US graduates suffer income inequality
By Kristine Guth and Alex Becket in Washington
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Earnings of the average US worker with an undergraduate degree have not kept up with gains in productivity in recent decades, according to research by academics at MIT that challenges traditional explanations of why income inequality is rising.

The findings, which will be presented to the New America Foundation on Tuesday, come amid widespread concern about the sluggish trend in middle class income growth, both in absolute terms and relative to the new superstar class of chief executives, hedge fund managers and other financiers.

While in the short term labour market conditions are now good for most US workers, the state of the “American dream” is already emerging as a big theme in the run-up to the 2008 presidential election.

In a recent speech, Hillary Clinton, the Democratic frontrunner, complained that “while productivity and corporate profits are up, the fruits of that success just haven’t reached many of our families… It’s like trickle-down economics but without the trickle.”

Meanwhile, John Edwards, the former senator, has made “eliminating poverty within 30 years” a centrepiece of his left-leaning campaign, which addresses the problems of inequality in the US.

The Massachusetts Institute of Technology economists, Frank Levy and Peter Temin, repeat earlier findings that the gap between the earnings of the average university graduate and high school graduate — which was stable for much of the 1960s and 1970s — expanded relentlessly from 1980 to 2000 before slowing a little in recent years.

This is consistent with the conventional explanation that the rise in inequality is largely due to technology trends that disproportionately benefit skilled workers.

But Mr Levy and Mr Temin go on to show that, while graduates certainly did better than non-graduates in recent decades, the average graduate also failed to keep up with gains in economy-wide productivity, once those productivity gains are adjusted for the composition of the workforce.

Male graduates in particular failed to capture a full share of productivity advances, with female graduates keeping pace until the last five years — probably due to increasing opportunities for women in the workplace. This casts doubt on the conventional argument that the solution to rising inequality is to improve the standard of education across the workforce as a whole, and encourage more people to go to university.

“Is the average bachelor’s degree still sufficient to catch the rising tide? In the case of men at least, the answer is no,” the authors conclude.

They point out that rising inequality may still be caused by “skill-biased” technical change — but of a kind that disproportionately benefits the very skilled, rather than the merely educated.

If so, this creates a huge headache for policymakers because while it is in principle at least possible to greatly expand the number of basic college places, it is not possible to send every worker in the US to Harvard Business School.

Mr Levy and Mr Temin argue that the failure of workers even with undergraduate degrees to keep up with productivity is due to a change in labour market institutions and norms that reduced the bargaining power of most US workers.

They argue only a re-orientation of government policy can restore the general prosperity of the “median worker”.

The paper follows the presentation last week of joint Pew/Brookings Institute research showing that men in their 30s earned on average 12 per cent less in 2004 than their fathers did in 1974 after adjusting for inflation.

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**Economist (Op-Ed)**

**Income Inequality, Writ Larger**

INCOME inequality is a hot topic in politics and economics. The rising economic tide is lifting a bunch of yachts, but leaving three in simple boats just bobbing along.

Two professors — Thomas Piketty of the Paris School of Economics and Emmanuel Saez of the University of California, Berkeley — have found that the share of gross personal income of the top 1 percent of American earners rose to 15.4 percent in 2005 from 8.2 percent in 1980.

Many economists, especially those who find themselves in the Bush administration, argue that the winner-take-all trend is fueled by other, unsustainable trends: After all, globalization, information technology and free trade place a premium on skills and education. "The good news is that most of the inequality reflects an increase in returns to ‘investing in skills’ — workers completing more school, getting more training and acquiring new capabilities," as Edward P. Lazear, the chairman of the Council of Economic Advisors, put it last year.

It takes an optimist to find good news in the fact that the top 1 percent have steadily increased their haul while the other 99 percent haven’t, after all, many more than one in every 200 Americans are investing in skills and education.

But the orthodoxy surrounding income inequality is being undermined by research that looks at institutional issues: changes in the way the corporate world measures the performance of workers, the decline of unions, and government wage and tax policy. In this view, skills, education and trade aren’t the whole story. They’re simply "factors operating within a broader institutional story," as Frank Levy, the Rose professor of urban economics at the Massachusetts Institute of Technology, describes it.

One big change in recent decades has been an rise in performance-based pay. Through the 1970s, thanks in part to unions that negotiated wages collectively, "people with different abilities and capabilities were frequently paid the same amount for doing similar jobs," said W. Bentley MacLeod, an economics professor at Columbia.

But as companies and compensation consultants began using information technology to determine more accurately the contributions of individual employees, employers began to discriminate among employees based on performance. In a working paper, Professor MacLeod, along with Thomas Lemieux of the University of British Columbia and Daniel Parent of McGill University, mined census data and found that the proportion of jobs with a performance-pay component rose to 49 percent in the 1990s from 30 percent in the late 1970s.

"Since companies are better able to measure precisely what an employee contributes, we’ve seen a greater range of incomes among people doing roughly the same job," Professor MacLeod said.

The fact that more Americans are paid less on the basis of a job title and more on their individual output inherently leads to greater inequality. The authors’ conclusion is that the rise of performance-based pay has accounted for 25 percent of the growth in wage inequality among male workers from 1976 to 1993.

"All the bits of evidence we have tend to say that this trend is continuing," Professor Lemieux said. In 2000, the authors note, 44.5 percent of workers at Fortune 1000 companies received some form of performance-based pay, up from 34.7 percent in 1990. And think of the growing legion of self-employed — people selling items on eBay, mortgage brokers and real estate brokers, freelance journalists and consultants of all types — for whom all pay is performance-based. Among these growing cadres, the dispersion of incomes is rather large.

"When you look at the self-employed and contractors," Professor Lemieux said, "inequality is much higher."

Aside from corporate compensation policies, public policies have played a significant role in contributing to the growth of income inequality. That’s the argument made in a recent, brilliant National Bureau of Economic Research working paper by Professor Levy and Peter Temin, the Ehrenpreis-Grayson professor of economics at N.Y.U. "The paper, which is more narrative than quantification — Professor Temin is a distinguished economic historian — argues that the rise of income isn’t simply a byproduct of the free market working its wonders."

Professor Levy and Professor Temin divide the second half of the 20th century into two periods. In the first, 1950 to 1980, a grand bargain between labor and corporate America involving New Deal-era protections for workers and high marginal tax rates on the top rate (the top rate was 90 percent in the 1950s) led to what economists have called the Great Moderation. The middle class grew dramatically, income inequality decreased, and corporations generally enjoyed better labor.

Since 1980, they argue, it’s been a different story, thanks in part to a shifting political environment. Unions have weakened, the minimum wage hasn’t come close to keeping up with inflation, and marginal income tax rates have been cut — the top marginal rate is now 35 percent, down from 70 percent in 1980. As a result has been declining bargaining power for workers and the rise of a winner-take-all environment.

"The last six years of federal tax history have involved an inhospitable politics in which winners have used their political power to expand their winnings," the authors say. In other words, if capital has lately been prevailing in the centuries-long battle with labor, it is doing so with a substantial assist from the government.

Professor Saez agrees with the broad argument, but says that the impact of tax policy in recent years has been minor. When the top income tax rate was 90 percent in the 1970s, he says, "the force to pay according to talent was much weaker" because most of the excess pay would be eaten up by taxes. "Once the very high tax rates for big fortunes were removed in the 1980s," Professor Saez says "then the market could drive up the compensation at the top."

WHAT are the political — and policy — implications of this rethinking of the roots of income inequality? Too often, economists have argued that the government can’t — and shouldn’t — do much to reverse the growth of income inequality, beyond reeducating workers to get more skills and education. But given the institutional factors at work, that may be a cop-out.

"The historical evidence suggests that institutions do have some power to modify some of these outcomes," Professor Levy said.

It is commonplace to hear that the current set of arrangements and policies is the only possible way the economy can work, given trends like the rise of China and global economic integration. As Professor Levy said, "That’s a very convenient argument for people to make if they’re doing very well."

YOU HAVE NEVER HEARD OF THE TREATY OF DETROIT, which you may connect with the French and Indian War (1756–1763). Guess again. The Treaty of Detroit is a long-lost label describing a series of landmark labor agreements between the United Auto Workers and the Big Three U.S. automakers. Starting with a 1948 contract at General Motors, the agreements guaranteed annual wage increases, job security and generous fringe benefits. As Detroit’s present turnaround attests, the treaty is in tatters.

Now come economists Frank Levy and Peter Temin of the Massachusetts Institute of Technology, who resurrect the label and say it explains something much greater: the rise of economic inequality. This promise to be a hot issue in the 2008 election. Until now, most economists have blamed the growing pay gap on skill differences caused by the explosion of computer technologies. Levy and Temin contend (correctly) that this is too simple; they also blame a shift in social norms and business practices.

First, some historical background. In late 1945, President Truman summoned 36 business, union and government leaders to a conference. The aim: to forge an understanding between labor and capital and prevent it from leading to World War II’s cooperation. But in the late 1960s, it failed; the postwar era began badly. In 1946, there were 4.985 strikes, involving 4.6 million workers (11 percent of all workers). Automakers, railroad workers, steelworkers all struck.

The Treaty of Detroit fashioned a truce that spread elsewhere. Between major contracts, the automakers got labor peace. In return, workers got job security (reminder: in the 1930s, unemployment averaged 18 percent) and higher incomes. The treaty influenced other unionized industries, where patterns bargaining—companies signing similar contracts—became common. Many non-union companies embraced comparable norms: workers should receive wage gains beyond inflation, job security and good fringe benefits. The result, say Levy and Temin, was that “market outcomes” in pay were

But the story is more complicated. On the whole, the economy that produces these growing inequalities outperforms the one that created more statistical equality. The norms and practices highlighted by Levy and Temin collapsed mainly because they no longer worked. The idea that everyone’s wages should reflect inflation plus a few percentage points worsened both inflation and stability. There were four recessions between 1969 and 1981; by then, inflation was 10 percent and mortgage rates 15 percent. Productivity growth had plunged.

Greater competition—from imports, deregulation, new technologies—also doomed pattern wage setting. Companies with lax pay practices shrunk or died. Consider GM, Ford and Chrysler as exhibits A.

Economic inequality is an intellectual quagmire, because its origins and consequences are so murky. Contrary to popular belief, for example, it has not prevented most Americans from getting ahead.

Citing income increases of the most wealthy evokes images of greedy CEOs and hedge-fund managers. But the story is more complicated.

Paralleled productivity gains—improvements in efficiency. From 1959 to 1973, productivity rose 97 percent. Over the same period, median compensation of high-school male graduates aged 35–44 rose (after inflation) 95 percent; for college graduates 35–44, the increase was 106 percent. Those in the top one half of 1 percent received only a 27 percent gain. From 1980 to 2005, productivity increased 71 percent. Median compensation for high-school graduates dropped 4 percent, and compensation for college graduates rose only 24 percent. For those in the top one half of 1 percent, it jumped 89 percent. Comparisons like these evoke images of greedy CEOs and hedge-fund managers.
The New York Times

Economic Life After College

Commencement is a time for idealism.
But economic reality is lurking everywhere, and new college graduates are vulnerable to ambush. They have been told repeatedly that a college degree is an open sesame to the global economy. But that’s not necessarily so, according to new research by two economists at the Massachusetts Institute of Technology, Frank Levy and Peter Temin.

It is true that people with college degrees make more money than people without degrees. The gap has narrowed somewhat in recent years, which is disturbing. But the earning power of college graduates still far outpaces that of less-educated workers.

The bad news, though, is that a college degree does not ensure a bigger share of the economic pie for many graduates. In recent decades, Mr. Levy and Mr. Temin show, only college-educated women have seen their compensation grow in line with economywide gains in productivity. The earnings of male college graduates have failed to keep pace with productivity gains.

Instead, an outsized share of productivity growth, which expands the nation’s total income, is going to Americans at the top of the income scale. In 2005, the latest year with available data, the top 1 percent of Americans — whose average annual income was $1.1 million — took in 21.8 percent of the nation’s income, their largest share since 1929.

Administration officials, and other politicians and economists, often assert that income inequality reflects an education gap. But Mr. Levy and Mr. Temin show that in the case of men, the average bachelor’s degree is not sufficient to catch the rising tide of the global economy.

They argue that the real reason inequality is worsening is the lack of strong policies and institutions that broadly distribute economic gains. In the past, for example, a more progressive income tax and unions fostered equality. Affirmative action has also helped and probably accounts, in part, for the pay growth of college-educated women. But such institutions have been eroding and new ones have not yet emerged. At the same time, corporate norms that restrained excessive executive pay have also eroded, making the income gap even greater.

Mr. Levy and Mr. Temin conclude that only a reorientation of government policy can restore general prosperity. That’s a challenge to the nation’s leaders and today’s graduates. America needs them to build the new institutions for a global economy.