The Great U-Turn

Corporate Restructuring and the Polarizing of America

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With a New Preface by the Authors

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PREFACE TO THE PAPERBACK EDITION

WHEN WE FIRST WROTE *The Great U-Turn,* we began with a simple and fundamental premise: what is essential to the American Dream is the promise of an ever-improving standard of living. Americans expect to find and hold higher-paying jobs as they get older, and they expect their children to fare even better. As generations pass, we also look forward to more time for leisure without suffering losses in pay. Americans have always been willing to work and work hard. But we have grown to expect a good return for our effort.

We also presumed that the American Dream has traditionally been infused with a strong social conscience and an abiding belief that, all things considered, a more equal society is a more equitable one. That principle of purpose has been honored in the breach as often as in the practice. But polls show repeatedly that we like ourselves better when our institutions are promoting equality—at least equality of opportunity—than when they are not.

We discovered in the course of doing research for *The Great U-Turn* that for a quarter of a century, from the late 1940s to the early 1970s, the American Dream was indeed becoming a reality for a growing segment of the population. Real family income rose surely and, for the most part, steadily. An increase in social opportunity and a real reduction in poverty supplied the wherewithal for social cohesion in the face of the wrenching effects of McCarthyism, Vietnam, and a revolution in cultural mores and standards.

Yet our research led us to believe that the American Dream began to unravel more than a decade and a half ago and continues to this very day. The affluent society stopped becoming more affluent in the early 1970s. On average, real (inflation-adjusted) individual wages have no longer gone up; for the average worker, 1973 was the high-water mark in material gain. Moreover, the economic distance between rich and poor, between well paid and poorly paid, is higher today than at any point in the lifetimes of all but our most senior citizens, the veterans of the Great Depression. Instead of working shorter hours at wages capable of sustaining a respectable middle-class life style, a growing number of Americans are being shuffled into low-paying jobs. And even though families are working longer hours and holding down two or more jobs, annual incomes are no higher today than those of an earlier generation.

The decade of the 1980s, we found, bore a credible resemblance to the 1920s. Underneath a small sliver of society with an almost unfathomable wealth lay a precarious economy and an increasingly uneasy and struggling middle class. Perhaps most disturbing of all is the realization that we have just been barely able to hold on to our overall standard of living despite borrowing mightily against the future to finance current consumption. The cost of financing the federal debt, trade deficit, and mounting consumer credit will soon begin to extract a larger share of our resources, leaving us with an even lower standard of living. Our book thus became one about the great U-turns America has endured in wages, incomes, and inequality. It attempts to explain why this has occurred and what we can do to restore economic growth and pursue greater equality.

The origins of this book can be traced to the summer of 1986 when the Joint Economic Committee (JEC) of the U.S. Congress commissioned the two of us to prepare a report on the quality of American jobs generated during the 1960s, 1970s, and 1980s.[1] It was common knowledge that the nation had an excellent record in terms of job creation. The sheer quantity of new jobs developed in the United States since the early 1960s had been—and continues to be—the envy of the western world. But the quality of the new jobs—especially the wages paid on those jobs—was another matter. Were we becoming a nation of low-wage hamburger flippers, nurse's aides, janitors, and security guards as the mass media sometimes reported? Or was the restructuring of the American economy leading in the opposite direction toward better jobs at better pay? The demise of high-wage manufacturing jobs in cities like Detroit and Youngstown, combined with the proliferation of McDonald's and K-Marts in virtually every town, provided an image of America as a new low-wage bastion. News accounts of "yuppie" stockbrokers, who had made their first million by the age of twenty-seven, seem to imply a different story. Tom Wolfe's novel *The Bonfire* *of the Vanities* captured a vivid image of both: the destitution of the South Bronx juxtaposed to the opulence of the Upper West Side.[2]

Our JEC report was made public in December 1986. Entitled "The Great American Jobs Machine," it was to become one of the committee's most controversial reports of the year. The "Jobs Machine" study found that during the first half of the 1980s the U.S. economy continued to churn out new jobs at about the same rapid pace as during the previous decade, *but* we discovered that a majority of the jobs created after 1979 were of dubious quality when measured by the annual earnings they offered. America was surely creating more than just hamburger flippers and security guards, but nearly three out of five (58 percent) of the net new jobs created between 1979 and 1984 paid $7,400 or less a year (in 1984 dollars). In contrast, less than one in five of the additional jobs generated between 1963 and 1979 had paid such low wages.

Reaction from the White House to the sobering message in the JEC report was swift and shrill. In an article entitled "They're Not 'McJobs' " appearing in the *Washington Post* soon after the report was released, Secretary of Labor William E. Brock suggested that "new life has been injected into this 20th Century Flat Earth Society" comprised of believers in the "bad job myth."[3] The American economy, he warranted, is generating millions of new "good" jobs in high-paying fields such as transportation, public utilities, communications, finance, banking, insurance, and data processing. Indeed, he concluded, "In the five years of the recovery [1983–1987], only one major segment of the job sector has declined: minimum-wage jobs have fallen 25 percent, while those jobs paying $10 an hour or more have increased by 50 percent."

Such conflicting views of the jobs data—represented by the JEC report and the comments of the highest-ranking official in the labor department—whetted the appetite of a small cadre of social scientists. What followed was something of an academic battle royal. Out of that battle came this book, *The Great U-Turn,* which attempts to explain how and why America moved from the path of higher wages and greater equality in earnings and family incomes to lower wages during the 1970s and 1980s and to income inequality that rivals that of the Great Depression of the 1930s.

Like the original JEC report, the hardcover edition of *The Great*

U-Turn generated a spate of critical reviews and an outpouring of new research. Research from groups as diverse as the conservative American Enterprise Institute to the moderate Brookings Institution to the progressive Economic Policy Institute ultimately came to a nearly unanimous agreement on the basic wage and income trends suggested in the JEC study and *The Great U-Turn.* Almost everyone who studied the jobs data concurred that average wages have stagnated or actually declined since the early 1970s. Virtually all of the new studies agree that the low-wage share of total employment has expanded, particularly among workers who work year round and full time, and most studies show a growing polarization in earnings—more low-wage jobs, more high-wage jobs, and a shrinking middle.

Agreement on the nature of the trends, however, has not closed the book on the "good jobs–bad jobs" debate. In dozens of journal articles, monographs, and books, the protagonists in the debate have moved beyond debating wage trends themselves to more serious differences over the underlying causes of these labor market outcomes. In a moment we shall turn to these.

Bringing the Wage Trends Up to Date

When *The Great U-Turn* first appeared, the latest data available for inclusion in the book were for the year 1986. Many critics suggested that the wage trends would not stand the test of time, particularly as the post-1982 economic recovery continued into its fifth and sixth years. We now have additional data and these have persuaded even some of the most skeptical observers to begrudgingly admit that the trends have still not reversed. In 1987 and 1988, real average weekly earnings continued to decline, maintaining a trend that began back in 1973.[4] By 1988, inflation-adjusted weekly earnings were lower than at any time since 1960, thirty years ago. We also have available one more year of data on our measure of wage inequality and on the size of the low-wage share. Wage inequality went up in 1986, and we now know that it rose again in 1987. As for the low-wage share among year-round, full-time workers, the latest data available show a slight improvement in 1987, but hardly of a serious magnitude. At 16.2 percent, it was still higher than at any time in the 1970s.

As for families, real median income rose slightly in 1987, but just enough to finally return to its 1973 level.[5] At the same time, however, family income was continuing to become more unequally distributed, setting for the fifth year in a row a new post–World War II record for inequality. The findings on family income were confirmed in a detailed study carefully prepared by the House Ways and Means Committee of the U.S. Congress and released six months after the publication of *The Great U-Turn.*[6] According to the Ways and Means study, from 1979 to 1987 the standard of living for the poorest fifth of the population fell by 9 percent, despite a growing economy during the last five years of the period. The living standard of the top fifth rose by 19 percent. Essentially, the lamentable wage and income trends depicted later in chapters 1 and 5 persist undisturbed despite continued "prosperity."

There is one issue concerning the trend in the low-wage share of jobs that critics of *The Great U-Turn* clearly recognized. Since low-wage share by construction depends on both the *level* of overall wages and the *distribution* of wages, it had been unclear whether the expansion in low-wage employment since 1979 simply reflects the stagnation in real earnings across the board or marks a true redistribution toward the low end of the wage spectrum. We now have an answer to this question. In statistically decoupling the two effects, we find that for the work force as a whole virtually *all* of the changes in wage shares—the growth in the low and high strata and the decline in the number of middle-wage jobs—are due to a pure redistribution effect. Thus, the decline in average wage merely confirms what we already know: the number of new low-wage jobs created since the late 1970s exceeds the number of additional high-wage positions.

The results differ for men and women. For men, redistribution accounts for nearly three-fourths of the growth in the low-wage share among those who were working year round and full time. Among women, downward redistribution would have increased their low-wage share, but because of nearly across-the-board increases in their average earnings, the final downward impact of redistribution on wage levels has been tempered. Hence, women's low-wage share rose by less than a percentage point between 1979 and 1987 (in contrast to 4.3 percentage points for men) in spite of the fact that women's wages, like men's, were becoming more polarized. On average, women's wages continue to improve slowly, particularly in relation to men's, but like men the greatest job gains have been in the lowest and highest ends of the wage spectrum.

New Directions in Explaining the U-Turn Pattern

As wage and income trends continued to deteriorate into the late 1980s, understanding the roots of these trends has taken on greater urgency. This is where the controversy persists. One particular theory is advanced in this book.

As the reader will discover, it is our contention that the recent stagnation of American incomes and the rise of inequality have their origins in the growth in global competition and specifically in a distinctive array of business strategies adopted by American corporate managers to cope with the ensuing decline in corporate profitability. While foreign competition intensified toward the end of the Vietnam era and workers and communities continued to bid for better working and environmental conditions, the leaders of American industry inevitably faced a crucial strategic choice. They could attempt to relieve the squeeze on profits through a short-term fix by attacking labor costs and social regulation or they could join in the difficult and largely uncharted search for new forms of organization, new product development, and new relationships with civil society that might restore long-term productivity growth and rebuild the competitive position of American goods and services.

For the most part, the evidence suggests to us that American business pursued the former and easier course. Instead of pioneering in new products and technologies to boost revenues, U.S. firms overwhelmingly chose to work on the cost side of the profits equation. New products such as the video tape recorder and the compact disc player were ceded to the Japanese. New technologies such as computer-aided design and manufacture (CAD/CAM) and computerized numerically controlled machinery (CNC) were adopted only slowly, well behind

Europe and the Far East. Instead, regaining profits became synonymous with reducing costs, particularly labor costs. Plants were shut down in the United States, production was moved offshore, wage concessions were forced on the work force still on the job at home, and part-time jobs were carved out of full-time work schedules—all in the name of becoming "lean and mean."

There is no question that business found new allies in Washington. Government policies to weaken organized labor and reduce the burden of taxes and regulations reinforced corporate initiatives. A new era of laissez-faire was instituted, tentatively at first under the Democrats in the Carter administration and then under the Reagan administration with passion.

For many companies even the strategy of getting "lean and mean" failed to rebuild profits fast enough. When that happened, a growing segment of business leaders switched to a different strategy. They turned their companies away from productive activity altogether, shifting their capital into essentially unproductive services, financial acquisitions, and rank speculation. *Business Week* popularized this inauspicious trend as the "hollowing" of America. This trend accelerated the nation's movement toward a "post-industrial" society and, in the process, sped up the "Great American Jobs Machine." Millions of new jobs were created in the service economy, but a large proportion at low wages.

Recent history suggests this strategy "worked." Profit rates, which had been falling since the middle of the 1960s, rebounded strongly after the 1981–82 recession. But we believe the cost to America of pursuing this particular set of strategies was immense: average wages fell, low-wage employment increased, and earnings and incomes polarized.

Two major reports, one issued about the same time and one shortly after the completion of the *The Great U-Turn,* came to essentially the same conclusions. The Cuomo Commission, created by New York Governor Mario Cuomo, focused on America's seeming inability to compete successfully in international markets and blamed both corporate and federal government policy. Subsequently, the prestigious M.I.T. Commission on Industrial Productivity, in a volume that assembled an elaborate series of industry case studies, castigated the nation's industrial leaders for outdated production strategies, short-term planning horizons, technological weakness in product development and production methods, neglect of human resources, failure to implement industrial cooperation and teamwork, and an inability to form public–private sector relationships that could enhance productivity. The ringing indictments of American business practices and public policy found in these two reports echo and elaborate upon many of the themes found in this book.

Since the original publication of *The Great U-Turn,* however, others have come forward with alternative—often much more benign—explanations of the wage and income trends. Altogether, we now count at least five competing theories that vie for distinction. They range from hypotheses about the business cycle, economic stagnation, and changes in the demography of the labor force to explanations that focus on the "deindustrialization" of America and on the changes in the "institutional" environment that regulates the labor market. These competing explanations of the great U-turn are important because they forecast very different patterns of development in the 1990s and call for very different public policy responses.

THE BUSINESS CYCLE HYPOTHESIS

The essential point underlying the business cycle hypothesis is that the alleged secular trends in wages and wage shares reflect nothing more than cyclical phenomena having to do with normal expansions and contractions in the economy. Janet L. Norwood, the commissioner of the Bureau of Labor Statistics, was most explicit on this point in her critique of the original JEC study. She wrote:

> Most of the studies done thus far . . . have attempted to find a long-term trend in the size of different wage groups. Our work at the Bureau of Labor Statistics suggests, however, that there is *a strong cyclical pattern that overwhelms any long-term trend.* (emphasis added)
>
> The lack of progress [toward reducing low-wage employment] reflects the impact of the 1981 to 1982 recession rather than a general inability of our economy to generate good jobs. We have nearly five years of earnings data for the recovery after the end of the 1973 to 1975 recession, but only three years (1983 to 1985) of data during the current recovery. Clearly we need more years of recovery to improve the situation.[7]

According to this view, as the recovery continues, wages should rise as a consequence of ever-tightening labor markets. Firms bidding for labor will eventually offer higher wages, resulting in rising average earnings and a decline in the low-wage share of employment. A simple extension of the economic recovery will therefore be sufficient to reverse the recent adverse U-turns.

THE STAGNATION HYPOTHESIS

Closely related to the business cycle thesis is the theory that the decline in real average wages, and perhaps the growth in wage inequality, is due to a secular slowdown in the rate of productivity growth. Researchers at the Brookings Institution have estimated that the growth in labor productivity was 2.4 percent per year between 1950 and 1973. It slipped to an annual growth rate of 0.8 percent between 1973 and 1979, then only slightly recovered to 1.1 percent per year in the period between 1979 and 1986.[8] Even that apparently meager improvement has been called into question. Recent research shows that the techniques used by the U.S. Commerce Department to calculate various economic measures have tended to overestimate productivity growth since the late 1970s.[9] Since the long-term growth rate of real earnings cannot exceed the long-term growth rate in productivity without permanently eroding corporate profits, the slowdown and even decline in real wages is directly due to the slowdown in productivity growth. By implication, any effort that raises productivity should raise wages.

THE DEMOGRAPHIC HYPOTHESIS

By far the most prevalent alternative explanation for the slippage in average real wages and the growth in the low-wage share of employment is based on two demographic trends: the growth in female labor force participation and the coming of work force age of the "baby-boom" generation. According to this hypothesis, the crowding of a large cohort of relatively inexperienced workers into the labor market beginning in the late 1960s temporarily depressed wage levels. The enormous increase in labor supply posed by the combination of baby boomers and a large number of women of all ages entering the labor force at the same time bid wages down for the entire economy and led to greater wage dispersion between younger, inexperienced workers and their older colleagues. When the baby-boom generation gains labor market experience and its successor, the baby bust generation, enters the labor market in smaller numbers, this trend should reverse itself as normal supply and demand come into equilibrium. Thus, in like manner to the business cycle proponents, the demographic theorists see the U-turn as a temporary phenomenon, presumably soon to be reversed.

"DEINDUSTRIALIZATION" HYPOTHESIS

Counterposed to the business cycle and demographic hypotheses is the "deindustrialization" theory. Its premise is that the observed U-turns in real wages and wage dispersion can best be explained by the shift in the economy from manufacturing to services and the evolution of corporate strategies intended to boost profits by slashing labor costs throughout the economy. Accordingly, the displacement of workers from the manufacturing sector and the restructuring of the wage bargain within industry has resulted in the destruction of a disproportionate number of higher wage jobs. In their place, the service and retail trade sectors of the economy have generated millions of new jobs, but these tend to be associated with a polarized earnings distribution with more low-wage employment being created than high-wage positions. Moreover, the "outsourcing" of more and more manufacturing jobs from larger firms to smaller suppliers effectively shifts work from high-wage, low-inequality companies to production sites typically, although not invariably, characterized by lower average wages and greater inequality. Unless there is a renaissance in manufacturing employment and an improvement in the wages offered by smaller subcontractors or substantial upgrading of jobs in the service and trade economy, the deindustrialization hypothesis predicts that the stagnation in real wages, growth in the low-wage share, and polarization of the entire earnings distribution will continue—*regardless* of expected demographic trends and the state of the business cycle.

THE INSTITUTIONAL HYPOTHESES

Finally, there are a host of specific hypotheses about the effect of changes in labor market institutions—primarily, the decline in unionization and the falling valve of the statutory minimum wage—on wage stagnation and earnings inequality. In particular, several researchers at the National Bureau of Economic Research (NBER) have argued that growing wage differentials between less-educated and less-skilled workers on the one hand and more-educated and more-skilled workers on the other can be explained by the fact that trade unions and the minimum wage traditionally boosted the wages of the less-educated and less-skilled work force relative to those not unionized and those who are paid well above the statutory minimum.[10] With the recent decline in union strength and the erosion of the real value of the minimum wage, these institutional structures no longer enhance wages for many workers in the less-skilled end of the labor market, contributing to the polarization of earnings.

Testing the Alternative Hypotheses

In the current debate over the causes of the U-turns in labor market developments, there is no single conclusive test of these hypotheses. For the most part, various investigators have attempted to assess the significance of one or another of them. Although these studies have not provided a definitive answer to the origin of the labor market U-turns, they have served to shed additional light on the relative merit of each theory.

The preponderance of evidence from statistical tests provides little support for the business cycle theory. Our own tests are reported in chapter 5. New research at the Brookings Institution, more technically rigorous than our own, comes to precisely the same conclusion for the period between 1967 and 1987.[11] What makes the evidence even more convincing is the test of time. Despite the continued economic recovery that began in 1983 and despite an unemployment rate half that of the peak jobless rate during the 1981–82 recession, average real wages continue to stagnate and wage inequality continues to grow. Recent history is consequently the best refutation of the business cycle argument.

Similarly, tests of the baby-boom hypothesis have yielded little support for this theory. Once again, our own empirical research has been supplemented by that of other researchers. The same Brookings study finds that inequality has grown since 1967 in every age category for males while remaining essentially unchanged for women, suggesting that "generational crowding by itself cannot provide a complete explanation of growing inequality among men, for the trend is apparent even in the oldest age groups where no effect would be anticipated." We think that inequality *is* growing among women as well as among men, but that its effects have been largely offset by the increasing average wage of women as a group.

Inspection of the actual data on the age composition of the work force suggests an additional reason why these results are not surprising. Again, for this hypothesis to hold, the timing of the trends would have to be different. By the early 1980s, the baby-boom generation was already fully integrated into the prime age work force. The young, inexperienced cohort of the 1980s is not a baby-boom cohort, but rather a baby-bust generation. The proportion of the work force under the age of twenty-five today is lower than before the baby boomers came on the scene. The baby boomers are approaching middle age with all of the labor market experience and skill that this implies. Yet, despite the sharp decline in the labor supply of young, inexperienced workers and the growing experience of the baby boomers, average real wages, wage inequality, and the low-wage share have continued to grow right through the mid- and late 1980s. If the demographic hypothesis was correct, the labor force experience of the baby boomers should by now have paid off in rising real average wages and a falling low-wage share. It has not.

The effect of higher female labor force participation on labor market outcomes has more evidence in its favor. There seems to be little doubt from new statistical analyses of real wage trends that the rise in women's labor force participation has kept their average wages from increasing even faster than they actually did. The fact that women earn on average only 65 percent as much as men—in part because of pervasive gender discrimination in hiring, promotion, and pay—suggests that mathematically an increase in the female share of the work force will inevitably lead to a decline in the overall average wage even if men's and women's earnings are rising individually.

It must be added, however, that the gender factor can explain only part of the trend in average wages and the low-wage share because of the timing of these trends. The low-wage share declined from 1963 to 1973 although the female share of the labor force was growing rapidly. In the following period, 1973 through 1979, the low-wage share stabilized despite the fact that female labor force participation continued to increase. Only after 1979 did the low-wage share increase, but ironically this was during a time in which the annual rise in the female share of total employment was beginning to slow. The slower growth in the female work force should have signaled a return to rising average wages and a declining low-wage share, but it has not.

In contrast to the business cycle and demographic hypotheses, there is now even stronger evidence for the stagnation and deindustrialization hypothesis than we first adduced. This is particularly true in terms of the close agreement between patterns of productivity growth and the trend in real weekly earnings. The high rate of productivity growth during the period ending in 1973 corresponds to the rapid growth in real weekly earnings up to that time. Similarly, the slowdown in productivity advance after 1973 corresponds to the decline in real wages, while the small resurgence in productivity in the 1980s corresponds to a slight slowing down in the rate of wage decline.

As for the deindustrialization hypothesis, there is also new empirical evidence beyond that reported in chapter 5. Inspection of data on the level of wage inequality *within* industries reveals two phenomena. One is that the goods-producing industries (mining, construction, and durable and nondurable manufacturing) have traditionally had more equal wages than the service industries. The second is that wage inequality is rising significantly faster in the service sector. Wage inequality actually declined in mining and durable manufacturing during the 1980s and rose only modestly in construction and nondurable manufacturing. In contrast, every one of the service sector industries—transportation, communications, and utilities; wholesale and retail trade; finance, insurance, and real estate; business and repair services; entertainment and recreation services; and professional services—had larger percentage increases in their wage dispersions