



Declining Economic Opportunity in America

Isabel V. Sawhill and Daniel P. McMurrer

America has always called itself “the land of opportunity.” Reality has never quite matched the rhetoric, but a number of factors historically have brought America progressively closer to that ideal. The continued expansion of opportunities to previously excluded groups, the extension of education to an ever-increasing share of the population, and the impressive economic growth that prevailed for many years all made it easier for opportunity to spread broadly through the population.

In recent years, however, this record has not been sustained. The period since the early 1970s has been marked by an unprecedented decline in opportunity for many, especially young men without college degrees. Today, it is more difficult than it has ever been for young workers to surpass their parents’ standard of living, thereby achieving the proverbial American dream.

The decrease in opportunity is illustrated by the average earnings of young men. Men born between 1938 and 1947, who were ages 25 to 34 in 1972, had average incomes of \$30,000 that year (in 1993 dollars). Men born between 1958 and 1967, by contrast, who were 25 to 34 in 1992, averaged about \$22,000 in that year—a precipitous drop (see Chart 1).¹ Similar trends prevail with regard to family and household incomes,² although an increase in the number of two-earner families and growth in fringe benefits have partially offset the effects of the decline in individual wages.³

Overall, young men today have lower incomes than their counterparts did in earlier years.⁴ This reduction in relative well-being early in the earnings cycle is likely to persist or even worsen as this generation ages.⁵

These economic trends could well have political consequences, as those affected look for someone to blame for their downward mobility.

Causes of the Decline in Intergenerational Opportunity

What has gone wrong? Two broad economic trends lurk behind the recent decline in opportunity. First, economic growth has slowed significantly since 1973, causing average earnings to stagnate. Almost simultaneously, earnings inequality has increased, bringing about a dramatic reversal of the trend toward greater equality that had prevailed since World War II. Either trend, occurring alone, would have had troubling consequences. The two trends together have wrought a wrenching change in prospects for many members of the younger generation.⁶

Today, it is more difficult than it has ever been for young workers to surpass their parents’ standard of living, thereby achieving the proverbial American dream.

Slower Economic Growth

Upward economic mobility and strong economic growth have frequently gone hand in hand. Indeed, in comparing the United States with other countries, some scholars have suggested that the faster rate of economic growth that prevailed in the United States until recently is the primary reason this country enjoyed greater social mobility.⁷

Productivity has increased at an average annual rate of about 2 percent since 1870. The 1960-1973 period saw especially strong growth, with productivity increasing by 3.0 percent per year.⁸

The good news did not last. Productivity slowed to a crawl after 1973—an average of 1.1 percent per year between 1973 and 1993.

Because the compensation of workers tends to track their productivity, real wage growth slowed commensurately.

What is the impact on an average worker of this slowdown in productivity from 3.0 percent annually to 1.1 percent? Quite a lot. In 1973, the typical male high school graduate could expect an average full-time entry-level wage, in 1993 dollars, of \$20,820 (see Chart 2). If productivity had continued to grow at the *higher* rate of the earlier postwar period, and if that growth had benefited everyone equally, entry-level wages for a male high school graduate by 1993 would have been over \$16,000 higher (\$37,603). Distributed equally, the *actual* (slower) growth in productivity would have increased entry-level wages for male high school graduates by only about \$5,000 from 1973 to 1993 (to \$25,912).

Thus, the slowdown in productivity growth by *itself* has sharply curtailed the opportunity for the average male high school graduate to improve on standards of living enjoyed by previous generations. Because of the productivity slowdown, his entry-level wages are only slightly higher on average than those of the cohort born twenty years earlier.⁹

Increasing Earnings Inequality

But this is not the end of the story. An increase in earnings inequality exacerbated the effects of the decline in productivity growth. When rising inequality is also taken into consideration, the entry-level wages for a male high school graduate working full-time were only \$14,518 in 1993, more than \$6,000 *lower* than entry-level wages in 1973. This is over \$23,000 less than would have been expected if there had been faster growth from which everyone had benefited equally. Thus, the combined costs to this group of slower growth and rising inequality have been enormous. Each accounts for

approximately 50 percent of the \$23,000 gap.

The increase in inequality has been documented and analyzed by numerous researchers, who have concluded that wage inequality today is higher than at any time since World War II.¹⁰ It began to increase during the 1970s, surged during the early 1980s, and has since continued to increase.¹¹

for *entry-level* wages, where the “wage premium” for college graduates was 77 percent in 1993, an increase from 37 percent in 1979.¹²

Most analysts attribute the increased wage differential for education primarily to a substantial increase in the demand for more-educated workers, a shift that appears to have been driven by factors related to technological change. Workers who use computers on the job enjoyed faster wage growth than other workers during the 1980s, which supports this view.¹³ Indeed, the forces related to technological change are considered so powerful that they are generally assigned a significant percentage of the responsibility for the overall increase in wage inequality in the United States.¹⁴

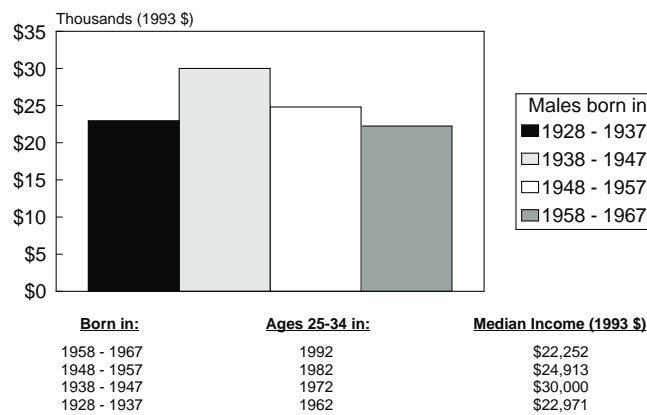
What Can Be Done?

Stagnating incomes and increasing earnings inequality have

reconfigured the economic landscape for tens of millions of Americans—particularly younger Americans. Government did not create these problems and they are too large and deeply rooted for the public sector to solve alone. But it can help.

Government should target its energies to areas in which it can be most effective—such as reducing the deficit, which is a drag on economic growth, and using its leverage, leadership, and limited resources to encourage early childhood education, local school reform, more private sector job training, and greater portability of benefits. It should also extend various kinds of help—such as retraining and placement assistance—to workers who lose their jobs. The evidence that such assistance increases future earnings or employment is mixed. But it can at least cushion the impact of current trends on those least likely to prosper in the new economy. At the same time, other social institutions—

CHART 1
Young Adults Have Lower Incomes than Their Parents Did at the Same Age
(Median Income of Males, 25-34, by Birth Cohort)



Source: U.S. Bureau of the Census, P60-184 (1992), p. B-33.
Urban Institute, 1996

Males, younger workers, and those who are not college-educated have been particularly affected by the combined trends. Although trends in *inequality* have been the same for men and women, male median earnings have decreased even as female median earnings have increased (in part because of their increased work hours). At the same time, work experience is more highly rewarded by employers than in the past, so younger workers without this experience have also seen a disproportionate decrease in their wages.

Most important, less-skilled, less-educated men have experienced particularly sharp drops in real earnings. In part, this is a result of a significant increase in the pay differential between college-educated workers and others, with college graduates (male and female) earning 58 percent more than high school graduates in 1993, compared with 38 percent more in 1979. The disparity is even greater

families, schools, local communities, and businesses—must all play a role in preparing the next generation for a world in which education will increasingly determine the success of both individual citizens and the nation as a whole.

There is no sense in pretending the solutions—public or private—will be cheap or financing them easy. Indeed, in the present fiscally constrained environment, making the necessary investments will require shifting more of society's resources from the support of an aging population to education, training, and other types of assistance aimed at preparing younger families to take full advantage of today's opportunities.

Government should at a minimum avoid actions that make matters worse. Proposals to reduce assistance to lower-income families (such as cuts in the Earned Income Tax Credit) or to reduce the taxes paid by those who are doing well are especially misguided in the face of a rising tide of inequality. To ignore this trend is to invite a political backlash that would be both divisive and inimical to further growth.

The New Deal worked to soften the rough edges of capitalism at a time when the foundations of a market-oriented economy were under great stress and subject to political challenge. In the 1990s we face a similar challenge. We need to forge a public philosophy that recognizes the benefits of living in a dynamic, technologically advanced economy but is also responsive to the collateral damage it inflicts on many workers and their families.

Notes

1. It should be noted that these numbers slightly underestimate the actual change in total compensation because they do not include fringe benefits, which

have constituted a rising proportion of compensation over time.

2. See Lawrence Mishel and Jared Bernstein, *The State of Working America: 1994-1995*, M.E. Sharpe, 1994, p. 74.

3. The increase in the number of female-headed households, however, has exacerbated the effects of the wage decline. See, e.g., Robert I. Lerman, "The Impact of the Changing U.S. Family Structure on Child Poverty and Income Inequality," *Economica* (forthcoming).

"Baby Boomers and Their Parents," *Journal of Human Resources*, vol. 30, 1995, pp. 791-806.

5. See, e.g., Easterlin et al. (1993), who find that "higher income for a cohort at earlier ages typically foreshadows higher income at later ages." Easterlin, Richard A., Christine M. Schaeffer, and Diane J. Macunovich, "Will the Baby Boomers Be Less Well-Off Than Their Parents? Income, Wealth, and Family Circumstances Over the Life Cycle in the United States," *Population and Development Review*, vol. 19, 1993, p. 503. Mishel and Bernstein (1994) find that, in recent years, median family incomes have not only started at a lower income for younger cohorts, but have also grown more slowly than in the past as the members of the cohorts get older.

6. It should be noted that real wage growth has slowed and inequality has increased in other industrialized nations as well, although the trends have been most pronounced in the United States. See, e.g., *Economic Report of the President 1995*, p. 172.

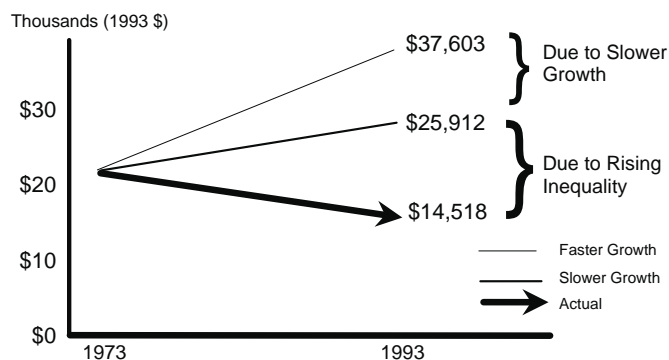
7. See, e.g., Daniel Heath (ed.), *America in Perspective*, Houghton Mifflin Co., 1986.

8. *Economic Report of the President 1996*, p. 332. All productivity statistics reported here are defined as output per hour in the nonfarm business sector, reflect the January 1996 comprehensive revisions of the national income and product accounts, and were computed using chain-type output indices. At this time, revised data are not available prior to 1959. Earlier (unrevised) data suggest that the rate of productivity growth that prevailed between the end of World War II and 1959 was slightly lower than the rate between 1960 and 1973.

9. Because this example assumes that the impact of the change in productivity is distributed *evenly* across the labor force, the preceding two sentences apply to all workers—not only male high school graduates.

10. See, e.g., Frank Levy and Richard J. Murnane, "U.S. Earnings Levels and Earnings Inequality: A

CHART 2
Downward Mobility Is the Result of both
Slower Growth and Rising Inequality
(Entry-Level Wages, High-School Educated Males, 1973-1993)



Source: Lawrence Mishel and Jared Bernstein, *The State of Working America: 1994-1995* (1994), p. 147. Note: Faster growth is defined as 3.0 percent per year (actual rate of productivity growth from 1960-1973); slower growth is defined as 1.1 percent per year (actual rate of productivity growth from 1973-1993). Wages are what a full-time full-year worker would earn at average entry-level wage. Urban Institute, 1996

4. Although average real earnings have declined compared to preceding generations, other measures of economic status indicate some improvement for recent generations relative to predecessors. For example, "earnings per adult equivalent," which adjusts for household size, has increased for more recent generations. This apparent improvement, however, is due primarily to various "demographic adjustments" that have been made by individuals and have had the effect of countering the impact of decreasing earnings. For example, compared to earlier generations, younger adults today are more likely to remain single, marry later, and have fewer children. One study concludes that "this economic success has been purchased at the expense of noneconomic aspects of welfare, such as family life, leisure, privacy, and independence." Richard A. Easterlin, Christine MacDonald, and Diane J. Macunovich, "How Have American Baby Boomers Fared?," *Journal of Population and Economics*, vol. 3, 1990, p. 287. See also John Sabelhaus and Joyce Manchester,

Review of Recent Trends and Proposed Explanations," *Journal of Economic Literature*, vol. 30, September 1992, pp. 1333-1381; and Janet L. Norwood (ed.), *Widening Earnings Inequality: Why and Why Now*, Urban Institute, 1994.

11. Lawrence F. Katz notes that inequality has been found "along essentially every dimension one cuts the [earnings] data and appears to remain no matter how finely one cuts it" (Katz, "Comments and

Discussion," *Brookings Papers on Economic Activity*, vol. 2, 1994, p. 257).

12. Mishel and Bernstein (1994), pp. 140-147.

13. Alan B. Krueger, "How Computers Have Changed the Wage Structure: Evidence from Microdata, 1984-1989," *Quarterly Journal of Economics*, vol. 108, February 1993, pp. 33-60.

Isabel V. Sawhill is a Senior Fellow at the Urban Institute, occupying the Arjay Miller Chair in public policy. She is editor of *Welfare Reform: An Analysis of the Issues* (Urban Institute, 1995).

Daniel P. McMurrer is a Research Associate at the Urban Institute. His principal areas of research are income inequality and job security.

Sawhill and McMurrer are currently working on a series of issue briefs to be published over the next year on the general theme of "Opportunity in America."

This series, funded in part by the Ford Foundation, focuses on challenges for policymaking in the 21st century.

Advisory Board

C. Eugene Steuerle
Christopher Edley, Jr.
Edward M. Gramlich
Hugh Hecla
Pamela Loprest
Demetra S. Nightingale
Isabel V. Sawhill
William Gorham

Published by

The Urban Institute
2100 M Street, N.W.
Washington, D.C. 20037
Copyright © 1996

The views expressed are those of the authors and do not necessarily reflect those of the Urban Institute, its board, its sponsors, or other authors in the series.

Extra copies may be requested by calling (202) 857-8687.

Designed by Robin Martell and
Barbara Willis

Telephone: (202) 833-7200 ■ Fax: (202) 429-0687 ■ E-Mail: paffairs@ui.urban.org ■ Web Site: <http://www.urban.org>



THE URBAN INSTITUTE

2100 M Street, N.W.
Washington, D.C. 20037

Nonprofit Org.
U.S. Postage
PAID
Permit No. 8098
Washington, D.C.

Address Correction Requested