The Plight of Labor

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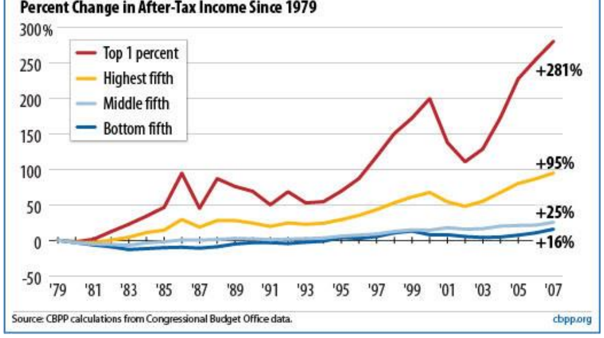
Over the past three decades, the U.S. economy has evolved in a way that has widened the gap between rich and poor, reversing the trend toward a growing middle class that had been in place since the early1900s. While slight real income gains have been made at the lower end, the wealthiest Americans have improved tremendously. Many economists will tell you that since the early 1980s, productivity and wages have diverged after decades of moving in lock step. However, as pointed out by James Sherk of the Heritage Foundation, this is not really true. When you include benefits in addition to wages and adjust properly for inflation, total compensation has basically kept up with productivity. Yet, within this dynamic, the results are skewed. The highest-skilled, top-income earners have more than kept up with productivity while the lower-skilled have dramatically fallen behind. During this divergent period, corporations have experienced decreasing borrowing costs and debt burdens, lots of cash and, currently, record profit margins. This would imply potential investment opportunities are available with high rates of return on capital. Why is it that these corporations are not expanding rapidly, hiring cheap labor and investing in capital? Many say that the confidence of business has been shaken by the new health care laws, which are complicated and full of unknown costs affecting business decisions to expand. This may be true to some extent, but the widening income gap between higher- and lower-skilled workers began over 30 years ago and has continued unabated. What has occurred over this long 30-year period to undermine the price of labor?

Figure 1:
Income Gains at the Top Dwarf Those of Low- and Middle-Income Households



In the early 1980s, the personal computer began to take off, and it is not a coincidence that this is right at the point when productivity and low-skilled wages diverged. Hailed as a great productivity enhancement, computers accelerated the economic growth rate to match any other expansion period since World War II. As software applications blossomed, the imagination of entrepreneurs was unleashed to rapidly create new products, value and wealth. It empowered the gifted, the educated and the creative. The jobs of our waiters, groundskeepers, house painters and salespeople in stores have changed very little during this period. Computers have had the effect of eliminating many lower-skilled jobs while enabling the most educated. Productivity has certainly grown over the decades, but it is important to understand where the productivity gains have occurred. In my wealth management business, computers have eliminated back-office jobs, enabling fewer people to do more administrative work. They may be higher paid, but there are less of them. This pattern is repeated throughout many service industries, keeping labor demand low in spite of low wages. Computers create wealth and some jobs but eliminate jobs more quickly than the ones they have created. In today's world, the labor pyramid is getting inverted with fewer less-skilled jobs and more high-skilled jobs. In 1970, high school graduates qualified for 80 percent of all jobs performed in the United States. Today, that number is in the low 30s. The unemployment rate for college graduates is half that of non-college graduates. If you are an engineer, you can readily find work.

If wage pressure due to lower demand for unskilled workers is not enough of a problem, the world scene has contributed as well. With the economic rise of China, India and parts of Latin America, we are witnessing a unique period in that the majority of the world population is economically emerging. There is a plethora of cheap semiskilled labor the world has never seen before. Since World War II, we have witnessed small countries emerge in isolated examples by utilizing cheap semiskilled labor. Taiwan, South Korea, Poland and others have had rapid economic growth along with a huge rise in wages resulting in a large middle class with relatively little remaining poverty. During the 1950s, the vast majority of the world population was poor. We are now in the midst of an enormous shift in which 40 percent of the world's population are leaving farms and entering the international work force. This is a one-time event, and the result is an unprecedented amount of available labor for nimble global corporations.

This global story, however, does have a potential silver lining for labor. All industrialized nations witness low birth rates and, in many cases, stagnant population growth. The old adage is that agrarian cultures have many children for survival reasons. More farm workers assure that Grandma and Grandpa will be fed in their old age. Today, families in industrialized nations view children as a luxury. In affluent areas of our country, some believe that a larger family is a status symbol. They can afford them. In the long run, there will be no large emerging nations left to pressure wage rates. Assuming the labor is absorbed in a stagnant population, wage rates of some jobs might get quite high. Jobs that are immune to cheap overseas labor and also not readily replaced by computers might be very well paying. The low-paid waiters and house painters of today might find their skills in high demand in the future, but this is going to take a painfully long period of time.

The immediate problem is clearly that we have many high-skilled, unfilled jobs with many-lesser skilled people in the workplace seeking jobs, a huge mismatch. These mismatches are aggravated during weak economic periods. The current U.S. economic recovery has been extremely slow compared to past recoveries due in large part to the debt overhang we started with.   Historically, whenever the economy has emerged from a deep recession, growth and job creation have been swift, such as in early 1983. As debt has grown over the past three decades, each recovery out of recession has been slower, with the attendant slow growth in job creation. There is a clear correlation between total debt levels, as a percent of GDP, and the rate of recovery. In 2008, debt levels were as high as the late 1920s, right before the Great Depression. Although debt levels at the consumer level have declined nicely over the past few years, we still have a ways to go. The debt burden has contributed to slow growth as a sizable amount of cash flow has gone to pay off debt in lieu of buying goods and services. In spite of the large excess capacity in capital and labor, economic growth will be modest.

The current unemployment rate of 6.7 percent understates the extensiveness of the problem. During depressed economic periods, we always have people give up looking for a job and drop out of the labor force, but this time the labor participation rate has declined more than normal. The job market is so bad that if participation stayed the same, the jobless rate would be at least 10 percent. More important, the number of people looking for a job over six months is at a very high level not seen since the 1930s. This is not simply a problem of high costs to the system for unemployment payments or welfare checks. Having a segment of the population out of work so long creates a permanent class of dependents. It creates resentment and despair. The ripple effect of such things on crime and depression are widespread in a nation of high unemployment.

There seem to be few short-term solutions. The long-term solution is clearly higher education levels. On that score, the nation has come up short. Since 1970, due largely to the declining demographic of the Baby Boomers, the number of high school students has grown a mere 8 percent. During this period, the number of high school teachers and high school administrators has grown over 90 percent. The wealth poured into our school systems has been massive, but the results have shown virtually no improvement. A variety of approaches have been tried around the country, such as magnet schools, some of which have been quite successful. This topic is complicated, and the country's focus and emphasis on education are appropriate, but we must do a better job.

The structural issues of unemployment are the center of the nation's problems today. There are many headwinds that affect the labor market, but there is no greater path to national prosperity than job creation for these millions of people. Our long-term success is dependent on it.