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One of the most troubling aspects of the surge of inequality since the mid-1970s is the sharp decline in real earnings for less-skilled workers, particularly for men with a high school education or less. Most economists and policymakers attribute the problem to a decline in the demand for low-skill workers, which is seen as a result of technological change and/or international trade. This essay challenges the conventional interpretation. Based on a careful analysis of the timing of labor market changes and the particular groups that were affected, the author argues that changes in management practices and government policies provide a better explanation of the collapse of low-skill wages..

The Collapse and the Standard Explanations

The collapse in the real value of workers’ paychecks is a well-known and troubling development in the U.S. labor market. Average real weekly earnings for production and nonsupervisory workers rose steadily after World War II until the 1970s, then fell steadily from 1973 to 1990. The gap between more and less educated workers widened rapidly, particularly among men. In the 1980s, real earnings rose 5% for men with college degrees, while falling 11% for male high graduates and 20% for high school dropouts.

The collapse at the bottom of the earnings ladder is almost universally attributed to downward shifts in the demand for low-skill workers; there is said to be a mismatch between the skills employers demanded and those that workers could supply. The most popular explanation for the skill mismatch is technological change in the workplace, perhaps augmented by growing import competition from low-wage developing countries. Technology and trade are thought to have reduced the demand for low-skill American workers, a pattern which is apparently consistent with the empirical evidence of skill upgrading, introduction of computer-based workplace technologies, and the growth of imports in the 1980s. The technology-trade explanation is also consistent with simple supply and demand models of the labor market - and it leads directly to the policy conclusion that education and retraining are the only appropriate responses to the wage collapse.

Computerization and the Demand for Skills

Two major empirical studies are often cited to support the “fact” that skill-biased technological change caused a collapse in the demand for low-skill workers (Berman, Bound and Griliches

1994, and Katz and Murphy 1992). These studies demonstrate that both substantial skill upgrading and computerization of workplaces occurred in the 1980s, and infer that there is a causal connection.

Yet on closer examination, the two great changes of the 1980s were not simultaneous. Investment in computers and related equipment took off only after 1983, increasing from less than \$200 per full-time worker in 1982 to more than \$600 in 1989 and more than \$1000 in manufacturing by 1992. However, these studies present annual employment figures that show that virtually all of the observed skill upgrading had taken place by 1982. For lack of better data, skilled work in manufacturing is often identified with the category of nonproduction workers; the nonproduction worker share of manufacturing employment climbed rapidly in the early 1980s, but was the same in 1983 as in 1989. And it has remained essentially unchanged in the 90s.

Further analysis by the author confirms the stability of the skill mix in manufacturing after 1983. The ratio of skilled craft workers to unskilled laborers in manufacturing actually dropped slightly from 1983 to 1988, while the ratio of craft workers to semi-skilled workers remained constant. In contrast, in the service sector there was a modest decline in the employment share of low-skill white-collar workers, such as clerical workers, that occurred simultaneously with computerization in the late 1980s. However, the change in shares was not large, and service sector employment as a whole continued to expand.

Joblessness and Low-Wage Employment Trends

If the 1980s were characterized by a strong “twist” in labor demand toward higher skills, the simple supply and demand model predicts that we should observe growing joblessness among low-skill workers and a declining share of employment in low-skill jobs. Again, the timing is wrong. For the 1970s and 1980s as a whole, there was an increase in unemployment, but the upward trend is visible only through 1982, before computerization became significant. Many measures confirm this pattern: for example, the proportion of black males aged 20 to 24 who were employed fell from 73% in 1973 to 54% in 1982, but then rose steadily to 64% by 1988. If the problem was a skill mismatch, why did joblessness increase so sharply in the decade before new computer technologies were introduced in the workplace, but show little or no increase when those technologies arrived?

The skill mismatch theory also predicts a decline in the employment share of low-skill and low-wage workers. The author’s calculations show that for workers under 40, there was steady decline from 1975 to 1990 in the proportion with a high school degree or less as predicted by the theory. However, the proportion of young workers earning no more than 1.5 times the poverty level actually increased, with the largest jump again occurring in the early 1980s. The same is true for many individual industries. For example, in the auto industry the low-skill employment share declined from 76% to 71% between 1975 and 1990, but the low-wage share grew from 17% to 40%.

Further evidence that the skill mismatch does not explain the actual patterns of low wages can be found in the much-discussed contraction of the middle of the earnings structure, as corporate downsizing during the 1980s drove many workers into lower-paid jobs, even in boom years.

Throughout the 1980s about 20% of college graduates were working at jobs that don't normally require a college degree, and that proportion is expected to increase. The proportion of black and Hispanic college graduates with poverty-level wages rose from about 9% to 15% during the 1980s, casting doubt on the efficacy of education alone as a cure for low earnings.

Other problems have been found with the skill-biased technological change argument. Although some researchers found a statistical link between earnings and computer use at work, others found similar results from using pencils.¹ It is likely that computer users have unobserved, valuable skills or that computers were first introduced in higher paid occupations. Another study found that research and development (a proxy for technological change) is associated with higher wages for college graduates, but is unrelated to wages for other groups. Finally, some computer technologies, such as scanning devices used by cashiers, can reduce skill requirements and expand job opportunities for the least skilled.

The Political Economy of the Wage Collapse

An institutionalist framework is needed for an adequate explanation of wage trends in the 1980s. In such a framework, “[d]emand and supply matter, but so do management strategies, worker militance and organization, and perceptions of fairness and community values.” [28] Workers and employers bargain over wages, individually or collectively, and the outcome reflects their relative strengths as well as factors like productivity, incentives and morale.

In the late 1970s, faced with growing competition from the recovering economies in Europe and Japan and from newly industrializing countries, employers became more confrontational in their approach to workers. Some firms took the “high road,” investing in the technology and training necessary to create high-performance workplaces. Most, however, appear to have taken the low road, making reduction of labor costs their top priority. They undertook what Douglas Fraser, then president of the United Auto Workers, called a “one-sided class war”: downsizing, demanding concessions in wages and benefits, outsourcing or relocating production to low-wage regions or countries, and increasing part-time and contingent employment.

Political and ideological shifts in the direction of a laissez-faire approach to management strategy and economic policy led to reductions in regulation and a freer hand for market-based economic activity. The financial sector reinforced the focus on cost-cutting and profit-maximizing, putting the short-run interests of stockholders first and workers last. Unions came under attack as management demanded (and usually got) reopening of contracts to freeze or reduce wages, hired permanent replacements for striking workers, and relocated work to non-union facilities. The real value of the minimum wage fell sharply.

“The consequence of low-road employment policies ... has been declining real wages for those with the least skills and ... a job structure that is being transformed from one with a diamond shape (lots of good, relatively low-skilled jobs) to one with an hourglass shape (only the best and worst jobs are expanding).”[36] Since the skill mismatch alone does not explain the wage collapse, education alone cannot solve the problem. Few would, or should, oppose efforts to raise skill levels, but there is a need for public policies that will create better jobs as well as “better” workers. Tax or benefit policies should be designed to raise the after-tax incomes of

low-wage workers. All of America's leading international competitors in the developed world have stronger labor market institutions and more active government intervention, suggesting that the declining position of American workers cannot be blamed solely on competition.

Notes

1. Studies on both sides of this debate are summarized in our previous volume, *The Changing Nature of Work*.