
The State of Working America 2006/2007

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Forthcoming from ILR Press,
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To my bride-to-be, Ellen Brown.

- LAWRENCE MISHEL

To my children, Ellie, Kate, and Sarah.

- JARED BERNSTEIN

To Susan M. Borrello, my wonderfully wacky sister
and a dedicated elementary school teacher for over 20 years.

- SYLVIA ALLEGRETTO

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The Economic Policy Institute's Web sites contain current analysis of issues addressed in this book. The DataZone section presents up-to-date historical data series on incomes, wages, employment, poverty, and other topics. It also includes graphic image files of every figure and table in this volume. The data can be viewed online or downloaded as spreadsheets.

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

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Executive Summary

Introduction: Life and times in the new economy

Starting in 1995, a new and important change occurred in the U.S. economy: productivity—the output of goods and services per hour worked—began to grow more quickly. After growing 1.4% per year since the mid-1970s, productivity accelerated to 2.5% a year from 1995 to 2000, and then jumped to 3.1% a year from 2000 to 2005. The post-1995 shift in productivity growth, partly attributed to the diffusion and more efficient use of information technology, has sometimes been labeled the “new economy.” Because productivity growth provides the basis for rising living standards for everyone, its acceleration is an unequivocally positive development for the economy.

Yet, despite this unequivocally beneficial development, many Americans report dissatisfaction with where the economy seems to be headed, and many worry about their own and their children’s well-being. These concerns have led some policy makers and economists to ask: why aren’t people happier about the economy? The question seems reasonable to those who follow the top-line numbers of the economy, such as the growth of the total economy (e.g., gross domestic product), the stock market, or corporate profits. The question is easily answered, however, for those who follow and report on the data that fill the chapters in this book.

Our findings show that while faster productivity growth creates the potential for widely shared prosperity, if that potential is to be realized, a number of other factors have to be in place. Those factors include labor market institutions (such as strong collective bargaining), an appropriate minimum wage, and, importantly, a truly tight labor market, all of which are necessary to ensure that the benefits of growth reach everyone, not just those at the top of the wealth scale.

When these institutions are weakened or absent, growth is likely to bypass the majority of working families. The chapters that follow elaborate this story in greater detail by

examining trends in incomes, mobility, wages, jobs, wealth, and poverty, and by placing recent developments in their historical, regional, and international context.

Family income: “New economy” drives a wedge between productivity and living standards

A family’s income is, of course, one of the most important determinants of their economic well-being. Most working families depend on their income to meet their immediate consumption needs (like food and gas), to finance longer-term investments in goods and services (like housing and education), and to build their savings.

Many families face two separate but related challenges regarding the growth of their real incomes: (1) post-2000 wage stagnation, especially among middle- and lower-income families, and (2) the gap between income and productivity growth. Despite the fact that the most recent economic expansion began in late 2001, the real income of the median family fell each year through 2004, the most recent available data. Between 2000 and 2004, real median family income fell by 3%, or about \$1,600 in 2004 dollars.

The post-2000 income trends stand in stark contrast to the extent and pattern of family income growth in the latter 1990s. Then, during a period of uniquely tight job markets, full employment conditions compelled employers to more broadly share the benefits of accelerated productivity growth. Between 1995 and 2000, output per hour grew 2.5% per year, while real median family income grew 2.2% annually. Importantly, the income growth of less-advantaged groups proved to benefit the most from the availability of more and better jobs fostered by the tight labor market. Real median income was up 2.9% per year for African Americans, 4.6% for Hispanic families, 2.3% for young families (family head: 25-34 years old), and 3.1% for single-mother families.

The post-2000 reversal of these favorable trends was a function of diminished employment opportunities, not just during the recession, as we would expect, but over the protracted jobless recovery that followed. This decline in median income during the initial years of expansions appears to be more the norm than the exception in recent recoveries. Over both the 1980s and 1990s recovery, it took seven years for median family income to regain its peak, far longer than in earlier cycles.

In fact, when it comes to income growth over the past generation, the extent of a family’s prosperity is largely the result of their placement in the income scale, with the richest families experiencing the fastest income growth. Between 1979 and 2000, for example, the real income of households in the lowest fifth grew 6.1%; the middle fifth was up 12.3%; the top fifth grew 70%; and the average income of those in the top 1% grew by 184%.

Higher inequality shows up whether we look at consumption or income. Although inequality is not driven by tax changes, lowering the tax burden on the wealthy has demonstrably exacerbated the problem.

Greater inequality has also been generated by an expansion of capital income and an increased concentration of capital income among the very highest income families. Whereas the top 1% received 37.8% of all capital income in 1979, their share rose to 49.1% by 2000 and rose further to 57.5% in 2003 (most recent data). This shift toward greater concentration of capital income reflects an increase in the share of income flowing to cor-

porate profits and that profit rates in 2005 are the highest in 36 years (excepting 1997). If the pre-tax return to capital (i.e., profit rate) in 2005 had remained at its 1979 level, then hourly compensation would have been 5.0% higher in the corporate sector, equivalent to an annual transfer of \$235 billion dollars from labor to capital (measured for 2005).

One way that middle-income families have kept their incomes rising over the past few decades has been for women in general and wives in particular to enter the paid labor market. Among married-couple families with children, for example, middle-income wives added over 500 hours of work to total family work hours between 1979 and 2000. While this has been a positive force for women's economic independence, it has also put a strain on the need to balance work and family.

Income-class mobility: How much is there?

Another important dimension of income and living standards involves income-class mobility. How much progress do families typically make in terms of income growth over their lifetimes? To what extent are children's economic fates determined by the income position of their parents? And is there more or less such mobility in the United States versus other advanced economies?

In fact, we find significant income correlations between parents and their children, implying that income-class mobility is at least partially restricted by a parent's position in the income scale. For example, one recent study finds the correlation between parents and children to be 0.6. One way to view the significance of this finding is to note that it implies that it would take a poor family of four with two children approximately nine to 10 generations—over 200 years—to achieve the income of the typical middle-income four-person family. Were that correlation only half that size—meaning income differences were half as persistent across generations—it would take four to five generations for the poor family to catch up.

In a similar vein, we find that sons of low-earning fathers have slightly less than a 60% chance of reaching above the 20th percentile by adulthood, about a 20% chance of surpassing the median, and a very slight chance—4.5%—of ending up above the 80th percentile.

In other words, the extent of income mobility across generations plays a significant role in the living standards of American families. It is, for example, a key determinant of how many generations a family will be stuck at the low end of the income scale, or snugly ensconced at the high end.

Our folklore often emphasizes the rags-to-riches, Horatio-Alger-like stories that suggest that anyone with the gumption and smarts to prevail can lift themselves up by their bootstraps and transverse the income scale in a single generation. The reality in the United States, however, shows much less mobility than such stories suggest. Surprisingly, international comparisons reveal less mobility in America than other countries with comparably advanced economies. For example, one study reveals the intergenerational income correlations in Finland, Sweden, and Germany to be 0.22, 0.28, and 0.34, respectively, compared to the U.S. correlation of 0.43. Note that these are countries that U.S. economists often criticize for their extensive social protections—each one has universal health coverage, for example—yet their citizens experience greater mobility than do our own.

Another important dimension of the mobility story is the question of how it has evolved over time. One reason this is so important relates back to our findings regarding income inequality. The growth of inequality between two time periods, say between the late 1970s and today, is of less concern if mobility is up, thus offsetting the greater distances between income classes. The evidence reveals, however, that mobility is either flat or diminished over the very period when inequality has been on the rise. For example, one study shows that the intergenerational correlation between fathers' and sons' income has grown from 0.32 to 0.58 (higher correlations imply less mobility). Another study shows that the share of families remaining in the top fifth of the income scale went from 49% in the 1970s to 53% in the 1990s.

What explains the lack of mobility here in the United States? Certainly unequal education opportunities and historical discrimination play a role. As such, opportunities for advancement are limited for those with fewer economic resources. For example, we show that children from wealthy families have much greater access to top-tier universities than kids from low-income families, even once innate skills are taken into account. We also find wealth concentration to be correlated across generations, and this creates another impediment to the upward mobility of the economy's "have-nots." For instance, about two-thirds of children whose parents were in the lowest fifth of the wealth scale ended up in the bottom 40% as adults.

Wages: Growth stalls while productivity and compensation diverge

The major development in the labor market in recent years has been the stunning disconnect between the rapid productivity growth and pay growth, especially given the rapidity of productivity's growth and the how stunted pay growth has been in the past several years.

Also of great concern is the tremendous widening of the wage gap between those at the top of the wage scale, particularly corporate chief executive officers, and other wage earners. The importance of these two developments cannot be overstated because wages and salaries make up about three-fourths of total family income, and as such, are the primary driving force behind income growth and income inequality. Over the 1995-2005 period, productivity grew a remarkable 33.4%, and over half of that growth has occurred since 2001. This pace of productivity growth far exceeded that of the earlier period from 1973 to 1995. However, despite enormous growth in productivity, wages for the typical worker and for those with either a high school or a college degree were about the same in 2005 as in 2001.

By comparison, pay did rise in the earlier period from 1996 to 2001, fueled by the higher productivity and the progressive drop in unemployment to 4.0% by 2000. Moreover, the wage momentum carried forward through 2001 and into 2002, despite rising unemployment. The wage momentum from the late 1990s is important to understand when looking at trends over the 2000-05 period—all of the wage growth from the 2000-05 period occurred within the first two years. The poor job creation and increased job shortages during the early 2000s recession and its lackluster recovery eventually knocked wage growth down so that prices rose at least as fast. This was the case even in 2005, when the unemployment rate fell to 5.1%.

In short, historically high productivity growth and historically low unemployment have benefited compensation and wages very little. While productivity grew 33.4% between 1995 and 2005, benefits (health and pension) grew less than half that much and wages for typical workers grew one-third as much as productivity. After 2001, there has been basically no wage improvement for typical workers regardless of significant gains in productivity.

Digging a little deeper into these trends, we find that women are much more likely to earn low wages than men. In 2005, 29.4% of women earned poverty-level wages or less, significantly more than the share of men (19.9%). Women are also much less likely to earn very high wages. In 2005 only 10.1% of women, but 17.6% of men, earned at least three times the poverty-level wage. The proportion of minority workers earning low wages is substantial—33.3% of black workers and 39.3% of Hispanic workers in 2005. Minority women are even more likely to be low earners—37.1% of black women and 45.7% of Hispanic women in 2005.

The trend in the share of workers earning poverty-level wages corresponds to the patterns previously described: momentum in reducing poverty-level work began in the late 1990s, continued until 2002, then dissipated. So, although the share of workers earning poverty-level wages actually fell from 25.1% to 24.5% in the 2000-05 period, this progress came in the first two years of that period and then partially reversed. Among blacks the increase in low-wage work after 2002 was large enough to reverse the progress from 2000 to 2002.

A historical look at wage inequality shows that it has worsened considerably over the past three decades. The deterioration in real wages from 1979 to 1995 was both broad and uneven. Wages were stagnant or fell for the bottom 60% of wage earners over the 1979-95 period and grew modestly for higher-wage workers—over 16 years the growth was just 5.0% at the 80th percentile and 10.9% to 13.9% at the 90th and 95th percentiles, respectively.

More recently, the importance of the late 1990s full-employment labor markets that provided across the board wage increases is in contrast to the most recent 2000-05 period. Starting in the early 1990s low-wage workers experienced either more or comparable wage growth to that of middle-wage workers, so that the expanding wage gap between the middle and bottom lessened and then stabilized. Tight labor markets along with increases in the minimum wage in the early and late 1990s combined with the drop in unemployment in the late 1990s can explain this trend.

There are three key elements of wage inequality. One is the gap at the “bottom,” meaning the difference between median-wage and low-wage workers. Another measure of wage inequality takes into account the “top half” gap, that is, between high-wage (90th or 95th percentile wage earners) and middle-wage earners. The third element is the gap at the very top, i.e., the growth of wages for those in the upper 1%, including chief executive officers (CEOs). These three elements have had differing historical trajectories. The gap at the bottom grew in the 1980s but has been stable or declining ever since, whereas the “top half” wage gap has persistently grown since the late 1970s. The very highest earners have done considerably better than other workers for at least 30 years, but they have done extraordinarily well over the last 10 years.

Explaining these shifts in wage inequality requires attention to several factors that affect low-, middle-, and high-wage workers differently. The experience of the late 1990s is a reminder 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 again in recent years has disempowered wage earners and provided the context in which other forces—specifically, a weakening of labor market institutions and an increase in globalization—could drive up wage inequality. Significant shifts in the labor market, such as the severe drop in the minimum wage and de-unionization, can explain one-third of the growth in wage inequality. Similarly, the increasing globalization of the economy—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: high unemployment in the early 1980s greatly increased wage inequality, the low unemployment of the late 1990s reduced it, and high unemployment in recent years has renewed it.

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 percentile 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 at the bottom among women has resumed its growth. This reversal is partially the effect of the jobless recovery and the still-remaining shortage of jobs and partially a result of 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 this 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 half—the 90/50 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.

The erosion of the extent and quality of employer-provided benefits, most notably pensions and health insurance, is an important aspect of the deterioration in job quality for many workers. Employer-provided health care coverage eroded from 1979 until 1993-94, when it stabilized, and then began falling again after 2000 through 2004 (the latest data). In fact, coverage dropped from 69.0% in 1979 to 55.9% in 2004, with a 2.9 percentage-point fall just since 2000. Employees have absorbed half the rise in costs for employer-provided health premiums (not counting any of the higher deductibles or co-pays paid by employees) since 1992, even though their share of costs in that year was just 14%. Employer-provided pension coverage tended to rise in the 1990s but receded by 2.8 percentage points from 2000 to 2004 to 45.5%, 5.1 percentage points below the level in 1979. Pension plan quality also receded, as the share of workers in defined-benefit plans fell from 39% in 1980 to just 19% in 2003. Correspondingly, the share of workers with a defined-contribution plan (and no other plan) rose from 8% to 31%.

Young workers' prospects are another good barometer of the strength of the labor market. Wages actually fell for all entry-level workers since 2000, whether high school or college educated, male or female. This contrasts to the extremely strong wage growth for each of these groups from 1995 to 2000, when wages rose roughly 10% for entry-level high school men and women, 20.9% for entry-level college men, and 11.7% for college women.

Unionized workers earn higher wages than comparable non-union workers and also are 18.3% more likely to have health insurance, 22.5% more likely to have pension coverage, and 3.2% more likely to have paid leave. The erosion of unionization (from 43.1% of blue-collar men in 1978 to just 19.2% in 2005) can account for 65% of the 11.1 percentage-point growth of the blue-collar/white-collar wage gap among men over the 1978-2005 period.

The real value of the minimum wage has been steadily falling in real terms, thereby causing the earnings of low-wage workers to seriously fall behind those of other workers and contributing to the rise in wage inequality. Those affected by the lower minimum wage make important contributions to their family's economic well-being. For instance, minimum wage earners contribute 58% of their family's weekly earnings; in 43% of the affected families the minimum wage earner generated all of the family's earnings. Moreover, there are 7.3 million children living in the families that would benefit from a modest minimum wage increase. While minorities are disproportionately represented among minimum wage workers, 60% are white. These workers also tend to be women (59% of the total) and concentrated in the retail and hospitality industries (46% of all minimum wage earners are employed in those industries, compared to just 21% of all workers).

Conversely, the 1980s, 1990s, and 2000s have been prosperous times for top U.S. executives, especially relative to other wage earners. Over the 1992-2005 period the median CEO saw pay rise by 186.2%, while the median worker saw wages rise by just 7.2%. In 1965, U.S. CEOs in major companies earned 24 times more than an average worker; this ratio grew to 300 at the end of the recovery in 2000. The fall in the stock market reduced CEO stock-related pay (e.g., options), but by 2005 CEO pay had recovered to the point where it was 262 times that of the average worker. The lion's share of the gains for the top 1% in the pay scale accrued to the upper 10% of that elite group (i.e., those in the 99.9th percentile). Of the 3.6 percentage-point gain in the share of all earnings that the top 1% experienced between 1989 and 2000, 3.2 of them accrued to very upper tier.

The jobs of the future will require greater education credentials, but not to any great extent. In 2004, the occupational composition of jobs required that 27.7% of the workforce have a college degree or more. This share will rise by just one percentage point, to 28.7%, by 2014, according to BLS projections.

Jobs: Diminished expectations

Strong job creation that fully utilizes the available workers and skills in our workforce is a critical component to a strong, lasting, and equitable recovery. A robust job market is what is needed to ensure that the proceeds of economic growth are broadly shared. By that measure, the current recovery has fallen short. As is well known, this recovery, which began

in late 2001, was a “jobless recovery” well into 2003. That is, real gross domestic product was expanding, but we were losing jobs on net for a year and a half into the expansion (net jobs refer to the number of jobs created minus the number of jobs lost).

Historically, it took just less than two years—21 months—to regain the prior employment peak; in this current cycle, it took almost four years (46 months). Since then, we have consistently added jobs on net, but at a slower rate than in past recoveries. As of this writing the current cycle is five years old and employment is up 1.9% since the last cyclical peak. Comparatively, employment growth for the five year period of the 1990s cycle was 7.1% and the historical average for cycles of this length was 10%.

This record of historically weak job creation is costly for the economy and for workers. Lackluster job creation is partially responsible for the ongoing disjuncture between overall economic growth and the wages and incomes of working families, as shown in earlier chapters. The resulting lower rates of employment and lack of wage pressures translate into lost output and forgone increases in living standards.

Depressed employment rates are usually a sign of weak labor demand. Since the 2001 peak, employment rates are down 1.4 percentage points for men and 1.3 percentage points for women. However, there have been debates as to whether employment rate declines have been a cyclical response to weak demand or if they represented a structural change. Since young college graduates are a group with high attachment to the job market, they make a good test case for whether the low employment rates are related to weak demand as opposed to a voluntary decline in employment (i.e., cyclical vs. structural).

The employment rate of young college graduates fell 3.5 percentage points from 2001 to mid-2003—in step with the recession and jobless recovery. In 2003, when employment started to pick up, this rate also increased significantly. Young college graduates (ages 25 to 35) who had at least a bachelor’s degree, and in some cases, an advanced degree, would have been highly motivated to secure employment. Now that employment rates are rebounding, it seems the cyclical responses may have dominated structural ones.

The unemployment rate is, in a historical sense, relatively low—4.8% as of this writing. Unemployment rates that prevailed during the expansion of the late 1990s into 2000—when the annual unemployment rate was 4.0%—were considerably lower. For most of the current recovery, the relatively low unemployment rates have not been particularly good indicators of the actual slack that existed throughout the labor market, particularly in the first several years.

Persistent long-term unemployment has been another problem over this cycle. Shares of those unemployed 27 weeks or longer, as a share of total unemployment, were unusually high, especially given the relatively low unemployment rates that prevailed throughout the 2001 recession and recovery. As of this writing, the unemployment rate varied over the past year between 4.6 and 5.0%, and the average share of long-term unemployment was 18.4%. By comparison, the historical share of long-termers associated with this range of unemployment was just 10.8%.

It is still the case that those with less education disproportionately bear the brunt of economic downturns, but it is also the case that higher levels of education no longer provide the same protection against cyclical forces as in prior downturns. This was evident with depressed employment rates of young college graduates, and it is also evident in long-term

unemployment woes associated with this latest cycle. The share of educated long-termers increased 2.8 percentage points from 2000 to 2005, while the share decreased by 5.4 percentage points for those with less than a high school degree.

Job growth has been too tepid to boost living standards for most workers—even as the economy expanded and labor productivity had posted some impressive gains over this recovery. Hopefully the economy is poised to generate robust job creation and tight labor markets akin to those in the late 1990s, finally transforming output growth and strong worker productivity into broadly shared prosperity.

Other trends of note regarding jobs:

- There are two struggling industrial sectors: manufacturing employment, which is off 16%, and the information sector, which includes telecommunications, is down 17% from peak employment levels of 2001.
- Blue-collar workers made up 43.4% of long-term unemployment shares in 1989; in 2005 the share was 29.9%. Corresponding white-collar shares went from 31% to 42%.
- “Perma-temping,” that is, the percent of temporary agency workers who have been on the same work assignment for a year or more, increased from 24.4% in 1995 to 33.7% in 2005.
- Employment rates for men and women at least 55 years old have trended upward since the early 1990s, and the trend even continued over the 2001 recession—the only age cohort to do so.

Wealth: Unrelenting disparities

Wealth and its accumulation are very important to a family’s financial stability. Wealth, for example, enables a family to invest in a home, education, and retirement. In the short term, wealth reserves can help a family through difficult times, such as job loss. Wealth accumulation and debt often go hand-in-hand—for example, wealth, as well as, debt is generated by home ownership. The ability of families to accumulate wealth and manage their debts is critical. This chapter dissects the two components that make up wealth or net worth—assets and liabilities.

The distribution of wealth is unequally distributed, more so than wages or incomes. Moreover, wealth has become more concentrated at the top of the distribution over time. In 2004, those in the top 1% of the wealth scale held over one-third of all wealth. The top-fifth controlled 84.7% of all wealth in the United States, while the bottom 80% could claim only 15.3% of the country’s total wealth in 2004. Over the 1962-2004 period, the wealth share held by the bottom 80% shrunk by 3.8 percentage points, and that 3.8% share of wealth shifted to the top 5% of households. Over time wealth inequality has increased—as measured by the ratio of the wealthiest 1% to median wealth. In the early 1960s, the wealthiest Americans held 125 times that of the median wealth holder; in 2004 the wealthiest held 190 times more. As the wealthiest continue to thrive, many households are left behind with little or nothing in the way of assets and often have significant debt. Approximately one in six households had zero or negative net wealth.

Second, the notion that a vast majority of American households are greatly invested in the stock market is erroneous. Less than half of all households hold stock in any form,

including mutual funds and 401(k)-style pension plans. From 2001 to 2004, the share of households holding stock declined—for the first time since 1989—from 51.9% to 48.6%. Moreover, of those households that held stock, just 34.9% had stock holdings of \$5,000 or more.

Furthermore, the ownership of stocks was particularly unequal. In 2004, the top 1% of stockowners held 36.9% of all stocks, by value, while the bottom 80% of stockholders owned less than 10%. Additionally, stocks are a bigger part of the asset portfolio for wealthier households. For those in the top 1% of the wealth distribution, stock assets made up over 21% of their total assets, while stocks consisted of just 4.8% of all assets for households in the middle fifth of the wealth distribution. While stock performance is very important, on a daily basis it does not significantly affect average households.

Another key observation is that household debt has consistently trended upward, and it was over 130% of disposable personal income in 2005. As expected, debt-service burdens continued to plague lower-income families disproportionately and they increased from 2001 to 2004. By 2004, it took about a fifth of income from a middle-income family to service their debt. Approximately one in four low-income households had debt-service obligations that exceeded 40% of their income, as did 13.7% of middle-income households.

The opportunity to start anew through fair and reasonable bankruptcy laws is crucial for those who are faced with insurmountable debt. Personal bankruptcy filings soared at the end of 2005 just before new, stricter laws went into effect. For the year, nine out of every 1,000 adults declared personal bankruptcy. Only time will tell how the new laws will affect the number of bankruptcy filings, and ultimately how families will cope with large debt burdens often caused by the loss of employment, unmanageable medical bills, or divorce.

That wealth differs considerably by race is another primary observation of this analysis. Median wealth of white households is 10 times that of black households. Home ownership rates also vary considerably by race. Less than half of black and Hispanic households own their homes, when 72.7% of white households do. While approximately one-in-six households had zero or negative net wealth, broken down by race the numbers diverge considerably—13.0% of white households compared to 29.4% of black households have zero or negative net wealth.

Other key finding from this chapter include:

- Wealth inequality is greater than income inequality: The top 1%, next 9%, and bottom 90% shares of income were 16.9%, 25.6%, and 57.5%, respectively in 2004. Shares of wealth were 34.3%, 36.9%, and 28.7%, respectively.
- Average wealth held by the top 1% was close to \$15 million, while it was \$81,000 for households in the middle-fifth of the wealth distribution.
- Approximately 30% of households have a net worth of less than \$10,000.
- About half of those in the bottom quarter of the income distribution own their homes, while 88.9% in the top quarter of the income distribution own homes.

Poverty: Rising over the recovery as the job market stalls

We next move to the other end of the wealth spectrum and examine the problem of poverty in America.

One of the most important challenges in discussing poverty in America is definitional. What, precisely, characterizes poverty in the U.S. economy? The government has an official definition, but it is widely considered to be an outdated benchmark (the 2005 threshold for a family of four was \$19,961). The official thresholds have fallen well behind income growth among middle and higher income families, creating a situation wherein the poor are by definition more economically isolated. For example, the poverty line for a family of four was 48% of median family income in 1960; now it is 29%.

That said, trends in poverty are still revealing of changes in the living standards of our most economically vulnerable families. After falling steeply throughout the latter 1990s, poverty rates increased not only in the recessionary year of 2001, but in each year through 2004 (most recent data available), from 11.3% in 2000 to 12.7% in 2004, when 37 million persons, including 13 million children, were in poverty. This is the first time that poverty rose through each of the first three years of a recovery, another indicator of the narrow distribution of growth over this recovery. If we use a threshold of twice poverty, then the increase over the 2000-04 period went from 29.3% to 31.2% (about 91 million persons were below twice poverty in 2004).

Given their lower incomes, poverty rates for minorities are consistently higher than those of whites. The rate for African Americans, for example, was at least three times that of whites through 1989. However, poverty among blacks and Hispanics was much more responsive than for whites to the faster and more broadly distributed income growth during the 1990s, and by 2000 the poverty rate for blacks was the lowest on record, though even then, more than a fifth of blacks were poor (22.5%).

Tight job markets played a critically important role in poverty reduction in the latter 1990s, as overall poverty fell by 2.5 percentage points, with much larger declines for minorities: 6.8 points for blacks and 8.8 points for Hispanics. Yet, even under the best macroeconomic conditions, many poor families will need extra help to escape poverty. In the latter 1990s, for example, the push of welfare reform and the pull of strong labor demand drew many single mothers into the job market. And for many of these women, full employment conditions helped generate significant wage gains in percentage terms. But even hourly wage gains of about a third, from around \$6 to around \$8 dollars an hour, do not provide enough income for these families to meet their basic consumption needs. Fortunately, significant work supports—public benefits tied to work—were added or expanded over the 1990s. In the early 1990s, the highest benefit level under the Earned Income Tax Credit for a family with at least two children rose from about \$1,700 to about \$4,000 in 1995 dollars. The minimum wage was also increased, and more resources were devoted to health and child care subsidies.

The last point is an important one in thinking about the steps policy makers need to take to diminish poverty amid the plenty in the U.S. economy. With both the economy and social policy pushing hard in the same direction, poverty was significantly reduced in the 1990s. The 2000s, by contrast, reveal a different picture. The policy levers from

the earlier period were largely still in place, but the absence of full employment meant that a critical piece of the puzzle was missing, and poverty rose over these years.

International comparisons: How does the United States stack up?

The more market-driven U.S. economic model is often deemed superior to European economic models. The evidence of U.S. supremacy is often made by the singular assertion that the United States is the richest country in the world. While it is true that, in per capita terms, the United States is quite wealthy, a comparative analysis as to how the U.S. economy stacks up to other advanced economies must take into consideration a broader set of criteria.

International comparisons are made between 20 countries all belonging to the Organization for Economic Cooperation and Development (OECD). Comparing the U.S. economy to similar economies facing the same global conditions with respect to trade, investment, technology, and the environment provides an independent yardstick for gauging economic outcomes derived from different economic models. It is important to note that what is commonly referred to as the “European model” is actually many different economic models. Not only is each country unique, but unique occurrences—like the integration of East Germany—need to be taken into account. Many of the countries evaluated here are less market driven and more “interventionist” than the U.S. economic system, and much insight can be drawn from a general comparative analysis.

A main determinant of an economy’s standard of living is its productivity, which can be relatively measured by the amount of gross domestic product (GDP) per hour worked. In terms of GDP per hour worked, in 2004 several European countries caught up to or surpassed U.S. levels of productivity. For example looking at productivity relative to the United States (U.S.=100), five countries are above or equal to U.S. levels—Norway (125), Belgium (113), France (107), Ireland (104), and the Netherlands (100).

The growth rate of productivity is also important, and the United States is currently enjoying an extremely productive economy. In the current cycle (2000-05), U.S. productivity grew at 2.5%, and the United Kingdom came in second at 2.0%. However, as this book’s discussion of family income and wages shows, the workforce responsible for this high level of productivity has not been able to enjoy the fruits of their very productive labor. Simply put, earnings have been stagnant for the majority of workers throughout this cycle.

The United States is one of the richest countries in the world. Per capita income in the U.S. was \$39,728, but, perhaps surprisingly, that posting was second to Norway’s \$42,832. Many other economies have very respectable—all above \$30,000—per capita incomes, such as Ireland, Switzerland, Austria, Canada, Australia, Denmark, Sweden, Netherlands, Finland, Belgium, and the United Kingdom. Many Europeans and Canadians view their social protections as factors that raise their living standards and as such are unmeasured and not captured in income measures. A main reason why per capita incomes in Europe are below U.S. levels is because Europeans, relative to those in the U.S., seem to value leisure over the consumption of more goods.

While the United States is one of the wealthiest countries, it also has the highest degree of inequality of the OECD countries analyzed. The gap between richest and poorest is largest in the United States—whether measured in terms of Gini coefficients or the ratio of high earners (90th percentile) to low earners (10th percentile), the United States’ inequality stands out. Low-income earners in the United States not only earn relatively lower incomes than their OECD counterparts, but they also are worse off because of limited social policy and safety nets. Access to health care is a good example.

The United States spends more on health care (whether measured as a percentage of gross domestic product or per capita spending) than any of these other countries. The United States spent 15% of its GDP on health care in 2003—30% more than the next highest spender (Switzerland at 11.6%). Ireland (7.4%), Austria (7.5%), and Finland (7.5%) spent the lowest percentages of GDP on health care. Even with such high spending, 46 million people in the United States do not have health insurance, and access to health care is much more limited than in the countries of its economic peers. In Canada, Japan, and Europe there is essentially universal health care coverage.

Perhaps surprisingly, the income advantages and high health spending in the United States do not produce better outcomes relative to other developed countries regarding life expectancy, infant mortality, and poverty. The United States has the lowest life expectancy, the highest infant mortality rates, and the highest overall and child poverty rates of all the countries studied. The relatively poor performance of the United States in these categories is symptomatic of the high degree of economic inequality and unequal access to health care in the United States.

Other important insights to come out of this chapter:

- The U.S. unemployment rate in 2004 was above 10 and below nine of the 20 countries examined in this analysis.
- A breakdown in per capita income shows that, while U.S. productivity is an important determinant of relatively higher U.S. incomes, even more significant is that Americans simply work more annual hours.
- European vacation time is mandated, usually four to five weeks worth, while there is no mandated vacation time in the United States.
- U.S. labor costs are not necessarily more prohibitive, as relative U.S. manufacturing labor costs are below that of seven European countries.

Conclusion

America’s working families continue to work hard to make ends meet, improve their living standards, and create better opportunities for their children. New economy or old, this remains the case today much as it was a century ago.

Yet there are clearly aspects of today’s economy that make it historically unique. Some of these tilt against the bargaining power of American workers: increased global trade, less union membership, and more low-skilled and high-skilled immigration. There are fewer favorable social norms that guide employer behavior or support policies that provide adequate safety nets, pensions, and health care arrangements.

Other new forces in play have the potential to lift the living standards of working families in ways hardly seen in this country for 30 years. Most important of these is a new, stronger productivity growth regime and a brief encounter with full employment in the latter 1990s that showed that, once workers' bargaining power gets a boost, the benefits of this regime shift in productivity growth can be broadly shared.

In other words, the biggest challenge in what many have called the new economy is not growth per se, but rather how growth is distributed. Of course, economists and policy makers will be concerned with whether the economy is growing as fast and efficiently as it can, and they might turn to greater investments in public and private capital stock, more research and development, monetary policy that stresses full employment, and the educational upgrading of the workforce.

Yet, if the findings in the hundreds of tables and figures that follow can be reduced to one observation, it would be that, when it comes to an economy that is working for working families, growth in and of itself is a necessary but not a sufficient condition. The growth has to reach the people: the bakers need to benefit from bread they create each day of their working lives.

The benchmarks by which we judge the economy must reflect these distributional concerns, and we must construct policies and institutions to address them. If we do not—if our enhanced productive capacity continues to benefit mostly the wealthiest Americans—we risk sacrificing bedrock principles that have historically defined the American economic experience.



Introduction

Life and times in the new economy

Starting in 1995, a new and important change occurred in the U.S. economy: productivity—the output of goods and services per hour worked—began to grow more quickly. After growing 1.4% per year since the mid-1970s, productivity accelerated to 2.5% a year from 1995 to 2000 and then jumped to 3.3% a year from 2000 to 2005. The post-1995 shift in productivity growth, partly attributed to the diffusion and more efficient use of information technology, has sometimes been labeled the “new economy.” Because productivity growth provides the basis for rising living standards for everyone, its acceleration is an unequivocally positive development for the economy.

In addition, the productivity acceleration has produced ancillary benefits. One key example of such a benefit is the fact that Federal Reserve officials view faster productivity growth as forestalling inflationary pressures, thereby enabling them to pursue more accommodating monetary policy than would otherwise be the case. Research suggests that these dynamics themselves will lead to longer and less volatile business cycles, an obviously positive development.

Yet, despite these clear economic advances, many Americans report dissatisfaction with where the economy seems to be headed, and many worry about their own and their children’s well-being. These concerns have led some policy makers and economists to ask: why aren’t people getting it? Why are people pessimistic when the economy is growing strongly? The question seems reasonable to those who follow the top-line numbers of the economy such as the growth of the total economy (e.g., gross domestic product), the stock market, or corporate profits. The question is a strange and dissonant one, however, for those who follow trends in living standards and pay attention to the distribution of growth, since the answer is so apparent.

The economic recovery that began in November 2001 set a record not for growth but for hosting the longest “jobless recovery” on record (the government began tracking em-

ployment in the 1940s). By 2006, the employment rate (the share of the population at work) was still below its 2000 peak. The weak job market and the lack of policies and institutions that help ensure that growth is broadly shared meant that the living standards of most working families have been stagnant in recent years. In fact, by 2004 (the latest data), the real income of the median or typical family was lower than in 2000, and inflation-adjusted wages, whether for high school or college-educated workers, grew hardly at all since 2000. The number of poor persons grew by 5.4 million between 2000 and 2004, while six million were added to the ranks of the uninsured.

If the nation is indeed wealthier in 2006 than at the peak of the last business cycle in 2000, but many families' incomes are lower and the share in poverty has grown, where is all the money going? This answer is fairly obvious as well: wages, income, and wealth are being drawn to the very top earners and families. This redistribution is a continuation of a historic trend that began in the late 1970s, paused for a few years when the financial bubble burst in 2000, and has most recently returned.

In other words, the economist's mantra that faster productivity growth leads to higher living standards needs updating. Such growth creates the *potential* for widely shared prosperity. For that potential to be realized, a number of other factors—labor market institutions such as strong collective bargaining and a minimum wage with some bite, and, importantly, a truly tight labor market—have to be in place to ensure that the benefits of growth reach everyone, not just those at the top of the wealth scale.

A second key ingredient of the new economy, globalization, also has the *potential* to lift living standards by lowering prices and providing much greater supplies of the products and inputs that help keep the economy humming. But its fingerprints are all over the diminished bargaining clout of blue- and white-collar workers who now compete directly with workers from abroad, many of whom are highly skilled but from low-wage countries.

As these disparate economic forces have interacted, we have seen some of the best and worst of what the new economy has to offer. With the late-1990s boom, the U.S. achieved the first full employment economy in three decades; rising real wages throughout the wage scale; steeply falling poverty rates, especially for the least advantaged; and the narrowing of gaps between most income classes and racial groups (for example, the gap between African American and white median family incomes fell to its lowest level on record).

The 2000s have not been nearly so beneficial. In the absence of the institutional mechanisms that convert overall growth to broadly shared prosperity, and once the recession and jobless recovery did away with the full employment conditions of the latter 1990s, the benefits of productivity growth stopped flowing to the majority of working families.

In this introduction, we highlight current trends as well as some longer-term trends in order to address this fundamental question: to what extent is the economy's growth reaching those largely responsible for its creation, America's working families? The chapters that follow elaborate this story in greater detail by examining trends in incomes, mobility, wages, jobs, wealth, and poverty, and by placing recent developments in their historical, regional, and international context.

Good and bad times in the U.S. economy, 1995-2005

The discussion that follows breaks our usual rule of making historical comparisons at similar points in a business cycle because it is important to examine the unique period that started in the *middle* of the last business cycle. The expansion that began in 1991 and peaked in 2000 includes two distinct periods, one from 1991 to 1995 that had the same sluggish productivity growth that had prevailed since 1973, and one from 1995 to 2000 that was characterized by faster productivity growth. After the recession of 2001 productivity accelerated even further but, unlike in the 1995-2000 period, the high productivity was accompanied by a jobless recovery and then modest employment growth. An interesting question is, how have families fared during the productivity-rich period between 1995 to 2005?

From the perspective of working families, the comparison yields stark and disappointing results. The wage and income growth of middle- and low-income families reversed course sharply, severing the latter-1990s link between productivity growth and living standards. Poverty rose, as did the number of persons without health coverage. Growth in inequality, which slowed markedly following the bust in the capital markets in late 2000, began climbing again by the mid-2000s, as the largest income gains began to accrue to those at the very top of the wealth scale.

Productivity growth and living standards

Table 1 shows the change in a comprehensive set of indicators of living standards between 1995 and 2005 (for some the latest data are 2004). The reversal of fortune between 1995-2000 and 2000-05 is striking.

Productivity grew 13.2% in the second half of the 1990s, and the typical family's income rose at a similar rate of 11.3%. Even more impressive is the fact that the real median income of minority and single-mother families outpaced productivity, a powerful example of who reaps the greatest benefits from a full employment economy.

Productivity rose 4.5% faster in the 2000s, yet income growth has been uniformly negative, with especially large reversals for less-advantaged families. Real median income for African Americans fell by 4.8% in 2000-04, for a swing, or deceleration, of -20.4% between the two periods (meaning their incomes grew about 20% less quickly in the 2000s compared to the latter 1990s). For Hispanic families, the reversal was even larger, from 24.9% to -6.3%. Young families saw a large switch as well.

The number of poor people fell 13.3% from 1995 to 2000, for a decline of 4.8 million people from the poverty rolls, and the number of uninsured fell slightly (-1.9%). These trends reversed in the 2000-04 period, as the number of poor grew by 17.1%, or 5.4 million people, and the number without health coverage grew by 15.1%, adding six million to the ranks of the uninsured.

Net worth per household grew by almost 27% from 1995 to 2000, led by housing wealth and financial asset appreciation. Though homeownership kept growing in the 2000s, financial losses were large, and net worth grew 24.7% more slowly in the 2000s than in the latter 1990s.

The main factors behind the slide in family incomes are slower hourly wage growth and fewer available hours of work in the paid job market. As jobs grew 11.1% more slowly

TABLE 1 Productivity growth and living standards, 1995-2005

	Percent changes		
	1995-2000	2000-04/05	Difference
Productivity growth	13.4%	16.6%	3.2
Median family income*			
All	11.3%	-2.9%	-14.2
African American	15.6	-4.8	-20.4
Hispanic	24.9	-6.3	-31.2
Single-mother families	16.4	-4.4	-20.8
Young families (25-34)	12.3	-5.8	-18.1
Poverty and health insurance (percent change in number poor and insured)*			
Poverty	-13.3%	17.1%	30.4
No health coverage	-1.9	15.1	17.0
Net worth per household	26.9	2.3	-24.7
Job growth	12.4	1.3	-11.1
Median wage	7.7	3.0	-4.7
High school wage	5.8	1.4	-4.4
College wage (bachelor's degree)	11.3	1.3	-10.0
Annual hours worked, individual workers*	2.7	-0.6	-3.3
Annual hours worked, middle-income families*	5.2	-4.3	-9.5
Employer-provided benefits*			
Health insurance**	0.4%	-2.9%	-3.3
Pension coverage**	2.4	-2.8	-5.2

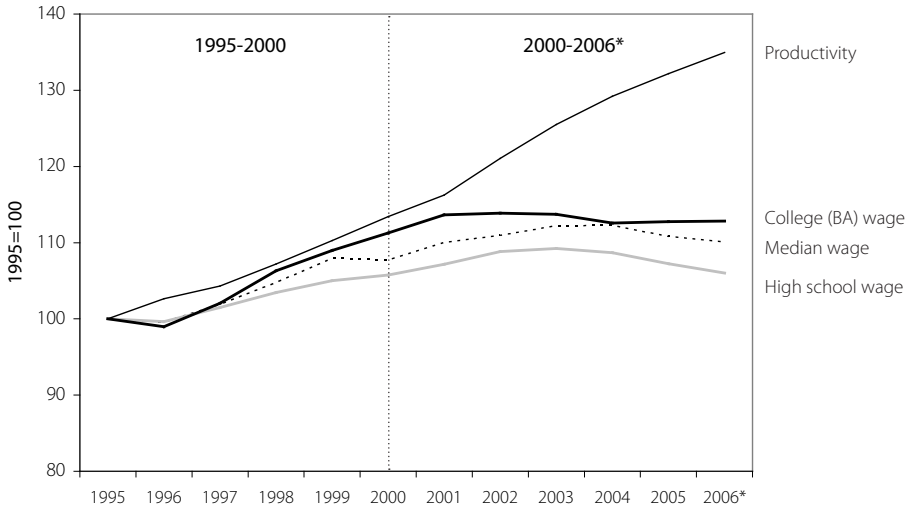
* Data through 2004. All others are 2005.

** Percentage-point changes.

Source: Various tables throughout *The State of Working America*.

in the 2000s, growth in real median hourly wages decelerated as well for both high school and college graduates. The latter experienced a larger reversal: the real hourly wage for persons with a bachelor's degree rose 11.3% in the 1995-2000 period but only 1.3% over the next five years. The 10% deceleration in wage growth is indicative of a job market that was particularly tough for college-educated workers, due in part to the bursting of bubbles in industries like information technology and financial services that use a lot of these workers. The 2000s have also been a period of greater offshoring of white-collar jobs, and this too puts downward pressure on college wages.

Annual hours worked by both individuals and middle-income families (this latter measure sums hours worked across all family members) rose in the late-1990s but fell after 2000. The share of the workforce with employer-provided health and pension coverage

FIGURE A Real wages and productivity growth, 1995-2006

* Wages through first half of 2006; productivity through first quarter of 2006.

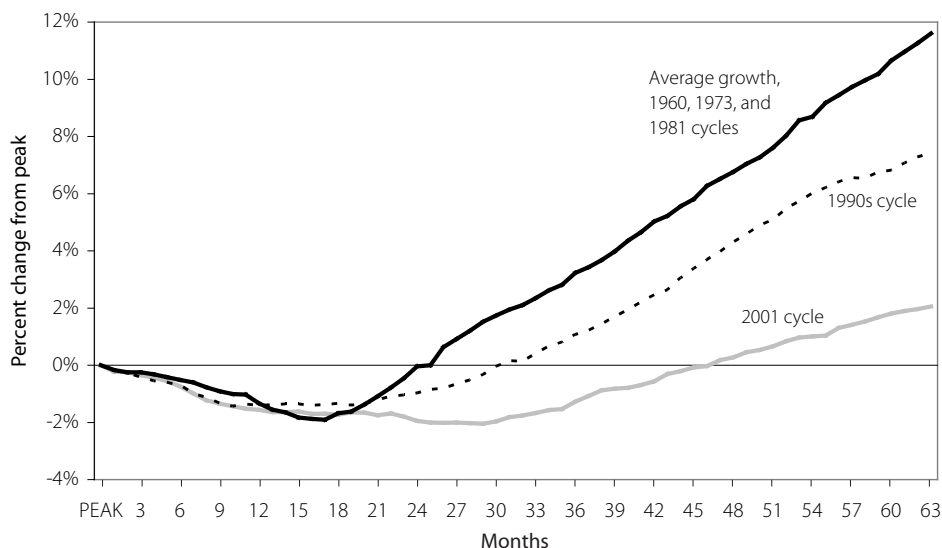
Source: Analysis of data drawn from Tables 3.1, 3.4, 3.17.

also contracted in the 2000s. In addition, as shown in Chapter 3, employers have been shifting more of the cost of these fringe benefits onto workers.

Given the different points in the business cycle that we are comparing—the 1995-2000 period had five years of expansion behind it, whereas the 2000-05 period began with a recession—we would expect wages and incomes to perform less well over the early 2000s relative to the latter 1990s. Yet the reversals shown in the last column of the table are economically large and disconcerting, especially given the significant acceleration in productivity growth. Furthermore, yearly trends of some of the key living standards indicators shown in the table reveal movements that have actually worsened as the 2000s business cycle has progressed.

Figure A plots productivity and real hourly wages for the median, high-school-educated, and college-educated worker from 1995 through the first half of 2006, indexed to 100 in 1995. During the latter 1990s, as the job market moved toward full employment, these values all grew together and helped link real wages to overall growth.

After 2000, even as the recession and jobless recovery occurred, the momentum of the latter 1990s boom fueled continued real wage growth through 2003. Since then, real wages have been flat for college-educated workers and falling for median and high-school-educated workers, leading to a historically large gap between wage and productivity growth. In other words, real wages stopped trending along with the business cycle, which was clearly improving when real wages reversed course. By 2006, the fifth year of

FIGURE B Job growth in the current business cycle compared with previous cycles

Source: Authors' analysis of BLS data.

a uniquely productivity-rich expansion, with solid GDP growth, one would expect to see a different trend in real wages.

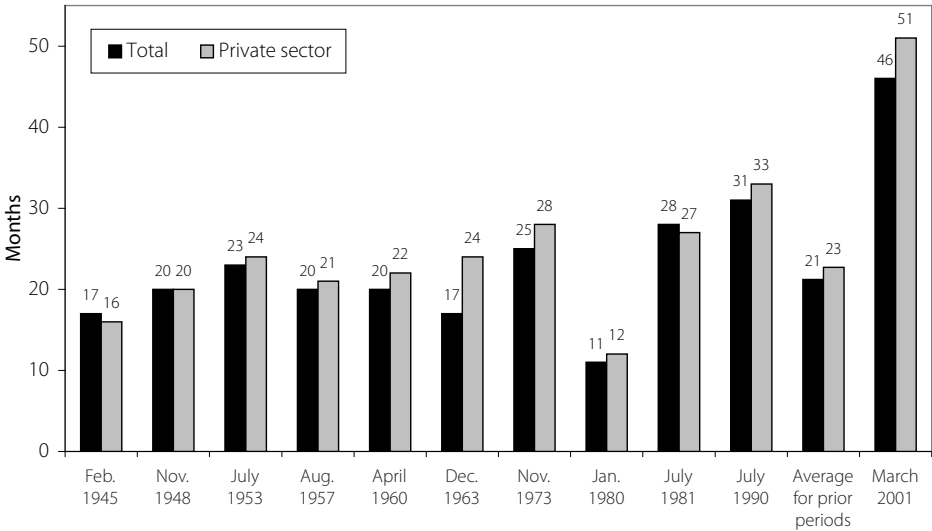
The job market

A tight labor market is an essential element in ensuring that the benefits of growth flow broadly throughout the income scale. Unfortunately, the recession of 2001 and the jobless recovery erased the full employment conditions responsible for the healthy wage growth of the late 1990s. Even by mid-2006 the job market was still failing to generate the number and quality of jobs needed to ameliorate the negative trends that have prevailed thus far in the expansion.

Figure B plots the loss and then growth of jobs over this business cycle compared to the last cycle (the early 1990s) and to the average of the three other previous cycles that lasted at least as long as this one (63 months as of this writing; note that we also performed this analysis including all cycles, and the results were the same). The lines plot the percent change in job growth since the previous business cycle peak.

The unique weakness of the current business cycle in terms of job growth is clear in the figure, even compared to the early 1990s recovery, which was also labeled jobless. By month 63 in the current cycle, employment was up by just 2%, compared to 7% in the 1990s and 12% in the average of the three prior cycles. If this cycle were comparable to the last one at this point, the U.S. economy would have seven million more jobs, or about 100,000 more per month.

FIGURE C Number of months to regain peak-level employment after a recession, current and prior business cycles



Source: Author's analysis of BLS (2006c) data.

To put this monthly number in context, consider that, since net job growth turned positive in mid-2003, we have added about 170,000 jobs per month, on average (leaving out the impact of the Gulf Coast hurricanes, which lowers the average). Over the comparable period in the last recovery, the one that ultimately led to the full employment job market and the commensurate gains in wages, the economy was adding about 250,000 jobs per month. In other words, another 100,000 jobs per month would have put the economy back on a track similar to the last recovery, helping to rid the post-2000 period of the job market slack that has precluded growth from reaching many working families.

Figure C shows a related dimension of the jobs problem. While it took 21 months for payrolls to regain their peak in the average post-war business cycle, in this case it took more than twice that long: 46 months for total payrolls and even longer for the private sector. These long lags delay the arrival of any job-market-related bargaining power workers need in order to claim a larger share of productivity growth.

A look at current unemployment rates—they have fallen as low as 4.6% in recent months—might suggest that the economy is now at or near full employment. But the unemployment rate was 4.0% in 2000, and there is a significant difference between these values for those groups with the least bargaining power. A sustained unemployment rate of 4.0% is a necessary ingredient for generating broad-based wage and income gains, and the current weak trend in median wages certainly belies any claim that the economy is at

full employment. Furthermore, the unemployment rate is artificially reduced if job seekers give up their search. Only those actively seeking work are counted as unemployed, and if, due to a perceived lack of opportunity, enough people give up the job search—they put off entering or they leave the job market—they will not be counted as jobless. This dynamic can serve to lower reported unemployment. In such periods, it is essential to examine labor force participation rates and employment rates to see if they reveal more slack than does the unemployment rate.

In fact, even by mid-2006, the share of the population at work—the employment rate—was 1.6 percentage points below its 2000 peak. This drop implies that literally millions of potential workers have not been looking for work, and their exit from the labor force lowers the jobless rate.

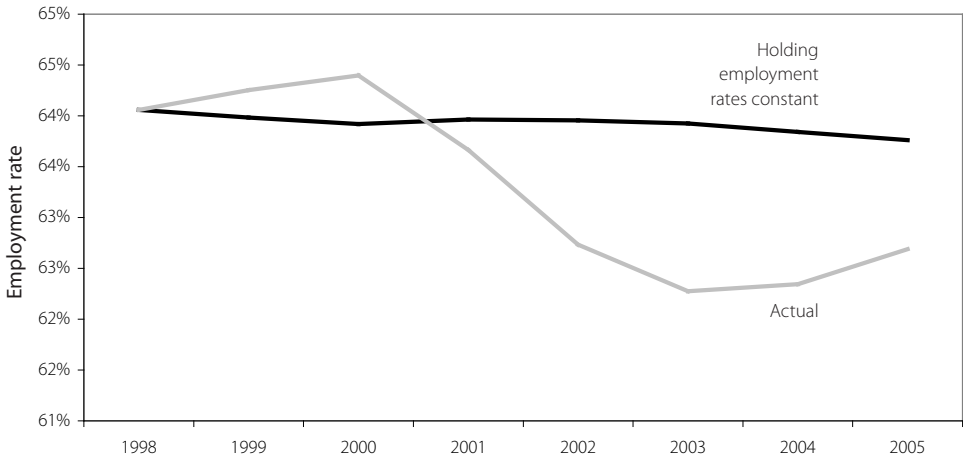
Some analysts object to this comparison of today's employment rates with those of the last cycle's peak, claiming that the 2000 job market was inflated by a market bubble. But the gap between today's employment rate and that of other, pre-bubble years is still large. For example, employment rates in 1997, 1998, and 1999, a period of strong but not obviously speculative demand, were still about one point higher than today's.

One of the key lessons of our analysis of the full employment economy is that we need to aim high when setting employment benchmarks. That is, since it takes a truly tight labor market ("chock-full employment," as late Nobel Laureate economist William Vickery once put it) to ensure widespread gains, we diminish the chance of reaching full employment if we set benchmarks to periods when income and wage growth were stagnant. The speculative demand of the late 1990s may not have been good for the economy overall, but that does not mean one should ignore the success story in the job market. Besides, there are other, non-speculative sources of strong demand, and good economic policy can push back against demand-killers, like the large and growing trade deficit.

A strain of the bubble argument says that demographic change (an older workforce), not a shortage of jobs, is responsible for the decline in both labor force participation and employment rates since 2000. This is a tough case to make, given that job creation was weak over the period when these rates fell, so a decline in labor force participation due to insufficient demand for workers seems to offer a more straightforward interpretation. Moreover, demographic changes usually don't have much impact over the short run.

In fact, as **Figure D** shows, holding employment rates constant for each demographic group at their 1998 level and simply allowing their population shares (by age and gender) to change leads to a simulated rate that falls much less than the actual trend; this suggests a very minor role for demographic change (to stave off the 2000 bubble critique, this simulation starts earlier, in 1998). While the actual employment rate falls 1.4 percentage points over this period, the simulated rate driven solely by the aging of the workforce falls only 0.3 points, indicating that forces other than demography lead to a 1.1 percentage-point drop in employment.

Given the size of the U.S. working-age population in 2005 (226 million), the lower employment rate implies that over three million workers were missing from the labor force in that year, and of these, about 675,000 might be explained by the aging of the workforce since 1998. That leaves about 2.4 million persons missing from the job market. It is likely

FIGURE D Changes in the employment rate, 1998-2005

Note: This result differs from that of an influential Federal Reserve Paper (Aaronson et al. 2006, Figure 3). The results of that study, however, appear to stem from the authors' choice to begin the simulation in 1995, well before employment or labor force participation rates peaked. While we prefer employment rates as a measure more indicative of labor demand, they use labor force participation rates (LFPRs). However, our results are the same when using LFPRs.

Source: Authors' analysis of BLS data.

that many of these workers, were they to enter the job market, would be added to the seven million unemployed in mid-2006, leading to a significantly higher unemployment rate.

The uptick in the actual employment rate trend at the end of the figure coincides with the period when job growth turned positive, and this is another indication that cyclical forces are at work. We pursue this analysis further in Chapter 4 by tracking the employment rates of groups like young college graduates and minorities, who might be expected to be particularly responsive to the availability of jobs. Like this figure, these analyses reveal a clear cyclical response to the deterioration and then improvement in the job market, all of which suggests that the low unemployment rate is, at least for now, an inadequate measure of the true degree of labor market tightness.

Family incomes

Middle-income families derive about three-quarters of their income from the labor market. Thus, weakening labor market trends can explain the income reversals experienced since 2000. **Table 2** summarizes some of the results from Chapter 1, where we examine changes in family income and its components for families by income fifth. Here we focus on middle-income families, whose real income fell 2.1% from 2000 to 2004 after growing almost 12% in the five years prior.

TABLE 2 Changes in real incomes, annual hours, and earnings, 1995-2004, among middle-income families

	Income	Earnings	Hours	Hourly wage
1995-2000	11.7%	14.9%	5.2%	9.2%
2000-04	-2.1%	-3.1%	-4.3%	1.2%
Difference	-13.8	-18.0	-9.5	-8.0

Source: Authors' analysis of March CPS data.

The data clearly suggest that the income loss was a function of labor market contraction. Annual hours worked by all family members fell 4.3%, after rising 5.2% during the 1990s boom. Hourly wages continued to rise (though yearly trends show a real decline in 2004), but by 8.0% less in the 2000s compared to the latter 1990s. Losses in hours worked explain almost 60% of the reversal in income growth, and much slower hourly wage growth explained the rest.

Inequality in income, wealth, and earnings

The gap between productivity, wages, and incomes suggests that inequality is on the rise. The growth embodied in these macro-indicators has to be going somewhere, and if only trace amounts are finding their way into the paychecks of many working families, it stands to reason that the gains are flowing up the wealth scale.

We provide two pieces of supportive evidence. First, **Table 3** examines recent research on income movements among the richest households, including the value of realized capital gains. Between 1995 and 2000, real income grew 12.5% for the bottom 90%, 15.0% for the next highest 5% (the 90-95th percentile), 25.1% for the next highest 4%, and so on, up to the more than doubling of income—up 156.0%—at the very top sliver of the top 1% (the 99.99-100th percentile). So, even as the job market progressed toward full employment, income growth was still skewed toward the top over this period.

The bursting of the financial and investment bubbles led to sharp real declines in the incomes of wealthy households in 2001 and 2002, with the biggest losses among the richest. By 2003, however, the earlier pattern was returning, and in 2004, a year when the economy expanded by 4.2% and productivity grew by 3.4%, the income of the bottom 90% got a mere 1.4% boost. The rest accrued to the top 10%, and the gains were largest at the top of the income scale. The step pattern repeats, with larger percentage gains as we move up to the very top of the income scale. The average income gain at the very top was 27.5% in 2004 alone.

The growth of capital incomes (from corporate profits or, as received directly by individuals, from dividends, interest, and capital gains) has also driven up inequality. First, most capital income is received by the best-off families, so the growth in capital incomes reinforces income inequalities (the decline in capital incomes in 2000-02 actually reduced

TABLE 3 Income inequality in the late 1990s vs. the early 2000s

	Bottom 90%	Top 10%					
		Next 5%	Next 4%	Next 0.5%	Next 0.4%	Next 0.09%	Top 0.01%
	90th-95th	95th-99th	99th-99.5th	99.5th-99.9th	99.9th-99.99th	99.99th-100th	
1995-2000	12.5%	15.0%	25.1%	37.9%	52.4%	92.7%	156.0%
2001	-2.0	-3.0	-6.7	-10.9	-15.8	-25.2	-32.1
2002	-3.4	-2.8	-4.7	-6.8	-9.2	-14.7	-19.4
2003	-1.9	-0.5	-0.4	0.2	1.2	3.5	10.4
2004	1.4	2.6	4.7	10.0	12.5	17.8	27.5

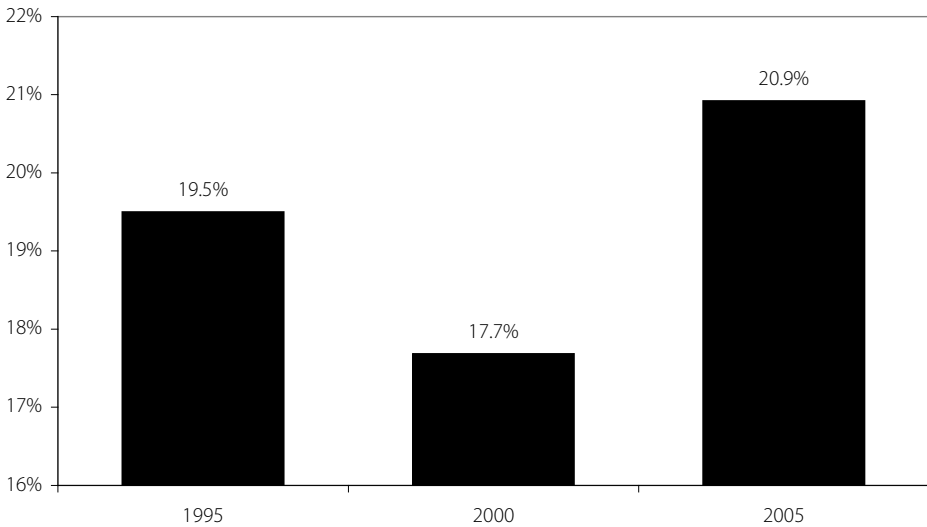
Source: Piketty and Saez (2006).

inequality). For 2006, for instance, it is estimated that 84.2% of all capital income will have been received by the upper fifth, with 55.3% received by the top 1% and 36.6% by the top 0.1% alone. In contrast, 3.6% of such income is held by middle-income families. This income landscape implies that fast growth for capital income will disproportionately benefit the best-off income groups.

The rise in inequality caused by the shift toward greater capital income has been compounded by the growing concentration of capital income among the very highest income groups, particularly the top 1%. According to the Congressional Budget Office, the share of capital income received by the top 1% grew by 14.3 percentage points from 1995 to 2003 (the latest data), with proportionately less capital income received by the remaining households in the top fifth (down 7.5 percentage points) and a lesser share received by the bottom 80%.

The shift to greater capital income in the economy can be illustrated by the recent movements in the division of corporate sector income (which excludes proprietorships and other unincorporated businesses but includes more than 75% of the entire private sector) and in the growth of profitability (returns on capital investments). As **Figure E** shows, capital's share of income tumbled in the late 1990s in the context of a tight labor market, but it more than recovered by 2005. This helped boost profitability in 2005 to the highest level reached in 36 years (excepting 1997).

The growth in profitability has left less room for (or, rather, was caused by the muting of) wage growth, and might be considered the consequence of businesses successfully restraining wage growth as sales and profits grew, even in years of seemingly low unemployment. If the pre-tax return to capital in 2005 (11.9%) had been at the 1979 level (9.6%), then hourly compensation would have been 5.0% higher in the corporate sector. This difference is equivalent to an annual transfer of \$235 billion from labor to capital (measured in 2005 dollars), or roughly \$1,760 per wage-and-salary employee or \$3,032 if this redistribution came from the bottom 80% of workers, who earn just 58% of all hourly earnings.

FIGURE E Share of capital income in the corporate sector, 1995-2005

Source: Family Income chapter, Table 1.23.

Even this analysis misses an important part of the picture, since the definition of labor's share includes the pay of chief executive officers and thereby overstates the income share going to typical workers and understates profits, since the bonuses and stock options given CEOs are more akin to profits than wages. The amount of CEO pay relative to corporate profits has grown: in the mid-1990s CEO pay was equivalent to roughly 5% of corporate profits, but that amount rose to roughly 10% of profits by 2003 (unfortunately, more recent data are not available).

The hit on young workers and families

The challenges to living standards that working people and their families have faced over the last few years have been even more pronounced for young workers and their families. When times are good, they are particularly good for young workers, but when times are not so good, they tend to be awful for young workers. Since young workers and their families are at the beginning of their economic life cycle, these differences are important. Those starting off in a down period often suffer losses that will reverberate throughout their careers.

Not surprisingly, the recession, jobless recovery, and then weak job growth of the last five years have sharply reversed the progress that young workers and their families were making in better times. **Table 4** presents indicators of labor market trends (wages, benefit coverage, and employment) and family income and living arrangements that illustrate the hit on young people.

TABLE 4 Employment, wage, benefit, and income trends for young workers and families, 1995-2005

Category	1995	2000	2005	Change*		Difference, 2000-05 minus 1995-2000
				1995-2000	2000-05	
EMPLOYMENT, WAGES, AND BENEFITS						
High school						
<i>Entry-level wages (\$2005)</i>						
Men	\$10.15	\$11.10	\$10.93	9.3%	-1.5%	-10.9
Women	8.65	9.49	9.08	9.8	-4.3	-14.1
<i>Entry-level benefits coverage**</i>						
Health insurance	38.2%	37.8%	33.7%	-0.4	-4.1	-3.7
Pension	20.6	21.9	18.8	1.4	-3.2	-4.5
<i>Employment rate**</i>						
All	78.0%	80.0%	75.7%	2.0	-4.2	-6.2
College						
<i>Entry-level wages (\$2005)</i>						
Men	\$16.97	\$20.51	\$19.72	20.9%	-3.9%	-24.8
Women	15.59	17.41	17.08	11.7	-1.9	-13.6
<i>Entry-level benefits coverage**</i>						
Health insurance	69.2%	70.6%	63.5%	1.4	-7.0	-8.4
Pension	45.1	54.6	49.3	9.6	-5.3	-14.9
<i>Employment rate**</i>						
All	87.8%	87.4%	85.5%	-0.4	-2.0	-1.5
FAMILY INCOME AND LIVING ARRANGEMENTS						
Share living at home (ages 25-34)**						
Male	15.4%	12.9%	13.7%	-2.5	0.8	3.3
Female	8.5	8.3	8.2	-0.2	-0.1	0.1
Median family income (ages 25-34)**						
All	\$44,336	\$49,769	\$46,878	12.3%	-5.8%	-18.1

* Wages and income data are *percent* changes, all others are *percentage-point* changes.

** Data available only through 2004.

Source: Tables 1.7 and 3.21, Figures 3Q and 3R, analysis of CPS ORG and Census Bureau (2006).

One way to illustrate the difficulties faced by young workers in the labor market is to examine the wages and benefit coverage of entry-level workers, both those with a high school degree (and no further education) and those with a four-year college degree. The table presents the trends of the late 1990s and compares them to the latest five-year period in order to illustrate the change in fortunes that has occurred.

The wages earned by entry-level high-school-educated workers (those out of school for one to five years) rose over 9% from 1995 to 2000, then deteriorated over the 2000-05 period. The difference between these two trends was a 10.9% turnaround for men and a 14.1% turnaround for women. Entry-level high school graduates had low rates of benefit coverage from their employers, with only 38.2% receiving health coverage and 20.6% receiving pension coverage in 1995; these rates are substantially down from their levels in 1979 (the health coverage rate was 63.3% that year). Given the declining coverage before 1995, the good news about entry-level high-school-graduate jobs is that employer-provided health and pension benefits fell only a small amount over the late 1990s. However, a sharp erosion of benefits returned from 2000 to 2005, with health coverage falling so that only a third now receives it, roughly half of the coverage in 1979. This leaves young workers joining the growing ranks of the uninsured, unless they are lucky enough to have coverage through a spouse's employer.

The change in fortune was even starker for young college graduates. This group benefited during the late 1990s a great deal, as those graduating then (reflected in the entry-level wages and benefits in 2000) enjoyed far greater pay than those who had graduated in the early 1990s (and measured for 1995). Entry-level wages for male college graduates ballooned 20.9%, and those for women rose 11.7%. Benefit coverage, particularly pensions, improved in the late 1990s for these new workers, but the poor labor market conditions of the 2000-05 period hit college graduates hard, as entry-level wages fell and benefit coverage dropped significantly (for example, health coverage fell from 70.6% to 63.5%). Had the late 1990s trends continued over the 2000-05 period, the entry-level wages of college graduates would have been 24.8% higher for men and 13.6% higher for women, and a much larger share would have been covered by employer-provided health and pensions (a 14.9% coverage rise for pensions and an 8.4% rise for health).

Another reflection of the dramatic turnaround in labor market trends is that employment rates for young (in this case 25-34-year-old) high school graduates grew in the late 1990s (up 2.0%) but then fell 4.2 percentage points from 2000 to 2005, a 6.2 percentage-point turnaround. Even college graduates saw their fortunes turn around as the share employed fell from 2000 to 2005.

Given these faltering labor market trends, it should come as no surprise that families headed by someone age 25-34 had 5.8% lower incomes in 2005 than in 2000. In contrast, this type of family enjoyed incomes 12.3% higher in 2000 than in 1995, amounting to a remarkable 18.1% reversal. Another reflection of these trends is that more young men age 25-34 are living with their parents. The share declined in the late 1990s, from 15.4% in 1995 to 12.9% in 2000, but rose to 13.7% in 2005. Young women's living arrangements have been relatively stable in this period.

Starting lower, growing slower

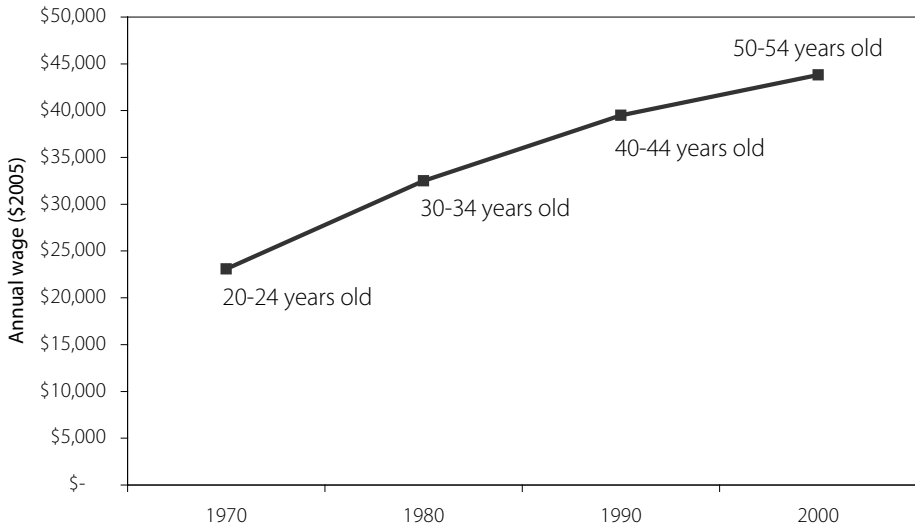
Thus far, we have examined the productivity gap by comparing, for example, the hourly wages or income of the median worker or the median family in a recent year to that of an earlier year. This is a useful and conventional way of tracking group trends where the median is representative of a group. However, this method does not directly portray how individuals or individual families actually experience the economy. Both dimensions of economic reality are important. Analysts need to track how people experience the economy as they and their cohort age, as well as how groups such as communities, the nation, the working class, or the middle-income family are faring in the economy. The difference arises because the comparisons we have shown thus far inevitably compare different people—for instance, the median worker in 1995 is not likely to be the median worker in 2005.

An illustration reveals the differences between these approaches. How can it be true that the average high-school-educated or non-college-educated worker's wage (inflation-adjusted) can fall over a 10-year period while most individual workers in this group saw their inflation-adjusted wage rise over that same period? As individuals gain experience, change jobs, or get promotions, they usually obtain higher pay, and so it makes sense that the vast majority of workers earn more when they are in their thirties than in their twenties and make further gains into their forties and fifties. Yet it still can be true that the average wage of a group—say, non-college-educated workers—can decline over a decade or two. This is because the average includes workers of all ages and the process by which a group's average wage has declined arises because younger members of the group start out at lower wages and progress more slowly than did their predecessors.

Figure F illustrates this phenomenon. Consider the annual earnings of the group of workers with some college—a group with schooling beyond high school, possibly including an associate's degree, but without a degree from a four-year college. We can illustrate the process of workers raising their wages as they age by following a cohort of “some college” workers over time. For instance, in 1970, when these workers were 20 to 24 years old, they earned an average annual wage of \$23,071 (in 2005 dollars). By 1980 this group's earnings had grown to \$32,498, a 41% improvement. By ages 40-44 in 1990 their earnings had grown 22% further to \$39,488, and by 2000, at ages 50-54, they had grown to \$43,809. Overall then, this group saw its earnings grow 90% as it progressed from 1970 to 2000.

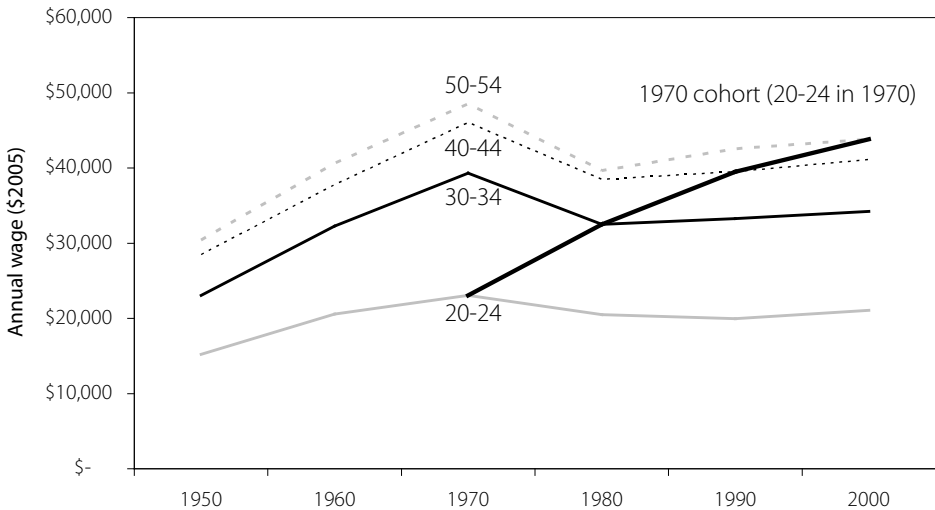
Figure G puts this experience of the 1970 cohort into a broader historical context by presenting the annual earnings of particular age groups at each 10-year point from 1950 to 2000. This exercise allows a comparison of how particular age groups in 2000 fared relative to similarly aged workers in the earlier decades. As the figure shows, the \$43,809 earnings level that the 1970 cohort attained in 2000 at ages 50-54 was roughly 10% less than the earnings of \$48,511 attained by similarly educated workers at the same age 30 years earlier in 1970. Compared to this earlier cohort, the members of the 1970s cohort made far less progress over their working lives. In fact, the earnings of every age group of workers with some college in 2000 were less than what that same age group of some-college workers earned in 1970. So, although the cohort climbed the ladder successfully, the rungs on the ladder were lowered. That is why the average earnings of prime-age earners (ages 25-54) with some college were 11% lower in 2000 than in 1970.

FIGURE F Annual wages of “some college” workers who entered labor force in 1970



Source: Authors' analysis of PUMS data.

FIGURE G Annual wages of workers with some college attendance (less than a degree) by age, 1950-2000



Source: Authors' analysis of PUMS data.

TABLE 5 Annual earnings of 25-29-year-olds, by education, 1950-2000

Education	Annual earnings (\$2005)					
	1950	1960	1970	1980	1990	2000
High school	\$18,382	\$25,242	\$30,903	\$25,396	\$24,873	\$25,944
Some college	20,172	27,221	33,550	27,194	27,733	29,180

Source: Authors' analysis of PUMS data.

Another way of viewing this development is to compare the starting earnings of the same age/education group over the decades. As the economy becomes more productive and workers become more educated, we expect new cohorts to start out with higher earnings than their predecessors. **Table 5** illustrates that this process prevailed from 1950 to 1970, as earnings for 25-29-year-olds for both high-school-educated workers and those with some college grew each decade. In this period of fast productivity growth and broadly shared income growth, their starting earnings grew appreciably (about two-thirds more) as each successive cohort started out on a higher rung of the ladder.

However, in the ensuing years, including the rapid growth period in the late 1990s, the starting wage remained below that obtained in 1970. So, despite an economy that was two-thirds more productive in 2000 than in 1970, the beginning earnings of high school workers and workers with some college were actually lower.

Conclusion

Every era's economy seems new to contemporary observers, and our discussion of the historically large gains in productivity is not meant to oversell the notion that today's economy is vastly different from yesterday's. As has always been the case, the majority of families work hard to make ends meet, improve their living standards, and create better opportunities for their children. This remains the case today much as it was a century ago.

Yet there are clearly aspects of today's economy that make it historically unique. Some of these tilt against the bargaining power of American workers: increased global trade, fewer unions, and more low-skilled and high-skilled immigration. There are fewer favorable social norms that guide employer behavior and support public and employer policies that provide adequate safety nets, pensions, and health care arrangements.

Other new forces in play have the potential to lift the living standards of working families in ways hardly seen in this country for 30 years. Most important of these is a new, stronger productivity growth regime and a brief encounter with full employment which showed that, once workers' bargaining power gets a boost, the benefits of this regime shift in productivity growth can be broadly shared.

In other words, the biggest challenge in what many have called the new economy is not growth per se; it's how growth is distributed. Of course, economists and policy mak-

ers should be concerned with whether the economy is growing as fast and efficiently as it can, and they might turn to greater investments in public and private capital stock, more research and development, monetary policy that stresses full employment, and the educational upgrading of the workforce.

Yet, if the findings in the hundreds of tables and figures that follow can be reduced to one observation, it would be that, *when it comes to an economy that is working for working families, growth in and of itself is a necessary but not a sufficient condition. The growth has to reach the people: the bakers need to benefit from bread they create each day of their working lives.*

The benchmarks by which we judge the economy must reflect these distributional concerns, and we must construct policies and institutions to address them. If we do not—if our enhanced productive capacity continues to benefit mostly the wealthiest Americans—we risk sacrificing bedrock principles that have historically defined the American economic experience. Such principles include basic fairness—the notion that those who work hard can truly get ahead—as well as the belief that the economy will provide growing opportunities for the least-advantaged while sustaining a large and flourishing middle class.

In the previous version of this book, we wondered whether the distributional problems of the then-young post-2000 expansion would work themselves out. By now, in the fifth year of the recovery, it is clear that they have not. Some commentators urge working Americans to be patient and wait for the lags in the economy to play out. Eventually, we are told, wages and incomes will start rising with productivity.

Except if they don't. In an era with severely weakened distributional institutions, where labor market slack is the norm and full employment is the exception, working families cannot afford to wait for growth to catch up with them. That argument might have some saliency in the second or third quarter of an expansion. But by year five, it is an unacceptable position for policy makers to take. The time for economic growth to be a “spectator sport” for the majority of American families is past.

And even if those urging patience are correct, what about the lost jobs, income, and wages that have already been experienced? What about the years spent in poverty that might have been prevented or at least diminished if more of the growth were flowing widely? These losses can never be made up.

Thus, there is a role for policy makers in reconnecting growth and prosperity. The goal of the chapters that follow is to provide readers with the empirical analysis needed to judge the extent to which the economy is working for working families. In the interest of suggesting ways to reconnect growth and living standards, we have also created an accompanying policy document, available at www.epi.org, to go with this book.

America's working families continue to work harder and smarter. But, while the economy provides them with the potential for prosperity, that potential has yet to be consistently realized. Until that occurs—until living standards can once again be counted on to regularly reflect the benefits of growth—the state of working America will continue to be challenged by inequities that undermine our basic values.

Documentation and methodology

Documentation

The comprehensive portrait presented in this book of changes in incomes, taxes, wages, employment, wealth, poverty, and other indicators of economic performance and well-being relies almost exclusively on data in the tables and figures. Consequently, the documentation of our analysis is essentially the documentation of the tables and figures. For each, an abbreviated source notation appears at the bottom, and complete documentation is contained in the Table Notes and Figure Notes found at the back of the book. (In rare circumstances, however, we incorporate data in the discussion that are not in a table or figure.) This system of documentation allows us to omit distracting footnotes and long citations within the text and tables.

The abbreviated source notation at the bottom of each figure and table is intended to inform the reader of the general source of our data and to give due credit to the authors and agencies whose data we are presenting. We have three categories of designations for these abbreviated sources. In instances where we directly reproduce other people's work, we provide an "author/year" reference to the bibliography. Where we present our own computations based on other people's work, the source line reads "Authors' analysis of *author (year)*." In these instances we have made computations that do not appear in the original work and want to hold the original authors (or agencies) blameless for any errors or interpretations. Our third category is simply "Authors' analysis," which indicates that the data presented are from our original analysis of microdata (such as much of the wage analysis) or our computations from published (usually government) data. We use this source notation when presenting descriptive trends from government income, employment, or other data, since we have made judgments about the appropriate time periods or other matters for the analysis that the source agencies have not made.

Time periods

Economic indicators fluctuate considerably with short-term swings in the business cycle. For example, incomes tend to fall in recessions and rise during expansions. Therefore, economists usually compare business cycle peaks with other peaks and compare troughs with other troughs so as not to mix apples and oranges. In this book, we examine changes between business cycle peaks. The initial year for many tables is 1947, with intermediate years of 1967, 1973, 1979, 1989, and 2000, all of which were business cycle peaks (at least in terms of having low unemployment). We also present data for the latest full year for which data are available (2005, when available) to show the changes over the current business cycle.

In some tables, we also separately present trends for the 1995-2000 period in order to highlight the differences between those years and those of the early 1990s (or, more precisely, 1989-95) and earlier business cycles. This departs from the convention of presenting only business-cycle comparisons (e.g., comparing 1979-89 to 1989-2000 trends) or comparisons of recoveries. We depart from the convention because there was a marked shift in a wide variety of trends after 1995, and it is important to understand and explain these trends.

Growth rates and rounding

Since business cycles differ in length, we usually present the annual growth rates in each period rather than the total growth. We also present compound annual growth rates rather than simple annual rates. Compound annual growth rates are just like compound interest on a bank loan: the rate is compounded continuously rather than yearly. In some circumstances, as noted in the tables, we have used log annual growth rates. This is done to permit decompositions. In presenting the data we round the numbers, usually to one decimal place, but we use unrounded data to compute growth rates, percentage shares, and so on. Therefore, it is not always possible to exactly replicate our calculations by using the data in the table. In some circumstances, this leads to an appearance of errors in the tables. For instance, we frequently present shares of the population (or families) at different points in time and compute changes in these shares. Because our computations are based on the “unrounded” data, the change in shares presented in a table may not match the difference in the actual shares. Such rounding errors are always small, however, and never change the conclusions of the analysis.

Adjusting for inflation

In most popular discussions, the Consumer Price Index for All Urban Consumers (CPI-U), often called simply the consumer price index, is used to adjust dollar values for inflation. However, some analysts hold that the CPI-U overstated inflation in the late 1970s and early 1980s by measuring housing costs inappropriately. The methodology for the CPI-U from 1983 onward was revised to address these objections. Other changes were introduced into the CPI in the mid-1990s but not incorporated into the historical series. Not all agree that

these revisions are appropriate. We chose not to use the CPI-U so as to avoid any impression that this report overstates the decline in wages and understates the growth in family incomes over the last few decades.

Instead of the CPI-U, we adjust dollar values for inflation using the CPI-URS index. This index uses the new methodology for housing inflation over the entire 1967-2001 period and incorporates the 1990s changes into the historical series (though not before 1978, which makes economic performance in the years after 1978 falsely look better than the earlier years). The CPI-U-RS is now used by the Census Bureau in its presentations of real income data. Because it is not available for years before 1978, we extrapolate the CPI-U-RS back to earlier years based on inflation as measured by the CPI-U.

In our analysis of poverty in Chapter 6, however, we generally use the CPI-U rather than the CPI-U-RS, since Chapter 6 draws heavily from Census Bureau publications that use the CPI-U. Moreover, the net effect of all of the criticisms of the measurement of poverty is that current methods understate poverty. Switching to the CPI-U-RS without incorporating other revisions (i.e., revising the actual poverty standard) would lead to an even greater understatement and would be a very selective intervention to improve the poverty measurement. (A fuller discussion of these issues appears in Chapter 6.)

Household heads

We often categorize families by the age or the race/ethnic group of the “household head,” that is, the person in whose name the home is owned or rented. If the home is owned jointly by a married couple, either spouse may be designated the household head. Every family has a single household head.

Hispanics

Unless specified otherwise, data from published sources employ the Census Bureau’s designation of Hispanic persons. That is, Hispanics are included in racial counts (e.g., with blacks and whites) as well as in a separate category. For instance, in government analyses a white person of Hispanic origin is included both in counts of whites *and* in counts of Hispanics. In our original analyses, such as the racial/ethnic wage analysis in Chapter 3, we remove Hispanic persons from other racial (white or black) categories; using this technique, the person described above would appear only in counts of Hispanics.

