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CAUSES OF WAGE STAGNATION

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Over the last 35 years (with the exception of the late 1990s), hourly wages of the vast majority have lagged far behind economy-wide productivity. This failure of wages to grow and rising wage inequality is the primary explanation for the rise of family income stagnation and income inequality over the past generation. Additionally, progress in closing gender and racial wage gaps throughout this period has been either nonexistent (for racial gaps) or disappointingly slow (for gender gaps).

Low-wage Americans are not the only workers affected by stagnant wages and rising inequality. The middle class has also experienced stagnating hourly wages over the last generation, and even those with college degrees have seen no pay growth over the last 10 years. Since the late 1970s, wages for the bottom 70 percent of earners have been essentially stagnant, and between 2009 and 2013, real wages fell for the entire bottom 90 percent of the wage distribution. Even wages for the bottom 70 percent of four-year college graduates have been flat since 2000, and wages in most STEM (science, technology, engineering, and math) occupations have grown anemically over the past decade.

This dismal wage growth is the result of intentional policy choices made on behalf of those with the most income, wealth, and political power. As explained below, these choices fall into five broad categories: the abandonment of full employment as a main objective of economic policymaking, declining union density, various labor market policies and business practices, policies that have allowed CEOs and finance executives to capture ever larger shares of economic growth, and globalization policies. Collectively, these policy decisions have shifted economic power away from low- and middle-wage workers and toward corporate owners and managers.

The fact that wage stagnation stems from intentional policy decisions means that fundamental economic forces did not make these trends inevitable. The income, wealth, and wages generated over the last generation were sufficient to provide broadly shared prosperity for all families. There will be substantial growth in income, wealth, and wages over the next few decades as well, and whether the vast majority appropriately benefits from this growth will depend entirely on the policy choices that will be made.

The abandonment of full employment

The failure of macroeconomic policymakers to seek full employment for most of the past 35 years, out of fear that low unemployment rates would spark accelerating inflation, has had profoundly destructive effects on wage growth for the vast majority. It has been a key cause of wage inequality, since research shows that high rates of unemployment dampen wage growth more for workers at the bottom of the wage ladder than at the middle, and more at the middle than at the top.[1] Since the official end of the Great Recession in mid-2009, the most glaring policy choices that worsened unemployment, and therefore contributed to wage stagnation, are Congress's embrace of fiscal austerity and state and local governments' spending cutbacks.

When job opportunities are as weak as they have been in the current recovery, it is not just job seekers who suffer; workers with jobs see their paycheck and benefits falter. That there are far more jobless workers than available jobs means employers can get and retain workers without offering significant wage increases.

The importance of unemployment to wage stagnation and inequality is demonstrated by the trends in the 1995–2000 period: The last time we saw persistently low unemployment (the late 1990s) was also the last episode of across-the-board wage growth and a time when low-wage workers' wages fared better than those in the middle. The most important policy decisions affecting wage growth over the next few years will be made by the Federal Reserve Board about when, and to what degree, to raise interest rates in an effort to slow the recovery. It is critically important that monetary policy seek to restore full employment that brings unemployment down in all communities and facilitates inflation-adjusted wage growth that matches (or even exceeds for a time) productivity growth.

Declining union density

Research shows that unionization does not harm economic efficiency but does lead to higher wages, and does more to lift wages of low- and middle-wage workers than of high-wage workers. Collective bargaining also leads to a larger share of corporate income going to wages rather than profits; the fact that corporate profits are at historic highs is a reflection, in part, of the current weakness of collective bargaining and the heightened power of corporate owners and managers.

A significant portion of the rise of wage inequality between high earners and middle earners is clearly associated with the ongoing erosion of unionization—which leads not just to reduced union bargaining power, but also weakens unions' ability to set norms and wage standards that raise the wages of comparable *nonunion* workers. The decline of unions can explain about a third of the entire growth of wage inequality among men and around a fifth of the growth among women from 1973 to 2007.[2] Reversing these destructive trends requires better, fairer labor laws, which have not come close to keeping pace with dramatically increased employer aggressiveness in fighting workers' efforts to choose to bargain collectively. We should restore workers' rights to bargain collectively, to strike, to boycott, and to use strategies that increase the economic leverage of workers to shape their pay and working conditions.

Other labor market policies and business practices

A range of changes in what we call *labor market policies and business practices* have weakened wage growth in recent decades. One of the most visible and best-documented of these changes is the lowering of the inflation-adjusted value of the federal minimum wage, a significant determinant of the distribution of U.S. wage growth. The minimum wage, in inflation-adjusted terms, is currently more than 25 percent below its peak in 1968, despite a low-wage workforce that is much older and more educated. The minimum wage's declining inflation-adjusted value explains roughly two-thirds of the increase in the wage gap between low- and middle-wage workers.[3]

However, a range of other, far less visible changes in labor market policies and business practices have steadily eroded the standing of typical workers vis-à-vis their employers as well—such as the right of workers to earn overtime pay premiums for working excessive hours, and the difficulty some workers (particularly immigrants) have in simply getting paid for the work they do (i.e., the problem of "wage theft"). Employers' ability to exploit undocumented workers lowers the wages of those workers and those in similar fields of work. Other workers are "misclassified" as self-employed rather than payroll workers, a practice that lowers their pay and protections (i.e., no unemployment insurance or workers compensation). Stronger and modernized labor standards (e.g., paid sick leave and family leave) and tougher enforcement by better-staffed government agencies can deliver wage increases to workers *even during periods of weak labor market conditions*, when their individual bargaining power is significantly reduced.

The unleashing of the top 1 percent, particularly finance and CEOs

Why have salaries of those in the top 1 percent increased so much faster than those of other high-wage earners (say, those in the top 10 percent), let alone those of the middle class? There are two key reasons: the superlative growth of compensation of CEOs and other top managers, and excessive salaries in the expanding financial sector.[4] The higher pay to executives and financial-sector employees does not reflect a corresponding increase in their economic output or productivity; consequently, their income gains have come at the expense of those earning less. Therefore, one necessary strategy to restore broad-based wage growth is to curtail the excessive wage growth at the top.

One driver of these wage trends has been financial deregulation, which has affected wage growth for the vast majority in a number of ways. First, it has enabled finance professionals to claim excessive pay and bonuses by simply hiding risk that they should be managing. The financial sector has more than doubled in size relative to the rest of the economy over the past generation, and is hugely overrepresented in the top 1 percent of wage and income earners. Second, because wealth holders are significantly more inflation-averse than the rest of the population, the financial industry has used its political power to ensure that economic policy favors low inflation rates over low unemployment rates. Third, the extension of financial deregulation to international capital flows has kept policymakers from addressing imbalances (e.g., the U.S. trade deficit) that result from international financial flows. If policymakers had stopped the large influx of capital flows from countries looking to manage the value of their own currency for competitive gain vis-à-vis the United States in the 2000s, this would have not only helped job growth in manufacturing, it could have deprived the financial sector of the cheap financing it used to inflate the housing bubble.

The tax treatment of corporate executive pay has also had a large impact on these trends in the distribution of wage and income growth. In 1993, corporate tax law was changed to allow firms to deduct only the first $1 million of executive salaries from corporate income taxes, with an important caveat: Pay above the $1 million threshold could continue to be deducted as an expense so long as it was "performance-based."[5] This led to an enormous change in the structure of CEO and corporate executive pay, with stock options and profit-related bonuses becoming much more popular. That this change came right before the enormous rise in stock prices in the late 1990s essentially guaranteed an explosion in the share of total wages accruing to the very top through CEO and executive pay. One can also speculate that tightly linking corporate executive pay to profits and stock prices led to a shift in corporate strategy to suppress labor costs of typical and even white-collar workers and boost corporate profits, leading to a rise in the share of overall income going to profits.

Falling top tax rates, preferential tax treatment of stock options and bonuses, failures in corporate governance, and the deregulation of finance all combined to increase the incentive and the ability of well-placed economic actors to claim larger incomes over the past generation.[6]

Globalization policies

One key item on this list concerns economic globalization, which is deeply influenced by American policy decisions. For most of the three decades leading up to the Great Recession, trade agreements reliably harmonized protections for corporate interests up to the highest standard, but generally provided no protection against a race to the bottom on labor standards. Increasing global integration with low-wage countries has the impact, as predicted by conventional economic theory, of lowering the wages of non–college educated workers and boosting profits and the wages of the highest earners.

Other aspects of international economic policy—particularly the failure to maintain a competitive value of the U.S. dollar—have also undercut good jobs in manufacturing, with significant adverse spillover effects on the vast majority. The emergence of high trade deficits and import surges in the early 1980s, late 1990s, and mid-2000s put substantial pressure on mid-level wages. The steady acceleration of imports from less-developed countries has continued to reward CEOs and executives while punishing middle earners and those without a college education. International trade has been a clear factor suppressing wages in the middle of the wage structure while providing a mild boost to the top, particularly since 1995.[7]

Conclusion

The central role that economic power constructed through political power plays in the way wages are set, and the dizzying number of things that influence how this power is distributed, are actually *good* news: Opportunities to boost low- and middle-wage workers' economic power, and hence their wages, are all around us, all the time. It is up to the public using their electoral and workplace power to reconstruct economic relationships so that the vast majority will be the primary beneficiaries of future economic growth.

About the author

Lawrence Mishel, a nationally recognized economist, has been president of the Economic Policy Institute since 2002. Prior to that he was EPI's first research director (starting in 1987) and later became vice president. He is the co-author of all 12 editions of *The State of Working America*. He holds a Ph.D. in economics from the University of Wisconsin at Madison, and his articles have appeared in a variety of academic and non-academic journals. His areas of research are labor economics, wage and income distribution, industrial relations, productivity growth, and the economics of education.

Endnotes

1. Lawrence Mishel, Josh Bivens, Elise Gould, and Heidi Shierholz, *The State of Working America, 12th Edition,* Ithaca, N.Y.: Cornell University Press, 2012.

2. Lawrence Mishel, Josh Bivens, Elise Gould, and Heidi Shierholz, *The State of Working America, 12th Edition,* Ithaca, N.Y.: Cornell University Press, 2012, Table 4.38.

3. Lawrence Mishel, Josh Bivens, Elise Gould, and Heidi Shierholz, *The State of Working America, 12th Edition,* Ithaca, N.Y.: Cornell University Press, 2012.

4. Lawrence Mishel, Josh Bivens, Elise Gould, and Heidi Shierholz, *The State of Working America, 12th Edition,* Ithaca, N.Y.: Cornell University Press, 2012, Tables 4.42 and 4.43.

5. Steven Balsam, *Taxes and Executive Compensation,* Economic Policy Institute, Briefing Paper #344, August 14, 2012.

6. Josh Bivens and Lawrence Mishel, "The Pay of Corporate Executives and Financial Professionals as Evidence of Rents in Top 1 Percent Incomes," *Journal of Economic Perspectives*, vol. 27, no. 3, summer 2013, pp. 57–78.

7. Josh Bivens, *Using Standard Models to Benchmark the Costs of Globalization for American Workers Without a College Degree,* Economic Policy Institute, Briefing Paper #354, March 22, 2013.