THE WHITE HOUSE
Office of the Press Secretary

FOR IMMEDIATE RELEASE
April 26, 2013

As Prepared for Delivery: EXCERPTS from "Fairness as an Economic Force"
Alan B. Krueger, Chairman, Council of Economic Advisers
"Learning and Labor Economics" Conference at Oberlin College
April 26, 2013

On Changing the Norms, Institutions and Practices to Maintain Fairness:

In considering reasons for the growing wage gap between the top and everyone else, economists have tended to shy away from considerations of fairness and instead focus on market forces, mainly technological change and globalization. But given the compelling evidence that considerations of fairness matter for wage setting, I would argue that we need to devote more attention to the erosion of the norms, institutions and practices that maintain fairness in the job market. We also need to focus on the policies that can lead to more widely shared – and stronger – economic growth. It is natural to expect that market forces such as globalization would weaken norms and institutions that support fairness in wage setting. Yet I would argue that the erosion of the institutions and practices that support fairness has gone beyond market forces.

For example, policies and tactics that undermine the ability of workers' to join unions and exercise their right to collectively bargain, erode a critical institution that has long fought for fairness in the labor market, and served to strengthen the middle class, both for union members and nonmembers.

An alternative argument, however, is that the zone of indeterminacy has shrunk due to market forces, and some might even argue that this is a good thing. At first blush, I see little support for either of these propositions. Corporate profits as a share of the economy are near their all-time high, so it is hard to argue that companies do not have the ability to support higher wages. Second, the workforce is older and less mobile, which should increase the rents from specific training and other sources that are available to be divided between workers and firms. Third, productivity growth has not accelerated over the past 30 years; in fact, except for the late 1990s (when inequality narrowed) productivity growth has slowed. If the rise in inequality had improved incentives, one would have expected productivity growth to rise even more quickly, not slow down. Indeed, it is hard to see what the macroeconomy has gained from the enormous shift in the income distribution.

I already mentioned that the decline in the real value of the minimum wage and tax cuts tilted to the top have eroded norms of fairness. But these policies can be reversed.

. . . Say-on-Pay and other actions can introduce more fairness into the job market, and help narrow the growing wage gap. Given the strong human desire for fair treatment, the bully pulpit and well-targeted public policies provide an opportunity to strengthen the norms, institutions and practices that enforce fairness in the economy. I mentioned earlier that mottos matter. In this regard, President Obama's focus on "growing the economy from the middle out" is an appropriate motto, and one that should focus our attention on making choices that strengthen the middle class and provide more support for people struggling to get into the middle class.

I want to emphasize that much is at stake in this debate. Just about any way you measure it, the share of middle class jobs has been declining in the U.S. for the past three decades. This trend has deeply worrisome consequences for the future our economy and our country. Rising inequality is very likely reducing intergenerational mobility and restraining economic growth. This is one of the reasons why President Obama has proposed new Ladders of Opportunity to distressed communities and those struggling to get by, including his new proposal for universal preschool education.

. . .

On Fairness as an Economic Force:

The implication of fairness is that utility functions are interdependent, involving the wages of other people as well as one's own wage. This is the main theme that I want to emphasize tonight – despite much research showing the importance of fairness for labor market outcomes, economists have devoted too little attention to the profound role that considerations of fairness have on the distribution of pay.

In addition, I will argue that over the past three decades there has been an erosion of the norms, institutions and practices that maintain fairness in the U.S. job market – that occurred on top of market forces – that has exacerbated income inequality and made it harder for families to make it into the middle class in America. … The erosion of traditional wage contours that have enabled the top earners to take home an ever larger share of the income distribution has not, in the end, served to raise productivity or improve incentives, and it is hindering intergenerational mobility. Instead of "you're own your own economics" we need, as President Obama has stressed, a return to growing the economy from the middle out, and a recognition of the reciprocal responsibilities of citizenship.

The shift in norms and practices concerning fairness was partly spurred on by market forces, but government policy and shifting attitudes of scholars and opinion leaders also exacerbated the breakdown in norms that previously supported a growing middle class in the post-war period. For example, at a time when we saw rapidly rising before-tax income inequality, the previous administration cut taxes disproportionately for high-income earners. At the other end of the distribution, in the 1980s the nominal value of the minimum wage was unchanged from 1981 to 1989, causing a 26 percent decline in the value of the minimum wage after accounting for inflation. In a job market characterized by imperfect information, search frictions and varying degrees of bargaining power, the minimum wage serves an anchor for other wages that provides a reference point for wage setting.

An astonishing 84 percent of total market-based income growth from 1979 to 2011 went to the top 1 percent of families, and more than 100 percent of it from 2000 to 2007 went to the top 1 percent. This shifted the equivalent of over $1 trillion in annual income to the top 1 percent.

. . .

###