

## U.S. Living Standards in an Era of Globalization

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The U.S. workforce has experienced downward pressure on wages and benefits over recent decades. Median and average wages have stagnated for thirty years, while the availability and quality of health insurance and pension benefits have substantially eroded (figure 1). By contrast, the concentration of wealth at the top of U.S. society has skyrocketed, to levels unseen since the 1920s.

Meanwhile, the world economy has also changed, with globalization weaving the United States and other countries into an increasingly close interdependency. Because the downward pressure on wages at home has partly coincided with the period of globalization, many have blamed the latter for the former. Some see this in nationalistic terms, as a rivalry between the United States and other countries, particularly China. Others see the problem as policies that favor the wealthy at home and abroad, noting that globalization has been very kind to U.S. billionaires. Still others believe that global market forces make declining living standards for most U.S. households inevitable.

Is there a causal link between globalization and U.S. wage stagnation or are rising inequality and eroding incomes driven by other causes? The question has enormous importance: It is essential to understand the

underlying cause-and-effect relationships in order to find solutions that can reverse or mitigate the unwanted consequences. It is also important because, left unaddressed, economic anxiety will corrode support for U.S. global engagement and could lead to other undesirable political behaviors as well.

The rupture between the fortunes of the U.S. economic elite and the rest of the country has drawn attention at the highest policy levels. Federal Reserve Board chairman Ben S. Bernanke, officials of the International Monetary Fund, and others have grappled with the issues and causes. This policy brief agrees in part with their analyses, which point to technological and global forces as causal factors, but it argues that *domestic policy choices* have also been a critical cause of stagnating incomes for most of the workforce and have interacted with technology and globalization in ways that make Americans more vulnerable to the harsher effects of globalization. The paper proposes an integrated set of policies to create a more promising economic future in the new global context.

### The Collapse of the Old Order

The golden age of broad-based economic expansion and opportunity for Americans was the quarter century after World War II. Large parts of the industrial capacity of Europe and

### Summary

U.S. wages have stagnated for the past three decades, while the workforce has also faced an erosion of job security, health care, and pension plans. This increasing economic insecurity has coincided with rapid globalization. Is there a causal relationship between the two?

This policy brief probes domestic and international economic changes over the past half century to argue that the main causes of eroding U.S. living standards have been “made in the USA,” as the postwar consensus in favor of egalitarian economic policy has broken down.

Creating a more promising economic future for the U.S. workforce will require the reform of domestic labor laws and the tax system—among the most difficult political debates in any country. Reforms of international economic policy are also needed. However, blaming foreigners or attempting to disengage the country from the global economy are not part of the answer. Instead, international economic policy should be reoriented to stimulate better worldwide growth and a more equitable distribution of the gains from globalization. These changes would provide a more favorable global environment for U.S. livelihoods over the medium to long term, after short-term solutions are found in the realm of domestic policy.



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Japan had been destroyed in the war. The U.S. manufacturing sector, scaled up for wartime production, was left unscathed and ready to satisfy demand in both domestic and hungry world markets, with purchases in the latter financed in part by the Marshall Plan. In the context of the Cold War, countries in the developing world were courted by both the United States and the then-USSR; they received economic support from the competing superpowers without constraints on their own economic policy space. Overall, it was a period of strong economic growth in most of the world.

On the home front, U.S. policies such as active macroeconomic demand management and generous veterans' benefits for housing and education stimulated a thriving domestic economy. Equally important, the New Deal legacy was still vibrant. A host of government policies balanced the interests of labor and capital, rich and poor. Employees had the right, favored by the government, to organize into unions and bargain collectively. This ensured that rising productivity and profit levels were shared with the workforce in the form of higher wages, health insurance plans, and pensions. Progressive taxation policies redistributed income from corporations and high earners to policies and public investments that

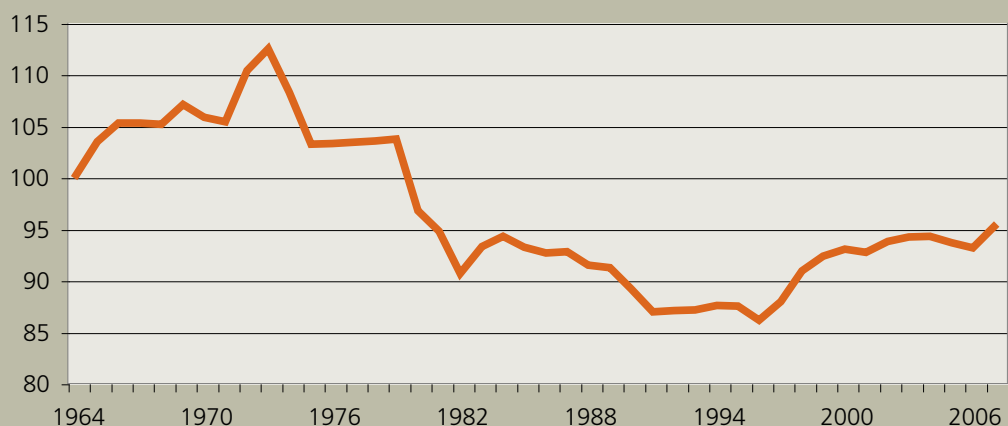
benefited the working and middle classes, including good roads, good schools, and subsidies to higher education. The political consensus in favor of Keynesian demand management supported steadily rising minimum wages and Social Security benefits. In the 1960s, a health care safety net was added in the form of Medicare and Medicaid. The civil rights and women's movements and antipoverty programs further expanded the circle of inclusion in U.S. prosperity. Governments of both parties—and the success of the U.S. economy—were measured in terms of gains in living standards and a growing middle class.

This golden age began to tarnish in the mid-1970s. Macroeconomic shocks (energy market disruptions, exchange rate misalignments, Vietnam War spending) played a role, but a more fundamental long-term factor was the gradual collapse of the domestic U.S. political consensus in favor of inclusive growth. Europe and Japan, having rebuilt their industrial bases, began to compete with U.S. manufactures. As U.S. firms faced growing competition from abroad, they tried to roll back the wages and benefits that had been won by strong unions in the preceding decades. In 1981, employers got a major strategic boost from the Reagan administration, which permanently replaced striking air traffic control-

**FIGURE 1**

### Index of Average Weekly Earnings of Non-supervisory Employees

Figures for January 1 of each year, adjusted for inflation



Source: United States Bureau of Labor Statistics, Current Employment Survey

lers and gradually weakened judicial protections for union organizing, bargaining, and the right to strike. Employers used their increased bargaining power to capture greater shares of productivity increases and profits that had previously been shared more equally with workers. Other legislated protections for employees, such as pension guarantees and minimum-wage levels, also became targets. Ideological conservatives argued for the unfettered functioning of markets, while business lobbies justified the erosion on grounds of foreign competition or stock market expectations. Reductions in welfare programs for low-income households put pressure on them to accept low-wage jobs, adding to the downward pressure on wages. Cutbacks in private pensions and health insurance shifted risk from firms to households.

Compounding these trends, tax policy was gradually turned from progressive to regressive, with corporations and high-income groups favored with tax reductions and the burden of supporting government increasingly shifted to middle-income households (figure 2).

Cumulatively, these changes in government policy and corporate attitudes were major causes of wage stagnation and increasingly precarious employment, health coverage, and pensions for middle-class households in the United States, despite ongoing productivity increases and overall economic growth.

While the U.S. social compact was dissolving, the global environment was also changing. The most significant change was the end of the Cold War and the integration of China, Russia, India, and the socialist bloc into the capitalist production system (see *Job Anxiety Is Real—And It's Global*, which is listed, along with the other publications mentioned here, in the Related Resources section). This added enormous productive capacity and a hard-working, low-paid labor force of almost 2 billion people. In its recent *World Economic Outlook*, the IMF estimates that the labor force effectively available to global producers *quadrupled* from 1980 to 2005, with most of the change occurring in recent years. This increase

in the supply of labor created heightened competition for jobs, downward pressure on wages, and stronger bargaining power for capital. The IMF study finds that labor's share of gross domestic product has declined in the United States and other advanced economies over the past quarter century, while capital's share has increased.

Technological change is often cited as the main cause of increasing inequality and downward pressure on the wages of less-skilled

### Globalization revealed and exacerbated, rather than created, the basic problems with the U.S. system.

workers. Computer-based changes in work processes undoubtedly increased rewards to higher education and eliminated some less-skilled jobs. However, recent research by economists Frank Levy and Peter Temin of the Massachusetts Institute of Technology shows that workers with college degrees are also capturing a smaller share of productivity increases than in earlier decades. This is particularly true for men with bachelor's degrees but recently appears to be affecting female college graduates as well. The expansion of global electronic transmission networks in the 1990s made it inexpensive to transmit massive amounts of electronic data internationally. This allows firms to shift computer-based, knowledge-intensive work abroad to take advantage of the expanded global labor force. The overseas offshoring of service-sector jobs has now added to the overall downward pressures on U.S. wages.

#### Understanding the Causal Relations

The domestic consensus that supported a relatively egalitarian U.S. economy and good living standards for a broad middle class had seriously eroded before the current phase of globalization began. Globalization revealed and exacerbated, rather than created, the basic problems with the U.S. system. However, the collapse of the domestic social bargain left U.S. workers and households more vulnerable to

#### BOX 1

#### How Do U.S. Households Maintain Consumption?

U.S. households responded to the thirty-year erosion of wages and benefits first by sending more workers, notably women, into the labor market. Two- and even three-income households replaced the postwar norm of a single breadwinner. More recently, households maintained living standards by saving less and borrowing much more, particularly from home equity, as the housing bubble drove up prices of the main asset of most U.S. families. Each of these strategies helped to maintain living standards and consumer demand. However recent trends suggest that these buffers are approaching their limits, as house prices decline and consumption weakens.

the pressures from a globalized labor market than their counterparts in countries with stronger social safety nets, better unemployment insurance and retraining schemes, universal health insurance, and portable pensions. The recent IMF study shows that, while labor's share of gross domestic product has declined in all advanced economies during the past twenty-five years, European workers still enjoy a larger share of their countries' wealth than U.S. workers. Europe is grappling with the same global pressures, but social safety nets have been strengthened in the Nordic countries. In France and Germany, modest reductions have left safety nets in place that would be the envy of anxious U.S. employees.

### Policies for a New Global Context

Is a continued decline in U.S. living standards inevitable, or is there a policy course that could restore broad-based income growth and assuage economic anxiety? Though *relative* U.S. incomes will decline as other parts of the world grow at faster rates, a different policy mix could lead to higher-quality job creation and mitigate insecurity. These policies would not retrace those of the postwar golden age. While the United States continues to be the only military superpower, the economic world has become decidedly multipolar. This reconfiguration changes the range of options available to the United States. A new combination of domestic and international policies will be re-

quired to set a course that produces good jobs in sufficient quantities, rebalances the interests of employers and investors with those of employees, and offers appropriate support to the increasingly large segment of the workforce at risk of job loss in a rapidly changing economy.

### Domestic Policy Reforms

New domestic policies should aim at three targets: changing labor laws to rebalance bargaining power between employers and employees, returning progressivity to tax policy, and mitigating the increased level of economic risk facing workers and households. Labor law is badly in need of reform in two areas: the right of employees to join unions and bargain collectively; and systemic reform of minimum-wage law. The right to organize at work has been profoundly weakened over recent decades, as employers have grown increasingly bold in using dismissals, intimidation, and lengthy delays to discourage unionization. The law must be reformed to fully protect the right of employees to organize, including by facilitating practices such as card-check recognition of unions and requirements for employer neutrality that allow employees to choose union representation without submitting themselves to harsh and protracted anti-union campaigns by their employers. The right to collective bargaining has been eroded by years of judicial interpretations of weak or ambiguous laws that favored rights of employers over rights of employees. For example, the right to strike has been seriously damaged by decisions allowing employers to hire permanent replacements for striking workers, thus effectively chilling the use of this bargaining tool. Laws must be strengthened and clarified to give employees more influence on decisions about their wages and benefits and the distribution of gains from productivity.

Also in need of reform is minimum-wage law, which has been set in a piecemeal fashion. Instead, the minimum floor for wages should initially be set with reference to the poverty line, to allow a full-time worker to earn enough to lift his or her household out of poverty.

#### BOX 2

#### White Collar Blues?

The U.S. economy has been reshaped by fundamental structural shifts since the golden age. Eighty percent of U.S. jobs are now in the service sector. Unlike the decades after World War II, manufacturing now employs only 12 percent of the workforce. As manufacturers shed workers, unionized jobs with middle-class pay and benefits were replaced by lower-paying positions, often with no benefits, in the service sector. However, the fact that most service-sector jobs today are not adequate replacements for manufacturing jobs is not inevitable, but the result of policy choices by government and firms. There is no reason why service-sector jobs at the high, medium, and low skill levels cannot provide remuneration comparable to similarly productive jobs in manufacturing. The difference is that the manufacturing sector predominated at a time when union organizing was protected by law and encouraged by the government, whereas the service sector has expanded under weakened labor and minimum-wage laws and a more hostile employer environment.

Currently, over 30 million workers—one-fifth of the U.S. workforce—earn less than the \$9.80 per hour that would be required for a sole wage earner to lift a family of four out of poverty. The minimum wage should also be indexed to inflation and increases in worker productivity. This productivity link would help to distribute the gains from productivity more broadly across the economy and correct the disproportionate capture of gains by investors and corporate executives. This would be good for both low-income households and domestic demand. If the minimum wage grew with average productivity gains, it would also steer capital toward more productive firms that succeeded by increasing the productivity of minimum-wage workers rather than toward firms relying on sweatshop wages. This would increase the overall efficiency of the economy.

Rebalancing economic interests will also require major reforms to the tax code, which has been inverted from a progressive to a regressive system. Corporate income taxes have declined from 53 percent of government income tax receipts in 1960 to 34 percent today, while the top marginal tax rate for the wealthiest households has been reduced from 91 to 35 percent over the same period (figure 2). Without a progressive tax code, the United States cannot reclaim its historical character as a society offering opportunity for all and cannot afford the improvements in education, social safety nets, research, and infrastructure that are required to achieve both security and dynamism in the economy. As noted in box 1, adjustment strategies such as sending more household members into the workforce and drawing equity out of rising house prices have allowed low- and middle-income households to maintain spending in the face of stagnant incomes. As those strategies reach their limits, consumer demand will stagnate, as is already becoming apparent. Tax reform will become not only a political necessity but also an economic necessity.

The third major sphere for domestic policy reform is the creation of a modern social safety net that will hold even under conditions of

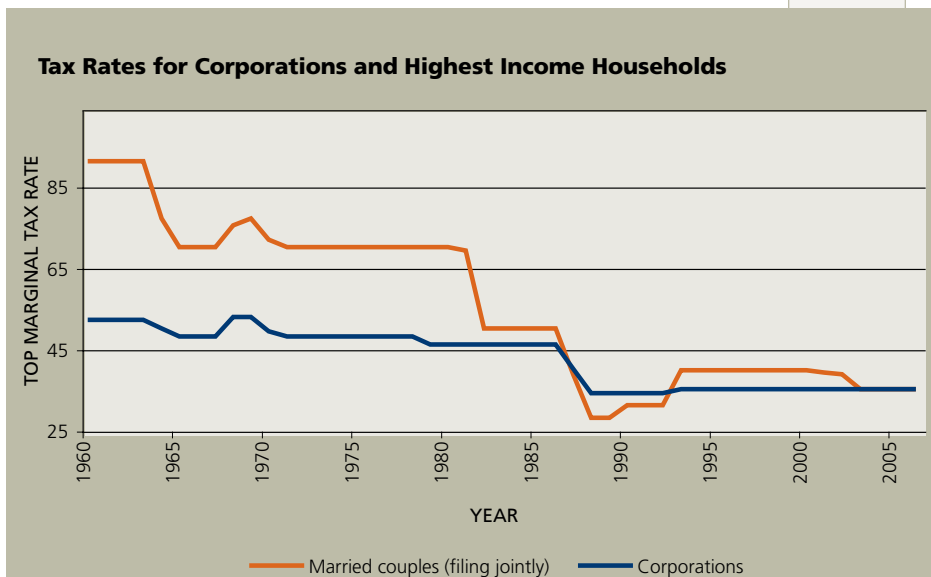
globalization and rapid change in the domestic economy. It should include expanded unemployment insurance, with wage insurance for older workers who lose their jobs and can find only lower-paid employment. Job-retraining programs must be much better funded and targeted to future job opportunities. The safety net should also encompass universal access to health insurance, funded by employer and employee payroll taxes and general revenue sources. Medicare funding and efficiency must be strengthened. Private pension plans should be made fully portable, with strengthened legal requirements for adequate funding, equity, and security. Social security taxes must be increased to guarantee the soundness of the retirement safety net and to underpin domestic demand as the population ages.

Such a safety net is not out of reach in the era of globalization. As noted above, European countries offer similar or better safety nets, allowing their citizens to adjust to change with less economic pain. Despite the taxes required to maintain these programs, many European firms are more successful in competing in global markets than their U.S. counterparts (box 3).

### International Policy as if Livelihoods Mattered

At the international level, a new approach to trade policy should be adopted that prioritizes

FIGURE 2



broad-based, sustainable growth and job creation throughout the global economy. In recent years, the U.S. government has used its trade clout to wrest benefits from other countries for overseas U.S. investors and for politically influential sectors, such as agriculture and pharmaceuticals. These narrowly targeted gains have not benefited the U.S. economy as

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a whole and have drawn resistance from other countries, reducing cooperation on common economic challenges such as the need for job creation. We have recently seen the limits of U.S. economic strategy in the stalled Doha negotiations of the World Trade Organization and the unsuccessful efforts to force China to revalue its currency.

A more appropriate international economic policy would emphasize the need to increase global demand for labor (given the current oversupply) and thereby increase the demand for goods and services, particularly in the developing world. The supply of goods and services from developing countries has grown enormously, while their demand has increased far too modestly, producing severe trade imbalances. Demand in many countries is de-

pressed by persistent, widespread poverty, especially in the countryside, which prevents households from consuming the food, manufactured goods, and services they need.

Any serious attempt to address the global oversupply of labor must begin in the field of agricultural trade. The United States and other wealthy countries offer agricultural subsidies to their farmers that induce overproduction, with the surpluses sold below cost to the rest of the world. This causes prices for farm goods to fall in the developing world, lowering the incomes of already poor farmers or forcing them off the land. That in turn further reduces their household demand and aggravates the oversupply of unskilled workers who are looking for work in already crowded manufacturing industries or migrating abroad. This reinforces downward pressure on national and global wages, completing a vicious cycle. The experience of Mexican corn farmers is a well-documented example.

U.S. trade and farm subsidy policies should be revised to end the current perverse pattern of agricultural trade, whereby high-income farmers in developed countries displace low-income farmers in developing countries. The United States should drop its insistence that countries with large numbers of poor farmers, such as India and Kenya, must open their agricultural markets to subsidized U.S. farm exports. These countries should instead be allowed time to create jobs in modern sectors in sufficient numbers to absorb farmers before the latter are displaced by the forces of international competition.

A related U.S. trade policy that goes in the wrong direction is the strategy of “competitive liberalization,” under which the United States seeks trade agreements with small countries that have relatively little bargaining power and insists on terms that lopsidedly favor the politically connected U.S. interests discussed above. These pacts displace the poorer countries’ producers in agriculture and other sectors, with a negative impact on employment and wages.

It should become accepted policy in all trade negotiations to evaluate potential trade

**BOX 3**

**Does manufacturing have a future in the United States?**

It is not inevitable that U.S. manufacturers cannot compete with producers in other countries. Under current conditions of global competition and overcapacity, Germany is the world’s largest exporter of manufactured goods, ahead of China and the United States. German wages and benefits are higher than those in the United States and the safety net is considerably stronger. A combination of product quality and high productivity (by motivated workers who have a seat on firms’ boards of directors) provides a strong foundation for competitive exports. By contrast, in the United States, fragmented, inefficient, and expensive health care and pension plans put disproportionate burdens on U.S. manufacturers. U.S. investment in research and development has declined as a share of GDP, allowing U.S. product quality to erode. Inefficient energy use, both in production and product design, reflects a failure of national policy and a failure of U.S. firms to voluntarily create energy efficient products that can compete abroad.

pacts in advance for their net impact on overall employment and on sectoral employment in both the United States and its trading partner countries, using modern modeling techniques. In addition to determining whether an agreement would create or destroy more jobs, this approach would also allow estimates of the extent of structural adjustment that would be induced and the costs in terms of transitional unemployment.

A more constructive approach is also needed with respect to the link between trade and labor standards. Modern trade pacts address not just tariffs but also a broad range of issues including the overseas rights of investors, as mentioned above. In the 1990s, the United States began to insist on protecting the rights of workers in its trading partner countries, with a view to distributing the gains from trade to more workers and households in those economies. This policy approach was scaled back by the George W. Bush administration. However, a recent pact between congressional Democrats and the administration reestablishes the goal of improving basic worker rights as part of trade agreements and restoring some balance between the rights of workers and those of investors, a desirable step in the context of global labor oversupply. The effective monitoring, oversight, and enforcement of such provisions would further enhance the quality of employment and incomes abroad and increase global demand.

## Conclusion

The creation of full employment and good living standards is not the inevitable result of market forces. Egalitarian growth results only when an appropriate framework of government policies has been put in place to achieve wide distribution of the fruits of economic advance. During the New Deal and the postwar decades, the United States developed such a framework, but it was subsequently dismantled. In the current globalized economy, with a high and sustained pace of economic change, a new framework is required that creates opportunity, distributes rewards more fairly, and

mitigates the increased risks faced by working households.

Some advocates for the U.S. workforce seek to disengage the country from the global economy, for example, through higher tariffs or punitive actions toward perceived national rivals. This is a mistake. Globalization has greatly benefited many U.S. firms and investors while dealing losses to many U.S. workers and households. However the unfair distribution of gains and losses can be traced largely to *domestic* labor, social, and tax policies and to the priority placed by the U.S. government on achieving

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gains in international negotiations for a few sectors and elites. Closing the U.S. economy would choke off important sources of growth and destroy jobs in many industries.

It is not possible to recreate the global and domestic conditions that so favored the U.S. workforce in the postwar period. However it is possible to create a new policy framework that supports and encourages job creation, good living standards, and political cohesion—at home and abroad—under conditions of globalization. Achieving these goals requires a clear analysis of the current global environment and the factors stressing U.S. living standards and, above all, the political will to restore balance and equity to U.S. domestic and international policy. ■

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## Related Resources

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**The Level and Distribution of Economic Well-Being**, Ben S. Bernanke, Remarks before the Greater Omaha Chamber of Commerce, Omaha, February 6, 2007 (Federal Reserve Board), <http://www.federalreserve.gov/boardDocs/Speeches/2007/20070206/default.htm>.

**Will the Middle Class Hold? Two Problems of American Labor**, Alan S. Blinder, Testimony to the Joint Economic Committee of the U.S. Congress, January 31, 2007, <http://www.jec.senate.gov/Documents/Hearings/blindertestimony31jan2007.pdf>.

**World Economic Outlook**, chapter 5, “The Globalization of Labor” (International Monetary Fund, April 2007), <http://www.imf.org/external/pubs/ft/weo/2007/01/index.htm>.

**Inequality and Institutions in 20th Century America**, Frank S. Levy and Peter Temin (Department of Economics Working Paper 07-17, Massachusetts Institute of Technology, May 2007), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=984330](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=984330).

**The Evolution of Top Incomes**, Thomas Piketty and Emmanuel Saez (NBER Working Paper 11955, National Bureau of Economic Research, 2006), [p://www.jourdan.ens.fr/piketty/fichiers/public/Piketty-Saez2006.pdf](http://www.jourdan.ens.fr/piketty/fichiers/public/Piketty-Saez2006.pdf).

**Combining Global and Local Forces: The Case of Labor Rights in Cambodia**, Sandra Polaski (*World Development* 34, no. 5, May 2006), <http://www.carnegieendowment.org/files/WDCambodia1.pdf>.

**Job Anxiety Is Real—and It’s Global**, Sandra Polaski (*Policy Brief* 30, Carnegie Endowment for International Peace, April 2004), <http://www.carnegieendowment.org/publications/index.cfm?fa=view&id=1504>.

**Winners and Losers: Impact of the Doha Round on Developing Countries**, Sandra Polaski (Carnegie Endowment for International Peace, 2006), [www.carnegieendowment.org/publications/index.cfm?fa=view&id=18083](http://www.carnegieendowment.org/publications/index.cfm?fa=view&id=18083).

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