Increasing Inequality in the United States

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A Sad Status Quo

The United States economy has grown at a reasonably healthy pace over the last quarter century, with GDP growth averaging 3.1 percent annually from 1980 to 2005. However, the benefits of this growth have gone overwhelmingly to the richest 10 percent of families, and among this group, disproportionately to the richest 1 percent. Most households have had very modest gains in income over this period, and the gains they did experience have been largely the result of the growth in two-earner households.

The growth of inequality in the United States is widely acknowledged in policy debates. While there is little dispute about the general pattern of rising inequality, there is considerable debate about the cause. While some policy analysts argue that rising inequality in the United States is an outgrowth of globalization and technology, a strong argument can be made that the driving force has been a series of deliberate policy choices. This article describes some of the key policies that have fostered an upward redistribution of income over the last quarter century.

US Trade and Immigration Policy – a Major Cause of Inequality?

Perhaps the most basic fact about globalization is that there is vast supply of workers in the developing world who are prepared to work at much lower wages than their counterparts in the developed countries. Trade policies that open up segments of the U.S. labor force to increased competition from workers in the developing world will lower the wages for the workers affected. At the same time, such trade openings will offer gains to the larger economy, since the goods and services produced by these workers consequently will fall in price.

In the United States, trade and immigration policy has been quite explicitly focused on placing less educated workers that do not have a college degree in competition with workers in the developing world, while leaving the most highly educated workers such as doctors, lawyers, accountants and economists largely protected. This has been done, first and foremost, by making it as easy as possible for companies to establish manufacturing operations in developing countries and ship their output back to the United States. Recent trade agreements have been focused on establishing an institutional structure that protects corporations against expropriations or restrictions on repatriating profits by developing country governments, while also prohibiting tariff and non-tariff barriers that could exclude manufactured goods from the United States. The effect of such agreements is to place U.S. manufacturing workers in direct competition with their counterparts in the developing world.

U.S. immigration policy has also placed downward pressure on the wages of less educated workers by allowing immigrant workers in many less-skilled jobs such as custodians, restaurant workers, and construction to work in the United States in violation of the law. Although it is illegal, over the last quarter century, employers have knowingly hired millions of immigrant workers, who lack legal authorization to work, for these jobs.

It is important to realize that the United States does not have an “open border” immigration policy. The relatively unskilled workers who work in violation of the law risk deportation any time they encounter a law enforcement officer – for example, if they are stopped for a traffic violation. Similarly, these workers often risk dangerous border crossing to get into the United States. Relatively unskilled workers in Mexico and other developing countries may be willing to take such risks because the wages offered at even low paying jobs in the United States are so much higher than what they could earn in their native country. Doctors, lawyers, and other professionals in developing countries would not take the same risks, even though they can earn much more in the United States, because they would be sacrificing a relatively comfortable existence in their home country.

If U.S. trade negotiators had a different agenda, they could have constructed trade agreements to place highly educated workers in the United States in competition with their counterparts in the developing world. This could have been accomplished by setting transparent professional and licensing requirements for medicine, law, and other highly paid professions and removing all the legal obstacles that make it difficult for hospitals, universities, and other employers to hire non-citizens. To eliminate concerns about a “brain drain” from developing countries, it would be a simple matter to impose a modest tax on the earnings of foreign-born professionals. This tax would reimburse developing countries for their educational expenses, and could allow them to educate two or three professionals for every one that came to the United States.

A policy that focused on subjecting highly paid professionals to international competition would have allowed for large economic gains in the form of lower prices for health care, college education, and many other goods and services in which the wages of highly paid professionals are a sizable portion of the total cost. This sort of trade and immigration policy also would lead to more equality, rather than inequality.

Anti-Inflation in Favor of Social Policies

A second important cause of rising inequality is the policy and strategy of the Federal Reserve Board, the central bank for the United States. The Federal Reserve Board, or Fed has the responsibility for both sustaining high levels of employment and keeping inflation under control, but in the last quarter century, it has focused much more on combating inflation that it had earlier in the post-war era. This policy relies on keeping unemployment high enough to prevent inflation from rising above the rates it views as acceptable.[2] When the Fed raises interest rates to slow the economy, the people who lose their jobs are disproportionately those at the middle and bottom of the wage distribution. A recent analysis found a strong link between low unemployment and real wage growth for workers in the bottom half of the wage distribution.[3]

In effect, this means that less-educated workers are being called upon to sacrifice by facing higher unemployment rates, and also earning lower wages, in order to keep the inflation rate under control. In prior decades, the government had tried to maintain some equality of sacrifice through wage-price guidelines. As the OECD has recently documented in its new Jobs Strategy, many European countries still effectively use centralized wage bargaining as a mechanism to control inflation without resorting to high levels of unemployment.

Anti-Unionism in the United States

A third important force placing downward pressure on the wages of large segments of the work force has been the anti-union policies that were put in place in the last quarter century. Partly as a result of these policies, the share of the private sector work force that is unionized fell from more than 20 percent in 1980 to less than 8 percent in 2005. Furthermore, the unions that continue to exist have far less power due to a change in tactics by employers.

In the eighties it became a common practice for employers to fire workers who are involved in union organizing drives. While it is illegal for an employer to fire a worker for their union activity, it is difficult to prove an employers' motivation. Furthermore, the penalties for being found guilty of violating this law are sufficiently trivial that employers risk these penalties in exchange for keeping a union out of their workplace. The ability of employers to fire the leaders of organizing drives has made it extremely difficult for unions to organize new workplaces.

Unions have tried to counter this practice by using outside pressure from various sources – churches, community groups, political figures – to force corporations to recognize unions where the majority of the workers want one. They have also tried to use the bargaining process in sectors of a company where they are organized to force management's neutrality in sectors that they are trying to organize. For example, the Communication Workers have used their bargaining in the traditional sector of the phone industry to force some of the major communications companies to be neutral toward organizing drives in their Internet and mobile phone divisions. However, the tilt toward management in the enforcement of labor laws over the last quarter century has been a major impediment to organizing.

The other major change in labor-management relations during this period has been the practice of hiring replacement workers to take the jobs of workers on strike. This was an extremely rare practice prior to 1980. The turning point came in 1981, when President Reagan brought in military air traffic controllers to replace the civilian air traffic controllers who were out on strike. Most of the striking controllers permanently lost their jobs. Shortly after this strike, there were several highly visible private sector labor disputes in which employers hired permanent replacements for striking workers. This practice made strikes a far less effective weapon against management. As a result, the ability of unions to secure wage gains for their members was further diminished.

The Costs of Health: Sky-High and ever Increasing

A fourth major area of public policy that has led to rising inequality has been the failure to contain the growth of health care costs. While rising health care costs have posed problems in all developed countries, no country has experienced a health care cost explosion comparable to that experienced in the United States. Health care costs rose from 8.8 percent of GDP in 1980 to 15.3 percent of GDP in 2005, in spite of the country's relatively young demographic structure. Health care costs are projected to rise by another 4 percentage points of GDP over the next decade.

Germany and other wealthy countries have been far more effective in keeping their costs under control. One reason that costs in the United States are so high is that it does not have universal health coverage, but rather relies on private insurers to provide coverage for most of the non-elderly population. The insurers have proved largely ineffective in containing costs and incur enormous administrative expenses, with their administrative costs average of 20 percent of the benefits they pay out. Insurers are most profitable when they can find ways to avoid paying benefits to people who are sick and when they can avoid insuring sick people altogether.

Since per person health care costs are largely the same across income groups which means that health insurance costs the same for a high wage worker and a low wage worker, the rise in health care costs imposed a much larger burden on low and moderate wage earners than it did on high wage earners. If health care costs continue to rise as projected, increases in health care costs are likely to absorb whatever real wage gains that workers at the middle and bottom of the wage distribution are able to earn.

There are other policies that have played a role in the rise of inequality over the last quarter century. For workers near the bottom of the wage distribution, the decline in the real value of the minimum wage has been an especially important factor.[4] The real value of the minimum wage was 30 percent lower in 2005 than it had been in 1980, even though average productivity had risen by more than 70 percent.

Together these policies have led to an economic structure in which the bulk of the gains from economic growth go to those at the top, and disproportionately to those at the very top of the income distribution. Until recently such policies could be justified by the relatively low unemployment rate in the United States, but even this rationale appears to be disappearing. The most recent data from the OECD show the employment to population ratio for prime age workers between 25 and 54 years of age in the EU-15 is almost identical to the ratio in the United States. And, the EU-15 has actually generated jobs at a more rapid pace than the United States since 2000.

Prospects for Change

While the leadership of both major political parties have gone along with many of the policies described above, it is clear that there will be more opportunity for change if the Democrats were to come back into power. In some areas the differences are quite clear. For example, the Democratic Party will be much more supportive of union organizing drives and will look for ways that the government can accommodate unionization efforts instead of actively trying to thwart them. The Democrats would also have more of a commitment toward extending health care coverage. While there is no consensus within the party on how this can best be accomplished, increasing coverage is accepted as an important goal for public policy. The Democratic Party is also committed to raising the minimum wage, which will provide a substantial benefit for those at the very bottom of the wage ladder.

Reversing the trend toward rising inequality over the last quarter century will not be done easily and quickly. However, removing the Republicans from power is likely to be an important first step in this process.

Notes

1. Dean Baker is the co-director of the Center for Economic and Policy Research in Washington, D.C. He is the author of *The History of the United States Since 1980*, New York: Cambridge University Press, forthcoming 2007.

2. The basic policy view that guides the Fed is the doctrine of the "non-accelerating rate inflation rate of unemployment" or NAIRU, which was first laid out in a number of articles by Robert Gordon (e.g. "Inflation, Flexible Exchange Rates, and the Natural Rate of Unemployment," in M. Bailey, ed., *Workers, Jobs, and Inflation*, Washington, D.C.: the Brookings Institution).

3. Bernstein, J. and Baker, D., 2004. *The Benefits of Full Employment*, Washington, D.C.: Economic Policy Institute.

4. Hegewisch, A., "The Minimum-wage in the United States of America," *Focus America*, Nr. 1, 2006: Friedrich Ebert Foundation.

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