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The State of Working America, 2004/2005

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Abstract

The State of Working America, prepared biennially since 1988 by the Economic Policy Institute, includes a wide variety of data on family incomes, wages, taxes, unemployment, wealth, and poverty--data that enable the authors to closely examine the effect of the economy on the living standards of the American people.

Keywords

work, america, economy, economic, policy, labor, conditions, political, economics, wages, income, data

Disciplines

Economics

Comments

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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 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 capital 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* shed light on the economic conditions 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.