

The State of Working America

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To Ellen, The Mercury Lady and a wonderful woman
– LARRY MISHEL

To Catherine Ling Bernstein
– JARED BERNSTEIN

To Charlotte Allegretto, who worked over two decades
for the same company and luckily retired just before the plant closed
and relocated; and to Edmond Allegretto, Sr., a lifetime member
of the International Union of Painters and Allied Trades, AFL-CIO
– SYLVIA ALLEGRETTO

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The Economic Policy Institute's web site contains current analysis of issues addressed in this book. The DataZone section presents up-to-date historical data series on incomes, wages, employment, poverty, and other topics. The data can be viewed online or downloaded as spreadsheets.

The publisher's edition of this book can be ordered at epinet.org.

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Executive summary

Despite being two and a half years into an economic recovery, many of the problems that beset working Americans in the 2001 recession and protracted jobless recovery persist today. The 2001 downturn stopped and even reversed most of the positive economic trends that characterized the latter 1990s, a period when historically tight labor markets ensured that the growth of productivity was, for the first time in two decades, broadly shared throughout the income scale. Through the late 1990s, real wages grew rapidly not just for high-wage workers, but also for those in middle- and lower-wage jobs. Incomes rose across the board, poverty rates fell quickly, and the growth of inequality was significantly dampened.

In contrast, since 2000, unemployment has been high (relative to the preceding period of full employment) and not responsive to the productivity growth that has occurred. In fact, the unemployment rate of 5.6% in mid-2004 stood at precisely the same level as that of November 2001, when the recovery began. The great American job machine was uniquely dormant for almost two years into this recovery, with consistent job creation finally occurring in the fall of 2003. Since then, the U.S. economy has added 1.5 million jobs, yet it remains 1.2 million jobs below the last business cycle's peak employment level in March 2001. The United States has been tracking employment statistics since 1939, and never in history has it taken this long to regain the jobs lost over a downturn.

This persistent labor market slack and its negative effect on wages and incomes is a central theme of this book and is explored throughout the chapters that follow. Yet this book's analysis goes far beyond a review of the past few years, as it explores in great detail the history of the U.S. economy from the perspective of working families. As with most economic analyses, the focus is

on unemployment, jobs, gross domestic product, productivity—the usual set of indicators of interest to those who follow economics.

The analysis does not stop there, and for a very important reason: the living standards of working families depend not only on overall growth, but also on how that growth is distributed. For that reason, every chapter in this book focuses far less on statistical averages than it does on the richly varied set of economic outcomes that can be viewed through the lenses of race, gender, family type, and wage/salary/wealth status. In this regard, the inequality of economic outcomes is of great concern to us, and we pay particular attention to its evolution, both in the distant past and in recent months.

The book's chapters—summarized below—provide a detailed portrait of the economy and its relationship with working Americans and their families. Each chapter provides a history-in-numbers that focuses on incomes, wages, jobs, wealth, poverty, variations between regions, and comparisons with international peers.

Family income: higher inequality leads to uneven progress

The full employment economy of the latter 1990s ushered in a unique period of fast and broadly shared income growth. Not only did middle-income families get ahead over those years, but the least-advantaged families did the best in terms of income growth. From 1995 to 2000, median family income grew at an annual rate of 2.1% for whites, 2.9% for blacks, and 4.6% for Hispanics.

The 2001 recession and subsequent jobless recovery halted these gains. Real median family income fell by over \$1,300 (2.4%) from 2000 to 2002 (in 2003 dollars), and the loss of employment opportunities alone explains 80% of the decline in middle-class family incomes over these years. In percentage terms, lower income families took a bigger hit, as incomes at the 20th percentile (where 80% of families have higher incomes) fell 4.2%. Wealthy families also lost ground, as the bursting of a stock market bubble led to large losses in capital gains. Hours of work fell for married-couple families at all income levels, as did their real incomes.

As noted, the broad-based income growth of the latter 1990s was a unique period given income trends over the past 25 years. Prior to that period of full employment, income growth was highly unequal. Between 1979 and 2000, for example, the real income of households in the lowest fifth (the bottom 20% of earners) grew 6.4%, while that of households in the top fifth (the top 20% of earners) grew 70%, with the top 1% achieving real income gains of 184%. In contrast to this unequal pattern of growth, in the 1950s and 1960s, real incomes just about doubled for each income fifth.

The extent to which middle-class incomes have diverged from productivity growth is intimately related to this historical perspective on income inequality. Between 1947 and 1973 productivity and real median family income both grew 104%, a golden age of growth for both variables. Over this era, there could be no doubt that the typical family fully benefited from productivity growth.

Yet starting in the mid-1970s, this lockstep relationship broke down. From 1973 to 2002, median family income grew at about one-third the rate of productivity (22% versus 65%). That is, while faster productivity growth led to a larger economic pie, growing inequality meant that slices were divided up such that some income classes—those at the top of the income scale—claimed most of the income growth.

Thus, there now exists far more income inequality in the United States than has been the case in earlier periods. Some commentators have downplayed this problem by citing supposedly high levels of income mobility, such that those who begin at the low end of the income scale have a strong likelihood of leapfrogging to the top. The evidence, however, contradicts this contention. Of those who started out in the lowest income fifth in the late 1980s, more than half (53%) were still there in the late 1990s, and another 24% had climbed only to the next fifth, meaning that 77% of those who started out in the low end of the income scale remained there a decade later. Furthermore, the rate of mobility has slowed slightly over time. In the 1970s, 49% of families that started out in the bottom fifth were still there 10 years later.

Once all income sources are taken into account, including capital gains, the extent of income concentration at the end of the last business cycle was remarkably high by historical standards. Using newly available income data that goes all the way back to 1913, income in 2000 was only slightly less concentrated among the top 1% of households than during the run-up to the Great Depression, which was the worst period of uneven income concentration in the last century. In 2000, the top 1% held 21.7% of total income, compared to 22.5% in 1929. Chapter 7, which focuses on international comparisons, shows such high levels of inequality to be uniquely American.

Recent regressive changes in federal taxation will further boost income inequality. For households in the top 1% of the income scale, the full tax savings from the cuts that were made from 2001 to 2003 were about \$67,000; for middle-income families, the cuts amounted to just under \$600; and for the lowest 20%, the savings was \$61. The effect of these cuts has thus been to redistribute after-tax income up the income scale, leading to an inequality-exacerbating transfer of 0.8% of total, after-tax household income from the bottom 99% to the top 1%.

Most recently, profits and capital incomes appear to have recovered from their losses in the early years of the decade. Since the first quarter of 2001, virtually all (98.5%) of the real income growth in the corporate sector has accrued to capital income (profits, interest, and dividend payments), a hugely disproportionate share when considering that capital income comprised just 16.3% of the total corporate income when the recession started in early 2001.

Finally, the necessary strategy for income growth for many middle-income families has been to devote more hours to work in the paid labor market than in the past. Largely due to the increased labor supply of wives, married couples with children in the middle-income fifth, for example, were working 500 hours more per year in 2000 than in 1979—the equivalent of 12 and a half more full-time weeks per year. Because of these wives' contributions, instead of growing only 5% in real terms, middle-class family income grew 24%.

Wages: battered by labor slack

Because wages and salaries make up roughly three-fourths of total family income (the proportion is even higher among the broad middle class), wage trends are the primary determinant of income growth and income inequality trends. This chapter examines and explains the trends in wage growth and wage inequality of the last few decades up through 2003, focusing particularly on the current business cycle, from 2000 to 2003, and the earlier cycles over the 1979-89 and 1989-2000 periods. The most recent wage trends, through early 2004, are examined in this book's Introduction.

The wage story of the last few years is mixed. The strong wage growth of the late 1990s continued into 2002, despite the rising unemployment from 2000 to 2002. However, the high and continuous labor slack of the early 2000s eventually knocked down wage growth, lowering the yearly growth of real median hourly wages over the 2000-03 period by 1.0% among women and 1.5% among men. The persistent labor slack affected lower-wage workers even more—knocking yearly wage growth down 1.5% and 2.2%, respectively among low-wage women and men. The consequence of this high and persistent labor slack has been to reestablish a growing wage inequality between low- and middle-wage workers, a phenomenon not seen since the late 1980s.

The wage story of the past quarter century has three predominant themes. First, an era of stagnant and falling wages gave way to one of strong wage growth. Wages were stagnant overall and median wages fell from the early 1970s to 1995. After 1995, wages changed course, rising strongly in response to persistent low unemployment and the faster productivity growth relative to the 1973-95 period. Second, the pattern of wage growth has shifted. In the

1980s wage inequality widened dramatically and, coupled with stagnant average wages, brought about widespread erosion of real wages. Wage inequality continued its growth in the 1990s but took a different shape: a continued growth in the wage gap between top and middle earners, but a shrinking wage gap between middle and low earners. Since 1999, however, wage inequality has been growing between the top and the middle but has held steady between the middle and the bottom. A third theme is the critical role played by rising unemployment in raising wage inequality and the role played by low unemployment in boosting wage growth overall, but particularly at the bottom.

The trends in average wage growth—the slowdown in the 1970s and the pick-up in the mid-1990s through the early 2000s—can be attributed to corresponding changes in productivity growth. Productivity accelerated in the mid-1990s, and its growth continued into the current recession, leading to historically high growth in average wages. But as Chapter 1 shows, income shifted from labor to capital in the mid-1990s though labor’s income shares rebounded in the last few years of the boom. In the 2000-03 period income shifted extremely rapidly and extensively from labor compensation to capital income (profits and interest), so the benefits of faster productivity growth went disproportionately, in fact completely, to capital (see the Introduction).

Explaining the shifts in wage inequality requires attention to several factors that affect low-, middle-, and high-wage workers differently. The experience of the late 1990s should remind us of the great extent to which a low unemployment rate benefits workers, especially low-wage earners. Correspondingly, the high levels of unemployment in the early and mid-1980s and in recent years disempowered wage earners and provided the context in which other forces—specifically, a weakening of labor market institutions and globalization—could drive up wage inequality. Significant shifts in the labor market, such as the weakening of unions and the severe drop in the real value of the minimum wage, can explain one-third of the growing wage inequality. Similarly, the increasing globalization of the economy—specifically with regard to immigration, trade, and capital mobility—and the employment shift toward lower-paying service industries (such as retail trade) and away from manufacturing can explain, in combination, another third of the total growth in wage inequality. Macroeconomic factors also played an important role: as high unemployment in the early 1980s greatly increased wage inequality, the low unemployment of the late 1990s reduced it. High unemployment has renewed growing wage inequality since 2000.

The shape of wage inequality shifted in the late 1980s as the gap at the bottom—i.e., the 50/10 gap between middle-wage workers at the 50th percen-

tile and low-wage workers at the 10th—began to shrink. However, over the last few years, this progress against wage inequality at the bottom has been halted among men, and wage inequality among women has resumed its growth. This reversal is partially results from the rise in unemployment and is partially due to the continued drop in the real value of the minimum wage. The greatest increase in wage inequality at the bottom occurred among women and corresponded to the fall in the minimum wage over the 1980s, the high unemployment of the early 1980s, and the expansion of low-wage retail jobs. The positive trend in the wage gap over the 1990s owes much to increases in the minimum wage, low unemployment, and the slight, relative contraction in low-paying retail jobs in the late 1990s. The wage gap at the top—the 95/50 gap between high- and middle-wage earners—continued its steady growth in the 1990s and early 2000s but at a slightly slower pace than in the 1980s. The continuing influence of globalization, de-unionization, and the shift to lower-paying service industries (“industry shifts”) can explain the continued growth of wage inequality at the top.

There is a popular notion that the growth of wage inequality reflects primarily a technology-driven increase in demand for “educated” or “skilled” workers. Yet economists have found that the overall impact of technology on the wage and employment structure was no greater in the 1980s or 1990s than in the 1970s. Moreover, skill demand and technology have little relationship to the growth of wage inequality within the same group (i.e., workers with similar levels of experience and education), and this within-group inequality was responsible for half of the overall growth of wage inequality in the 1980s and 1990s. Technology has been and continues to be an important force, but there was no “technology shock” in the 1980s or 1990s and no ensuing demand for “skill” that was not satisfied by the continuing expansion of the educational attainment of the workforce.

The conventional story about technology leading to increased demand for skills and the erosion of wages among the less-skilled does not readily explain the pattern of growth in wage inequality. In particular, the late 1990s are seen as a period of rapid technological change, yet during that period wage inequality diminished at the bottom. Similarly, education differentials grew slowly during most of the 1990s and declined in the early 2000s, a trend incompatible with rapid technological change driving up demand for skills. The decline in the wage payoff for experience in the later 1990s also runs counter to the technology story. Moreover, it was the growth of wage inequality among workers of similar education and experience, not easily linked to technology, which accounted for all of the wage inequality growth since 1995.

Despite the strong wage improvements starting in 1995, it was not until 1997 that the wage level for middle-wage workers (the median hourly wage) jumped above its 1979 level. Wage growth was very strong in the late 1990s, a period of broad-based wage growth (for the first time in several decades) that resulted from faster productivity and persistent low unemployment.

As for benefit coverage, it declined through the early 2000s. In contrast, in the 1990s, there were modest extensions of employer-provided health insurance coverage for the bottom 20%, while erosion of coverage continued for middle- and high-wage workers. Health insurance coverage declined for all wage groups in the 2000-02 period. After rising over the 1990s, pension coverage receded in the 2000-02 recession, leaving overall pension coverage at only 45.5%, or 5.1 percentage points less than the 50.6% coverage of 1979. In other words, less than half the workforce is covered by employer-provided pensions.

Unionized workers earn higher wages, as is well known, but it is also true that they enjoy a premium in every dimension of the compensation package. Unionized workers are 28.2% more likely to be covered by employer-provided health insurance. Unionized employers also provide better health insurance—they pay an 11.1% higher share of single-worker coverage and a 15.6% higher share of family coverage. Moreover, deductibles are \$54, or 18.0%, less for union workers. Finally, union workers are 24.4% more likely to receive health insurance coverage in their retirement.

The rising trade deficit was responsible for a major loss of jobs in the 1990s, especially in manufacturing (over 4 million jobs lost between 1989 and 2002). The trade impact over the last 10 years was more evenly spread over the workforce, affecting college and other workers in rough proportions to their share of the workforce. The issue of the offshoring of white-collar technical and professional jobs to low-wage countries has become prominent. Though hard data on these trends are not available, information in software and other industries suggests that these trends are not trivial.

As the wage of the typical worker fell in the early 1990s and rose in the latter 1990s, executive pay soared. From 1989 to 2000, the wage of the median chief executive officer grew 79.0%, and average compensation grew 342%. CEO compensation, however, declined 36.0% between 2000 and 2003, reflecting the fall in stock values and the value of stock options available to CEOs. This decline affected only the very highest paid CEOs, as those at the median and the 25th and 75th percentiles saw increases (16.1% at the median). Nevertheless, CEOs in 2003 still made 185 times as much as a typical worker, whereas in 1965, CEOs made 26 times more than a typical worker. This level of executive pay is a distinctly American phenomenon: U.S. CEOs make three times as much as their counterparts abroad.

The jobs of the future will not be far different than the current jobs available. The change in occupation mix will raise annual wages by just 1% over 10 years. Future jobs will require more education credentials but not to any great extent. The occupational composition of jobs in 2012 will require that 27.9% of the workforce have at least a college degree, just one percentage point more than the 26.9% of workers who held college degrees in 2002.

Jobs: persistent jobless recovery follows 2001 recession

The 2001 recession and subsequent prolonged weak recovery brought an end to an expansion that proved historically unique in the extent to which it lifted the economic prospects of American workers. Employment opportunities increased considerably during the tight labor market of the 1990s, especially for traditionally disadvantaged groups, including women, African Americans, and Hispanics. Overall, low unemployment over the second half of the 1990s strengthened workers' bargaining power as many employers had to compete for workers. This in turn spurred strong wage and income gains over the latter half of the 1990s economic boom.

March 2001 marked the official beginning of the last recession, initiating a time of higher unemployment and labor slack that resulted in a substantial amount of underutilized labor. While the unemployment rate was low relative to past recessions, the rate continued to increase two years after the recovery began. In March 2001 the unemployment rate was 4.3%; it trended upward until June 2003 when it reached 6.3%, and it was most recently (June 2004) 5.6%. From December 2003 until June 2004, the unemployment rate has been at an unyielding 5.6% or 5.7%.

Due to the lack of job opportunities, many potential job seekers left the labor market over this period, and were hence not counted in the unemployment rate. Thus, throughout the recession and jobless recovery, there was a persistent decrease in the share of the adult population working or looking for work (known as the labor force participation rate). In March 2001 the labor force participation rate was 67.1%. It trended downward until it hit 65.9% in February 2004—a 15-year low—and it was 66.0% by mid-2004. Factoring in the decreased labor force participation rate and assuming these workers would have been unemployed had they been in the labor force, the unemployment rate would currently be 7.2%—substantially higher than the official 5.6% rate.

The lack of job creation has been unprecedented in this latest recovery—which is why the recovery was deemed a “jobless” one. A jobless recovery occurs when an economy begins to expand (as defined by the National Bureau

of Economic Research) but businesses continue to shed jobs as if the economy were still in recession. During the 2001 recession, the economy lost 1.6 million nonfarm payroll jobs. A severe jobless recovery, during which an additional 870,000 jobs were lost, followed the recession and lasted 21 months (November 2001 until August 2003). In June 2004 (the most recent data available) the economy was still down 1.2 million jobs from the March 2001 peak—an unparalleled occurrence this far into a recovery.

The 2001 downturn, as usual, disproportionately affected minorities and workers with less education: in 2001 African Americans had an unemployment rate of 8.7%, compared to the overall average of 4.8%. However, the 2001 downturn also adversely affected other groups usually thought to have some protection against recessions. For example, the employment to population ratio for young college graduates hit a 30-year low during the recovery. The recession and its aftermath affected a broadly diverse contingent of workers: young and old, less educated to highly educated, laborers to professionals. Manufacturing jobs were lost for a record 41 consecutive months. However, significant job loss occurred in other occupations, such as the information technology sector. The stock market bubble burst in 2000, which left many white-collar workers unemployed. In addition, firms' demand for offshoring is increasing. Technological advancements coupled with a supply shock of skilled labor that resulted from the opening up of global labor markets have made this labor practice possible.

The lack of job creation has led to unemployment spells that are much longer than would be expected given the level of unemployment. In 2003, when unemployment was 6.1%, long-term unemployment (i.e., unemployment lasting 27 or more weeks) and the average duration of unemployment spells were at levels historically associated with much higher levels of unemployment. In 2003, for example, the share of long-term unemployed as a percent of total unemployment was 22.1%—the highest since 1983, when the unemployment rate was 9.9%. In addition, the problem of long jobless spells was broad-based, as the number of college-educated workers unemployed for long periods increased by 300% from 2001 to 2003.

Despite the return of job growth in September 2003, the labor market as of mid-2004 remains slack, and the benefits that accompanied the tight labor market of the 1990s remain elusive. As we stress in the Introduction that follows, this persistent weakness has led much of the growth that has occurred over the jobless recovery to flow to profits, leaving little for compensation. Whether we soon return to a more equitable job market remains an open question.

Wealth: persistent inequality

The income data examined in Chapter 1 represent the flow of family's economic resources. Wealth, however, is the stock of a family's income and assets, minus their debt. Its distribution is highly unequal in the United States, far more so than income. For example, in 2001 (the most recent data available) the wealthiest 1% of all households controlled over 33% of national wealth, while the bottom 80% of households held only 16%. The share of average wealth by wealth class shows that wealth inequality is stark and persistent. This skewed distribution is, in part, perpetuated by the passing of wealth from generation to generation. The level of wealth a family acquires is, to a large degree, determined by where it starts on the wealth ladder. Wealth determines how adequately a household can smooth consumption when financial emergencies arise. Those with little wealth can be financially devastated by any economic setback. It is a difficult challenge for middle- and lower-income families to accumulate ample wealth.

Some debt can be acquired for a worthy cause such as home ownership (mortgage debt) or school loans, but such debt can be hard to acquire for those who presumably have the greatest needs for such loans. Other types of debt, such as the use of high-interest-bearing credit cards, can be much more problematic—especially when balances accrue to meet day-to-day living expenses.

Several key features about American wealth stand out. For example, 17.6% of households had zero or negative net wealth in 2001. There are vast differences when race is factored in; for instance, 13.1% of white households versus 30.9% of African American households have zero or negative net wealth. Median wealth for African Americans was \$10,700 in 2001, just 10% of the corresponding median for whites.

The ownership of stocks is particularly unequal. Given the increases in stock ownership over the last decade, along with the boom of the 1990s, it may be surprising that roughly half of Americans still do not participate in the stock market, either directly or indirectly through the likes of mutual funds. The top 1% of stockowners held 33.6% of all stocks, by value, while the bottom 80% of stockholders owned just 10.7% of total stock value in 2001. On average, the wealthiest 1% of households owned \$3.5 million in stocks, while the bottom 40% of households owned an average of \$1,800 in stocks. While 48.1% of households had no stock investment, another 11.8% had less than \$5,000 of stock, leaving only 40.1% of all households with \$5,000 or more in stock assets.

It follows, then, that the wealthiest households gain the most from the growth in the stock market. From 1989 to 2001, the top 10% of wealth hold-

ers reaped 74.9% of the growth in stocks, while the bottom 80% received 11.1%.

Home ownership—the most important source of assets for most American families—continued the upward trend that started in 1994, especially among nonwhite households. In 1994 the rate of home ownership was 64%, and it increased to 68.3% in 2003. However, home ownership rates vary considerably by income and race. Only 50.9% of those in the bottom quarter of the income distribution owned their homes in 2001, while 88% in the top quarter of the income distribution owned homes. Blacks and Hispanics, while slowly increasing home ownership rates, still lag behind whites. In 2003, 72.1%, 48.1%, and 46.7% of whites, blacks, and Hispanics, respectively, owned homes. There is a lot of room for improvement in home ownership rates for racial minorities and those at the bottom of the income distribution.

The aftermath of the 1990s boom left most Americans better prepared for retirement than before: in 2001, almost three out of four Americans will be able to replace at least half of their pre-retirement income with income from Social Security, pensions, and defined-contribution plans. This was a marked improvement from 1998, when 57.5% could expect to replace half of their current income in retirement. It will be interesting to see if this improvement will hold up in the 2004 survey.

Household debt as a share of assets was, on average, 18% in 2003. As expected, debt burdens continued to plague lower-income families disproportionately, although debt burdens for the typical household decreased slightly. By 2001, middle-income families had a slight increase in debt, but experienced larger increases in stocks, assets, and overall net worth. Conversely, the most recent government data show that 16% of households in the \$20,000-\$39,999 range had debt-service obligations that exceeded 40% of their income, while 11.7% of these households had at least one bill that was more than 60 days past due. Moreover, the official report of debt by the Federal Reserve Board has undoubtedly understated serious financial hardships—akin to debt—incurred by households with high levels of financial insecurity. These households increasingly access loans and money through nontraditional or predatory lending institutions such as pawn shops and check-cashing centers. Additionally, despite the robust state of the economy, personal bankruptcy rates reached all-time highs in 2001. Next year, the Federal Reserve Board's Survey of Consumer Finances will release data from its 2004 survey, at which time we will be able to determine the longer-term impact that the stock market crash of 2000 had on household finances.

Poverty: rising in this business cycle

While America is the richest of the industrialized nations, it has always, to a greater or lesser degree over time, suffered the problem of poverty amidst prosperity. In recent decades, the growth of inequality has meant that much of the economic growth that did occur was channeled to higher income families, while incomes at the bottom stagnated. For example, the official poverty rate—the share of Americans living in households with incomes below the federal poverty threshold—was about the same in 1973 (11.1%) as in 2000 (11.3%), despite the fact that real per capita income grew 66% over that period.

To some, the fact that a bit more than one-tenth of Americans—12.1%, or 34.6 million persons in 2002—face material deprivation may be disheartening, but not particularly alarming. Yet, like many other poverty analysts, we strongly believe that the official poverty statistics underestimate the extent of material hardship in America. The thresholds used to determine poverty status, critiqued in detail below, were developed half a century ago, and they have only been updated for inflation. In 2003, for example, a single parent with two children is considered poor if the family income (before taxes but counting cash transfers like welfare benefits) is below \$14,824; for two parents with two children, the income threshold is \$18,660.

Various alternative measures are used in this chapter to expand the scope of poverty analysis. One useful measure simply doubles the poverty thresholds. This seems arbitrary—if the official thresholds are so inferior, what is gained by simply doubling them? In fact, the Economic Policy Institute's own work on family budgets reveals that twice the poverty threshold corresponds quite closely to more rigorously defined measures of a family's ability to meet its basic needs. These family budget thresholds are developed by adding up the costs of basic consumption components, including food, shelter, clothing, health care, taxes, and child care.

Regardless of the metric, a few trends clearly emerge. First, after making impressive progress against poverty in the 1960s, the trend stalled and then generally drifted up from the early 1970s to the mid-1990s. The 1995-2000 period was one of dramatic progress, as poverty fell by 2.5 percentage points, and twice-poverty by 4.3 points (corresponding to 4.8 million fewer poor and 8.6 million fewer twice-poor persons). The 2001 recession and jobless recovery partially reversed these gains.

As is always the case in a recession, the ranks of the poor and near-poor expanded in the recent downturn, as poverty rates rose from 11.3% in 2000 to 12.1% in 2002, while twice-poverty rates went from 29.3% to 30.5%. These rate increases translate into about 3 million more officially poor, and 6 mil-

lion more near-poor over this two-year period. In addition, this chapter examines the extent to which the safety net helped to catch those economically vulnerable families hurt by the recession. Focusing on low-income single-mother families, for example, shows that welfare benefits—which fell steeply throughout the latter 1990s—continued to slide in the recession, thus failing to play their historical countercyclical role. Furthermore, the slowing economy led to a significant reduction in the hours worked by these women, and that, in turn, led to lower earnings and less income from the Earned Income Tax Credit (EITC), a generous wage-subsidy that is key to lifting the incomes of low-income working families. In this regard, the safety net is less countercyclical than it used to be for some groups of poor and near-poor persons (a related finding is that the EITC fails to reach many families between the one and two-times poverty range).

Taking a longer-term view, this chapter examines which factors might best explain the lack of progress in reducing poverty over the past 30 years. The growth of inequality and weak low-wage labor markets have certainly played primary roles. Throughout the 1980s, when poverty rates were particularly unresponsive to growth, the effect of inequality was to drive poverty up by 2.9 percentage points (poverty rose 1.1 points over the decade because other factors, such as the improved education of low-income family heads, offset the inequality effect). That effect was significantly dampened in the 1990s, but as the economy moved into the next business cycle, growing inequality appears poised to return, creating potentially strong headwinds against poverty reduction.

Another factor implicated in much research on this topic is the increase in mother-only families. This view emphasizes the increase in the share of such families since at any given point in time, they have considerably lower income and higher poverty rates than families with two earners. Although this argument may have some merit, the upward pressure on poverty rates by the formation of single-parent families has diminished considerably over time, while the economic determinants—growth, inequality, and unemployment—have, if anything, grown more important. Over the 1970s, for example, had all else remained constant, the shift to more mother-only families would have contributed two percentage points to the poverty rate according to our decomposition of these trends (in fact, poverty fell slightly over the decade). But the effect fell steeply after that, and by the 1990s, this factor contributed only 0.3 points to higher poverty.

Given the policy shift emphasizing work as the primary pathway out of poverty, this chapter focuses closely on the opportunities in the low-wage labor market. In the latter 1990s, fast productivity growth combined with low unem-

ployment to give a significant boost to the earnings of low-wage workers. In fact, by comparing a few different time periods, it is clear that, by itself, fast economic growth is unlikely to move the wages of the lowest-paid workers. In the last five years of the 1980s business cycle, productivity grew 1.5% per year, but average unemployment was a high 6.4%. As a result of a labor market too slack to ensure low-wage growth, the real wages of low-paid workers barely budged, and poverty rates were largely unresponsive to growth. Over the last five years of the 1990s business cycle, productivity grew a point faster per year (2.5%), and, equally important, average unemployment was 4.8%. Under these conditions, 20th percentile real wages grew as employers needed to bid even low wages up to get and keep the workers they needed to meet strong demand in these years. In fact, low wages grew at almost the rate of productivity, an unprecedented trend over the last 30 years, and poverty rates fell more quickly than they had in decades.

The most recent trends of low wages corroborate the view that fast productivity growth alone will not suffice to fuel the growth of low wages. Between 2001 and 2003, productivity grew far more quickly than in the earlier periods mentioned above. Yet unemployment was high, on average, compared to the latter half of the 1990s. Under these conditions, the extra income generated by the fast growth of productivity did not flow to low-wage workers, as earnings at the 20th percentile slowed to 0.5% per year.

Thus, it is reasonable to conclude that it takes a combination of fast growth and very low unemployment to ensure that the benefits of growth are distributed broadly enough to connect the fortunes of the poor with those of the rest of working America. At the same time, we need to be mindful of the historically important role of an effective safety net in a dynamic economy like that of the United States, with business cycle downturns that can do great damage to the living standards of the most economically vulnerable among us.

Regions: labor market slump widespread in most states

While much of this book focuses on information of national scope, this chapter examines the state of the economy in each of the nation's regions, Census divisions (groups of states within regions), and individual states. A regional focus is important because, in many ways, state or regional data more accurately represent the economy faced by workers in a particular area than do broad national data.

This chapter focuses on what happened to state labor markets between 2001 and 2003, a period of weak labor markets in nearly every state. Two years after the recession's official end in November 2001, job growth was worse in

39 states. By 2003, 36 states—spread out in every region and division of the country—had fewer jobs than they did three years earlier.

The manufacturing sector was a key factor in the recession and jobless recovery: making up 13.1% of jobs in 2000, this industry lost 15.9% of its jobs in the next three years, compared to slight job *growth* of 0.8% in the other industries combined. Furthermore, 21 of the 36 states that had fewer jobs in 2003 than in 2000 experienced job growth outside of manufacturing. For example, while Arkansas lost 14.2% of its manufacturing jobs, all other industries grew by 2.1%.

As of mid-2004, the national labor market had finally started to show signs of recovery. While this was welcome news, it comes three years after the recession started and over two years after the economy purportedly entered the recovery. For many states, it will take numerous consecutive months of robust job growth to return to the employment levels of three years ago.

Not surprisingly, the recession and jobless recovery led to increased unemployment. From 2000 to 2001 the unemployment rate of 16 states rose by one percentage point or more, mostly in those states affected strongly by manufacturing losses, including North Carolina, Michigan, Oregon, and Washington. By 2003, all but nine states had unemployment rates of one percentage point or more above their 2000 rates.

Long-term unemployment rose considerably in every state except Hawaii and Delaware between 2000 and 2003. For example, in Georgia, where the 2003 unemployment rate was lower than the national average (4.7% compared to 6.0% nationally), the share of unemployed workers that had been unemployed for more than half a year rose from 7.6% in 2000 to 27.7% in 2003.

A weak labor market affects the living standards of working families directly when workers lose jobs or are unable to find work that pays well and offers enough hours and benefits. Another effect of high unemployment is that workers have less bargaining power and wage growth can either decline or disappear. After rising at an annual rate of 2.3% from 1995 to 2000, the growth in low wages slowed to less than 1% annually from 2000 to 2003.

The federal minimum wage has not been raised since 1997. Once again, some states have stepped in and raised their own state-level minimum wage rates. The number of states with higher minimum wages has more than doubled, from five in 1997 to 13 in 2004. The wage levels set by these states range from \$5.50 in Illinois to \$7.16 in Washington state.

The contrast between the economy of the late 1990s and that of the last three years was sharp in most states. Expanding payrolls, full employment, and strong, broad-based wage growth were replaced by fewer jobs, higher unemployment, and stagnating wages. A state-by-state analysis of labor markets re-

veals that the recent slump has been uniquely geographically pervasive, but that the plight of the manufacturing sector has been a central factor in states with the most severe job losses: while most states' economies have suffered in the last three years, states with heavy reliance on manufacturing have generally done worse.

International: beyond the U.S. model

In this chapter, the economic performance of the United States is compared to that of 19 other rich, industrialized countries that, like the United States, belong to the Organization for Economic Cooperation and Development (OECD). This analysis—which compares the U.S. economy with similar economies facing the same global conditions with respect to trade, investment, technology, and the environment—provides an independent yardstick for gauging the strengths and weaknesses of the U.S. economy.

In 2002, per capita income in the United States (\$36,102) was greater than that of all 19 other OECD countries (\$26,680 on average). However, the gap has been closing, as annual growth rates in per capita income are, on average, higher in the other OECD countries (0.9%) compared to the United States (0.4%) between 2000 and 2002.

OECD countries are also catching up and surpassing the United States in output per hour worked. In 1950, the average of the other OECD countries output per hour was only 41% of the U.S. average; in 2002, the average was 88%. Additionally, the U.S. is no longer a leader in this category, as seven other countries have surpassed the United States in terms of output.

Inequality has been and continues to be a mainstay of the U.S. economic model. Measuring the gap between the richest and poorest workers in each country, U.S. households at the 90th percentile had incomes that were 5.5 times that of those at the 10th percentile. The United States had the largest gap of all the OECD countries. The United States also reported the largest Gini coefficient (0.368), which is another measure of within-country inequality.

Supporters of the U.S. economic model generally acknowledge the relative inequality in the United States but argue that the model provides greater mobility, greater employment opportunities, and greater dynamism than do more “interventionist” economies. The evidence, however, provides little support for this view. First, there was less mobility out of poverty in the United States than in other nations. The U.S. percentage of people who were “always poor” is 9.5%, the highest reported figure for any OECD country. One of the most disturbing statistics is the rate of childhood poverty in the United States: 21.9% of U.S. children lived in households that faced severe financial distress, which

was again the highest percentage for any country in this analysis. Poverty was deeper and harder to escape in the United States and much less in the way of adequate social policy was available relative to other OECD countries. Social expenditures in the United States, as a percentage of gross domestic product, were the lowest for any country.

The evidence in this chapter underscores the diversity of international experience in providing wage, income, and employment security. Many OECD countries have economic and social policies that differ from those in the United States and that have not been detrimental to their productivity levels. In fact, in many cases, these alternative policies have been pursued in economies with productivity levels that surpass U.S. levels. Such findings suggest that those formulating policy—in both the United States and abroad—may benefit from looking beyond the U.S. model.

Conclusion

The analyses to be found throughout this edition of *The State of Working America 2004/2005* shed light on the economic landscape facing working families in America today. The lessons are not hard to derive: the U.S. economy is capable of generating tremendous wealth, but there is absolutely no guarantee that this wealth will reach the working families responsible for its growth. In fact, as this book goes to press, the U.S. economy has been consistently expanding for years, yet real wages of the middle-class working Americans have been falling, and virtually all of the growth that has occurred has flowed to profits, not to labor.

Thus, a central goal of this analysis is to identify the necessary and sufficient conditions needed to ensure that economic growth is broadly shared. We have many facts at our disposal, and these are useful in their own right, painting a detailed picture of both the historical and prevailing economic conditions facing working families. But the many tables and figures that follow are also instructive in pointing toward a better economy, one that lifts the living standards of all working Americans.

Introduction: an economy at the crossroads

The persistent weakness of the current recovery

When the previous edition of this book was written in the summer of 2002, the recovery that had begun in late 2001 did not appear to be particularly promising from the perspective of working families. At that point, we had observed that, although the economy was expanding, “the unemployment rate remained well above its level of a few years back, job growth was virtually zero, wage growth was slowing, and the share of the long-term unemployed was hitting historically high rates....early signs indicate a return to the pattern of widening wage inequality seen in the 1980s.”

Remarkably, two years later, and after hundreds of billions spent on poorly targeted fiscal stimulus, all those problems remain. A welcome exception is that, by September 2003, employment growth finally got underway. Nevertheless, one critical trend has worsened—the wage growth of many workers has continued to slow and is now falling behind inflation.

Due largely to the decline in employment opportunities over the jobless recovery, the real income of the median family fell in 2002 for the second consecutive year and is down 2.4% from 2000. Based on the fact that unemployment rose in 2003—job growth only appeared in the last third of the year—and wage growth slowed, it is likely that the real median income fell again (or rose only slightly) in 2003. Poverty rates also rose from 2000 to 2002 by 0.8 percentage points, adding three million more to the ranks of the poor; this indicator also may have worsened in 2003.

Unfortunately, there still remains considerable slack in the labor market even though the recovery, which started in November 2001, is nearly three

years old. The 5.6% unemployment rate in June 2004 was precisely the same as when the recovery got underway. The unemployment rate, however, has been a particularly poor barometer of labor slack in this business cycle because it has not reflected the employment losses and the millions of workers who are missing altogether from the labor force. The share of the population employed, a reliable indicator of the strength of a labor market, was 62.3% in June 2004, 2.0 points below its level of 64.3% at the peak of the last business cycle in March 2001.

Even with the recent job gains, long-term unemployment remains high by historical standards—and not just for those usually hurt by weak labor markets, such as minorities and those with lower-education levels, but also for college-educated workers. The unemployment rate among computer programmers was 7.6% in the first half of the year, and the employment rate of young college graduates remained near historic lows. Less-advantaged workers have also felt the brunt of the lagging recovery, with African American unemployment at 10.1% in June 2004, slightly higher than at the start of the recovery (9.8% in November 2001). As we highlight below, this persistent weakness in the job market has led to substantially slower wage growth, and real hourly wages (that is, wages adjusted for inflation) in June 2004 that were 1.2% below their year-ago level.

The upside in the economy is that job growth appears to have returned in earnest, with gains of over 200,000 per month through the first half of 2004. As a result, many economic commentators assure the public that various “lags” are in play, and that the recovery will soon reach down and lift the living standards of middle- and working-class families. The last edition of this book cited similar frequently made assurances (“The fundamentals are all in place” was the mantra in mid-2002). We hope, of course, that this prediction will soon bear out.

Yet as of this writing, 31 months into the recovery, the U.S. economy remains more than one million jobs below the last employment peak. By this time in every other recovery on record (going back to 1939) we had surpassed, usually far surpassed, the prior employment peak. This jobs deficit is the primary reason that, after over two-and-a-half years of consistent economic expansion and stellar productivity growth, many working families are either worse off or about where they were at the end of the last business cycle in March 2001.

This introduction presents an overview of the facts that make up the material explored in careful detail throughout the next seven chapters. Here, the goal is to marshal a choice few indicators and trends that best describe how the recovery has evolved from the perspective of working families. These last few years have been a very unique period, one that deserves close scrutiny, particu-

larly because it is not clear at what point the growing economy will begin to lift the living standards of working families, as it did in the latter 1990s.

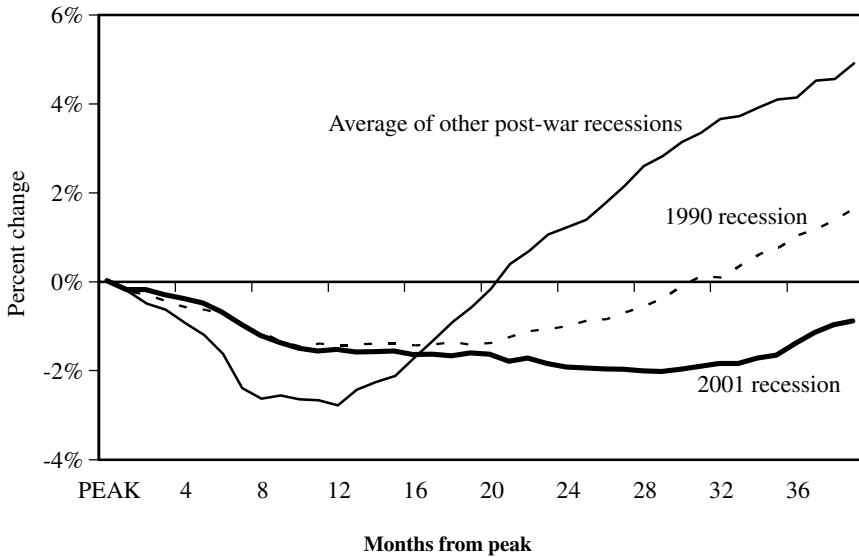
Looking to the future, the critical question is whether this business cycle will resemble the second half of the 1990s, when full employment ensured that the benefits of fast productivity growth were broadly shared, driving wages up strongly throughout the wage scale, lifting middle and low-incomes, and driving down poverty rates, most strongly among the least advantaged? Or, is the stage set for another period like that of the 1980s, of unbalanced growth, high budget deficits, high average unemployment, stagnant wage growth for many, and increasing inequality?

Labor market slack in the aftermath of the jobless recovery

The labor market shed jobs from the official end of the downturn in November 2001 until September 2003. Although the U.S. economy has had a few strong months in 2004, the overall job growth during the last 10 months has been modest and has yet to significantly diminish the slack in the job market. This “labor slack” remains at the heart of the economic challenges facing working families today. In earlier periods, like the latter 1990s or the 1950s and 1960s, tight labor markets in tandem with strong labor market institutions (such as unions and higher real minimum wages) served as a conduit through which the benefits of growth were broadly shared. Unfortunately, labor market institutions have been weakened over time, which is one of the reasons why the wedge of economic inequality grew so quickly in the 1980s and early 1990s. Thus, at this point, many working families depend more on tight labor markets to raise their living standards.

The importance of tight labor markets is by no means simply about low unemployment and enough job vacancies to meet the needs of job seekers. It is also about creating the conditions that lead employers to increase compensation in order to get and keep the workers they need. As shown in Chapter 1 (see, for example, Figure 1K), such conditions are historically associated with far more evenly spread income growth than occurs in weaker periods. One reason for this positive dynamic is the virtuous cycle engendered by wage-led demand growth, wherein broad-based income gains generate equally broad consumption, triggering greater confidence among investors and producers. This confidence in turn feeds greater investment and sustains further growth. At the same time, these growing incomes boost government coffers, leading to a better fiscal position and other associated benefits, from reassuring financial markets to providing government with more resources to meet social needs.

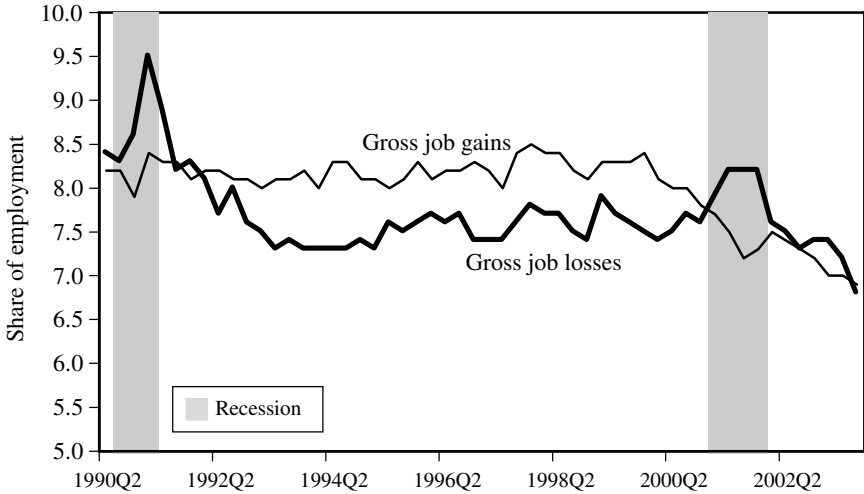
FIGURE A Percent change in employment 39 months after business cycle peak



Source: Authors' analysis of BLS (2004d).

These conditions are uniformly absent from the present economic environment. Starting with the current jobs deficit, **Figure A** compares the trend in employment growth in this business cycle to the average of all the others (the values are indexed to the peak of the prior cycle, and thus show percent changes), with the early 1990s jobless recovery plotted separately to facilitate a comparison with the current cycle. In the past, employment regained its prior peak by about 20 months past the onset of recession; in the early 1990s jobless recovery, it took 30 months. In the case of the current recovery, 39 months past the peak the U.S. economy remained 1.2 million (0.9%) jobs below the employment level in March 2001. The emergent trend in job growth toward the end of **Figure A** is clear enough that, if it persists, will soon regain the peak. But in historical terms, the depth of this jobless recovery has been unique.

It should be noted that **Figure A** tracks net job gains, that is, the difference between the jobs lost and added throughout the labor market. In that regard, this indicator masks the underlying dynamics of job creation, which have had a distinctive characteristic in recent years that is critical to understanding the unusually weak employment performance over this recovery: the lack of job gains. **Figure B** shows total job gains and losses (the difference between the

FIGURE B Gross job gains and gross job losses, 1990-2003

Source: Faberman (2004).

two is net job gains or losses) since 1990. In the early 1990s downturn—and other evidence suggests that this is the usual dynamic—the main factor leading to net job losses is a sharp spike in gross job losses surrounded by fairly steadily paced period of job gains. As the recovery ensues, the gross losses subside and net job growth prevails.

This time, however, the pace of job gains declined through the recession and continued to trend sharply downward throughout the first few years of recovery. Clearly, employers were able to meet the demands for the goods and services they produce and sell without creating many new jobs. Most commentators have attributed this trend to the faster productivity growth that occurred over the period, but this explanation is not particularly informative because growing output in a period of net job losses mechanically amounts to faster productivity growth. In addition, productivity usually grows quickly as a recovery gets underway (though it grew faster this time), but demand usually picks up quickly, too, triggering the virtuous cycle noted earlier. This cycle did not occur this time around, in part due to the absence of wage-led demand growth.

Yet throughout this period of weak job creation and, until recently, net job losses, the unemployment rate stayed relatively low in historical terms, rising

as high as 6.3% before falling to 5.6% in June 2004. The level of the unemployment rate, however, belies the extent of remaining labor slack. **Table 1** presents a range of indicators that tell this story.

First, the unemployment rate of 5.6% is 1.3 percentage points above the rate at the start of the recession. So, recent unemployment, though “historically low,” is significantly higher than the low rates achieved at the end of the 1990s boom (unemployment bottomed out at 4.0% in 2000). Furthermore, a broader measure of underemployment—which includes unemployment plus involuntary part-time work (people wanting full-time but holding part-time jobs), discouraged job seekers, and those marginally attached to the job market (i.e., those who have looked for work in the last year but are not counted as “officially” unemployed)—has increased since the recession started by 2.3 percentage points to 9.6%.

In addition to the rise of unemployment, there has been an unusually large 2.0 percentage-point erosion in the share of the workforce employed (i.e., the employment rate) since March 2001. The share of the working-age population in the labor force has shrunk since the recession started (and not grown at all in the recovery), a reflection of workers dropping out of the labor force or failing to enter because of disappointing job prospects. As shown in Chapter 3, there is a missing labor force of 2.5 million workers, a facet of labor market slack not captured by the unemployment rate. Had these labor force absentees instead been job seekers, the unemployment rate would have surpassed 7.0% by the middle of 2004.

Finally, another labor market indicator that points up the labor market’s current weakness is the increase in the share of the long-term unemployed (i.e., those unemployed that have been looking for work for at least six months). This kind of difficulty in finding work runs counter to expectations during a period of low unemployment (by historical standards).

Labor slack’s effect on wages and incomes

High unemployment and extensive labor slack adversely affect family income and cause greater inequality. Chapter 1 shows that middle-class family incomes fell 2.2% from 2000 to 2002. Most of the decline was due to lower annual earnings (2.1% of the 2.2% decline), which is not surprising since most of the income of a middle-class family comes from labor market earnings. The decline in annual earnings, in turn, arose from fewer hours worked in the family (as the result of unemployment and cutbacks in weeks worked and hours worked per week). However, the wages earned per hour fell 0.3%, further contributing to this overall income loss.

TABLE 1 Labor market indicators since the recession and recovery began

Indicator	Beginning of:		Latest month, June 2004	Change since recession began	Change since recovery began
	Recession, March 2001	Recovery, November 2001		March 2001 to June 2004	November 2001 to June 2004
Payroll employment (000s)					
Total	132,507	130,871	131,301	-1,206 [-0.9%]	430 [0.3%]
Private sector	111,564	109,535	109,762	-1,802 [-1.6%]	227 [0.2%]
Government	20,943	21,336	21,539	596 [2.8%]	203 [1.0%]
Unemployment					
All	4.3%	5.6%	5.6%	1.3	0.0
Men	4.3	5.7	5.6	1.3	-0.1
Women	4.2	5.4	5.6	1.4	0.2
Underemployment					
All	7.3%	9.4%	9.6%	2.3	0.2
Employment rate					
All	64.3%	63.0%	62.3%	-2.0	-0.7
Men	71.4	70.0	69.2	-2.2	-0.8
Women	57.7	56.6	55.9	-1.8	-0.7
Labor force participation rate					
All	67.1%	66.7%	66.0%	-1.1	-0.7
Men	74.6	74.3	73.3	-1.3	-1.0
Women	60.2	59.8	59.2	-1.0	-0.6
Share long-term unemployed (%)*					
All	11.2%	14.0%	23.9%	12.7	9.9

* Share of the unemployed who were jobless for at least 27 weeks.

Source: Authors' analysis of BLS data.

Although low inflation and the momentum of the full-employment economy kept real wages rising through the early part of the recession, the growing labor market slack eventually retarded wage growth. This is illustrated in **Table 2**, which shows the inflation-adjusted annualized growth in wages in the final two years of the 1990s recovery, from 1998 to 2000, and compares that to the wage growth from 2002 to 2003. The table presents trends for workers with low, middle, high and very high wages among both men and women. Because labor

TABLE 2 Deceleration of wage growth in 2003

Wage level*	Inflation-adjusted hourly wage growth		Deceleration
	1998-2000**	2003	
Men			
Low	1.0%	0.1%	-0.8%
Middle	1.6	-0.9	-2.5
High	1.8	0.2	-1.6
Very high	2.8	0.5	-2.3
Women			
Low	2.0%	-0.2%	-2.1%
Middle	1.5	0.2	-1.3
High	1.1	-0.1	-1.2
Very high	2.1	1.3	-0.7
Inflation	2.7%	2.3%	-0.4%
Productivity	2.8%	4.4%	1.6%

* Wage levels correspond to the 20th, 50th, 80th, and 95th percentiles.

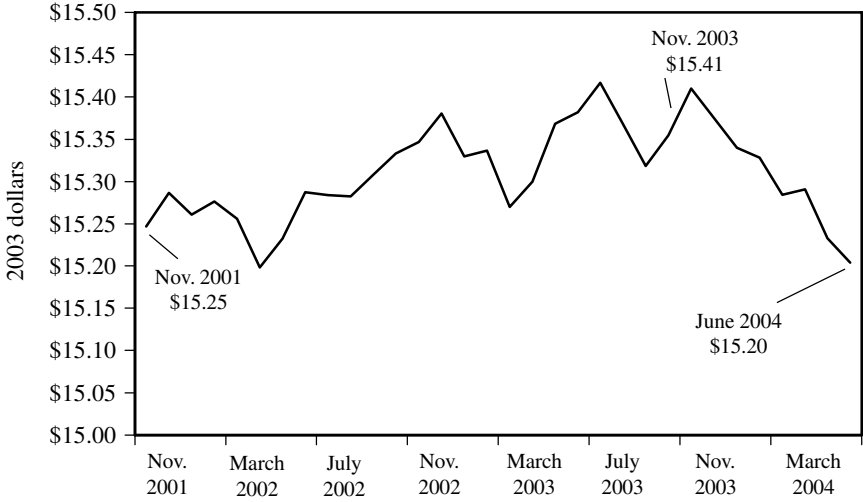
** Average annual growth from 1998 to 2000.

Source: Authors' analysis of CPS and BLS data.

slack and unemployment was much greater in the early 2000s through 2003, wages grew substantially slower (roughly one to two percentage points slower in 2003) than in the 1998-2000 period. The result was that wages were essentially stagnant or falling for low-, middle-, and high-wage earners in 2003, among both men and women; only very high earners enjoyed real wage growth in 2003. This slower wage growth for most workers came about despite faster productivity (up 1.6 percentage points from 2.8% to a very high 4.4%) and subdued inflation (down to 2.3% from 2.8%).

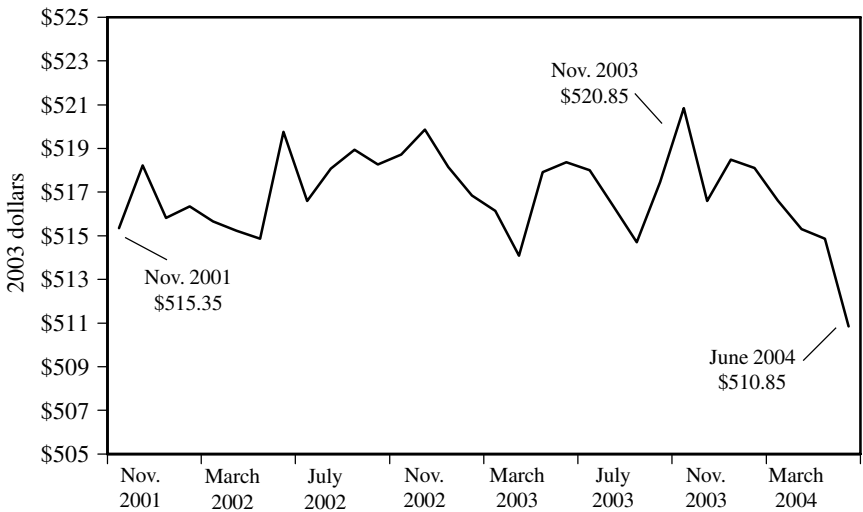
Since 2003, wage trends have deteriorated further, as seen in **Figures C** and **D**. The figures present hourly wages and weekly earnings of blue-collar (production) workers in manufacturing and non-managers in services in 2003 dollars through June 2004 (these workers represent about 80% of the employed U.S. workforce). Since November 2003, the trend in real hourly wages has been consistently negative, and by June 2004 hourly wages were 1.2% below their year-ago level. Due to a loss in hours worked per week, weekly earnings fell further over this period, by 1.5%. In fact, as **Figures C** and **D** highlight,

FIGURE C Real hourly wages since recession ended, November 2001-June 2004



Source: Authors' analysis of BLS data.

FIGURE D Real weekly wages since the recession ended, November 2001-June 2004



Source: Authors' analysis of BLS data.

these negative trends have taken back any gains in hourly wage or weekly earnings made over the recovery. After adjusting for inflation, both hourly and weekly earnings are below where they were when the current recovery got underway.

One relevant question about these negative trends is to what extent they are largely just a function of faster inflation, and thus less indicative of a labor market weakness. It is, of course, true that faster inflation in recent months has meant that nominal wages need to grow faster to beat price growth. Yet, because of the factors noted throughout this introduction, nominal wage growth has slowed sharply, from an annual average of 2.9% in the second quarter of last year to 2.1% in the same quarter this year. Inflation over this same period has accelerated from 2.2% to 2.8%. Thus, even if inflation was back at its level of a year ago, wages would still be stagnant at best, with real wage growth far behind the growth rate of productivity.

The erosion of wages illustrates that extensive labor slack adversely affects those who remain employed in a downturn, by lowering their earnings, as well as adversely affecting those who lose their jobs or cannot find work.

Job quality

As noted, employment has begun to grow fairly steadily, and, while considerable slack remains, the jobless recovery appears to be safely behind us. Here too, however, there is an arising problem: the quality of the net new jobs, or, more specifically, the wages and compensation in the industries and occupations growing most quickly relative to those growing more slowly.

Table 3 presents a worrisome dimension of changes in job quality: the industries that are expanding (as shares of total employment) pay far less in wages, benefits, and total compensation than industries that are contracting. This trend holds true during both the recession and the recovery. For instance, industries expanding over the recovery paid just \$30,369 per year, \$20,902 or 42.7% less than the \$51,270 paid by contracting industries. The difference in benefits is even larger, with expanding industries paying only half as much in benefits (\$5,178) as contracting industries (\$10,713).

Other changes in job quality are more positive, such as the continued shift toward higher-paying white-collar occupations. However, the impact of “upscaling” among occupations is smaller than the downward push to jobs in lower-paying industries. For instance, an analysis that takes both occupational and industry shifts into account shows that expanding sectors paid 9.5% less per week than sectors in which jobs were contracting. This analysis would show a much larger pay gap if it could have used more detailed information on indus-

TABLE 3 Compensation, wages, and benefits in expanding and contracting industries, 2001-04

	Since recession's start	Since recovery's start
	March 2001- June 2004	Nov. 2001- June 2004
Expanding industries		
Annual compensation	\$37,052	\$35,546
Annual wages	31,818	30,368
Annual benefits	5,234	5,178
Contracting industries		
Annual compensation	\$57,330	\$61,983
Annual wages	47,403	51,270
Annual benefits	9,927	10,713
Difference (\$)		
Annual compensation	\$-20,278	\$-26,437
Annual wages	-15,584	-20,902
Annual benefits	-4,694	-5,535
Difference (%)		
Annual compensation	-35.4%	-42.7%
Annual wages	-32.9	-40.8
Annual benefits	-47.3	-51.7

Source: Authors' analysis.

tries and annual, not weekly, pay (especially full compensation, including benefits). In any case, the severe contraction of jobs in manufacturing and information technology over the last several years has eroded the quality of jobs available to workers in the recovery.

The unbalanced nature of the current recovery

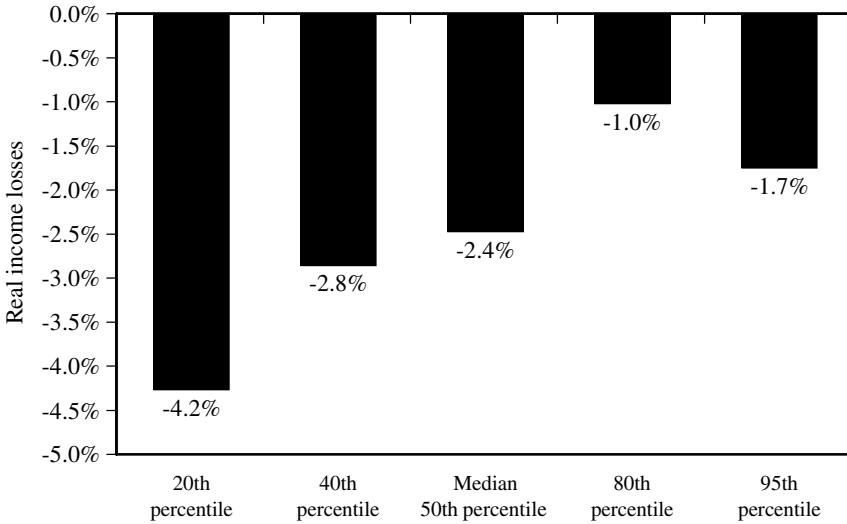
An economy characterized by these sort of unemployment and wage trends is conducive to increasing inequality. Tight labor markets perform a distributional function, that is, they distribute the gains of faster growth among all income classes in the workforce. Unfortunately, over much of the past 25 years, high average unemployment (in tandem with weaker unions, lower real minimum wages, and a diminished manufacturing sector) have contributed to a steady rise in the inequality of economic outcomes. In fact, as documented in Chapter

1, by the end of the last decade, income was only slightly less concentrated among the richest households than it was in the run-up to the Great Depression. Chapter 7 on international comparisons shows such high levels of inequality to be uniquely American.

By ensuring that more of the benefits of growth flowed to middle- and low-income families, the movement toward historically tight labor markets in the latter 1990s helped to partially reverse this pattern for a few years. But with the recent recession and jobless recovery, labor market conditions have produced slower relative growth among those with lower wages and incomes. There was, however, an important countervailing factor that occurred in 2001: the stock market bust and the decline in income from capital sources such as interest and dividends, an income source far more important to those at the very top of the income scale. The sharp capital losses over the recession reduced, but did not eliminate, the large gap that had evolved between the wealthiest families and everyone else (historically large capital losses related to the decline in stock prices are not included in the Census data that follow). Of course, as capital markets rebound, this inequality-dampening factor is likely to be reversed.

In fact, as shown in **Figure E**, the pattern of income growth over the recession and jobless recovery was predictably unbalanced, with larger income losses at the bottom and middle of the income scale than at the top. Each bar in Figure E shows the percent loss in income at different points, or percentiles, in the income scale. The largest declines occurred for the lowest-income families (at the 20th percentile, meaning 80% of families have higher incomes), and the declines grew smaller moving up the income scale, underscoring the point that those most vulnerable to slack labor market conditions tend to fare worse during such periods. The exception is the larger income loss at the 95th percentile than at the 80th (-1.7% versus -1.0%), driven in part by the significant capital income losses among the most wealthy. Even so, the fact that low and middle incomes fell faster than those at the top of the income scale heralds a return to a pattern of unbalanced income growth that has dominated much of the past 25 years.

The data in Figure E focus exclusively on pretax income and thus leave out another source of increased inequality: the unbalanced nature of the federal tax cuts legislated over the past few years. Chapter 1 shows the reduction in tax liabilities resulting from these cuts by income class. For those households in the top 1% of the income scale, the full tax savings from the cuts that were made from 2001 to 2003 were about \$67,000; for middle-income families, the cuts amounted to just under \$600, and for the lowest 20% the tax cut came to \$61. The effect of these cuts has thus been to redistribute after-tax income up the income scale, leading to an inequality-exacerbating transfer of 0.8% of total, after-tax household income from the bottom 99% to the top 1%.

FIGURE E Change in real income by income percentile, 2000-02

Source: Authors' analysis of Census data.

Another major indicator of the unbalanced pattern of growth during this downturn and recovery comes from the fact that capital income (profits and interest) has grown very quickly by historical standards, while total compensation has been flat. This development can be examined using a set of aggregate statistics: the total amount of income flowing to profits (including interest and dividend payments) and compensation in the corporate sector of the economy, as distinguished from the hourly and weekly wage series stressed above (we use the corporate sector for this analysis because it does not include proprietors' income, which cannot easily be divided between capital and compensation, or government income, which has employee compensation but no capital income). **Table 4** shows that inflation-adjusted capital income grew 32.2% over the recession and jobless recovery, while real compensation was up only 1.2%. Thus, the vast majority (84.6%) of the real income growth in the corporate sector since the first quarter of 2001 has accrued to capital income, a hugely disproportionate share when considering that capital income comprised just 16.6% of total corporate income when the recession started in early 2001.

Reflecting this shift in income growth, the returns to capital (the amount of capital income per dollar of assets) grew from 10.5% in 2000 to 11.1% in 2003

TABLE 4 Growth of income in corporate sector, 2000:1q to 2004:1q

Time period	Compensation*	Capital income*	Total corporate income*
Since recession started			
2001:1q	4,288	856	5,143.6
2004:1q	4,338	1,131	5,469.2
<i>Change</i>			
Percent	1.2%	32.2%	6.3%
Dollars	50	275	326
Share of change	15.4%	84.6%	100.0%

* In billions of 2004 dollars.

Source: Authors' analysis.

(**Table 5**). However, because the share of corporate income subject to taxation declined over this same period (from 39.5% to 24.9%), the after-tax return on capital grew three times as much as the pretax returns, up 2.0 percentage points from 6.3% to 8.3%.

The poor growth of total compensation in recent years reflects the lack of job creation and the slowdown in the growth of wages as a result of the extensive labor slack that has characterized this recovery. But how unique is this period compared to past recoveries? As shown in **Figure F**, the division of the economic pie between profits and compensation over this cycle is far more unequal than in past periods. On average over the post-WWII period, 12 quarters after an economic peak, real capital income was up 11.3%, only slightly ahead of compensation growth's 9.4%. Comparable figures for the most recent three years are 32% for capital income and little real growth at all for compensation. This extremely unbalanced division of income growth in the corporate sector stands out as historically unique.

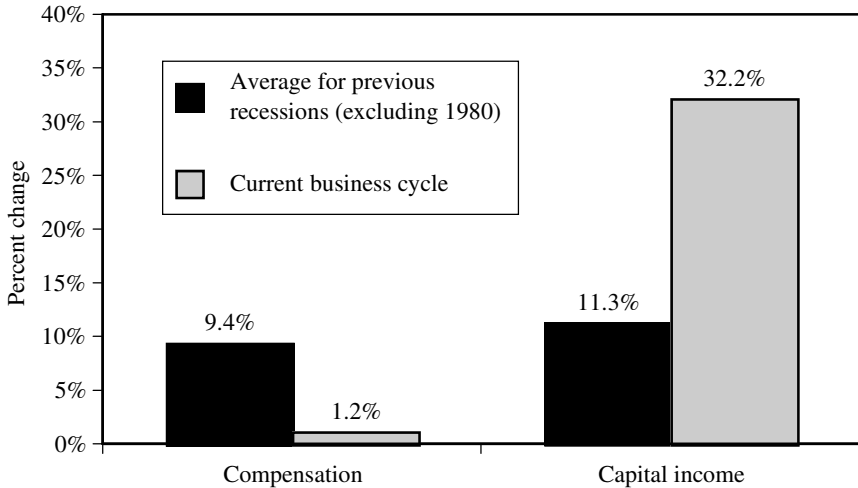
Conclusion: a recovery at the crossroads

The recovery that began in late 2001 proved to be the worst on record for jobs, and its lingering effects—the slack that remains a hallmark of our current job market—are amply documented throughout this book. The chapters that follow also stress historical analyses that highlight various periods in the U.S.

TABLE 5 Returns to capital, 2000-03

Year	Corporate sector		
	Returns to capital		Implied tax rate
	Pre-tax	After-tax	
2000	10.5%	6.3%	39.5%
2001	9.0	6.0	33.0
2002	10.0	7.4	26.0
2003	11.1	8.3	24.9

Source: Authors' analysis of NIPA and BEA data.

FIGURE F Real growth of compensation and capital income in the corporate sector, 12 quarters after peak, current cycle versus average of prior cycles

Source: Authors' analysis of BEA data.

economy when full employment in tandem with a set of adequate labor market institutions (e.g., stronger unions, higher real minimum wages) lifted the bargaining power of the millions of workers who depend on such conditions and policies to maintain living standards that rise with productivity.

What does this analysis tell about where we are right now? The evidence suggests that, as of mid-2004, the recovery is at a crossroads. One path leads to a broad-based, balanced recovery, where tight labor markets ensure widely

shared real wage and income growth; where the benefits of the faster productivity regime that began in the mid-1990s flow freely to all income classes; where inequality is held at bay and poverty rates are driven down by a growing economy that provides quality jobs to even the least-advantaged worker.

The other path leads to an economy more like that of the 1980s, although with faster productivity growth. Throughout those years—which were characterized by large and growing budget deficits, high average unemployment, sharply growing inequality, and declining real wages and incomes for many in the bottom half—the living standards of far too many working families were stagnant at best.

Although the evolution of the recovery thus far, as documented above, is pushing us in the wrong direction, it is not too late to change course. The question is, of course, what can be done to avoid the wrong path and promote the correct one? First, policy makers, journalists, and most importantly, the electorate need to be well versed in the economic facts that determine the living standards of working families. Those facts are the subject of the seven chapters that follow. Once we have these facts in front of us, we then need a national economic discussion about the type of economy we want, and how to get there.

This framing of the economy as being at a crossroads may sound strange to many policy makers and citizens who believe that the path of the economy is determined by fate, not by fiat. But we firmly reject that notion, and maintain that we can—in fact, we must—wield public policy most effectively to push the economy toward the better path.