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In the 1980s, the rapid rise of income inequality led to debate about the nature and the causes of the new trends. The authors of this article were among the initiators of that debate, maintaining that the American economy had taken a "great U-turn" and that the middle-income population was now shrinking, leading to increased polarization between rich and poor. The article summarized here reviews the evidence for wage polarization in the 1980s and argues that rising inequality was caused by a change in management strategy that reshaped labor relations.

Income Distribution and Economic Growth

Growing inequality raises obvious normative concerns. It also has troubling economic consequences. In macroeconomic terms, it has been suggested that low incomes for a growing fraction of the workforce could lead to insufficient aggregate demand to sustain economic growth. In microeconomic terms, a growing pool of low-wage labor sends precisely the wrong signal to firms, encouraging them to compete on the basis of cheap labor rather than technological improvement and skill upgrading. Firms that survive, despite obsolete technology, because they can use low-wage workers, become caught in a low-level productivity trap from which there is no easy escape.

Overall productivity growth in the U.S. averaged about 1 percent annually in the 1970s and 1980s, compared to well over 2 percent in the 1950s and 1960s. Given this productivity performance, it is not surprising that average weekly wages stopped growing in the early 1970s. After reaching an all-time peak in 1973, real average weekly wages fell by 9 to 16 percent, depending on how they are measured, by 1987. Of course, stagnation of the average wage need not lead to increased inequality; but in the U.S., the two trends have occurred together. The U.S. was not alone in experiencing this pattern; trends in inequality exhibit a similar "U-turn" at about the same time in Canada and in several European countries for which data is available.

Inequality and Polarization

The growing inequality of earnings could, in theory, result from increasingly unequal distribution of hours of work. While there has been growth in part-time employment, the rise in inequality does not primarily result from the distribution of hours. In fact, it can be seen in the earnings of year-round, full-time workers, who usually represent 55 to 60 percent of the U.S. labor force.

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To illustrate the polarization of earnings among year-round, full-time workers, consider the proportions of this group with particularly high or low earnings. The proportion earning less than 50 percent of the 1973 median, in real terms, was roughly constant throughout most of the 1970s, then rose steeply after 1978. The proportion earning more than 200 percent of the 1973 median fell slightly during the 1970s, then began rising after 1981. As a result, the middle group, earning between 50 and 200 percent of the 1973 median, was shrinking in the 1980s.

Disentangling Stagnation from Redistribution

There is a risk of some confusion in using a fixed median wage, e.g. from 1973, to define high and low wage workers over time. Yearly changes in the average wage, as well as the redistribution of earnings, will affect the numbers in the high and low wage groups. Moreover, the experience of men and women should be examined separately, since they have very different average wages and average rates of growth in earnings.

To address these issues, low and high wages can be defined as less than 50 percent, and more than 200 percent, respectively, of current year medians, separately for each gender. On this basis, mid-wage workers dropped from 81.0 percent of male year-round full-time workers in 1979 to 76.3 percent in 1987, a drop of 4.7 percent. Among women the drop was even steeper, from 88.2 percent in 1979 to 81.7 percent in 1987, or 6.4 percentage points. The majority of those who left the mid-wage group fell into the low-wage group, for both men and women. Thus "downward redistribution has clearly been the prime cause of the growth in low-wage employment." (361)

Explaining the U-turn in Inequality

There are several possible causes of the rise in earnings inequality. A sustained slowdown in growth could cause a breakdown in union wage agreements that formerly equalized earnings, as appears to have occurred in Sweden in the 1980s. Or, as in the U.S. in the 1980s, stagnation could cause a breakdown in traditional wage contours, i.e. the widespread follow-the-leader patterns of wage setting that prevailed after World War II. Technology could have changed in ways that promote dualism between leading and lagging sectors. Demography could be blamed, at least in the 1970s, as the baby-boom generation of inexperienced young workers flooded the labor market, lowering entry-level wages. Another popular theory attributes the change to deindustrialization: since manufacturing has relatively high means and low variances of wages, increased inequality would result from the shift of labor from manufacturing into services, where there is a relatively low average and high variance of wages.

A simple statistical test finds that wage dispersion is related to productivity growth and to manufacturing employment, just as expected (more productivity and more manufacturing jobs both tend to create more equal earnings). However, once these factors, and the business cycle, are taken into account, demographic variables do not add meaningfully to the relationship. A full explanation for the U-turn in wage inequality requires consideration of other factors.

The Flexibility Debate and Wage Dispersion

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What is missing from the mainstream debate over the U-turn is the possible role of management's attempts to increase labor market flexibility. Growing inequality of earnings could result from corporate responses to the "profit squeeze" of the 1970s. By any of several measures, corporate profits fell throughout the developed world after the mid-1960s; the fall was particularly severe in manufacturing. A variety of explanations have been proposed for the decline in profits, but whatever the underlying causes, lower profit rates led to new corporate strategies.

Many of these strategies have been described as the pursuit of flexibility in different aspects of business operations. Some authors have argued that businesses are responding to fast-changing markets by adopting "flexible specialization," with customized, small-scale production allowing rapid response to shifts in demand. Businesses are also seeking flexibility in the definition of work tasks, the deployment of resources, relationships with suppliers (as in the "just-in-time" inventory system), and other areas. The growing importance of part-time and other contingent workers of course allows employers added flexibility in controlling the labor process. Finally, the widespread attempts to reduce wages and avoid unions embody the most extreme vision of flexibility for management.

A few aspects of this process can be quantified. An international comparative study found that average plant size was shrinking in the 1970s and 1980s, especially in manufacturing. Meanwhile, the average number of plants per firm and the number of legally distinct firms were growing. Smaller firms, on average, pay lower wages and benefits, have lower levels of unionization, and in some cases are exempt from protective legislation; thus the move to smaller firms has significant risks for workers.

Of perhaps even greater significance is the wave of corporate demands for wage concessions. Initially justified as a response to the recession of the early 1980s, wage freezes or outright reductions were written into many collective bargaining agreements – and continued to expand long after the 1982 trough of the business cycle. Other "innovations" in the employment relation have included two-tiered pay scales, increased use of pay-for-performance or bonus schemes, contracting out, and restructuring of full-time into part-time jobs. All of these changes are likely to increase inequality in the distribution of earnings.

The 'Low Road' to Profitability

Why have so many American (and British, though usually not other European) managers taken the low road to resolving the profit squeeze? Part of the answer is the current weakness of the labor movement. Stronger unions would have pressured employers to adopt productivity-enhancing, rather than wage-cutting, strategies. The absence of unions does not cause companies to abandon the high road of innovation and productivity growth – but it allows them to choose the easy way out.

Other factors promoting the low road include: the fluctuating and uncertain economic environment, in which it appears safer to cut back than to make bold new investments; the growing dependence on equity finance, with its demands for short-term profits; and the

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chronically high interest rates of the period, which were an attempt to control inflation and other macroeconomic turmoil.

It is by no means certain that the negative trends of the 1980s will all continue. But it is clear that the rise of wage inequality and polarization were not simply cyclical phenomena that would disappear with sufficiently strong economic recovery. "Whatever structural changes have conjoined to produce the growing disparities between well paid and poorly paid workers in the U.S. and elsewhere, there is no longer any reason to doubt that these socially and economically disruptive trends are likely to be with us for a long time to come." (370)

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