New Economy Hurting People in the Middle the Most

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By Steven Pearlstein
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It's the new conundrum.

The last several years have been marked by low unemployment, strong economic growth, robust productivity gains and record corporate profits. Normally, you'd expect most Americans to be doing pretty well. As it happens, however, inflation-adjusted income for all but a tiny fraction of the wealthiest households hasn't increased at all.

So what gives? Why is there such a disconnect between economic growth and household income? What happened to all the money?

Anyone who offers a simple answer to those questions -- that it's all the fault of the Bush tax cuts, or it can be solved by sending everyone to college -- is blowing smoke.

There is also a plethora of data sets that can be used to show that, in reality, we're all still better off than we were 10, 20 or 30 years ago, or, if you wish, that the American Dream is dead and the economy is now run by and for the super-rich.

What is almost certain, however, is that fundamental changes in the structure of the labor, product and capital markets are accelerating a long-term trend toward income inequality. And this is happening not only here in the United States, but other places as well.

My favorite statistic comes from a recent study of tax returns by the Internal Revenue Service. It shows that, in 1979, the top 10 percent of households earned 33 percent of all pretax income. By 2003, their share had climbed to 44 percent. The shares of everyone else declined.

That's not to say that the households at the top in 1979 were the same as in 2003 (they weren't), or that the living standards of everyone else declined (they didn't). But it does show the degree to which income distribution has become more skewed.

Two things are going on here.

First, the share of the economic pie going to workers in the form of wages, salaries and benefits seems to have fallen, while the share going to holders of capital -- in the form of interest, dividends and capital gains -- has gone up.

The culprits here include the variety of factors that go under the heading of globalization -- trade, immigration, outsourcing, the rise of the multinational corporation and cross-border investment -- all of which have weakened the position of workers in negotiating for wages and benefits. Just as significant have been the decline in the influence of labor unions, the employer tilt of labor laws and the rising influence of Wall Street that now focuses corporate managers on the single-minded goal of increasing shareholder value.

Even while labor's share of the economy is shrinking, the distribution of income within labor's share has become more unequal.

Until recently, most of the academic research focused on the role of trade and technology in reducing the demand for unskilled workers -- those whose jobs could be more efficiently done by machines or by lower-paid workers in foreign countries. At the same time, they increased the demand for workers with higher skills and education. As a result, the more education you had, the better off you were.

But two recent studies -- one by David Autor of Massachusetts Institute of Technology, Lawrence Katz of Harvard University and Melissa Kearney of the Brookings Institution, and another by Frank Levy of MIT and Richard Murnane of Harvard -- have found that most of the impact from trade and technology has shifted to workers in the middle of the wage and skill distribution. More powerful computers and software and the Internet have reduced the demand for travel agents, retail salesmen and inventory control specialists, while making it possible for companies to outsource to India and Poland work like computer programming, tax preparation and customer service.

Those developments, according to the studies, had a "barbell" effect on wages. At the high end, they have increased demand (and pay) for workers with the higher-level skills needed to design and market all this new technology and the new goods and services associated with it. At the same time, these newly enriched people near the top now demand more services from yoga instructors, gardeners and manicurists, boosting demand (and pay) for such lower-paid workers who can't easily be replaced by machines.

According to Levy and Murnane, those trends have created a new imbalance in the labor market, where workers with moderate skills and education are chasing a diminishing number of jobs, "hollowing out" the middle of the income scale even as incomes rise at the top and the bottom.

It's one thing to lay out or bemoan these developments. It's quite another to figure out what to do about them. I'll leave that for a column next week.