

Chicago Fed Letter

Strategies for Improving Economic Mobility of Workers— A conference preview

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On November 15–16, 2007, the Federal Reserve Bank of Chicago's Economic Research Department and Consumer and Community Affairs Division, along with the W. E. Upjohn Institute for Employment Research, will cosponsor a conference to present research on policies, practices, and initiatives affecting low-wage workers.

Conference speakers include Alan S. Blinder, Princeton University; Alex Kotlowitz, author and journalist; and Edward P. Lazear, Council of Economic Advisers. For more information, including the agenda, visit www.chicagofed.org/news_and_conferences/conferences_and_events/2007_strategies_improving_economic_mobility_announcement.cfm.

By almost all measures, American workers overall have gained economic ground over time. However, it has also been well documented that inequality in economic outcomes has increased: Wages for those in the bottom (10th percentile) of the income distribution have not grown as quickly as those in the top (90th percentile). In fact, the wages for those at the bottom may even be stagnating. These trends imply that the economic mobility of some segments of the labor force is relatively limited. How can the economic opportunities for low-wage workers be improved? And how effective are existing policies at helping low-wage workers gain more skills or improve them? In this *Chicago Fed Letter*, I provide a brief review of key issues related to low-wage earners and policy prescriptions, as a preview to our conference, Strategies for Improving Economic Mobility of Workers.

Trends in poverty, wages, and income mobility

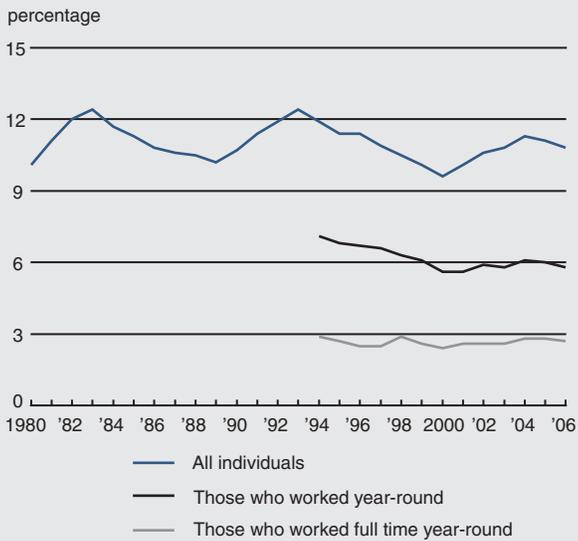
The adverse consequences of substandard wages and poverty on individuals, families, and communities are numerous and interconnected. Families with low to moderate income generally have little in savings to deal with unanticipated events, such as the loss of a job or a serious health problem. They are

less likely to have a bank account or become homeowners, and they have much lower than average household wealth.¹ Children in poor families receive lower-quality child care and health care, and they are exposed to a less stimulating learning environment in the home.²

Living in a poor family increases the chances of living in a poor neighborhood. As research by the Brookings Institution suggests, nationwide about one in ten individuals below the poverty line in 2000 lived in communities with geographically “concentrated poverty,” where at least 40% of the population is poor.³ Forty-six of the nation's 50 largest cities contained at least one such neighborhood. Many of these neighborhoods lack adequate housing, jobs, business and financial services, and transportation infrastructure. As a result, residents tend to face higher local prices for goods and services. Living in distressed neighborhoods also increases one's exposure to health hazards and violence. Given these trends, how can economic opportunities be improved for workers and households in poor communities?

Researchers have focused on three important empirical questions in studying low-wage workers. They measure the size of the low-wage labor market,

1. Share of population under the poverty level, 1980–2006



NOTES: The sample for this figure includes all individuals aged 18–64. Information on how the U.S. Census Bureau measures and defines poverty can be found at: www.census.gov/hhes/www/poverty/definitions.html.

SOURCES: Author's calculations based on data from Haver Analytics and the U.S. Census Bureau, *Current Population Survey, Annual Social and Economic Supplement*, table POV22.

identify the characteristics of low-wage earners, and gauge the extent to which they experience income growth. They have used several different approaches to define the “low-wage” labor market and to evaluate the material well-being of the poor.⁴ One approach defines a low-wage worker as one who works at least 37 weeks per year, but whose total family annual income falls below the federal poverty level (an annual threshold based on U.S. Census data)—\$15,735 in 2005 for a family of three. Using this definition, figure 1 depicts the poverty rate among individuals aged 18–64 years old for each year since 1980. The figure shows that the percentage of individuals with income below the poverty line has remained relatively stable over time, hovering around 11% and 12%. More than half of those individuals work during the whole year, and over one-quarter work full time the whole year.

Another approach is to consider the relative position of workers in different quartiles of the income distribution. This approach is illustrated by figure 2, which shows the average real hourly wages of workers by quartile from 1979 through 2006. Real hourly wages for workers at the 10th percentile and below have remained stable—at about \$7.00. Most of

the workers with less than a high school degree are below the 10th percentile. By contrast, real hourly wages of those in the 90th percentile and 95th percentile (where most of the workers with college degrees are) rose by 30% or more over this period. This approach has been used to illustrate rising inequality in the wage distribution and the increasing return associated with marketable skills and higher education.⁵

What figure 2 does not show is the income mobility of workers, i.e., the extent to which

workers are moving up (or down) the income ladder over the course of their lifetimes or across generations. Data limitations make this question harder for researchers to address. However, the few studies that focus on mobility suggest that, in general, families in the U.S. experience upward mobility over the life-cycle and across generations.⁶ Not surprisingly, mobility largely depends on the income and education level of the family. One study suggests that over the past 25 years, a child born into a low-income family had a 20% to 25% chance of earning above the median income as an adult and less than a 5% chance of moving into the highest fifth of the income distribution. Another study shows that, among families who started in the bottom fifth of the income distribution in 1988, more than half remained there in 1998, and fewer than one-quarter managed to achieve at least middle-income status by the end of the decade.⁷

Low wages and weak labor market attachment

A growing body of research investigates the causes of low earnings and the characteristics of those likely to experience relatively limited economic mobility.

Focusing on the “working poor,” researchers have found determinative factors to include age, education, skill, and demographic and racial characteristics.⁸ Blacks and Hispanic immigrants are twice as likely as whites to be among the working poor.

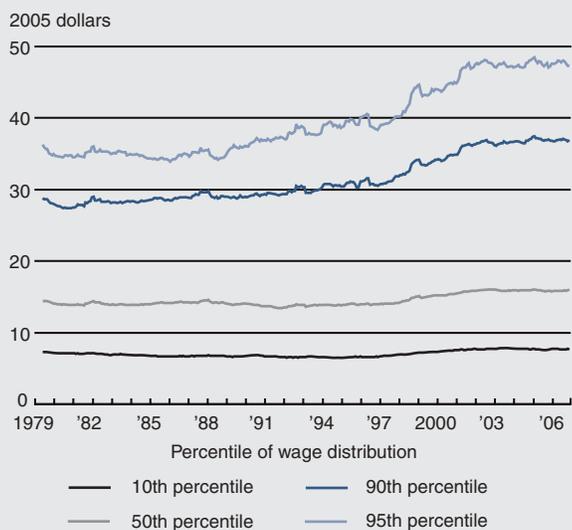
Having a high school diploma or higher education significantly lowers one’s risk of being poor. For example, in 2004, according to the U.S. Bureau of Labor Statistics, among workers with a college degree, only 1.7% were among the working poor, compared with 15.2% of those with less than a high school diploma. Along with lower levels of formal education, the working poor population has a higher level of individuals with weak cognitive, written, and verbal communication skills than the rest of the working population.⁹

For particular demographic groups, such as former welfare recipients or black males in inner-city neighborhoods, research suggests that access to stable, relatively well paying jobs is limited because of a lack of information, informal contacts, or networks. The working poor also tend to have high turnover rates and greater job instability owing to poor work performance or frequent absences, perhaps related to problems finding child care or appropriate transportation.¹⁰ Certain segments of the working poor are considered “hard to employ,” including individuals with substance abuse problems, those who have served time in jail, and those with mental and health disabilities.¹¹

Creating more economic opportunities

In a February 2007 speech, Federal Reserve Chairman Ben S. Bernanke pinpoints three general principles that are broadly accepted in our society: The first is that economic opportunity should be as widely distributed and as equal as possible; the second, economic outcomes need not be equal but should be linked to the contributions each person makes to the economy; and the third, people should receive some insurance against the most adverse economic outcomes, especially those arising from events largely outside their control.¹²

2. Average real hourly wages, 1979–2006



NOTES: The sample for this figure includes all individuals older than 24. The six-month moving averages of hourly wages are shown for the various percentiles of wage distribution.

SOURCE: Author's calculations based on data from the U.S. Census Bureau, *Current Population Survey, Outgoing Rotation Group files*.

Policies to address poverty and labor market distributional disparities fall into two broad categories. The first category includes direct “redistributive” policies, including increased minimum wages, progressive taxation, and special tax provisions for low-income workers (e.g., the Earned Income Tax Credit).¹³ The second type comprises social policies addressing access to health care, child care, job retraining, and educational opportunities. It is worth noting that at the core of all policy debates involving income transfers, there remains one central and difficult question: What is the right trade-off between upholding market-based incentives, which encourage labor market flexibility and firms’ ability to invest in technology, and providing social insurance to workers against economic and financial risks?¹⁴

Given the increasingly high returns to education, most economists agree that investment in early childhood education is one of the most potent means to promote the skills necessary to adapt to a changing labor market.¹⁵ Technological changes have increased the skill requirements for jobs that offer better salaries and benefits (health care, etc.).¹⁶ This suggests that additional job training and vocational education opportunities for adult workers may also be worth

considering as part of a comprehensive strategy to enhance opportunities for disadvantaged workers. Policy proposals such as the Workforce Investment Act of 1998 are aimed at addressing mismatches between required job skills and low-skilled workers.¹⁷

Some of these types of initiatives might be directed at higher-skilled workers as well. It is suggested that middle-income workers are also facing rising risks and income volatility in connection with the offshoring of skilled jobs, downsizing, and job displacement.¹⁸ Research

shows that in their new positions, displaced workers are more likely to be downgraded relative to their previous earning levels and job quality. Increased income instability and associated loss of lifetime income affect the welfare of individual workers, lead to declines in living standards, and raise personal debt. Federal programs such as Trade Adjustment Assistance are in place to help cushion the impact of job losses.¹⁹

Programs such as Moving to Opportunity—a U.S. Department of Housing and Urban Development program that offers housing vouchers to families in public housing—are among the other initiatives developed to help resolve the spatial mismatches between residents in poor neighborhoods and areas with job growth.²⁰ In addition, a number of work force development initiatives are targeted at populations with specific needs. For example, some programs provide or improve access to transportation and housing, and some offer job training and placement to former welfare recipients. Finally, there are community-based programs that assist ex-offenders reentering the job market.²¹

Conclusion

The net effects to date of policies and practices aimed at improving the labor

force outcomes of the working poor and enhancing labor force participation overall are unclear.²² Accordingly, this area remains ripe for further research. Our November 15–16 conference at the Federal Reserve Bank of Chicago, co-sponsored by the W. E. Upjohn Institute for Employment Research, will discuss policies and initiatives related to spatial mismatch, income assistance or transfers to the poor, and work force development programs, drawing on the expertise of national researchers, community development professionals, and policymakers.

¹ See Ben S. Bernanke, 2006, “Increasing economic opportunity: Challenges and strategies,” speech at the Fifth Regional Issues Conference of the Fifteenth Congressional District of Texas, Washington, DC, June 13, at www.federalreserve.gov/newsevents/speech/bernanke20060613a.htm.

² Gale Group Inc., “Overview of poverty and education,” *Encyclopedia of Education*, available at www.answers.com/topic/overview-of-poverty-and-education.

³ See Alan Berube, 2006, “Metropolitan poverty in the United States,” presentation at Poverty and Place Workshop, Cambridge-MIT Institute, Cambridge, UK, September 28, available at www.brookings.edu/metro/speeches/20060928_metro-poverty.htm.

⁴ Some argue that measures based on consumption are preferable. See Bruce D. Meyer and James X. Sullivan, 2003, “Measuring

Charles L. Evans, *President*; Daniel G. Sullivan, *Senior Vice President and Director of Research*; Douglas Evanoff, *Vice President, financial studies*; Jonas Fisher, *Economic Advisor and Team Leader, macroeconomic policy research*; Richard Porter, *Vice President, payment studies*; Daniel Aaronson, *Economic Advisor and Team Leader, microeconomic policy research*; William Testa, *Vice President, regional programs, and Economics Editor*; Helen O’D. Koshy, Kathryn Moran, and Han Y. Choi, *Editors*; Rita Molloy and Julia Baker, *Production Editors*.

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ISSN 0895-0164

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- ⁵ See Daron Acemoglu, 2002, “Technical change, inequality, and the labor market,” *Journal of Economic Literature*, Vol. 40, No. 1, March, pp. 7–72, and David H. Autor, Lawrence F. Katz, and Melissa S. Kearney, 2006, “The polarization of the U.S. labor market,” National Bureau of Economic Research, working paper, No. 11986, January, available at www.nber.org/papers/w11986.
- ⁶ Ben S. Bernanke, 2005, “Economic opportunity,” speech at the National Economists Club, Washington, DC, October 11.
- ⁷ Alan Berube, 2007, “The geography of U.S. poverty and its implications,” testimony before the Subcommittee on Income Security and Family Support, Committee on Ways and Means, U.S. House of Representatives, Washington, DC, February 13, available at www.brookings.edu/views/berube20070213_povertytestimony.htm.
- ⁸ U.S. Bureau of Labor Statistics, 2006, “A profile of the working poor, 2004,” report, No. 994, May, available at www.bls.gov/cps/cpswp2004.pdf.
- ⁹ See Derek Neal, 1996, “Who are the ‘low-wage’ workers?,” Employment Policies Institute, report, July.
- ¹⁰ See Harry J. Holzer and Karin Martinson, 2006, “Can we improve on job retention and advancement among low-income working parents?,” *Focus*, Vol. 24, No. 2, Spring–Summer, pp. 31–38, available at www.irp.wisc.edu/publications/focus/pdfs/foc242f.pdf.
- ¹¹ Harry J. Holzer, Steven Raphael, and Michael A. Stoll, 2004, “Will employers hire former offenders? Employer preferences, background checks, and their determinants,” in *Imprisoning America: The Social Effects of Mass Incarceration*, Mary Pattillo, David F. Weiman, and Bruce Western (eds.), New York: Russell Sage Foundation Publications, pp. 205–246.
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- ¹⁵ See Lynn A. Karoly, M. Rebecca Kilburn, and Jill S. Cannon, 2005, *Early Childhood Interventions: Proven Results, Future Promise*, Santa Monica, CA: RAND Corporation.
- ¹⁶ David H. Autor, Frank Levy, and Richard J. Murnane, 2003, “The skill content of recent technological change: An empirical exploration,” *Quarterly Journal of Economics*, Vol. 118, No. 4, November, pp. 1279–1333.
- ¹⁷ For a summary of the Workforce Investment Act, see the U.S. Department of Labor, Employment and Training Administration’s website, www.doleta.gov/usworkforce/wia/Runningtext2.htm.
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- ²¹ See John Tyler, 2004, “Prison-based education and reentry into the mainstream labor market,” Brown University, Department of Economics, working paper, No. 2004-10, August.
- ²² Several researchers have questioned the reliability of measures of the effectiveness of specific job training programs in closing gaps. See James J. Heckman, Rebecca L. Roselius, and Jeffrey A. Smith, 1993, “U.S. education and training policy: A reevaluation of the underlying assumptions behind the ‘new consensus,’” University of Chicago, Harris School of Public Policy Studies, working paper, No. CSPE94-1, December, available at http://harrisschool.uchicago.edu/About/publications/working-papers/abstract.asp?paper_no=93%2E04.