Economists generally believe that computer technology introduced into the workplace in the 1980s and 1990s has favored more-skilled workers and helps explain growing inequality. However, by opening up the possibility of offshoring many service jobs, the development of the Internet and other communications technologies potentially will have far-reaching implications for American workers at all skill levels in the future.

Globalization reinforces pressures from financial markets and new technology. Recent political and economic reform in China, Eastern Europe, and elsewhere has enabled tremendous expansion of trade to occur in large sections of the world. Bilateral and multilateral trade agreements have further paved the way for the expansion of trade. These factors—coupled with lower transportation and communications costs and financial market pressures on U.S. companies to lower costs through offshore outsourcing—have greatly increased the importance of trade in the U.S. economy. Figure 1.2 displays the manifestation of this trend through U.S. exports and imports as a percentage of GDP. From 1980 to 2006, the combination of exports and imports rose as a proportion of GDP in the United States from 20 to 28 percent. Almost all of that increase was attributable to the growth of imports, reflecting the steep increase in the U.S. trade deficit, particularly in the last several years (Figure 1.3). While Americans broadly benefit from lower-priced imports, the growth of the global economy has led to substantial worker dislocation and placed further downward pressure on many workers' wages.

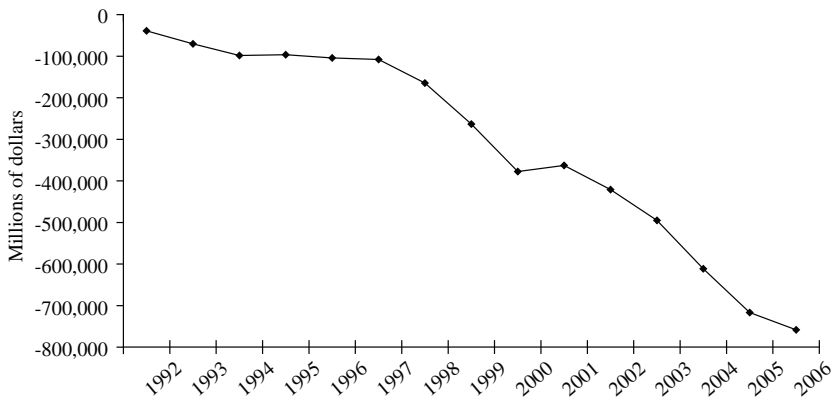
At the same time that these economic forces are placing strains on middle-class and low-wage workers, institutions that historically have helped to mitigate income inequality have significantly weakened. Most notable are the decline in the value of the minimum wage and the decline in union representation. Before its increase in July 2007, the minimum wage had fallen to 77 percent of its real value in 1996, the year the minimum wage was last increased.<sup>11</sup> Unionization rates have continued to fall from their peak in the 1950s. In 2006 just 12 percent of all U.S. workers and just 7.4 percent of the private-sector workforce belonged to a union.

**Figure 1.2 The Growing Importance of Trade in the U.S. Economy:  
Imports and Exports as a Percent of Gross Domestic Product**



SOURCE: Authors' calculations based on data from the Bureau of Economic Analysis.

**Figure 1.3 Balance of Trade for Goods and Services**



SOURCE: U.S. Census Bureau (2005, 2007).

## **POLICY ACTION PLAN**

To address the problems of inequality and pressures from globalization, the contributors to this volume recommend several key reforms of labor market policy:

### **Reform the Delivery of Education and Training**

Virtually all agree that improving the skills of our current and future workforce is critical to competing in a global economy. Yet, Robert Lerman points out, current federal and state policies are overly narrow and often counterproductive. According to Lerman, a key problem is that the United States lacks comprehensive measures of skills. The common focus on school completion and academic test scores leads to policies that devote too few resources to productivity-enhancing noncognitive skills and occupational skills. The results are poor preparation of many workers and an insufficient supply of workers for many jobs that are in demand and pay good wages.

Lerman urges the development of education curricula that are more closely tied to workplace needs, that meet the diverse learning styles of students, and that expand support for vocational training in high schools. High school students should be able to achieve occupational qualifications by combining school instruction with well-structured work-based learning. The K-12 system should be rewarded for raising noncognitive skills and occupational skills, even if some students do not complete all of the requirements for admission to a four-year college. The minimal federal budget allocation for apprenticeship programs should be increased. Finally, Lerman recommends changes in financial accounting rules so that firms count their workforces' human capital as assets and thereby are encouraged to invest more in worker training.

### **Reform Health Insurance**

Can employers continue to afford health insurance coverage for employees and remain competitive in the global economy? The answer for a growing number of small and large companies is no. Katherine Swartz explains why the current system of employer-sponsored health

insurance is inefficient and is leading to a downward spiral of coverage in our country. Swartz warns that the rapid drop in employer-sponsored health insurance coverage adds a new urgency to reform in the financing of health insurance, and she offers a road map for universal coverage based on three principles: 1) everyone should enroll in a health plan and pay a minimum amount, 2) additional premiums should be collected from individuals in proportion to family income, and 3) companies should contribute to financing the insurance. The Netherlands, Germany, and Switzerland have health insurance systems that meet these three principles and so offer potential models for a reformed U.S. system. The system proposed by Swartz would preserve a central role for private health insurance.

Swartz emphasizes that changing the financing of health insurance would change the way health insurance costs are shared but should not increase—and possibly would lower—the total amount spent on health care. A reformed system could avoid inefficiencies that result from lack of insurance coverage, increase productivity by allowing individuals to switch jobs without losing coverage, increase competitiveness of U.S. companies in the global market, and reduce perverse incentives employers have to contract out work or avoid hiring older workers.

### **Expand and Revamp Return-to-Work Programs**

Federal funding of employment and training programs in 2007 is about 40 percent lower in real terms than it was a decade ago (Abraham and Houseman 2008), while the need for such programs has grown because of declining job security and a growing population. Failure to implement effective return-to-work programs is expensive for society, leading to lower employment and greater dependence on public assistance.

In their respective chapters, first Lori Kletzer and then Katharine Abraham and Susan Houseman present proposals for expanded employment and training programs, wage insurance programs, and better targeting of government programs to the needs of dislocated and older workers. Kletzer recommends expanding the Trade Adjustment Assistance program, currently limited to manufacturing workers, to include displaced service-sector workers and also to include additional monies for training. The wage-loss insurance program, started in 2002,

provides trade-displaced workers over age 50 with up to half the difference between their old and new wages. Kletzer calls for evaluating this program—as Congress stipulated that it should be—and possibly extending the program to workers in their 40s. Echoing the call for program evaluation, Abraham and Houseman emphasize the need to evaluate promising older-worker initiatives being taken at the state level—including placing older-worker specialists in employment centers, instituting outreach for seniors, and providing older workers with basic computer skills—to determine their effectiveness and suitability for expansion at the national level.

### **Implement Special Policies for Low-Skilled Workers**

The growth in inequality has hit low-skilled workers hardest. Paul Osterman calls for a two-pronged approach to improving the quality of jobs at the low end. The first is improvement in labor standards: continued increases in the minimum wage, protection for unions and other forms of worker organization, and tax incentives that promote the development of good jobs. The second strategy involves programmatic assistance to employers to encourage job upgrading. Osterman proposes that the U.S. Department of Labor establish a “Low Wage Challenge Fund” to assist employers in improving the skills of their workforce and thereby the quality of jobs. The Low Wage Challenge Fund would also provide matching funds to states for customized training programs oriented toward the low-skill workforce and would provide funding to community colleges to increase their involvement with employers and the low-skill workforce.

To boost earnings of the least skilled workers, Steven Raphael proposes expansion of the successful Earned Income Tax Credit. Specifically, Raphael proposes an expanded EITC for childless adults, with liberalization of benefits for the poorest married couples.

The rapid rise in incarceration rates and the precipitous drop in employment rates of low-skilled men require special policies to bring this growing underclass out of the cycle of crime and poverty and into productive employment. In addition to an expanded EITC program, Raphael advocates four specific policies to reduce barriers to employment for those with criminal records: 1) removing summary disqualifications of former inmates from financial assistance for education or

other public assistance, 2) basing publicly mandated employment bans of former felons from certain jobs on specific offenses rather than having blanket bans, 3) expunging selected criminal records after a period of time, and 4) funding training intermediaries to prepare ex-inmates for employment.

## CONCLUSION

Taken together, the policies proposed here balance the need to increase workers' wages and benefits with the need to preserve employers' competitiveness. For instance, the health insurance proposals in this book would guarantee health insurance coverage for all while lowering many employers' health insurance costs. Expanding the Earned Income Tax Credit increases workers' take-home wages without increasing employers' costs. And although the book includes proposals for increases in the minimum wage and more protection for unions' organizing rights, the book also includes proposals for greater availability of customized training grants to firms, which would increase worker productivity and, in turn, support higher pay.

In an era of tight government budgets, can the United States afford to implement the set of policies proposed in this book? We argue that any additional government expenditures required by these policies represent investments that are necessary to improve the efficiency and equity of the American economy. An education system that addresses the diversity of needs of students and prepares them for a range of jobs in the workplace is central to increasing American workers' wages and to improving the future competitiveness of our country. The United States has the highest per-capita spending on health care in the world, yet among developed countries it has the lowest rate of health insurance coverage and relatively poor health outcomes (Anderson et al. 2000; Anderson and Poullier 1999; Swartz 2008). Although reform of the employer-sponsored system of health insurance will require increased government expenditures on health care, such reform is essential to improve the efficiency of health care delivery and lower health care expenditures overall. In some cases, government expenditures to improve the effectiveness of certain programs may significantly reduce govern-

ment expenditures in other program areas. For example, our failure to fund and implement effective employment and training programs and policies for dislocated workers, older workers, and the poor results in high public costs in the form of expensive and extensive dependence on public support programs, including Social Security, lower levels of employment and tax revenues, and higher crime and health problems.

Although healthy growth of the aggregate U.S. economy has accompanied rapid globalization in recent years, the benefits of economic expansion have accrued disproportionately to those at the very top of the income distribution. Many lower and middle income Americans have instead experienced less security and lower employment rates, stagnant or falling real wages, and lower benefit levels. The policies advocated in this book would go a long way toward guaranteeing a future of good jobs for all Americans.

## Notes

1. These statistics are based on our analysis of data from the Current Population Survey—Outgoing Rotation Group (CPS-ORG). We averaged over multiple percentiles to minimize the statistical noise for individual percentiles.
2. It is sometimes asserted that much of the gap between wage and productivity growth can be explained by the growth of the cost of benefits such as health insurance (see, for example, Council of Economic Advisers 2007, p. 51). This is largely true if we focus on the gap between productivity growth and mean wage growth using consistent price deflators. But the growth of nonwage compensation only explains a small portion of the gap between U.S. economic output and measured real wage growth for the median worker, or for most workers. For example, in the National Income and Product Accounts of the United States, average real wages per hour grew 1.27 percent per year from 1979 to 2005, whereas average real compensation (including benefits) per hour grew 1.42 percent per year from 1979 to 2005, a difference of 0.15 percent per year.
3. Productivity for the nonfarm business sector grew 2.0 percent per year, according to figures published by the Bureau of Labor Statistics. The estimated 1.7 percent annual growth rate of productivity for the overall economy adjusts for the lower productivity growth in the farm sector, as reported in Dew-Becker and Gordon (2005).
4. We exclude all observations with imputed earnings, hours, or wages. For workers paid by the hour, we use hourly wages. For other workers, we use usual weekly earnings divided by usual weekly hours, where available. For workers whose usual weekly hours vary, we use actual weekly hours the previous week. For workers whose usual weekly earnings are top-coded, we multiply the top code by 1.4. Wage observations are treated as outliers and dropped if the real wage is less

than \$2 per hour or more than \$200 per hour in 2004 dollars, deflated using the Consumer Price Index research series produced by the Bureau of Labor Statistics. The percentiles are then calculated over all remaining workers in the CPS-ORG sample for each year. The CPS earnings weights are used in calculating the percentiles. The reported statistics in the figure equal the ratio of the 2006 wage to the 1979 wage at each percentile.

5. Wage growth consistent with productivity growth would be less than 1.7 percent, for a couple of reasons. First, total compensation includes benefits, such as health insurance and retirement plans, whose value grew at a rate greater than 1.7 percent. Second, the GDP deflator used to deflate real output in the productivity statistics grew more slowly than the Consumer Price Index (CPI) deflator used to calculate the real wage trends. The first factor might explain an annual growth difference of 0.2 percent (see Note 1). The second factor suggests that real wage growth using the CPI will be lowered by 0.4 percent per year relative to real productivity statistics using the GDP deflator. These figures come from Bureau of Labor Statistics data on the CPI research series (BLS 2007) and Bureau of Economic Analysis data on the GDP price deflator, taken from Table 1.1.4 of the National Income and Product Accounts (BEA 2007).
6. These estimates are based on data on earnings or hourly wages and weekly hours of work from the outgoing rotation groups in the Current Population Survey in 1979 and 2006. First, we computed real hourly wages in 2006 consistent with a 1.1 percent annual growth in real hourly wages from 1979 to 2006 for the first to the eighty-ninth percentile. We subtracted from these figures the actual wage rates in 2006 at each percentile to get the hourly wage increment required for wage growth to match productivity growth. The annual earnings increment at each percentile was computed as the product of this hourly wage increment, the number of workers in each CPS percentile in 2006, the average weekly hours of those in each percentile, and 52 (for the number of weeks per year). In computing these figures, we dropped all observations with imputations for earnings, hours, or wages, and excluded wage outliers. Thus, we adjusted these numbers upwards to reflect the ratio between total CPS employment, as measured by the BLS in 2006, and the smaller estimated number of weighted CPS workers in our sample. The estimate of \$734 billion is the sum of this annual earnings increment across the first 89 percentiles.
7. All employment-rate statistics come from our analysis of CPS-ORG data.
8. Employment rates among low-educated Hispanic men, in contrast, have been fairly stable.
9. The employment rate among prime-age Hispanic men was slightly higher, 85.8 percent, and among black prime-age men significantly lower, 75.0 percent, in 1979.
10. This may be surprising to some because of the presumed effects of welfare reform on labor-force participation among low-educated women. Although the employment rate among high-school-dropout women aged 25–54 did increase from 45 percent to 51 percent between 1979 and 2000, it fell back to 47 percent by 2006.
11. The new minimum wage law will incrementally increase the federal minimum wage from \$5.15 to \$8.25 by 2009. Assuming a rate of inflation of about 3 percent

per year, the minimum wage would approximately return to its real 1996 value in 2009. However, without future policy initiatives to increase the nominal minimum wage, the real value of the minimum wage would start declining again in 2009.

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