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Wage Inequality: A Story of Policy Choices

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Along essentially every measure that economists track, economic inequality has been rising since the late 1970s. The wage gap between those earning the minimum wage and those in top management slots, the income gap between families at the official poverty line and those in the "1 percent," and the wealth gap between families drowning in mortgage, student loan, and credit card debt and those making the Forbes 400 list are all much higher now than they were at the end of the 1970s. This broad, relentless increase in inequality is all the more striking because it follows five decades when economic inequality was falling—sharply in the 1930s and 1940s and more slowly in the 1950s, 1960s, and 1970s.

It is possible to explain the entire rise of economic inequality since the late 1970s as the outcome of an array of economic policies.

The mainstream of the economics profession offers one over-riding explanation for the rise in inequality: workers who have the skills needed for new technologies have done well, while those lacking those skills have fallen farther and farther behind. This "skill-biased technological change" (SBTC) view does not deny that other factors, such as globalization or the decline of unions, might play a role in rising inequality, but it does cast these other factors as distinctly secondary.[1] We take a different view. We believe that it is possible to explain the entire rise of economic inequality since the late 1970s as the outcome of an array of economic policies that had the easy-to-predict effect of widening the gap between the top 1 percent and the rest.[2]

Over each of the last three decades, macroeconomic policy (fiscal, exchange rate, monetary policies), trade agreements, deregulation of the financial sector, the legal environment governing unionization, the minimum wage, industry deregulation (in airlines, trucking, inter-state busing, and elsewhere), the privatization of state and local government functions, and other policies have had different effects on different kinds of workers, helping some and hurting others. These policy choices also often had a different impact on women than on men. Together, we argue, these policies can explain changes in wage trends for workers—both men and women—across the wage distribution.

The Facts

Our policy-based explanation concentrates on workers at four key points in the wage distribution: workers at the bottom (the 10th percentile, who earn more than 10 percent of workers, but less than 90 percent), the middle (the 50th percentile, or median, worker right in

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the middle of the wage distribution), the top (the 90th percentile, who earn more than 90 percent of workers, but less than the top 10 percent), and the very top (roughly, the top 1 percent).

Any reasonable explanation of wage inequality must account for at least four well-documented wage trends. The first is the different wage pattern for the wage gap between the median and low-wage (10th percentile) earner in the 1980s and the years since. Between 1979 and 1986 (for men) or 1987 (for women), wages at the middle pulled strongly away from those at the bottom, similar to what occurred as the top pulled away from those in the middle. But, starting in the late 1980s, wages at the bottom actually caught up somewhat with wages in the middle and then were stable for most of the 1990s and 2000s. As a result, from the mid-1990s, the wage gap between the middle and the bottom has remained fairly steady.

The second is the large and continuous increase since 1979 in the distance between wages at the top and the middle. In 1979, the typical high-wage worker (one at the 90th percentile of the wage distribution) made 1.95 times what the median worker (one at the 50th percentile) earned. By 2013, workers at the 90th percentile earned 2.42 times that of the median worker.[3] These changes between the late 1970s and the mid-2010s were fairly continuous over time, although a bit slower since the mid-1990s. This stands in contrast to the wage gap between the bottom and middle which only grew in the 1980s.

Consequently, we explain rising wage inequality by separately examining the growth of the gap between the top and the middle (which has grown continuously since the late 1970s) and the growth of the gap between the middle and the bottom (which grew in the 1980s).

The third key trend is the sharp deceleration after about 1995 in the growing gap between the earnings of the average college-educated worker and the average non-college-educated worker. Between 1979 and 1995, the distance between the 90th percentile worker and the rest closely tracked the rising gap between college-educated workers and the rest. After 1995, the 90th percentile worker continued to outpace the middle as it had from 1979 to 1995, but the "college wage premium" began to grow much more slowly than in the past. In other words, over the past decade or so, the difference between the 90th percentile and the 50th percentile workers expanded, but wages of college-educated workers grew only modestly faster than the wages of those without a college degree.

Between 1979 and 2007, the inflation-adjusted annual wages of the top 1.0 percent grew by 156 percent.

A fourth important trend is the astronomical rise in wages of the top 1 percent. Between 1979 and 2007, the inflation-adjusted annual wages of the top 1.0 percent grew by 156 percent, far greater than 34.1 percent growth among those of high-wage earners (in the 90th to 95th percentiles) and far faster than the 17 percent increase for the bottom 90 percent of wage earners. Those in the top 0.1 percent fared even better, enjoying 362 percent growth.[4]

Policy, Politics, and Bargaining Power

The Gap between the Bottom and the Middle

Policy can easily explain the initial expansion and subsequent contraction in the earnings gap between the bottom and the middle. As we mentioned, the wage gap between the middle and the bottom (the "50-10" wage gap) expanded from 1979 to the late 1980s (growing much more for women than for men) and has been relatively stable since then. The initial rise in the gap between the bottom and the middle closely follows the erosion of the inflation-adjusted value of the minimum wage over almost the entire decade of the 1980s. With no congressional action to raise the minimum wage (until 1990), the purchasing power of the minimum wage declined by roughly 30 percent, undercutting wages at the bottom, with a particularly big impact on women.[5] More formally, Autor, Manning, and Smith calculate that, in 1979, 12.7 percent of the female workforce was affected by the minimum wage, but, by 1989, only 5.4 percent were affected.[6] Thus, the 10th percentile wage among women was set by the minimum wage in 1979, but not in 1989. The minimum wage had much less influence on low-wage men with 4.7 percent affected in 1979, falling to just 3.0 percent in 1989. Autor, Manning, and Smith's analysis shows that roughly two-thirds of the growth of the 50-10 wage gap for women from 1979 to 2009 can be explained by minimum-wage trends.

The initial rise in the gap between the bottom and the middle follows the erosion of the inflation-adjusted value of the minimum wage over the 1980s.

The stable 50-10 wage gap among women in the 1990s and 2000s is consistent with minimum-wage trends as well. In the 1990s (1989-2000), the value of the minimum wage grew, in inflation-adjusted terms, by 14.6 percent and then rose an additional 7.8 percent, also in real terms, between 2000 and 2011. Over the same two periods, the median wage for women grew 9.9 percent (1989-2000) and then another 4.8 percent (2000-2011). As a result, the minimum wage more than kept pace with median wages among women after 1989 and, not surprisingly, there was no appreciable change in the 50-10 wage gap among women over this period (0.644 log points in 1989, 0.624 in 2007, and 0.627 log points 2011).

In the 1980s, the 50-10 wage gap grew much less among men, rising only about 4 percent between 1979 and 1989. In the 1990s, the 50-10 gap for men fell by about the same amount before rising about one percentage point by 2013. As Autor, Manning, and Smith show, the minimum wage had little impact on the 10th percentile men's wage.

In our view, the big driver of wages at the bottom for men has been unemployment. Mishel et al. estimate that the impact of a one percentage point higher unemployment rate on wages for men is 1.96 percent more per year at the 10th percentile and less than half that much (0.87 percent) at the median and less at the 90th percentile (0.52 percent).[7,8] These estimates are consistent with the high unemployment of the 1980s expanding the 50-10 wage gap among men and the persistent low unemployment in the late 1990s bringing it back down.

The Gap between the Middle and the Top

The decades-long expansion of the wage gap within the top half of the wage structure—between the 95th or 90th percentile and the 50th percentile worker—also stems from concrete policy choices, including the erosion of union power, trade policy, industry deregulation, macroeconomic policy (manifested in excessive unemployment rates), and other factors that worked to reduce the bargaining power of workers at the middle, relative to workers at the top.

The long decline of unions has affected middle-wage men more than any other group. According to Mishel et al., the fall in union representation explains about three-fourths of the expanded wage gap between white- and blue-collar men and over a fifth of the expanded wage gap between high school– and college-educated men from 1978 to 2011.[9,10] A separate analysis by Western and Rosenfeld, which includes both the direct and norm-setting impact of unions, shows that de-unionization 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.[11] DiNardo, Fortin, and Lemieux found that a large portion (40 percent) of the increase in the 90-50 gap for men in the 1980s can be linked to the fall of unionization.[12,13] These effects have continued into the 2000s.

De-unionization can explain about a third of the entire growth of wage inequality among men.

The opening up of the economy to international trade has been another factor suppressing wages in the middle of the wage structure, particularly since 1995. The wage gap between college- and non-college-educated workers (the median worker is non–college educated) has grown modestly since 1995, rising about five percentage points.[14] Using a model developed by Krugman and updated in Bivens, Mishel et al. demonstrate that almost all of this increase can be explained by downward pressure on wages of non-college-educated workers exerted by trade with less developed nations.[15] Autor and colleagues also find that the emergence of high trade deficits and the import surge in the early 1980s put substantial pressure on mid-level wages.[16] International trade not only reallocates employment away from manufacturing but also puts direct pressure on the wages of those workers remaining in manufacturing as the prices their employers can charge are diminished.[17] In recent years, offshoring is expanding the impact of globalization to higher-wage, white-collar workers, which may help to explain the slowdown in the wage growth of college-educated workers since the mid-1990s.[18]

Offshoring is now expanding the impact of globalization to higher-wage, white-collar workers.

Excessive unemployment through most of the last four decades has also put downward pressure on wages in the middle. Two policy trends have brought about excessive unemployment: (1) the use of macroeconomic policy to explicitly increase the level of unemployment—as was the case in the early 1980s under Fed Chair Paul Volcker when interest rates rose to double digits; and (2) an inadequate response to cyclical unemployment, notably the failure to use federal spending to "stimulate" the economy—as has been the case through much of the 2000s, including the Great Recession. In both cases, the underlying macroeconomic approach views wage growth primarily as a threat to price stability, rather than a positive economic outcome.

Starting in the 1970s, Congress deregulated various industries, including airlines, trucking, inter-state busing, telecommunications, utilities, and railroads. In each of these industries, deregulation had a strong adverse impact on the wages and compensation of blue-collar workers, because as competition grew, firm profitability fell and cost containment escalated. Fortin and Lemieux showed that 9 percent of the workforce in the 1980s was affected by industry deregulation and that in such industries there was a much larger erosion of middle-wage jobs. According to their estimates, between 1979 and 1988, deregulation explained about 7 percent of the rise in male wage inequality, especially for those above a low-wage threshold.[19] Card shows a 10 percent decline over 1980 to 1990 in the relative earnings of airline workers after deregulation.[20] Deregulation weakened the ability of employers to pay high wages and in many sectors, most notably trucking, led to a steep erosion of unionization.

A range of other economic policies have also put downward pressure on middle-wage (and low-wage) workers. These include ongoing efforts to privatize public-sector functions; weakened labor standards (for example, regarding overtime pay and independent contractor status); lax enforcement of existing labor standards; an eroded safety net, including changes to unemployment insurance (tightening eligibility requirements, shortening duration of benefits, and making it more difficult for the unemployed to turn down jobs with inferior pay) and what used to be called "welfare" (formerly Aid to Families with Dependent Children, now Temporary Assistance to Needy Families); an increasingly dysfunctional immigration policy that includes temporary worker programs that undercut the wages of workers in such disparate fields as landscaping and hospitality, at the lower end, and science and technology workers, at the higher end.

The Top 1 Percent

Much of the increase in inequality has taken place in the top 1 percent. In an accounting sense, the explosion of wages at the very top is primarily the result of two factors: the superlative growth of compensation of CEOs and other top managers, and the expansion of the financial sector with its increasingly high salaries. In our view, these wage trends are overwhelmingly a story of what we could call "financialization" of the economy as well as the rocketing pay of top managers resulting from failed corporate governance and the ability of managers to engineer their own pay increases.[21]

Based on an analysis of tax returns, Bakija, Cole, and Heim identify the occupation or sector of the primary earners in the top 1.0 and top 0.1 percent of households (tax filing units). Executives and managers in non-financial sectors and those in the financial sector (executives and other earners) are associated with the bulk of the rise in incomes of the top 1.0 and top 0.1 percent of households. The contribution of the financial sector to the overall increase reflects both the expansion of finance and the increasingly high pay earned in the sector. Together, these two groups—executives/managers and finance—accounted for at least 58 percent of the growth of the income share of the top 1.0 percent of households and 67 percent—two-thirds—of the increased income share of the top 0.1 percent of households between 1979 and 2005.[22]

An important part of this increase appears to be the result of rent-seeking behavior by high-level corporate insiders. Bivens and Mishel show that CEOs have earned pay increases that have far outpaced those of even the top 0.1 percent of earners. The ratio of CEO compensation to the wages of the top 0.1 percent of wage earners (including those of other executives) rose from 3.16 in 1979 to 4.23 in 2007 and then to 4.70 in 2010.[23] CEO compensation has also grown nearly twice as fast as major stock indices. SBTC does not seem to play a major role in the increase in the earnings of the top 1 percent.

Conclusion

Focusing on technology as the cause of rising wage inequality over the last thirty-five years diverts attention away from the real, underlying causes of inequality: conscious choices about economic policy, which have consistently undermined the bargaining power of workers at the middle and the bottom. Stopping and reversing the rise in inequality will require restoring the bargaining power of workers at the middle and the bottom. Part of rebuilding bargaining power will involve undoing the policies described here, but part will involve developing new ways to build worker power.

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Notes

1. For an excellent discussion of the skill-biased technological change (SBTC) view, see Claudia Goldin and Lawrence Katz, *The Race between Education and Technology* (Cambridge: Belknap Press of Harvard University Press, 2008). Goldin and Katz's treatment makes little mention of unions, the minimum wage, trade agreements, immigration policy, macroeconomic policy, or other issues often implicated in the rise of wage inequality.
2. For longer discussions of many of the themes presented here, see Lawrence Mishel et al., *The State of Working America, 12th Edition* (Ithaca, NY: ILR Press of Cornell University Press, 2012); Dean Baker, *The United States since 1980* (New York: Cambridge University Press, 2007); Josh Bivens, *Failure By Design: A Story behind America's Broken Economy* (Economic Policy Institute, Ithaca, NY: Cornell University Press, 2011); and John Schmitt, "Inequality as Policy: The United States since 1979" (Center for Economic and Policy Research, Washington, DC, 2009). For a detailed discussion of the impact of labor-market policies on labor-market outcomes, see Gordon Lafer, "The Legislative Attack on American Wages and Labor Standards, 2011-2012" (Economic Policy Institute, Washington, DC, 2013). For a discussion of the broader political context, see Jacob S. Hacker and Paul Pierson, *Winner-Take-All Politics: Public Policy, Political Organization, and the Precipitous Rise of Top Incomes in the United States* (New York: Simon & Schuster, 2011).
3. Mishel et al., *The State of Working America*.
4. Mishel et al., *The State of Working America*, have used data from Wojciech Kopczuk, Emmanuel Saez, and Jae Song, "Earnings Inequality and Mobility in the United States: Evidence from Social Security Data since 1937," *Quarterly Journal of Economics* 125, no. 1 (2010): 91–128; and extending it based on published Social Security Administration wage data to track annual wages (there is no accurate hourly wage measure) of the top 1.0 and top 0.1 percent.
5. Lawrence Mishel et al., "Wages: The Top, and Very Top, Outpace the Rest," in *The State of Working America*, 12th ed., ed. Lawrence

Mishel et al. (Ithaca, NY: ILR Press of Cornell University Press, 2012), 173–310.

6. David Autor, Alan Manning, and Christopher Smith, "The Contribution of the Minimum Wage to U.S. Wage Inequality over Three Decades: A Reassessment" (NBER Working Paper No. 16533, National Bureau of Economic Research, Cambridge, 2010), Figure 1.
7. Mishel et al., *The State of Working America*.
8. Lawrence F. Katz and Alan B. Krueger, "The High Pressure U.S. Labor Market of the 1990s," *Brookings Papers on Economic Activity* 30, no. 1 (1999): 1–87. These estimates are based on the analysis of Katz and Krueger extended through 2007.
9. Mishel et al., *The State of Working America*.
10. Mishel et al., *The State of Working America*, 274, Table 4.63. Updating an analysis made in Richard B. Freeman, "How Much Has De-unionization Contributed to the Rise in Male Earnings Inequality?" in *Uneven Tides: Rising Inequality in America*, ed. Sheldon Danziger and Peter Gottschalk (New York: Russell Sage Foundation, 1992), 133–64; based on changes in union wage premium and union coverage.
11. Bruce Western and Jake Rosenfeld, "Unions, Norms, and the Rise in the U.S. Wage Inequality," *American Sociological Review* 76, no. 4 (2011): 513–37.
12. John DiNardo, Nicole M. Fortin, and Thomas Lemieux, "Labor Market Institutions and the Distribution of Wages, 1973-1992: A Semiparametric Approach," *Econometrica* 64, no. 5 (1996): 1001–1044.
13. David Card, "The Effect of Unions on Wage Inequality in the U.S. Labor Market," *Industrial and Labor Relations Review* 54, no. 2 (2001): 296–315. Freeman, "How Much Has De-unionization Contributed."
14. Paul Krugman, "Growing World Trade: Causes and Consequences," *Brookings Papers on Economic Activity* 26, no. 1 (1995): 327–77.
15. Josh Bivens, *Everybody Wins, Except for Most of Us: What Economics Teaches about Globalization* (Washington, DC: Economic Policy Institute, 2008); and Mishel et al., *The State of Working America*, Table 4.29.
16. David Autor, David Dorn, and Gordon Hanson, "The China Syndrome: Local Labor Market Effects of Import Competition in the United States," *American Economic Review* 103, no. 6 (2013): 2121–68.
17. Bivens, *Everybody Wins*.
18. Alan S. Blinder, "How Many U.S. Jobs Might Be Offshorable?" (CEPS Working Paper No. 142, Center for Economic Policy Studies, Princeton University, Princeton, 2007); Alan S. Blinder and Alan B. Krueger, "Alternative Measures of Offshorability: A Survey Approach" (NBER Working Paper No. 15287, National Bureau of Economic Research, Cambridge, 2009); shown in Table 4.30 of Mishel et al., *The State of Working America*.
19. "The percentage of male workers in the upper middle of the distribution, with hourly wages between \$7.50 and \$12.50 in 1979 dollars, fell from 52 percent to 38 percent in deregulated industries, whereas it fell only from 33 percent to 26 percent in other industries." (Page 85 in Nicole M. Fortin and Thomas Lemieux, "Institutional Changes and Rising Wage Inequality: Is there a Linkage?" *Journal of Economic Perspectives* 11, no. 2 [1997]: 75–96.)
20. David Card, "Deregulation and Labor Earnings in the Airline Industry" (NBER Working Paper No. 5687, National Bureau of Economic Research, Cambridge, 1996).
21. By rents, we mean that CEOs are receiving payments in excess of what would be required to have them supply their current level of effort. For a fuller treatment of the issues discussed in this section, see 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* 27, no. 3 (2013): 57–78.
22. Jon Bakija, Adam Cole, and Bradley T. Heim. "Jobs and Income Growth of Top Earners and the Causes of Changing Income Inequality: Evidence from U.S. Tax Return Data," 2012, available at http://web.williams.edu/Economics/wp/BakijaColeHeimJobsIncomeGrowthTopEarners.pdf.
23. Bivens and Mishel, "The Pay of Corporate Executives and Financial Professionals."

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