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What has Caused the "Great U-Turn" in Income Inequality?

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>
> - **Rapid Technological Change**
> - **Reduced Trade Barriers**
> - **Changing Institutional Rules**
> - **"Low Road" Business Tactics**

The first few decades following WWII has come to be known as the "Golden Age" of the US economy. Businesses enjoyed high rates of profitability, incomes were growing faster than the rate of inflation, poverty was declining and the ranks of the middle class swelled. The 1970s, unfortunately, witnessed the demise of the "Golden Age" with firm profitability dropping, growth in wages fell behind inflation, and the middle class began to hollow out. Today the gap between the top and lowest income groups is growing at an alarming rate (see *CEN* #308 June 2002). Barry Bluestone has called this reversal in economic fortunes as the "Great U-Turn" where for over the past 30 years, the rich are getting richer and the poor are getting poorer.

What are some of the underlying factors that have fostered the "Great U-Turn" in economic equality? Some argue that the promotion of free trade has produced a race to the bottom while others maintain that the rapid introduction of computer technologies into the work place has fundamentally altered the demand for labor. Some conservative social commentators go as far as to argue that the demise of the traditional nuclear family and the rise of the single parent family is the root cause. As with most economic phenomena, there is no easy answer nor is there a magic bullet that will return us to the "Golden Age." In this issue of *Community Economics,* I will review some of the more popular hypotheses.

Rapid Technological Change. Neoclassical economics argues that labor is paid equal to the value of its marginal productivity. Workers who are more productive will receive higher wages than the less productive worker. The introduction of computer technologies has caused a massive shift in labor productivity with those workers able to grasp these new technologies leap frog ahead of those workers who can not. New technologies are causing a widening gap between skilled and un-skilled workers.

There are two nagging facts that discredit this intuitive hypothesis. First, the "Great U-Turn" began in the middle of the 1970s, years before commuter technologies entered into the business world. Indeed, commuters were first introduced into the workplace in any meaningful way in the late 1980s and did not fundamentally alter the work environment until the 1990s. Second, studies detailing the depth of growing inequality show that there is a widening wage gap across and within educational achievement levels. In other words, there is evidence that even within those classified as skilled workers, there is increasing wage inequality.

Reduced Trade Barriers. By reducing trade barriers, firms are able to move operations over-seas to low cost markets. The resulting "race to the bottom" is dragging low-skilled workers' wages down. While there is significant evidence that firms that produce commodities, as opposed to branded products, find stiff competition from over sea firms, the wave of reduced trade barriers did not start until the 1990s, almost twenty years after the start of the "Great U-Turn."

Changing Institutional Rules. While there is evidence of a widening income gap across nearly all developed counties, the gap is widest in Anglo-Saxon economies (i.e., England and US) and much more modest in European economies, particularly in Scandinavian economies. This difference has caused many economists to look to changing institutional rules and philosophies as a source of the widening income gap. This research has focused on two areas: the weakening of labor organizations (i.e., unions) and a fundamental shift in the role of government in the welfare state.

It has been widely documented that union membership is on the decline in the US and England. This decline is partially a reflection of the changing nature of moving from a goods to a service producing economy. Unions have traditionally had a strong presence in manufacturing and construction industries, but a weak presence in retail and other service sector industries. In addition, beginning with the Reagan Administration and the demise of the air traffic controllers' union in 1981, the political influence of unions has been greatly reduced. The proportion of National Labor Relations Board cases decided in favor of unions has dropped significantly.

Policies at the federal and state levels have also moved away from redistributive policies aimed at reducing poverty. Income taxes have become less progressive and welfare programs aimed at the poor have been drastically curtailed. Within Europe, unions remain strong and government has retained a commitment to social support programs.

"Low Road" Business Tactics. One of the largest factors that defined the end of the "Golden Age" was the decline in firm profitability across the board. Growth in productivity declined significantly, coupled with inflation and high unemployment of the late 1970s and the record interest rates of the early 1980s, caused businesses to rethink their corporate strategies. Some firms took the "high road" investing in new technologies and aggressively retraining their labor force in an attempt to maximize revenues. Most firms, however, took the "low-road" of aggressively seeking to minimize costs. This "low road" strategy involved demanding concessions from labor, movement to a flexible workforce (i.e., part-time and temp-workers), relocation of operations to low cost developing countries, and demands for lower taxes and fewer regulations.

Cast in the light of dual labor market theory, the primary labor market includes management and professionals where wages and benefits are high and are augmented with profit sharing plans. The secondary market, traditionally the realm of unions, is now composed of part-time and temp-workers where no benefits are offered and the chance at promotion are limited. The raising income inequality is directly tied to the two components of the dual labor market.

Independently, each of these explanations of the "Great U-Turn" in economy equality provides pieces of the complex puzzle. But, in unison, a complete picture is offered.

Additional Readings: *The Political Economy of Inequality.* 2000. F. Ackerman, N.R. Goodwin, L. Dougherty and K. Gallagher editors. Island Press: Washington DC.

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